

Selected Topics in Agricultural Law*

³/₄ by Neil E. Harl**

I. Income Averaging for Landlords

On January 7, IRS issued final regulations governing the 1997 statute which allows the tax on income from a “farming business” to be calculated as though one-third of elected current farm income had been carried back to each of the three prior years. It's a help if one has a spike up in income. Until the final regulations were issued, it was not clear whether landlords were eligible.

Under the final regulations, landlords under a share lease (but not a cash rent lease) are eligible for income averaging. After December 31, 2002, for income to be eligible for averaging, the landlord's share of farm income must be set in a “written rental agreement” entered into “before the tenant begins significant activities.”

Whether the landlord materially participates under the lease is irrelevant. Therefore, those reporting income and expenses on Form 4835 (and even share-rent landlords filing on Schedule E) should be eligible as well as those who file on Schedule F (those materially participating in the operation).

II. Federal Estate Tax Changes in 2001

The 2001 tax act, which was signed on June 7, repealed the federal estate tax and generation-skipping transfer tax for deaths after December 31, 2009. That's also the date for the new carryover basis rules to take effect. Note that Congress did *not* repeal the federal gift tax. That tax was retained to provide backing for the income tax to prevent massive gifting to low tax bracket members of the family to reduce federal income tax.

But *one year later*, on December 31, 2010, the entire 2001 tax bill sunsets. That means the provisions are no longer effective. Why was that done? Congressional rules in effect state that tax cuts more than 10 years out can only be approved with a 60 percent vote—and that wasn't possible.

So here are the possible scenarios—

- If nothing is done, the tax system ends 2009 with a \$3.5 million unified credit applicable exclusion amount, a new income tax basis at death for assets and a maximum federal estate

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tax rate of 45 percent. On January 1, 2010, there would be no federal estate tax, a federal gift tax at a maximum rate of 35 percent (and a \$1 million unified credit) and a modified carryover basis arrangement. On January 1, 2011, the system reverts to a \$1 million unified credit applicable exclusion amount, a new basis at death, a maximum federal estate rate of 55 percent and a federal gift rate of 55 percent if nothing further is done.

- If the sunset provision is repealed along the way, after 2009 the federal estate tax would be history, a carryover basis regime would be in place and a gift tax at a 35 percent maximum rate (and a \$1 million unified credit) would be in effect.
- If both the repeal provision and the sunset provision for the federal estate tax are voted out, and no other changes were made, the federal estate tax system would continue beyond 2009 with a \$3.5 million unified credit application exclusion amount for estates, a new income tax basis at death, a gift tax system at a 35 percent maximum rate and a \$1 million unified credit for gift tax purposes.

If that's not enough to cause heartburn, nothing would. To say that planners—and estate owners—face huge uncertainty is a vast understatement.

Between 2001 and 2009

The uncertainty lies well into the future, however. In the meantime, there are some changes to be absorbed.

Federal estate tax credit. The federal estate tax credit applicable exclusion amount jumps up dramatically—

2001	\$675,000
2002	\$1,000,000
2003	\$1,000,000
2004	\$1,500,000
2005	\$1,500,000
2006	\$2,000,000
2007	\$2,000,000
2008	\$2,000,000
2009	\$3,500,000

Top estate tax rate. The maximum federal estate tax rate is scheduled to drop from 55 percent in 2001 to 50 percent in 2002 followed by a one percentage point drop each year until the rate is 45 percent in 2007 and later years.

Family-owned business deduction. The family-owned business deduction, enacted in 1997 and substantially overhauled in 1998, is slated for repeal at the end of 2003.

Basis at death. The new basis at death, which has been part of tax law for a very long time, will continue at least through 2009.

Legislation has been enacted to eliminate the new basis at death after 2009 with a basis increase of up to \$1.3 million per estate, \$3 million in addition for a surviving spouse, and \$60,000 for a non-resident who is not a U.S. citizen. The basis increase amounts are adjusted for inflation for decedents dying after 2011 (if carryover basis is still in effect at that time).

The \$1,300,000 figure is increased by the amount of unused capital losses, net operating losses and certain “built-in” losses of the decedent.

Requirements for property to be eligible for an increase in basis—

- The property must have been owned, or treated as owned, by the decedent at the time of the decedent’s death.
- For property held in joint tenancy or tenancy by the entirety with the surviving spouse, one-half of the property is treated as having been owned by the decedent (the so-called “fractional share” rule under I.R.C. § 2040(b)) and is, therefore, eligible for an increase in basis.
- For property held jointly with a person other than the surviving spouse, the portion of the property attributable to the decedent’s consideration furnished (the so-called “consideration furnished” rule under I.R.C. § 2042(a)) is treated as having been owned by the decedent and is eligible for a basis increase.
- The 2001 Act does not acknowledge the “Gallenstein” rule which allows the consideration furnished rule to be applied to husband-wife joint interests created before 1977 when the owner dies after 1981.
- For community property, the decedent is treated as having owned the surviving spouse’s one-half share of community property, which is eligible for a basis increase if at least one-half of the property is owned by, and acquired from, the decedent.

Property not eligible for a basis increase—

- Property over which decedent held a power of appointment with respect to such property (even if it is a general power of appointment).
- Property acquired by the decedent by gift (other than from the spouse unless the spouse acquired the property by gift) during the three-year period ending on the date of the decedent’s death.
- Property that constitutes a right to receive income in respect of decedent (such assets did not receive a new basis at death under prior law).
- Stocks or securities of a foreign personal holding company.
- Stocks of a DISC or former DISC.

- Stock of a foreign investment company.
- Stock of a passive foreign investment company (except for which a decedent-shareholder had made a qualified electing fund election with respect to the decedent).

In no event can the basis of an asset be increased above the fair market value.

Property passing to a spouse is eligible for a basis increase if it is—

- Outright transfer property or
- Qualified terminable interest property.

Carryover basis was enacted in 1976 and was repealed in 1980 without having gone into effect on a mandatory basis. The concept was very unpopular with practitioners as well as taxpayers. The reasons for the unpopularity related mostly to the complexity of administering the concept.

For any system of carryover basis, the burden in maintaining records on purchase price, improvements and depreciation (for depreciable property) and on stock splits, stock dividends and purchase price for securities is substantial. Moreover, carryover basis tends to “lock” assets into families and to discourage sale as gain accrues on assets. This is a negative feature for the economy.

State death tax credit. In a move sure to rile the states, the state death tax credit—which has provided substantial revenue to the states, even those that have repealed their state death tax, is scheduled to be phased out. It drops by a quarter in 2002, by half in 2003 and by 75 percent in 2004. After 2004, it is replaced by a deduction for state death taxes actually paid. Well over three-fourths of the states have repealed their state death taxes.

Installment payment of federal estate tax. The 2001 tax bill increased from 15 to 45 the maximum number of partners and shareholders for eligibility for 15-year installment payment of federal estate tax. The bill also allows installment payment for “lending and financing businesses” which includes “engaging in rental and leasing of real and tangible personal property.”

Suggestions for Planning

The substantial uncertainty over the future of transfer taxes poses a huge challenge for planners. Here are some suggested guidelines for planning—

- Balance the estates (provided balancing is philosophically acceptable).
- Be particularly careful not to underfund the marital share as the unified credit applicable exclusion amount increases between 2001 and 2009.

- Plan to review wills and trusts more frequently than would ordinarily be suggested.
- Communicate thoughts on the future of the transfer tax system to Senators and Representatives in Congress.
- Plan to die in 2010.

Prospects for Further Legislative Action

Future action by Congress is expected to be influenced by three major considerations—

- The fiscal condition of the country (at the moment, this factor would suggest that a partial reversal of the 2001 action is indeed fairly likely).
- Who controls the U.S. House of Representatives, the U.S. Senate and the White House.
- The attitude of the American people.

My own projection is that the Congress will revisit the 2001 Act and will—(1) reduce the tax cuts, (2) eliminate repeal of the federal estate tax, (3) leave the ramp up in the unified credit in place and halt further increases after 2008, (4) leave the federal estate tax with a maximum rate of 45 percent and (5) retain the new basis at death.

III. The Structural Transformation of Agriculture

A major concern as we move into the Twenty-first Century is the structure of the agricultural sector. By structure, is meant considerations of size and scale as well as who is to manage control and finance farming and agribusiness operations.

Structure of the Agricultural Sector

With the dramatic increases in concentration in recent years of input supply and output processing firms and with striking increases in the level of vertical integration (the proportion of slaughter hogs sold under some type of marketing or production contract approaching 70 percent for example), it is important to assess the implications for producers. Such a structural transformation of a subsector is not unknown—the broiler industry went that direction several decades ago—but it is a first for the Middle West.

The critical question: is it important to farmers—and to society—whether agriculture is populated by independent entrepreneurs or serfs? The structural change now occurring will determine which direction agriculture takes. A producer without meaningful competitive options is a relatively powerless pawn in the production process.

The evidence is overwhelming that the agricultural sector is undergoing the greatest structural transformation in the history of the sector. *Without much doubt, low commodity prices*

are contributing to the structural transformation of the sector. A low risk, low return choice looks attractive if the alternative is bankruptcy.

Competition is the most critical element of a price oriented, market economy. Without competition, firms become complacent, are less likely to innovate, tend to become arrogant and indifferent and are inclined to produce less and obtain a higher price for their output.

To a considerable extent, structure will be driven by economic considerations. This country has been committed for some time to the notion that if someone can develop ways to produce goods or services at a lower cost, barriers are unlikely to be erected to prevent that from happening. In large part, the consumer is king and generally rewards the best value with purchases. However, for the economic system to function properly, it is critical to have—

- Policies in place to deal with cost externalities such as odors and stream and groundwater pollution, and
- A system of market protection (or antitrust) to penalize collusion and to prevent undue concentration of economic power.

The era of contract agriculture. The signs of increasing use of contracts are commonplace—especially on the production side of agriculture.¹ Specialty grains, feeder livestock, milk production, even fruits and vegetables, are being produced under contract and have for some time. So what's the concern about the rising tide of contract agriculture? Basically, the concern is a tilt in market power with a possible shift in bargaining power as input suppliers and output processors (and first purchasers otherwise) gain greater economic power, undoubtedly at the expense of producers.²

Concentration in input supply and output processing companies. Mergers, alliances, and various other types of arrangements are reducing the number of players in input supply and output processing and handling and increasing the level of concentration. While the level of mergers, alliances and consolidations is not a completely reliable indicator of competition, the fact that nearly \$15 billion of such amalgamations has occurred over the past five years in the seed business, some at price levels difficult to justify under present economic conditions, suggest that—(1) some are discounting revenue from a pot at the end of some unknown rainbow; (2) irrational behavior is being displayed; or (3) some acquiring firms are assuming that a greater share of the world's food bill can be claimed by those who control the germ plasm involved in food production.

Increasing levels of concentration among firms do not tell the entire story. The revolution in ownership of germ plasm, the feature of cells that determines the characteristics of offspring, also is moving rapidly toward concentration in a few hands. This development is partly related to the changing role of the land grant universities, partly to the ability in recent years to manipulate germ plasm through genetic engineering, and partly to the consequences of the ability

¹ See, e.g., Harl and Lawrence, "Long-term Marketing Contracts with Packers...A Journey Through the Downside," *Iowa Pork Producer*, Sept., 1998, pp. 5-7.

² See generally Harl, "Contract Agriculture: Will It Tip the Balance?" 10 *Leopold Letter* No. 4 (1998); Harl, "Agriculture in the Twenty-First Century," <http://www.econ.iastate.edu/faculty/harl/papers>.

to obtain a monopoly-like position over unique life forms and over the process of genetic manipulation.

- The advent of genetic engineering meant that scientists could manipulate genetic composition—not through conventional crop breeding techniques but through laboratory procedures—to change the genetic makeup of plant and animal life. That has produced herbicide-resistant crops, for example.
- Finally, the U.S. Supreme Court in a 1980 landmark case determined that life forms could be patented.³ In addition to federal Plant Variety Protection (PVP)⁴ and simply shrouding research efforts with secrecy, the ability to patent life forms provides a powerful tool to keep competitors at bay.

While a major concern is over concentration in seeds and chemicals, there is also concern over concentration in livestock slaughter, grain handling and shipping, farm equipment manufacture and food retailing. Indeed, rapidly rising concentration in food retailing may be the most worrisome development in recent years.

At the same time concentration is occurring among agribusiness firms and vertical integration has been occurring from the top down, producing firms are also consolidating. While farm and ranch consolidation does not raise concerns about reduced competition in production, it has led to policy concerns about the magnitude of government payments to larger producers. Payment limitations in place have been ineffective in limiting payment inasmuch as some payments (notably marketing assistance loan gains) have not been subject to the limitations.

Driving forces to consolidate. One of the drivers in the trend toward greater concentration in almost all sectors of the US. economy is increasing concentration in markets *into which products are being sold*. Thus, the rising tide of concentration in food retailing leads to consolidation by suppliers to match the buying power of the retailers. The driving force is an increase in negotiating power, not necessarily an increase in efficiency.

Example: In late July, 2000, the merger announcement by Pillsbury and General Mills noted that a major reason for the merger was to position the resulting firm to better do battle with the major players in food retailing. The importance of getting shelf space at the retail level is another critical factor in food production and distribution. Concentration in food retailing leads to concentration among those who sell to the big food retailers which leads to concentration among those to sell to those who sell to the big food retailers and so on down the scale to the powerless producer. In early 2001, the president of Tyson Foods was quoted as saying that the proposed merger with IBP “should give us 100 feet of shelf space at Wal-Mart.”

³ *Diamond v. Chakrabarty*, 447 U.S. 303 (1980) (bacterium having unique genetic characteristics is patentable subject matter under the general patent statute). The scope of plant patenting was back before the U.S. Supreme Court in the case of *J.E.M. Ag Supply v. Pioneer Hi-Bred International, Inc.* The U.S. Supreme Court upheld patenting in that case and determined that the Plant Patent Act of 1930 and the Plant Variety Protection Act of 1970 are not the sole means of protection of intellectual property rights.

⁴ Pub. L. No. 91-577, 84 Stat. 1542 (1970), 7 U.S.C. §§ 2321-2581. See generally 12 Harl, *Agricultural Law*, Ch. 110 (2001).

Just how concentrated is food retailing? In 1992, the five leading food retail chains controlled 19 percent of U.S. grocery sales. By 1998, the five largest chains (Safeway, Albertson's, Kroger, Ahold and Wal-Mart) controlled about 33 percent of U.S. grocery sales with that figure at an estimated 42 percent in 2000. Table 1 shows the five leading firms in terms of retail sales. Unless mergers are curbed, that figure is expected to reach 60 percent within three years.

Table 1. Five leading firms in retail sales

	<u>Sales (billions)</u>	<u>Percentage of total sales</u>
Wal-Mart	\$57.2	11.1
Kroger	49.0	9.5
Albertsons	36.4	7.1
Safeway	32.0	6.2
Ahold USA	27.8	5.4

Effect of contracts. An important question is the effect concentration will likely have on contract negotiations with producers. It depends on the options open to producers who don't like the terms of contracts offered to them. With numerous contract possibilities available, each offering inputs of roughly equal productivity and cost and each marketing option equally attractive, the answer is perhaps "not much."

But if there are just a few options, with the next best offering a much less attractive set of options, such as when a variety of seed is developed with significant yield premium over otherwise competitive varieties, the answer is "take what you're offered." A greater proportion of the value of the yield premium is expected to be captured by the seed supplier under those conditions than has historically been the case. The outcome is likely to be a tilting in the terms of contracts in favor of the input supplier. The division of revenue from production would be expected to shift over time in favor of the party with the monopoly or near-monopoly position. Input suppliers can be expected to drive the best possible bargain which means, in the case of seed, capturing the greatest possible percentage of the value from any yield premium.

- The outcome would be a smaller share of the revenue from production going to the producer, resulting in less compensation to the producer and less to capitalize into land values.
- Seed companies, for example, would end up with a larger share of the pie with more to capitalize into the stock of the input supply firms. Even if unique corn derivatives produce revenue of \$2 million per acre, it's fairly clear that whomever holds the rights to the technology involved will capture the lion's share of the revenue, not he producer.

A good argument can be made that this perception of potential profits in the future is part of what was driving the intense push toward concentration in control over germ plasm.

Thus, a major issue is whether a shift in market power occurs between input suppliers and producers, whether that shift in market power is translated into enhanced bargaining power and

whether the enhanced bargaining power is employed to siphon a greater proportion of the economic return generated by the sector into the hands of input suppliers.

The “deadly combination.” Without much doubt, the greatest economic threat to farmers as independent entrepreneurs is the deadly combination of concentration and vertical integration. Producers are vulnerable to a combination of high levels of concentration in input supply and output processing and high levels of vertical integration from the top down.

Example: let’s assume concentration in hog slaughter continues to increase (the four largest firms now control about 60 percent of hog slaughter compared to more than 80 percent for steer and heifer slaughter, as show in Table 2.) and the hog slaughtering firms vertically integrate in the manner pioneered by Smithfield. Before dropping the Tyson merger, Smithfield would have controlled about 68 percent of its hog slaughter. Let’s say we’re down to two huge firms and each is 90 percent integrated. A producer with a five-year contract with one of the two major firms comes to the end of the contract. The new contract is considerably less attractive than the expiring contract. The producer is told—take it or leave it. If the closest competitive option is 900 miles away—and is also heavily integrated—the producer seeking another option for hogs is highly vulnerable. If the producer had made a heavy commitment to facilities, the vulnerability is greater yet with significant barriers to exit. Clearly, a producer in that situation is likely to be squeezed.

Table 2. Four firm packer concentration ratios (in percent)

<u>Year</u>	<u>Cattle</u>	<u>Steer & Heifers</u>	<u>Cows/Bulls</u>	<u>Hogs</u>
1980	28	36	10	34
1985	39	50	17	32
1990	42	55	18	33
1995	69	81	28	46
1996	66	79	29	55
1997	68	80	31	54
1998	70	81	33	56
1999	70	81	32	56

Source: International Agricultural Trade and Development Center, University of Florida.

As is well known, in addition to pressure on suppliers, monopoly generally leads to prices higher than competitive levels plus the use of technologies that are less efficient than could have been used.⁵

As a group of Purdue agricultural economists has stated, “We see evidence of increased concentration to the point where public vigilance is warranted. Concentration indices are high and may be reaching the point where markdown pricing on hogs will be significant and place

⁵ See, e.g., Holmes and Schmitz, “Competition at Work: Railroads vs. Monopoly in the U.S. Shipping Industry,” *Quarterly Review*, Federal Reserve Bank of Minneapolis, Vol. 25, No. 2, Spring, 2001, pp. 3-27.

producers at a clear disadvantage.... Two major policy options are anti-trust activity on the one hand and increasing the market power of hog producers on the other.”⁶

In short, whoever controls the limiting factor or controls the “hold-up” points in any process is in a position to exert influence over the entire process and, if the level of concentration is high, exact a hefty charge against the fruits of production. In hogs the limiting factor is not capital or labor or buildings; the limiting factor is slaughter capacity or “shacklespace.” In food generally, an important limiting factor is shelf space.

Vertical integration. The moves made by the major players, both input suppliers and output processors and handlers, could lead one to conclude that the objective is to vertically integrate the sector. Such an objective could be pursued for several reasons—(1) to gain and maintain greater control over patented products or products subject to intellectual property protection otherwise; (2) to apply economic pressure on producers to relinquish functions in favor of the integrator (such as risk management) or to merely provide an opportunity for risk to be off loaded onto the integrator; (3) to reduce costs (particularly acquisition costs for raw materials) of the integrating firm; (4) to achieve greater market share on an assured basis; or (5) to deliver with greater precision what consumers want. The latter point is debatable. In an early example, seed/chemical companies misjudged consumer acceptance of genetically engineered foods and stumbled badly in the process.

Although vertically integrating a sector or subsector may produce economies—including reduced costs for acquisition of raw materials—vertical integration by powerful integrators can have decidedly negative consequences. Among those negative outcomes is the demolition of open, transparent, competitive markets and replacement of those markets with negotiated prices. With a huge difference in bargaining power, as between the parties, the outcome is predictable. The party with the weaker market power tends to be the loser. Unless producers act collectively, producers tend to be the weaker party.

Are economies from vertical integration likely to be passed on to consumers? With a high level of concentration, that’s doubtful. Actually, several possible outcomes could be occurring in the merger/vertical integration movement.

- If the structural transformation now being observed reflects efficiencies, lower costs could be passed to consumers if competition is present and the competitive system is functioning well.
- In the event gains from efficiency are not passed to consumers, but are passed to shareholders or used to pad costs within the firm, the trend is objectionable even though some would argue that system-wide gains in efficiency should be permitted even in the face of anti-competitive conditions.

⁶ Paarlberg, Boehlje, Foster, Doering and Tyner, “Structural Change and Market Performance in Agriculture: Critical Issues and Concerns About Concentration in the Pork Industry,” Staff Paper #99-14, Purdue University, October 1999, submitted as testimony to the U.S. House of Representatives, Committee on the Judiciary, October 20, 1999.

- The third scenario, which is concerned with the distributional effects of competition policy, does not recognize gains from efficiency as a positive offset to an otherwise anti-competitive merger unless the gains are passed on to consumers.

Clearly, the higher the level of concentration and vertical integration, the greater the risk of unacceptable market conduct.

What all of this adds up to is this—*if farming is to be made up of independent entrepreneurs as producers, it is absolutely essential for producers to be assured of meaningful competitive options.* To assure that outcome, it is necessary to—(1) limit concentration in input supply and output processing or handling and (2) possibly limit the extent of vertical integration.

Barriers to entry. In general, one would expect high handed economic behavior by near monopolists to be met by entry of new competitors attracted by the generous terms of contracts in favor of the input suppliers. And that would likely occur if entry were possible. However, barriers to entry may be fairly high.

- One barrier is capital needed to mount the kind of research effort needed to maintain a product flow similar to that of the firms pressing for monopoly-like concentration levels. The capital needed is very substantial.

- Also, in the seed/chemical industry, existing patent and plant variety protection may mean that potential competitors are frozen out of competition as a practical matter for the duration of the patent or PVP certificates or the duration of a patent over processes by which genetic manipulation occurs.

Reform of contract practices. The great disparity in market power tends to lead to contracts with oppressive features (as viewed by the weaker party), retaliatory practices by the stronger party and vulnerability of the weaker party in terms of securing payment. The Producer Protection Act, which has been proposed and endorsed by 17 State Attorneys General, would take several steps as a matter of state law towards providing full information to the producer and lien protection to the producer to secure payment of amounts due and reducing the probabilities of economic retaliation in producer-processor contract relationships.

The proposed legislation contains six parts—

- Require contracts to be stated in plain language and disclose material risks;
- Provide contract producers with a right to review and a three-day cancellation period;
- Prohibit confidentiality clauses;
- Provide producers with a first priority lien for payments due under the contract;
- Prevent capricious or retaliatory termination of the contract; and
- Prevent retaliation against producers who participate in producer organizations.

Although the proposal has been criticized,⁷ the provisions all have precedent in other areas of the law, such as consumer protection legislation and trade regulation, and all are based on basic principles of fairness, full information and equity which are common throughout the law.⁸

The Family Farmer Cooperative Marketing Amendments Act of 2001, which has been introduced in the U.S. House of Representatives, would address some of the same issues at the federal level.⁹

Antitrust Surveillance

One possible area of protection against a sharp tilt in the economic terms of contracts is vigilance by federal (or state) anti-trust agencies. Certainly the Federal Trade Commission and the U.S. Department of Justice should be sensitized to the potential for economic abuses down the road.

Further consolidation in any highly concentrated sector merits scrutiny under the Clayton Act rules that impose limits on mergers expected substantially to diminish competition. So-called horizontal mergers or mergers of competitors are the most likely to be challenged. Other areas of antitrust challenge involve production, including price fixing, agreements to divide markets and group economic boycotts. These are all per se offenses under federal antitrust law.

It's been well established for decades that firms with monopoly power over a product should not be able to "tie" other products to the transaction and extend the monopoly position.¹⁰ Such contracts are used to create "economic leverage" by using monopoly power in one market (the market for the tying good) to create monopoly power in a second market (the market for the tied good). Such arrangements, which involve tying products over which a firm does not have monopoly power (such as financing, insurance or risk management) to a product over which the firm does have monopoly power (such as a seed variety), are also illegal per se unless it can be demonstrated that the product in monopoly status wouldn't work as well with other firms' products. And, that is rarely the case.

If the objective is to maintain significant levels of competition, FTC and the Department of Justice should scrutinize all agribusiness mergers carefully for anti-competitive consequences from the standpoint of producers (as well as consumers) and all practices by companies in tying credit, insurance, risk management or other needed inputs to potential items. One problem in relying on FTC or the Department of Justice is that both agencies seem to believe that the agriculture is the last bastion of perfect competition and is competitive by a comfortable margin. The problem is not one of diminished competition among producers but among those who supply inputs and process or handle products from the producing subsector.

⁷ See Boehlje, Schrader, Hurt, Foster and Pritchett, "The Producer Protection Act—Will It Protect Producers?" 18 *Agric. Law Update* No. 2, pp. 4-6 (2001).

⁸ See Harl, Stumo, McEowen, Heffernan and O'Brien, "The Producer Protection Act—Will It Protect Producers? A Rejoinder," 18 *Agric. Law Update* No. 3, pp. 1-7 (2001).

⁹ H.R. 230, 107th Cong., 1st Sess. (2001).

¹⁰ See generally Neale, *The Antitrust Laws of the United States of America* Ch. XI (2d ed. 1970).

The approaches used by the Antitrust Division of the Department of Justice and by the Federal Trade Commission (FTC) in analyzing mergers have traditionally focused on the probable impact on consumers. That has been the principal concern of the antitrust system. For agriculture, however, the concern is the impact on *producers*—assuring producers competitive options. Consumers may ultimately be affected but that is down the road. That’s why a different approach is needed in the evaluation of agribusiness mergers if there is a shared vision of maintaining a sector of independent entrepreneurs as producers. Unless that vision is articulated by the Congress and the Administration, the chances of meaningful actions by the antitrust system are slight.

Solutions

If sufficient public interest and political will are generated, three solutions seem to lie within the feasible set.

Antitrust oversight. First, aggressive antitrust oversight at the federal level (and among the states) is the traditional way for proposed mergers and alliances, tying contracts and other anti-competitive practices to be evaluated on the basis of potential anti-competitive effects. The objective should be to insure that all sectors and subsectors have equal, and low, economic power. Because of the importance of food and the policy significant of maintaining a healthy producing sector, it may be necessary for the Department of Justice to be funded specifically to maintain a substantially higher level of oversight over structural shifts in food and agriculture.

Collective action by farmers. One possible strategy for farmers is to forge alliances among producers (which is specifically allowed by federal law so long as it does not “unduly enhance” price).¹¹ The push to achieve such countervailing power was the driving force behind the formation of labor unions a century ago. Historically, however, farmers have been unwilling to accept such a disciplined approach to achieving bargaining power.

Section 1 of the Capper-Volstead Act of 1922¹² provides protection from antitrust challenge for producers who seek to bargain collectively with processors, handlers and input suppliers.¹³ The Capper-Volstead Act provides that “persons engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers, may act together in associations, corporate or otherwise, with or without capital stock, in collectively processing, preparing for market, handling, and marketing in interstate and foreign commerce, such products of persons so engaged.”¹⁴ The Act goes on to allow “Associations [to] have marketing agencies in common; and such associations and their members may make the necessary contracts and agreements to effect such purposes.”¹⁵

¹¹ Capper-Volstead Act, 7 U.S.C. §§ 291, 292. See generally 14 Harl, *Agricultural Law* § 137.04 (2001).

¹² 7 U.S.C. §§ 291, 292.

¹³ See generally 14 Harl, *Agricultural Law* § 137.04 (2001).

¹⁴ 7 U.S.C. § 291. See *Green v. Associated Milk Producers, Inc.*, 692 F.2d 1158 (8th Cir. 1982) (transportation of milk is handling activity protected by Capper-Volstead Act; employees of dairy cooperative acting within scope of their authority could not be guilty of conspiracy with cooperative because employees and cooperative are part of same entity; cooperative members and cooperative are considered one entity and incapable of conspiring with each other).

¹⁵ 7 U.S.C. § 291.

To come within the protection of the Capper-Volstead Act, an organization must—(1) be operated for the mutual benefit of its members; (2) either limit each member to one vote regardless of the amount of stock or membership capital the member owns or, if dividends are paid on the basis of members' stock or membership capital, the dividends must be limited to a maximum of eight percent per annum; (3) not handle a greater amount of products from nonmembers than from members; and (4) not be operated for profit.¹⁶

The grant of immunity from antitrust challenge was further limited by a provision that if the Secretary of Agriculture finds that an association “monopolizes or restrains trade in interstate or foreign commerce to such an extent that the price of any agricultural product is unduly enhanced thereby he shall issue...an order...directing such association to cease and desist from monopolization and restraint of trade.”¹⁷

The key question is whether producers will be willing to sacrifice independence of action in order to bargain collectively for access to inputs and for greater market power in marketing their products. The most likely avenue for such collective action is through organizations specifically created for that purpose.

The time may be near when that will be the only practical alternative to vulnerability and serfdom.

Need for enabling legislation. It is unlikely that countervailing power can be achieved in one grand move to get large numbers of producers to bargain collectively for inputs and for the sale of commodities. Rather, greater market power is likely to be achieved, if at all, by bargaining groups of relatively modest size and comprised of producers committed to collective marketing and committed to producing commodities at a quality level desired by processors and on a schedule consistent with the purchaser's capacity.

To facilitate the formation and operation of such collective marketing (and input supply) groups, enabling legislation at the state (or federal) level is needed to assure that—(1) agribusiness firms would be required to bargain in good faith; (2) would assure that recriminatory behavior would not be allowed by agribusiness firms; (3) members of the unit would be required to be producers.

A level playing field. The provisions in the Producer Protection Act, proposed by 17 State Attorneys General, would constitute a modest first step toward leveling the field of contracting. Indeed, serious consideration should be given to adding such provisions to federal antitrust law.

More germ plasm in the public domain. Another potential solution for concentration in seed supply is for the public to increase its support for crop breeding by land grant universities and other public agencies with transgenic hybrids and varieties made available to smaller seed companies. *However, it should be made crystal clear that germ plasm from public funds should go into the public domain and not be channeled to the giant transgenic seed producers on a basis of exclusivity.* This would restore the land grant universities to the role played before the

¹⁶ *Id.*

¹⁷ 7 U.S.C. § 292.

advent of genetic manipulation and the dramatic increase in private sector funding for new varieties and hybrids to the extent that public funds are used; however, the results should be in the public domain.

To a considerable extent, this possible outcome is dependent upon the perception in state legislatures and the Congress as to the public interest, long-term, in maintaining a greater degree of competition in seed supply. Legislative bodies are more likely to respond if convinced that dominance of seed supply by a few large firms, worldwide, could affect food costs by influencing the supply of food through contractual mechanisms.

Role of Institutions

Arguably what is likely to emerge over the next few years is a heightened awareness of the efficacy of institutions in limiting or constraining economic activity. To the extent that institutional intervention is successful, a major concern is how to keep institutions in adjustment with changing economic circumstances. Markets reflect changes day by day, minute by minute. Yet, institutions tend to remain in place, frequently producing economic rents for some, until sufficient momentum is generated to effect change. To a considerable degree, institutions limit (as well as facilitate) market operations but without the same self-adjusting features as markets.

IV. Becoming a Dependable Non-GMO Supplier

With the odds currently favoring increasing consumer resistance to products produced with GMO commodities, exporting countries with substantial plantings of GMO crops and a reputation as a GMO supplier are expected to gear up for simultaneous production of GMO and non-GMO crops with intensive effort devoted to (1) maintaining acceptable levels of segregation of the crops and (2) developing a reputation, worldwide, as a dependable supplier of both GMO and non-GMO crops. For countries nudged in that direction, several steps can be taken to facilitate the task.

- One superficially attractive solution is to zone a country for crops on the basis of genetic modification. This is expected to be unworkable for several reasons. No area within a country wants to be on the losing side of an evolving market. Moreover, such a move is antithetical to the time-honored tradition of producers being given free rein to produce what they want.

What could emerge, is a form of de facto zoning as producers, on a local basis, voluntarily agree to limit their plantings to non-GMO crops in order to be positioned to take advantage of non-GMO markets. This would require buffer areas unless natural barriers (such as rivers or mountains) limit sufficiently gene flow from pollen drift for crops for which that can be a problem.

- Another step that could be taken is for the regulating agencies to require the ultimate purchasers of seed that has not been approved for all uses and approved for export as well as domestic use, to advise in writing well in advance of planting all producers within at least one mile from every field planted to the limited registration crop. The requirement should also

require the grower planting the limited registration crop to obtain the approval of all other growers within the one mile radius to signify approval of the planting of the limited registration crop which could involve negotiated payments.

- A multi-track system of crop production, involving both GMO and non-GMO varieties, will likely produce acceptable results only if there is low cost, quick and reliable testing of the presence of GMO germ plasm at every point of commingling of the crop. This is clearly not possible at present and is likely to be unattainable in the near term although the development and implementation of testing protocols would be accelerated in the face of economic pressure brought on by loss of markets for crops.

- As an interim measure, a certification procedure, of the type developed in the autumn of 1999 by Iowa State University and the Office of the Iowa Attorney General would provide a helpful paper trail albeit with some shortcomings. The Iowa “Uniform Certification Procedure,” involves a pre-delivery certification segment which requires a declaration of the particular varieties planted, where they were planted and the seed lot (for tracing any gene flow problems in the production of the seed); that reasonable care was utilized in planting, harvesting, handling and storage of the crop; and a disclaimer of implied warranties of merchantability and fitness. The post-delivery portion is completed upon delivery and associates the scale tickets (and any sample identification for samples obtained for later testing) with the pre-delivery portion of the certification. The obvious shortcomings are—(1) a stack of certificates does not assure that the crop is uncontaminated (particularly in light of misrepresentations in a market environment of significant premiums for non-GMO crops); and (2) once samples are tested, the load has already been dumped into a bin based on the representations made with the potential for large-scale contamination.

V. Landlord’s Lien Changes

Not every state gives a landlord a lien for rent due. But many do have landlord’s lien statutes. The liens are a helpful boost to landlords in collecting their rent. Where available, the landlord has a lien, typically over the tenant’s crops and, in some states, over the tenant’s equipment and livestock.

Over the years, landlord’s liens have been a powerful device for landlords. A landlord’s lien takes priority over the rights of a purchaser of property subject to the lien and it takes priority over security interests held by lenders. The landlord’s lien generally prevailed against purchasers of commodities even though the landlord’s lien was not recorded. Ironically, in the event a tenant files bankruptcy, the landlord’s lien goes to the bottom of the list of priorities.

Last July, a major change went into effect on landlord’s liens. A landlord’s lien became subject to treatment as an “agricultural lien.” That means a landlord’s lien, to have priority, must be filed using a financing statement. That’s the same document used by a lender to handle a new secured loan.

When must the landlord file the financing statement? For leases in effect on July 1, 2001, it had to be filed *before* July 1, 2001. For leases entered into later, the financing statement must

be filed when the tenant takes possession of the leased premises or within 20 days after the tenant takes possession.

A financing statement filed to give a landlord a priority position must include a statement that it is filed for the purpose of perfecting a landlord's lien.

One final point: it takes a separate filing to make the landlord a secured creditor with a priority in the event of bankruptcy of the tenant.

VI. Bioterrorism

Without much question, agriculture is vulnerable to bioterrorist attacks. Now that our attention is focused on terrorism, one can quickly compile a lengthy list of areas of possible mischief by those bent on disrupting activities in this country. The key issue is the probability of such events.

Probabilities of Bioterrorism

Terrorism is about risks—(1) to life, (2) to property and (3) to a way of life. The United States is vulnerable to attack in several areas—(1) governance, (2) telecommunications, (3) transportation, (4) water supplies, (5) food production, (6) food processing and (7) food distribution.

We are confronted by risks every day and have come to accept the fact that life is full of risks. Bridges, for example, are not designed for 100 percent safety. Bridges can, and occasionally do, fail. Likewise, dams have been known to fail, leading to damage to property and even loss of life. The incidence of serious diseases, both animal and human, tends to be relatively low but significantly greater than zero. Aircraft engines have been the subject of exhaustive tests and notwithstanding the fact that two-engine jets have been allowed to fly over-water routes, occasionally fail. Tire life has been the focus of manufacturers and consumers worldwide in recent months and as almost everyone knows, the chances of tire failure have not been reduced to zero. Even household appliances are designed and manufactured with an accepted failure rate.

The risks of nuclear plant failure became the subject of public attention and debate more than two decades ago and, because the risk of failure was significantly greater than zero, were influential in essentially shelving plans for additional reactors. Existing reactors pose a threat to people and property including agricultural production although the risks are generally perceived as quite low.

In all likelihood, the risks from terrorism will likewise eventually be reduced to acceptable levels but probably not eliminated entirely. It is generally agreed that it would be very costly to reduce all risks to zero and indeed some risks can probably never be reduced to zero.

But an acceptable level of risk is based on observed events. The study of risk factors has become a science as data have been compiled revealing the incidence of risk for particular activities. In this country, the probability of terrorist attacks was perceived as quite low until September 11, 2001. Indeed, it appears that even insurance companies assumed the probabilities of such attacks were quite low. However, the attacks this year have permanently altered perceptions of risk from terrorist activity.

By comparison, the risks from terrorist attacks have been viewed much differently in the Middle East and at the gateway airports to the Middle East. Our perceptions of risk from terrorist attack are now aligned with much of the rest of the world.

Vulnerability of the Food System

The food system in the United States (and in much of the world) is clearly vulnerable to terrorist interference.

- U.S. borders are porous, even yet, especially for entry by air.
- Aerial applications of disease-causing organisms or fatal maladies are entirely possible.
- Concentration in livestock production has added to the vulnerability.
- Security levels on farms and ranches, in processing firms and in food distribution are uniformly low.

Food security experts estimate that the average U.S. city has a five-day supply of fresh meat, fruits and vegetables and three to five weeks of food supplies if edibility is the governing criterion. On the average, food supplies travel more than 1300 miles from the farm or ranch where produced to the urban resident's dinner table. Food supplies in distribution are highly vulnerable to interference.

Vulnerability is increased because of low wage workers involved in direct contact with food products, relatively high levels of turn over of employment in many food related industries and the ease with which contaminants could be injected into foodstuffs. Reduced levels of inspection in recent years have added to the vulnerability.

Government Oversight

The federal government has only limited authority over foodstuffs. Indeed, there is no mandatory recall authority over food products. Surprisingly, the inspection of imported foodstuffs is inadequate. Virtually no seafood, domestic or imported, is inspected.

The General Accounting Office in 2001 stated that the government's food safety system is beset by "inconsistent oversight and poor coordination." Twelve separate agencies are attempting to enforce 35 different laws pertaining to food safety. The Food and Drug Administration, in charge of inspecting 70 percent of the nation's food, has 150 inspectors in

charge of 57,000 food establishments and food arriving at 132 ports. USDA has 10 times as many inspectors to handle 6,000 facilities for inspection of meat, poultry and processed egg products. GAO's recommendation was to form a single food safety agency.

On January 7, the Food and Drug Administration issued guidelines to help prevent bioterrorist attacks on the nation's food supply. The guidelines cover the entire food chain, from the food producer to the grocery store. One set of guidelines is for food importers; the other is for domestic food producers, processors and retailers.

Some of the points included in the FDA guidelines for increasing food security at food facilities in the United States—

- Inspect vehicles, both incoming and outgoing, for suspicious activity.
- Beware of unsolicited visitors.
- Restrict access to laboratory facilities and to bacteria and toxins.
- Keep track of which employees are on which shifts and watch for employees coming in early or leaving late.
- Prevent workers from bringing personal items (such as lunches) into food handling areas.
- Watch for unusual or suspicious behavior by new employees.
- Conduct regular inspections of employee bags, lockers and vehicles.
- Restrict access to computer control systems.
- Inspect ingredients, compressed gas, packaging and returned products for signs of tampering.

Vulnerability of Water Supply

Security levels for water supply facilities have been low. Major concerns are now being voiced over the backflow of toxic materials into water systems (which could be pulled off rather easily from about any home or business which is part of a water distribution system). Moreover, about 75 percent of our water is supplied through reservoirs with little security over water in storage and in transit to storage through aqueducts, virtually no security over watersheds and a growing capacity to circumvent the effectiveness of water treatment facilities.

A Dynamic Problem

The country is not facing a static challenge. The technology of detection is changing and becoming more precise but the technology of evasion is also changing. We are educating the best and the brightest in the world who become familiar with our technologies. What we know, we must assume they know.

It is a peculiar battle. Unlike other wars we have fought, this one is different.

- It will likely be never-ending
- It has the capacity to impact this country directly (unlike most wars since the Civil War).

- Like most wars, it will consume enormous amounts of resources and some human lives.

Why Has the Problem Arisen?

Part of the problem is our enormous success over the last century—(1) in higher levels of per capita personal incomes in real terms; (2) higher levels of wealth, particularly as perceived by others; (3) technological dominance; and (4) the widespread influence of our culture (music, literature, movies, television, clothing and language) in other countries.

Solutions

As we ponder a range of solutions, several stand out in bold relief—(1) increased security at all levels, (2) more funding for detection technology, (3) tighter controls over borders, (4) increased government surveillance and authority and (5) consolidation of food safety oversight in a single agency. Other ranking solutions include reduced dependence on imported oil (the military presence in the Middle East has been a catalyst for increased terrorist activity) and a global food and agriculture policy to boost economic development in struggling Third World economies.

As for the long view, we can never be truly safe but we are more likely to be secure if the poorer countries of the world—(1) have hope for the future and (2) are reasonably well fed and feel the world respects their culture, language and traditions.

As we did from World War II to the Serbian bombing campaign, we should follow the current armed conflict with a helping hand as we did with the Marshall Plan after World War II and the \$1.3 billion of assistance for Serbia in 2001. The helping hand up should be extended to all struggling economies of the world, not just Afghanistan.

Moreover, we need to be even-handed in our foreign policy and work toward a pluralistic world which is respectful without regard to religion, ethnicity, race or sex.



PROPOSED UNIFORM CERTIFICATION (PRE-DELIVERY PORTION OF CERTIFICATION)

I, _____, residing at _____
(Name of Producer) (Address)

_____, have delivered _____ in the amount of _____ bushels.
(corn or soybeans)

The delivery(ies) are represented by scale ticket numbers and sample numbers which will be specifically identified after delivery is completed in the "Post-Delivery" portion of this Certification.

With regard to the above-referenced grain, by placing my initials in the corresponding blank, I hereby certify and affirm the following:

1. The above-referenced grain was grown from the following varieties of seed:

<u>Seed company</u>	<u>Variety No.</u>
a. _____	_____
b. _____	_____
c. _____	_____
d. _____	_____
e. _____	_____

- _____ ;
2. I used ordinary care to clean my harvesting equipment prior to harvesting the above-referenced grain;
 3. I used ordinary care to clean my on-farm storage facilities prior to placing the above-referenced grain in said facilities;
 4. I used ordinary care to clean the transportation delivery vehicles prior to using said vehicles to deliver the above-referenced grain; and
 5. (Other) _____

No other warranties, express or implied, including implied warranties of fitness and implied warranties of merchantability, are made as to the commodity in question with respect to the commodity's nature, genetic composition, fitness for a particular purpose or use or otherwise.

Name

Date

Address

Telephone No.

Source: Office of the Iowa Attorney General and Iowa State University.



(POST DELIVERY PORTION OF CERTIFICATION)

The delivery(ies) made pursuant to this Certification are evidenced by scale ticket number(s)

_____, and sample number(s) _____.

Name

Date

Address

Telephone No.



Proposed Purchaser Certification Statement

I hereby certify and affirm that the lot of _____ which is the subject
(corn, soybeans)
of this statement, described as containing approximately _____ bushels and sold this
_____ day of _____, 1999, was harvested from seed represented by the seed
supplier as non-genetically modified, and that the commodity in question was not the product of
seed represented by the seed supplier as genetically modified. The undersigned has on file
certifications of producers indicating the variety planted in each case and certifying that
ordinary care was used in harvesting, handling, drying and storing the commodity in question to
avoid contamination with genetically modified varieties. The undersigned further certifies that
reasonable care was used in receiving, handling, storing and shipping the commodity in question.

**No other warranties, express or implied, including implied warranties of fitness and
implied warranties of merchantability, are made as to the commodity in question with
respect to the commodity's nature, genetic composition, fitness for a particular purpose or
use or otherwise.**

Purchaser

Address

Date