Fighting for the U.S. Cattle Producer!

R-CALF USA

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March 28, 2011

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 Position Limits for Derivatives: Notice of Proposed Rulemaking (RIN 3038-AD15 and 3038-AD16)***

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 Notice of Proposed Rulemaking on *Position Limits for Derivatives* (proposed rule) published at 76 Fed. Reg., 4752 *et seq*. (Jan. 26, 2011).

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 strongly supports the CFTC's rigorous implementation of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 by setting meaningful position limits to prevent excessive speculation, market manipulation, and ensure market liquidity for *bona fide* hedgers and preserve the price discovery function of the futures market. Our direct interest is in the core referenced futures contracts: Chicago Mercantile Exchange (CME) Feeder Cattle (Feeder Cattle) and CME Live Cattle (Live Cattle). R-CALF USA members also are end-users of energy commodities and feed commodities, so we have an indirect interest in the reform of these futures market contracts as well.

A. Cattle Futures Markets Are Uniquely Susceptible to Manipulation

Due to the highly concentrated structure of the U.S. cattle industry, the end-users of the commodity Live Cattle, which are the meatpackers that convert live cattle into consumable beef, are uniquely positioned to manipulate the market. Today just four meatpackers control over 80 percent of the fed cattle, or Live Cattle, market.[1] This level of market concentration is cause for alarm. Oklahoma State University Economist Clement Ward asserted in 2002 that concentration levels in the U.S. meatpacking industry were already among the highest of any industry in the United States, "and well above levels generally considered to elicit non-competitive behavior and result in adverse economic performance."[2] With tremendous market power arising from their dominant market positions, the four largest meatpackers possess the capacity to manipulate markets, and the prospect of procuring Live Cattle at prices below fair market value is a compelling incentive for such behemoth margin operators to manipulate Live Cattle prices.

The factors giving rise to manipulation concerns in the Live Cattle market are becoming increasingly prevalent in the Feeder Cattle market as well. Today, two of the largest meatpackers that are among the largest purchasers of Live Cattle also own the largest of feedlots, making them among the largest Feeder Cattle end-users/buyers in the nation. For example, meatpackers Cargill and JBS are the second and third largest meatpackers in the U.S., respectively, and also the third and first largest cattle feeders, respectively.[3] Thus, the dominant market participants in the Live Cattle market are becoming dominant participants in the Feeder Cattle market, where their economic interests are the same – they have an interest in reducing the price of cattle.

R-CALF USA has long suspected that the largest meatpackers were engaged in cattle futures market strategies that enabled them to, either individually or through their agents, manipulate the cattle futures market to lower cattle prices, both in the futures market and in the cash market. Recently, the CFTC completed an investigation that substantiated R-CALF USA's suspicions by implicating meatpacker JBS in a cattle futures transaction that resulted in the

[1] *See* Figure 15, Combined Market Share of the Four Largest Steer and Heifer Slaughter Firms, Four Largest Cow and Bull Slaughter Firms, 2010 Annual Report, Packers and Stockyards Program, U.S. Department of Agriculture, Grain, Inspection, Packers and Stockyards Administration, March 2011, at 48, available at http://archive.gipsa.usda.gov/pubs/2010_psp_annual_report.pdf.

[2] 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, 2002, at 1, available at http://caes.usask.ca/cafri/search/archive/2002-ward3-1.pdf.

[3] *See*, e.g., Recent Acquisitions of U.S. Meat Companies, Congressional Research Service, 7-5700, RS22980, March 10, 2009, at 2 ("The proposed JBS acquisition of Five Rivers Ranch Cattle Feeding, which was part of the Smithfield deal, also took place, making JBS the largest cattle feeder in the United States."); *see also id*., Table 1 (Cargill Cattle Feeders, LLC, was ranked as the third largest cattle feeding company in 2006, marketing approx. 6 percent of the nation's fed cattle). Based on information and belief, Cactus Feeders, Inc., and Friona Industries, LP, which also are listed in Table 1 as among the largest cattle feeding companies, are considered captive feedlots and predominantly market their cattle to only one meatpacker.

CFTC's imposition of a $220,000 fine for commission merchant Newedge USA, LLC (Newedge).[4]

According to the CFTC order issued in this matter, Newedge purchased 4,495 October 2009 live cattle futures contracts on the CME from their client JBS, and then Newedge sold JBS an over the counter swap (OTC) in live cattle on Oct. 9, 2009 – a transaction that caused Newedge to exceed the 450 contract speculative limit for trading live cattle by 4,045 contracts.[5]

R-CALF USA recognized the Live Cattle market was functioning abnormally during the month of October 2009. In December 2009 it informed the U.S. Department of Agriculture (USDA) Grain Inspection, Packers and Stockyards Administration (GIPSA) that some outside force had broke the October board, causing it to fall the $3.00 limit and resulting in an unexplained convergence that was suggestive of direct manipulation. R-CALF USA also informed the CFTC of this anomaly in April 2010.[6] However, it was not until the CFTC's 2011 announcement regarding the unlawful futures transaction that took place in October 2009 did R-CALF USA have any inkling as to what outside forces were at work to disrupt the futures market.

The point is this: Neither cattle producers nor their organizations have access to nor knowledge of the specific cattle futures market practices employed by the dominant meatpackers or their agents. As a result, the integrity of the cattle futures market is dependent on the CFTC's vigilance in monitoring the meatpackers and the meatpackers' agents' practices and its aggressive enforcement of market rules. In addition, the CFTC should, in this rulemaking, determine if the position limits set for the Live Cattle futures contract and Feeder Cattle futures contract are adequate to eliminate any potential for manipulation by the highly concentrated meatpackers that have both the market power and incentive to manipulate the markets.

B. The CFTC Must Monitor Its Initially Set Position Limits to Determine if they Function to Attract or Deter Physical Hedgers

There has been an ever-decreasing share of physical hedger interests in the Live Cattle and Feeder Cattle markets as evidenced by 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,

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[4] *See* CFTC Orders Chicago-Based Futures Commission Merchant Newedge USA, LLC to Pay More than $220,000 for Violating Speculative Position Limits in Live Cattle Futures Trading, CFTC, Release PR5981-11, Feb. 7, 2011, available at http://www.cftc.gov/PressRoom/PressReleases/pr5981-11.html.

[5] *See* Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions, In the Matter f Newedge USA, LLC, Respondent, CFTC Docket No: 11-07, available at http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfnewedgeorder020711.pdf.

[6] *See* R-CALF USA Comments Concerning Proposed Federal Speculative Position Limits for Referenced Energy Contracts and Associated Regulations, submitted April 26, 2010.

respectively, in 2008.[7] Such a drastic decline in the physical hedgers open interests in just a 10-year period in these commodities show either or both that physical hedger 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. These data may provide a useful benchmark for making changes to position limits after the proposed rule takes effect. If the initially set position limits for Live Cattle and Feeder Cattle (i.e., those established in Appendix A to Part 151 of the proposed rule) do not facilitate increased market share by physical hedgers, with a corresponding reduction in the speculators share, then the position limits should be further reduced for the next available period in an attempt to reverse this unfavorable, long-term trend. R-CALF USA is concerned that the initial starting-point for position limits may be too high, and our recommendation is that they be lowered quickly if speculator interests continue to dominate the cattle futures market.

C. The CFTC Should Draw a Clearer Line Between Physical Hedgers and Speculators to Ensure that Dominant Physical Hedgers do not Unduly Influence the Market by Assuming a Dual Role of Both Physical Hedger and Speculator

Give the dominance of just four meatpackers that control the lion's share of the Live Cattle market and a growing share of the Feeder Cattle market, the CFTC must protect the integrity of the market from meatpackers that, acting individually or through their agents, would far exceed their respective physical hedging requirements to engage also in speculative practices, such as speculative short selling, that would have the effect of artificially lowering the price of either Live Cattle or Feeder Cattle. The CFTC should reserve for itself the authority to reset position limits mid-year in the event that market anomalies indicate excessive speculation by meatpackers acting as speculators or by any other market participant.

We appreciate the CFTC's ongoing efforts to eliminate manipulation, excessive speculation, and other practices that cause artificial price distortions in the commodities futures market. We urge the CFTC to issue its final rule expeditiously.

Sincerely,

Bill Bullard, CEO

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[7] *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.