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Administrator James E. Link
Grain Inspection, Packers and Stockyards Administration
U.S. Department of Agriculture
Stop 3601, Room 2055-South Building
1400 Independence Avenue, SW
Washington, DC 20250-3601

BY FAX: 202-205-9237

Dear Administrator Link:

We are writing to request an investigation of a pattern of practice by the meat packing industry that raises concerns regarding compliance with the Packers and Stockyards Act (P&S Act).[1] In 2003, Congress mandated a study to assess the effects on the market of packer ownership of livestock more than 14 days in advance of slaughter, and to examine alternative methods of procuring and selling livestock. The Grain Inspection, Packers and Stockyards Administration ("GIPSA") commissioned this livestock and meat marketing study from the Research Triangle Institute ("RTI"), and the final phase of the study was released in February of this year. While the RTI report contains a number of conclusions that are beyond the scope of this letter to address, the data included in the study reveal a particular pattern of pricing for cattle transactions that appears to raise issues regarding compliance with the P&S Act.

In particular, it appears from the market data analyzed and reported by RTI that there are two significant anomalies in the prices paid by meat packers for live cattle. First, it appears that the prices paid by meat packers for cattle sold on a live weight valuation basis are higher than the price paid for cattle that is sold on a carcass weight basis. Second, it appears that the prices paid for cattle that sold on a live weight basis are also higher than prices paid for cattle sold on a cash grid with quality and yield premiums and discounts. Together, it is estimated that these two price penalties for dressed weight and grid cattle lowered revenue for producers by more than $200 million in the period studied by RTI.

The RTI study states that in direct trade transactions based on a carcass weight valuation, the average cattle price is 1.3 cents lower than the average price for direct trade transactions with live weight valuation.[2] Even more striking is the difference for grid valuation transactions,

[1] R-CALF USA is requesting that the Administrator institute an inquiry on his own authority under 7 U.S.C. § 210(c), which provides broad authority to conduct inquiries "relating to the enforcement of any of the provisions" of the Act.
[2] RTI International, *GIPSA Livestock and Meat Marketing Study*, Vol. 3 (Jan. 2007) at 2-39.

where prices average 1.8 cents lower than the average price for direct trade transactions.[3] Assuming an average dressed weight for cattle of 781 pounds,[4] this price differential translates into a loss of $10.15/head for producers selling on a carcass weight basis and a loss of $14.06/head for producers selling on a cash grid basis compared to producers selling on a live weight valuation. It is important to note that these comparisons hold other explanatory variables for price differentials fixed in the model.[5] When this price difference is multiplied times the volume of cattle sold during the period examined by RTI, it adds up to a total loss of $202,631,068 for producers who sold their cattle on the cash market on a carcass weight or grid basis rather than a live weight basis.[6]

These results are counter-intuitive, and would seem to contradict a conclusion that packer pricing behavior creates incentives for producer quality. If the prices paid for cattle on a dressed weight basis or using a quality grid are lower than prices paid for cattle sold on a live weight basis, it would seem to create a disincentive for producers to make such sales and create an incentive to simply sell on a live weight basis. Yet, the prices a producer will receive when he sells on a carcass weight or grid basis cannot be known with certainty when a producer enters into such a sale arrangement. These sales transactions transfer to the producer some of the risk that his cattle will have lower quality or yield than the average animal. In return, the arrangements are also designed to provide producers with a premium if his cattle have higher-than-average quality or yield characteristics.

Yet, the fact that the average prices under these arrangements are lower than the average prices for cash sales on a live weight basis seems to reveal that the pricing arrangements for carcass weight and grid transactions fail to adequately compensate producers for the risks they take on. In fact, the distortion may be even greater than reflected in the gross averages if producers who tend to have higher quality and higher yield cattle are more likely to sell that cattle on a carcass weight and grid basis, and thus should not only be, on average, matching the price for live weight transactions overall but exceeding it. Producers may be accepting carcass weight and grid basis pricing terms that fail to reflect market fundamentals because they lack access to the same kinds of information that packers have regarding the prices, quality, yield, and other market dynamics, or for other reasons. Thus, pricing terms that appear to provide an advantageous opportunity for producers who prize the quality and yield characteristics of their cattle may actually be depriving these producers of the full revenue they would receive in an open and transparent market with more equal bargaining power between producers and packers.

In sum, the data suggest that packers have been able to manipulate the grid system to engineer a lower overall average return to producers who sell on a grid basis. This practice fails

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[3] *Id*.
[4] *Id*. at 1-21.
[5] *Id*. at 2-39.
[6] This estimate is based on a total of 58 million head of cattle sold reported to RTI from October 2002 through March 2005 and RTI statistics showing that 61.7% of these cattle were sold on the cash or spot market, 17% of which were on a carcass weight basis and 28% of which were on a grid basis. *Id*. at ES-3 – ES-4, 2-40.

to send the right market signals to producers and feeders, and it creates a counter-intuitive disincentive to sell on a grid basis and to seek premiums for yield and quality characteristics. The RTI data reveal an unreasonable and unfair depression of cattle prices for those producers who sell on a grid basis that is contrary to market fundamentals as well as being contrary to the overall theme of the RTI report.

R-CALF USA is concerned that these pricing patterns found in the RTI report reveal purchasing practices by meat packers that may violate the P&S Act. Section 202 of the P&S Act provides that it shall be unlawful for any packer to, among other things:

> (a) Engage in or use any unfair, unjustly discriminatory, or deceptive practice or device; or
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> (b) Make or give any undue or unreasonable preference or advantage to any particular person or locality in any respect, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect; or
>
> * * *
>
> (e) Engage in any course of business or do any act for the purpose or with the effect of manipulating or controlling prices … or of restraining commerce ….[7]

First, if meat packers are using carcass weight basis and grid basis transactions to depress prices, the practice could be unfair and deceptive in violation of § 202(a) and it could also allow packers to engage in price control or manipulation in violation of § 202(e). While courts have differed on the issue of whether such claims under the P&S Act must demonstrate that the practice alleged to violate the Act had an adverse effect on competition to succeed,[8] that issue should not hamper an investigation in this case. It is clear that the carcass weight and grid basis sales transactions are depressing prices for producers below the average price for cash transactions on a live weight basis. This price effect directly harms producers who sell their cattle on a carcass weight or grid basis, and may even operate to depress prices on the market overall over time. This price effect appears to contradict market fundamentals and to serve no purpose other than to transfer revenue from producers to packers. Such manipulation of the grid system harms competition and distorts the market. Thus, GIPSA should investigate whether the

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[7] 7 U.S.C. § 192(a), (b), (e).

[8] *See, e.g., London v. Fieldale Farms Corp.*, 410 F.3d 1295 (11th Cir. 2005) (finding that a showing of anti-competitive impact was required to prevail on an unfair practice claim under the Act), *cert. denied*, 126 S.Ct. 752, 163 L. Ed. 2d 574 (2005); *Spencer Livestock Com'n Co. v. Dep't of Agriculture*, 841 F.2d 1451 (9th Cir. 1988) (concluding that no such showing was necessary under the Act because the Act is not a mere mirror of the antitrust laws); *Wheeler v. Pilgrim's Pride Corp.*, No. 02-136 (E.D.Tex. Mar. 30, 2007) (finding that no showing of adverse effect on competition is necessary under the Act).

way in which packers use these transactions violates the P&S Act as an unfair or deceptive practice and as a form of price manipulation or control.

Second, it may be that the failure to adequately price risk and to adequately reward positive quality and yield characteristics operates as an "undue or unreasonable preference" in violation of § 202(b). In effect, the packers' practices act to confer a preferential price on producers selling on a live weight basis, with no reasonable basis for such a preference given that producers selling on a dressed weight or grid basis are assuming more risk and theoretically have an incentive to provide higher quality and higher yield cattle. Thus, the anomalous pricing pattern for carcass weight and grid basis transactions may also violate § 202(b) of the P&S Act.

The RTI study reveals that cattle producers selling their animals on a carcass weight basis or a grid basis have lost more than $200 million on these transactions in the period covered by the study. The anomalous price differential for dressed weight and grid basis cattle compared to cattle sold on a live weight basis appears counter-intuitive and contradicts a conclusion that packers use purchasing methods that provide an incentive for quality and yield. Instead, it appears that the uncertainty inherent in dressed weight and grid basis transactions, and the transference of that price risk from packers to producers through these types of transactions, has only operated to depress prices for live cattle and to deprive cattle producers of a market-based price for their product. As the courts have recognized, the purpose of the P&S Act is "to safeguard farmers and ranchers against receiving less than the true market value of their livestock"[9] These contracting practices appear to fall short of that standard. R-CALF USA respectfully requests that these practices be investigated by GIPSA to determine whether they may constitute an unfair or deceptive practice, an undue or unreasonable preference, or a practice resulting in price (and grid) manipulation or control in violation of the P&S Act.

Thank you for your attention to this important matter.

Sincerely,

R. M. Thornsberry DVM

R. M. Thornsberry, D.V.M.
President, R-CALF USA Board of Directors

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[9] *Bruhn's Freezer Meats of Chicago, Inc. v. U.S. Dep't of Agriculture*, 438 F.2d 1332 (8th Cir. 1971).