The proposed definition fails to consider, as required by the various judicial decisions discussed above, that the required competitive injury is injury to the competitive process. Such a construction of the PSA makes sense given the history of the statute. The only concept of injury to competition existing at the time of the PSA's enactment was the Sherman/Clayton/FTC Act concept of harm to the competitive process, and the terms used in the statute have to be understood in that context. The terms used in section 202 are terms of art that evince Congressional intent that there must be competitive harm in the antitrust sense before a violation is found. Therefore, any regulations issued under the authority of section 202 of the PSA may be no broader than the underlying statutory mandate.[69]

Many of the types of "competitive harm" identified in the proposed rule's definition of "likelihood of competitive injury" have no economic or legal content. In that regard, the concept of "raising rivals costs" is really a type of monopolization or attempted monopolization, but is utterly without definition in the proposed rule. Unclear from the proposed rule or the preamble is whether <u>any</u> conduct by a packer that causes the costs of a rival packer to increase is effectively a form of competitive injury under the proposed rule? For example, assume Packer A is more efficient than Packer B and therefore is able (and willing) to pay his livestock suppliers or poultry growers slightly more for their products than Packer B. If Packer A raises his price to his suppliers and Packer B must raise his price to match, has Packer A engaged in conduct that "raises rivals' costs" in an unlawful manner? Interestingly, such an interpretation would hurt not only the packer, but its livestock suppliers. The preamble and the proposal, however, provide no guidance, leaving the affected packer unsure of its regulatory responsibilities.

[69] This principle is enshrined in numerous cases but most notably in the Supreme Court's securities law jurisprudence, which holds that rules promulgated by the Securities and Exchange Commission may not reach conduct not addressed by the statutory scheme that purports to authorize the regulations in the first instance. *Morrison v. National Australia Bank, Ltd.*, 130 S. Ct. 2869, 2881 (2010) (regulation promulgated under a statute "'does not extend beyond conduct encompassed by [the statute's] prohibition'") (quoting *United States v. O'Hagan*, 521 U.S. 642, 651 (1997)); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 214 (1975) ("scope [of a rule] cannot exceed the power granted the [agency] by Congress under [the relevant statute]").

Other provisions of the proposed rule certainly trade in antitrust concepts, throwing around terms such as "market power" and "competition" liberally. The agency, however, apparently takes the position that "competitive injury" is not required to violate section 202 of the Act, leaving vague how such terms will be construed.

Similarly, the provision that would prohibit "wrongfully depress[ing] prices paid to a producer or grower below market value" is incoherent. Does the agency mean "predatory buying" of the type that was at issue in *Weyerhaeuser v. Ross-Simmons Hardwood Lumber*? In the alternative, does the agency intend it be a form of monopsony pricing? "Market value" is far too vague a term to be enforceable because, by definition, the "market value," at least with respect to prices, is the price on which a willing buyer and willing seller agree when neither is compelled to enter the transaction and both have no information constraints. Moreover, "market value" must surely encompass more than price terms. Contracts are a bundle of rights and obligations. All of the obligations could be given a monetary value. A poultry grower who promises to provide a certain number of units to a processor and to provide services A, B, and C may expect and be entitled to a higher price than a grower who merely promises to provide a certain number of units to a processor without services A, B, and C. In other words, to determine "market value," one must look at a transaction as a whole -- in both monetary and non-monetary terms -- and classify them accordingly.

From a practical standpoint and given the absence of any standard or guidance, this "market value" clause will become a *de facto* "seller's remorse" provision. This would allow a poultry grower or livestock producer to challenge a contract or a transaction once he finds out that another grower or producer got a "better deal," maybe because the favored grower or producer offered a higher quality product, agreed to provide additional services, or was simply a shrewder negotiator.

The "receive the reasonable expected full economic value from a transaction" provision also is unacceptably vague. No packer could possibly know what the "full economic value from a transaction" is, much less the "reasonable expected" full economic value. These terms have no economic meaning. The preamble does not provide any discussion regarding the phrase because the agency cannot provide a meaningful definition. Unlike a breach of contract case in which there is a set of objective standards to measure the validity of the conduct of the two parties, in the proposed definition the expectancy is itself the measure of the "wrongful conduct." Both parties could adhere strictly to the terms of a contract, but if the dealer or packer does something that the grower or producer does not like, he may well be accused of "impair[ing]" the grower or producer's ability "to receive the reasonable expected full economic value from a transaction."

In short, as written, this proposed rule is a recipe for price controls. The only way that there can be any coherent application of it as drafted is for GIPSA, or jury in a civil trial, to get into the business of determining market prices and "reasonable expected full economic value" from a transaction. Even then, the proposal provides no way to know how to determine such values. This section is a price control regime without standards and Congress has not authorized that and therefore the proposal does not accord with the Act.

In addition, the proposed rule is unconstitutionally vague. Although not a criminal statute, the rule raises several due process concerns. Even in statutes establishing civil legal violations the operative provision must give those subject to it fair notice of what is prohibited so that they may reasonably conform their conduct to the legal requirements. This proposed rule does not come close to meeting that standard. In that regard, the Act shares some characteristics of a penal statute, most notably the possibility of imposing enhanced damages on violators.

Supreme Court precedent has controlled the quantum of punitive damages imposed in civil cases under the due process clause of the 14th Amendment because the standards for imposing punitive damages are often vague or malleable and depend upon the values of the jurors. Indeed, unlike the underlying liability standards in punitive damages cases, the liability standards in the proposed rule are not readily ascertainable. In fact, the "standards" in the proposed rule are much worse than the vague punitive damages standards because they go to liability rather than remedy. For that reason, the proposal raises significant risks of violating Fifth Amendment due process requirements.[70]

[70] Antitrust theory provides that a competitive injury/consumer welfare standard is required in antitrust cases to meet constitutional due process requirements. See Professor Bork's discussion in the *Antitrust Paradox*. *See generally* R. Bork, *The Antitrust Paradox* 73-89 (1978).

## The Requirement to Keep Records Justifying Differential Pricing or Deviations from Standard Pricing or Contract Terms is Unduly Onerous and Unconstitutionally Vague.

Subsection 201.94(b) would require a packer, swine contractor, or live poultry dealer to keep "written records that provide justification for differential pricing or any deviation from standard price or contract terms offered to poultry growers, swine production contract growers, or livestock producers."[71]

GIPSA asserts in the preamble that a packer, swine contractor, or live poultry dealer must keep records that justify differential treatment of poultry growers, swine production contract growers, or livestock producers. The agency further asserts that the "justification need not be extensive but should be enough to identify the benefit-cost basis of any pricing differentials received or paid, and may include increased or lower trucking costs; market price for meat; volume; labor, energy, or maintenance costs, *etc.*" In that regard, GIPSA cites as an example packer participation in a particular program that yields a premium for the meat as justification for paying a higher price for cattle.[72] The preamble goes on to state that the packer's justification data essentially identify "those pecuniary costs and benefits associated with the treatment that demonstrate its decreased costs or increased revenues from a standard business practice."[73]

This proposed requirement ignores the realities of livestock procurement and is unworkably and unconstitutionally vague. As an initial matter, the proposed rule grossly underestimates the economic impact of this detailed cost analysis and recordkeeping burden. This proposed rule will result in packers spending much more time and incurring significantly more expenses to calculate in detail and document the necessary justification. This is especially true when one considers that many of the tens of thousands transactions that some packers engage in every year take place "in the field." For example, if, on the same day, different representatives of a packer buy cattle from several sellers in the same market region but pay different prices because some sellers simply are better negotiators than others, what would the agency expect and deem sufficient in terms of written justification? Or,

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[71] 75 *Fed. Reg.* at 35351. (Emphasis added).
[72] *Id.* at 35344.
[73] *Id.* (Emphasis added.)

what if the buyer's assumptions about the will grade are wrong? Given the provision's reference to "standard price," is the first sale the standard price and does the proposed rule contemplate all sellers receiving that price on that day or at that time? How do other changing elements of the market on a given day affect the construct of the "standard price?" Similarly, it is unclear how the proposed provision would function in an auction setting with different prices paid for different animals that may not be cost or revenue driven but may be a function of a factor as simple as supply and demand.

Indeed, one of the biggest differences in prices paid is simply supply and demand, *i.e.*, competition. If a packer needs 1,000 head to cover a day's kill and only acquires 500 head on its first offer, the packer may have to "pay up" to get the other 500 head needed. This circumstance results in paying two producers who may operate next door to each other different prices within the same hour. The proposed rule as written and as explained in the preamble does not consider supply and demand as a justification for different prices. Ironically, as written, the proposed rule would favor the use of marketing agreements generally where, if in writing, the justifications for premiums paid or discounts assessed are documented, in contrast to the spot market, the prices for which present have little opportunity for contemporaneous written justification and may be largely if not solely a function of supply and demand factors.

GIPSA's preamble statement that it "would consider the particular circumstances of any pricing disparity in determining whether a violation of the P&S Act occurred" is insufficient for a packer to be able to make an informed decision as to what constitutes compliant behavior, including whether there is a legitimate justification for the disparity. As discussed in the previous section, the only way that there could be any reasonable certainty about what this section requires would be for GIPSA to get into the business of determining market prices and contracts so that the packer can have some ability to ascertain what "standard price or contract terms" are in order to comply with the rule.

**The Unfair, Unjustly Discriminatory and Deceptive Practice or Device Provisions are contrary to the Purposes of the Act and Are Unworkable and Unconstitutionally Vague.**

Many subsections of section 201.210 include elements or provisions that are so vague that it would be virtually impossible for a packer, swine contractor or live poultry dealer to behave in a manner ensuring compliance. For the reasons that follow, section 201.210 should be withdrawn.

It is well settled that laws of a penal nature must be of "sufficient definiteness that ordinary people can understand what conduct is prohibited and in a manner that does not encourage arbitrary and discriminatory enforcement."[74] Laws not meeting this standard are unconstitutionally vague and invalid.[75]

Specifically, section 201.210(a)(1) provides that an unfair, unjustly discriminatory and deceptive practice or device includes, but is not limited to "[A]n unjustified material breach of a contractual duty, express or implied, or an action or omission that a reasonable person would consider unscrupulous, deceitful or in bad faith in connection with any transaction in or contract involving the production, maintenance, marketing or sale of livestock or poultry."[76]

This subsection inappropriately would turn state law contract disputes into federal cases. The courts have recognized this problem and rejected such a concept. "Failure to require a competitive impact showing would subject dealers to liability under the PSA for simple breach of contract or for justifiably terminating a contract with a grower who has failed to perform as promised."[77] Moreover, the proposed standard, what a "reasonable person" would consider to be is unworkably vague, and therefore arguably unconstitutional, making it virtually impossible for a regulated entity to

[74] *Kolender v. Lawson*, 461 U.S. 352, 357 (1983); *Village of Hoffman Est. v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498 (1982) (applying standard to law imposing civil penalties).
[75] *Id.*
[76] 75 *Fed. Reg.* at 35351. Unclear from the proposed langue and the preamble is whether the agency envisions the possibility of a "justified material of a contractual duty." (Emphasis added.)
[77] *London v. Fieldale Farms Corporation* 410 F.3rd 1295 (11th Cir. 2005). See also *Been v. O.K. Indus., Inc.*, 495 F.3d 1217 (10th Cir. 2007) citing *London.* (Emphasis added).

know what behavior, other than treating every producer exactly the same, would be compliant.

Proposed subsection 201.210(a)(2) would make it an unfair practice for a packer, swine contractor, or live poultry dealer to take a retaliatory action or omission "in response to the lawful expression, spoken or written, association, or action of a poultry grower, livestock producer or swine production contract grower."[78] As with subsection (a)(1) the breadth and vagueness of this provision makes ensuring compliance virtually impossible. For example, if a livestock producer or poultry grower makes defamatory remarks about a packer or live poultry dealer and the packer in turn sues for defamation, would that lawsuit be deemed to be a retaliatory action? Similarly, if a poultry grower frivolously sues a live poultry dealer and the dealer elects to terminate a contract, would that constitute a retaliatory action in violation of this standard?

Some of the problems associated with proposed subsection 201.210(a)(5) are, in many respects, similar to those raised by proposed section 201.94. Beyond that, however, the subsection ignores a fundamental reality of the livestock industry – many transactions are done on a handshake. Requiring substantiation of premiums or discounts in such circumstances is at best a difficult task. More generally, unclear from the proposed rule and nowhere discussed in the preamble, is whether a premium paid must be at least as much as (or not greater than) the financial benefit the company gained from the product or, conversely, that the discount applied is at least much loss as the company incurred. To engage in such calculations and document that justification will take far more time by the packer than the agency purports to have estimated in its Executive Order 12866 analysis, even if it were possible to make such calculations.

Beyond that, however, such an approach would be virtually impossible to achieve in the cash market, negotiated bid process. For example, would a packer have violated the proposed rule in the circumstance in which a buyer purchases a pen of cattle in the cash market and in doing so pays a premium for cattle, which later turn out not to be of the quality estimated at the feedlot? Likewise, if buyer discounts a pen of cattle that ultimately turn out to be better in quality than estimated, has a violation occurred? Also unclear is whether the packer has to provide revenue or cost justification for

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[78] *Id.*

differences in negotiated transactions that occur on or about the same time at different locations, and potentially with different buyers, that may be due solely to the dynamics of negotiations.

The proposed rule also likely will provide a disincentive for creativity and innovative marketing programs. It is not uncommon for a packer and producer to enter into an agreement with a "let's see how this works" attitude. Sometimes, however, such arrangements do not work and it may be impossible, for example, for the packer to be able to revenue justify a premium paid to a producer in such a circumstance.

Finally, the proposed rule includes a catch-all provision that will trigger the filing of countless lawsuits and, as demonstrated above, is founded on a definition that is unconstitutionally vague and unworkable. Specifically, subsection 201.210 (8) provides that "any act that causes competitive injury or a likelihood of competitive injury" is an unfair practice.

Certain groups purporting to represent producers have, on several occasions, alleged that various practices engaged in by packers "distort competition in the marketplace" or impair the ability of a producer to compete with other producers. Given that the agency provided no explanation as to what the clause "distorts competition in the marketplace" means, it is virtually impossible for regulated entities to know what activity or behavior is compliant. For example, can a packer be accused of distorting competition in the market if it chooses to change operations from two shifts to one or if the packer elects to close a plant or transform the plant from a slaughter operation to a processing-only facility? Do any of these changes, or others, provide a claim to a private plaintiff who finds it more difficult to market livestock if the plant no longer slaughters or is limited to one shift? Has such action by the packer impaired the ability of that producer to compete with other producers? And how broad and geographically dispersed a group of producers must be considered? Similarly, has the packer impaired the ability of a producer to compete if the packer enters into an agreement or series of agreements with other producers that occupies considerable plant capacity? The possible scenarios in which the packer could be subject to litigation based on the breadth and vagueness of the proposed rule are endless. For the foregoing reasons, section 201.210 should be withdrawn.

**The Undue or Unreasonable Preferences or Advantages; Undue or Unreasonable Prejudice or Disadvantages Provisions are Unworkable and Unconstitutionally Vague.**

Section 201.211 provides several, but not all-inclusive, criteria that the Secretary may consider in "determining if an undue or unreasonable preference or advantage, or an undue or unreasonable prejudice or disadvantage, has occurred in violation of the Act." Similar to section 201.210 discussed above, this provision of the proposed rule cites several subjective factors that the agency can consider in determining compliance. The language, however, is too vague for packers and processors to know how to operate to accomplish their business objectives while maintaining compliance with the rules.

Specifically, subsection 201.211(a) refers to whether contract terms "based on number, volume or other condition, or contracts with price determined in whole or in part by the volume of livestock sold are made available to all poultry growers, livestock producers or swine production contract growers who individually or collectively meet the conditions set by the contract."[79] (Emphasis added.) Unclear from the language of the proposed rule or the preamble discussion is how a packer will, or is expected to, know which growers or producers are capable of meeting the terms and conditions of a contract. The language in the proposal suggests that a packer has an affirmative obligation to advise all producers or growers about the availability of a contract and to accept livestock or poultry from anyone who purportedly can satisfy the conditions of the contract, presumably on first come, first served basis. That is the equivalent of requiring a consumer to buy a Chevrolet if the Chevrolet dealer is the first to offer a functioning car. Moreover, should a consumer be forced to explain why he is willing to pay more for a Cadillac? If that is the agency's intent, it is an inappropriate intrusion into the private right of contract. A packer or poultry dealer should be permitted to contract with whatever growers it wants based on a host of factors, including among others, past history and performance. If, on the other hand, the above interpretation is not the agency's intent, that interpretation should be made clear and the rule revised to establish clear, ascertainable, and economically sensible guidelines. In either event, the proposed rule should be withdrawn.

[79] *Id.* at 35352. (Emphasis added).

Subsection 201.211(c), with respect to "whether information regarding acquiring, handling, processing, and quality of livestock is disclosed to all producers when it is disclosed to one or more producers" is similarly flawed. Specifically, the proposed rule as written again seems to impose an affirmative duty on a packer to notify every producer regarding certain details of a transaction or agreement. The limited preamble discussion states that the agency would consider whether price differences based on the cost of acquiring or handling are disclosed "equally" to all producers. Although that concept is, alone, problematic given the logistical challenges of notifying all producers, the language in the proposed rule is broader and again raises the question of whether the rule imposes an affirmative obligation on a packer to provide such information to all producers or to know how to do so instantaneously on a real time basis throughout a buying day. If so, absent posting in a public forum, e.g., on the packer's website, the terms at issue, it is virtually impossible for a packer to disclose "information regarding acquiring, handling, processing, and quality of livestock" to all producers. Indeed, even that vehicle does not satisfy the rule's requirement for producers without access to the internet. In short, the rule as written exposes a packer to an enforcement action by the agency or, in the alternative, a private lawsuit, if a producer can show he or she was not provided information about "acquiring, handling, processing, and quality of livestock," whatever that means.

Finally, subsection 201.211(b), which includes as a criteria "whether price premiums based on standards for product quality, time of delivery and production methods are offered in a manner that does not discriminate against a producer or group of producers that can meet the same standards" is problematic for a different reason. In that regard, the proposed rule would read out of the statute the terms "undue" or "unreasonable."

The PSA allows packers, swine contractors, and live poultry dealers to give preferences and advantages. It does not allow the giving of undue or unreasonable preferences or advantages. Likewise, the Act does not allow a person to be subject to any "undue or unreasonable prejudice or disadvantage."[80] The proposed rule deletes the words undue and unreasonable from the standard when referencing discrimination and offering price premiums. In doing so, the proposed rule establishes a

[80] 7 USC 192(b).

different, lesser standard provided by the statute and for that reason conflicts with the Act and should be withdrawn.

**The Proposal will Adversely Affect Competition by Requiring Dealers to Purchase Livestock for a Single Packer.**

Proposed section 201.212(a) provides that "dealers who operate as packer buyers must purchase livestock only for the packer that identifies that dealer as its packer buyer."[81] Related to that limitation, subsection (b) would preclude a packer from entering into an exclusive arrangement with a dealer unless the packer has identified that dealer and reported that relationship to GIPSA on approved forms. These requirements ignore the economics of livestock acquisition and rather than foster competition will adversely affect it. Moreover, given the agency's existing authority, the provisions are unnecessary.

The issue of joint livestock purchasing or shared agents has been a topic of discussion by GIPSA for a number of years. Indeed, several annual assessments that GIPSA has published over the years reference this topic. GIPSA's *Assessment of the Cattle and Hog Industries Calendar Year 2000* prepared in June 2001 discussed what GIPSA characterized as shared agents. Specifically, the report said

> It is a common practice for one buyer to represent more than one packer at an auction sale, especially in sales involving cull livestock. Auction market owners and livestock sellers have raised concerns that the use of common buyers, or shared agents, reduces the number of competing buyers. This practice has the potential for reducing competition. <u>However, the issue is complicated by a general lack of buyers at many auctions. Sharing a buyer may result in packers purchasing livestock at auctions where the packers otherwise would not be active.</u> P&SP continues to investigate complaints about shared agents at livestock markets.[82]

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[81] 75 *Fed. Reg.* at 35352.
[82] *Assessment of the Cattle and Hog Industries Calendar Year 2000,* p.30 (Emphasis added) (Attachment D).

This discussion, acknowledging the potential risk, highlights the problem created by the proposed rule. Ten years ago there were not enough buyers at auctions, and it was not economical for packers to send individual buyers to every location. Those economic challenges are more acute today, and several packers have advised AMI unequivocally that this proposed rule will limit even further their ability to procure livestock that best suits their purchase criteria. Contrary to the agency's assertion in the preamble that the proposal will increase participation in the cow and bull slaughter market, simply put, if the proposed rule becomes final, although the number of people at auctions may not change much, there likely will be fewer buyers and less competition at many of those locations.

The above discussion demonstrates that the proposed rule will have adverse effects on packers, auctions, and producers. That the proposed rule is ill-advised is further highlighted by the fact that the agency already has tools to address the "problem" that the agency asserts it is attempting to address and GIPSA has acknowledged it possesses those tools.

In its *Assessment of the Cattle, Hog, and Poultry Industries Calendar Year 2004* GIPSA again acknowledged that concerns had been raised about joint livestock purchasing and even went so far as to say that the activities identified were "potential violations of the P&S Act."[83] GIPSA's response included an assertion that the agency investigates complaints concerning shared agents, *etc.*, as well as an acknowledgement that whether such activity violates the Act "depends on the circumstances of each case."[84] Significantly, GIPSA cited two existing regulations, sections 201.69 and 201.70, which give the agency the authority to investigate the types of activities complained about and to take action against a packer, dealer, or market agency if appropriate. AMI presumes that GIPSA, in fact, has investigated complaints received and, where appropriate, has taken the necessary steps to preclude or address anticompetitive behavior or actions. That GIPSA activity is proof that the proposed rule is unnecessary.

Given the adverse impact shown above and the fact that GIPSA has the authority to address concerns about collusion and price manipulation, proposed subsections 201.212(a)-(b) should be withdrawn.

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[83] *Assessment of the Cattle, Hog, and Poultry Industries Calendar Year 2004,* p. 16. (Attachment E)
[84] *Id.*

**<u>The Prohibition on Packer-to-Packer Livestock Sales is a *De Facto* Ban on Packer Ownership of Livestock and will Adversely Affect Consumer, Producers, and Packers</u>**

The proposal, if finalized, would impose an indirect ban on packer ownership of livestock and in doing so will adversely affect producers and packers. Specifically, subsection 201.212(c) provides that a packer "shall not purchase, acquire, or receive livestock from another packer or another packer's affiliated companies, including but not limited to, the other packer's parent company and wholly owned subsidiaries of the packer or its parent company."[85] In the preamble the agency asserts that this section is necessary to "limit the ability of packers to manipulate prices."[86] The agency, in attempting to address a purported issue of concern, *i.e.* alleged price manipulation, either fails to appreciate or simply ignores several significant considerations in proposing this ill-conceived and unnecessary provision.

First, GIPSA has tools available to help ascertain whether any illegal activity is occurring and if so it has the tools to take action.[87] Significantly, there is no discussion in the preamble about the fact that every packer-to-packer sales transaction is required to be reported pursuant to the provisions of the mandatory price reporting program administered by GIPSA's sister agency, the Agricultural Marketing Service. This fact alone makes the reason proffered by GIPSA for the prohibition dubious at best.

The agency's rationale for the rule is even less compelling when one considers the price monitoring program that GIPSA has in place to address these issues. In that regard, GIPSA's 2009 Annual Report, published in March 2010, just three months before the proposed rule was published, discusses the fed cattle and hog market price monitoring program that GIPSA has in place. That program, initiated because of concerns about the cattle market in the wake of the 2003 case of bovine spongiform encephalitis (BSE) in the United States, "includes a weekly internal reporting regime and a detailed work plan to conduct in-depth investigations into possible violations of the Act if the initial regulatory reviews of price differences do

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[85] 75 *Fed. Reg.* at 35352.
[86] *Id* at. 35342.
[87] Indeed, the provision can be viewed as, and perhaps it is, a tacit admission that the agency is incapable of preventing or addressing instances of purported price manipulation.

not clarify whether they were caused by external market factors."[88] According to the report, the

> model is run weekly, and any price outlier that is not caused by certain technical statistical factors <u>triggers a regulatory review by P&SP. If the regulatory review does not determine that the price outlier was caused by certain external factors or readily observable market conditions, then a formal investigation is initiated to determine the cause of the price outlier</u>. The formal investigation involves deeper examination of the price data and cattle characteristics, and interviews with buyers, sellers, and other market participants.[89]

That GIPSA has in place a program, about which the agency appears quite proud of its rigor and effectiveness, to monitor pricing in order to prevent the very threat that this packer-to-packer ban is intended to help preclude speaks volumes about how unnecessary the proposed rule is. This conclusion is particularly compelling in light of the fact that, during the time the monitoring program has been in effect, the agency has not brought any price manipulation cases, suggesting that the packer-to-packer sales ban is a solution in search of a problem.

Not only is the packer-to-packer sales ban provision unnecessary, its impact will be detrimental to packers and producers because of the various inefficiencies it will introduce into the marketing system and the displacement of livestock that will occur. In that regard, there are numerous examples of transactions that will be prohibited that make the livestock procurement system efficient. A few examples are presented below.

<u>**Example One**</u>

The most glaring example of how this proposed provision would adversely affect a packer was presented during the July 20, 2010 hearing before the House Agriculture Subcommittee on Livestock, Dairy and Poultry. At that hearing USDA officials were apprised that a packer with a slaughter

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[88] 2009 Annual Report, Packers & Stockyards Program, United States Department of Agriculture Grain Inspection, Packers and Stockyards Administration, p. 13. http://archive.gipsa.usda.gov/pubs/2009_psp_annual_report.pdf (Attachment F)
[89] *Id.*

facility in Washington State also has feedlots more than 1500 miles away in Kansas. For obvious logistical and animal welfare reasons it is not practical to transport the cattle in the Kansas feedlot to Washington for harvest so those animals typically are sold to one of several packers with plants in Kansas or Nebraska.[90] Yet, the proposed ban leaves the Washington packer with two options: ship the cattle across the Rocky Mountains or sell them to an independent entity who in turn can sell the cattle to the very same packers who buy the Kansas feedlot cattle.

The first option, as the agency must be aware, is simply not feasible and could result in unnecessary injuries to livestock.[91] The second option, which the agency advanced in its ill-considered and misleading *Misconceptions and Explanations* document provided the following simplistic, and economically unrealistic, solution:

> **EXPLANATION**
>
> The proposed rule prohibits only direct sales of livestock between packers. A packer could sell to individuals, market agencies, dealers or other buyers.[92]

The proffered explanation ignores, or misunderstands, the realities of the market by suggesting that introducing an independent third party into the mix does anything other than introduce inefficiencies and costs into the system. Clearly, the Washington packer with the Kansas cattle will incur costs that competing feedlot operators not owned by packers will not suffer, putting the Washington packer at a competitive disadvantage. In the long run, the Washington packer's incentive will be either to divest the Kansas feedlot(s) or divest the slaughter establishment.

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90 In this circumstance the agency's purported reason for the proposed ban, limiting price manipulation, is wholly inapplicable given that the Washington state packing plant does not in any meaningful way compete for the purchase of cattle with the plants that buy the Kansas feedlot cattle.

91 See *Ag Department Proposal Threatens Animal Welfare, Huffington Post,* Oct. 20, 2010, http://www.huffingtonpost.com/temple-grandin/ag-department-proposal-th_b_769717.html. (Attachment G).

92 http://archive.gipsa.usda.gov/psp/rulefacts.pdf. P. 3.

**Example Two**

The above discussion, although extreme in some respects, is not an isolated example. For example, an AMI member Company X operates a hog slaughter facility in California. That facility harvests approximately 1.8 million hogs annually. The majority of these hogs are obtained from a facility owned or affiliated with another packer. The proposed rule would prohibit those hogs from being sold to Company X. There are, however, not enough non-packer-affiliated hog production facilities near this slaughter facility to supply sufficient replacement hogs. Moreover, environmental, political, and capital constraints make it highly unlikely that independent producers would enter the area to provide a supply of hogs. If the proposed provision goes into effect that circumstance leaves Company X with the following options.

1. Ship market hogs from the Midwest. The costs and logistics of transporting such a large number of hogs make this option infeasible. As undesirable as it is to ship cattle more than 1500 miles across the Rocky Mountains, it is even less desirable to transport hogs a like distance, particularly from an animal welfare standpoint.

2. Limit the harvest to company-owned hogs only. Because there are currently an insufficient number of company-owned hogs to fill the plant, Company X would have two options: the company could expand its farm operations to become completely vertically integrated, which is contrary to the proposed rule's purported intent to benefit independent producers; or reduce the harvest to company-owned hogs only at current production levels, supplemented with any other independently produced hogs. This option, however, is infeasible because it would result in a harvest reduction such that the plant would fail to cover costs. In that case, Company X would be forced to cease harvest operations at that plant, which would leave independent hog producers who sell to that slaughter facility with no outlet for their pigs.

Compounding that problem is the fact that more than 900,000 hogs that previously went to the Company X plant from the other packer owned hog production facility now have nowhere to go because there are not other proximate hog slaughter facilities capable of processing that number of hogs.

In short, the proposed provision will have introduced inefficiencies into the livestock procurement system to address a perceived problem that the agency has been monitoring using other resources and about which it has never brought a case during the several years it has engaged in such monitoring.

**Example Three**

In another circumstance, a group of hog producers are members of a cooperative packing operation, *i.e.*, Packer A. Packer A can process about half the hogs its cooperative members produce. The other 50 percent of the hogs are sold by the producer members to other packers. Unclear from 201.212(c), which provides that a "packer shall not purchase, acquire, or receive livestock from another packer or another packer's affiliated companies, including but not limited to, the other packer's parent company and wholly owned subsidiaries of the packer or its parent company" is the scope of prohibition with respect to "affiliated companies."[93] The qualifying language "including but not limited to," coupled with absence of any discussion in the preamble about the scope of the prohibition creates considerable uncertainty regarding its effect on this group of producers. GIPSA's sister agency, the Agricultural Marketing Service, does not consider these producers to be packer affiliates.

If other packers are prohibited from purchasing these hogs, the member producers of Packer A have two choices: (1) reduce their herds to remain within the capacity of Packer A processing operation; or (2) increase Packer A's capacity so it can accommodate all the hogs the members produce. In any case, the result is complete vertical integration. Conversely, if the agency concludes that the scope of 201.212(c) does not extend to the producer owners of Packer A the agency has provided a notable and distinct competitive advantage to Packer A.. Indeed, the agency has distorted the market, benefitting one packer at the expense of others.

Ironically, given the uncertainty caused by the broad language of the ban and the absence of any discussion in the preamble, some of the producer owners of Packer A who currently do business with other packers are requesting longer-term contracts in hopes of delaying the effect of the ban on packer-affiliated sales. Such actions are only band aids on the bleeding that would be caused by this proposed ban, and in the long run the ban would

[93] 75 *Fed. Reg.* at 35352.

fundamentally alter the way the member producers do business and force other packers to find other sources of supply, likely leading at least in part to further vertical integration among packers.

**Example Four**

The proposed ban also is problematic for packers that are largely vertically integrated. For example, one such packer numerous times throughout the year will sell excess market hogs to another packer. This excess could be due to a plant breakdown, a legitimate scheduling decision or any number of other business reasons. Although the provision would allow a packer to apply for a waiver in the case of a catastrophe, natural disaster, or other emergency, this exception does not sufficiently recognize the many legitimate reasons packers buy from one another.

Further, some packers have ongoing procurement agreements and engage in spot market purchases from other packers. Whether on a current or prospective basis the proposed rule limits a packer's ability to purchase market hogs that may satisfy preferred product quality objectives, because the rule likely would make it more costly for such packers to procure other market hogs due to having to haul them a further distance to a plant. These considerations could spur further vertical integration.

In addition, the proposed ban would, in some circumstances, likely "displace" hogs sold by independent producers. For example, Packer D has a plant near Guyman, Oklahoma. A different packer, Packer E, with a plant 450 miles away in Nebraska, owns hogs at a facility located close to the Guyman plant. Absent introducing the economically nonsensical inefficiencies and costs involving a third party dealer, the proposed ban would force those hogs to be hauled an incremental 450 miles to Packer E's plant in Nebraska. These hogs would then "displace" market hogs raised by producers nearer the Nebraska plant who historically have sold their hogs to that facility. The newly displaced hogs would then need to be transported either that same 450 miles to the Guyman plant or elsewhere. The result is that both operations would not only incur incremental freight costs and inefficiencies but also have a larger impact on the environment, *etc.* Ultimately, these costs may be passed on to consumers.

The proposed ban would also adversely affect vertically integrated packers in selling cull sows. Today, integrated packers typically cannot process cull sows because they are markedly different from the market hogs processed in their plants. So the integrated packer usually sells cull sows to other packers who specialize in harvesting hogs of that type and producing the items they can yield. The proposed ban would end those transactions and force the integrated packer to sell its cull sows to a third party dealer who in turn will sell them to the very same cull sow processor the integrated packer sells to today. Again, the net effect of the proposed ban is to place the integrated packer at a competitive disadvantage to others who sell cull sows directly to the cull sow processor and to introduce unnecessary costs and inefficiencies into the system.

In addition, one the country's largest procurers of cull sows is a subsidiary business of a packer. In explicably, with evidence of any price manipulation, the proposed ban would render this business relationship illegal and force the packer to divest its cull sow buying business.

The agency's purported purpose for the proposed ban on packer-to-packer sales is to limit opportunity for price manipulation by packers, which the Act in subsection 202(e) clearly makes illegal. Yet, packer-to-packer sales of livestock occur everyday and have for many years. Nonetheless, the agency has not brought any price manipulation cases involving packer-to-packer sales utilizing the tools and authority available. To suggest, as the agency does in the preamble, that this proposed ban is needed to prevent behavior that is prohibited but which the agency has never found it necessary to pursue an enforcement action suggests that a different, yet unstated, reason to preclude packer ownership of livestock is the true motive behind the proposal.

## The Requirement that each Unique Contract be Submitted to GIPSA for Posting on the Agency's Website is an Inappropriate Intrusion into Private Contracts.

Section 201.213 would require packers, swine contractors, and live poultry dealers to submit GIPSA each "unique type of agreement or contract."[94] This proposed rule is ill-considered for several reasons. First, publishing contracts could well have the long-term effect of encouraging live

[94] *Id.*

poultry dealers or processors to grow their own birds or packers to raise their own livestock. Rather than be subject to the intrusions inherent in this rule, becoming more vertically integrated eliminates the necessity of submitting the multitude of contracts and agreements that will have to be filed and updated and limits the ability of private plaintiffs to mine the contracts posted as a means to file a lawsuit alleging an unfair practice or an undue preference.

Second, at a minimum the proposal is an unnecessary and inappropriate intrusion into private transactions that is not contemplated by the PSA. In that regard, section 223 of the PSA provides for the establishment of a swine contract library and providing information about those contracts. It is noteworthy that this library is limited to swine contracts only. The proposed rule, would in effect, expand the scope of a contract library into areas and species that Congress has not chosen to capture. Given that the Congress in 2008 amended the Act in several respects, it did not direct the agency to broaden the scope of the existing contract library. For the foregoing reasons, this section should be withdrawn.

**The Capital Investment Requirements and Prohibitions are Beyond the Scope of the Act and Will Encourage Greater Vertical Integration.**

Section 201.217 provides that any requirement that a live poultry grower or swine production contract grower make an initial or additional capital investment "must be accompanied by a contract duration" to allow the grower "to recoup 80 percent of the cost of the required capital investment."[95] This provision is problematic for several reasons. First, this provision is tantamount to the agency requiring that packers pay a grower a price that ensures a certain rate of return. There is no authority within the Act that permits the agency, in effect, to take such action and guarantee a return on investment to a grower. Thus, the proposal fails for lack of statutory authority.

Second, the proposed rule makes no exception for capital improvements that are necessary to comply with changes that may be required by law. For example, an investment required by a statutory or regulatory change (e.g., gestation crate bans) is less optional than an

[95] *Id.* at 35353.

investment contracted for by a packer in order to improve efficiency, although both should be considered as lawful. In addition, although the agency documents released publicly, as well as statements made by USDA officials refer to this provision as requiring an "opportunity" for the grower to recoup 80 percent of the investment, the word "opportunity" is not found in either the preamble or, more importantly, the regulatory language. Therefore, although this provision has been "pitched" by various USDA officials as only requiring an opportunity to recoup 80 percent, the plain language of the rule and the preamble establish a hard requirement of 80 percent.

Finally, this 80 percent recoupment requirement likely will stifle innovation in the industry. Risk is a necessary component of innovation. And that risk must necessarily be shared by both sides – the packer who seeks to improve quality and the producer who seeks to increase his efficiencies. If the risk of innovation is disproportionately shifted to one side of the equation then, given the price equity requirements imposed by the proposed rules, there is no incentive for the producer to improve and the risk is too high for the packer to require improvements. At a time in which the meat industry as a whole faces pressures to address everything from health and wellness to antibiotic usage to animal welfare, the industry cannot afford a regulatory requirement that provides a disincentive to innovation.

**The Proposed Rule's "Reasonable" Period of Time to Remedy a Breach of Contract Does Not Consider Circumstances that Warrant Faster Action.**

Section 201.218 of the proposed rule prescribes "reasonable" times to notify, rebut, and cure a breach of contract. In that regard, the rule, in essence, would set a minimum of 14 days for a grower to rebut the allegations included in a notice of breach of contract. The proposed rule fails to provide a contractor the ability to act quickly in certain circumstances.

For example, neglect or intentional abuse of livestock or birds, or poor animal husbandry practices by a grower, is a serious issue that a packer, processor, or contractor should be permitted to address immediately. The proposed rule, however, does not allow the packer, processor, or contractor to suspend deliveries or terminate the contract, even though the grower's actions may violate the law and are a clear breach of contract. Indeed, under the proposal a contractor would be required to continue to do business with such a grower, thereby creating the possibility that the harm to the animals or birds could continue, while perpetuating harm to the packer's or processor's reputation in the marketplace. Immediate termination must be permitted in such circumstances. Failure to allow the contractor to act could result in damage to the contractor's assets in those cases where the contractor owns the livestock or birds and could damage the reputation of the packer and the reputation of the industry as a whole.

Similarly, a packer, processor, or contractor should be able to take immediate action regarding a grower who acts in a manner that jeopardizes food safety or the environment. The proposed contract termination rules emasculate a contractor's ability to act quickly if a grower fails to observe required drug withdrawal periods or discharges emissions in violation of environmental regulations. If a grower fails to observe the required drug withdrawal period, and those animals are harvested, a food safety issue exists for end consumers that likely will result in a recall of the affected food products. The grower could be liable under the contracts for damages sustained by the packer as a result of the recall. The proposed rules, however, do not allow a contractor to suspend deliveries or terminate a contract, even though the grower's actions would be a clear breach of contract. Requiring the continuation of deliveries raises the threat of additional recalls and the possibility of additional monetary claims against the packer, processor, or contractor and the grower.

## IV. THE PROPOSAL WOULD INHIBIT THE U.S. LIVESTOCK AND MEAT INDUSTRIES' ABILITY TO SERVE INTERNATIONAL MARKETS, LEADING TO LOSS OF COMPETITIVENESS, EXPORTS, REVENUE, AND JOBS IN THE UNITED STATES.

In addition to the above-discussed consequences and problems, the proposed rule would adversely affect international trade in that it would restrict, and in many cases preclude, U.S. exporters of beef, pork, and poultry from meeting the demands for high quality products requested by international customers. Specifically, an erosion of the U.S. position in Asian and European premium meat markets likely would result from the implementation of this rule.

U.S. exports of red meats and poultry totaled $11.7 billion in 2009. Maintaining and increasing export sales is vital to the health and sustainability of U.S. meat and poultry industry because U.S. per capita meat consumption has leveled off in recent years.

As international markets have become more sophisticated, international customers want to know about livestock origin and the processing of the meat they are purchasing from the United States. Knowledgeable foreign customers will pay high premiums to purchase the highest quality specialty meat produced from grain-fed livestock available from U.S. livestock producers and packers. These customers are willing to work with producers and packers, especially on pre-harvest conditions and post-harvest unique processing techniques, to obtain the type and quality of beef, pork, and poultry they need in their specialty markets. The very high premiums paid for this meat cannot be earned in the U.S. domestic market and represent the additional income needed to keep U.S. ranchers and processors in business.

The proposed rule would largely eliminate the marketing agreements that offer the incentives to develop and maintain these customized meat production programs including:

- European Union beef business (certified hormone free; 45,000 MT quota for each of the next three years);
- Natural beef business;
- Each packer's "Premium Program" beef;
- Meat from age-verified livestock; and
- Specialized production systems such as "Certified Angus Beef."

Some countries demand meat production programs with strict parameters, such as requiring no beef tallow and/or no meat and bone meal in feeds, or imposing specific age restrictions and traceability to the producer. Specialized diet requirements used with cattle from superior genetic stock and breeding must also be met.

Use of unique feeds and customized feed rations drive the quality of the final meat product and ability of the producer and processor to add value in creating taste and quality characteristics. Livestock operations and processors must be able to guarantee the quality of the meat produced from cattle raised under these strict feeding regimes. The significant disincentive to enter into marketing agreements because of the threat of litigation caused by the proposed rule's waiver of the proving competitive injury and its definition of likelihood of competitive injury will inhibit all of these programs.

The impact will also be felt in foreign countries that require meat produced from age verified (AV) cattle. Processors and exporters must be able to predict the supply of AV cattle destined for specific markets or the business will be lost. International customers pay a premium to U.S. producers and packers to meet these requirements and producers benefit from participating in these specialty programs. The proposed rule would remove the incentives to enter into these specialty programs and contracts. The inability to differentiate products, create brands, and market unique end product characteristics would result in significant loss of income and jobs throughout the livestock and meat processing industry.

Some producers and processors note that high value international markets are serviced with customized systems blending the highest quality genetics, feed formulations, intricate concentrated feed management, livestock hauling and handling. The resulting meat products are created in such a way, special to each producer and process, to allow promotion and marketing which cannot be matched by our competitors.

International meat buyers and importers are now requiring traceability of the livestock in purchase contracts and have limited or strict tolerances for feed additive and veterinary drug residues. Meeting these specifications becomes nearly impossible without source information. The proposed rule will virtually ensure that the specifications cannot consistently be maintained, will erode the quality of U.S. meat products, lower meat standards for all domestic and foreign consumers, and eliminate the competitive advantages the U.S. currently benefits from at home and overseas in producing the best meat in the world.

In short, if the proposed rule is enacted, the U.S. would lose international markets because competitive suppliers in other countries will not face similar restrictions or public disclosure of contracts. The inability to produce and guarantee the meat characteristics in demand overseas would turn U.S. beef and pork cuts into commodity cuts with lower values and lower returns to producers and packers throughout the production and marketing chain. The proposed rule, thought to create economic activity and jobs, would do just the opposite when considering international meat demand — the inability of the U.S. to meet overseas specifications will lower demand for quality livestock, reduce the quality of meat production, eliminate jobs throughout the industry, and lead to shifts in production to U.S. competitors.

## V. THE PROPOSED RULE VIOLATES EXECUTIVE ORDER 12866 AND IS NOT SUPPORTED BY THE NECESSARY, COMPREHENSIVE ECONOMIC IMPACT ANALYSIS.

### Executive Order 12866 Requires a More Comprehensive Assessment than the Cost-Benefit Analysis Conducted as Part of the proposed Rule

The 2008 Farm Bill directed GIPSA to promulgate regulations to address five distinct areas related to livestock and poultry marketing:

- the arbitration process,
- criteria that GIPSA would use to determine what constitutes undue or unreasonable preference,
- notice regarding suspension of the delivery of birds,
- additional capital investment requirements in growing contracts, and
- the time producers and growers are given to remedy a breach of contract.

The proposed rule, however, goes far beyond the scope of this mandate, proposing additional regulations that would, among other things:

- require packers to maintain records justifying differences in price and contract terms,
- prohibit specific conduct alleged to be unfair without regard to its competitive effects,

- prohibit packer to packer sales
- prohibit packer buyers from purchasing livestock for more than one packer
- require packers to guarantee that producers recoup capital investment costs and
- require packers to make available to GIPSA copies of contracts and agreements that they have with producers.

Against this statutory background GIPSA must satisfy the parameters of Executive Order 12866 (EO) and the Regulatory Flexibility Act. The EO requires regulatory agencies to conduct an economic impact analysis of any "significant" rule, with special consideration given to small entities. Specifically, agencies are required to demonstrate the need for any proposed significant regulatory action, assess the costs and benefits of that action, and make those assessments available for public review and comment. Here, the agency has failed to properly conduct a thorough economic impact analysis as required. That failure compels the agency to perform that analysis and then propose a rule consistent with its analysis.

Specifically, the EO provides, in pertinent part, that

> Federal agencies should promulgate only such regulations as are required by law, are necessary to interpret the law, or are made necessary by compelling public need, such as material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people. In deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating. Costs and benefits shall be understood to include both quantifiable measures (to the fullest extent that these can be usefully estimated) and qualitative measures of costs and benefits that are difficult to quantify, but nevertheless essential to consider.[96]

[96] Executive Order 12866 Section 1(a).

As part of a rulemaking agencies are directed to "ensure that the agencies' regulatory programs are consistent with the philosophy set forth above, agencies should adhere to the following principles, to the extent permitted by law and where applicable."[97] Specifically, each agency is to

> identify in writing the specific market failure (such as externalities, market power, lack of information) or other specific problem that it intends to address (including, where applicable, the failures of public institutions) that warrant new agency action, as well as assess the significance of that problem, to enable assessment of whether any new regulation is warranted; ...
>
> identify and assess available alternatives to direct regulation, including providing economic incentives to encourage the desired behavior, such as user fees or marketable permits, or providing information upon which choices can be made by the public; ...
>
> assess both the costs and the benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs; ...
>
> base its decisions on the best reasonably obtainable scientific, technical, economic, and other information concerning the need for, and consequences of, the intended regulation or guidance document; ...
>
> tailor its regulations and guidance documents to impose the least burden on society, including individuals, businesses of differing sizes, and other entities (including small communities and governmental entities), consistent with obtaining the regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations; and

[97] *Id.* at section 1(b).

> draft its regulations and guidance documents to be simple and easy to understand, with the goal of minimizing the potential for uncertainty and litigation arising from such uncertainty.[98]

The EO also defines a "significant regulatory action" as any "regulatory action that is likely to result in a regulation that may: (1)[H]ave an annual effect on the economy of $100 million or more or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities."[99]

Furthermore, the EO imposes certain additional responsibilities on agencies regarding rulemaking. In that regard, the EO provides that

> (B) For each matter identified as, or determined by the Administrator of OIRA to be, a significant regulatory action, the issuing agency shall provide to OIRA:
> (i) The text of the draft regulatory action, together with a reasonably detailed description of the need for the regulatory action and an explanation of how the regulatory action will meet that need; and
> (ii) An assessment of the potential costs and benefits of the regulatory action, including an explanation of the manner in which the regulatory action is consistent with a statutory mandate and, to the extent permitted by law, promotes the President's priorities and avoids undue interference with State, local, and tribal governments in the exercise of their governmental functions.
> (C) For those matters identified as, or determined by the Administrator of OIRA to be, a significant regulatory action within the scope of section 3(f)(1), the agency shall also provide to OIRA the following additional information developed as part of the agency's decision-making process (unless prohibited by law):
> (i) An assessment, including the underlying analysis, of benefits anticipated from the regulatory action (such as, but not limited to, the promotion of the efficient functioning of the economy and

[98] *Id.* at section 1(b)(1, 3, 6, 7, 11, 12).
[99] *Id.* at section 3(f)(1) (Emphasis added).

> private markets, the enhancement of health and safety, the protection of the natural environment, and the elimination or reduction of discrimination or bias) together with, to the extent feasible, a quantification of those benefits;
> (ii) An assessment, including the underlying analysis, of costs anticipated from the regulatory action (such as, but not limited to, the direct cost both to the government in administering the regulation and to businesses and others in complying with the regulation, and any adverse effects on the efficient functioning of the economy, private markets (including productivity, employment, and competitiveness), health, safety, and the natural environment), together with, to the extent feasible, a quantification of those costs; and
> (iii) An assessment, including the underlying analysis, of costs and benefits of potentially effective and reasonably feasible alternatives to the planned regulation, identified by the agencies or the public (including improving the current regulation and reasonably viable nonregulatory actions), and an explanation why the planned regulatory action is preferable to the identified potential alternatives. (Emphasis added)[100]

Although GIPSA identified the proposed rule as a "significant regulatory action," because the agency did not conduct the assessments required in EO section 6(a)(3)(C), it did not make them available as required by subsection (E). Accordingly, GIPSA either erroneously concluded that the proposed rule is not a significant regulatory action within the scope of section 3(f)(1) or failed to meet its obligations under the EO. Specifically, it appears that GIPSA improperly viewed the proposed rule's economic impact as narrowly as possible in an effort to avoid having to conduct the above-referenced assessments.

In several parts of the preamble GIPSA discusses the "adjustment costs" that packers will incur because of changed packer behavior driven by the proposed rule. Because of the lawsuits that were previously filed against packers regarding their past use of marketing agreements, about which GIPSA was fully aware, the agency knew or should have known and therefore should have considered how the proposed changes regarding proving

[100] *Id.* at section 6 (3)(B),(C), and (E).

competitive injury or the likelihood of competitive injury would increase the risk of litigation and affect packers' behavior.

In that regard, any reasonable analysis of the industry and the proposed rule would have led to the conclusion that the "annual effect on the economy" would exceed $100 million and just as relevant that the proposed rule would "adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs."[101] To that end, an analysis done by John Dunham and Associates examining the impact of the proposed rule and the fact that it will significantly alter and lessen the use of marketing agreements by packers yielded a conclusion that implementation of the proposed rule as written will cause the loss of approximately 104,000 jobs and adversely affect GDP by $14 billion.[102] In addition, the Dunham analysis shows that implementation of the proposed rule would cause consumers to pay 3.3% (approximately $2.7 billion) more for meat and poultry than they do under the current structure. By several measures included in the EO this analysis requires GIPSA to conduct the more complicated assessments mandated in section 6(a)(3)(C).[103]

Similarly, another study conducted by Informa also demonstrates that the economic impact of the proposed will easily exceed the $100 million threshold, which triggers the requirement that GIPSA conduct the more comprehensive analysis provided in section 3(f)(1).[104] Specifically, the Informa analysis concluded that the proposed rule would cause the loss of approximately 22,900 jobs, cause a loss of annual GDP of $1.5 billion, and result in lost annual tax revenues of $389 million. Informa's analysis also found that the proposed rule would impose one time direct costs on the meat and poultry sector totaling $136 million, direct annual ongoing costs to the beef, pork and poultry industries of $169 million, and annual indirect losses to the beef, pork, and poultry industries in the amount of $1.341 billion. In addition, Informa estimated that because of the proposed limitation on buyer/packer representation at auction barns, approximately 150-200 of the

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[101] *Id.* at section 3(f)(1).

[102] *The American Meat Institute Meat Demand Study; The Impact of Proposed Grain Inspection, Packers and Stockyards Administration Proposed Rule*; John Dunham and Associates, Inc.; August 24, 2010; see pages 1-2 (Attachment H).

[103] *Id.*

[104] *An Estimate of the Economic Impact of GIPSA's Proposed Rules*; Informa Economics, Inc. November 8, 2010 (Attachment I).

smallest auction barns will go out of business.[105] Similarly, a study commissioned by the National Chicken Council and conducted by FarmEcon LLC evidenced a cost the chicken industry of more than $1 Billion over the first five years.[106]

Whether using the Dunham analysis or the Informa study, in either event, the impact of the proposed far exceeds the $100 million threshold that triggers a 3(f)(1) assessment. The agency failed to do so and such an assessment must be done in order for GIPSA, the affected industries, and the public to understand the significant and adverse impact this proposed rule would have.

**<u>The Proposed Rule does not Comply with Executive Order 12866 with Respect to Numerous Proposed Provisions.</u>**

In addition to failing to conduct the necessary assessments, GIPSA fails to provide information or evidence to substantiate many assertions in the proposed rule. In that regard, absent from GIPSA's EO analysis is any documentation or other empirical evidence that supports the vague generalizations used to justify many of the proposed sections. GIPSA provides no evidence that the producer complaints cited as justification for the rule have been verified or documented nor has the agency taken enforcement actions against a packer based on those assertions.

Similarly, the agency does not provide any data or empirical evidence that increased contracting or purported market concentration has adversely affected the industry or the economy, or that packers have used their alleged "market power" to harm producers, impair property rights of growers or producers, or injure consumers. Nor does GIPSA provide any evidence to support its assertions that transparency, competition, and the financial integrity of the markets have lessened. The agency's failure to provide any tangible, documented support beyond unsubstantiated claims from a few disgruntled producers on any of these issues proves that the proposed rule does not satisfy the EO. A careful review of whether GIPSA met the EO requirements unquestionably leads to the conclusion that the agency has

105 *Id.*

106 *Proposed GIPSA Rules Relating to the Chicken Industry: Economic Impact*; FarmEcon LLC, November 11, 2010 (See Attachment J).

failed to comply in numerous respects with the EO. A fuller explanation of specific failures and why the proposed rule should be withdrawn follows.

GIPSA has failed to comply with EO section 6(a)(3)(E). GIPSA identified the proposed rule as a significant regulatory action and section 6(a)(3)(E) provides that

> (E) After the regulatory action has been published in the *Federal Register* or otherwise issued to the public, the agency shall:
> (i) Make available to the public the information set forth in subsections (a)(3)(B) and (C);
> (ii) Identify for the public, in a complete, clear, and simple manner, the substantive changes between the draft submitted to OIRA for review and the action subsequently announced; and
> (iii) Identify for the public those changes in the regulatory action that were made at the suggestion or recommendation of OIRA. [107]

The agency, however, has not identified for the public the "substantive changes between the draft submitted to OIRA for review and the action subsequently announced" (ii) nor has the agency "identified for the public those changes in the regulatory action that were made at the suggestion or recommendation of OIRA" (iii).

In addition, the preamble discussion regarding the EO fails to discuss, or inaccurately identifies, several significant elements of the proposed rule. Notable is the preamble discussion pertaining to proposed "Terms Defined." The EO preamble discussion regarding newly defined terms says

> Proposed new section 201.2(l) through (t), "Terms Defined," would contain definitions for eight terms used in the proposed regulations. These definitions are of commonly used terms in industry and enter into the cost analysis through the proposed regulations.[108]

[107] See 75 *Fed. Reg.* at 35345.
[108] *Id.*

The proposed rule, however, contains 10 new definitions. Unclear from the preamble discussion is whether the agency is attempting to sweep under the rug any required analysis regarding two very significant newly defined terms, "competitive injury" 201.2(t) and "likelihood of competitive injury" 201.2 (u), or whether GIPSA has simply failed to recognize and consider the ramifications of these terms – or both. In that regard, the agency's assertion that the cost-benefit analysis of "commonly used" but newly defined terms such as "production contract" (201.2(s)) or forward contract (201.2(q)) "enters into the cost analysis through the proposed regulations" is dubious with respect to an accurate EO analysis.

More importantly, however, unlike terms such as "forward contract" and "production contract" the terms "competitive injury" and likelihood of competitive injury" are not commonly used in the industry and, in light of the their importance to the rule and the potential for significant amounts of litigation involving those terms, the agency's new minting of these terms warranted a thorough cost-benefit analysis of at least those two terms. For this reason alone the EO requirements have not been met.

The agency's analysis also fails to satisfy other elements of the EO requirements. In that regard, section 1(b)(12) of the EO requires an agency to "draft its regulations and guidance documents to be simple and easy to understand, with the goal of minimizing the potential for uncertainty and litigation arising from such uncertainty." As discussed below in Section III of these comments, many aspects of the proposed rule are anything but simple and easy to understand and are an open invitation to litigation.

For example, the newly defined term "likelihood of injury to competition" includes several elements that almost defy definition. Specifically, an element of likelihood of injury to competition is whether situations that "impair a producer's or grower's ability to receive the reasonable expected full economic value from a transaction in the market channel or marketplace."[109] The preamble recites almost verbatim the language in the proposed rule, providing no explanation or discussion regarding what the phrase "reasonable expected full economic value" means. This amorphous phrase is the epitome of creating a "potential for uncertainty and litigation" and thus at odds with the intent and direction of section 1(b)(12) of the EO.

[109] Proposed section 201.2(u), 75 *Fed. Reg.* at 35351.

The agency also has not identified a need for some of the proposed rules. For example, section 201.212(c) would impost a ban on packer to packer livestock sales. In the preamble the agency states that the proposed section is necessary to "address situations where a packer (or group of packers) is able to manipulate prices paid for livestock, such as where a packer-to-packer sale signals the price that packers will pay producers or whether a packer purchases cattle through exclusive arrangements."[110] Missing from the discussion, however, is any evidence or supporting documentation that the behavior the proposed rule seeks to curb has occurred. Nor does the agency explain in the EO discussion why an absolute ban is necessary when the agency is currently empowered to take enforcement action on a case-by-case basis.[111] To take necessary enforcement actions on an as-needed basis rather than a blanket ban on packer to packer livestock sales is far more in keeping with EO sections 1(b)(7) and (11) than imposing a ban that will disrupt not only the operation of so many packers but many producers as well. (See discussion in Section III) This is particularly true considering all packer to packer transactions are currently reported to USDA through USDA's mandatory price reporting program and GIPSA has a program that monitors every transaction.[112]

The EO analysis is replete with vague and unsupported generalities about the benefits that what will accrue from the proposed rule. In that regard, GIPSA states that

> Potential benefits include gains from having market prices for commodities or grower services more accurately reflect supply-demand conditions; from making decisions based on more accurate price signals and from remedying anticompetitive conduct and minimizing associated dead weight losses and other inefficiencies."[113]

[110] 75 *Fed. Reg.* at 35342.
[111] The agency fails to cite to a single instance where an enforcement action was brought against a packer because its transactions with other packers allegedly resulted in price manipulation.
[112] 2009 Annual Report, Packers & Stockyards Program, United States Department of Agriculture Grain Inspection, Packers and Stockyards Administration, p. 13.
[113] 75 *Fed. Reg.* at 35345. (Emphasis added).

Setting aside the fact that GIPSA characterizes the above as "potential" benefits, nowhere in the discussion and as required by the EO, however, does GIPSA provide any evidence that: (1) market prices do not currently reflect supply-demand conditions, (2) decisions are not based on accurate price signals, or (3) that there is anticompetitive conduct that needs to be addressed.

Also lacking is any meaningful, accurate evaluation of the costs attendant to this proposed rule. GIPSA seems to dismiss with a wave of the hand the costs attendant to proposed sections 201.210 and 201.211, which would define "unfair practice" and "undue preference" under subsections 202(a) and (b) of the Act. For both proposed sections GIPSA simply asserts that "because these regulations merely clarify existing requirements, any such cost must be incurred regardless of whether the regulations are issued and are therefore not costs associated with the regulations themselves." From an Executive Order 12866 perspective this assertion is flawed for several reasons. First, the proposed sections do not merely clarify existing requirements – in some circumstances, e.g., proposed section 201.210(a)(5), they impose substantive new obligations on packers and other regulated entities. Ironically, other elements of the proposed sections, e.g., 201.210(a)(8), violate the EO because they are so vague that the only certainty associated with the rule is the litigation that will ensue.

Second, not only does the agency provide no support for its cost assertions, but they conflict with the agency admission in the preamble that the new regulations would "constitute a material change in circumstances" by removing the requirement to prove competitive injury or likelihood of injury for violations of sections 202(a) and (b) of the Act.[114] Because the conduct set forth in sections 201.210 and 201.211 would now be in violation of the Act without a showing of competitive harm, proposed sections 201.210 and 201.111 would impose new requirements, with costs associated thereto.[115]

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[114] 75 *Fed. Reg.* at 35341.

[115] Also noteworthy is GIPSA's reliance on the Interim Report done by RTI. Nowhere does GIPSA discuss the GIPSA Livestock and Meat Marketing Study done by RTI. *See* United States Dept. of Agriculture. Grain Inspection, Packers and Stockyard Administration. *GIPSA Livestock and Meat Marketing Study*. Vol. 1. Research Triangle Park: RTI International, 2007.

Because the EO analysis conducted by GIPSA fails to meet the criteria established by Executive Order 12866, the proposed rule should be withdrawn.

## VI. THE PROPOSED RULE FAILS TO SATISFY THE REQUIREMENTS OF THE DATA QULAITY ACT

The Proposed rule also fails to comply with the restrictions and guidelines imposed by the Data Quality Act (DQA).[116] Pursuant to the DQA and USDA's Information Quality Guidelines (Guidelines), in addition to the comments filed herein, AMI submits a request for correction of information contained in the Notice of Proposed Rulemaking, published in the *Federal Register*. The DQA and the Guidelines are intended to ensure the quality of the information used by GIPSA, including the information's utility, objectivity and integrity.

Specifically, this request pertains to certain information used in support of and in partial justification for the proposed rule. In the preamble the agency refers to public meetings held in October 2008, in Arkansas, Iowa, and Georgia. These meetings purportedly were used to gather comments, information, and recommendations from interested parties. In addition to the meetings, GIPSA contends that it gathered data concerning market participants. According to GIPSA, the proposed rule is "based on comments, information, and recommendations received in the previously mentioned meetings, along with GIPSA's expertise, experience, and interactions in the livestock and poultry industries."[117]

GIPSA purports to rely on the information described above, but to the best of AMI's knowledge, that information has not been made available to the public nor is it included in the proposed rule. There is no specific information that would allow AMI or the public to determine whether the drastic changes in the implementation of the PSA that would occur if the proposal is implemented are warranted. Until GIPSA can justify these changes, the proposed rules is arbitrary, capricious, and not in accordance with law.

[116] 44 U.S.C. § 3516.
[117] 74 *Fed. Reg.* at 35339.

GIPSA, through the preamble or the record, has failed to provide any evidence to support this sweeping overhaul of the PSA. The federal government should not, indeed cannot, change a 90-year old statute to suit a perceived need without support. The DQA and the Guidelines were implemented to prevent just this type of misuse of administrative authority.

Significantly, the information used by GIPSA to justify the proposed rule violates many of the "Regulatory" or "Influential Regulatory" standards provided under the Guidelines. For example, the Guidelines require the agency to use "reasonably reliable data and information," which includes data from surveys, complied information, and/or expert opinion. In the proposed rule, however, GIPSA relies on data and information provided at what are, in effect, "town hall meetings." Information gathered at such meetings can only be described as inherently unreliable. Moreover, utilizing the aforementioned meetings as well as the general "expertise" of the agency provides no transparency into any analysis conducted by GIPSA, nor does it clearly identify sources of uncertainly affecting data quality.

Because this rulemaking is *significant* pursuant to EO 12866, the information used to justify the proposed rule is considered *influential.* Influential information should, in pertinent part, "(i) use the best science and supporting studies conducted in accordance with sound and objective scientific practices, including peer-reviewed science and studies where available; and use data collected by accepted methods or best available methods."[118] The information gathered meetings and the "general expertise" of the GIPSA simply does not conform to these standards.

Because the agency has failed to comply the DQA and EO 12866, AMI cannot know or understand GIPSA's justification or rationale for the proposed rule. More importantly, AMI and its members will be harmed by the proposed rule, particularly if the rule is promulgated using biased or faulty information.

[118] *USDA Information Quality Activities, Regulatory Guidelines,* http://www.ocio.usda.gov/qi_guide/regulatory.html

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For the foregoing reasons, AMI respectfully requests that the proposed rule be withdrawn and that the agency repropose a rule consistent with Congressional direction in the Farm Bill and consistent with longstanding judicial precedent.

Sincerely,

Mark D. Dopp
Senior Vice President, Regulatory Affairs and General Counsel

Enclosures

# <u>ATTACHMENT A</u>

# Review of Western Organization of Resource Councils (WORC) Petition for Rulemaking

Grain Inspection and Packers and Stockyards Administration
Packers and Stockyards Programs

August 29, 1997

**Table of Contents**

## Executive Summary

The Secretary of Agriculture received a petition for rulemaking submitted by the Western Organization of Resource Councils (WORC) on October 12, 1996. WORC requested that the United States Department of Agriculture (USDA) issue rules under the authority of the Packers and Stockyards Act (the Act) that would: (1) prohibit packers from procuring cattle for slaughter through the use of a forward contract, unless the contract contains a firm base price that can be equated to a fixed dollar amount on the day the contract is signed and the forward contract is offered or bid in an open, public manner and (2) prohibit packers from owning and feeding cattle, unless the cattle are sold for slaughter in an open, public manner.

On January 14, 1997, the WORC petition was published in the *Federal Register*. USDA solicited public comments on the petition. In early April 1997, a team from USDA was assembled to review the WORC petition and assess the comments received. The comment period closed on April 14, 1997.

There were 1,757 comments received regarding the WORC petition of which 1,651 of the comments totally supported the petition. There were an additional 13 comments received that supported only a portion of the WORC petition. Forty-six comments were received that did not clearly state a position either supporting or opposing the proposed rulemaking. There were 45 comments received that opposed the WORC petition in its entirety and two comments that opposed a portion of the WORC petition.

There were 1,706 comments received from 40 states and the District of Columbia. One comment was submitted from Canada and 50 comments could not be identified to a geographic location. Of the comments received, 80 percent came from four states, Montana (31 percent), Wyoming (24 percent), South Dakota (17 percent) and North Dakota (8 percent).

Of the total number of comments received, 73 percent were in the format of a "form letter" supporting WORC's petition. Of the total comments received, 59 percent were form letters from the following states: Montana (24 percent), Wyoming (22 percent) and South Dakota (13 percent).

Information provided in the comments was used to categorize each commentor by occupation/affiliation. There were 511 comments received from persons or firms related to the raising or feeding of cattle. There were 73 comments received from various associations. Elected officials submitted 32 comments and agricultural economists submitted four comments. There were 18 comments received from other agriculture-related businesses and 163 comments that were categorized as other occupations. The balance of the comments did not state an occupation/affiliation.

A majority of the comments received supporting WORC's petition also had numerous alternative comments that offered reasons for or solutions to industry problems. The five most frequently submitted alternative comments were: (1) manipulation of market price, (2) enforce P&S Act, (3) oppose packer concentration, (4) restore competition and (5) retail beef price does not reflect lower cattle prices.

The majority of the comments that supported the petition did not provide any economic data or analysis, but referred to the petition's economic arguments or to an economic study referenced in the petition. There were 25 comments (mostly opposed) that provided economic data, analysis, or an assessment.

WORC wants the Grain Inspection, Packers and Stockyards Administration (GIPSA) to selectively regulate the fed cattle segment of the beef industry to comply with their petition. This would affect the sellers of fed cattle and their lenders by limiting the ways in which they can market their product.

The difference between the legal opinion expressed by WORC and that of the Office of the General Counsel (OGC) regarding the Secretary's authority to issue regulations under the Act is primarily the level of association required to prove a likelihood of injury or harm. OGC and GIPSA believe that a causal relationship between the complained of activity and the injury must be shown in order to regulate the activity. WORC, on the contrary, believes that the Secretary is authorized to regulate an activity based only upon any degree of association between the complained of activity and the injury.

The power of the economic, logical, and empirical arguments was the primary basis for developing our conclusions, rather than the number of comments supporting or opposing the petition. The team finds no compelling evidence to suggest that anything other than basic economic conditions determined the general price level of the fed cattle market. After weighing the economic arguments supplied by WORC, commentors (supporting and opposing), and other information assembled by the team, we could not definitively conclude that spot prices were affected or manipulated by captive supplies. The economic evidence does not indicate the use of captive supplies is a violation of the Act. Therefore, we conclude that promulgating the rules suggested by the petition is unwarranted.

## Background

In early 1995, there was a sharp decline in cattle prices. This caused various groups in the industry, mainly cattle producers, to urge Congress and USDA to take action to improve conditions. During that same period of time, USDA was conducting a congressionally-mandated study on concentration in the red meat industry.[1] The study, released on February 14, 1996, confirmed the existence of concentration but provided no definitive evidence that it had an appreciable effect on cattle prices. Following release of the study, USDA has undertaken several initiatives in response to the concerns of the industry.

The Advisory Committee on Agricultural Concentration was appointed by the Secretary to review the study and a number of other issues involving concentration in agriculture. The Advisory Committee submitted its recommendations and findings on June 6, 1996.[2] The recommendations of the majority report included increased monitoring and enforcement of antitrust and regulatory policy, limiting packer activities regarding price differentiation, improving collection and reporting of market data, and value-based pricing. The Advisory Committee also submitted three minority reports. The recommendations of the minority reports included taking additional action to address the concerns of producers relating to the effects of concentration on the cattle industry, increased reporting of export data, and educating producers about the current market environment.

On July 31, 1996, the Secretary announced the first in a series of actions by USDA to improve competition in the livestock industry. These actions address two of the major areas of recommendations made by the Advisory Committee. These first actions, taken to immediately address the concerns of many livestock producers, included price reporting initiatives that broadened the coverage of market transactions reported and improved the timeliness and availability of information on the growing international trade in livestock and meat products.

On June 4, 1997, the Secretary announced new actions to address concentration and promote competition in agriculture. These actions include restructuring GIPSA in response to an independent review of its enforcement of anticompetitive practices.

## The Petition

Independent of USDA's activities, the Secretary received a petition for rulemaking submitted by WORC on October 12, 1996. WORC requests that USDA issue rules under the

[1] *Concentration in the Red Meat Packing Industry,* Packers and Stockyards Programs, Grain Inspection, Packers and Stockyards Administration, USDA, February 1996.

[2] *Concentration in Agriculture: A Report of the USDA Advisory Committee on Agricultural Concentration*, Agricultural Marketing Service, USDA, June 1996.

authority of the Act that: (1) prohibit packers from procuring cattle for slaughter through the use of a forward contract, unless the contract contains a firm base price that can be equated to a fixed dollar amount on the day the contract is signed and the forward contract is offered or bid in an open, public manner and (2) prohibit packers from owning and feeding cattle, unless the cattle are sold for slaughter in an open, public market.

## The Petitioner

WORC is a federation of grassroots organizations located in Colorado, Idaho, Montana, North Dakota, South Dakota, and Wyoming that was formed in 1979. The various organizations are composed of affiliated citizen groups in 42 communities across the region. The 6,000 members of these groups are farmers, ranchers, small business owners, and working people who seek to protect natural resources, family farms, and rural communities. They include both cattle ranchers and beef consumers.

## Need For The Suggested Rules

WORC has submitted this petition for rulemaking because it believes that packers' direct ownership and feeding of cattle for slaughter and their procurement of slaughter supplies through formula or basis-priced forward contracts have decreased prices paid to cattle producers. WORC also believes that because cattle sold through formula or basis-priced forward contracts are not traded publicly and packer-fed cattle are not sold publicly, these practices unjustly discriminate against some producers and provide unreasonable preferences to others. According to WORC, these practices are in violation of Section 202 of the Act and should be restricted through rules.

## Request For Comments

On January 14, 1997, the entire petition was published in the *Federal Register*.[3] USDA solicited public comment on the petition and utilized the comments in assessing the need for the requested rulemaking.

USDA sought public comment on the petition from all segments of the industry (producers, marketing firms, meat packing firms, etc.), academia and other interested parties, including small entities that may be affected by implementation of WORC's proposal. Small entities were defined as firms that meet the following standards: (1) beef cattle producers, except feedlots, with annual receipts of $500,000 or less for beef cattle sales; (2) beef cattle feedlots with annual receipts of $1.5 million or less for beef cattle sales; and (3) meat packing plants with 500 employees or less.

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[3] *Federal Register*, Vol. 62, No. 9. Tuesday, January 14, 1997, pp. 1845-59.

USDA requested comments on the petition that would provide the Secretary with additional information to consider in determining whether or not the rulemaking requested by WORC should be undertaken. USDA also requested comments that addressed the following questions to be used as a framework for comments submitted:

1. What competitive or other economic effects would implementing the rules that WORC is asking USDA to propose (hereinafter "proposed rules") have on individual businesses and the cattle and beef industry as a whole?

2. What are the competitive effects of formula or basis-priced forward contracting and packer feeding on cattle producers, feedlots, meat packers, meat wholesalers and retailers, and consumers?

3. What would be the effects of implementing the proposed rules on the structure, conduct, and competitive performance of the cattle producing, cattle feeding, meat packing, wholesaling and retailing industries? What would be the effect on the structure, conduct and competitive performance of livestock and meat markets? In answering these questions, what do you consider to be the relevant markets and how do you define them?

4. How do formula or basis-priced forward contracting and packer feeding affect cattle prices? Do formula or basis-priced forward contracting and packer feeding have adverse competitive effects or other adverse economic effects? Are there competitive benefits or other economic benefits associated with use of formula or basis-priced forward contracting and packer feeding that would not support implementing the proposed rules?

5. Do the research studies cited by the Petitioner support its position that the formula or basis-priced forward contracting and packer feeding practices outlined in the petition result in competitive harm or other economic harm to cattle producers and that the practices harm competition in beef packing? Are there other studies that USDA should consider?

6. Does sufficient evidence exist to find that the formula or basis-priced forward contracting and packer feeding practices outlined in the petition violate Section 202 of the Packers and Stockyards Act? If so, what is that evidence?

7. Is regulatory action needed?

8. Are the proposed rules too broad or too restrictive?

9. Do the proposed rules adequately address the concerns raised by the Petitioner?

10. Are there alternatives to rulemaking that would address the concerns raised by the Petitioner?

**Summary of Comments**

GIPSA logged, as received, a total of 1,772 comments. Fifteen of the comments logged, as received, were inadvertently logged twice and were excluded from the final tally of 1,757 comments. The comment review revealed that 19 individuals submitted two comments each. Although the comments were not exact duplicates of each other, they were very similar. These multiple comments were left in the final tally.

Forty-six of the comments received did not clearly state a position either supporting or opposing the proposed rulemaking (Table 1). These comments were categorized as "no position." Many of these comments offered alternatives to the proposed rulemaking or stated that available information on the issues was inadequate or inconclusive to enter a position. One thousand six-hundred fifty-one (1,651) of the comments supported the proposed rulemaking in its entirety. Most of these comments expressed deep concern about the decline in prices paid producers, the level of concentration in the meat packing industry, the dominance of the "big three packers" and the failure of GIPSA to enforce section 202 of the Act. Thirteen of the comments voiced support for only parts of the proposed rulemaking. These comments were categorized as "support portions." Forty-five comments opposed the proposed rulemaking in its entirety. Most of these comments expressed the view that the proposed rulemaking was based on incorrect assumptions regarding how prices paid producers are impacted by a packer's direct ownership and feeding of cattle, a packers use of formula or basis-priced forward contracts, and concentration in the red meat industry. Many of the comments in opposition also stated that the proposed rulemaking was intrusive government regulation and would be counter-productive to innovations in the meat industry. Two of the comments voiced opposition for only parts of the proposed rulemaking. These comments were categorized as "oppose portions."

Table 1

| **Number of Comments by State and Position** | | | | | | |
|---|---|---|---|---|---|---|
| State | Support Petition | Support Portions | Oppose Petition | Oppose Portions | No Position | Total |
| MT | 530 | 5 | 3 | 1 | 10 | 549 |
| WY | 414 | 2 | 2 | | 5 | 423 |
| SD | 281 | 2 | 1 | | 10 | 294 |
| ND | 137 | 1 | | | 4 | 142 |
| ID | 35 | | 1 | | | 36 |
| NE | 24 | 1 | 2 | | 1 | 28 |
| NY | 23 | | | | | 23 |
| TX | 13 | | 5 | | 4 | 22 |
| OR | 15 | | 1 | | | 16 |
| CO | 6 | | 8 | | 1 | 15 |
| KS | 10 | | 5 | | | 15 |
| CA | 10 | | 2 | | 2 | 14 |
| DC | 7 | 1 | 5 | | | 13 |
| NV | 13 | | | | | 13 |
| MO | 10 | | 1 | | | 11 |
| GA | 8 | | | | | 8 |
| OK | 6 | | 1 | | | 7 |
| WA | 6 | | | | 1 | 7 |
| MI | 3 | | 2 | | 1 | 6 |
| IL | 2 | | 3 | | 1 | 6 |
| AL | 5 | | | | | 5 |
| MA | 5 | | | | | 5 |
| MN | 5 | | | | | 5 |
| IA | 4 | 1 | | | | 5 |
| WI | 4 | | | | | 4 |
| OH | 1 | | | | 2 | 3 |
| CT | 3 | | | | | 3 |
| PA | 2 | | 1 | | | 3 |
| UT | 2 | | | | 1 | 3 |
| NC | 3 | | | | | 3 |
| TN | 2 | | | | | 2 |
| VT | 2 | | | | | 2 |
| AR | 2 | | | | | 2 |
| FL | 1 | | 1 | | | 2 |
| IN | 1 | | | | 1 | 2 |
| KY | 2 | | | | | 2 |
| NM | 2 | | | | | 2 |
| MD | 2 | | | | | 2 |
| VA | | | 1 | | | 1 |
| AZ | 1 | | | | | 1 |
| MS | 1 | | | | | 1 |
| Canada | | | | | 1 | 1 |
| Unknown | 48 | | | 1 | 1 | 50 |
| Total | 1651 | 13 | 45 | 2 | 46 | 1757 |

Those wanting to comment were asked to provide the Secretary of Agriculture with additional information for consideration in determining whether or not the rulemaking should be undertaken. The USDA posed 10 questions as a framework to help commentors address their responses to the petition. Those submitting comments were also asked to include any data, analysis, or other empirical evidence that supports their position. Only 25 of the 1,757 comments submitted included some form of data, analysis, or other empirical evidence in support of their position. Instead, most of the comments expressed emotional concerns and anecdotal evidence.

One thousand seven hundred and six comments were submitted from 40 states and the District of Columbia (Table 2). One comment was submitted from Canada and 50 comments could not be identified to a geographic location. Eighty percent of the comments received came from four states; Montana (31 percent), Wyoming (24 percent), South Dakota (17 percent ), and North Dakota (8 percent). The balance of the comments originated in equal proportions from the remaining states. No other state accounted for more than 2 percent of the total number received.

Seventy-three percent of the comments received were in the format of a "form letter" supporting WORC's position. Fifty-nine percent of the total number of comments received were "form letters" from Montana (24 percent), Wyoming (22 percent), and South Dakota (13 percent). Attachment 1 illustrates the locations of WORC's affiliated associations.

Forty of the comments received contained multiple signatures totaling 273 signatures. However, each comment was only counted once in the final tally of comments. These multiple signature comments were submitted on behalf of individuals, county commissioners, associations, and various state, county or local departments of government or elected officials.

Using information provided in the comments, each was categorized by the commentor's stated occupation or affiliation with a trade, association, or business entity. Table 3 provides a tabulation showing each commentor's position on the proposed rulemaking categorized by occupation or affiliation.

Table 2

| Number of Comments and Form Letters By State | | | | |
|---|---|---|---|---|
| State | Number of Comments | Percent of Total | Number of Form Letters | Percent of State's Total Comments as Form Letters |
| MT | 549 | 31.2 | 421 | 76.7 |
| WY | 423 | 24.1 | 389 | 92.0 |
| SD | 294 | 16.7 | 220 | 74.8 |
| ND | 142 | 8.1 | 95 | 66.9 |
| ID | 36 | 2.0 | 17 | 47.2 |
| NE | 28 | 1.6 | 20 | 71.4 |
| NY | 23 | 1.3 | 20 | 87.0 |
| TX | 22 | 1.3 | 9 | 40.9 |
| OR | 16 | 0.9 | 11 | 68.8 |
| CO | 15 | 0.9 | 1 | 6.7 |
| KS | 15 | 0.9 | 1 | 6.7 |
| CA | 14 | 0.8 | 5 | 35.7 |
| DC | 13 | 0.7 | | |
| NV | 13 | 0.7 | 12 | 92.3 |
| MO | 11 | 0.6 | | |
| GA | 8 | 0.5 | | |
| OK | 7 | 0.4 | 3 | 42.9 |
| WA | 7 | 0.4 | 1 | 14.3 |
| IL | 6 | 0.4 | | |
| MI | 6 | 0.3 | | |
| AL | 5 | 0.3 | 5 | 100.0 |
| IA | 5 | 0.3 | 1 | 20.0 |
| MA | 5 | 0.3 | 2 | 40.0 |
| MN | 5 | 0.3 | 2 | 40.0 |
| WI | 4 | 0.2 | | |
| CT | 3 | 0.2 | | |
| NC | 3 | 0.2 | 1 | 33.3 |
| OH | 3 | 0.2 | | |
| PA | 3 | 0.2 | | |
| UT | 3 | 0.2 | | |
| AR | 2 | 0.1 | 1 | 50.0 |
| FL | 2 | 0.1 | 1 | 50.0 |
| IN | 2 | 0.1 | | |
| KY | 2 | 0.1 | 1 | 50.0 |
| MD | 2 | 0.1 | 1 | 50.0 |
| NM | 2 | 0.1 | 1 | 50.0 |
| TN | 2 | 0.1 | | |
| VT | 2 | 0.1 | | |
| AZ | 1 | 0.06 | | |
| MS | 1 | 0.06 | | |
| VA | 1 | 0.06 | | |
| Canada | 1 | 0.06 | | |
| Unknown | 50 | 2.8 | 36 | 72.0 |
| Total | 1757 | 100 | 1277 | |

Table 3

| Position on Petition By Occupation or Affiliation | | | | | | |
|---|---|---|---|---|---|---|
| Occupation | No Position | Support Petition | Support Portions | Oppose Petition | Oppose Portions | Total |
| Agricultural Economist | 1 | | | 3 | | 4 |
| Association (farm) | | 7 | 1 | 2 | | 10 |
| Association (cattle) | 1 | 1 | 1 | 11 | | 14 |
| Association (other) | 2 | 41 | 2 | 4 | | 49 |
| Business | | 18 | | | | 18 |
| Cow/Calf Producer | 4 | 256 | 3 | | 1 | 264 |
| Cattle Feeder | 5 | 59 | | 15 | | 79 |
| Elected Official | 2 | 28 | | 1 | 1 | 32 |
| Livestock Producer | | 166 | | 2 | | 168 |
| Rancher /Farmer | 8 | 49 | 2 | | | 59 |
| Other | 5 | 150 | 1 | 7 | | 163 |
| Unknown | 18 | 876 | 3 | | | 897 |
| Total | 46 | 1651 | 13 | 45 | 2 | 1757 |

Seventy-three comments were received from various associations, national, state and local. The association comments were placed into three categories; "farm associations," "cattle associations," and "other associations." "Farm associations" and "other associations" clearly supported the proposed rule making with 81 percent of their comments voicing support. In contrast, the comments received from "cattle associations" clearly opposed the proposed rulemaking with 79 percent voicing opposition. Table 4 is a tabulation providing a brief description of the membership of each national association submitting a comment and the association's stated position on the proposed rulemaking.

Table 4

| National Associations | | |
|---|---|---|
| **Association** | **Membership** | **Position** |
| American Farm Bureau Federation | Farm organization representing 4.7 million member families in the U.S. and Puerto Rico. | Opposes Petition |
| American Meat Institute (AMI) | Represents packers and processors of beef, pork, lamb, veal and turkey products and their suppliers throughout North America. Approximately 1103 members. | Opposes petition |
| American Veal Association | Represents over 1,300 U.S. veal growers supplying product to meat packers, feed companies, and animal health companies | Opposes Petition |
| Food Marketing Institute (FMI) | 1500 members include food retailers, wholesalers and their customers in the U.S. and 200 international members from 60 countries. | Opposes Petition |
| Farm Aid | Public organization to raise awareness about the plight of the American family farm and provide assistance to farm families | Supports Petition |
| Livestock Marketing Association (LMA) | Represents livestock marketing businesses, including auction markets, dealers and livestock commission firms throughout the U.S. Approximately 1,200 members | Opposes Petition |
| National Meat Association (NMA) | Represents interests of meat packers, processors, and equipment manufacturers and suppliers who provide services to the meat industry. Over 600 members throughout U.S., Canada, Australia, and Mexico | Opposes Petition |
| National Association of State Departments of Agriculture | Represents Commissioners, Secretaries, and Directors of Agriculture form 50 states and 4 territories. | No Stated Position |
| National Cattlemen's Beef Association (NCBA) | Represents 40,000 individual members, 46 state cattle associations and 27 breed organizations | Opposes Petition |
| National Farmers Union | Represents 300,000 family farmers and ranchers | Supports Petition |
| National Farmers Organization (NFO) | Represents independent livestock producers nation wide. | Opposes prohibitions on forward contracts<br><br>Supports prohibitions on packer feeding and ownership |
| National Catholic Rural Life Conference | Information unavailable | Supports Petition |
| National Family Farm Coalition | Information unavailable | Supports Petition |
| Rural Advancement Foundation International, USA | Organization dedicated to the conservation of agriculture biodiversity and socially responsible development of technologies useful to rural societies. | Supports Petition |
| Women Involved in Farm Economics (WIFE) | Organization of Women throughout the U.S. with interests in all Agriculture commodities. | Supports Petition |

There were 1,757 comments received regarding the WORC petition, of which 990 letters had additional or alternative substantive comments. There were other alternative comments such as ranching is not lucrative and ranchers should be able to make a decent living without working in town. Although these types of alternative comments may be true, they offer nothing of substance regarding solutions to industry problems. Of the 990 alternative comments that were classified as substantive, 297 letters had multiple alternative comments. These alternative comments ranged from comments stating that manipulation of market prices is the main reason for low cattle prices to concerns about the affect on producer packing cooperatives to a comment that the definition of captive supply should be redefined. Table 5 lists alternative comments received that either support WORC's petition totally, support a portion of the petition, or commented without taking any position on the WORC petition. Also included is the number of letters received for each comment and the number of comments that were "form letters."

Table 5

| **Alternative Comments** | **Number of Comments** | **Number of Form Letters** |
|---|---|---|
| Manipulation of market price | 495 | 422 |
| Enforce P&S Act | 465 | 380 |
| Oppose packer concentration | 92 | 41 |
| Restore competition | 85 | 65 |
| Retail beef price does not reflect lower cattle prices | 37 | 37 |

The following comments are a sample of other alternative comments received. Some of these comments were received from more than one commentor:

- More and/or better market price information
- Mandatory market price reporting
- Report fixed price contracts
- Oppose beef imports
- Label imported meats
- Regulate imports
- Imported meat should show country of origin
- Report import prices
- Report captive supply
- Prohibit captive supply

- Change definition of captive supply
- Opposes non-competitive captive supply
- Prohibit packers from controlling captive supply beyond 7 days
- Oppose vertical integration
- Future packer mergers should be prohibited
- Repeal ban on interstate shipment of state-inspected meat
- Prohibit packers from buying feedlot cattle using an average price for all cattle
- Oppose 30 minute window for feedlots to market their show list
- Government should force packers to divest all ownership in livestock
- Stop packer ownership of feedlots and ranches
- Packers should not be allowed to feed their own cattle
- Concerned that beef industry is headed toward vertical integration like the poultry industry
- Totally eliminate all forward contracting
- Disputes the theory that there is an over supply of cattle
- Limit the packers market share to 7 percent
- Limit packers board of trade buying and selling
- Packers should report purchase and delivery dates
- Packers should report fixed contract prices
- Public bidding is the best marketing method
- The P&S Act needs to be amended in order to keep up with today's changes in marketing
- Wants level playing field with poultry
- Reverse decision regarding yogurt as a meat substitute
- Require packers to report prices paid, the number of head purchased, the kind and the quality of their purchases
- Require packers, processors, wholesalers and distributors to report the types of product sold, the price and to whom
- Prohibit packers and processors from speculative "short" selling of commodity futures contracts
- Require packers and processors to divest themselves when production capacity exceeds 20 percent of total production share
- Require USDA to report the retail value of all meat and meat products

- Require country of origin identification for all livestock, meat and meat products
- Require all imported or domestic meat, poultry and seafood products to be subject to the same inspection, testing, labeling and standards
- Implementation of a value-based pricing structure for live purchases that reflects potential premiums received by the packer when the meat is sold

There were 45 comments opposed to the WORC petition of which 28 had alternative comments. Of the 28 alternative comments, a majority had multiple alternative comments. None of the comments received opposing the WORC petition were form letters. Some of the comments gave reasons why cattle prices are low and offered ways to improve cattle prices in addition to other statements regarding the industry. Some of these comments were received from more than one person. The following is a majority of the substantive alternative comments:

- Continue to enforce the P&S Act
- Market price reporting should be mandatory
- USDA should do more/better market price reporting
- Imported meat should be labeled
- Industry must work to make beef a more consistent product and a more competitive animal protein
- Elimination of captive supply will work to the detriment of the beef industry
- Cattle prices move inverse to the trend in beef production
- Average price selling encourages the surplus production of below average cattle
- It's the consumers who determine the real value of beef
- Per-capita beef consumption has declined 14 percent in the past 10 years
- Quality of beef has deteriorated during the past several decades
- Change definition of captive supply
- Opposes any limitation of any method of marketing fed cattle
- Supports free market system
- Opposes any type of action that alters current trends toward private business arrangements in the beef industry
- Captive supplies have had a small negative effect on fed cattle prices
- Develop value-based marketing system
- Checkoff monies should be used more for new product development and product quality enhancement
- Value-adding marketing cooperatives should be developed

- Better price discovery
- Concerned about the effect the WORC petition would have on small packers
- Captive supply helps packers control costs, run at near capacity and avoids large price peaks and valleys thus allowing more stable prices
- Large packers pay higher prices for cattle
- Beef is not a consistent product, not convenient to prepare and is high in cholesterol
- More buyers do not necessarily equal higher prices
- The law of supply and demand is working
- Cattle prices have always been cyclical
- Cattle should be sold on a carcass merit basis in order to improve quality
- Implementation of the WORC petition would cause lower cattle prices
- Packer concentration is caused by a combination of declining demand for beef and the need to increase efficiency

Table 6 shows the number of comments that addressed the ten questions posed by USDA in the *Federal Register.* The table also shows the number of comments that provided information for each question with their comments.

Table 6

| **Number of Comments That Addressed Questions Posed by USDA in the Petition** | | |
|---|---|---|
| Question Number | Addressed Question | Provided Information |
| 1 | 439 | |
| 2 | 361 | |
| 3 | 28 | |
| 4 | 346 | 2 |
| 5 | 13 | 4 |
| 6 | 24 | 2 |
| 7 | 1692 | 1 |
| 8 | 47 | |
| 9 | 26 | |
| 10 | 32 | 1 |

## Assessment

### Problem Statement

In preparing their rulemaking petition, WORC believes that less than competitive prices are being paid to fed cattle producers because of increased packer concentration and packers' use of procurement practices commonly referred to as "captive supplies." Concentration (size distribution of firms) is one of several attributes describing industry structure that influence the nature of the competitive process. Captive supply is but one of many industry practices or attributes (conduct) describing firms' behavior. In WORC's petition, their problem statement (pg. 1846) is "[p]ackers' direct ownership and feeding of cattle for slaughter and their procurement of slaughter supplies through forward contracts have decreased prices paid to cattle producers . . . [and] unjustly discriminate against some producers and provide unreasonable preferences to others."

The problem that WORC wishes to address refers to the use of captive supplies, which is an industry practice or behavior issue, rather than a market structure problem. Coordination activities, such as captive supply, are utilized to transfer information, specify quality, transfer risk, and enhance scheduling and timing of production. Furthermore, WORC's proposed regulations only address coordination activities that are part of the actual operation and conduct of individual firms.

WORC's written comment submitted April 11, 1997, on behalf of their own petition, identifies meat packer concentration as the root of the problem. WORC ". . . contends that the current methods of using captive supplies to procure cattle for slaughter are the mechanisms by which the major packers exercise the market power created by the rapid increase in market concentration."

WORC also ". . . seeks to reduce the disadvantages of a concentrated market by instituting rules which will move the market closer to the outcome observed in competitive markets, without going to the extreme of plant divestiture and losing either the advantages of reduced processing costs or the risk reduction packers get when they can ensure the supply of cattle to the plant."

### Legal Assessment

The Review Team asked the Office of the General Counsel (OGC) to explain the difference between the position expressed by WORC and that of OGC regarding the Secretary's authority to issue regulations under the Packers and Stockyards Act (the Act). The difference is primarily that OGC and P&S believe that a causal relationship between the complained of activity and the injury must be shown in order to regulate the activity. Such a relationship would support a finding that the complained of activity is likely to result in a harm or injury that the Act was intended to prevent. WORC, on the contrary, believes that the Secretary is authorized to regulate an activity based only upon a showing of some lesser degree of association between the complained of activity and the injury.

WORC asserts that the Secretary's rulemaking authority is broad and limited only in that the activity or practice must in fact violate the Act, citing *Swift & Co. V. Wallace*, 105 F.2d 848 (7th Cir. 1939). OGC agrees with WORC's assertion.

In its petition, WORC cites *Armour & Company v. United States*, 402 F.2d 712, 717 (7th Cir. 1968) and cases cited therein for the proposition that to find a violation of Section 202(a) and (b) of the Act, the Secretary need only find either some non-competitive intent or some likelihood of competitive injury; there is no requirement to find actual injury. 62 Fed.Reg. 1857. WORC offers its legal opinion that the Secretary has the authority to issue the proposed regulations if the Secretary concludes that the practice violates the Act, and to establish that it does, the Secretary need only find either some non-competitive intent or some likelihood of competitive injury; there is no requirement to find actual injury. OGC agrees with WORC's opinion on this point.

WORC goes further, however, to state that any association between captive supplies and declines in prices paid to producers is sufficient to support a finding of the reasonable likelihood of injury:

> [I]t is not necessary to show any certain degree or level of association between the use of captive supplies and declines in price. To show that there is some adverse impact on producer prices is all that is necessary to provide sufficient basis for the proposed rules. WORC Comment, p.11.

If there is a reasonable likelihood that a harm the statute was designed to prevent will occur, the Secretary can regulate that activity even before any harm results. In the opinion of WORC, the likelihood of competitive injury would be shown by **any** degree of association between captive supplies and decline in prices paid to producers. According to WORC, only a minimal showing of relationship between the allegedly violative practice and the harm likely to result therefrom is necessary to support regulation of that practice by the Secretary.

Practices of packers must violate the Act in order for the Secretary to take enforcement action to prohibit those practices, and as the *Armour* court states, evidence of the likelihood of injury, or predatory intent must be shown to support a finding that such practices violate the Act. The level of association required to prove a likelihood of injury or harm is the critical point of divergence between the opinions of WORC and OGC. OGC has opined:

> In order to prohibit activities of the packers through regulation or to file a complaint citing a violation of section 202, the Department must develop evidence that the packers have either predatory intent or that there is the likelihood that the complained of activity will

> result in injury. (OGC Memorandum to the Chief Economist, June 20, 1996, p.5 (Attachment 2)).

Case precedent supports this statement of the Secretary's authority to regulate packer activities. As the *Armour* court states:

> The clearer the danger of the [likelihood of competitive injury], as when competitors conspire to eliminate the uncertainties of price competition, the less important is proof of [predatory intent]. Conversely, the likelihood of injury arising from conduct adopted with predatory purpose is so great as to require little or no showing that such injury has already taken place.

*Armour*, 402 F.2d 717. WORC has not asserted that the packers have or are conspiring to reduce prices paid to producers through the use of captive supplies (predatory intent). Therefore, to satisfy the *Armour* test, WORC would have to establish a violation of the Act based on evidence of the likelihood of injury. The likelihood of injury must be more than "the mere specter" (*Central Coast Meats v. USDA*, 541 F.2d 1325, 1328, n.2 ($9^{th}$ Cir. 1976)) that WORC avers is sufficient. In order to prohibit captive supply, there must be a likelihood that the complained of activity will result in the kind of injury the Act was designed to prevent. Whether or not that likelihood is present is made under a "reasonable person" standard. If a reasonable person who reviewed the evidence would find that the Act was likely to be violated if the complained of activity continued, then the Secretary could prohibit that activity through the regulatory process.

WORC's position that only a minimal showing of injury or the likelihood of injury is sufficient to authorize rulemaking has not been adopted by the courts. Conversely, the OGC opinion of the Secretary's legal authority under the Act to promulgate regulations is based on case precedent, statutory interpretation and analysis of the legislative history of the Act.

**Economic Evidence Regarding the Proposed Rule**

The vast majority of the comments that support the petition, did not provide any economic data or analysis, but either referred to the petition's economic arguments or to the same economic studies referenced in the petition. Only 25 comments provided economic data, analysis, or assessment. Most of these were comments that opposed the petition's rulemaking. This section presents the economic arguments from the petition, supporting comments (primarily WORC's comment), opposing comments, and other publicly available economic studies. The discussion follows the order of the principal (and related) economic arguments presented in the section "Economic Evidence Supporting the Proposed Rule" starting on page 1848 of the petition.

Impact of Concentration

Quoting the Center for Rural Affairs' report on livestock competition, the petition states (p. 1849) "[t]here is a large body of economic research establishing a high positive relationship between the level of concentration among sellers and prices buyers must pay. About three-fourths of the more than 70 studies undertaken in this field in general conclude that concentration is related to prices (Weiss 1988). Although this research relates to situations in which the concentration level is high among sellers (called oligopoly) rather than among buyers (called oligopsonies), the basic theory is the same on both sides of the market. Higher levels of concentration should result in price levels that favor the more concentrated side of the market--higher prices for concentrated sellers (oligopolies), lower prices for concentrated buyers (oligopsonies)."

The studies referenced in the petition used two major approaches to examining industry competition and concentration, the Structure-Conduct-Performance (SCP) and New Empirical Industrial Organization (NEIO). The Structure-Conduct-Performance (SCP) paradigm attempts to examine the relationships between industry structure (number, size, location, and concentration of firms) and performance (prices paid/received and profitability). The SCP models test the hypotheses that industry structure affects performance. Structure-performance correlations were then indicative of some form of noncompetitive behavior (practice or conduct).

The New Empirical Industrial Organization (NEIO) approach attempts to focus more on the conduct of firms in the industry. This approach starts with an explicit theoretical model of firm optimization, usually profit maximization. Based on an application restricted to an explicit theoretical model, empirical results (through statistical inference of price-taking behavior) are used to assess aspects of market power.

The petition (pp. 1848-49) also quotes Dr. John Helmuth "Economic studies show that when the four-firm concentration ratio gets over 40% firms start to have enough market power to have some control over price. By the time it gets to 80% they have as much power as a monopoly would have." In response, Professor Clem Ward, Oklahoma State University, (p. 4) writes "[t]he petition quotes John Helmuth regarding when the four-firm concentration level becomes problematic. In fact, there is no definitive literature regarding this issue."

Many of the comments supporting the petition (mostly form letters) stated that the big three packers controlled over 80 percent of the cattle market and were manipulating prices. Also, many of the comments in support of the WORC petition cite the petition itself as evidence enough or they cite the same studies reviewed in the petition. A couple of comments cited concentration studies and statistics for other species and agricultural industries. Albert Medvitz discusses concentration in the U.S. lamb industry by citing a Texas A&M University study and the National Farmers Union discusses concentration issues in the livestock, grain, and food processing industries.

Several of the commentors, in particular, the agricultural economists, commented on the petition's lack of references on the most recent and exhaustive studies on the packing industry. Clem Ward laments that "the resulting research reports [GIPSA concentration study] have been virtually ignored by agricultural journalists, industry associations, analysts, and producers."[4] He goes on to say "[m]any contractors involved in the P&SP study have a long history of addressing concentration, pricing, and related industry issues. Our access to data was better for this study than any ever before undertaken. In many cases, data came from a broader segment of the industry, covered a longer time period, and contained information never before available. In short, this was the most thorough work done on these issues to date and the results should not be buried or ignored because some people had preconceived ideas not supported by scientific research." He concludes (p. 121) "Did this study find negative effects from concentration? No. Did this study exonerate packers from questions about use and abuse of market power? No."

Professor Wayne Purcell, Virginia Polytechnic Institute and State University, writes (p. 11) "[e]ven more important is the fact that the 1996 round of studies published under the auspices and via the coordination of the Packers and Stockyards Administration is a result of a massive effort that far exceeds anything that has been possible prior to that date with regard to researching these various issues. Because the industry didn't like the results that came out of those studies, results such as no serious price impact from captive supplies, or no decisive and expected negative relationship between concentration and prices paid for cattle, the research has been largely dismissed and ignored."

Clem Ward writes (pp. 3-4) "[s]everal studies cited and discussed were conducted by me, either alone or in conjunction with others. The petition discusses market shares in national and local markets, citing some of my work. However, the petition fails to address the question of relevant markets anywhere and does not draw on the research pertaining to defining relevant markets in the GIPSA concentration study." He also states (p. 4) "[t]he petition addresses the relationship between packer concentration and prices paid for livestock. My work, which can support both sides of this issue, is cited. The research literature is not consistent on this question. Considerable relevant, recent research is omitted from the discussion. (1850) While citing some of the work by Azzam, the petition does not include some of his more recent work. Implications and inferences from some of my studies and others extend well beyond those that are possible based on the data used and time period covered. The literature review by Azzam and Anderson in the GIPSA concentration study is considerably more thorough and correct and I'll defer to it rather than attempt to indicate the numerous limitations of the review in the petition."

Azzam and Anderson, from their recent exhaustive literature review of packer studies state (p. 123-24), "[i]n summary, because of interpretational difficulties, stemming largely from

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[4]Ward, Clement E. "Important and Ignored Messages from the Packers and Stockyards Program's Concentration Research Study," in *Price Discovery in Concentrated Livestock Markets: Issues, Answers, Future Directions*, ed. Wayne Purcell (Research Institute on Livestock Pricing, Department of Agricultural and Applied Economics, Virginia Tech., Blacksburg, VA, February 1997), p. 110.

using *ad hoc,* reduced-form models, SCP studies of the U.S. meatpacking industry offer no objective benchmark for judging the reasonableness of their empirical assessments of market power. Parameters lack clear, fundamental, economic interpretations to which the analyst can appeal in seeking to validate empirical results. Therefore, the validity of SCP methodology in the assessment of competition in the U.S. meatpacking industry is questionable. . . . an overall conclusion of noncompetitive conduct from the empirical results seems unwarranted. . . . The same is equally true of NEIO models. The key parameter estimates, from which market conduct (in the sense of price-taking behavior) is inferred, are extremely sensitive to the functional forms of the auxiliary demand and supply curves, and of cost or production functions."[5] They conclude (p. 124) "[t]he returns from the considerable investment in SCP and NEIO studies may appear fairly meager; but given measurement and interpretational problems, that is the most one should expect from such studies. We must, finally, reach the decision that the body of empirical evidence from both SCP and NEIO studies is not persuasive enough to conclude that the industry is not competitive."

The most recent and exhaustive review of the relevant economic literature conducted by Azzam and Anderson confirmed the earlier findings of the 1990 GAO report on beef industry concentration. The 1990 GAO concluded, ". . . our review of empirical studies did not lead us to draw any overall conclusions regarding the impact that market concentration in the beef-packing industry has on the prices packers paid for steers and heifers in the 1980s. Industry analysts and experts we spoke with said that recent packer concentration has not lowered steer and heifer prices in the 1980s. Some industry analysts believe that cattle prices may be higher because the increased efficiencies that accompanied increased concentration enabled beef packers to pay more for cattle. . ."[6]

Schroeder, et al. based on numerous meat industry studies state, "[t]wo questions that surfaced recently relative to packer concentration and captive supplies are: (1) whether recent declines in fed cattle prices have been created by packer captive supply? and (2) whether recent high margins of beef packers are related to captive supply levels? The answer to each is no."[7]

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[5]Azzam, Azzeddine M. and Dale G. Anderson. *Assessing Competition in Meatpacking: Economic History, Theory, and Evidence*. Grain Inspection, Packers and Stockyards Administration, U.S. Department of Agriculture, GIPSA-RR 96-6, May 1996.

[6] United States General Accounting Office, *Beef Industry: Packer Market Concentration and Cattle Prices*. GAO/RCED-91-28, December 1990.

[7] Schroeder, Ted C., Clement E. Ward, James Mintert, and Derrell S. Peel. "Beef Industry Price Discovery: A Look Ahead," in *Price Discovery in Concentrated Livestock Markets: Issues, Answers, Future Directions*, ed. Wayne Purcell (Research Institute on Livestock Pricing, Department of Agricultural and Applied Economics, Virginia Tech., Blacksburg, VA, February 1997), p. 63.

Impact of Packer Feeding on Prices

The petition (p. 1850) cites the findings of a "... Packers and Stockyards Division study that examined the price impacts from packer-feeding in the mid-1960s explains how an oligopsonistic packer that feeds its own cattle can adversely affect prices paid to other producers for slaughter supplies."[8] The petition then concludes that "[t]his study found that packer-fed cattle caused a significant decline in the local market price when the packer had some oligopsonistic power."

Clem Ward comments (p. 3) "[t]here is no evidence that packer feeding has increased significantly in recent years. GIPSA data I believe suggests packer feeding has remained a relatively small proportion of fed cattle marketings over the past decade." He also states (p. 4) that "[t]he petition bases much of its argument on a single study conducted 35 years ago. It ignores more recent research from the GIPSA concentration study on captive supply impacts." The GIPSA study that Clem Ward refers to is the captive supply study that states (p. 81) "[p]rices for packer-fed cattle were not significantly different than cash market cattle."[9] The study also concludes (p. 82) "[t]he overall short-run impact on fed cattle transaction prices from captive supply deliveries or inventories based on the this study was small and would be virtually impossible to observe in raw transaction price series."

Forward Contract Impact on Price

The WORC petition cites two studies that examined forward contracts. The first focussed on southwest Kansas marketing region during six months in 1990. The second is the GIPSA concentration studies. WORC states (p. 1850) that these "studies have found that forward contracting for fed cattle supplies has a depressing effect on prices."

Clem Ward states (p. 4) "[t]he literature on impacts from forward contracting on balance suggests decreased prices result as forward contracting increases. However, the magnitude of the impact varies considerably based on data period and coverage. When the petition cites the more recent work in the GIPSA study on captive supplies, the much smaller magnitude of negative impacts found was not reported. Increases in deliveries of cattle from the inventory of forward contracted cattle were associated with \$0.03-\$0.05/cwt. (dressed weight basis) lower cash market fed cattle prices. The petition correctly reports findings from the GIPSA study indicating that contracting increased when cash prices and cash price variability increased. Rather than

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[8] 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.

[9] Ward, Clement E., Ted C. Schroeder, Andrew P. Barkley, and Stephen R. Koontz. *Role of Captive Supplies in Beef Packing*, Grain Inspection, Packers and Stockyards Administration, U.S. Department of Agriculture, GIPSA-RR 96-3, May 1996.

concluding that this behavior by packers 'is likely to have the effect of manipulating prices,' this finding simply verifies that packers behave rationally in their use of forward contracts."

Wayne Purcell writes that "[t]he findings from these efforts [GIPSA concentration study]... indicated either no statistically significant impact on prices [Purcell's emphasis] paid or coefficients on measures of captive supplies, while statistically significant because of the large number of observations, were relatively meaningless in an economic context." [Purcell's emphasis] (pp. 3-4)

Use of Formula-Priced Forward Contracts

Addressing the use of forward contracts and formula pricing arrangements, the WORC petition for rulemaking follows closely the Secretary of Agriculture's Advisory Committee on Concentration in Agriculture minority report.[10] One of the petition's allegations is price manipulation. The petition (pg. 1847), quoting from the USDA Advisory Committee minority report, states "[w]hen the futures market is used to establish a base, the packers are heavy players on both sides. Their futures market activities, whatever the motivation and whether the packers are long or short in the market, affect the price they pay for formula cattle and, ultimately, for negotiated sales." WORC alleges that packers manipulate futures market prices to lower prices paid in the cash market.

The Commodity Futures Trading Commission (CFTC) investigated similar allegations that the largest meat packers manipulated futures market prices during the period April 4 through June 30, 1994. The CFTC issued two separate reports based on their investigation. The first report was on CFTC's analysis of large trader position data that examined end-of-day futures positions and day-to-day position changes.[11] This report concluded (p. 6) "[t]hese overall data do not support an assertion that beef packers engaged in a pattern of consistent selling of live cattle futures or that their futures trading was a principle contributor to the fall in cattle prices that occurred from mid-April to late May." The second report was on CFTC's packers intraday trading analysis.[12] This analysis was conducted to see if packers manipulated futures prices within a trading day to lower cash prices that same day. The second report concluded that packers did not engage in manipulative intraday trading activity, stating (p. 5) "[p]acker day trading generally was not a large portion of their total trading, representing less than 11 percent of all packer

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[10] *Concentration in Agriculture: A report of the USDA Advisory Committee in Agricultural Concentration*, Agricultural Marketing Service, USDA, June 1996, pp. 29-36.

[11] Commodity Futures Trading Commission, Report to Congressional Oversight Committees and National Cattlemens Association. Market Surveillance Section, Division of Economic Analysis, CFTC, Washington, DC, June 20, 1994.

[12] Commodity Futures Trading Commission, *An Analysis of Intra day Trading of Beef Packers in Live Cattle Futures*. Market Surveillance Section, Division of Economic Analysis, CFTC, Washington, DC, September, 1994.

trading." The report also stated (p. 6) "[o]ver the period, packers on average were net buyers of futures on each day of the week. Moreover, total sales on each weekday over the period varied little. . ."

WORC also contends in their comment (p. 6) that "[f]orward contracts that are not traded publicly give preferences to those producers who are offered contracts over those who are not." In the petition (p. 1851), WORC states that ". . . marketing agreements as defined by the report [GIPSA concentration study] are included in the definition of forward contract in the proposed rule. . ." They also state (p. 2) that "[u]ndue preference or discrimination and the tendency to manipulate prices are inherent in privately negotiated captive supply agreements, as the case GIPSA has brought against IBP for its arrangements with selected Kansas feeders has shown."

GIPSA's complaint and subsequent hearing before a USDA Administrative Law Judge alleges that IBP, inc. has violated sections 202(a) and (b) of the Packers and Stockyards Act by paying a preferential price for fed cattle to an exclusive group of Kansas feedlots. GIPSA's complaint did not allege price manipulation as suggested by WORC.

The WORC petition (p. 1851) states "[t]he report states: Small firms use spot markets almost exclusively, whereas the Big Three packers are more likely to use alternative procurement methods." WORC continues, "[t]he report clearly demonstrates that the Big Three packing firms and the largest feedlots account for the vast majority of the formula-priced agreements. . . This data suggests that in practice the largest feedlots have preferential access to marketing agreements -- and therefore to an assured market for their cattle. And that this preferential status does not only ensure market access in the long term but also provides a price advantage not available to producers not offered the marketing agreements." WORC also alleges (p. 1847) that smaller feeders are ". . . most easily pressured into exploitative, captive supply contract arrangements." They also suggest (pp. 1847-48) that because of "severe discounting" and "volatile" market prices, retained ownership by cow/calf producers ". . . involves an intolerable and unnecessary degree of price risk."

Clem Ward writes (p. 3), ". . . I know of no evidence that smaller feeders are 'pressured into exploitative, captive supply contract arrangements.' In fact, the GIPSA concentration study verified that most forward contracting and marketing agreement arrangements are between larger packers and larger feeder, not smaller feeders." Ward continues. ". . . there is no evidence of 'severe discounting of feeder prices in response to the volatility of the fat cattle market.' There are clear economic reasons to discount input prices (feeder cattle) where possible in light of increased volatility, both for outputs (fed cattle) and other inputs (grain). Such volatility gives rise to contractual relationships that benefit both buyers and sellers. This petition would have little effect on retained ownership opportunities.. . . In fact, reducing the use of forward contracts might increase price volatility and reduce the attractiveness of retained ownership."

Based on the concentration study that larger packers and feedlots were general users of forward contracts and marketing agreements, results do not show causation or preferential treatment. The concentration study analyzed individual transactions data (including prices for forward contracted, marketing agreement, and packer fed cattle) for 43 beef packing plants that slaughtered at least 75,000 steers and heifers per year. As such, the captive supply use of smaller packers was not examined. Conclusions about the use of captive supplies cannot be drawn beyond the scope of the concentration study data and the study's results.

Clem Ward writes (p. 4), "[t]he petition draws on findings from the GIPSA concentration study to incorrectly conclude 'that in practice the largest feedlots have preferential access to marketing agreements.' . . . Higher prices paid by larger packers to larger feeders relate in part to the increased plant efficiency resulting from having consistently large supplies of cattle available for slaughter. Throughout the petition, any research related to plant efficiency is omitted. Yet cost of operation is critical in understanding the competitiveness of rival firms in a margin business such as meatpacking."

In their comment (p. 6), WORC believes that packers dictate delivery times for formula priced marketing agreement cattle to manipulate prices, stating "[f]orward contracts that do not contain firm-base prices establish the incentive for packers to manipulate captive supply inventory and delivery levels..." Referring to marketing agreements and alliances, Schroeder, et.al. state that it is the cattle feeders, not packers, decision when to deliver cattle, writing "[f]requently, cattle feeders determine the day or week cattle will be delivered, giving them more control over deliveries and the terminal date than in cash market trades."[13]

Grande Ranch Company comments that "[t]he vast majority of formula price agreements in place in the industry today have been proposed by the feeders/producers as ways of generating premium prices for above average cattle. They are not the idea of the packers. . . In the Northwestern corner of the country, while there are smaller packers, one packer (IBP) dominates the market. The majority of cattle in this area are sold to IBP on a formula based on the weekly averaged price in areas of the country (such as Kansas) where many packers competitively bid the fed cattle. By using this formula agreement, feeders get access to a series of premiums and discounts for quality, but more importantly, they get access to a base established by competitive bidding."

Kevin Brockhoff of BeefEx (the Beef Exchange electronic market) writes (p. 4) ". . . eliminating basis contracts would be of benefit to the majority of producers who do not understand basis trading." However, Wayne Purcell (p. 6) writes ". . . it is very important for the producer to be able to determine the time of pricing. A basis contract that ties the final price to the futures contract and leaves the flexibility of timing of the final price to the producer can be a very effective forward pricing instrument . . ." Based on this, he continues by saying (p. 7) ". . . I

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[13]Schroeder, Ted C., Clement E. Ward, James Mintert, and Derrell S. Peel. "Beef Industry Price Discovery: A Look Ahead," in *Price Discovery in Concentrated Livestock Markets: Issues, Answers, Future Directions*, ed. Wayne Purcell (Research Institute on Livestock Pricing, Department of Agricultural and Applied Economics, Virginia Tech., Blacksburg, VA, February 1997), p. 37.

prefer the basis contract to the formula price contract" and (p. 6) ". . .would be inclined to want to see discontinuance of the formula price contract."

Captive Supply Decisions and Impact on Price

The WORC petition (p. 1851) contends that the GIPSA concentration study ". . . does demonstrate that the use of captive supply procurement methods in the cattle industry causes a decline in the cash-market price for cattle. It shows that packers increase their captive supply inventories when cash-market prices increase. The report also demonstrates that as packers increase the deliveries of captive supplies, the cash-market prices decline." However, WORC's comment (p.10) even questions causality between captive supplies and prices, stating ". . . the negative associations shown for all three captive supply types to spot prices say nothing about causality..."

Clem Ward states (p. 4) "[t]he petition correctly reports findings from the GIPSA study indicating that contracting increased when cash prices and cash price variability increased. Rather than concluding that this behavior by packers 'is likely to have the effect of manipulating prices,' this finding simply verifies that packers behave rationally in their use of forward contracts. . . In fact, while many of our findings suggested negative relationships between captive supplies and cash market prices, the magnitude of those negative effects were small. While statistically significant, they may not be economically significant."

Wayne Purcell writes that "[t]he findings from these efforts [GIPSA concentration study] ...indicated either no statistically significant impact on prices [Purcell's emphasis] paid or coefficients on measures of captive supplies, while statistically significant because of the large number of observations, were relatively meaningless in an economic context." [Purcell's emphasis] (pp. 3-4) He continues by stating that the GIPSA concentration study ". . . found that when captive supply cattle were more readily available at larger percentage levels, the slaughtering facilities operated more nearly at capacity and with less variation around their designed capacity level. In turn, the studies showed that when packing plants operated consistently at and around designed operating levels, higher prices were paid for cattle. . . It would appear, then, that one of the possible ramifications of captive supplies is to cut off the price peaks and fill up the price valleys and make prices paid for cattle more stable over time than they would be in the absence of that procurement practice. This does not argue, however, that the mean price paid for cattle is reduced by captive supplies. The research says that captive supplies are not in any economically significant way related to lower cattle prices, meaning changes in captive supplies are not an important factor in explaining short-run variations in fed cattle prices."

Impact of Number of Buyers on Price

The WORC petition summarizes several studies that examined the number of bidders and bids on prices. The results from these studies generally support the view that more buyers and bidders increase livestock price.

Wayne Purcell (p. 6) contends that if the petition's regulations are enacted that ". . . it would prompt some disinvestment by the current big 3 packers. . . .[and] that capacity [would] move into the hands of more disaggregated smaller packer/processors who inevitably are going to face higher costs of operation. [Because] the economies of size in packing and processing are clearly very large and very important . . . [t]his would probably bring at least some 'window dressing' competitiveness in the industry because it has the potential to raise the number of bids a particular producer might garner. The question, then, becomes one of whether or not more bids from higher cost, smaller operations result in better prices to cattle producers and cattle feeders than do fewer bids from larger, more cost effective operators."

Alternatively, if the larger packers do not divest from the industry, because of their economies of size and cost efficiency, smaller higher cost packers may be forced to exit the industry. This would result in a more concentrated industry and the potential for fewer bidders. This view is shared by several commentors. Don Anderson of the Colorado Cattle Feeders Association writes, "[r]estricting procurement practices would likely inhibit the ability of small- and mid-sized packers to compete and could actually contribute to increased packer concentration." Lynn Cornwell of the Montana Stockgrowers Association believes that the petition ". . . could actually contribute to more packer concentration in that bigger packers could bid on smaller 'nitch market' cattle contracted by smaller packers or alliances." Cindy Garretson-Weibel with the Wyoming Stock Growers Association suggests "[i]mplementation of the rules asked for by WORC could adversely affect small packers and branded beef promotion efforts, which would only serve to further increase packer concentration."

Conclusion from Economic Studies

WORC's petition (p. 1852) argues "[t]he economic studies discussed above provide substantial evidence supporting findings that the current use of forward contracts [including marketing agreements] and packer-owned cattle to procure captive slaughter supplies are likely to have the effect of manipulating prices by depressing those prices paid to cattle producers. These studies also support a finding that the trading of forward contracts and packer-owned cattle in a public market designed to encourage more bidders on cattle is likely to improve prices paid to producers."

Clem Ward's (p. 5) reaction to this section of the petition is that "[t]he first sentence in this section is simply wrong. Economics research does not 'provide substantial evidence supporting findings that the current use of forward contracts and packer-owned cattle to procure captive slaughter supplies are likely to have the effect of manipulating prices by depressing those prices paid to cattle producers.'" Ward also states (p. 2) ". . . the intent appears to be protection of a declining segment of the livestock industry, i.e., public markets. Public markets have played and continue to play an important role in the livestock economy. However, there is no per se reason to single them out for protection and alter the evolution of markets. Direct marketing of fed cattle has replaced public marketing for sound economic reasons, not because anyone imposed them onto the marketplace." Wayne Purcell also states (p. 10) [m]uch of the thrust of the petitioner's proposed changes is based on the notion that unless prices for cattle are negotiated in some sort of public arena, we can't possibly have effective price discovery. <u>This assumption, assertion, or whatever it may be called, is very wrong</u>. [Purcell's emphasis] . . . Just negotating the price of cattle on a liveweight basis in an auction arena, any electronic system, or any other publicly accessible price arena in no way guarantees effective and efficient price discovery."

Schroeder, et al. conclude "[t]wo questions that surfaced recently relative to packer concentration and captive supplies are: (1) whether recent declines in fed cattle prices have been created by packer captive supply? and (2) whether recent high margins of beef packers are related to captive supply levels? The answer to each is no."[14] Clem Ward also concludes "Did this study [GIPSA concentration study] find negative effects from concentration? No. Did this study exonerate packers from questions about use and abuse of market power? No."[15]

Wayne Purcell states (p. 5) "[m]y overall conclusion is that captive supplies that allow meat packers to schedule flows of cattle into the plants in future weeks or months are not a major factor in the relatively low cattle prices of recent years." Despite his reservation regarding formula prices, he goes further, (p. 8) "'Is regulatory action needed?' My response is no." He also writes, (p. 5) "I think the proposed rules are both too broad and too restrictive. I don't see the justification for this type of constraint on how the seller and buyer can interact in the important fed cattle complex."

The Secretary of Agriculture charged the Advisory Committee on Concentration in Agriculture (p. iii) to review market concentration in meat packing industry, including the effects of procurement practices (captive supplies) and concentration on prices for slaughter cattle.[16] The chairman of the Advisory Committee, Dr. Daniel I. Padberg, Professor Emeritus of Agricultural

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[14] Schroeder, Ted C., Clement E. Ward, James Mintert, and Derrell S. Peel. "Beef Industry Price Discovery: A Look Ahead," in *Price Discovery in Concentrated Livestock Markets: Issues, Answers, Future Directions*, ed. Wayne Purcell (Research Institute on Livestock Pricing, Department of Agricultural and Applied Economics, Virginia Tech., Blacksburg, VA, February 1997), p. 63.

[15] Ward, Clement E. "Important and Ignored Messages from the Packers and Stockyards Program's Concentration Research Study," in *Price Discovery in Concentrated Livestock Markets: Issues, Answers, Future Directions*, ed. Wayne Purcell (Research Institute on Livestock Pricing, Department of Agricultural and Applied Economics, Virginia Tech., Blacksburg, VA, February 1997), p. 121.

[16] *Concentration in Agriculture: A report of the USDA Advisory Committee in Agricultural Concentration*, Agricultural Marketing Service, USDA, June 1996, pp. 29-36.

Economics, comments (p. 1) that ". . . we considered the evidence available to us, and what we could produce from hearings. . ." He continues, "[s]hould our industry have restrictive rules placed on it? As it turned out, the majority answered, **No** ..." [Padberg's emphasis]

## General Economic Conditions

Historically, the cattle industry has suffered through periods of cyclically low prices. Industry participants and analysts have often pointed to many general economic factors for observed price levels. WORC states in their comment (p. 2), "[t]he increases in market concentration and use of captive supplies are not the only factors affecting prices paid to producers." They also write in their comment (p. 12), "[a]nalysts who seek to minimize the impact of captive supplies on prices often do so by showing that normal supply and demand factors are at work and responsible for changes in prices. It does not follow from this that captive supplies do not have an effect on prices, unless it is shown that all of the change in prices is caused by supply and demand forces. Of course, it is perfectly possible for the supply of cattle, the price of corn, industry concentration and the level of use of captive supply all to effect the price of fed cattle at one time." However, WORC did not specifically address industry supply and demand factors in the petition. Also, the petition did not address all of the economic benefits and reasons feeders and packers use various marketing arrangements. Most of WORC's discussion focusses on their allegations of economic harm.

General economic conditions of supply and demand factors are important determinants of price. There are also many benefits for using various marketing arrangements not specifically addressed. Several comments presented supply and demand analyses and reasons for using captive supply arrangements. The following sections present arguments on these topics.

### Supply and Demand

Several comments stipulate that declining demand for beef is a primary problem for the industry. Andrew Gottschalk (p. 1) writes "Beef demand peaked during the spring of 1979 and remains in a continuous downtrend." Gottschalk also states "[t]his primary problem of declining beef demand is precipitous and ongoing." Wayne Purcell (p. 5) concurs, stating that decreased beef demand ". . . is one of the long-term structural-type changes in the industry that has prompted lower fed cattle prices." Purcell continues by writing (p. 10) ". . . the long-term villain in the beef business that is responsible for the often desperately low prices in recent years is the sustained decreases in demand. Those decreases have occurred primarily because the product offering made available to the consumer is outdated, outmoded, and totally lacking in adherence to modern consumer preferences." Andrew Gottschalk (p. 2) says "[t]here is no disagreement with the fact that the quality of beef has deterioated during the past several decades." Jerry Bohn of the Kansas Livestock Association (p. 2) also says ". . . declining beef demand and loss of market share remains the most significant challenge faced by all beef producers." Andrew

Gottschalk (p. 1) suggests that "[c]umulatively, each consumer's decision has led to a 14% decline in per capita consumption of beef during the past ten years (equivalent to losing 36 million consumers) and a 28% decline since beef production peaked in 1976."

Beef's loss of market share to competing meats has hurt the industry. Tim Hammonds with the Food Marketing Institute says "[t]he competition to beef is not found within the beef distribution system. It comes form alternative meat sources -- chickens, turkeys, pork, lamb, fish, and shellfish." Andrew Gottschalk says (p. 2) ". . . during the period form 1990 - 1996 combined meat supplies increased 13.2 billion pounds. Of this increase, beef comprised only 21% (2.8 billion pounds) of the combined 13.2 billion pound production gain. The competing meats, reflecting consumer [Gottschalk's emphasis] preference, comprised 79% (10.4 billion pounds) of the combined increase in beef, pork and poultry production during the 1990 - 1996 period. Thus, the shrinkage in beef's market share continues." Wayne Purcell states (p. 5) that per-capita beef consumption "has declined from near 95 lbs. in 1976 to just above 65 lbs. in the early 1990s."

On the production (supply) side, Andrew Gottschalk writes (p. 2) "[a]dding confusion to this issue, cattle inventories declined from 132 million head during 1975 to 103.5 million in 1996, a 21.6% decline. Ignored by the petitioners is the basic [Gottschalk's emphasis] fact that during this period, average carcass weights increased from 579 pounds to a peak of 709 pounds in 1994. This represents a carcass weight gain of 22.4%, which offsets the entire reduction in cattle inventories. Thus, during the past year, commercial beef production at 25.4 billion pounds nearly equaled the previous peak beef production during 1976 at 25.7 billion pounds. The level of beef production in 1996 was achieved with a cattle inventory approximately 25 million head (103.5 million vs. 128.0 million head) smaller than in 1976."

**Reasons Packers and Feedlots Use Captive Supplies**

Several commentors also discussed the reasons for and benefits of captive supply arrangements in the livestock industry. Buyers and sellers enter into various marketing arrangements expecting to benefit in some manner. In the cattle industry, Clem Ward states (p. 6) ". . . that many times feeders have approached packers regarding alternative means of marketing and pricing fed cattle." Larry Ragains of the Idaho Cattle Association states that "[c]aptive supply and various forms of price discovery have been developed over time for inventory and risk management by both producers and packers."

There are several benefits for cattle feeders and packers to enter into various marketing arrangements. Schroeder, et al.[17] write, "[p]rimary benefits to cattle feeders may include improved risk management, access to more financing options, guaranteed buyer for cattle,

[17] Schroeder, Ted C., Clement E. Ward, James Mintert, and Derrell S. Peel. "Beef Industry Price Discovery: A Look Ahead," in *Price Discovery in Concentrated Livestock Markets: Issues, Answers, Future Directions*, ed. Wayne Purcell (Research Institute on Livestock Pricing, Department of Agricultural and Applied Economics, Virginia Tech., Blacksburg, VA, February 1997), p. 57-58.

improved opportunity for carcass quality premiums, and reduced marketing costs. Packers' primary benefits include securing cattle slaughter needs so they can operate large packing plants near capacity, having more control over the type and quality of cattle to fill their plants, and reducing procurement costs." They also suggest "[s]ome captive supply agreements are also a step toward value-based marketing of live cattle. Captive supply agreements that contain price adjustments for varying carcass quality attributes provide cattle feeders increased incentives to produce cattle possessing desired quality characteristics."

Andrew Gottschalk agrees by writing "[s]o called 'captive supply' cattle circumvent the latter problem, [average pricing of cattle] as producers are paid for the quality of their production with premiums and discounts paid on carcass merit. Average pricing occurs when feedlots sell a pen of high quality cattle together with a pen of lower quality cattle at a single price. Andrew Gottschalk (p. 2) argues that "'[a]verage pricing' only encourages the surplus [Gottschalk's emphasis] production of below [Gottschalk's emphasis] average product."

## Effect On Current Procurement and Pricing Methods

The WORC petition is requesting rules that would restrict or limit the industry's use of common procurement and pricing methods. The petition would restrict packers from procuring cattle for slaughter through the use of a forward contract (including marketing agreements), unless the contract contains a firm base price that can be equated to a fixed dollar amount on the day the contract is signed and the forward contract is offered or bid in an open, public manner. The petition also restricts packers from owning and feeding cattle, unless the cattle are sold for slaughter in an open, public market.

### Fed Cattle Industry Procurement Methods

#### Spot Market

Spot market transactions are purchases directly from the feedlot or seller at a fixed price at the time the transaction is agreed upon. The cattle are usually picked up by the packer within 1 to 7 days. Spot market transactions would not be affected by the proposed rules.

#### Marketing Agreements

Marketing agreements are normally long-term arrangements between a packer and a feedlot in which the packer agrees to purchase cattle offered for sale by the feedlot for the period of the agreement. Cattle procured by marketing agreements are generally priced by using a formula agreed upon by both the packer and feedlot. Essentially, the WORC petition eliminates marketing agreements by disallowing formula pricing. This is because, if applied literally to a marketing agreement contract, the rule requiring a firm base price would require the buyer and seller to agree upon a firm base price at the time the cattle are contracted. This would be possible, but somewhat impractical and risky given the long-term nature of the agreement.

Feedlots that utilize marketing agreements usually deliver cattle to the packer on a regular basis. There is almost a continuous flow of cattle going from the feedlot to the packer. Negotiating price on every delivery would possibly disrupt this flow of cattle, and defeat at least one of the reasons for having an agreement, i.e., a dependable supply of and/or outlet for cattle. The marketing agreement not only allows the stream of cattle to keep flowing out of the feedlot and into the plant but it also offsets the dilemma that the feedlot, and the packer would face in trying to guess what the market price will be at some future date. Under the proposed WORC rules, neither the packer nor the feedlot could count on any individual group of cattle entering the flow, until a price was agreed upon.

Packer Feeding

Packer owned or fed cattle are cattle that a packer owns and is feeding either at a custom feedlot or at a feedlot owned and controlled by the packer. These are usually cattle that the packer has procured as feeders and placed on feed. However, they could be cattle that the packer procured during some stage of their feeding period and is finishing them to a heavier weight and hopefully to a higher grade. The WORC proposed rules likely would discourage this method of procurement because it would require packers to offer their own cattle for sale publicly. This would cause packers to incur a marketing cost which would add to their overall cost of procurement.

Forward Contracts

Forward contracts are contracts to purchase cattle, which a packer enters into with a seller and in which both parties agree that delivery of the cattle will occur at some future date. (Basis contracts are a form of forward contracting as well as a pricing method) The rules proposed by the WORC petition would allow only contracts which specified a fixed price or a fixed base price.

## Fed Cattle Industry Pricing Methods

Formula Price and Basis Contracts

Basis contracts are so called because they utilize the futures market to establish a base price from which the contract price is computed. The difference between the futures price and the contract price is referred to as the basis. Although basis contracts are never written with a firm base price, they always have a firm "basis" at the time the cattle are contracted. If applied literally to a basis contract, the rule requiring a firm base price would mean that the price must be tied to the sale of a futures contract or contracts on the day the cattle are contracted to the packer. Under the present method, timing of the pricing decision is in the hands of the seller. Typically, the seller has several weeks in which to select the day on which to price the cattle. Sellers always try to price the cattle on a day which favors themselves. Conversely, the price isn't important to most packers because they usually hedge these cattle as soon as the seller picks a futures day. If the cattle are hedged, the price is irrelevant to the packer, because it becomes more or less an even trade and the only thing relevant is the basis.. The WORC petition requiring a firm base price would effectively eliminate basis contracts.

Formula Priced Cattle

On page 1847 of the petition for rulmaking submitted by WORC it states " 1. Restrictions on use of forward contracts . No packer shall procure cattle for slaughter through the use of a formula or basis price forward contract." Later on the same page it states that: " packers and producers could still enter into contracts in which the price is set through a formula if there is a firm base price which can be equated with a specific dollar amount when the contract is entered into." The WORC proposed rules would eliminate all types of formula priced transactions including Carcass Weight, Grade and Yield and so called Grid sales unless they are tied to a firm base price. It would also eliminate liveweight transactions which are based off market reports.

## Conclusions

The vast majority of the comments supported the WORC rulemaking petition to restrict the use of captive supply arrangements. A large percentage of these comments were form letters that referred to or endorsed the petition's arguments.

The power of the economic, logical and empirical arguments was the primary basis for developing our conclusions, rather than the number of comments supporting or opposing the petition. The team finds no compelling evidence to suggest that anything other than basic economic conditions determined the general price level of the fed cattle market. After weighing the economic arguments supplied by WORC, commentors (supporting and opposing), and other information assembled by the team, we could not definitively conclude that spot prices were affected or manipulated by captive supplies. Furthermore, the economic evidence does not indicate the use of captive supplies is a violation of the Act. Also, there was insufficient evidence to show that implementation of the petition would improve or solve WORC's stated problems. Therefore, we conclude that it is unnecessary and unwarranted to effectively ban the industry's use of various procurement (marketing agreements, forward contracts, and packer fed) and pricing (basis price and formula price) methods that the industry relies on to assure packers a reliable source of cattle, assure feeders an output market, a mechanism to transfer risk, and the opportunity to reduce transactions costs.

WORC wants GIPSA to selectively regulate the livestock industry by requiring only the fed cattle segment of the beef industry to comply with their petition. It would be unfair to the sellers of fed cattle and their lenders to limit the ways in which they can market their product. It should be noted that hog, lamb and special-fed veal producers rely heavily on the use of marketing agreements and contracts without fixed prices. These producers select the type of contract or marketing agreement that they feel most comfortable with. Fixed price contracts have always been an option available to sellers of fed cattle, however, sellers might prefer to price their livestock using an alternative method, i.e. formula or basis pricing. Some sellers are reluctant to commit to a fixed price for their fed cattle with a delivery date 2 to 4 months in the future without some mechanism for offsetting that price risk. Livestock producers, including sellers of slaughter cattle, use marketing agreements and contracts other than fixed price, to market their livestock because they choose to. The buyer and seller enter into a contract or marketing agreement freely, both expecting to benefit in some manner.

## Attachment 1

Attachment 1 is a set of three maps illustrating the locations and statistics of WORC's affiliated associations presented in Tables 1 and 2 in the report. These are available upon request.

**Attachment 2**

Attachment 2 is not being made available.

# ATTACHMENT B

January 2007

# GIPSA Livestock and Meat Marketing Study

Contract No. 53-32KW-4-028

## Volume 1: Executive Summary and Overview
**Final Report**

Prepared for

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# Abstract

Over time, the variety, complexity, and use of alternative marketing arrangements (AMAs) have increased in the livestock and meat industries. Marketing arrangements refer to the methods by which livestock and meat are transferred through successive stages of production and marketing. Increased use of AMAs raises a number of questions about their effects on economic efficiency and on the distribution of the benefits and costs of livestock and meat production and consumption between producers and consumers. This final report focuses on AMAs used in the beef, pork, and lamb industries from the sale of live animals to final meat sales to consumers and addresses the following parts of the Grain Inspection, Packers and Stockyard Administration (GIPSA) Livestock and Meat Marketing Study:

- Part C. Determine extent of use, analyze price differences, and analyze short-run market price effects of AMAs.
- Part D. Measure and compare costs and benefits associated with spot marketing arrangements and AMAs.
- Part E. Analyze the implications of AMAs for the livestock and meat marketing system.

This final report follows the publication of an interim report for the study that used qualitative sources of information to identify and classify AMAs and to describe their terms, availability, and reasons for use. The portion of the study contained in this final report is based on quantitative analyses using industry survey data from producers, feeders, packers, processors, wholesalers, retailers, and food service operators; transactions data and profit and loss (P&L) statements from packers and processors; Mandatory Price Reporting (MPR) data; and a variety of other published data sources.

The final report contains separate volumes that describe the data collection methods and results (Volume 2) and the analysis results for the beef industry (Volume 3), the pork industry (Volume 4), the lamb industry (Volume 5), and meat distribution and sales (Volume 6). Volumes 3 through 6 address the effects of AMAs on prices, costs, quality, risk, and consumers and producers, to the extent feasible given the availability of data.

The principal contributors to this study are the following:

RTI International Management, Data Collection, and Analysis (across all species):

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# Contents

# Executive Summary

As part of the congressionally mandated Livestock and Meat Marketing Study, this volume of the final report presents the results of analyses of the effects of alternative marketing arrangements (AMAs) in the fed cattle and beef, hog and pork, and lamb and lamb meat industries. This final report focuses on determining the extent of use of AMAs, analyzing price differences and price effects associated with AMAs, measuring the costs and benefits associated with using AMAs, and assessing the broad range of implications of AMAs. The analyses in this volume were conducted using results of industry interviews, industry survey data, transactions and profit and loss (P&L) statement data from meat packers, Mandatory Price Reporting (MPR) data, and data from other publicly available sources. Analyses are limited to the economic factors associated with AMA use, and the report does not analyze policy options or make policy recommendations.

In this report, AMAs refer to all possible alternatives to the cash or spot market. AMAs include arrangements such as forward contracts, marketing agreements, procurement or marketing contracts, production contracts, packer ownership, custom feeding, and custom slaughter. Cash or spot market transactions refer to transactions that occur immediately, or "on the spot." These include auction barn sales; video or electronic auction sales; sales through order buyers, dealers, and brokers; and direct trades.

It is important to note that the data collection period for the study, October 2002 through March 2005, was an unusual time for the U.S. meat industry. The beef industry experienced a turbulent market because of the discovery of bovine spongiform encephalopathy (BSE) in North America. The initial BSE case in Canada in May 2003 stopped imports of live cattle to the United States. The first U.S. case of BSE in December 2003 blocked U.S. beef exports until July 2005. Cattle prices set annual record highs in 2003, 2004, and 2005. Packers experienced significant losses because of tight cattle supplies and continued imports of Canadian boxed beef. While hog prices were not at record highs, hog producer returns, which were negative during 2002 and much of 2003, turned positive from February 2004 through the end of 2006. The higher hog prices in 2004 and 2005 came at a time of record production, while demand for pork improved. Lamb prices increased sharply—setting record highs in the first quarter and second quarters of 2005—while the supply of lambs declined.

## ES.1 GENERAL STUDY CONCLUSIONS

Within the context of these market conditions, the general conclusions of the study are as follows:

- Use of AMAs during the October 2002 through March 2005 period, including packer ownership, is estimated at 38% of the fed beef cattle volume, 89% of the finish hog volume, and 44% of the fed lamb volume sold to packers.
- Packer-owned livestock accounted for a small percentage of transactions for beef and lamb (5% or less), even when the small percentage of partial ownership arrangements is included, but accounted for a large percentage of transactions for pork (20% to 30% depending on assumptions).
- Given the current environment and recent trends, we expect moderate increases in use of AMAs in the lamb industry, but little or no increase in the beef and pork industries.
- Cash market transactions serve an important purpose in the industry, particularly for small producers and small packers. In addition, reported cash prices are frequently used as the base for formula pricing for cash market and AMA purchases of livestock and meat.
- The use of AMAs is associated with lower cash market prices, with a much larger effect occurring for finished hogs than for fed cattle.

- Many meat packers and livestock producers obtain benefits through the use of AMAs, including management of costs, management of risk (market access and price risk), and assurance of quality and consistency of quality.
- In aggregate, restrictions on the use of AMAs for sale of livestock to meat packers would have negative economic effects on livestock producers, meat packers, and consumers.

Primary conclusions for this final report by species are described below.

## ES.2 FED CATTLE AND BEEF INDUSTRIES

The primary conclusions for this final report, as they relate to the fed cattle and beef industries (Volume 3), are as follows:

- **The beef producers and packers interviewed believed that some types of AMAs helped them manage their operations more efficiently, reduced risk, and improved beef quality.** Feedlots identified cost savings of $1 to $17 per head from improved capacity utilization, more standardized feeding programs, and reduced financial commitments required to keep the feedlot at capacity. Packers identified cost savings of $0.40 per head in reduced procurement cost. Both agreed that if packers could not own cattle, higher returns would be needed to attract other investors and that beef quality would suffer in an all-commodity market place.
- **Eighty-five percent of small producers surveyed used only the cash market when selling to packers, compared with 24% for large producers, and pricing methods also differed by size of operation.** Large producers used multiple pricing methods, including individually negotiated pricing (74% of producers), public auction (35%), and formula pricing (57%). In comparison, small producers used individually negotiated pricing (32%), public auction (84%), and formula pricing (6%). Four times as many large producers sold cattle on a carcass weight basis with a grid compared with small producers.
- **Ten percent of large beef packers surveyed reported using only the cash or spot market to purchase cattle, compared with 78% of small beef packers.** Large packers relied heavily on direct trade and less on auction barns and dealers or brokers for their cattle procurement compared with small packers.

Conversely, small packers used AMAs for approximately half as much on a percentage basis as large packers. Both large and small packers used multiple pricing methods when buying cattle, including individually negotiated prices, formula pricing, public auction, and internal transfer pricing. While nearly all packers bought some cattle on a liveweight basis, 88% of large packers purchased cattle based on carcass weight with grids, while almost no small packers used this type of valuation.

- **Neither the producers nor packers surveyed expected the use of AMAs to change dramatically in the next 3 years.** In addition, they indicated that their use of AMAs had not changed significantly from 3 years earlier. Auction markets were the predominate marketing method across all producers selling cattle and calves. Based on the survey results, which tend to represent smaller packers, 19% of fed cattle are purchased through auctions. This is a substantially higher percentage than the estimate based on the transactions data obtained from larger packers.
- **The producers surveyed that used AMAs identified the ability to buy/sell higher quality cattle, improve supply management, and obtain better prices as the leading reasons for using AMAs.** In contrast, the producers surveyed that used only cash markets identified independence, flexibility, quick response to changing market conditions, and ability to buy at lower prices and sell at higher prices as primary reasons for using only cash or spot markets.
- **The packers surveyed that used AMAs said that their top three reasons for using AMAs were to improve week-to-week supply management, secure higher quality cattle, and allow for product branding in retail stores.** Much like producers, packers that used only cash markets identified independence, flexibility, quick response to changing market conditions, and securing higher quality cattle as reasons for using only the cash or spot market.
- **Transactions data summarized from the 29 largest beef packing plants during the time period of the study included more than 58 million cattle and 590,000 transactions and indicated that the cash or spot market was the predominate purchase method used.** Specific estimates of the percentage of cattle purchased through each type of marketing arrangement are as follows:

Note: To ensure the confidentiality of the companies that provided data for this study, the packer ownership category is often combined with other categories in the summary statistics presented in this volume. Results of analysis for the packer ownership category are provided in cases for which the results do not reveal company-specific confidential information.

- 61.7% cash or spot market
- 28.8% marketing agreements
- 4.5% forward contracts
- 5.0% packer owned, other method, or missing information

Thus, marketing agreements are the primary AMA used in the fed cattle and beef industries, but other types of AMAs are used extensively by individual firms for specific reasons that benefit their operations.

- **Transactions data indicate that packing plants in the Cornbelt/Northeast used AMAs less frequently than plants in the High Plains or West regions.** High Plains plants procured 61% of cattle by direct trade, 30% through marketing agreements, and a very small percentage through auctions and forward contracts. Cornbelt/Northeast plants bought the majority of their cattle by direct trade, but some were purchased through auctions and marketing agreements. Plants in the West bought a lower percentage by direct trade compared with the other regions and a higher percentage through marketing agreements and auction barns.
- **Individually negotiated pricing was the most common method used to determine purchase prices for fed cattle.** Specifically, 60% of cattle purchased by plants in the High Plains used individually negotiated pricing, with a similar percentage in the Cornbelt/Northeast and a substantially lower percentage in the West. Formula pricing was used to purchase 34% of the cattle in the High Plains, with a higher percentage in the West and a substantially lower percentage in the Cornbelt/Northeast. The formula was based most often on either U.S. Department of Agriculture (USDA)-reported prices or subscription service prices. Cornbelt/Northeast packers purchased the largest percentage of cattle on a liveweight basis (47%) in comparison with the High Plains (40%) and the West (25%). Packers in the West purchased more than half of their cattle using carcass weight with grid valuation, while packers in the High Plains and Cornbelt/Northeast used this valuation method for 42% and 44% of their purchases, respectively. The remainder were predominately purchased on a carcass weight basis without a grid.

- **Regression analysis of the relationship between all fed cattle transactions prices and use of marketing arrangements indicates that, relative to direct trade transactions, prices for fed cattle sold through auction barns tended to be somewhat higher and prices for fed cattle sold through forward contracts tended to be somewhat lower.** These results are likely due, in part, to the differences in risk associated with the two methods: auction barn sales are subject to greater price risk, but forward contracts ensure market access and a guaranteed price for cattle producers. However, the results also are influenced by the period of the analysis, during which fed cattle prices were at record highs. The prices for fed cattle sold through marketing agreements and transferred through packer ownership were relatively similar to direct trade. Prices for cattle under packer ownership are internal transfer prices that are typically based on external market prices; thus, implications of the results for packer-owned cattle are less clear.
- **Regression analysis of the relationship between cash market (auction barns, dealers and brokers, and direct trade) transactions prices for fed cattle and use of marketing arrangements suggests that if capacity utilization within a plant increases through the use of AMAs, firms pay slightly less per pound for cattle purchased in the cash market.** Specifically, a 10 percentage point increase in capacity utilization through AMAs is associated with a 0.4 cent per pound carcass weight decrease in the cash market price. Furthermore, if more cattle are available through AMAs within the following 21 days, cash market prices decrease slightly. Specifically, a 10% reduction in the volume of cash market transactions, assuming that volume is shifted into AMAs, is associated with a 0.11% decrease in the cash market price.
- **Beef packer plant-level P&L data showed significant economies of scale in beef packing, and costs were decreasing across the entire data range analyzed.** When both are operated close to capacity, smaller plants are at an absolute cost disadvantage compared with larger plants. When larger plants operate with smaller volumes, they have higher costs than smaller plants operating close to capacity and, thus, have an incentive to increase throughput. For all plants, large and small, average total cost increases sharply as volumes are reduced. A representative plant operating at 95% of the maximum observed volume is 6% more

efficient than a plant operating in the middle of the observed range of volumes and is 14% more efficient than a plant operating at the low end of the observed range.

- **Based on an analysis of P&L statements, procurement of cattle through AMAs results in production cost savings to the plants that use them.** However, the results differ across firms and plants. Some plants benefited substantially from AMAs and other plants did not appear to capture any benefits. The weighted average industry total production cost savings associated with AMAs was approximately $6.50 per animal. For an industry with an average loss of $2.40 per head during the 30-month sample period, this is a substantial benefit.
- **Marketing agreements are the most widely used AMAs in the beef industry, and thus restrictions on the use of marketing agreements would have the greatest negative effects on costs of production in the beef packing industry.** Forward contracts and packer-owned cattle were used, but to a much lesser extent. Therefore, restrictions on the use of packer ownership and forward contracts for cattle would have lesser effects on costs of production.
- **While the results differ by plant and firm, simulation analysis indicates that reducing or eliminating AMAs would result in higher average total cost (ATC) for slaughtering and processing beef cattle and, likewise, reduced gross margins and packer profits.** The average increase to beef slaughter and processing ATC would be 4.7% with a hypothetical elimination of AMAs and 0.9% with a hypothetical 25% reduction is use of AMAs. Packer profits are estimated to decrease by 6.0% and 1.5% if AMAs were reduced by 100% or 25%, respectively.
- **Beef quality has a positive effect on beef demand, the producers and packers interviewed and surveyed believe that AMAs are important for beef quality, and quantitative analyses suggest that AMAs are often associated with higher quality.** Regression analysis of MPR data found a small but positive relationship between formula and packer ownership procurement and USDA Quality Grade and found no statistical relationship between cash purchases and USDA Quality Grade. Regression analysis on transactions data found that marketing agreement cattle had a higher percentage Choice and Prime carcasses without increasing the percentage of Yield Grade 4 and 5

carcasses and had only modest declines in Yield Grade 1 and 2 carcasses. Other procurement methods had a greater trade-off between preferred quality grade and preferred yield grade. Furthermore, marketing agreement cattle and packer-owned cattle were associated with relatively higher quality compared with direct trade cattle, as measured by a composite quality index, but the small percentage of cattle sold through auction barns was associated with the highest quality and the highest variability in quality. The small percentage of cattle sold through forward contracts was associated with the lowest quality but also the lowest variability in quality.

- **The producers and packers surveyed that use AMAs value them as a method of dealing with production, market access, and price risks.** More specifically, feedlots believed that AMAs allow them to secure or sell better quality cattle and calves and improve operational management, efficiency, and capacity utilization. Packers identified AMAs as an important element of branded products and meeting consumer demand by producing a higher quality, more consistent product.
- **Regression analysis accounting for cattle quality and sales month found that auction market and forward contract prices were more volatile than direct trade, marketing agreement, and packer-owned cattle prices.** Furthermore, the volatility of prices for direct trade and marketing agreement cattle were relatively similar. Results were generally consistent for fed beef cattle and fed dairy cattle.
- **Hypothetical reductions in AMAs, as represented by formula arrangements (marketing agreements and forward contracts) and packer ownership, are found to have a negative effect on producer and consumer surplus measures.** Beef and cattle supplies and quality decreased and retail and wholesale beef prices increased because of reductions in AMAs. However, feeder and fed cattle prices decreased because of higher slaughter and processing costs resulting from the AMA restrictions. The short-run, long-run, and cumulative present value surplus for producers and consumers associated with reduced AMA volumes are all negative. Over 10 years, a hypothetical 25% restriction in AMA volumes resulted in a *decrease* in cumulative present value of surplus of
  - 2.67% for feeder cattle producers,

- 1.35% for fed cattle producers,
- 0.86% for wholesale beef producers (packers), and
- 0.83% for beef consumers.

A hypothetical 100% restriction in AMA volumes resulted in a *decrease* in cumulative present value surplus of

- 15.96% for feeder cattle producers,
- 7.82% for fed cattle producers,
- 5.24% for wholesale beef producers (packers), and
- 4.56% for beef consumers.

Thus, feeder cattle producers lose more surplus relative to the other sectors under either scenario. In addition, the estimated changes would imply a reduction in the competitiveness of beef relative to other meats.

- **The cost savings and quality improvements associated with the use of AMAs outweigh the effect of potential oligopsony market power that AMAs may provide packers.** In the model simulations, even if the complete elimination of AMAs would eliminate market power that might currently exist, the net effect would be reductions in prices, quantities, and producer and consumer surplus in almost all sectors of the industry because of additional processing costs and reductions in beef quality. Collectively, this suggests that reducing the use of AMAs would result in economic losses for beef consumers and the beef industry.

## ES.3 HOG AND PORK INDUSTRIES

Primary conclusions for this final report, as they relate to the hog and pork industries (Volume 4), are as follows:

- **AMAs are an integral part of hog producers' selling practices and pork packers' procurement practices.** There are significant regional differences in the observed patterns of use of AMAs: a stronger reliance on cash/spot markets and marketing contracts is apparent in the Midwest, and a stronger reliance on production contracts and packer ownership of hogs is apparent in the East. The pattern of future use of AMAs is not expected to change dramatically; hence, we do not expect that hog industry industrialization will emulate the industrialization of the poultry sector.
- **Based on individual transactions data, there are substantial differences in daily hog prices paid by packers on a carcass weight basis.** On average, the

price dispersion is about 40% of the average value of the transaction prices each day. One part of such strong price dispersion can be explained by factors such as region, quality, or plant size. However, even after controlling for these factors, the remaining differences must be due to organizational issues related to supply chain management in the pork processing sector.

- **Results indicate that, on average, plants that use a combination of marketing arrangements pay lower prices for their hogs relative to plants that use the cash/spot market only.** In addition, comparing the magnitudes of the portfolio effects to the magnitudes of the individual marketing arrangement effects shows that individual marketing arrangements have minimal additional impact on the average price after accounting for the portfolio effect. That is, the portfolio system categorical variables capture almost the entire effect on lowering the average price.

- **Of particular interest for this study is the effect of both contract and packer-owned hog supplies on spot market prices; as anticipated, these effects are negative and indicate that an increase in either contract or packer-owned hog sales decreases the spot 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.

- **Based on tests of market power for the pork industry, we found a statistically significant presence of market power in live hog procurement.** However, the results regarding the significance of AMA use for procurement of live hogs in explaining the sources of that market power are inconclusive. Whereas the model based on farm–wholesale price spread data shows that a higher proportion of AMA use leads to increased market power, the model estimated with company-level individual transactions data indicates that AMA use may not be a source of market power in pork packing.

- **Estimated total and average cost functions indicate that economies of scale diminish as the pork packing firm size increases.** The estimates indicate that the scale economies are exhausted well within the sample output range such that the biggest plants already exhibit negative returns to scale. That is, they operate on the upward-sloping portions of their average cost curves. The observed patterns of procurement portfolio choices by packers also indicate that certain combinations of marketing arrangements may reduce costs and/or increase economies of scale. In particular, relative to using spot market procurements alone, all other combinations of marketing arrangements improve the efficient scale of production.
- **Based on the observation that packers use marketing arrangements in clusters (portfolios), we hypothesized that marketing arrangements may be complementary to each other in the sense that implementing one procurement practice may increase the marginal return of the other practice; however, the analyses of the complementarity of marketing arrangements produced inconclusive results.** Simpler tests based on the correlation/association approach indicate that marketing contracts are in fact complementary to production contracts and/or packer owned arrangements. Also, the portfolio coefficients in the performance equations based on either the earnings before insurance and taxes (EBIT) or the gross margin show that all marketing arrangement portfolios improve plant performance relative to simple spot market purchases. However, the coefficient associated with the portfolio of three marketing arrangements is smaller than the coefficient associated with portfolios of two marketing arrangements, thus violating the complementarity requirement. More conclusive formal tests were not feasible given data limitations.
- **To analyze quality differences in live market hogs across alternative procurement methods (AMAs), we tested whether various quality attributes used by the industry are significantly different across AMAs and found that different AMAs are associated with different levels of quality of hogs.** Even though the rankings are not unique, we found that marketing contracts (especially other purchase arrangements and other market formula purchases) are consistently associated with higher quality hogs than negotiated (spot market) purchases.

- **An examination of the relationship between the proportion of AMAs used to procure live hogs and the quality of resulting pork products indicates that a higher proportion of AMA use is associated with higher quality pork products.** We measured pork product quality using Hicks' composite commodity index and hypothesized that a higher percentage share of the AMAs (essentially marketing contracts and packer-owned hogs) should produce higher quality pork products. The correlation coefficient showed that these two series are positively correlated, thus confirming our hypothesis.
- **An analysis of risk associated with different marketing arrangements shows that different types of marketing arrangements exhibit different price volatilities as measured by the variance of prices.** Therefore, hog producers selling hogs using different types of marketing arrangements experience different levels of risk. From the hog producers' point of view, the ordering of marketing arrangements in decreasing order of risk is as follows: (1) spot/cash market sales; (2) marketing contracts in which the pricing formula is based on spot market prices; (3) marketing arrangements in which the pricing formula is based on some futures or options price; (4) other purchase arrangements containing ledgers, windows, and other pricing mechanisms, which may serve as a cushion against price volatility; and (5) production contracts.
- **In analyzing the importance of hog producers' risk aversion for contract choice, we found that hog producers who use production contracts are more risk averse than producers who use cash/marketing arrangements.** The difference in risk exposure between contract producers and independent farmers is substantial because production contracts eliminate all but 6% of total income volatility. Therefore, the utility losses associated with forcing producers to market their hogs through channels different from their risk-aversion-preferred marketing arrangement choice are substantial.
- **In analyzing the economic effects of hypothetical restrictions on the use of AMAs in the hog and pork industries, we found that hog producers would lose because of the offsetting effects of hogs diverted from AMAs to the spot market, consumers would lose as wholesale and retail pork prices rise, and packers would gain in the short**

**run but neither gain nor lose in the long run.** The results applied to three different simulations: (1) 25% reduction in both contract- and packer-owned hogs, (2) increase the spot/cash market share to 25%, and (3) complete ban of packer-owned hogs. The reason that producers and consumers lose in all three simulation scenarios is because of efficiency losses from reducing the proportion of hogs sold through contracts and/or packer owned channels. Although a reduction in AMAs leads to an improvement for hog producers through a reduction in the degree of market power, the loss in cost efficiencies offsets the gains from reduced market power. In all instances, the price spread between farm and wholesale prices would be expected to increase because of the net increase in the costs of processing. Moreover, wholesale, and hence retail, prices would increase, causing pork to become more expensive for consumers.

## ES.4 LAMBS AND LAMB MEAT INDUSTRIES

Primary conclusions for this final report, as they relate to the lamb and lamb meat industries (Volume 5), are as follows:

- **Lamb packers procure fed lambs primarily through formula pricing arrangements and auctions.** According to MPR data, lamb packers procure 42.2% of fed lambs through formula pricing arrangements and 39.4% through auctions. Negotiated sales account for 12.0% of fed lamb procurement, and packer ownership represents 4.9%. Contracted procurement represents only 0.8% of lamb procurement, while imports represent only 0.7%. These data are similar to those obtained from the lamb packer survey.
- **The means and standard deviations of fed lamb prices from MPR data for formula pricing and cash arrangements were similar during the sample period.** The price series were highly correlated with an estimated correlation coefficient of 0.970. A reduced-form model of the difference between normalized formula pricing and cash fed lamb prices indicated that lamb inventories, lamb carcass price risk, and seasonality were the primary determinants of variations in the difference.
- **Changes in procurement methods for lamb would impose costs on the lamb marketing system by reducing efficiencies, but may also provide some benefits by altering potential market power effects.** If formula pricing procurement is restricted,

lamb acquisition costs would rise. However, some of this increase in costs may be offset by a reduction in potential oligopsony power. Ultimately, a combination of these effects yields net changes in lamb prices, quantities, and producer surplus.

- **Given that lamb markets are relatively thin, the primary effect of MPR may have been to reduce price risk rather than to influence price levels.** The implementation of MPR in 2001 increased slaughter lamb price by only 0.129%.
- **AMAs were found to have statistically significant although economically small effects on lamb prices.** A 10% increase in formula pricing lamb procurement would increase the slaughter lamb price by an estimated 2.54%; this effect is likely due to risk reductions. A 10% increase in cash lamb procurement increases slaughter prices by an estimated 2.68%. A 10% increase in packer ownership reduces slaughter lamb prices by an estimated 0.23%.
- **Increases in formula pricing and cash procurement methods reduce lamb procurement costs, while increases in packer ownership increase procurement costs.** The effects of formula pricing and cash procurement methods on procurement costs for lambs were similar and not statistically different from one another.
- **Technological change has likely increased lamb quality over time.** However, there does not appear to be any statistically significant difference in the quality of lambs procured through formula pricing and cash procurement methods.
- **Price risk shifting from lamb producers to lamb packers and breakers has not occurred as a result of AMAs.** No statistical difference was found between the variances of prices for each type of AMA.
- **Restrictions on the use of AMAs cause almost every sector in the lamb industry to lose producer surplus, even if potential market power (if it exists) is reduced or eliminated.** Reductions in the use of AMAs have both positive and negative effects on the lamb industry. Reductions in potential market power (a positive effect) do not offset the increases in processing costs and reductions in lamb quality (negative effects).
- **Restrictions on the use of AMAs would likely reduce the competitiveness of the lamb industry.**

Although lamb is not a strong substitute for beef and pork, restrictions on the use of AMAs would place it at a competitive disadvantage to these other meats. More importantly, however, it appears that imported lamb is a strong substitute for domestic lamb. Hence, the loss of competitiveness in response to restrictions on the use of AMAs is much more pronounced with respect to lamb imports.

- **AMAs may have multiple effects on accessing the lamb market.** Ease of entry may be affected by the availability of AMAs, because financing of production operations often depends on the assurance of market access and price risk management. However, for small producers, it may be more difficult to secure AMAs because it is more costly for packers to negotiate with many small producers relative to fewer large producers. Hence, if AMAs reduce the viability of public auctions, small producers may find that their market access is limited.
- **Restrictions on the use of AMAs may increase concentration of various segments of the lamb industry, but the effect of increased concentration on market power is unknown.** There are no clear effects of the changes in the use of AMAs on concentration in the lamb industry. Concentration in the lamb packing industry has remained relatively flat, even though the use of AMAs has increased. However, increased use of AMAs may reduce the viability of auctions and could lead to increased concentration in the lamb feeding sector. In addition, if restrictions on AMAs reduce the competitiveness of domestic lamb meat relative to lamb imports, then concentration in the lamb packing and processing industry is likely to increase in response to declining domestic demand.

## ES.5 MEAT DISTRIBUTION AND SALES

Primary conclusions for this final report, as they relate to meat processing, distribution, and sales (Volume 6), are as follows:

- **Transactions data on meat processor purchases indicate a much larger use of AMAs than do the survey data.** Based on transactions data, only 21% of beef and pork products were purchased on the spot market. Internal transfers were a large factor for pork but were virtually nonexistent for beef. Forward contracts were 28% of beef purchases, but less than 1% of pork purchases. The type of purchase method used is either not important to meat processors or they did not understand the meaning of the categories, because 39% of beef and 32% of pork purchase methods were listed as "other or missing."

- **Approximately 99% of pork and 55% of beef product pounds that were priced using formula pricing used a USDA-reported price as the base.** The other base used for purchased beef was a subscription service. Although nearly all pork pricing formulas are based on USDA-reported prices, it is worth noting that wholesale pork, while reported by USDA, is not covered under Mandatory Price Reporting (MPR).
- **Meat processors play an important distribution role in the meat value chain by purchasing large lots from a few sources and selling small lots to many firms.** Transaction purchase data included 53,831 records from 32 firms, averaging 22,800 pounds per transaction. Sales transactions from 11 firms included 848,295 records, averaging 771 pounds per transaction, and these were all case ready or RTE. A high percentage of these transactions did not identify the sales method, indicating that processors either did not understand the meaning of the categories that were listed or do not track this information.
- **When examining data specific to the beef industry, aggregate cattle purchase and beef sales transactions data suggest no relationship between cattle purchase methods and branded beef sales, although this relationship may be important to individual firms.** Plants that sold 0% to 20% of their beef as branded product purchased approximately the same percentage of their cattle on the spot market as did plants that sold 21% to 40% of their beef as branded product. Although the differences were small, the 21% to 40% plants used more forward contracts and less packer ownership than did the 0% to 20% plants. Shares of marketing agreement cattle were nearly identical across the two groups. In addition, 60% of the meat purchased on the spot market by processors was branded product compared with none through marketing agreements and internal transfers.
- **Although potentially important to some beef industry firms, aggregate transaction data suggest that downstream marketing arrangements have no relationship to cattle purchase methods.** Beef plants were divided into two groups based on beef sales methods–0% to 50% and 51% to 100% cash or spot market beef sales. Transactions from both groups indicated that they each bought 60% of their cattle

through the spot market and 40% using AMAs. The 0% to 50% cash sales group used more marketing agreements, and the 51% to 100% cash sales group had more packer-owned cattle.

- **Aggregate transactions data for the beef industry suggest some relationship between meat buyer type and cattle purchase methods.** Packers that sold more beef to meat processors bought fewer cattle on the spot market but about the same number of cattle through AMAs (with the difference resulting from a larger percentage of other purchases or missing information). Packers that sold a larger amount of beef to retailers and food service operators bought a larger percentage of their cattle on the spot market and a slightly lower percentage of cattle through AMAs.
- **The pork industry is more vertically integrated than is the beef industry.** Pork packers produce a higher percentage of the animals that they slaughter than do beef packers, and pork processors acquire much more of their product through internal transfer than do beef processors.
- **Meat processor buyers mix and match purchase and pricing methods.** Formula pricing was used as the pricing method for spot market, forward contracts, and marketing agreements. Likewise, individually negotiated prices were more common in forward contracts than in spot markets.

## ES.6 LIMITATIONS OF THE ANALYSES

Decisions regarding methodologies, assumptions, and data sources used for the study had to be made in a short period of time. The analyses presented in this final report are based on the best available data, using methodologies developed to address the study requirements under the time constraints of the study. Some analyses were limited because of availability and quality of the transactions and P&L statement data. However, secondary data were used, as available, to supplement primary data in order to conduct the analyses.

# 1 Introduction

AMAs include all possible alternatives to use of cash or spot markets for conducting transactions.

Over time, the variety, complexity, and use of AMAs have increased in the livestock and meat industries. Marketing arrangements refer to the methods by which livestock and meat are transferred through successive stages of production and marketing. A marketing arrangement also designates a method by which prices are determined for each individual transaction. The increased use of AMAs raises a number of questions about their effects on economic efficiency and on the distribution of the benefits and costs of livestock and meat production and consumption between producers and consumers.

USDA's GIPSA is charged with facilitating the marketing of livestock, meat, and other agricultural products. This agency also promotes fair and competitive trading practices for the overall benefit of consumers and American agriculture. In fulfilling its mission, GIPSA evaluates, among other things, the implications of the evolving landscape of AMAs and pricing methods.

*In 2003, Congress allocated funds to GIPSA to conduct a broad study of the effects of AMAs on the livestock and meat industries.*

In 2003, Congress allocated funds to GIPSA to conduct a broad study of the effects of AMAs on the livestock and meat industries. GIPSA developed the specific scope and objectives of the study, and following a competitive bidding process, RTI was awarded a contract to conduct the Livestock and Meat Marketing Study.

The questions posed by the Livestock and Meat Marketing Study included the following: What types of marketing arrangements are used? What is the extent of their use? Why do firms enter into the various arrangements? What are the terms and characteristics of these arrangements? What are the effects and implications of the arrangements on participants and on the livestock and meat marketing system?

The study examined the following species and meat types:

- fed cattle and beef,
- hogs and pork, and
- lambs and lamb meat.

The study comprised five main parts:

- Part A. Identify and classify types of spot marketing arrangements and AMAs.
- Part B. Describe terms, availability, and reasons for use of spot marketing arrangements and AMAs.
- Part C. Determine extent of use, analyze price differences, and analyze short-run market price effects of AMAs.
- Part D. Measure and compare costs and benefits associated with spot marketing arrangements and AMAs.
- Part E. Analyze the implications of AMAs for the livestock and meat marketing system.

The interim report released in August 2005 addressed Parts A and B of the study. This final report focuses on Parts C, D, and E.

An interim report released in August 2005 addressed Parts A and B of the study (Muth et al., 2005). The report described marketing arrangements used in the livestock and meat industries and defined key terminology.[1] Results presented in the interim report were preliminary because they were based on assessments of the livestock and meat industries using published data, review of the relevant literature, and industry interviews.

Concurrent with conducting Parts A and B of the study, the study team developed and pretested information collection plans for obtaining transactions data and P&L statements from packers, processors, and downstream market participants. In addition, the study team developed and pretested a set of 10 industry survey questionnaires to obtain additional information beyond what could be obtained in transactions data and P&L statements. We received approval for both information collection requests from the Office of Management and Budget (OMB) in October 2005.

[1] Terms used in the study are included in the glossary.

This final report describes the results of quantitative analyses addressing Parts C, D, and E of the study, using data from the industry surveys across all stages of livestock and meat production, transactions data and P&L statements from packers and processors, production contract settlement data from packers, and a variety of publicly available data. According to the Performance Work Statement (PWS) in the contract with GIPSA, the results of these analyses will provide information to

- livestock producers to help them make more informed production and marketing decisions,
- the general public to help them understand the roles and reasons for using these arrangements,
- GIPSA for its role in enforcing the Packers, and Stockyards Act, and
- USDA and Congress to help them determine whether policy changes affecting livestock marketing methods that were originally considered during the development of the 2002 Farm Bill are warranted.

*The Livestock and Meat Marketing Study was limited to economic factors associated with spot marketing arrangements and AMAs and did not analyze policy options or make policy recommendations.*

The study is national in scope, but it considered regional differences among marketing arrangements, if applicable, and international dimensions related to marketing arrangements, if significant. All stages of production and marketing were addressed, including farm level, slaughtering, processing, wholesaling and distribution, retailing, food service, and export. The Livestock and Meat Marketing Study was limited to economic factors associated with spot marketing arrangements and AMAs and did not analyze policy options or make policy recommendations.

# 2 Overview of Parts C, D, and E of the Study

Throughout the report, industry participants are grouped into the following categories:

- livestock producers and feeders
- meat packers and processors (or breakers)
- wholesalers and distributors
- exporters
- food service or restaurant establishments
- retail establishments

Parts C, D, and E include complementary analyses of the effects of AMAs in each industry. The aims of Part C were to determine the extent to which various types of spot marketing arrangements and AMAs are used, to analyze price differences among the marketing arrangements, and to analyze the effects of alternative arrangements on short-run spot market prices as follows:

- Determine the volume of livestock and meat transferred through the various types of spot and alternative arrangements by type, size, and location of market participants.
- Report average price levels and differences in prices by type, size, and location of market participants.
- Determine price differences associated with the various types of spot marketing arrangements and AMAs, adjusting for quality differences, lot size, and other relevant factors that may affect prices, and determine how price differences vary with market conditions.
- Determine if packers' use of alternative procurement and pricing arrangements for fed cattle, slaughter hogs, and lambs is causally related to spot market prices for these animals in the short run and determine the nature of the relationship.

The aims of Part D were to measure and compare possible costs and benefits associated with the various types of spot marketing arrangements and AMAs as follows:

- Determine cost and efficiency differences and measure size and other economies and diseconomies associated with the use of AMAs.
- Determine the extent to which any differences in animal and meat quality are associated with differences in spot marketing arrangements and AMAs.[2]
- Determine if the various types of marketing arrangements shift risks among market participants or alter risk levels.[3]

The aims of Part E were to analyze the implications of AMAs for the livestock and meat marketing system, using the models developed in Parts C and D, as follows:

- Assess system-wide economic implications of restrictions on AMAs used by packers to purchase livestock.
- Assess the relative overall strength of positive and negative economic incentives for increased or decreased use of the various types of marketing arrangements.
- Examine the implications of expected changes in the use of various marketing arrangements over time.

[2] As noted in the PWS, quality measures might include meat grades, tenderness, taste, nutritional characteristics, consistency, and conformity to specifications.

[3] As noted in the PWS, risk might relate to price, quality, loss of product, loss of supplier, loss of buyer, reduced credit rating, or less reliable trading partners.

# 3 Information Sources Used for Parts C, D, and E of the Study

The analyses conducted for the final report build on information obtained for and summarized in the interim report. The interim report was based on information from the empirical agricultural economics and management literature, information from the development and pretesting of the data collection instruments for the transactions data collection and the industry surveys, available contract forms for beef cattle and hogs, discussions with trade associations, and discussions with industry participants.

The analyses presented in this final report use the following types of data:

- purchase and sales transactions data from meat packers and processors
- P&L statements from meat packers and processors
- production contract settlement data from hog packers
- industry survey responses from livestock producers, meat packers, meat processors, meat wholesalers, meat exporters, grocery retailers, and food service operations
- a broad range of publicly available data, including MPR data

# 4 Organization of the Report

This final study report provides information and quantitative results for Parts C, D, and E of the Livestock and Meat Marketing Study. The volumes of the final report are as follows:

- Volume 2: Data Collection Methods and Results
- Volume 3: Fed Cattle and Beef Industries
- Volume 4: Hog and Pork Industries
- Volume 5: Lamb and Lamb Meat Industries
- Volume 6: Meat Distribution and Sales
- Appendix A: Glossary

The results from Volume 2 are incorporated into all volumes, in the relevant sections. Volumes 3 through 5 have a similar structure, which follows the requirements of the study, as specified in the PWS. Volume 6 has a different structure to include additional analyses beyond the species-specific analyses included in the previous volumes.

# 5 References

Muth, M.K., G. Brester, J. Del Roccili, S. Koontz, B. Martin, N. Piggott, J. Taylor, T. Vukina, and M. Wohlgenant. July 2005. *Spot and Alternative Marketing Arrangements in the Livestock and Meat Industries: Interim Report*. Prepared for the U.S. Department of Agriculture, Grain Inspection, Packers and Stockyards Administration.

# ATTACHMENT C

**Assessment of the Livestock and Poultry Industries**
Fiscal Year 2007 Report

United States Department of Agriculture
Grain Inspection, Packers and Stockyards Administration

May 2008

## Structural Change and Increased Coordination in Meat Packing

Concerns about increases in concentration and related changes in industry structure, and the perception that these changes are inherently anticompetitive continue to be expressed as criticisms of economic efficiency within the livestock and meat industry. Although concentration has stabilized somewhat in recent years in some segments of the livestock and meat industry, continued mergers and acquisitions, plant closings, and plans of leading firms to build new plants all suggest concentration and structural change will continue to be a source of concern. With increasing concentration (share of total market or production at a given stage), there has also been an increase in consolidation of control by individual firms. Consolidation refers to changes that often reduce the number of firms but also increase individual firms' coordination and control of activities across stages of the production and marketing system. Increased cross-stage coordination and control are often associated with use of production contracts, marketing contracts and ownership of production operations at another stage in the production and marketing system.

### *GIPSA Actions*

GIPSA has administrative authority in the livestock sector under the P&S Act and acts to enforce the Act and enhance competitive markets. GIPSA does not have authority to review or to prevent mergers and acquisitions, but often cooperates with and lends its industry expertise to DOJ in its review of mergers in the livestock, meatpacking, and poultry industries.

Changes in industry structure, such as concentration levels and vertical integration, tend to alter the focus GIPSA has on particular firms and behavior. These industry-wide changes reflect the dynamics of competition, and hence are not prohibited by the P&S Act. It is important to note that many of the changes in coordination associated with industry consolidation may also provide for improved economic performance of the industry, that is, lower processing costs and consumer prices. Also, structural change can lead to downstream market alliances to facilitate penetration of retail markets with branded products to increase consumer choices. Merger and acquisition activity in recent years has increased the market shares of firms with management expertise in supply channel management across channels, including value-added processing and branded product retailing. The capability to increase branded retail products depends on high levels of input supply management to achieve uniform and high levels of packing plant utilization, and production of carcasses that can be processed into uniform retail products.

In fiscal year 2003, GIPSA received $4.5 million in appropriations for a broad study of marketing practices in the entire livestock and red meat industries from farmers to retailers, food service firms, and exporters. The study addressed many questions and concerns that have been raised about changes in the structure and business practices in the livestock and meat industries. RTI, International Inc. delivered a final report in the late fall of 2006, and GIPSA publicly released the report in February 2007 after briefing Congress on the results of the study.[16] The study provided a quantitative analysis of prices and of costs-benefits of alternative marketing arrangements, and it assessed the implications of potential future changes in the use of various types of marketing arrangements, including packer feeding.

The study found that alternative marketing arrangements provide net benefits to producers, packers, and consumers, and that net economic losses would result from restrictions on the use of such arrangements.

In particular, the study found that packers and consumers receive better quality and more consistent product as a result of alternative arrangements, and producers receive value for better quality livestock. All parties are better able to set delivery/sale dates. The arrangements help to stabilize the flow of supply, and provide cost savings in sellers and buyers interactions to arrive at a market price (i.e., the price discovery process). In general, the use of alternative marketing arrangements provides livestock buyers and sellers with improved risk management options that lower costs or allow for the creation and capture of greater value.

Currently, GIPSA inspects the procurement records of the five largest fed cattle packers to verify firm reporting accuracy for cattle procured under alternative marketing agreements, including cattle procured through packer ownership, forward contracts, market agreements, and the spot market. In 2008, GIPSA will expand its inspection of procurement practices to include the five largest hog packers. GIPSA's review assists in correctly categorizing the cattle procured under contract into one of the committed procurement methods, or alternatively into a non-committed method. The review also contributes to available information on the trends and methods by which the packers procure cattle.

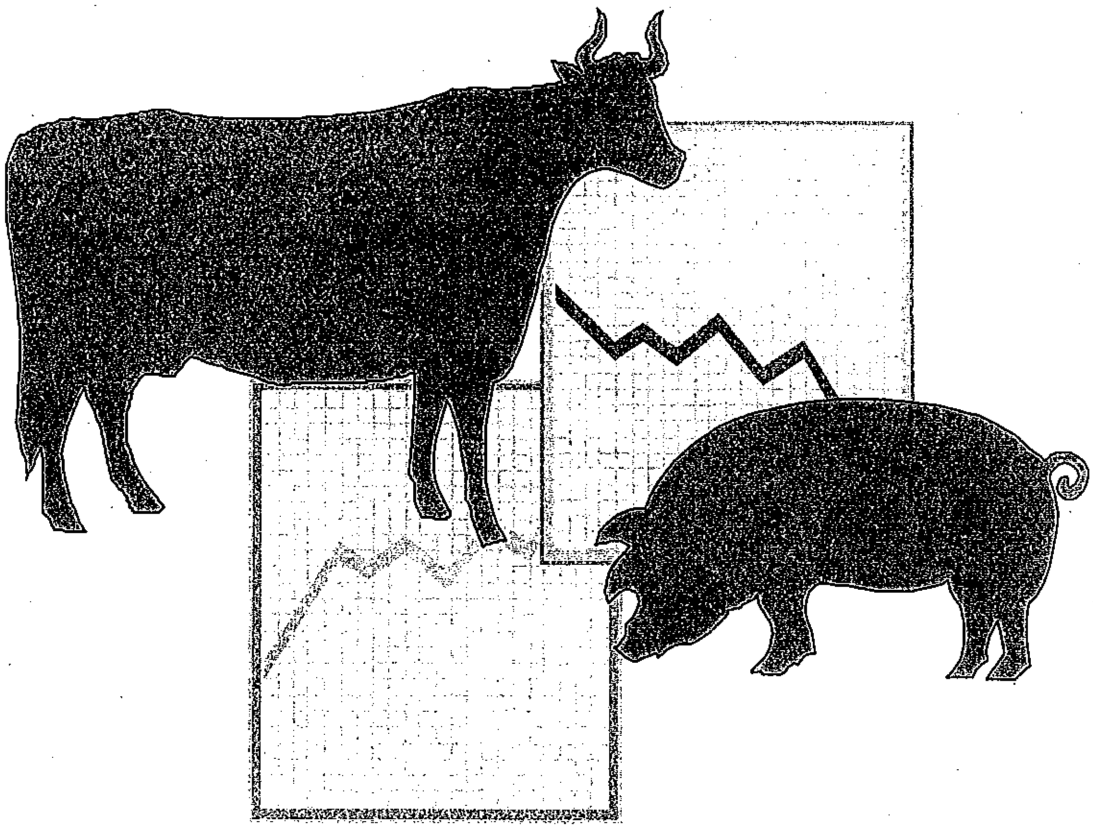
**Adequacy of Bonds for Regulated Entities**

The P&S Act provides that the Secretary may require packers, market agencies, and livestock dealers to have reasonable bonds (7 USC§204). The regulations issued under the P&S Act prescribe bond requirements and bonding formulas for market agencies either buying or selling on commission or acting as clearing agencies; for livestock dealers; and for packers purchasing over $500,000 of livestock annually. These entities must maintain a bond or bond equivalent to protect unpaid livestock sellers. The bonding formulas, last modified in 1983, rarely provide full coverage to livestock sellers when a bonded entity experiences financial difficulty. Between fiscal years 2002 and 2007, sellers who were not paid as a result of financial failures by market agencies selling on commission recovered between 35 and 78 percent of their total claim amounts each year. During the same period, the recovery rate ranged between 5 and 21 percent for livestock sellers owed by dealers that failed financially. Members of the livestock industry and Congress have expressed

[16] Copies of the report can be obtained at: http://www.gipsa.usda.gov/GIPSA/webapp?area=home&subject=lmp&topic=ir-mms.

# ATTACHMENT D

# Assessment of the Cattle and Hog Industries
# Calendar Year 2000



## United States Department of Agriculture
## Grain Inspection, Packers and Stockyards Administration

Issued June 2001

On many occasions, the public has expressed its belief that USDA may restrict meatpackers' behavior, without specific evidence of competitive harm. P&SP must prove any allegation of a prohibited anti-competitive practice in a litigated case by proving through a preponderance of the evidence that some measurable harm has occurred or is likely to occur. Most issues regarding competition and potentially anti-competitive practices are complex and interrelated. They often do not yield to easy answers. Extensive data collection and sophisticated economic analyses are required to fully understand the reasons for and implications of the practices.

**Packers Acting in Concert to Restrict Competition**–Members of the industry, especially producers, express concerns about possible concerted action by meatpackers. In some cases, concerns are expressed about wide-ranging impacts cutting across broad industry segments, such as allegations of packer behavior leading to low hog prices during December 1998-January 1999. In other cases, concerns address specific circumstances involving narrow industry segments, such as why few packers bid on cattle at a particular feedlot. These concerns do not necessarily suggest firms are engaging in unlawful practices and instead may be attributable to normal supply and demand forces, competitive bidding processes, or personal relationships that have developed over time between packers and livestock sellers. The P&S Act prohibits unlawful conspiracies, combinations, or agreements that result in certain anti-competitive activity.[96] Past analyses by P&SP of packers' livestock procurement patterns have not revealed such activity among packers.

**Short Trading Window**–A specific practice that raises concerns is the allegation that there is a short window during which trading of fed cattle occurs. Some cattle producers and market observers contend that virtually all spot-market cattle transactions occur during a relatively short period each week, often described as a 15- or 30-minute window. During its 1996 Texas Panhandle Fed Cattle investigation, P&SP found that the highest volumes of cattle were purchased on Wednesdays, but spot-market transactions occurred on every business day of the week. As discussed previously, the bidding process for fed cattle normally begins early on Monday mornings when packer buyers visit feedlots to view cattle for sale. The price discovery process continues during the week as buyers and sellers presumably assess market conditions, followed by rapid consummation of many transactions once market participants believe the market price has been discovered.

**Shared Agents**–It is a common practice for one buyer to represent more than one packer at an auction sale, especially in sales involving cull livestock. Auction market owners and livestock sellers have raised concerns that the use of common buyers, or shared agents, reduces the number of competing buyers. This practice has the potential for reducing competition. However, the issue is complicated by a general lack of buyers at many auctions. Sharing a buyer may result in packers purchasing livestock at auctions where the packers otherwise would not be active. P&SP continues to investigate complaints about shared agents at livestock markets.

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[96] 7 U.S.C. 192

# ATTACHMENT E

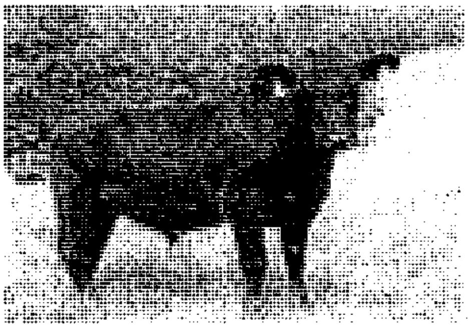
USDA

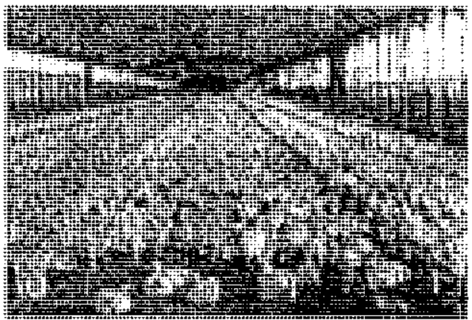
United States
Department of
Agriculture

Grain Inspection,
Packers and
Stockyards
Administration

2004 Report

# Assessment of the Cattle, Hog, and Poultry Industries





the livestock sellers under each of the purchase types and confirm the correct amount was paid. In the replication process, investigators verify the data used as variables in the formulas are accurately transferred into the formulas, and that computations are handled properly. The investigators also confirm that the factors used to determine the final payment amounts are clearly disclosed on the sellers' settlements and that any adjustments are explained in an appropriate manner.

**Joint Livestock Purchasing**

P&SP is aware of several situations in which two packers have used the same agent to procure livestock of similar type and quality, packers have bought livestock of similar type and quality for each other, and dealers and order buyers have orders from multiple packers for similar type and quality of livestock. These are potential violations of the P&S Act.

**GIPSA Response:** P&SP investigates all complaints about the use of shared agents, packers buying livestock for each other, and dealers or order buyers having orders from multiple packers for the same type and quality of livestock. Whether the P&S Act is violated depends on the circumstances of each case. Regulation §201.69 prohibits packers, dealers, and market agencies from furnishing information to competitor buyers for certain purposes. Regulation §201.70 requires every packer and dealer to conduct his or her buyer operations in competition with and independently from other packers and dealers similarly engaged.

**Livestock, Meat, and Poultry Evaluation Devices and/or Systems**

In the livestock and meatpacking industries, packers and producers are expanding beyond USDA grading to determine the value and appropriate prices to pay for livestock purchased on a carcass merit basis. The industries are developing sophisticated electronic evaluation devices and/or systems to measure live or carcass merit characteristics on which payment is based. Before 2003, there was no accredited (by the government or any other organization) procedure to evaluate the accuracy of electronic devices and/or systems used to evaluate beef or pork carcasses.

In the pork industry, packers pay most producers based on the lean percent of their hogs, estimated by formulas using measurements taken by electronic carcass evaluation devices. Many forms of evaluation devices and/or systems and in-house graders have taken the place of USDA graders. Due to the lack of performance standards for evaluation devices and/or systems, producers receive information from packers that is not comparable when marketing to multiple packers that use different evaluation devices for lean measurement.

In the beef industry, at least 50 percent of market ready slaughter cattle are sold on a value-based marketing grid, meaning that premiums and discounts are paid for carcass attributes that affect the total value of the products derived from that carcass. In contrast to the pork industry, these evaluations are based on visual appraisals from USDA graders alone or in combination with information garnered from the evaluation devices and/or systems.

USDA's Agricultural Marketing Service (AMS) is involved in developing standards for approval of evaluation devices. In 2003, for example, AMS developed a standard for approval of a vision-based system for evaluating the size of a beef ribeye, one of the most important factors in determining the estimated yield of boneless beef product. These standards establish the level of accuracy that systems must meet in order to be certified by USDA.

# ATTACHMENT F

# 2009 Annual Report

## Packers & Stockyards Program

*United States Department of Agriculture*
*Grain Inspection, Packers and Stockyards Administration*

Table of Contents



**MISSION:**

"To protect fair trade practices, financial integrity, and competitive markets for livestock, meat, and poultry."

March 2010

P&SP conducts many activities that monitor changes in industry behavior in order to understand the nature of and reasons for changes, and to anticipate potential competitive issues that may result from those changes.

Details of specific, ongoing individual monitoring efforts are described in the next three sections.

*Fed Cattle and Hog Market Price Monitoring*

P&SP undertook a price monitoring initiative in response to market issues that evolved from the announcement of the first case of bovine spongiform encephalitis (BSE) in the United States on December 23, 2003. A national task force comprised of P&SP economists modified an econometric model in use since the mid-1990s that detected price differences in regional fed cattle markets. The statistical model relied on publicly reported price data to assess regional price differences. If a statistically significant price difference was detected, P&SP initiated a regulatory review work plan to determine whether those price differences were caused by an undue or unreasonable preference or disadvantage in violation of section 202 (b) of the Act or by uncontrollable external factors, such as weather or other external macroeconomic conditions. The statistical model is similar to the model used by the Federal Trade Commission in 2008 to monitor retail gasoline prices.

The current fed cattle market price program was first implemented in 2004, but has since evolved into an enhanced program that includes a weekly internal reporting regime and a detailed work plan to conduct in-depth investigations into possible violations of the Act if the initial regulatory reviews of price differences do not clarify whether they were caused by external market factors. The model and the historical database upon which the monitoring program is based have also been enhanced through further economic and statistical research activity conducted by P&SP economists.

The model is run weekly, and any price outlier that is not caused by certain technical statistical factors triggers a regulatory review by P&SP. If the regulatory review does not determine that the price outlier was caused by certain external factors or readily observable market conditions, then a formal investigation is initiated to determine the cause of the price outlier. The formal investigation involves deeper examination of the price data and cattle characteristics, and interviews with buyers, sellers, and other market participants.

The fed cattle price monitoring program initiated 25 regulatory activities in 2009, and of these, 3 indicated cause for investigation (Table 4).

Table 4. **Regulatory Activities and Investigations Resulting From Weekly Statistical Monitoring of Fed Cattle Markets**

| Fiscal Year | Regulatory Activities Initiated | Investigations Initiated |
|---|---|---|
| 2006 | 25 | 6 |
| 2007 | 13 | 0 |
| 2008 | 19 | 4 |
| 2009 | 25 | 3 |

Of the three investigations initiated in 2009 with a request for data from the Agricultural Marketing Service (AMS), all three are ongoing with field interviews being conducted. Although no competition violations have been identified, P&SP continues to actively monitor market prices on a weekly basis and initiate timely regulatory reviews and investigations, if necessary, of observed market price anomalies.

Effective September 9, 2009, a statistical model similar to the fed-cattle model was implemented for daily monitoring of hog market prices for the three AMS barrow and gilt price reporting areas. These AMS market areas include Iowa-Minnesota, the eastern Cornbelt, and the modified western Cornbelt. The AMS reporting market area is the western Cornbelt region, which includes Iowa and Minnesota. To ensure non-overlapping markets, P&SP modified the territory to remove the Iowa and Minnesota hog transactions and prices from this region. Live and carcass prices are monitored, except in the modified western Cornbelt market, which only reports carcass prices. The model reported no daily price outliers for these five market prices from September 9, 2008, through September 30, 2009. Whether P&SP is monitoring fed-cattle or hog prices, when the statistical model reports an outlier, an economist from either the Midwestern or Western regional office reviews the suspect price and makes a recommendation report, which is reviewed by an economist in each regional office, the originating Business Practice Unit's supervisor, and an economist in headquarters. Based on the report and reviewer comments, the supervisor either closes the review or opens an investigation and requests firm-level data from AMS.

*Committed Procurement Review and Audit*

P&SP monitors the use of "committed procurement" arrangements, which commit cattle and hogs to a packer more than 14 days prior to delivery. Each year, P&SP economists obtain fed-cattle and hog procurement data for the previous calendar year from the five largest beef packers and four largest hog packers. If the packers change their procurement arrangements with suppliers from previous years, P&SP also collects any new or modified written marketing agreements or contracts. P&SP economists review the contracts and, if necessary, discuss them with the packers to determine how the terms of the agreements relate to committed procurement categories of interest. Economists then classify, review, and tabulate the individual transactions data, and calculate the reliance of the top packers on committed procurement methods. Finally, P&SP economists reconcile the calculations based on the detailed transaction data on committed procurement as reported by the packers in their Packer Annual Reports.

If there are significant differences between the transaction data and the Packer Annual Report submissions on committed procurement, the economists contact the packers to identify the cause of the discrepancy. If necessary, P&SP meets with the packers in person to discuss the packers' procurement methods and explain how they should be reported on the Packer Annual Report. These meetings foster a mutual understanding of the reporting of requirements for committed procurement and more reliable reporting and calculation of the packers' reliance on committed procurement methods.

Relying on written contracts and other information collected during the committed procurement reviews, P&SP agents analyze the various procurement and pricing methods used by hog and fed-cattle packers. Agents obtain and review all available contracts and agreements to determine if there have been any competition violations of the Act. The contracts are also used in procurement reviews of the packers to help determine if proper payment practices are being followed.

In 2009, P&SP conducted regulatory reviews of the procurement practices of the four largest hog packers. The reviews included analyses of contractual arrangements that packers had with pork producers, and price relationships among various procurement arrangements. P&SP also assessed whether the procurement methods reported to the Agency in the packers yearly reports accurately reflect packer procurement transactions, and whether packers made pricing decisions based on the size of the producer.

P&SP's review revealed hog prices differed based on pricing and procurement methods and seller sizes. For example, hogs purchased on the negotiated market, hogs priced on a live-weight basis, and hogs sold by smaller sellers tended to receive lower prices. Purchases from smaller sellers were primarily on the negotiated market, with most of these hogs priced on a live-weight basis, while purchases from larger sellers were primarily through marketing agreements using carcass-merit pricing. Hogs procured in the negotiated live market tended to be priced higher compared to hogs of equivalent quality procured using the carcass-merit negotiated market, based on a 75-percent yield. P&SP will be pursuing investigations in 2010 to determine if these differences constitute price discrimination in violation of the P&S Act.

The hogs procured in the reviews were mostly purchased on a formula basis using both written and verbal arrangements. P&SP regulatory reviews revealed that hogs procured through verbal agreements but reported to AMS on a formula basis were being reported to P&SP as spot market transactions because the agreements were made within 14 days before slaughter.

*Poultry Contract Compliance Review Process*

In 2009 P&SP added a formal poultry contract compliance review as a component of P&SPs performance measure (see Performance and Efficiency Measurement section below). Contract reviews in addition to the reviews conducted based on a random sample may be initiated based on industry intelligence or complaints.

A documented, automated process has been implemented for P&SP agents to follow in conducting such reviews. In general, the agent will collect relevant background information on the firm that is under review prior to conducting a site visit. Once on-site, the agent will conduct an interview and obtain copies of the grower contract being used at the plant location and 3 months of weekly ranking sheets for the contract. These documents are reviewed for consistency and adherence to P&S Act regulations. One week of payment data from the settlement sheet is selected as a random sample for a detailed review for accuracy and completeness. The results are compared to the firm's ranking sheets, settlement sheets, and payments to the growers to ensure consistency with the contract. If discrepancies are found, an investigation is opened. If the firm's practices are determined to be free of violation, the agent provides an exit interview indicating this to the firm's management.

# ATTACHMENT G

THE HUFFINGTON POST
BREAKING NEWS AND OPINION

HuffPost Social News

**Temple Grandin, Ph.D**

Professor of animal science at Colorado State University, subject of the HBO film, Temple Grandin

Posted: October 20, 2010 12:00 PM

# Ag Department Proposal Threatens Animal Welfare

It seems that some people can't see how a regulation that looks good on paper will have bad consequences. That is what is happening at the U.S. Department of Agriculture (USDA) with a new proposal that would have major animal welfare consequences if it's finalized. I always worry about rules that come out of Washington because the bureaucrats who write them often have no practical experience in the real world and that sure comes through in this latest missive.

Congress told USDA's Grain Inspection, Packers and Stockyards Administration (GIPSA) to write some rules about what constitutes an "undue preference" in livestock marketing and procurement. GIPSA is the agency the monitors the marketing of livestock and poultry to ensure that things are done properly and that markets are competitive. But the USDA has gone way beyond what Congress told the department to do. As proposed, the department wants to prohibit meat packers from purchasing, acquiring or receiving swine or cattle from another packer or packer-affiliated company.

That means that an integrated beef-processing company that owns feedlots or production facilities would, for example, be required to ship cattle to either its own plant or sell the livestock to an independent dealer, perhaps hundreds of miles away, rather than selling the cattle or pigs to another company's packing plant very close to the ranch or farm.

Adding shipping time is stressful to livestock and stands to increase injury and potential death losses, particularly among pigs because they are more subject to transport stress. Companies that don't want to ship the livestock the additional distance would be forced to sell their livestock to independent dealers, who serve as middle-men, to facilitate transactions. This also would present unnecessary animal welfare risks, because the dealers likely would not have the animal handling programs and standards in place that have become the standards among production and processing facilities.

I'm also worried that the proposed rule would complicate and compromise the effectiveness of many established animal welfare-certification programs by requiring another level of paperwork and recordkeeping to track the additional transactions and premiums paid to producers for higher quality or niche raised animals.

Niche producers are some of the great success stories in livestock agriculture. Companies with products that bear labels like Certified Humane, American Humane Certified, Certified Angus Beef, Whole Foods or Niman Ranch have made commitments to the principles behind these labels. These companies need established relationships with farmers and ranchers they can trust to raise livestock in a way that is consistent with their brands and their humane labels. But the new proposal would make it easier for farmers and ranchers to sue meat companies that pay premiums to farmers who offer a higher quality animal that was raised in a certain way.

In my view, a farmer with a progressive, humane veal production system deserves a higher price than one offering sick, weak calves -- and no justification should be necessary. Some other examples would be grass-fed beef, certified cattle vaccination programs and specific housing requirements for animals. Producers raising animals to fit specifications should get more money for their animals.

As a scientist who has dedicated her life to improving livestock welfare, I am extremely alarmed that the department ultimately responsible for enforcing the Humane Slaughter Act apparently has paid so little attention to the animal welfare implications of this proposal.

I urge Agriculture Secretary Vilsack to reconsider this rule in order to maintain good animal welfare and to foster development of important niche markets that create many marketing opportunities for producers. This will help animal welfare, rural development and family farms.

# ATTACHMENT H

JOHN DUNHAM & ASSOCIATES

# The American Meat Institute
# Meat Demand Study

## The Impact of Proposed
## Grain Inspection, Packers and Stockyards Administration
## Proposed Rule

## Methodology and Documentation

Prepared for

AMI
AMERICAN MEAT INSTITUTE

1150 Connecticut Avenue, NW 12th Floor
Washington, DC 20036

By

John Dunham and Associates, Inc.
32 Court Street, Mezzanine
Brooklyn, New York 11215

August 24, 2010

GIPSA Model Methodology and Results

## Summary Results:

A regulation proposed by the Grain Inspection, Packers and Stockyards Administration (GIPSA) would, among other things, adversely affect packers' and their suppliers' willingness to use marketing agreements. The proposed rule increases the risk associated with using marketing agreements because it would change long standing judicial precedent and make it easier for a disgruntled supplier to sue and win in a Packers and Stockyards Act lawsuit. In doing so, the proposed rule creates a disincentive for packers to use such agreements.

These limitations in particular will introduce inefficiencies into the existing livestock marketing system, and reduce selling options for livestock producers, while at the same time increasing price, quality and supply variability for packers. Taken together, these inefficiencies will raise retail meat prices for consumers, leading to lower meat sales, less jobs for packers, retailers and most importantly producers. Another result will be seen in lost tax revenues throughout the country.

In 2009, the American Meat Institute commissioned an analysis of the combined impact of the meat processing, poultry processing, hide and skin production and offal production industries (hereafter meat and poultry products). The industry was defined to include not only the production of meat and poultry based products, but meat distribution and retailing. Based on that analysis, the industry contributed about $832 billion in total to the US economy in 2009, or just under 5.9 percent of GDP.[1] All told, about 6.19 million people depended on the industry for their livelihoods, with an estimated 1.3 million of those being livestock producers.

In addition, to providing jobs, wages and economic opportunity, the meat industry was shown to be an important contributor to the public finances of the community. In the case of the meat and poultry products industry, this contribution comes in two forms. First, the traditional direct taxes paid by the firms and their employees provide over $81.224 billion in revenues to the federal, state and local governments. In addition, the consumption of meat and poultry generates $2.4 billion in state sales taxes.[2]

**Table 1: Economic Impact of the Meat and Poultry Products Industry (2009)**

| ($ In Billions) | Direct[3] | Supplier[3] | Induced[3] |
|---|---|---|---|
| Output | $ 228.590 | $ 377.734 | $ 226.080 |
| Jobs | 1,816,940 | 2,581,580 | 1,794,110 |
| Wages | $ 45.522 | $ 84.319 | $ 69.851 |
| Taxes | | | $ 81.224 |

1 Based on GDP of $14.1 trillion. See: *Gross Domestic Product:* US Department of Commerce, Bureau of Economic Analysis. Available at: http://www.bea.gov/national/. Economic sectors based on IMPLAN sectors.

2 Significant local sales taxes are also generated; however, as there are over 50,000 different taxing jurisdictions these are extremely difficult to calculate.

3 Direct jobs are those involved in the packing, wholesaling, and retailing of meat and poultry products. Supplier jobs include livestock and poultry producers, as well as those working in other companies that supply goods and services to meat packers, wholesalers, and retailers. Induced impacts come about when those working in the direct and supplier sectors spend their income in the regional economy.

Table 1 on the prior page presents a summary of the total economic impact of the industry in the United States.

Were the proposed GIPSA rules to take effect, there would be significant disruptions in the manner in which livestock are supplied to the nation's meat processors. Rather than being able to count on a stable supply of animals, packers will for the most part be subject to an extremely variable "cash" or "spot" market (or a similarly variable futures market) to purchase their livestock. The resultant inefficiencies (as well as the slightly higher prices found on spot markets) will lead to an increase of about 3.33 percent in the retail price of meat at a national level. In the case of most consumer goods consumer demand is impacted by prices. Inefficiencies brought on by the proposed rule will therefore be translated into lower demand. In this case it is estimated that overall consumer demand for meat will fall by 1.68 percent.[4]

As meat sales fall, so too will jobs in the meat industry. Not only will there be fewer opportunities for packers, wholesalers and retailers, but producers and other suppliers will also see a reduction in demand and economic opportunities. All told, it is estimated that about 104,000 people would lose their jobs following the implementation of this rule. This would reduce national GDP by $14.0 billion, and would cost a total of $1.36 billion in lost revenues to the Federal, state and local governments.

Table 2 below presents a summary of how the impact of the Proposed GIPSA rule will impact the meat production industry, and Appendix Table 1 shows the employment impact by state, Appendix Table 2 [5] shows industry figures by state, and Appendix Table 3 shows the consumer impact by state.

Table 2: Economic Cost of the Proposed GIPSA Rules

| | Direct | Supplier | Induced | Total |
|---|---|---|---|---|
| Jobs (FTE) | 30,518 | 43,443 | 30,151 | 104,112 |
| Wages | $764,318,247 | $1,415,726,892 | $1,172,971,419 | $3,353,016,558 |
| Economic Impact | $3,838,461,850 | $6,350,851,492 | $3,795,974,168 | $13,985,287,510 |

## Methodology

Three separate models were constructed in order to develop the estimates presented in the Executive Summary above. First, the Meat and Poultry Industry Economic Impact Model (Model) for the United States (2009) was developed by John Dunham and Associates based on data provided by Dun and Bradstreet (D & B), the US Department of Agriculture and various state agriculture departments. The analysis utilizes the Minnesota IMPLAN Group Model in

4 This implies a price elasticity of demand of about -0.44, meaning that for a 10 percent increase in the price of meat, demand will fall by about 4.4 percent. This decrease in demand could be due to either smaller sales volumes, or a substitution of lower cost products (like chicken) for higher cost products like lamb. Demand elasticity data are from the US Department of Agriculture, see: You, Z., J.E. Epperson, and C.L. Huang, *A Composite System Demand Analysis for Fresh Fruit and Vegetables in the United States*, Journal of Food Distribution Research, (October 1996):11-22

5 Most recent data available for number of livestock on farms and number of operations with livestock and broiler chickens obtained from: National Agricultural Statistics Service, United States Department of Agriculture. Cash receipts from farm marketings obtained from *Meat and Poultry Facts* 2009, Sterling Marketing, Inc., 2009. Labor expenses for livestock workers is the sum of both hired and contract labor expenses in livestock obtained from United States Department of Labor, *The National Agricultural Workers Survey*, Census of Agriculture, (2002).

order to quantify the economic impact of the meat and poultry products industry on the economy of the United States. The model adopts an accounting framework through which the relationships between different inputs and outputs across industries and sectors are computed. This model can show the impact of a given economic decision – such as a factory opening or operating a sports facility – on a pre-defined, geographic region. It is based on the national income accounts generated by the US Department of Commerce, Bureau of Economic Analysis (BEA).[6]

Producer employment is based on a census of federal and state inspected facilities as of 2009. The Federal government and 27 states inspect meat processors and slaughterhouses.[7] Data were gathered from the Federal and state agriculture departments, entered into a database and physically located in a geographic analysis system. All told, there were almost 8,500 plants identified (although there were some duplicates). These data provided the number of plants and the physical location; however, none of the government entities had employment data available. In order to estimate employment, data were gathered from D & B for companies that reported a primary SIC of 2011 (establishments primarily engaged in the slaughtering of cattle, hogs, sheep, lambs, and calves for meat to be sold or to be used on the same premises in canning, cooking, curing, freezing, and in making sausage, lard, and other products; SIC 2015 (establishments primarily engaged in slaughtering, dressing, packing, freezing, and canning poultry, rabbits, and other small game, or in manufacturing products from such meats, for their own account or on a contract basis for the trade. This industry also includes the drying, freezing, and breaking of eggs; and SIC 2013 (establishments primarily engaged in manufacturing sausages, cured meats, smoked meats, canned meats, frozen meats and other prepared meats and meat specialties, from purchased carcasses and other materials. Products include bologna, bacon, corned beef, frankfurters (except poultry), luncheon meat, sandwich spreads, stew, pastrami, and hams (except poultry). Prepared meat plants operated by packinghouses as separate establishments are also included in this industry. These data were matched to the inspected location data where possible by company name, phone number, and physical location. For those establishments where a match could not be found econometric techniques were used to estimate an employee count. All told, the number of estimated employees was within 99 percent of estimates from the actual employment levels as found in the IMPLAN tables.[8]

Jobs were then assigned to meat or poultry processing and slaughtering based either on allocations provided by the departments of agriculture or based on the national percentage of jobs in each industry.[9]

For hides, skins and offal producers, employment at specific locations reported to D & B by the companies as of April 2009 for a number of industries including some companies with a primary SIC code of 2833 - establishments primarily engaged in manufacturing bulk organic and inorganic medicinal chemicals and their derivatives, as well as some companies with the primary

6 The IMPLAN model is based on a series of national input-output accounts known as RIMS II. These data are developed and maintained by the U.S. Department of Commerce, Bureau of Economic Analysis as a policy and economic decision analysis tool.

7 These states are: Alabama, Arizona, Delaware, Georgia, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Minnesota, Missouri, Mississippi, Montana, North Carolina, North Dakota, Ohio, Oklahoma, South Carolina, South Dakota, Texas, Utah, Virginia, Vermont, West Virginia, Wisconsin, and Wyoming. Source: *FSIS Review of State Meat and Poultry Inspection Programs,* United States Department of Agriculture, March 2010.

8 IMPLAN employment levels are based on county employment data as reported by the US Department of Labor, Bureau of Labor Statistics.

9 Based on the input output accounts of the United States as compiled by IMPLAN.

SIC 5159 this industry's products are animal hair, bristles, feathers, furs and hides, broom corn, raw cotton, hops, unprocessed or shelled-only nuts, tobacco leaf, raw silk, and bovine semen.[10] Data are as of April 2009.

Wholesale employment consists of the number of jobs by facility as reported to D & B by companies with a primary SIC code of 5147. This industry consists of wholesale distributors of fresh, cured, and processed (but not canned or frozen) meats and lard. Data are as of April 2009.

Data on the retail sectors are all based on data from D & B as of April 2009. Data on total employment by zip code was obtained from D & B's Zapdata system for establishments with the following primary SIC codes:

- 5411 Grocery Stores
- 5812 Eating Places
- 5813 Drinking Places
- 5421 Meat and Fish Markets
- 5431 Fruit and Vegetable Markets
- 5441 Candy, Nut, and Confectionery Stores
- 5451 Dairy Products Stores
- 5461 Retail Bakeries
- 5499 Miscellaneous Food Stores

Employment figures were then multiplied by the percentage of sales of meat in each store type as calculated by the US Department of Commerce Bureau of the Census.[11] The resulting figure was then adjusted to remove seafood sales from the calculation. The resulting figures were then allocated to states and congressional districts based on the percentage of total establishments in each zip code falling within the particular boundary.

Once the initial direct employment figures have been established, they are entered into a model linked to the IMPLAN database. The IMPLAN data are used to generate estimates of direct wages and output in each of the three sectors: production, wholesaling and retailing. IMPLAN was originally developed by the US Forest Service, the Federal Emergency Management Agency and the Bureau of Land Management. It was converted to a user-friendly model by the Minnesota IMPLAN Group in 1993. The IMPLAN data and model closely follow the conventions used in the "Input-Output Study of the US Economy," which was developed by the BEA.

The Economic Impact Analysis provides a base level of employment, jobs and taxes in the industry (See Table 1 above). These data were then linked to a meat demand model for each state in the country. This demand model is based on a series of demand functions created for each of the 50 states and the District of Columbia, and examines not only in-state demand for meat products, but cross-state sales that can occur due to differential meat prices in each of the states. In other words, the model estimates in-state demand of own-state taxed sales of meat, exports to and imports from other states. The model can be "shocked" with different price

10 Not in both cases only companies engaged in manufacturing and selling animal products were included in these data.

11 See: *Table 2.4.5U. Personal Consumption Expenditures by Type of Product,* US Department of Commerce, Bureau of Economic Analysis, Revised October 31, 2008.

changes (in this case a National price change) and the resulting adjustments to demand are calculated.

The general methodology is an estimation of current demand equation linked to a non-linear programming model of the import and export patterns. Initial demand is assumed to be equal to current retail sales in each state as based on the Economic Impact Model of the Meat Industry (2009). Each state's current demand is obtained in dollars, and linked directly to the cross-border methodology. Since the Impact Model includes all types of meat, poultry, and offal the total demand can be assumed to approximate the weighted-average demand of all of these products across the state.

Obtaining a weighted average price is more complicated since comprehensive (series level) data are only available for livestock. Since the model being developed depends more on the percentage change in price, average retail prices are calculated based on livestock prices per hundredweight obtained from the US Department of Agriculture.[12] After converting the chicken price to the same units as the other data was presented in, these raw livestock prices are then multiplied by a processing margin which reflects the value added by the packer who converts livestock into cuts of meat.[13] The resulting prices were weighed to reflect actual consumption patterns calculated from the average household expenditure on the four meats in the Consumer Expenditure Survey.[14] This gives a weighted producer price for meat. This was then adjusted by applying transportation, wholesale and retail margins from the US Department of Commerce, Bureau of Economic Analysis.[15]

The calculation outlined above provides a national average price for meat products, but the model is based on differential prices on a state by state basis. In order to calculate this, the national price is multiplied by an index of the relative cost of groceries in each state obtained from the Missouri Economic Research and Information Center.[16] The resultant product provides an average price for each state.

The price and volume data are entered into the demand model.

Linear Programming Model

A non-linear programming model is used to determine consumption and trade patterns based on the current values developed above and any subsequent price shocks. The model contains a series of matrices that are multiplied together to produce a trade flow matrix. The first matrix is a distance matrix that contains adjusted centroid distances among all 50 states and the District of

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12 United States Department of Agriculture, National Agricultural Statistics Service, Quickstats 1.0. 2010. Data are monthly prices on the following products: Pork = Sows prices per 100 lbs., Chicken = Broilers, price per lb., Lamb = Lamb, prices per 100 lbs., Beef = Cattle 500+lbs, prices per 100 lbs. See www.nass.usda.gov/Data_and_Statistics/Quick_Stats_1.0/index.asp

13 Processing margins are obtained from IMPLAN and reflect the value added by meat and poultry processors. The margins are weighted with the poultry margin accounting for 24 percent of the total.

14 Bureau of Labor Statistics, Consumer Expenditure Survey, 2008, Table 4500: Selected Age of Reference Person: Average Annual Expenditures and Characteristics, All Consumer Units http://www.bls.gov/cex/

15 Stewart, Ricky et. al., U.S. Benchmark Input-Output Accounts, 2002, US Department of Commerce, Bureau of Económic Analysis, October 2007.

16 Missouri Economic Research and Information Center, *Cost of Living Index, 2010 Q1*, Grocery Sub-Index, See: www.missourieconomy.org/indicators/cost_of_living/index.stm