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April 26, 2010

David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Via E-Mail: www.regulations.gov

Re: ***R-CALF USA Comments Concerning Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations***

Dear Mr. Stawick,

The Ranchers-Cattlemen Action Legal Fund, United Stockgrowers of America (R-CALF USA) appreciates this opportunity to submit comments to the Commodity Futures Trading Commission (CFTC) concerning its proposed rulemaking on *Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations* (Proposed Rulemaking) published at 75 Fed. Reg., 4144-4172 (Jan. 26, 2010).

R-CALF USA, a national, non-profit trade association, is dedicated to ensuring the continued profitability and viability of the U.S. cattle industry and represents thousands of U.S. cattle producers on domestic and international trade and marketing issues. R-CALF USA's membership consists primarily of cow-calf operators, cattle backgrounders, and feedlot owners. Its members are located in 46 states and the organization has numerous local and state association affiliates, from both cattle and farm organizations. Various main street businesses are associate members of R-CALF USA.

R-CALF USA does *not* represent the entire U.S. beef supply chain. Rather, R-CALF USA exclusively represents the live cattle segment of the beef supply chain, meaning it represents the farmers and ranchers located across the U.S. who breed, birth, raise, and feed live cattle for breeding purposes and beef production. Many R-CALF USA members monitor closely the live cattle futures market because of its direct impact on live cattle cash prices. Some R-CALF USA members continue to use the commodities futures market in an effort to manage their risks associated with the cost of producing and feeding live cattle. And, some R-CALF USA members have ceased using the commodities futures market altogether due to the inexplicable volatility in the market, aberrations in the market that they attribute to manipulation, and their belief that the futures market is no longer responsive to fundamental supply and demand signals.

I. The CFTC Should Apply Reforms Recommended for Energy Contracts to Agricultural Commodities

A. The Futures Market for Live Cattle Is Broken

R-CALF USA believes the commodities futures market is fundamentally broken and no longer functionally capable of serving as an effective, economic risk management tool for U.S. cattle producers. Rather than to provide true price discovery, the live cattle futures market has become a device that enhances the ability of dominant market participants to manage, if not outright manipulate, both live cattle futures prices and cash cattle prices.

Evidence that the live cattle futures market is no longer functionally capable of serving as an effective risk management tool for U.S. cattle producers includes data that show the physical hedgers share of the long open interest in the feeder cattle futures market and the live cattle futures market declined from 52.4 percent and 67.6 percent, respectively, in 1998 to only 17 percent and 11.7 percent, respectively, in 2008.[1] Such a drastic decline in the physical hedgers open interests in just a 10-year period in these commodities show either or both that commercial (i.e., *bona fide* hedgers) interests are now avoiding the futures market (which they would not do if the market served an economically beneficial function) and/or speculator interests have now besieged the markets once dominated by actual sellers and buyers of the commodities.

Evidence, albeit anecdotal, that the cattle futures market is subject to undue influence by dominant market participants includes market events that occurred in October 2009. On the last trading day before the October 2009 futures contract expired, some outside force broke the October board, causing it to fall by the full $3.00 limit to $81.65 per cwt. However, the live cattle trade was at $87.50, resulting in an unexplained convergence that is suggestive of direct manipulation.

United States cattle producers sell their cattle into one of the most highly concentrated marketing structures in the U.S. economy – one that has exceeded levels generally considered to elicit non-competitive behavior and adverse economic performance.[2] Today, the four largest U.S. beef packers purchase and slaughter about 85 percent of all slaughter-ready U.S. steers and heifers.[3] Inherent to this high level of market concentration is substantial disparity between the

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[1] *See* The Accidental Hunt Brothers: How Institutional Investors Are Driving Up Food and Energy Prices, Michael W. Masters and Adam K. White, CFA, Table 10: Commodities Futures Markets – Long Open Interests Composition, July 31, 2008, at 34, available at http://accidentalhuntbrothers.com/wp-content/uploads/2008/09/accidental-hunt-brothers-080731.pdf.

[2] *See* A Review of Causes for and Consequences of Economic Concentration in the U.S. Meatpacking Industry, Clement E. Ward, Current, Agriculture Food and Resource Issues, 2001, at 1.

[3] *See* United States of America et al. vs. JBS S.A. et al., Amended Complaint filed on Nov. 07, 2008, U.S. District Court, Northern District of Illinois, Eastern Division, Civil Action No. 08-CV-5992, (The U.S. Department of Justice alleged, "Defendants [JBS S.A. and National Beef Packing Company, LLC] plus Tyson and Cargill together purchased over 85% - nearly 24 million – of these [fed] cattle.") at 3.

economic power of the hundreds of thousands of disaggregated U.S. cattle producers (i.e., cattle sellers)[4] and the economic power wielded by very few beef packers (i.e., cattle buyers).

As a result of this significant economic disparity, cattle producers, some of whom continue to rely on futures markets to offset price risk, are vulnerable to any market distortions caused by beef packers that may not only participate in the futures market as physical hedgers, but as significant speculators as well. The cattle futures market is susceptible to downward price movements – in contradiction of supply/demand fundamentals, when, e.g., beef packers, who may hold a physical hedging position in the market, also engage in substantial speculative short selling of the market. The effect of the beef packers' speculative short selling is to lower not only the futures market price, but also the cash spot market price, which is intrinsically tied to the futures market.

It is R-CALF USA's belief that futures market prices directly and significantly influence prices for all classes of cattle, including fed cattle, feeder cattle, stocker calves, and breeding stock, regardless of whether or not these cattle are included under any futures contract. For this reason, it is imperative that the futures market be protected from unfair, manipulative, and speculative practices that effectively distort otherwise competitive cattle prices.

B. The Cattle Futures Market Must be Protected from Manipulation by Speculators With a Vested Interest in the Prices for Cattle

R-CALF USA believes the ongoing distortions to and manipulation of the cattle futures markets, particularly those we believe are perpetrated through speculative short selling by one or more dominant beef packers and/or other concentrated/dominant trader, can be rectified by the Proposed Rulemaking's provision that traders holding positions pursuant to a *bona fide* hedge exemption would be prohibited from also trading speculatively.[5] To be effective, this provision would need to apply to any subsidiary, affiliate, or otherwise related entity of the *bona fide* hedger, particularly with respect to a dominant beef packer.

C. The Cattle Futures Market Must be Protected from Distortions Caused by Excessive Speculation

Like other commodity futures markets, the futures market for live cattle is highly susceptible to market distortion should excessive liquidity be introduced in the form of excessive speculation. The remaining participants in the U.S. live cattle industry, whose numbers have

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[4] There were 967,000 U.S. cattle operations in the U.S. in 2007. *See* Farms, Land in Farms, and Livestock Operations, U.S. Department of Agriculture, National Agricultural Statistics Service, Sp Sy 4 (08) a, February 2008, at 14.

[5] *See* 75 Fed. Reg., 4159.

already been reduced by an alarming 40 percent since 1980,[6] operate on slim margins and are highly vulnerable to even small changes in cattle prices.[7] As a result, cattle producers are particularly susceptible to financial failure caused by both market volatility and market distortions created by excessive speculation that can swing prices low, even for short periods, as they are operating in an industry already suffering from a long-run lack of profitability. In addition, small to mid-sized cattle producers do not have sufficiently deep pockets to cover margin calls associated with market volatility caused by excessive speculation, which, we believe, has rendered the cattle futures markets incapable of serving as an effective risk management tool for the small to mid-sized producer and is contributing to the ongoing exodus of these producers from the U.S. cattle industry.

R-CALF USA believes the ongoing distortions to the cattle futures market, particularly those we believe are created by excessive speculation, can be rectified by the Proposed Rulemaking's provision that would limit speculative positions by index funds and other trading entities that have no specific interest in the underlying commodity and bear no risk relative to the commodity's production or consumption. To achieve the goal of effectively preventing excessive speculation, which is known to facilitate abrupt price movements and price distortions in other futures markets,[8] we are inclined to agree with the recommendation made by Michael W. Masters:

> As a general rule of thumb, speculators should never represent more than 50% of open interest, because at that level, they will dominate the price discovery function, due to the aggressiveness and frequency of their trading. The level I recommend is 25%; this will provide sufficient liquidity, while ensuring that physical producers and consumers dominate the price discovery function.[9]

D. The Cattle Industry Must be Protected from Distortions In Feed Grain Prices Caused Also by Excessive Speculation

Because feed grains are a major component of production costs for fed cattle, the price of feed grains is a major consideration by *bona fide* hedgers when formulating expectations for future cattle prices. If feed grain prices are expected to rise – thus increasing the cost of cattle

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[6] The size of the U.S. cattle industry, as measured by the number of cattle operations in the U.S., declined from 1.6 million in 1980 to 983,000 in 2005 and further declined to 967,400 in 2007. *See* Fed. Reg. Vol. 72, No. 152, Wednesday, August 8, 2007, at 44,681, col. 2.

[7] *See* A Review of Causes for and Consequences of Economic Concentration in the U.S. Meatpacking Industry, Clement E. Ward, Current Agriculture Food and Resource Issues, 2001, at 2 ("[E]ven seemingly small impacts on a $/cwt. basis may make substantial difference to livestock producers and rival meatpacking firms operating at the margin of remaining viable or being forced to exit an industry.").

[8] *See, e.g.*, 75 Fed. Reg., 4148, col. 3.

[9] Testimony of Michael W. Masters, Managing Member/Portfolio Manager, Masters Capital Management, LLC, before the Commodities Futures Trading Commission, March 25, 2010.

production – without a corresponding expectation that beef prices also will rise, cattle feeders will attempt to offset the expectation of higher feed grain prices by purchasing feeder cattle at lower prices. The relationship between feed grain prices and cattle-feeder profitability has long influenced pricing decisions by *bona fide* hedgers. If, however, feed grain prices are themselves subject to non-market forces such as excessive speculation, as they were during the 2008 commodity bubble, the profitability of cattle feeders can be immediately affected. And, this lack of profitability, or reduced profitability, immediately translates into a perception that feeder cattle must be purchased at lower prices to offset the resulting increase in production costs. Thus, distortions in futures feed grain prices result in distortions to cattle futures prices and must be eliminated. R-CALF USA believes that effective speculative position limits imposed on all feed grain commodities markets would alleviate the transference of market distortions from the feed grains futures market to the cattle futures market.

II. The CFTC Should Consider Additional Reforms to Protect the Integrity of the Cattle Futures Market

The CFTC must ensure that the cattle futures market is always dominated by *bona fide* hedgers. In addition, the CFTC should strictly curtail, if not completely eliminate, the practice of allowing passive speculation in the commodities futures market by entities that hold large market positions without any interest in the underlying commodity and without any risk relative to the commodity's production or consumption. We further believe it important that the CFTC recognize the two types of excessive speculation that has invaded the cattle futures market: 1) the excessive speculation by one or more dominant market participants with market shares sufficient to engage in market manipulation (this can include dominant beef packers acting speculatively as discussed above or any other concentrated/dominant speculator), and 2) the excessive speculation by those without any vested interest in the underlying commodity and without any risk relative to the commodity's production or consumption (including both active and passive speculators). Both of these types of excessive speculation contribute to market distortions that are harmful to *bona fide* market participants, as well as to consumers who ultimately consume products derived from these commodities.

To achieve the optimal level of liquidity provided by speculators, it would be important that the actual speculative position limits for one or more concentrated/dominant speculators and the overall actual limit of speculation in the cattle futures market be established by *bona fide* hedgers in the futures market and adjusted by them from time-to-time as conditions may warrant. Further, we believe the CFTC should restore daily market price limits to levels that minimize market volatility. The previous daily market limit in the cattle futures market of $1.50, which could still be adjusted upward following extended periods of limit movement, resulted in far less volatility than the current $3.00 daily market limit. Finally, we seek a reform to the practice of allowing cash settlements on futures contracts in lieu of actual delivery of the commodity, a practice that effectively lowers the cattle futures price on the day of contract expiration.

III. Conclusion

We look forward to working with the CFTC to eliminate manipulation and other practices that have caused artificial price distortions in the commodities futures market and relegated the cattle futures market to an ineffective tool for price discovery and risk management for U.S. cattle producers. We appreciate the CFTC's Proposed Rulemaking that acknowledges many of the key factors that have contributed to the commodity futures market's perverse outcome and we encourage the CFTC to take the additional steps recommended above to ensure that the commodities futures market can function as a meaningful price discovery and risk management tool for the U.S. cattle industry.

Sincerely,

Bill Bullard, CEO