

# PROPOSED LEGISLATIVE BAN ON PACKER OWNERSHIP OF LIVESTOCK MISCHARACTERIZED BY ECONOMISTS

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## Overview of the Problem

In a paper dated January 14, 2002,<sup>1</sup> eight economists, none of whom is a lawyer, interpreted proposed legislation banning packer ownership of cattle as prohibiting pork and beef packers from making *any* arrangement with livestock producers to acquire their livestock more than two weeks prior to slaughter. The economists opined that the prohibition would include forward contracts, marketing agreements, contracts containing any promise of delivery, and would result in producers having no legally assured market for their livestock before the last two weeks preceding slaughter. The economists further assumed, based on their interpretation of the statutory language, that alliances in which packers participate with producers would also be banned. Based on their interpretations and assumptions concerning the statutory language, the economists predicted that the beef and pork sectors would become less efficient and less competitive due to the loss of contracting rights and alliances. This legal analysis is essential to all of their economic conclusions. Unfortunately, their interpretation constitutes a manifest misreading of the proposed statutory language. We write to correct the erroneous legal analysis of these economists.

## Statutory Language

On December 13, 2001, the United States Senate approved an amendment to the Senate Farm Bill<sup>2</sup> making it unlawful for a packer to own, feed, or control livestock intended for slaughter more than fourteen days prior to slaughter. The amendment includes exemptions for packing houses owned by farmer cooperatives, and packers with less than two percent of national slaughter. The amendment was approved 51-46, and is now a part of the Senate Farm Bill.

The legislation amends 7 U.S.C. §192 (§202 of the Packers and Stockyards Act of 1921) by adding a new subsection (f) as follows:

It shall be unlawful for any packer with respect to livestock, meats, meat food products, or livestock products in unmanufactured form, or

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<sup>1</sup> D. Feuz, G. Grimes, M.L. Hayenga, S. Koontz, J.D. Lawrence, W.D. Purcell, T.C. Schroeder and C.E. Ward, “*Comments on Economic Impacts of Proposed Legislation to Prohibit Beef and Pork Packer Ownership, Feeding, or Control of Livestock.*”

<sup>2</sup> S. 1731, The Agricultural, Conservation, and Rural Enhancement Act of 2001.

for any live poultry dealer with respect to live poultry, to:

- (f) Own, feed, or control livestock intended for slaughter (for more than 14 days prior to slaughter and acting through the packer or a person that directly or indirectly controls, or is controlled by or under common control with, the packer), except that this subsection shall not apply to –
  - (1) a cooperative or entity owned by a cooperative, if a majority of the ownership interest in the cooperative is held by active cooperative members that –
    - (A) own, feed, or control livestock; and
    - (B) provide the livestock to the cooperative for slaughter; or
  - (2) a packer that is owned or controlled by producers of a type of livestock, if during a calendar year the packer slaughters less than 2 percent of the head of that type of livestock slaughtered in the United States...<sup>3</sup>

### **Construing the Statutory Language – The Meaning of “Control”**

In their paper, the economists base their entire analysis, without any supporting documentation, on the assumption that the statutory prohibition of “control” of livestock will prohibit all types of marketing contracts, including forward contracts. They then focus their entire argument against the proposed legislation based on claims of harm to various kinds of contractual arrangements used in the livestock industry. Never once do the economists suggest that packers need to actually own or control livestock in order to accomplish any of the specific objectives that they identify as crucial to achieving economic efficiency and a competitive market. The clear implication of their argument is that the prohibition of actual packer ownership of livestock does not raise any significant efficiency or competition concerns.

Importantly, the amendment’s primary sponsor, Senator Tim Johnson (D-SD), offered a formal clarification in the Senate that the word “control” contained in subsection (f) of the proposed amendment is to be interpreted in the context of *ownership*.<sup>4</sup> The amendment is not designed to prohibit contracts for future delivery of livestock, but is designed to prevent packers from owning cattle outright, through a subsidiary, or through arrangements (contractual or otherwise) that give them *operational control* over livestock except within the last two weeks before slaughter.

From a legal standpoint, “control” issues arise frequently in an agency context in situations involving the need to distinguish between an “independent contractor” and an

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<sup>3</sup> Amendment No. 2534 to S. 1371, 107th Cong. 1st Sess.

<sup>4</sup> 147 Cong. Rec. S. 13647, 107th Cong., 1st Sess., Dec. 19, 2001.

“employee” for reasons including, but not limited to, liability and taxation.<sup>5</sup> Typically, the existence of an agency relationship is a question of fact for a jury to decide.<sup>6</sup> At its very essence, whether a relationship is an independent contractor relationship or a master-servant relationship depends on whether the entity for whom the work is performed has reserved the right to control the means by which the work is to be conducted.<sup>7</sup> Under many production contract settings, the integrator controls both the mode and manner of the farming operation.<sup>8</sup> The producer no longer makes many of the day-to-day management decisions while the integrator controls the production-to-marketing cycle. The integrator is also typically given twenty-four hour access to the producer’s facilities.<sup>9</sup> Conversely, forward contracts, formula pricing agreements and other types of marketing contracts typically do *not* give the integrator managerial or operational control of the farming operation or control of the production-to-marketing cycle. Instead, such contracts commonly provide the packer with only a contractual right to receive delivery of livestock in the future. While it is not uncommon that livestock marketing contracts contain quality specifications, most of those contract provisions relate exclusively to the amount of any premium or discount in the final contract payment for livestock delivered under the contract. Importantly, the manner in which quality requirements tied to price premiums are to be satisfied remains within the *producer’s* control.<sup>10</sup> Accordingly, such marketing contracts would likely be held to be beyond the scope of the legislation’s ban on packer ownership or *control* of livestock more than two weeks before slaughter. *Thus, a packer would still have the ability to coordinate supply chains and assure markets for livestock producers through contractual arrangements provided the contracts do not give the packer operational and managerial control over the livestock producer’s production activities.*

## Comparable State Legislation

The proposed federal legislation is also comparable to existing state legislation in several significant livestock producing states. For example, an Iowa statute prohibits any processor of beef or pork from owning, controlling or operating a feedlot in Iowa in

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<sup>5</sup> An employee is generally one who works subject to the control of the employer. This usually requires control both with respect to the manner and means of performing the particular job task. In these situations, the employer is responsible for the acts of the employee committed in the scope of the employee’s employment. If an employer-employee relationship exists, the employer is responsible for withholding and employment taxes. See, e.g., *Déjà vu Entertainment Enterprises v. United States*, 1 F.Supp. 2d 964 (D. Minn. 1998).

<sup>6</sup> See, e.g., *Carlton v. Alabama Dairy Queen, Inc.*, 529 So. 2d 921, 923 (Ala. 1988).

<sup>7</sup> See, e.g., McEowen, Roger A. and Neil E. Harl, *Principles of Agricultural Law*, §11.09[1] (2002).

<sup>8</sup> See, e.g., *Tyson Foods, Inc. v. Stevens*, 783 So. 2d 804 (Ala. 2000)(Tyson held to be in agency relationship with farmer under hog production contract; Tyson specified where hog houses to be located, the size of each house, mandated the implementation of a waste-management system, visited the farm weekly, provided the hogs, hog feed and veterinary supplies and care.)

<sup>9</sup> See *Id.*

<sup>10</sup> For example, under a formula pricing cattle contract, cattle feeders must adapt their feeder cattle procurement and cattle feeding management practices to produce slaughter cattle that can earn premiums in accordance with the price grid specified in the contract. Under these type of marketing contracts, the cattle feeder remains responsible for making the managerial decisions necessary to receive any price premiums specified in the contract. The packer does not gain substantial operational control over the cattle feeder’s production activities.

which hogs or cattle are fed for slaughter.<sup>11</sup> The legislation, however, does not prevent a processor from contracting for the purchase of hogs or cattle.<sup>12</sup> The provision has never been held to prohibit packers from entering into forward contracts, formula pricing agreements or other types of marketing arrangements with livestock producers so long as control of the farming or ranching operation remains vested in the producer.<sup>13</sup>

Nebraska law<sup>14</sup> prohibits direct or indirect packer ownership of livestock more than five days before slaughter, and has not been held applicable to any type of livestock marketing agreement. *Again, the key to understanding the scope of the statutory provision lies in determining whether the producer remains in decision making control of the farming operation.*

Importantly, the dire consequences the economists predict will occur if the Johnson amendment passes have not arisen in the livestock sectors of either Iowa or Nebraska since enactment of the comparable legislation in those states.

### **Application to Cooperatives**

Whether the statutory language applies to packer “alliances” with producers would also be judged under the same standard. If a packer merely provides marketing expertise and advantages to producer-members of the alliance, but does not exercise control over the manner in which the livestock are to be produced, insufficient control would be present to subject the activity to the ownership ban under either an agency or partnership theory. Indeed, Senator Grassley (R-IA) stated in debate over the Johnson amendment that “it has never been our intent to prevent cooperatives from engaging in relationships with packers, and the amendment does not do that.... Co-op members...can freely commit all or a portion of their cattle for slaughter without violating this amendment. *The reason is that the packer...exercises no operational control over livestock production.*”<sup>15</sup> (emphasis added)

### **Contractual Arrangements, Livestock Markets and the Proposed Legislation**

Contractual arrangements and various kinds of alliances can contribute significantly to the development of efficient and competitive livestock production. The proposed legislation in fact protects such arrangements in several ways.

Importantly, the legislation exempts small firms slaughtering less than two percent of any type of livestock so that small firms and new entrants can experiment and develop their products without having to be concerned about the legal details of the relationship. The legislation also exempts farmer cooperatives where the members are themselves feeders. This expands the range of opportunity for developing new and

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<sup>11</sup> Iowa Code §9H.2.

<sup>12</sup> *Id.*

<sup>13</sup> Indeed, many various types of marketing contracts are presently in use in Iowa.

<sup>14</sup> Neb. Rev. Stat. §54-2602.

<sup>15</sup> 147 Cong. Rec. S. 13647, 107th Cong. 1st Sess., Dec. 19, 2001.

creative solutions to the challenge of developing improved meat products. In addition, large packers still would have available a full range of contractual opportunities to obtain specific types of livestock designed to meet specific needs. Moreover, such contracts could be drafted to include future delivery times and other elements that facilitate the coordination of the packer and the producer. *Contracts that do not impose control over the producer can still provide all the benefits of coordination and end product specification that the economists identify as desirable elements of current arrangements.* Indeed, most contracts and marketing agreements would not necessarily have to be changed at all.

*The central challenge for the very competent lawyers for those buyers that currently use agreements to manage the actual day-to-day operation of producers will be to develop contracts that define the characteristics that are to be delivered without unlawfully limiting the freedom of the producer to select the methods and means of producing those results.* The packers, if they are not engaged in strategic conduct or manipulative behavior, should not have any problem in defining the objectives they seek and leaving it to the producer to achieve the desired result. Indeed, a result oriented system of contracting will free producers to substitute livestock from third parties when that is more efficient and practical within the context of the contractually required results. This would enhance competition and fairness in the production of livestock because the packers would not be as able to play one seller against another by refusing to buy directly.

## **Conclusion**

Our goal is to correct a manifest error in legal analysis. The economists “assumed” that the prohibition of “control” would extend to all future contracting and alliances. Our position is that this is a misreading of the statutory language and contrary to the actual history of comparable state legislation. *Irrespective of the merits of the economic argument that contracting and alliances in livestock production are essential to efficiency and competition, the ban on packer ownership will not bar producers and packers from entering into such agreements.*