

WORC

Western Organization of Resource Councils

August 27, 2010

The Honorable Tom Vilsack, Secretary
U. S. Department of Agriculture
Room 200-A Whitten Building
1400 Independence Ave. SW
Washington, DC 20250

The Honorable Eric H. Holder, Jr.
Attorney General of the United States
U.S. Department of Justice
950 Pennsylvania Avenue, NW
Washington, DC 20530-0001

Dear Secretary Vilsack and Attorney General Holder:

The Western Organization of Resource Councils (WORC) is requesting that USDA, through the Grain Inspection, Packers and Stockyards Administration (GIPSA), issue rules under the Packers and Stockyards Act (P&SA) requiring competitive and transparent pricing of packers' captive supplies of livestock.

WORC is a regional network of seven grassroots community organizations that include 10,000 members and 45 local chapters in Colorado, Idaho, Montana, North Dakota, Oregon, South Dakota, and Wyoming. Our livestock producer members and their communities are all harmed by packers' concentrated market power.

Captive supplies are livestock the packers own outright or control through marketing agreements and forward contracts for more than 14 days in advance of slaughter. It is through the use of captive supplies that we believe packers exercise their concentrated market power, providing undue advantages to a preferred few livestock feeders and manipulating prices paid for slaughter livestock in violation of the P&SA.

Request to Issue Competitive and Transparent Pricing Rules

Because of the declines in prices that livestock producers experience from packers' strategic use of captive supplies, WORC asks that GIPSA regulate these forms of procurement directly and in a manner that will eliminate the packers' ability to manipulate and control slaughter livestock prices.

In 1996, WORC submitted a petition for rulemaking to USDA seeking specific regulations restricting packers' use of captive supplies. It was published in the *Federal Register* for comment

on January 14, 1997 (62 Fed. Reg. 1845). USDA actively considered the petition for several years but never took any final action. **Today we again ask that USDA issue rules like those proposed in that petition. These competitive and transparent pricing rules would require:**

- 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.

Through the 1996 petition for rulemaking, we showed that Congress intended the P&SA to be the strongest antitrust and unfair and deceptive trade practices law that had ever been enacted in this country. We demonstrated that Congress designed the Act not just to ensure horizontal competition between packers, but also to ensure fair and competitive practices vertically between packers and their producer suppliers. The Act provided USDA with the strongest and broadest possible authority to issue substantive rules to ensure that the market in which packers purchase slaughter livestock would be open and competitive.

However, as a result of USDA's lax enforcement of the P&SA since 1921 as a few large packers again consolidated their market share and dramatically increased their use of captive supply procurement methods, America's livestock producers no longer have an open, competitive market in which to sell slaughter ready livestock. USDA must act immediately and aggressively to restore open, competitive markets for slaughter livestock to prevent destruction of independent livestock production in this country.

Trends in Livestock Markets Support the Need for such Rules

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 concentration level is well above levels generally considered by many economists to elicit noncompetitive behavior and result in adverse economic performance.

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 much as 44.4 percent

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.

of all cattle slaughtered by the top four packers in 2002.² USDA price reporting information indicates that the levels of captive supply have been continuing to increase substantially since March 2005.

Many economic studies consistently show that increases in the use of captive supplies are associated with lower cash market prices.³ The level of decrease in cash market prices related to use of captive supplies found in these studies varies in range from small to significant, from state-to-state, and by region. But because profit margins in feeding cattle are very little, even seemingly small decreases in fed cattle prices caused by packers' increased utilization of captive supplies results in significant negative returns to cattle 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 cattle accounted for about 38 percent of the cattle purchases over the 2001-2008 period.⁴ 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.⁵ 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.⁶

A GIPSA study also shows that large 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.⁷ This shows that small feeders may not have access to the same type of purchase agreements that packers offer to large feeders.

² 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.

³ 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 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.

⁴ *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.

⁵ 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.

⁶ 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.

⁷ RTI International, *GIPSA Livestock and Meat Marketing Study*, Vol. 3, "Fed Cattle and Beef Industries," Final Report, January 2007, at p. 2-2.

Because of the declines in prices that livestock producers experience from packers' strategic use of captive supplies, WORC asks that GIPSA regulate these forms of procurement directly and in a manner that will eliminate the packers' ability to manipulate and control slaughter livestock prices.

GIPSA's 2008 Farm Bill Proposed Rules

WORC commends GIPSA for issuing the June 22, 2010, proposed rules as a first step in bringing some fairness back into the livestock markets. WORC generally supports the proposed rules with some clarifications. Key elements of the proposed rules that should improve fairness in the slaughter livestock markets include GIPSA's efforts (1) to ensure that all livestock producers who can meet the contract terms have non-discriminatory access to beneficial prices and premiums offered by packers; (2) to clarify that it is not always necessary to show an injury to competition to prove that a packer violated the P&SA prohibitions against unfair, deceptive, unjustly discriminatory or unduly preferential practices; (3) to require packers' maintenance of documents supporting the cost or revenue basis for differential prices, premiums, discounts and other contract terms; (3) to obtain and make public sample forward contracts and marketing agreements used by packers; and (4) to restrict specific practices that allow packers to send each other price signals or reduce the number of bidders for slaughter livestock.

However, none of these steps, either individually or in combination, are sufficient to ensure that markets for slaughter livestock are open and competitive. Nor do they eliminate packers' ability to manipulate prices through cash market based formula price contracts. Only by requiring that packers procure livestock through an open, public market can competition truly be restored to the slaughter livestock market. Elimination of formula base pricing is essential to stop packers from strategically using such pricing arrangements to manipulate or control market prices.

Advantages of the Competitive and Transparent Pricing Rule

The advantages of the 1996 competitive and transparent pricing rule proposed by WORC include:

1. **Continuing the use of forward contracts and marketing agreements to coordinate livestock supplies in advance of slaughter.** The rule will allow packers to continue to obtain a sufficient supply of pre-committed livestock to keep plants running at peak efficiency. It will also allow feeders to ensure market access in advance of slaughter to promote feedlot capacity utilization. Packers can coordinate as high, and possibly a higher, percentage of their livestock supplies in advance as they do now under forward contracts and marketing agreements; they simply must bid for or offer these contracts in an open, public market.
2. **Continuing the use of value-based pricing and payment of premiums.** The rule allows for all types of pricing and premiums, except for cash market formula base pricing. 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. The premiums and discounts must simply be included in contracts that are traded in an open, public market.

3. **Providing real time price transparency.** Because the 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 rule would create instant price transparency for this large volume of livestock.
4. **Promoting actual competitive bidding for captive supply livestock.** Because the rule requires that forward contracts and marketing agreements for slaughter livestock and packer-owned livestock must be traded in an open, public market, it will promote actual competitive bidding for slaughter livestock by packers and any other potential buyers who wish to enter the market.
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 a forum in which packers can demonstrate that they are offering prices and premiums in a non-discriminatory, non-preferential manner.** Because the rule would define an open, public market as one in which sellers (livestock producers) generally would have access, by simply offering to buy slaughter livestock under its various forward contract and marketing agreement terms in such a market, a packer may be able to demonstrate that such terms were offered to sellers in general and, thus, in a non-discriminatory, non-preferential manner.
7. **Promoting competitive bids on packer-to-packer sales.** Because all packer-owned livestock would have to be sold in an open, public market, all packer-to-packer sales would have to be bid for and accepted in an open, competitive market where other potential buyers could bid up the price and acquire the livestock.
8. **Providing incentives for development of private electronic markets for slaughter livestock trading.** By requiring forward contracts, marketing agreements, and packer-owned livestock to be traded in an open, public market, GIPSA will be creating an incentive for development of private electronic markets for slaughter livestock. GIPSA can provide the time necessary for private sector development of open, public markets, including electronic markets, by promulgating the rule with a delayed effective date. USDA could also promote development of these competitive markets by offering grants, loans, or financial awards for private sector development.
9. **Promoting self-regulation by packers.** By defining open, public markets with simple and easily identifiable terms and allowing packers to use trades in these markets to demonstrate non-discriminatory offering of price, market access, premiums, discounts, and other contract terms, packers will have a clearly defined way to ensure their own compliance with the P&SA as it relates to captive supplies. Because captive supply procurement methods have become so entrenched in the livestock industries, system-wide compliance with the P&SA 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.

By requiring packers to trade forward contracts, marketing agreements, and packer-owned livestock in an open, public market and eliminating cash market based formula pricing, GIPSA can ensure open, competitive markets for slaughter livestock and end packers' manipulation of prices and unduly preferential treatment of a favored few feeders in violation of the P&SA.
Sincerely,

WESTERN ORGANIZATION OF RESOURCE COUNCILS

Mabel Dobbs
Chair of WORC Livestock Committee