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Unintended Consequences

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Charley Martinez, David P. Anderson, and John L. Park

The Livestock Mandatory Reporting Act was passed by Congress in 1999 and began in 2001 to “facilitate open, transparent price discovery and provide all market participants, both large and small, with comparable levels of market information for slaughter cattle, swine, sheep, boxed beef, lamb meat, and wholesale pork” (USDA). Livestock price reporting has been provided by USDA, AMS since 1946 with those prices provided voluntarily and reported when confirmed by both buyer and seller.

The Capper Volstead Act of 1922 gave agricultural producers the ability to form cooperative associations to produce, handle, or market agricultural products. The Act gave cooperatives limited exemptions from antitrust laws. Many of the nations farmers and ranchers have been cooperative members and formed new cooperative businesses, including meat packing businesses.

Mandatory price reporting (MPR) has been reauthorized in 2008, 2010, and 2015. Through the reauthorization process and implementation in intervening years, MPR evolved as markets have evolved. An important consideration in MPR has emerged recently, and that is the treatment and reporting of prices paid by cooperative owned packing plants. This paper briefly reviews MPR research and then explores the
implications of producer owned cooperative packing plants, the paper closes with a few further implications of the current implementation.

**Mandatory Price Reporting**

A broad set of research has been developed following the MPR’s passage. One set of research involves strategic and competitive behavior of firms under MPR (Wachenheim and DeVuyst; Azzam; Njorage). Cai, et al., demonstrated evidence that more market power was exercised in fed cattle markets following the implementation of MPR. Questions remain about the ability of MPR to improve noncompetitive behavior by meat packers. Research has demonstrated that MPR did lead to an increase in price transparency and accuracy. But, due to confidentiality of reporting rules regional price information has been lost. An excellent review of the literature on MPR and market information research was developed by Koontz and Ward (2011). Very little work has been done on the affects of business organization and structure on MPR.

A series of government reports on MPR have been conducted over the years. An ERS report in 2005 indicated some evidence that MPR contributed to increased price volatility. A GAO report, also in 2005, examined reporting procedures. The most recent study was released in 2016 (Parcell et al.) and commissioned by AMS in preparation for MPR reauthorization. This report provides a baseline of changes in livestock and meat marketing over the last few years that will affect future MPR implementation. It details a couple of items that are especially relevant to this paper: the increase in use of MPR data
for other purposes like insurance, and the changing structure of supply chains and packing business organization.

**Cooperatives**

Cooperatives, and their limited antitrust exemptions, have been codified since passage of the Capper Volsted Act in 1922. In general, a cooperative is a business that is owned and controlled by the people who use it. Commonly, owners share in the profits according to how much they patronize the business. For example, a customer-owner who provides 10% of the cooperative’s revenues would receive 10% of declared profits. Profits are generally shared partially as cash, and partially as equity to be redeemed at a later date. In this way, participation in the cooperative generates a cash return that adds to the producer’s bottom line, and ownership of a business in the producer’s value chain. As long as equity is redeemed at face value over time, current users maintain ownership and control of the business. When a cooperative relies on voluntary based patronage, its known as open or traditional. A producer in this type of cooperative has the choice to bring few or all of their animals to the cooperative for the marketing of their animals.

There is an alternative to this traditional form of cooperation known as a closed or new generation cooperative. Instead of relying on voluntary patronage of producers to generate equity, a new generation cooperative sells shares of ownership up front. Ownership of these shares also includes a contracted obligation to deliver a certain amount of business to the cooperative. The advantages of this less common form of cooperative are that the business has contracted the proper amount of volume in order to be profitable with an adequate and permanent equity base. This is especially important
for businesses that manufacture products whose consumers expect a steady supply throughout the year (imagine a flour mill trying to grow their market share among bakeries when they have an abundant supply one year and none the next). In this way, a small group of large producers may jointly own a facility to process their product into a value added product. As the value of this business grows, so too does the value of their individual shares, which can be sold if a member desires to exit the cooperative.

A farmer’s participation in cooperatives represents an investment in the infrastructure of our agricultural marketing system. Without this investment, would these market services and products be provided? Probably, but not in all market locations, and not under all market conditions. When farmers cooperatively own these assets, there is a greater likelihood that services will be available in a bad marketing year, and that profits will be shared in a good marketing year. It is crucial to highlight in the case of a producer-owned cooperative in either form (open or closed) the cooperative does not own the product or in this case, animals that the producer–owner brings to the cooperative. The cooperative owns the animals that it purchases from the producer for harvesting. In short, cooperatives help livestock producers manage the pressures that diminish profitability and bring greater prosperity to farms and communities.

**MPR and Coops**
AMS reports transactions conducted by packers in all the mentioned industries. Packers that process 125,000 for cattle, 100,000 for pork, 75,000 for lambs as well as importers of more than 2,500 metric tons of lamb meat. Packers are required to report all transactions that involve livestock as well as the details of the transactions. Details of these transactions can include domestic and export details of boxed products, carcasses, and imported details of boxed lamb product.

While packers are required to report transactions and details, AMS excludes some prices and transitions from reports. AMS exclusions can be due to double record reporting, mis-priced records, inaccurate data, confidentiality problems, and auction bought purchases. Of particular importance for lamb, in 2012, AMS published, “Operational Guidelines Reporting of Intra Company Transactions”, stating that packers or divisions inside of a company who supply livestock to the packing plant would not have their prices and transactions reported.

The position of AMS is that intra company transactions are outside of the structure in a normal marketplace. For cooperative owned packing plants, this means that their prices would not be reported. In this interpretation, lambs are then, technically, owned by a packing company the moment the lambs are born, which is not accurate depending on the organization of the cooperative. The cooperative does not own the animals until it purchases them from the producer for harvesting. The producer-cooperative member may have the choice to sell their livestock to any packing plant they choose.
This interpretation in the lamb industry has resulted in no price reporting for many slaughter lambs throughout most of 2016. The lack of reporting cooperative purchased lambs has resulted in the triggering of confidentiality rules which results in no prices reported. The unintended result in a lack of price transparency and reduced market information for both producers and packers. In the competitive market environment, the cooperative has asked for prices to be reported to enable them to pay competitive prices for lambs, from coop members and non-members. It is fair to say that others in the industry may argue the opposite, that those prices should not be reported because the absence of prices may help them.

An appropriate question to ask is “when do the lambs change ownership?” Does the fact that a producer is a member of a value added cooperative mean that the cooperative owns the producer’s production before it is sold and delivered? Does it matter if the producer is not obligated to deliver all of their production to their cooperative? It would seem that a legitimate argument is that the lambs are not owned by the cooperative packer until the sale is made and they change hands. Therefore, the prices could be reported because the lambs are producer owned, not packer owned. Could the interpretation of packer ownership of the cooperative members production change if it is a closed cooperative or if the producer member is obligated to deliver all their lambs? These are all extremely important implementation questions necessary to improve the working of MPR.

One additional impact of the lack of reported prices is in the area of insurance sales and indemnity calculation. The lamb industry has a price risk management tool called LRP-
Lamb. This insurance product allows the purchase of a policy to “lock in” a lamb price. Reported lamb prices are required for the LRP-Lamb product to be sold and to be settled at the end of the insurance period. The lack of prices has prohibited LRP-Lamb to be used by producers for price risk management.

Future Work

Currently, USDA-AMS is conducting a series of industry working group meetings for cattle, hogs, and lamb. These working groups are intended to improve implementation and MPR and to prepare for the next authorization. The next round of meetings is scheduled for Spring 2017. Some research toward estimating how alternative interpretations affect price reporting could be explored.

A couple of new hog packing plants, organized as cooperatives, are scheduled to open in 2017. While confined to lamb at the moment, this MPR implementation problem is likely to grow in impact this year.
References


