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Sent via e-mail to: comments.gipsa@usda.gov

Tess Butler
Grain Inspection and Packers and Stockyards Administration
United States Department of Agriculture
1400 Independence Ave. SW, Room 1643-S
Washington, DC 20250-3604

Re: "Farm Bill Comment," Federal Register, June 22, 2010, Vol. 75,
No. 119, page 35338

Dear Grain Inspection and Packers and Stockyards Administration:

On behalf of the Western Organization of Resource Councils (WORC) and the Campaign for Family Farms and the Environment, Farmers' Legal Action Group, Inc. (FLAG), submits these comments on the proposed rules issued by the Grain Inspection and Packers and Stockyards Administration (GIPSA) at 75 Fed. Reg. 35338 (June 22, 2010).

WORC is a regional network of seven grassroots community organizations with 10,000 members and 45 local chapters: [Dakota Rural Action](#) in South Dakota, [Dakota Resource Council](#) in North Dakota, [Idaho Rural Council](#), [Northern Plains Resource Council](#) in Montana, [Oregon Rural Action](#), the [Powder River Basin Resource Council](#) in Wyoming, and the [Western Colorado Congress](#). WORC's mission is to advance the vision of a democratic, sustainable, and just society through community action. WORC is committed to building sustainable environmental and economic communities that balance economic growth with the health of people and stewardship of their land, water, and air resources.

The Campaign for Family Farms and the Environment (CFFE) is a multi-state coalition of farm and rural groups that works to challenge the corporatization of the livestock industry and promotes policies that support independent family farms. The member organizations of CFFE are: Iowa Citizens for Community Improvement, The Missouri Rural Crisis Center, and The Land Stewardship Project (MN). These organizations represent thousands of independent livestock producers and a total of nearly 10,000 farm and rural member families.

I. Packers and Stockyards Act Authorities and Historical Lack of Enforcement

A primary purpose of the Packers and Stockyards Act (P&SA) is to ensure open, competitive markets for slaughter livestock to protect producers' interests from packers' exercise of excessive market power. Since the P&SA was enacted in the 1920's, the Secretary of Agriculture has held extraordinarily broad authority to issue substantive rules regulating packers both to prevent practices enumerated as unlawful and to compel lawful practices so as to induce healthy competition for slaughter livestock. In enacting the P&SA, Congress placed the obligation on the Secretary to monitor the packing industry and adjust regulatory controls to keep pace with the state and development of the industry for the purpose of ensuring open, competitive slaughter livestock markets. *See*, Appendix A1, beginning at p. 1852 for a thorough discussion of how the P&SA's legislative history and statutory provisions support the assertions in this paragraph.

With decades of lax enforcement of the Act and the failure of successive administrations to issue regulations designed to check packer practices as their consolidation of market share skyrocketed and relationships with producers were completely restructured through vertical integration and coordination, we are now faced with a slaughter livestock market that is no longer open and competitive. Instead we have an industry characterized by: (1) four-firm concentration levels that exceed those that catalyzed Congress to pass the Act; (2) packer procurement practices, including ever-increasing use of captive supplies, that routinely give undue preferences in prices, market access, and market information to a few favored producers and allow packers to manipulate livestock prices; and (3) virtually no open, competitive bidding for slaughter animals which has driven down prices to producers and caused near-complete collapse of price discovery and transparency mechanisms normally present in competitive markets.

II. Proposed Rules are Crucial First Step

We commend the Grain Inspection and Packers and Stockyards Administration (GIPSA) for finally stepping into the fray and issuing substantive regulations in response to Congress's 2008 Farm Bill mandates and the Agency's authorities and obligations under the P&SA. We commend GIPSA for taking a crucial first step in returning some degree of fairness to the slaughter livestock markets and for codifying its interpretation of the Act with regard to competitive injury issues.

The proposed rules begin to address some of the harms caused by the loss of an open, competitive market for slaughter livestock. For example, the proposed rules:

1. Address some of the serious preferential market access and pricing issues that emerge when packers do not purchase livestock in an open, public manner through competitive bidding.

2. Provide some additional price transparency by requiring that packers give GIPSA copies of unique types of contracts that may then be made public.
3. Take incremental steps to improve competitive bidding by prohibiting two or more packers from sharing a single packer buyer and attempting to address price distorting impacts of packer-to-packer sales.

A properly functioning open, public, competitive market would generate real time price transparency and price discovery. Through a competitive bidding process, the types of value-based pricing terms and the level of prices or premiums associated with each type would be generated by the bidding process itself, reducing the necessity of regulating justifications for pricing differentials. The open, public nature of the market would supply a forum in which packers would make the various pricing, premium, and other terms of purchase available to all producers in a non-discriminatory manner, because producers in general would have access to that public market.

As long as there remains no properly functioning open, public, competitively bid market for slaughter livestock, it will be essential to regulate packer practices as done in these proposed regulations. But we urge GIPSA to take additional steps designed explicitly to get packers competitively bidding for livestock in an open, public manner.

III. Additional Action Needed to Return to Open, Competitive Markets

We urge GIPSA to implement our recommended “safe harbor” amendments to the undue preference and packer-to-packer sale ban sections of these proposed rules which are designed to provide substantial incentives for packers to return to competitive bidding for slaughter livestock in an open, public market.

We also urge a second round of rulemaking to address the specific aspects of packers’ use of captive supply procurement methods—forward contracts and marketing agreements and packer-owned livestock—that violate the P&SA and mandate that these types of procurement methods be traded in an open, public, competitively bid market.

IV. Captive Supply Procurement Practices as they Relate to the Proposed Rules

While we recognize that the proposed GIPSA rules are not designed to address exclusively packers’ use of captive supply procurement methods, many provisions of the rules apply to forward contracts and marketing agreements, and some provisions apply to packer-owned livestock. Forward contract and marketing agreements are often the methods used to provide the unjustly discriminatory and unduly preferential pricing and other terms addressed in the proposed rules.

Therefore, it is useful to describe what we refer to as captive supply procurement methods and which aspects of these procurement practices cause violations of the P&SA. Packers acquire captive supplies of slaughter livestock by entering into forward contracts and marketing

agreements through which they obtain commitments of livestock more than 14 days in advance of slaughter and by owning livestock being fed for slaughter.

Through these captive supply procurement practices, packers have unfairly depressed prices paid for slaughter-ready livestock below competitive market value. In addition, because forward contracts and marketing agreements are not traded publicly and are only made available to a select group of producers, their current use unjustly discriminates against some producers and provides undue and unreasonable preferences to those with access to the agreements and the pricing and other terms included in them. Similarly, through packer ownership and feeding of livestock for slaughter, the packers give themselves as producers undue preferences over other producers by maintaining this standby reserve that can be transferred to the slaughter plant at any time, giving the packer-owner preferential access to the slaughter plant. Packer-to-packer sales of packer-owned livestock also allows for sending of price signals and collusion between packers to hold spot market prices at a certain level.

V. Economic Impact of Current Market Structure and Packer Practices

The following brief summary, along with the referenced supporting materials, provide a description of the current market structure and the adverse impact on producers of packer practices ingrained within this structure. This sets the context in which our comments on the proposed rules are made and in which the final rules will be issued.

Today the four-firm concentration of market share of the steer and heifer slaughter is well over 83 percent,¹ substantially higher than the 75 percent that five firms controlled when the P&SA was passed in 1921. This figure does not describe, and may grossly underestimate, buyer concentration in regional markets for slaughter animals. Even so, this level of concentration is well above levels generally considered by many economists to elicit noncompetitive behavior and results in adverse economic performance. The four-firm concentration of market share of the hog slaughter increased dramatically from 37 percent in 1987 to 64 percent in 2005.²

Packers' use of captive supply procurement methods for slaughter-ready livestock has also been increasing, rising by 37 percent between 1999 and 2002 and accounting for over 38 percent of all cattle procured for slaughter between October 2002 and March 2005 and as

¹ Hendrickson, Mary and William Heffernan, "Concentration of Agricultural Markets," April 2007 based on 2005 data. The purchase of Swift & Co. by JBS since that time has likely increased the four-firm concentration percentage substantially. *See also*, RTI International, *GIPSA Livestock and Meat Marketing Study*, Vol. 3, "Fed Cattle and Beef Industries," Final Report, January 2007, at p. 1-11.

² Hendrickson, Mary and William Heffernan, "Concentration of Agricultural Markets," April 2007 based on 2005 data.

much as 44.4 percent of all cattle slaughtered by the top four packers in 2002.³ USDA price reporting information indicates that the levels of captive supply have been continuing to increase substantially since March 2005.

Many economic studies of the cattle slaughter market have consistently shown that increases in the use of captive supplies are associated with lower cash market prices.⁴ A recent GIPSA study of hog slaughter markets found:

The effect of both contract and packer-owned hog supplies on spot market prices . . . are negative and indicate that an increase in either contract or packer-owned hog sales decreases the spot market price for hogs. Specifically, the estimated elasticities of industry derived demand indicate

- a 1% increase in contract hog quantities **causes** the spot market price to decrease by 0.88%, and
- a 1% increase in packer-owned hog quantities **causes** the spot market price to decrease by 0.28%.

A higher quantity of either contract or packer-owned hogs available for sale lowers the prices of contract or packer-owned hogs and induces packers to purchase more of the now relatively less expensive hogs and purchase fewer hogs sold on the spot market.⁵

The level of decrease in cash market prices related to use of captive supplies found in these studies varies by livestock type and range from what is referred to as small to significant, from state-to-state, and by region. But because profit margins in feeding cattle and hogs are tiny, even seemingly small decreases in fed livestock prices caused by packers' increased utilization of captive supplies results in significant negative returns to livestock feeders.

Because the cash market is often used to determine the base price in formula base price forward contracts and marketing agreements, this reduction in price is passed on through formula pricing to much of the captive supply livestock. Such formula base pricing of fed

³ See RTI International, "Spot and Alternative Marketing Arrangements in the Livestock and Meat Industries: Interim Report," report prepared for GIPSA, July 2005, at p. 3-15.

⁴ Ward, Clement E., "Economies of Competition in the U.S. Livestock Industry," submitted as comments to the USDA/DOJ Competition Workshops in January 2010, at p. 14-18. See also, RTI International, *GIPSA Livestock and Meat Marketing Study*, Vol. 3, "Fed Cattle and Beef Industries," Final Report, January 2007, at p. 7-10 and Vol. 1, "Executive Summary and Overview," Final Report, January 2007, at p. ES-6.

⁵ RTI International, *GIPSA Livestock and Meat Marketing Study*, Vol. 1, "Executive Summary and Overview," Final Report, January 2007, at p. ES-10.

cattle accounted for about 38 percent of the cattle purchases over the 2001-2008 period.⁶ At least one GIPSA study provided evidence that packers strategically use fixed base price contracts and formula base price contracts differently, slaughtering formula base priced cattle when cash market prices are relatively low compared to the cash market price when fixed base priced cattle are slaughtered. This is a strategic and manipulative use of captive supply cattle to hold down cash market prices, as well as prices for formula-priced cattle.⁷ Such evidence is supported by economic theory. In one economic study, a theoretical model showed that such formula pricing had anticompetitive implications when the contracts were exclusive and the buyers were operating in both the contract and cash markets.⁸

A recent GIPSA study also shows that large cattle feeders are much more likely to use alternative marketing arrangements, such as forward contracts and marketing agreements, with 52.5 percent of the head sold by the largest 25 feeders being sold under such arrangements, while only 8.5 percent of head sold by all remaining producers were sold through such arrangements.⁹ This shows that small feeders may not have access to the same type of purchase agreements that packers offer to large feeders.

Much more extensive analysis of economic studies and reports of the impacts of packer concentration and the use of captive supply procurement methods through 1996 are included in the *Petition for Rule-Making on Captive Supply Procurement Practices under the Packers and Stockyards Act* published at 62 Fed. Reg. 1845 (January 14, 1997) for public comment, and documents WORC submitted in support are attached as (Appendix A1 through A4). In addition, important descriptions of the livestock market structures and economic impacts on producers are included in *R-CALF USA Comments on Agricultural and Antitrust Enforcement Issues in Our 21st Century Economy*, (December 31, 2009) (attached as Appendix C) and *Restoring Economic Health to the Beef Markets* (August 25, 2010 by David A. Domina Law and C. Robert Taylor for the Organization for Competitive Markets) (attached as Appendix D) and which were both submitted as comments to the USDA/DOJ Competition Workshops. We incorporate these documents by reference into this letter for the descriptions and analysis of the industry structure and economic impacts.

⁶ *Id.* at 17. See also, RTI International, *GIPSA Livestock and Meat Marketing Study*, Vol. 1, “Executive Summary and Overview,” Final Report, January 2007, at p. ES-5.

⁷ Catherine A. Durham letter to Keith Collins, Office of the Chief Economist at USDA, in support of WORC Petition for Rulemaking discussing GIPSA Report on “Short-Run Captive Supply Relationships with Fed Cattle Transaction Prices,” prepared by Ward, Koontz, and Schroeder.

⁸ Ward, Clement E., “Economics of Competition in the U.S. Livestock Industry,” submitted as Comments to USDA/DOJ Competition Workshops in January 2010, at 17.

⁹ RTI International, *GIPSA Livestock and Meat Marketing Study*, Vol. 3, “Fed Cattle and Beef Industries,” Final Report, January 2007, at p. 2-2.

VI. Comments on Specific Sections of the Proposed Rules

The following include our detailed comments on several identified sections of the proposed rules.

A. Proof of Injury to Competition is Not Always Required

Section 201.3(c) Scope of Sections 202(a) and (b) of the Act. WORC and CFFE strongly support GIPSA's move to codify its interpretation of the P&SA's requirement for proof of a violation under Section 202(a) and (b). We agree that the very broad language of these statutory sections clearly was designed to address unfair, deceptive, unjustly discriminatory, and unduly preferential practices without necessarily requiring proof of predatory intent, or actual injury or likelihood of injury to competition. Violations of these sections can be proven by showing harm to the individual caused by unfair, deceptive, and discriminatory actions even when competition in general is not affected. Appropriate statutory interpretation principles and the legislative history of the P&SA support GIPSA's interpretation as codified at Section 201.3(c) of the proposed rules. Attached as Appendix E are detailed legal arguments supporting GIPSA's interpretation.

B. Definitions of Competitive Injury and Likelihood of Competitive Injury

As GIPSA acknowledges in Section 201.3(c), conduct can be found to violate Section 202(a) and/or (b) of the Act without a finding of harm or likely harm to competition. But depending on the nature and circumstances of the challenged conduct, such harm may need to be demonstrated. We strongly support GIPSA's move to include in definitions of "competitive injury" and "likelihood of competitive injury" examples of the types of harm that may fall within these definitions.

Section 201.2 (t) and (u) provide definitions of "competitive injury" and "likelihood of competitive injury." GIPSA is absolutely correct in incorporating within these definitions the concept that packer actions that impair a producer's or grower's ability to compete with other producers or growers constitutes competitive injury. Legislative history makes absolutely clear that the P&SA was designed expressly to address actions by packers that cause injury to competition between producers and not just competition between packers or that results in adverse impact on consumers.

When enacting the P&SA, Congress well knew that the only way open, competitive markets for livestock and meat could be maintained was if the Secretary were given the authority to regulate the practices of one sector of the industry (i.e., the packers) as that could adversely affect other sectors (i.e., livestock producers). Congress authorized regulation of unfair practices such as those between the packer and the producer and between the packer and the consumer. This was clearly expressed in the Act's legislative history. In response to a question as to how this Act strengthened the authorities under the Federal Trade Commission Act, Representative Anderson stated:

As to the intent of "unfair competition" [in the FTC Act] it only includes acts which constitute a violation of the rights of the competitor, and it must be a

method which is used by a competitor on the same plane. . . . For instance, the method of competition used by a manufacturer which we might think was a violation of the moral rights of the wholesaler would not be a violation of the Federal Trade Commission Act, because the interpretation of that is that it must be unfair as between competitors who stand on the same plane. This goes further than that, as it affects the public interest to a large extent, and the unfair competition or unfair practice as between the packer and the general public, *the packer and the producer*, or the packer and any other agency connected with the marketing of livestock.¹⁰

GIPSA is also correct in including in these definitions the concept that packer, swine contractor, or live poultry dealer actions that “wrongfully depress prices paid to a producer below market value” or that “impair a producer’s or grower’s ability to receive the reasonable full economic value of the transaction in the market channel or marketplace.” We, however, believe it is essential that GIPSA clarify these provisions to ensure that “market value” and “full economic value” may include the value that could reasonably be expected to be obtained if the market involved were an open, competitive one. The price Congress intended to protect for producers is a price that would be generated by an open, competitive market. Representative Jones of Texas, a strong supporter of the P&SA when it was initially enacted, made this precise point:

The producer must always sell in a market that he does not control. . . . *His only hope of securing a fair price lies in an open, competitive market.*¹¹

This clarification is necessary to ensure that producers and growers are not limited to protection of the price that might be generated in a market that is no longer open and competitive; but also may include the protection of the portion of the price that results from the lack of the open, competitive market itself.

We also suggest that GIPSA consider whether the list of examples of types of impact that may be included in these concepts fits more appropriately under the definition of “competitive injury” than under the definition of “likelihood of competitive injury.”

C. Undue and Unreasonable Preferences

Section 202(b) of the P&SA sets out one of the most important protections for livestock producers. It prohibits packers and swine contractors from making or giving any undue or unreasonable preference or advantage to any particular person or locality, or subjecting any particular person or locality to any undue or unreasonable prejudice or disadvantage.

¹⁰ 61 Congr. Rec. 1805 (1921).

¹¹ 61 Congr. Rec. 1861 (1921) (emphasis added).

Packer livestock purchasing practices are one of the primary areas in which undue or unreasonable preferences or advantages occur. Packers give unlawful preferences to some livestock producers over other producers both in the types of purchase agreements offered (marketing agreements, forward contracts, or spot market purchases) and through the terms and practices related to compensation under those various agreements. Packers grant undue preferences when they give selected producers long-term commitments to purchase their livestock through marketing agreements or forward contracts that are not offered to other producers. These agreements can provide undue preferences, not only by giving a long-term advance commitment to purchase livestock, but also in the compensation structure under the terms of those contracts including price terms, the types and rates of premiums paid and discounts taken, whether the producer or the packer is responsible for transportation, and the information given to producers regarding how their livestock rated on relevant grade, yield and other value-based factors. Packers' spot market purchases may also provide similar types of undue preferences without providing the long-term advance purchase commitment.

Section 201.211 of the proposed rules sets criteria the Secretary may consider in determining whether a packer has violated the P&SA prohibition against giving undue or unreasonable preferences or advantages and against undue and unreasonable prejudices or disadvantages. *See*, 7 U.S.C. § 192(b). WORC and CFFE support this section because for the first time it alerts meatpackers that some of the specific terms of acquisition of livestock that we assert have been used to provide some producers undue advantages over other producers may lead to a finding of a violation of the P&SA.

Section 201.211(a) recognizes that the Secretary may consider terms of acquisition, including but not limited to price terms, that are based in whole or in part on the number or volume of the livestock involved to be a violation of the P&SA if such terms are not made available to all producers who individually or collectively can meet the conditions set by the contract.

In the final rules, GIPSA should amend this provision to make clear that contract terms based on "number" or "volume" under **Section 201.211(a)** includes not just the one-time delivery volumes but also the total number or volume of animals the packer is committing to purchase over the full duration of the contract. This clarification must be made to ensure that one of the primary methods packers use for providing large volume producers with preference over other producers is through an advance commitment to acquire their livestock over a long duration. By such long term advance commitments, packers grant undue preference of market access. The amendment must make clear that forward contracts and marketing agreements that provide for multiple deliveries will be considered to include contract terms that are based on "number" or "volume." We suggest that at the end of subsection (a) GIPSA insert the following: "Purchase agreements, including forward contracts and marketing agreements, which provide for multiple deliveries over the duration of the contract will be considered to include contract terms based on 'number' or 'volume.'"

Section 201.211(a) should also be amended to prevent packers from requiring as one of the “conditions set by the contract” delivery of such a large volume of animals that small- and medium-sized feeders, by definition, would not be able to meet the conditions of the contract. Certainly in any instance in which producers are providing transportation to the packing plant, it should not make a difference to the packer whether it obtains ten truckloads from one producer or from multiple producers.

Section 201.211(b) alerts packers that the Secretary may find them in violation of the P&SA if they do not offer all price premiums based on standards of product quality, time of delivery, and production methods in a non-discriminatory manner to individual producers or groups of producers that can meet the standards. WORC and CFFE support this provision, because it is often through provision of differently structured quality premiums or discounts and incentives for early delivery that packers can mask their action to give undue preference to some producers over others.

GIPSA should make clear that the word “premiums” can include both a base price that is higher because of the quality, time of delivery, or production method, and/or an additional amount added to the base price to reflect an extra payment for these factors. In other words, the concept of “premium” is in the value being paid for the various factors, not simply in the idea that there is some specified amount added to the base price to reflect the quality, time of delivery, or production method.

GIPSA should also make clear that, when the Secretary considers whether these types of “premiums” were offered in a non-discriminatory manner, he will look both to whether the specific premium when looked at in isolation was offered in a non-discriminatory manner, and whether the specific premium in combination with all the other pricing terms of the purchase agreement was offered in a non-discriminatory manner. Ultimately, it is the combination of all price-related terms that must be offered in a non-discriminatory manner. The following is an example of when the combination of price-related terms will be relevant: In some instances packers have purchased cattle on a live weight basis and paid the cost of freight to the packing plant, and at the same time purchased cattle on grade and yield with the feeder bearing the cost of freight to the plant. It is both how the hauling cost and grade and yield provisions were offered in isolation, and the combination of how the hauling and live weight versus grade and yield terms were offered that should inform the Secretary’s decision.

Clarification, of whether special pricing terms that are based on the breed of the animal fall within the concepts of “quality” and/or “production method” under this section of the proposed rules, is needed.

Obviously, when the Agency reviews whether grade and yield or grid-based prices are offered in a non-discriminatory manner, it will be essential that the specific amount of the premiums or discounts attached to the various grade and yield or grid-based pricing terms be considered. Packers may offer to buy based on grade and yield or a grid but then assign different amounts to these pricing factors for different producers.

This subsection should be improved by adding the “form of pricing (e.g., live weight, carcass weight, in-the-meat, on-the-hook, on-the hoof, etc.)” to the list of types of contract terms that may be considered to violate the P&SA if packers offer or accept them in a manner that unjustly discriminates against some producers or provides other producers undue advantages. If these forms of pricing are offered in a discriminatory manner and they result in a higher payment to one producer over another, this is as much an avenue by which packers can unjustly discriminate as is the payment of some form of premium.

This section should also be amended to make clear that some types of premiums because of their nature would likely result in a finding of undue preference. For example, packers may pay a special price or add a premium to payments made to producers who are members of particular trade associations that favor the packers’ interests. This subsection should be amended to clarify that the Secretary will consider whether premiums based on factors not related to the animals purchased are undue or unreasonable preferences in violation of the P&SA.

Section 201.211(c) establishes that the Secretary may consider “whether information regarding acquiring, handling, processing, and quality of livestock is disclosed to all producers when it is disclosed to one or more producers” when determining whether packers have given undue preferences. WORC and CFFE support this section of the proposed rules because it appears to address situations where packers may provide key marketing-related information that could substantially affect producers’ marketing decisions. Those producers who received better information from packers will have an undue advantage in competing with other producers.

We ask that GIPSA clarify in the final rules that this provision will cover packers giving grade and yield information. Some packers may keep grade and yield data on each pen of cattle they procure for slaughter, including those pens purchased on a live weight basis. By having information about how the feeder’s livestock has fared with regard to grade and yield, the feeder can more accurately assess whether it would receive a higher payment by selling on a live weight or a grade and yield basis. By giving such information only to select producers but not to others, the packer gives those producers with the information an undue advantage over other producers in their ability to negotiate prices for their livestock.

We also ask that GIPSA clarify that this criteria includes packers giving information about anticipated procurement and/or buying practices. Information regarding many aspects of a packer’s anticipated procurement and/or buying practices can be of significant value to livestock producers in making decisions about when to market their livestock and what they believe an appropriate price for that livestock should be. If a packer gives such information to some, but not all, producers from which it is likely to procure livestock for slaughter, it gives those producers with the information an undue or unreasonable advantage in making marketing decisions over those producers without access to the information. If the packer has made this information available to producers exclusively

through a public reporting method, then the fact that some producers received the information by reviewing these public reports does not constitute a violation of the P&SA by the packer.

WORC and CFFE also recommend that GIPSA amend **Section 201.211** to create a “**safe harbor**” for packer compliance with subsections (a) and (b) when each and every trade involving contract terms referenced therein is made in an open, public market. An open, public market being defined as a forum (a) to which all potential buyers and sellers in general have access; (b) that is designed to solicit more than one blind bid; and (c) that allows buyers and sellers to witness bids and offers as they are made and accepted.

This “safe harbor” would provide a forum through which packers could demonstrate that they made available the various price, premiums, and other contract terms referenced in **Sections 201.211(a) and (b)** to producers in a non-discriminatory and non-preferential manner. Because the definition of the open, public market includes the requirement that sellers in general have access, packers would be able to show that, by offering the referenced contract terms in this forum, it made those terms available to livestock producers in general.

A more detailed discussion of this “safe harbor” concept is included below at Section VII, “Safe Harbor for Trades in an Open, Public Market.”

D. Additional Undue Preference Criteria

The very limited list of criteria included in the undue preference section of the proposed rules fails to address in any way the undue preferences inherent in two common practices in today’s vertically integrated and coordinated livestock markets: (1) packer ownership of livestock being fed for slaughter, and (2) packer ownership interests in custom feedlots.

WORC and CFFE ask that GIPSA issue additional proposed rules that list criteria for when packer ownership of livestock being fed for slaughter and packer ownership in custom feeding operations leads to undue preferences for the packer as feeder or the packer’s custom feedlot customers.

For packer ownership of livestock being fed for slaughter, such criteria should include consideration of (1) whether the packer is providing preferred timely access to the slaughter plant for its own livestock; and (2) whether through any type of investment, contribution, financing, cost-savings, or revenue- or profit-sharing associated with the packer being both in the business of slaughtering animals/selling meat and in the business of owning and raising livestock for slaughter, the packer is provided undue preference or advantage over other producers.

For packer ownership in custom feedlots, the criteria should include:

- (1) Whether any communication has occurred between the packer’s slaughter/meat-marketing enterprise and its custom feedlot enterprise regarding the packer’s proposed

buying operations such as species, classes, grade, or quality of livestock desired; volume of livestock to be purchased; volume of livestock committed to the packer for various time periods; pricing information; or other buyer information that is valuable to a producer in making production and marketing decisions. Any such valuable communication provides a preference to the packer's custom feeding operation producer customers over other livestock producers from whom the packer acquires livestock and who do not have ready access to the same information.

- (2) Whether there has been preferred timely access to a slaughter plant for the customers of the packer-owned custom feedlot over other producers. In order to satisfy its custom feeding operation's customers' desire for timely slaughter, the packer is likely to prefer acquisition of livestock held in its custom feeding operation over other producers' livestock when acquisition by other buyers will not clear the custom feedlot of slaughter-ready animals.
- (3) Whether the packer has taken action to impact or control the cost of custom feeding livestock by adjusting yardage fees, feed costs, transportation costs, and other expenses a livestock producer incurs at its feedlot provides the feedlot customers preferences over other livestock producers. Because a packer stands to profit from the custom feeding operation as well as from its slaughtering enterprise, the packer can lower fees and expenses charged to its feedlot customers and still profit through its slaughter transaction on those producers' livestock. Any reduction in the custom feeding costs charged to producers associated with the packer's dual enterprise constitutes a packer preference for its custom feeding operation's livestock producer customers over other livestock producers from whom it procures slaughter supplies.
- (4) Whether any type of investment, contribution, financing, cost-savings, revenue- or profit-sharing associated with the packer being both in the business of slaughtering animals/selling meat and in the business of owning a custom feedlot that has the effect of reducing the cost of the feeding operation's business and, thus, what it charges its producer customers will lead to preferences or advantages for the packer's custom feedlot customers over other livestock producers.

E. Ban on Packer-to-Packer Sales

WORC and CFFE agree with GIPSA that direct packer-to-packer sales result in price distortions in the slaughter livestock markets. Packers can send signals and collude on prices they intend to pay for slaughter livestock through such direct negotiated sales.

WORC and CFFE are, however, concerned that if direct negotiated packer-to-packer sales are banned that this also may have adverse impacts on prices for slaughter livestock. We assert that the oligopsonistic packers that exist today are able to use packer-owned livestock to exploit producers by paying lower prices. A Packers and Stockyards Division study explains how an oligopsonistic packer that feeds its own livestock can take actions that adversely affect prices paid to other producers for slaughter supplies:

An oligopsonistic packer that has a supply of cattle in its feedlots can use those cattle as a bargaining tool. Its fed cattle serve as a standby reserve in its price negotiations. Livestock sellers know that such a packer can fulfill his slaughtering needs at a particular time by transferring his own cattle to his plant, instead of buying cattle on the market. And since such a packer is—by definition—large enough to exert an influence on the local market, its management of its fed cattle during the price negotiations has an effect on the local market price. Stated simply, in the short run, packer feeding can confer an extra degree of market power on an oligopsonistic packer.¹²

A more detailed analysis of the price-depressing impacts of packer ownership of livestock on feed is included in Appendix A at p. 1850.

We are concerned that if there is no restriction on the volume of livestock on feed that a packer can own, but the number of potential buyers for that packer's livestock is severely restricted by eliminating all other packers, the packer will be required to slaughter an even greater percentage of the livestock it owns causing more downward pressure on prices paid to other producers.

The ultimate problem is that today's oligopsonistic packers are allowed to own livestock on feed at all. But short of a straight prohibition on packer ownership of livestock on feed, this particular problem won't be solved.

The problems with packer-to-packer sales identified by GIPSA stem not from the fact that one packer is selling to another packer or its subsidiaries or affiliates, but that such sales are direct negotiated sales and are not done in a forum that solicits other offers to sell livestock to the buying packer and other bids for selling the packer's livestock. In other words, the problem stems from the fact that the direct packer-to-packer trade is made in a market that is neither open, nor designed to solicit competitive bids.

To correct the price-distorting effects and the potential for price signaling and collusion to control prices resulting from packer-to-packer sales, WORC and CFFE recommend that GIPSA amend **Section 201.212(c)** of the proposed rules to provide a “**safe harbor**” for packer-to-packer sales, when they are made in an open, public market. An open, public market being defined as a forum (a) to which all potential buyers and sellers in general have access; (b) that is designed to solicit more than one blind bid; and (c) that allows buyers and sellers to witness bids and offers as they are made and accepted. A more detailed discussion of this “safe harbor” concept is discussed below at pages 18-21.

¹² Aspelin, Arnold and Gerald Engelman, *Packer Feeding of Cattle: its volume and significance*, Packers and Stockyards Division, Consumer and Marketing Service, USDA, Marketing Research Report No. 776, Nov. 1966.

F. Requirement to Give GIPSA Sample Contracts for Posting

Section 201.213 requires that packers give GIPSA copies of “a sample of each unique type of contract or agreement for purchase of livestock,” including forward contracts and marketing agreements, and that swine contractors and live poultry dealers also give GIPSA sample production contracts. It establishes the 10-day time frames for compliance. GIPSA is allowed to make these sample contracts public by posting them on the GIPSA website after deleting any trade secrets, confidential business information, and personally identifiable information. It requires that packers, swine contractors, and live poultry dealers must identify any confidential business information at the time the contract is submitted.

There is a wealth of literature describing the importance of price transparency in maintaining a functioning competitive market. Access by both parties to purchase or production arrangements to information about factors affecting prices is essential to ensuring some balance in the bargaining process. Without sufficient information to determine the value of the livestock to be sold or the value of facilities and services provided in production contracting arrangements, producers and growers cannot make informed decisions about marketing their livestock and/or their services for raising livestock. By withholding information about terms of livestock purchases and production contracts, packers, swine contractors, and live poultry dealers ensure that they have the upper hand in any negotiation with producers and growers. If forward contracts, marketing agreements, and other livestock purchasing were conducted in an open, public forum such as an electronic market, price transparency would automatically occur and would not need to be regulated by GIPSA. However, until there is such public trading, it is essential to take the measures included in the proposed rules to restore to producers and growers a small measure of balance in the bargaining process.

Disclosure of sample marketing agreements and forward contracts will provide livestock producers with additional information about the multiple terms under which packers are willing to purchase livestock. This will allow producers to make better production and marketing decisions and provide crucial information for negotiations with the packers. As such, it will provide a measure of additional transparency to the livestock markets.

With the clear statement in this section that any personally identifying information will be redacted before public posting of the sample contract, there can be no doubt that information about producers and growers who entered into such contracts will not be disclosed publicly.

For the sample contracts to be useful to livestock producers, the provision which allows for redaction of trade secrets, confidential business information, or personally identifiable information must not be allowed to become such a huge loophole that terms related to the number of deliveries, volume of deliveries, or any price-related term could be redacted. It is also essential that GIPSA not allow the current level of concentration of packer market share in the various regions to prevent public release of the sample contracts. Although it

is in part the level of concentration in the packing industry that has contributed to the lack of transparency in the markets, it should not be allowed as an excuse to continue the withholding of information crucial to producers who now must attempt to survive in today's highly concentrated markets.

G. Documentation and Justification of Pricing Terms

Section 201.94(b) requires that packers, swine contractors, and live poultry dealers maintain written records that provide justification for differential pricing or any deviation from standard price or contract terms. In addition, **Section 201.210(a)(5)** provides that it is an unfair, deceptive, or unjustly discriminatory practice to pay a premium or apply a discount to the purchase price paid to a livestock producer or to the grower's payment under a swine production contract without documenting the reasons and substantiating revenue and cost justification associated with them. WORC and CFFE strongly support these provisions because they address serious deficiencies in the livestock markets resulting from the lack of an open, public, competitive market and provide information that GIPSA will need to properly monitor packer practices for compliance with the P&SA.

In an open, competitive market for livestock, the types of value-based pricing terms and the level of prices or premiums associated with each type would be generated by the bidding process itself. Through an open bidding process, packers would send information to livestock producers in general about the characteristics that they are willing to pay top prices for. Producers, in turn, could adjust their production and marketing strategies to seek these premium prices. And, as supply and demand for each of the value characteristics fluctuates, the prices would also fluctuate. Without this competitive market mechanism, the forces of supply and demand fail to function properly, and pricing levels no longer respond appropriately to market conditions. As a result, the levels of the various prices and premiums become susceptible to use by packers to provide undue preferences or advantages to some producers while unjustly discriminating against others. This is precisely the problem presented in today's livestock markets.

GIPSA has appropriately responded to this deficiency in the livestock markets by demanding that packers and swine contractors maintain records that demonstrate that the levels of the prices and premiums they pay for various livestock or meat characteristics reflect some assessment of the true value and, thus, are not used to unjustly discriminate against some producers.

As GIPSA indicates, requiring such records is consistent with its statutory authority under Section 401 of the P&SA which mandates that "[e]very packer, any swine contractor, ...shall keep such accounts, records, and memoranda and fully and correctly disclose all transactions involved in his business."

These recordkeeping requirements should not be onerous, given that packers are generally very sophisticated businesses and, thus, presumably already maintain records that demonstrate why they are paying the prices and premiums they do and how this is

justified on a cost or revenue basis. For example, packers already maintain records on premiums paid to producers that will be sold as a branded beef product. They also maintain records that show the premium prices obtained from selling these branded products in the wholesale beef market. Such records should be sufficient to allow the necessary comparisons to determine whether the level of premiums paid to the producers is supported by additional revenue obtained for that branded beef product in the wholesale beef market.

H. Rules Must Not Narrow Broad Application of Sections 202(a) and (b)

Section 202(b) of the P&SA prohibition against packers, swine contractors, and live poultry dealers giving undue or unreasonable preferences or advantages contains extremely broad statutory language. It prohibits undue or unreasonable preferences that may be given not only to individuals but also that may prefer any particular location over another. The inclusion of the phrase “in any respect” means that it is intended to prohibit such undue preferences in any aspect of the relationship between packers, swine contractors, or live poultry dealers and livestock producers, poultry growers, marketing agents, wholesalers, retailers, or consumers. Section 202(a) of the Act also includes a broadly worded prohibition against acts by packers, swine contractors, and live poultry dealers that are unfair, deceptive, or unjustly discriminatory.

GIPSA cannot anticipate all possible applications when drafting undue preference and unfair and deceptive practices rules. Nor will GIPSA be the only entity enforcing these provisions of the P&SA. Federal courts also have the authority to address claims of violations of Section 202. It is imperative that GIPSA, in issuing the regulations required by the 2008 Farm Bill, does nothing that would in any way restrict, limit, or narrow the possible interpretation of these extremely broadly worded statutory provisions by the courts. GIPSA regulations should state explicitly that, by addressing only a small set of possible types of actions that could run afoul of Sections 202(a) and (b), the Agency is not in any way narrowing, restricting, or limiting the types of actions either it or the courts may find that violate these statutory provisions. Just using the phrase “includes, but is not limited to” may not be sufficient to adequately express this intention not to narrow or restrict the possible application of these statutory provisions when interpreted by the courts and future administrations.

We ask that GIPSA include in the final rules the following language:

Rules Do Not Narrow or Limit the Application of Section 202(a) and (b) of the P&SA: Sections 202(a) and (b) of the Packers and Stockyards Act consist of very broad statutory language. These statutory provisions may apply to an extremely broad array of actions by packers, swine contractors, and live poultry dealers in their dealings with livestock producers, poultry growers, marketing agents, wholesalers, retailers, and consumers. Nothing in these rules addressing undue or unreasonable preferences or unfair, deceptive, or unjustly discriminatory practices is intended, in any manner whatsoever, to restrict, limit, or narrow the types of

scenarios to which a court may apply Sections 202(a) and (b). These rules are intended only to provide guidance on how the Secretary may interpret Sections 202(a) and (b) in the scenarios specifically addressed herein. These rules do not prevent the Secretary from finding a violation of Section 202(a) or (b) in scenarios not fully addressed herein.

I. State Law Preemption and Primary Jurisdiction

Many states have strong unfair and deceptive trade practices laws under which livestock producers may obtain effective relief from unlawful packer practices. To ensure that producers do not lose the protections of state laws or the opportunity to challenge unfair or deceptive trade practices in state courts, GIPSA should add a provision to the final rules that explicitly states that GIPSA does not intend to preempt state laws that provide equivalent or greater protections or remedies for livestock producers.

When a federal regulatory agency has concurrent jurisdiction with courts over a subject, courts often invoke the principle of “primary jurisdiction” to delay judicial review of the challenged action by the agency. This can cause extensive delays for livestock producers to obtain a resolution of their claims against packers. For this reason, GIPSA should set out in the final rules a procedure that will ensure that whenever a court delays action under the principle of “primary jurisdiction,” GIPSA will take the following expedited action as appropriate: (1) to respond to the court explaining why concurrent jurisdiction does not exist; (2) to make a necessary Agency determination on the issue for which there is concurrent jurisdiction, or (3) to notify the court that the Agency will not be making a determination on the issue before the court.

VII. Safe Harbor for Trades in an Open, Public Market

In the discussion above, we ask that GIPSA include a “safe harbor” for packer’s slaughter livestock purchase transactions made in an open, public market. This section includes additional discussion of this idea.

A. Safe Harbor in Undue Preference and Packer-to-Packer Sale Ban

The undue and unreasonable preference and packer-to-packer sale ban sections [Sections 201.201 and 201.212(c)] of the proposed rules address two important packer practices that are violations of the Packers and Stockyards Act. Section 201.201 is designed to prevent packers from providing some slaughter livestock producers with illegal undue preferences or advantages over other producers by ensuring that all pricing terms based on volume of animals delivered, standards of product quality, methods of production and time of delivery are made available in a non-discriminatory manner to all individual producers or groups of producers that could meet the necessary conditions. Section 201.212(c) prohibits packer-to-packer sales of slaughter livestock to prevent price distorting impacts from collusion and price signaling involved in such transactions.

Despite the devastating impact these packer practices have on slaughter livestock prices and on producers' ability to fairly compete for the slaughter market, GIPSA has opposition to the proposed rule provisions designed to regulate these practices. Much of the opposition's argument against and alleged claims of adverse economic harm from the proposed rules is a reflection of the fact that there is no open, public market for slaughter livestock in this country. By either offering or accepting offers on the various price terms in an open, public market to which producers in general have access, packers could demonstrate that they made the price terms addressed in Section 201.201 available to producers in a non-discriminatory manner. By selling packer-owned livestock in a competitively bid open, public market to which all potential buyers have access, packers could sell their livestock to other packers while preventing harmful price signaling or collusion.

For this purpose of creating a "safe harbor" in these two sections of the rules, an "open, public market" would be defined as a forum (a) to which all potential buyers and sellers in general have access; (b) that is designed to solicit more than one blind bid; and (c) that allows buyers and sellers to witness bids and offers as they are made and accepted.

B. Advantages of the Safe Harbor for Trade in Open, Public Markets

The great advantages that result from providing such a "safe harbor" include:

1. **Promoting true price discovery through competitive bidding for slaughter livestock.** Such a "safe harbor" would create huge incentives for packers to return to trading in a competitively bid market structure because (a) they would be assured of compliance with the undue preference criteria of the rules; and (b) they could be assured that they would continue to be able to sell the livestock they own to other packers. Through the open, public market structure, more slaughter livestock would be competitively bid, thus promoting true price discovery in a larger share of the slaughter markets.
2. **Allowing the use of forward contracts and marketing agreements to coordinate livestock supplies in advance of slaughter.** The "safe harbor" within Section 201.201 of the proposed rules would allow packers the use of forward contracts and marketing agreements to obtain a sufficient supply of pre-committed livestock to keep plants running at peak efficiency. It would also allow feeders to ensure market access in advance of slaughter to promote full feedlot capacity utilization. Many of the pricing and premium terms referenced in the undue preference provision of the proposed rules are contained in forward contracts and marketing agreements. Under the "safe harbor," packers could continue to trade with feeders through forward contracts and marketing agreements because price terms subject to the undue preference criteria would be offered in a non-discriminatory manner through the open, public market to which producers in general have access.
3. **Promoting the use of value-based pricing and payment premiums.** The "safe harbor" within Section 201.201 would allow for all types of pricing and premiums.

It allows for live weight, carcass weight with a grid, in the meat, and other forms of pricing. It allows for premiums or discounts based on grade and yield, quality- or value-based factors, production methods, time of delivery, and other factors. By offering these various pricing structures, premiums, and discounts through the open, public market to which producers in general have access, such terms are offered in a non-discriminatory manner.

4. **Providing real time price transparency.** With the incentives created by the “safe harbor,” large volumes of packer-owned livestock, forward contracts, and marketing agreements would be traded in an open, public market in which bids and offers can be seen as they are made and accepted. The “safe harbors” would create instant price transparency for this large volume of livestock.
5. **Allowing smaller producers, who otherwise might not have access to them, to benefit from forward contracts and marketing agreements.** Smaller producers in general would have access to the open, public market and could offer livestock or accept bids on forward contract or marketing agreement terms. Similarly, through such an open, public market, smaller packers may obtain access to livestock from feeders that previously may have been tied to a particular packer through directly negotiated contracts.
6. **Providing incentives for development of private electronic markets for slaughter livestock trading.** Through the incentives of the “safe harbors” within Sections 201.201 and 201.212(c), GIPSA will promote packer interest in trading forward contracts, marketing agreements, and packer-owned livestock in an open, public market, thus providing the necessary catalyst for private sector development of electronic markets for slaughter livestock. USDA could further promote development of these competitive markets by offering grants, loans, or financial awards for private sector development.
7. **Promoting self-regulation by packers.** Through inclusion of the “safe harbors” defining an “open, public market” with simple and easily identifiable terms and allowing packers to use trades in these markets (a) to demonstrate non-discriminatory offering of price, market access, premiums, discounts, and other contract terms; and (b) to allow packers to sell to other packers, GIPSA will have clearly defined a way for packers to ensure their own compliance with the rules. Because forward contracts and marketing agreements and packer-to-packer sales have become so entrenched in the livestock industries, system-wide compliance with the rules is necessary and can only be accomplished through packer self-regulation. Due to limited resources, individual enforcement actions will never accomplish the structural change necessary to restore open, competitive markets for slaughter livestock.

In this age of the Internet, the “open, public market” definition contemplates electronic markets. There is a wealth of economic evidence and theory that supports the use of electronic markets to improve competition and fairness within industries. For decades, prominent

livestock market economists have promoted the use of electronic markets for slaughter livestock.¹³ Electronic markets for slaughter livestock can be developed quickly by private sector entities and can be designed to provide the variety of premium/discount grids necessary to allow for any type of product differentiation. In written comments to GIPSA, a representative of BeefEX, an electronic market for fed cattle, expressed the eagerness and ability to modify their market to provide for the full range of premiums/discounts for product differentiation.¹⁴

With the electronic technologies now available, there is no reason for the absence of electronic markets for slaughter livestock except that the packers have no incentive to participate in such markets while they continue to benefit financially from unlawful practices they are currently using to procure livestock. It will require action by GIPSA to provide the necessary incentives.

Though GIPSA may need to set some general guidelines for the private sector markets and provide minimal oversight, we do not anticipate that the open, public markets developed by the private sector would necessitate the commitment of vast resources by the Agency. General guidelines should include such factors as (a) a limit on the size of the individual trades to prevent smaller producers and packers from being frozen out of the market, and (b) a requirement that formula-priced contracts set a firm base price that is not tied to a cash market the packer participates in to ensure that the open, public market does not become a forum for price manipulation.

Implementing the “safe harbor” provisions recommended here will meet goals of the proposed rules while promoting real competitive bidding for slaughter livestock.

VIII. Second Round of Rulemaking to Ensure Open, Competitive Markets

WORC and CFFE support GIPSA’s efforts to return some fairness to the livestock markets through the specific provisions of the proposed rules. However, much more must be done to restore the open, competitive livestock markets the P&SA is designed to ensure.

At the USDA/DOJ Competition Workshop in Fort Collins, Colorado, WORC presented a letter to Secretary Vilsack and Attorney General Holder asking that USDA issue competitive and transparent pricing rules for slaughter livestock, requiring:¹⁵

¹³ See e.g. Koontz and Purcell, *Price Discovery and the Future of the Livestock Sector*, at p. 8, quoted in Appendix A-2 at pp. 26-27__

¹⁴ See Comments on WORC Petition for Rulemaking on Packers Livestock Procurement Practices, from Kevin Brockhoff, President of BeefEx, Inc., at Appendix A-4.

¹⁵ See Appendix B.

1. That all forward contracts and marketing agreements for slaughter livestock be offered or bid in an open, public market and contain a fixed base price (one that can be equated with a specific dollar amount on the day the contract is entered).
2. That all livestock owned and fed by packers be sold through an open, public market.

An open, public market is defined as a forum (a) to which all potential buyers and sellers in general have access; (b) that is designed to solicit more than one blind bid; and (c) that allows buyers and sellers to witness bids and offers as they are made and accepted.

Appendix A-1 through A-4 includes detailed information explaining these rules, the P&SA authority for their issuance, the economic support justifying them, and how they would apply in practice.

We urge GIPSA to move quickly to issue a second round of proposed rules to address these issues. Open, competitive livestock markets will be restored only when packers are required to participate in them.

Again, we commend GIPSA for issuing the proposed rules that take crucial steps in returning fairness to the markets for slaughter livestock.

Sincerely,

FARMERS' LEGAL ACTION GROUP, INC.

s/ Lynn A. Hayes

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LAH/rgc

Attachments: Appendix A1 through Appendix E