

## **Petition for Rule-making on Captive Supply Procurement Practices under the Packers and Stockyards Act**

Submitted by  
The Western Organization of Resource Councils

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### **Introduction**

The Western Organization of Resource Councils (WORC) petitions Secretary of Agriculture, Dan Glickman, to exercise his authority under the Packers and Stockyards Act to issue rules restricting packers' use of certain procurement practices to acquire captive supplies of slaughter cattle. WORC requests that the Secretary issue rules 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.
2. Prohibit packers from owning and feeding cattle, unless the cattle are sold for slaughter in an open, public market.

Packers' direct ownership and feeding of cattle for slaughter and their procurement of slaughter supplies through forward contracts have decreased prices paid to cattle producers. In addition, because 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. Thus, these practices are in violation of Section 202 of the Packers and Stockyards Act (7 U.S.C. § 192) and should be restricted through rules.

The Western Organization of Resource Councils (WORC) is a federation of grassroots organizations: the Western Colorado Congress (Colorado), the Idaho Rural Council (Idaho), the Dakota Resource Council (North Dakota), Dakota Rural Action (South Dakota), the Northern Plains Resource Council (Montana) and the Powder River Basin Resource Council (Wyoming). WORC was formed in 1979.

These six organizations are composed of affiliated citizens' groups in 42 communities across the region. The 6000 members of these groups are farmers, ranchers and small business and working people who seek to protect natural resources, family farms and rural communities. They include both cattle ranchers and beef consumers.

### **Language of Rules**

This petition for rule-making is submitted pursuant to the Administrative Procedures Act, 5 U.S.C. § 553(e) and USDA regulation 7 C.F.R. § 1.28. The statute provides that "each agency shall give an interested person the right to petition for the issuance, amendments, or repeal of a rule."<sup>1</sup> In addition, the USDA regulations provide that interested persons can petition USDA officials to issue, amend or repeal a rule.<sup>2</sup> WORC asks that the Secretary publish the following proposed rule in the Federal Register and invite public comment both in writing and at USDA-sponsored informal public hearings:

### **Restrictions on the Use of Captive Supply Procurement Practices**

#### **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. All forward contracts used by packers for purchase of cattle slaughter supplies shall contain a firm base price that can be equated to a specified dollar amount at the time the contract is entered into and be offered or bid in an open, public manner.

- a. The term "forward contract" means any contract, whether oral or written, for purchase of cattle that provides for their delivery to a packer at a date more than seven days after the date the contract is entered into, without regard to whether the contract is for a specified lot of cattle or for a specified number of cattle during a certain period such as a week, month or year.

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<sup>1</sup> 5 U.S.C. § 553(e).

<sup>2</sup> 7 C.F.R. § 1.28.

- b. The term “formula or basis price” means any price term that establishes a base from which the purchase price is calculated by reference to a price that will not be reported until a date after the day the forward contract is entered into. For example: (1) “formula price contract” would include a contract in which the base is the average reported cash price for some day or week in the future, and (2) “basis price contract” would include a contract in which the base is determined with reference to a futures market price that will not be determined until some future date.
- c. This section permits the use of forward contracts under which producers will be paid more or less than the firm base price, when the adjustments to the base are for quality, grade or other value factors that are readily verifiable market factors and are outside the control of the packer/buyer.
- d. The phrase “offered or bid in an open, public manner” means that the offer or bid is made in a forum (1) to which both potential buyers and sellers in general have access, (2) designed to solicit more than one blind bid, and (3) that allows sellers and buyers to witness bids made and accepted. For example, a forward contract could be traded in an electronic market to which both cattle sellers and buyers in general have access.

## **2. Restrictions on Packer Ownership of Cattle**

No packer shall own and feed cattle unless those cattle are sold for slaughter in an open, public market.

- e. This provision does not apply to cattle owned by a packer for fewer than seven days before slaughter.
- f. This provision applies to cattle owned by a packer without regard to whether they are fed at a packer owned facility or on contract at a facility owned by another.
- g. The term “public market” means a forum (1) to which both potential cattle buyers and sellers in general have access, (2) which is designed to solicit more than one blind bid, and (3) which allows sellers and buyers to witness bids made and accepted. The term “public market” includes, but is not limited to, live auction markets, video auction markets and electronic markets.

## **Explanation of the Rule**

### **A. Forward Contracts**

The forward contract provision of this rule prohibits packers from using “formula or basis price” forward contracts. This does not mean that packers can no longer use forward contracts to procure slaughter supplies. In fact, 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 difference is that the base price could not be the average reported cash price at some future date or a reference to a futures price that will not be determined until some future date. This part of the proposed rule attempts to eliminate the problem identified by the minority report of the USDA Advisory Committee on Agricultural Concentration:

The problem with formula pricing, as it is currently used, is not a problem of value pricing. Rather, the problem lies in the base from which the carcass value is calculated. In all the methods currently used, the packer has the power to artificially lower the base price from which premiums and discounts are calculated.

When 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. . . .

When the formula is based upon the average spot price for the preceding period, that base has three weaknesses which can be used to artificially lower the price received by the producer. First, formula producers and packers claim that the best cattle are sold on a formula basis. That means that the pool of cattle sold on a spot basis is below average in quality. Thus, the “average” market price upon which the formula cattle are sold is, in reality, a below-average price. Second, the base price is again determined in large part by the packers’ own market activities. They determine what price is bid for non-contract cattle. If they bid low for non-formula cattle, their price for formula cattle will likewise be lower. Regardless of whether

packers act consciously in this manner, it is in their best interest to do so. . .  
. Finally . . . the use of captive supply thins the market.<sup>3</sup>

As a result of this finding the minority report recommended that “formula contracts as they are presently constituted should be banned” and “value-based pricing must be based upon readily verifiable market factors outside the control of the packer/buyer.”<sup>4</sup>

The proposed rule on forward contracts also requires that all forward contracts for procurement of slaughter supplies must be “offered or bid in an open, public manner.” Under the proposed rule, in addition to containing a firm base price, all forward contracts must be offered or bid publicly to producers in general. This addresses another recommendation of the Advisory Committee on Agricultural Concentration minority report—that value-based pricing “must be made uniformly available within the limits of the packers’ purchasing needs.”

Requiring firm-base price, publicly bid forward contracts for slaughter supplies is a constructive reform. It meets the packers’ need for orderly procurement and provides them assurance that their competition is not “stealing” cattle (assurance that only public bidding can provide). By allowing forward contracts with firm base prices to continue, it meets the needs of the cattle producers’ lenders’ for security and solid cash flow projections for their loans. Further, it meets the entire industry’s need for timely, accurate, value-based, competitive price discovery.

A system of firm-base price, publicly bid forward contracts for slaughter supplies is friendly to smaller feeders, who are at the greatest disadvantage in direct “negotiation” and most easily pressured into exploitative, captive supply contract arrangements. It is friendly to custom feeders who have a hard time attracting investors in today’s manipulated market. And it is friendly to the basic cow/calf and feeder cattle markets, because it would work against the current severe discounting of feeder prices in response to the volatility of the fat cattle market. Finally, it would make retained ownership by the cow/calf or feeder operator throughout the fed cattle stage a viable option. Currently, retained ownership involves an intolerable and unnecessary degree of price risk.

Under this proposal feeders will not lose the ability to enter into forward contracts. With the use of hedges and options, up-to-date price reports from USDA and a public

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<sup>3</sup> *Concentration in Agriculture: A report of the USDA Advisory Committee on Agricultural Concentration*, Agricultural Marketing Service, USDA, June 1996, p. 31.

<sup>4</sup> *Id.* at 31.

open-bid market for slaughter supplies, feeders could forward contract at any point in the feeding process.

To make this system work, there needs to be a formally organized market in firm-base price bid forward contracts - a bit like a NASDAQ exchange for livestock. The able, ambitious people in the marketing sector of the livestock industry certainly can provide this vital market service. Several examples exist today of functioning electronic markets for agricultural commodities. The most applicable of these is BeefEx, or the Beef Exchange, an electronic exchange set up by the operators of the cotton exchange in Lubbock, Texas. There is also an electronic market for fed cattle in Canada (TEAM).

### **B. Packer Ownership of Cattle**

Under the proposed rule setting restrictions on packer ownership and feeding of cattle, packers could still feed their own cattle but they would be required to offer them for sale publicly. This could be done through a livestock auction yard, an electronic market or some other equivalent method of soliciting blind, open bids. Presumably, in most cases, a packer would outbid the other packers for its own animals. By requiring the public sale of those cattle, their value and impact on overall cattle prices would be properly reflected in the market. The physical movement of cattle and the packers ability to coordinate production and plan slaughter would be the same as now. The only difference would be that market demand for cattle would be publicly expressed and the true price discovered in the market.

As with forward contracts, packer-fed cattle can be publicly offered through electronic exchanges or some other equivalent method. There is widespread recognition that electronic markets could improve competition and provide better price discovery if all parties would participate. Historically, however, packers have been reluctant to do so, especially when they have benefited from less than perfect price discovery under the status quo.

### **C. Public Market**

The requirements that packer-fed cattle and firm-base price forward contracts be traded publicly means that they are traded in a market forum in which both buyers and sellers have general access. It does not mean that more than one bid must be made before the sale is completed. Rather, it means that the bid is made in a forum designed to solicit more than one bid and which allows other sellers and buyers to witness the bids made and accepted. The proposed rule does not limit any producer's ability to accept a bid, as long as it is a firm-base price bid and the offer and acceptance are made openly and in such a way that anyone can offer and anyone can buy.

### **Standards for Issuance of Informal Rules**

Final agency rules are accorded an assumption of procedural and substantive regularity.<sup>5</sup> This deferential standard of review of an agency's final rule decision "presumes the validity of agency action and *prohibits the reviewing court from substituting its judgment for that of the agency.*"<sup>6</sup>

Courts will defer to the agency's interpretation of statutory language that it has been charged with implementing when: (1) the action is within the agency's scope of authority, (2) the action is not arbitrary and capricious, and (3) the agency has followed required procedures.<sup>7</sup>

The arbitrary and capricious standard of review is a narrow one.<sup>8</sup> Under this narrow review standard, USDA's action to issue a rule need merely be rationally based on an administrative record: the agency's action can be set aside as arbitrary and capricious "only where it is not supportable on any rational basis."<sup>9</sup> An agency decision which demonstrates that the agency examined relevant data and articulated "a rational

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<sup>5</sup> Colorado Health Care Ass'n v. Colorado Dept. of Social Services, 842 F.2d 1158 (10th Cir. 1988); McLeod v. I.N.S., 802 F.2d 89 (3rd Cir. 1986); Diaz-Soto v. I.N.S., 797 F.2d 262 (5th Cir. 1986); Organized Fisherman of Florida V. Hodel, 775 F.2d 1544 (11th Cir. 1985); Air Pollution Control District of Jefferson County, Kentucky v. U.S. EPA, 739 F.2d 1071 (6th Cir. 1984); and National Small Shipments Traffic Conference, Inc. v. ICC, 725 F.2d 1442 (D.C. Cir. 1984).

<sup>6</sup> Manasota-88, Inc. V. Thomas, 799 F.2d 687, 691 (11th Cir. 1986).

<sup>7</sup> Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402 (1971); and Ethyl Corp. v. E.P.A., 541 F.2d 1 (D.C. Cir. 1976).

<sup>8</sup> Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971).

<sup>9</sup> United States v. Means, 858 F.2d 404, 409 (8th Cir. 1988), *cert. denied*, 492 U.S. 910 (1989)(quoting Brotherhood of Railway and Airline Clerks v. Burlington Northern Inc., 722 F.2d 380, 380 (8th Cir. 1983)).

connection between the facts found and the choice made” will not be reversed under this standard.<sup>10</sup>

The following extensive discussion of economic studies, the Packers and Stockyards Act’s legislative history, the statutory language and case law provides all of the necessary factual and legal bases for issuance of this proposed rule. The numerous cited economic studies present a substantial factual basis for the rules. The legislative history and case law demonstrate that there is a rational connection between the facts established in the studies and the decision to issue the proposed rules pursuant to Section 202 of the Packers and Stockyards Act, 7 U.S.C. § 192.

## **Economic Evidence Supporting the Proposed Rule**

### **A. Impact of Concentration on Prices**

Fifteen years ago the top four firms in steer and heifer slaughter controlled about 35% percent of the market, five years ago the four-firm concentration ratio for steer and heifer slaughter was about 70 percent, today it is over 80 percent.<sup>11</sup> These figures are measured on a national basis. However, when concentration is measured in smaller geographic market areas it is often even higher than when measured on such a broad basis. Two studies from Oklahoma State University demonstrate this point, as the author of those studies reports:

The four largest buyers of fed cattle in the Southern Plains (Southwest Kansas, Oklahoma Panhandle, and Texas Panhandle) bought 81 percent of fed cattle purchases in a study using 1979 data and 96 percent of fed cattle purchases in a similar study ten years later. Both percentages are considerably higher than the four-firm concentration

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<sup>10</sup> See, *Motor Vehicles Mfrs. Ass’n v. State Farm Insurance Agency*, 463 U.S. 29, 43 (1983).

<sup>11</sup> Helmuth, John W., *Buyer concentration in Livestock Markets: Trends, Impacts, and Implications*, Iowa State University, Address to Dakota Rural Action, July 10-12, 1995, at 1.



ratio of U.S. steer and heifer slaughter for the same years, 34.5 percent in 1979 and 70.4 percent in 1989.<sup>12</sup>

When just four packing firms have such a large share of the steer and heifer slaughter market, their individual buying decisions may have an effect on prices paid to cattle producers. Such effects may occur whether or not the packers deliberately take actions to manipulate prices. As Dr. John Helmuth has stated: “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.”<sup>13</sup>

The Center for Rural Affairs reports on a series of economic studies examining concentration’s effect on prices:

There 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).<sup>14</sup>

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<sup>12</sup> Ward, Clement E., *Meatpacking Industry Changes: Causes and Consequences*, Department of Agricultural Economics, Division of Agricultural Sciences and Natural Resources, Oklahoma State University, A.E. Paper 92137, December 1992, at 4, citing Ward, Clement E. *Relationship Between Fed Cattle Market Shares and Prices Paid by Beefpackers in Localized Markets*, Western Journal of Agricultural Economics 7(1982): 79-86: and Ward, Clement E. *Inter-firm Differences Between Fed Cattle Prices in the Southern Plains*, American Journal of Agricultural Economics, 74(1992):2 480-85.

<sup>13</sup> Helmuth, John W. (1995), *supra* note 9 at 1.

<sup>14</sup> Strange, Marty, Nancy L. Thompson, *Competition and the Livestock Market: Report of a Task Force Commissioned by the Center For Rural Affairs*, Center For Rural Affairs, Walthill, Nebraska, April 1990, at 10.

There is now also a considerable amount of research on the relationship of packer concentration and prices paid to livestock producers. This research strongly suggests that significantly depressed market prices have accompanied increases in concentration in regional markets. The Center for Rural Affairs reported on several of these studies that used data from periods when the meatpacking industry was much less concentrated than it is today:

One study (Quail 1986) analyzed the impact of market concentration on fed cattle prices in 13 regional markets between 1971 and 1980. Among the study's conclusions:

For every 10 percentage point increase in market share held by the top four firms in a market, fed cattle prices dropped \$.14 per cwt.;

in the four major regional markets, the four leading packers controlled from 67% to 97% of the market in 1980 and in each case there was a statistically significant negative correlation between concentration and market prices;

the increase in packer concentration between 1971 and 1980 is estimated to have cost cattle feeders \$.19 per cwt., or \$45.2 million in 1980 alone;

the price-depressing effect of buyer concentration averaged about 1.7% over the period 1976-1980;

if the four leading packers in the four leading regions had had only 40% of the market between 1976 and 1980, instead of the 55% to 85% they actually averaged, average cattle prices would have been \$.47 higher and cattle feeders would have had \$82 million more income.

Another study (Menkhaus et al 1981) analyzed the impact of concentration on fed cattle prices in twelve major cattle feeding states in 1972 and 15 states in 1977. It found that in both years more concentrated markets yielded lower fed cattle prices. In 1972, for each 10 percentage point increase in the share of the market procured by the top four packers, the price of choice steers fell \$.145 per cwt., and in 1977, \$.22 per cwt. This amounts to a price depressing effect of about 1.2% in 1972 and 1.6% in 1977.

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Ward (1981) considered the relationship between number of buyers and prices paid for fed cattle in 31 feedlots or marketing agencies in six regional markets in July, 1979. He found such a relationship in one of the four markets. In that market, each additional bidder raised prices \$.22 to \$.28 per cwt.

Not all studies reach such clear conclusions. Using the same data from July, 1979, Ward (1982) analyzed the relationship between market shares held by packers in local markets and prices paid for fed cattle in those markets. He concluded that larger packers were not depressing prices in local markets and found no evidence of lower prices in more concentrated markets.

But Ward (1983) did find that when there was a sudden change in the local hog market structure caused by the closing of Oklahoma's only pork plant, prices at the Oklahoma City terminal market in the year following the plant closing averaged \$.63 to \$1.05 lower per cwt. than in Kansas City and Omaha terminals and direct trade markets in interior Iowa-Southern Minnesota in the year following the plant closing.<sup>15</sup>

Two more recent studies, one published in December 1990 by Bruce W. Marion, Frederick E. Geithman and Gwen Quail, and one published by John R. Schroeter and Azzeddine Azzam in 1991, on the relationship between regional fed cattle prices and

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<sup>15</sup> From *Competition and the Livestock Market: Report of a Task Force Commissioned by the Center for Rural Affairs, Walthill, Nebraska*, Wes Sandall et al., Center for Rural Affairs, Walthill, Nebraska, April 1990, at 10, 11, citing (1) Quail, Gwen, Bruce Marion, Frederick Geithman, and Jeffrey Marquardt, 1986, *The Impact of Packer Buyer Concentration on Live Cattle Prices*, Working Paper 89, NC-117, University of Wisconsin-Madison; (2) Menkhaus, Dale J., and James S. St. Clair, and Zahedi Ahmaddaud, 1981, *The Effects of Industry Structure on Price: A Case in the Beef Industry*, *Western Journal of Agricultural Economics*, 6(1981): 147-53; (3) Ward, Clement E. 1981, *Short-Period Pricing Models for Fed Cattle and Impacts of Wholesale Carcass Beef and Live Cattle Futures Market Prices*, *Southern Journal of Agricultural Economics*, 13(1981): 125-32; (4) Ward, Clement, E. 1982, *Relationship Between Fed Cattle Market Shares and Prices Paid by Beefpackers in Localized Markets*, *Western Journal of Agricultural Economics*, 7(1982): 79-86; and (5) Ward, Clement E. 1983, *Price Impacts of a Structural Change in Pork Processing: A Case Study in Oklahoma*, Oklahoma State University, *Current Farm Economics*, 56(1983): 3-9.

meatpacking concentration, also demonstrate that higher levels of concentration were associated with lower prices paid for fed cattle.<sup>16</sup>

In addition, in April, 1994, Bruce Marion of the University of Wisconsin released an update of his earlier study which found that as concentration increases prices paid to farmers decrease. This study is worth quoting:

The results of this article support the hypothesis that packer monopsony power had a significant negative effect on cattle prices during the 1971-86 period...the presence of monopsony power is evident in regional live cattle markets throughout the period and is slightly stronger in the latter half than in the first half of the period.

For several regions on which most of our analysis was done, cattle prices were estimated to be about 3 percent less in the most concentrated region/year compared to the least concentrated region/year.<sup>17</sup>

As John Helmuth has pointed out in reference to this study, such a “three percent difference is more than \$20 per head on \$70/cwt cattle.”<sup>18</sup>

A study conducted by Clement E. Ward after a series of mergers and acquisitions in 1987 found that the Big Three packers paid significantly lower prices for fed cattle in the Southern Plains and in subregions of the Southern Plains (Southwest Kansas, North Texas and Oklahoma Panhandle, and South Texas Panhandle) than did their competitors as a

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<sup>16</sup> Ward, Clement E. (1992) *supra* note 12 at 7, citing Marion, Bruce W., Frederick E. Geithman, and Gwen Quail, *Monopsony Power in an Industry in Disequilibrium: Beef Packing, 1971-1986*, University of Wisconsin, WP-96, December 1990; Azzam, Azzeddine M. and John R. Schroeter, *Implications of Increased Regional Concentration and Oligopsonistic Coordination in the Beef Packing Industry*, *Western Journal of Agricultural Economics*. 16(1991): 374-81.

<sup>17</sup> Marion, Bruce W. and Frederick E. Geithman, *Concentration-Price Relations in Regional Fed Cattle Markets*, Food Marketing Policy Center, Research Report No. 25, April 1994, University of Connecticut, Department of Agricultural and Resource Economics, pp. 19-21.

<sup>18</sup> Helmuth, John W. (1995) *supra* note 11 at 4.

group. However, there were differences among the Big Three in how much they paid for fed cattle. Each firm did not pay lower prices than competing firms.<sup>19</sup>

Additional recent studies have found that packers do exercise monopsony powers to distort prices paid to livestock producers. These studies are described in a November 1995 report issued by the Center for Rural Affairs:

Azzam and Pagoulatos (1990) found that packers exercise market power to both raise the prices they receive for meat and to lower the price they pay for livestock, but that the degree of market power they had was significantly higher in the livestock procurement side of the market than in the wholesale meat market. . . .

Azzam and Schroeter (1991) next considered regional procurement markets for beef. They found that packers used market power to depress prices an estimated one percent, considerably less than other studies in this field. But they noted that even a half percent decline in cattle prices would increase packer profits about 35 percent and reduce cattle feeder profits about \$4.40/head, or nearly 9 percent. Using a different methodology for data over the same time period 1988-91, Azzam (1992) also found that beef packers have market power to lower cattle prices, but not to raise meat prices in the wholesale market.

Stieger, Azzam, and Brorsen (1993) found that packers typically price cattle on the difference between the wholesale price they receive for boxed beef or carcasses and their average processing cost. That difference is called the marketing margin. As anticipated supply of cattle decreases, making it more difficult for packers to keep their plants fully operating and therefore raising their average processing costs, they “markdown” cattle bids - that is, they increase their marketing margin in order to cover their increased cost. They may be paying more for cattle in an absolute sense, but not as much more as they are worth in the short supply situation. In effect, they are pricing the cattle below their marginal value. The statistical analysis

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<sup>19</sup> Ward, Clement E., (December, 1992) at 7 citing Ward, Clement E., Timm J. Bliss, *Forward Contracting of Fed Cattle: Extent, Benefits, Impacts, and Solutions*, Blacksburg, VA: Research Institute on Livestock Pricing, Research Bulletin 4-89, November 1989).

indicated that between 1972 and 1986, fed cattle were priced significantly below their marginal value during 31 of 59 quarters. On average, this markdown was 1.31 percent, or 17 percent of the marketing margin, and amounted to \$1.54 per hundredweight of retail meat. The authors estimate that was worth about \$62 million to the packers.<sup>20</sup>

These studies provide a sufficient basis for USDA to find that monopsony power of the packers is likely to have the effect of manipulating prices by depressing the prices paid to cattle producers.

### **B. Impact of Packer Feeding on Prices**

Other studies have examined whether particular slaughter cattle procurement practices effect prices paid to producers. One 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:<sup>21</sup>

It is the oligopsonistic packer that is able to utilize its packer feeding operations to influence the price of fed cattle in a local market. Only the oligopsonistic packer can do that, and the possible effects of packer feeding on the price of cattle are confined largely to the markets where oligopsony exists. ... [W]hen a degree of oligopsony exists, a packer's own supply of fed cattle can be used to restrict market purchases and exploit the market by

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<sup>20</sup> From *From the Carcass to the Kitchen: Competition and the Wholesale Meat Market*, Strange, Marty and Higby, Annette, Center for Rural Affairs, Walthill, Nebraska, November 1995, citing (1) Azzam, Azzeddine, and Emilio Pagoulatos, 1990, *Testing Oligopolistic and Oligopsonistic Behavior: An Application to the U.S. Meat-Packing Industry*, *Journal of Agricultural Economics* 41(3): 362-370; (2) Azzam, Azzeddine, and John Schroeter, 1991, *Implications of Increased Regional Concentration and Oligopsonistic Coordination in the Beef Packing Industry*, *Western Journal of Agricultural Economics* 16(2): 374-381; (3) Azzam, Azzeddine, 1992, *Testing the Competitiveness of Food Price Spreads*, *Journal of Agricultural Economics* 43(2): 248-256; and (4) Stieger, Kyle W., and Azzeddine Azzam and B. Wade Brorsen, 1993, *Markdown Pricing and Cattle Supply in the Beef Packing Industry*, *American Journal of Agricultural Economics* 75:549-558.

<sup>21</sup> 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.

paying lower prices than otherwise would have been paid. The amount of the price effect will depend on the extent of the packer's oligopsony influence as well as on how readily suppliers and local feeders can divert their marketings to other markets.

An oligopsonistic packer that has a supply of cattle in its feedlots can use those cattle as a bargaining tool. Its fed cattle serve as a standby reserve in its price negotiations. Livestock sellers know that such a packer can fulfill his slaughtering needs at a particular time by transferring his own cattle to his plant, instead of buying cattle on the market. And since such a packer is - by definition - large enough to exert an influence on the local market, its management of its fed cattle during the price negotiations has an effect on the local market price. Stated simply, in the short run, packer feeding can confer an extra degree of market power on an oligopsonistic packer.<sup>22</sup>

This study found that packer-fed cattle caused a significant decline in the local market price when the packer had some oligopsonistic power:

Packer-fed cattle transferred to the plant of the sample packer had a persistent depressing effect on the local price for Choice steers compared with prices at other markets. During the first five or six months of the year, the local price was consistently below the average for other markets, about in proportion to the number of packer-fed shipments to plant. As Packer-fed shipments to plant declined from a level of about 1,100 head a week early in the year to about 100 head in the 15th week, the local price approached the level of prices at other markets. From mid-year until the 38th-42nd weeks, packer-fed shipments generally declined to a low level (zero in the 40th week) and prices at the local market improved to the point that they exceeded the seven-market average by about \$.50 per cwt in the 40th week. Then, as packer-fed shipments to plant increased during the last 10 or 12 weeks of the year, the price situation at the market deteriorated in comparison to other markets.<sup>23</sup>

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Regression analysis of the data ... confirmed the conclusion that packer-fed shipments to plant depressed the local price relative to prices at other

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<sup>22</sup> *Id.* at 10.

<sup>23</sup> *Id.* at 13.

markets. A 100-head increase in packer-fed shipments to plant, on average, lowered the local average price for Choice steers relative to other markets for the entire week by about \$.06 cwt. Or, a 100-head decrease in packer-fed shipments to plant allowed the local price to improve by about \$.06 per cwt. compared to the other markets. Since packer-fed shipments varied from zero to over 1,000 head per week, packer feeding affected the local weekly price by as much as \$.50 per cwt.<sup>24</sup>

This study went on to find that in a competitive market “feeding done by an individual packer can have no appreciable effect on the price of cattle.”<sup>25</sup>

This study provides sufficient basis for USDA to find that packer ownership and feeding of its own slaughter supplies is likely to have the effect of manipulating prices by depressing the prices paid to cattle producers.

### **C. Forward Contract Impact on Price**

Other recent studies have found that forward contracting for fed cattle supplies has a depressing effect on prices. A study that estimated the short-run price impacts of forward contracting in the southwest Kansas marketing region during six months of 1990 found:

Over the six months, for the level of contracted cattle, contract deliveries were associated with \$0.15/cwt to \$0.31/cwt reduced transaction prices. When forward contract shipment levels were relatively high, changes in forward contract shipments had a larger impact on transaction prices than during periods when shipments were low.<sup>26</sup>

The authors of this study point out that these results may be related to the market condition during the data collection period of May through November 1990, during which time cattle supplies were very low. They suggested that “the relatively small supplies of

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<sup>24</sup> *Id.* at 16.

<sup>25</sup> *Id.* at 22.

<sup>26</sup> Schroeder, Ted C., Rodney Jones, James Minert and Andrew P Barkley; “The Impact of Forward Contracting on Fed Cattle Transaction Prices”, *Review of Agricultural Economics*, Vol. 15, No. 2, May 1993, pp. 326-337, at page 335.



cattle when compared to existing slaughter capacity are providing a safety net against any market power levied by the larger packing firms.”<sup>27</sup>

A recent report issued by the Grain Inspection and Packers and Stockyards Administration shows that from April 5, 1992 to April 3, 1993, the packers’ use of forward contracts and marketing agreements to procure slaughter cattle had a depressing effect on prices to producers.<sup>28</sup> The report states:

Increased deliveries of forward-contracted cattle were associated with reduced prices in the cash market while increasing inventories of forward-contracted cattle were associated with increased cash-market prices.

Daily increases in the rate of deliveries of forward-contracted and marketing agreement cattle had a slightly negative effect on daily cash-market prices. . . .

Prices paid for cattle delivered under forward contracts on a given day were about \$3.00 per cwt lower (dressed-weight basis) than prices for similar cattle on the cash market.

Increases in cash market price were found to lead to increases in the monthly quantities of the volume of forward-contracted, and marketing agreement cattle used by large plants. Cash-market price variability is positively associated with the volume of forward-contracted and marketing agreement cattle used by large plants.

This report demonstrates that when cash-market prices increased, packers increased their inventories of forward-contracted cattle. When deliveries of that forward-contract inventory increased, the cash-market price for cattle declined.

These statistics provide sufficient basis for the USDA to make a finding that the current use of forward contracts is likely to have the effect of manipulating prices by depressing the cash-market prices paid to cattle producers.

#### **D. Use of Formula-Priced Forward Contracts**

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<sup>27</sup> *Id.* at 335.

<sup>28</sup> *Concentration in the Red Meat Packing Industry*, Grain Inspection and Packers and Stockyards Administration, USDA., February 1996, pp. 25-31.

Forward contracts generally are not traded publicly. In practice they are often offered only to certain producers providing those producers with preferential treatment over other producers. The recent GIPSA report, *Concentration in the Red Meat Packing Industry*, does not directly address whether forward contracts and marketing agreements (marketing agreements as defined by the report are included in the definition of forward contract in the proposed rule) are offered by packers on a preferential basis to certain cattle producers. However, it does provide some insight into who *actually* enters into forward contracts.<sup>29</sup> The report states:

Small firms use spot markets almost exclusively, whereas the Big Three packers are more likely to use alternative procurement methods. Con Agra, Excel, and IBP account for 73 percent of spot market transactions, but [for] 88 percent of marketing agreements and 95 percent of forward contracts. . . .

The largest feedlots are also more likely than small feedlots to use alternative procurement strategies. Feedlots handling more than 32,000 cattle per year accounted for 26 percent of spot marketing transactions, but [for] 39 percent of forward contracts, 64 percent of marketing agreements. . . . Most forward contracts (73 percent) were priced on the basis of carcass weight, while formula pricing was used for most marketing agreements. . . . The Big Three firms handled 93 percent of the formula-priced lots and 83 percent of the carcass-weight arrangements.<sup>30</sup>

The report clearly demonstrates that the Big Three packing firms and the largest feedlots account for the vast majority of the formula-priced agreements. This is particularly important given the study's finding that "market agreement cattle brought prices about 54 cents above spot market prices."<sup>31</sup>

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

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<sup>29</sup> *Concentration in the Red Meat Packing Industry*, Grain Inspection and Packers and Stockyards Administration, USDA., February 1996, pp. 15-23.

<sup>30</sup> *Id.* at 16-17 [emphasis added].

<sup>31</sup> *Id.* at 22.

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.

This study provides sufficient basis to find that current use of the marketing-agreement types of forward contracts is likely to result in an undue and unreasonable advantage for certain large-scale producers, providing them over the long term with preferential access and a higher price than are afforded other producers.

### **E. Captive Supply Decisions and Impact on Price**

The *Concentration in the Red Meat Packing Industry* report issued by the Grain Inspection and Packers and Stockyards Administration in February 1996, despite its many flaws, 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. The report states:

The overall effect of captive supplies on prices paid for cattle in the cash market was negative but small. . . .

Increases in cash market price were found to lead to increases in the monthly quantities of packer-fed, forward-contracted, and marketing agreement cattle used by large plants. Cash-market price variability is positively associated with the volume of forward-contracted and marketing agreement cattle used by large plants. . . .

The findings indicate that expected higher prices increase the volume of packer feeding and other captive supply used, whereas expectations of falling prices lead to decreases. . . .

The overall effect of increased use of captive supply on shortrun prices paid for cattle in the cash market appears to be negative but small.<sup>32</sup>

This study provides sufficient basis for USDA to find that current practices with regard to captive supply use by packers, including formula-priced forward contracts and packer

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<sup>32</sup> *Concentration in the Red Meat Packing Industry*, Grain Inspection and Packers and Stockyards Administration, USDA,, February 1996, pp. 30-31.

ownership and feeding of its own slaughter supplies are likely to have the effect of manipulating prices by depressing cash-market prices paid to cattle producers.

## **F. Impact of Number of Buyers on Price**

Clement E. Ward has also recently summarized another line of relevant research designed to determine the effects which number of buyers had on livestock prices. He states:

A number of studies of the experimental electronic livestock markets have given us additional insight into the relationship between concentrated market structure and prices for livestock. Holder (1979) found that slaughter lamb prices were \$.70 per cwt. higher after introduction of a telemarket. Ward (1984) studied the relationship between the number of bidders in an Oklahoma teleauction and prices paid for slaughter lambs between 1979 and 1982, and found that each additional bidder added \$1.10 per cwt. to prices paid and widened the price difference between the teleauction and live auction at San Angelo, Texas, by \$.60 per cwt. Finally, Rhodus et al. (1985) analyzed the impact of an electronic market on hog prices in Ohio compared with direct trade markets in Indiana, the market in Peoria, Illinois, and a major order-buying company operating in Ohio. They concluded that average prices paid through the electronic market were \$.94 higher than order-buyer prices at Peoria and \$.99 higher than Indiana direct trades by order-buyers.<sup>33</sup>

The Center for Rural Affairs also has reported on studies designed to determine the effects which number of buyers had on livestock prices:

Generally, fewer buyers mean less demand for slaughter livestock and less buyer competition, both of which lead to lower livestock prices. . . .  
Three independent studies (Love and Shuffett; Ward 1983; Hayenga, et al.)

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<sup>33</sup> From *Competition and the Livestock Market: Report of a Task Force Commissioned by the Center for Rural Affairs, Walthill, Nebraska*, Wes Sandall et al., Center for Rural Affairs, Walthill, Nebraska, April 1990, citing (1) Holder, David L., *Benefits of a Sheep and Lamb Teleauction in Virginia and West Virginia*, U.S. Department of Agriculture, Economics, Statistics, and Cooperatives Service, selected paper for the Southern Agricultural Economics Association meetings, February, 1979; (2) Ward, Clement E., *An Empirical Study of Price Discovery and Competition for Slaughter Lambs*, *Western Journal of Agricultural Economics*, 9(1984): 135-44; and (3) Rhodus, W. Timothy, E. Dean Baldwin, and Dennis R. Henderson, *Pricing Accuracy and Efficiency in a Pilot Electronic Hog Market*, *American Journal of Agricultural Economics*, 71(1989): 874-82.

found that when hog slaughtering plants were closed in Kentucky, Oklahoma, and Iowa, slaughter hog prices in markets adjacent to the plants declined either absolutely or relative to other markets. In some cases, markets adjusted after a period of weeks to price levels close to those existing prior to plant closing.

Conversely, more buyers generally mean more demand for slaughter livestock and more buyer competition, both of which lead to higher prices. . . . Hayenga, et al. found that slaughter hog prices increased for a time when new hog slaughtering plants opened in Iowa. The adoption of electronic markets, giving more buyers better access to livestock offered for sale, has typically resulted in higher livestock prices. Such studies include electronic markets for slaughter lambs in Virginia and Oklahoma (Holder; Ward 1984), hogs in Ohio (Rhodus, et al.), and feeder cattle in Texas (Sporleder and Colling). Number of buyers bidding on fed cattle was found to have a positive effect on fed cattle transaction prices in three separate studies (Ward 1981, 1992; Schroeder, et al.).<sup>34</sup>

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<sup>34</sup> From *Meatpacking Industry Changes: Causes and Consequences*, December 1992, Agricultural Economics A.E. Paper 92137, Department of Agricultural Economics, Division of Agricultural Sciences and Natural Resources, Oklahoma State University, citing (1) Love, Harold G. and D. Milton Shuffett, *Short-Run Price Effects of a Structural Change in a Terminal Market for Hogs*, *Journal of Farm Economics*, 47(1965): 803-812; (2) Ward, Clement E., *Price Impacts of a Structural Change in Pork Processing - A Case Study in Oklahoma*, Oklahoma Agricultural Experiment Station, *Current Farm Economics*, 56(1983): 3-9; (3) Hayenga, Marvin L., Ronald E. Deiter, and Christobal Montoya, *Price Impacts Associated with the Closing of Hog Slaughtering Plants*, *North Central Journal of Agricultural Economics*, 8(1986): 237-42; (4) Holder, David L., *Benefits of a Sheep and Lamb Teleauction in Virginia and West Virginia*, U.S. Department of Agriculture, Economics, Statistics, and Cooperatives Service, selected paper for the Southern Economics Association meetings, February 1979; (5) Ward, Clement E., *An Empirical Study of Price Discovery and Competition for Slaughter Lambs*, *Western Journal of Agricultural Economics*, 9(1984): 135-44; (6) Rhodus, W. Timothy, E. Dean Baldwin, and Dennis R. Henderson, *Pricing Accuracy and Efficiency in a Pilot Electronic Hog Market*, *American Journal of Agricultural Economics*, 71(1989): 874-82; (7) Sporleder, Thomas L. and Phil L. Colling, *Competition and Price Relationships for an Electronic Market*, Texas A&M University, Department of Agricultural Economics, selected paper for the American Agricultural Economics Association meetings, August 1986; (8) Ward, Clement E., *Short-Period Pricing Models for Fed Cattle and Impacts of Wholesale Carcass Beef and Live Cattle Futures Market Prices*, *Southern Journal of Agricultural Economics*, 13(1981): 125-32; (9) Ward, Clement E., *Inter-firm Differences Between Fed Cattle Prices in the Southern Plains*, *American Journal of Agricultural Economics*, 74(1992):2 480-85; and (10) Schroeder, Ted, Rodney James, James Mintert, and Andrew Barkley, *Short-Run Price Impacts of Packer-Controlled Cattle Supplies*, Manhattan, KS: Invited Paper, Western Agricultural Economics Association meetings, July 1990.

These studies regarding the impact of the number of buyers on livestock prices provide sufficient basis for a finding that use of a public market, where buyers and sellers in general have access for trading of forward contracts and packer-fed cattle, will improve prices paid to cattle producers.

### **G. Conclusion from Economic Studies**

The economic studies discussed above 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. 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.

The following discussion of the legislative history, statutory language and case law interpretation of the Packers and Stockyards Act establishes that this evidence is sufficient basis for issuing the proposed rules restricting packer feeding of its own slaughter supplies and use of forward contracts.

### **Legal Authority to Issue Proposed Rule**

Under the Packers and Stockyards Act, the Secretary of Agriculture clearly has the authority to issue rules regulating packer captive supply livestock procurement methods to ensure compliance with Section 202 of the Act (7 U.S.C. § 192). In fact, the legislative history of the Act demonstrates that he has the obligation to issue rules necessary to ensure that packers continue to comply with Section 202 as the industry structure and procurement practices change.

### **A. Legislative History of the Packers and Stockyards Act**

#### **1. Context of the Packing Industry at the Time the Act was Passed**

Legislative history shows that the concentration levels in the beef packing industry at the time the Packers and Stockyards Act was enacted 75 years ago were lower than the concentration level today. Representative Voight, in the debate on the House bill, cited the concentration figures from the Federal Trade Commission report:

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It appears from the report of the Federal Trade Commission that in 1916 the Big Five's percentage of interstate slaughter was as follows: cattle 82.2, calves 76.6, hogs 61.2, sheep and lamb 86.4. . . . In view of the steady growth of the business of the Big Five it is reasonable to assume that at this date these figures should be raised from 5 to 10 percent. I conclude, therefore, that at the present time the Big Five's percentage of interstate slaughter is between 75 and 80 per cent . . . the monopoly of the Big Five becomes very apparent.<sup>35</sup>

In contrast, today, four firms, rather than five, control well over 80 percent of the steer and heifer slaughter.<sup>36</sup>

At the time the Act was passed Congress was also very concerned about the fact that the packers were continuing to charge wholesalers increasingly higher prices even while prices paid to producers were low. Representative McLaughlin and Senator Kendrick introduced figures in their respective houses that demonstrated that despite the fact that the packers were paying producers the same price for cattle in April 1921, as they had paid in February, 1916, they were charging the wholesalers 52.6 percent higher prices in 1921 than in 1916.<sup>37</sup> Similarly, over the last twenty-five years we have seen a steady climb in the percentage of the retail meat dollar that goes to packers. The annual average percent of the retail dollar going to packers in 1970 was 12.7. This figure fluctuated over the following twenty-five years, with a general trend upward, until in 1995 the packers share of the retail dollar was 25.5 percent. During this same period producers' share of the retail dollar dropped from 64 percent in 1970 to 49 percent in 1995.<sup>38</sup>

Seventy-five years ago when Congress recognized trends in the packing industry that virtually mirror those we see today it acted to pass the most comprehensive anti-trust legislation ever enacted in this country. The powers granted under that Act should be

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<sup>35</sup> 61 Cong. Rec. 1863 (1921).

<sup>36</sup> Helmuth, John W., (1995), *supra* note 10 at 1.

<sup>37</sup> 61 Cong. Rec. 1877-1878, and 2618-2619 (1921).

<sup>38</sup> "Beef Price Spread Data" Table 10-Estimated Historical Series for Beef, Choice Yield Grade 3: Retail, Wholesale and Farm Values, Price Spreads, and Farmers' Share. USDA, Economic Research Service, Stock No. 90006.

vigorously administered today to prevent the kind of harm to producers that the Act was written to address.

## **2. Extraordinarily Broad Rule-making Power**

Upon thorough review of the legislative history of the Packers and Stockyards Act there can be no doubt that Congress meant to grant the Secretary the broadest possible rule-making authority over the livestock procurement practices of the packers.

The extraordinarily broad scope of the regulatory authority granted to the Secretary under the 1921 Act was expressed in the House report as follows:

A careful study of the bill, will, I am sure, convince one that it and existing laws, give the Secretary of Agriculture *complete* inquisitorial, visitorial, supervisory, and *regulatory power* over the packers, stockyards and all activities connected therewith; that it is *a most comprehensive measure and extends farther than any previous law in the regulation of private business*, in time of peace, except possibly the interstate commerce act.<sup>39</sup>

The Congressional intention to give the Secretary of Agriculture complete regulatory powers over the packers and all their activities was emphasized throughout the debate on the bill.<sup>40</sup> Similarly, the intention to pass the “most far-reaching measure and extend further than any previous law into the regulation of private business” was also an often repeated point in the debate.<sup>41</sup>

The conference report on the bill emphasized, in the strongest terms possible, the Congressional intent to grant the Secretary extraordinary regulatory powers – “Congress intends to exercise in the bill, the fullest control of packers and stockyards which the Constitution permits”.<sup>42</sup>

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<sup>39</sup> House Report No 77, 67th Cong., 1st Sess. 2 (1921) (emphasis added).

<sup>40</sup> See also 61 Cong. Rec. 1799, 1801, 4738, 8310 (1921).

<sup>41</sup> See also 61 Cong. Rec. 1801, 1805-1806, 1887-1888 (1921).

<sup>42</sup> Conference Report, HR Rep. No. 324, 67 Cong. 1st Sess. , at 3 and 5-6. Statement of the Managers on the Part of the House; 61 Cong. Rec. 4778, 4779 (1921).



### **3. Authority to Regulate to Prevent and Compel**

The legislative history also makes it clear that Congress intended that the Secretary use his regulatory powers aggressively to prevent packer practices made illegal by the Act. Repeatedly the bill was described as giving the Secretary the authority “to prevent packers ... from engaging in an unfair, unjustly discriminatory, or deceptive practice or device.”<sup>43</sup> Representative Voight of Wisconsin, who strongly favored the bill, stated that it can be used to prevent unlawful practices by the packers and to compel them to employ lawful business practices:

The bill is sufficiently broad so that, if vigorously administered, the Secretary can prevent combination among packer and can compel them and all others connected with the industry to do business in a lawful and proper way. ... the Secretary under this bill is given the power to make rules that will make them [packers] do business on the level.<sup>44</sup>

The legislative history makes clear that Congress intended the Secretary to exercise his extraordinarily broad regulatory powers to prevent conditions under which packers could gain control of the livestock market, and, thereby, induce healthy competition. The report on the Hearings on several of the bills debated states that the Act seeks “to prohibit the particular conditions under which monopoly is built up, and to prevent a monopoly in the first place and to induce healthy competition.”<sup>45</sup>

### **4. Authority to Issue Substantive Rules**

There was extensive debate in the Senate over whether the regulatory body should be allowed to issue rules or regulations for which the packers could be held civilly and criminally liable. This debate was ultimately resolved when the Senate amended the House bill by adding a second provision granting the Secretary authority to issue rules and

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<sup>43</sup> H.R. Rep No. 77, 67th Cong. 1st Sess. 2 (1921); 61 Cong. Rec. 1799 (1921).

<sup>44</sup> 61 Cong. Rec. 1868 (1921) (emphasis added).

<sup>45</sup> Hearings on H.R. 14, H.R. 232, H.R. 5032, and H.R. 5692 Before the House Committee on Agriculture, 67th Cong, 1st Sess., ser. D, 26 (1921).

regulations necessary to carry out the provisions of the Act. The conference report on the bill explains how the two houses dealt with this double grant of authority to issue rules and regulations:

On Amendment No. 17: This amendment adds to the House bill a provision empowering the Secretary of Agriculture to ‘make such rules, regulations, and orders as may be necessary to carry out the provisions of this act.’. The House bill did not contain this specific provision, but did make applicable to the jurisdiction and powers of the Secretary of Agriculture in enforcing the act the powers given to the Federal Trade Commission by section 6 of the Federal Trade Commission act, one of the provisions of which authorized that commission to make rules and regulations for the enforcement of the act, the two being substantially the same; and the House recedes.<sup>46</sup>

Representative Haugen, the chief author of the bill that eventually was enacted, also similarly references this amendment in his comments on the conference report.<sup>47</sup>

Maybe as significant as the double grant of authority to issue rules, for purposes of determining Congressional intent with regard to the type of rules proposed in this petition, is the fact that the Senate defeated an amendment that would have limited the Secretary’s authority to issue rules only “as to procedures.”<sup>48</sup> During the debate on this proposed amendment Senator Walsh from Montana clearly stated that the intent of the bill without this amendment was to allow the Secretary to issue substantive type rules that are consistent with the act’s provisions. He also emphasized that courts would have the full authority to review such rules through a review of any order issued by the Secretary requiring a packer to comply with the rule.

I may say that a further examination of the general statutes does not reveal any statute making criminal the act which is denounced as unlawful. Accordingly the only procedure which can be instituted on charges of having violated an order, rule, or regulation is the procedure recited in the proposed

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<sup>46</sup> 61 Cong. Rec. 4780 (1921).

<sup>47</sup> 61 Cong. Rec. 4782 (1921).

<sup>48</sup> See 61 Cong. Rec. 2674-2675 (1921).

act. If the Secretary ... believes that the rule, regulation or order comes under the act, of course he will make the order; but that will be ineffective until it is passed upon by the court, and the court will pass upon the question as to whether the rule, regulation, or order falls under the provisions of this act so as to make disobedience of it contempt.<sup>49</sup>

Senator Walsh's reference to procedures for bringing charges for violations of the Act is to the provision of the bill that is now codified at 7 U.S.C. § 193. This is the statutory provision the Secretary uses to bring charges against packers for violating the unfair and deceptive trade practices section of the Act, 7 U.S.C. § 192. Senator Walsh's statement, thus, indicates that Congress intended that the Secretary would issue substantive rules defining what packers must do to comply with this provision of the Act, and that packers would be adequately protected from arbitrary rule-making by having access to review of the rule by the courts. Senator Walsh's statements demonstrate that Congress clearly envisioned that the Secretary would be issuing precisely the type of substantive rule that is proposed in this petition.

### **5. Purpose to Protect Producers Interest**

A primary purpose for passage of the Packers and Stockyards Act was to protect the interest of the producer. This intention is clearly expressed in the legislative history. Representative Tincher stated:

It is my judgment that the passage of this bill, that its proper administration, will *permit the meat producer to exist*; that it will reduce the amount paid out between the producer and the consumer to such an extent that it will make the business for the *producer more profitable*, and not be injurious to the consumer.<sup>50</sup>

Similarly, Representative Voight of Wisconsin expressed the sincere belief that this bill would benefit producer and consumer alike:

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<sup>49</sup> 61 Cong. Rec. 2675 (1921).

<sup>50</sup> 61 Cong. Rec. 1809 (1921).

I think if this monopoly of the Big Five is done away with, and the laws of trade are given a chance to function, it is going to benefit producer and consumer alike; genuine competition will benefit both.<sup>51</sup>

In an early case interpreting the Act the U.S. Supreme Court recognized that one of its primary purposes was to protect producers' from the packers' control over prices paid for livestock:

The chief evil feared is the monopoly of the packers, enabling them unduly and arbitrarily to lower prices to the shipper, who sells, and unduly and arbitrarily to increase the price to the consumer, who buys.<sup>52</sup>

The Eighth Circuit Court of Appeals has more recently stated

One of the purposes of the Packers and Stockyards Act is to safeguard farmers and ranchers against receiving less than the true market value of their livestock.<sup>53</sup>

Courts have held that the Act should be liberally enforced in order to accomplish its purpose of protecting producers interests:

The Act is remedial legislation and is to be construed liberally in accord with its purpose to prevent economic harm to producers and consumers at the expense of the middleman.<sup>54</sup>

## **6. Authority to Regulate to Ensure Open, Competitive Markets**

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<sup>51</sup> 61 Cong. Rec. 1868 (1921).

<sup>52</sup> *Stafford v. Wallace*, 258 U.S. 495, 515-516, 42 S.Ct. 397, 401 (1922).

<sup>53</sup> *Bosma v. USDA*, 754 F.2d 804, 808 (8th Circuit 1984), citing H. Rep. No. 1048, 85th Cong. 2d Session, *reprinted in* 1958 U.S. Code Cong. and Admin. News, 5212, 5213.

<sup>54</sup> *Swift & Co. v. United States*, 393 F.2d 247, 253 (7th Cir. 1968); citing *Stafford v. Wallace*, 258 U.S. at 521; and *Safeway Stores, Inc. v. Freeman*, 369 F.2d 952, 956 (1966); *see also*, *Farrow v. USDA*, 760 F.2d 211, 214 (8th Circuit 1984).

Congress recognized that to protect producers' interests the Secretary must be granted the authority to regulate packer practices to ensure open, competitive markets for livestock. When the Act was passed in 1921 virtually the sole source of supply for slaughter cattle was through the stockyards. So Congress not only emphasized regulation of the packers but also of the stockyards as the public market of that day.

Congress, however, did make clear its intention was to ensure open, competitive markets for buying and selling livestock no matter where those markets occurred. Rep. Haugen of Iowa, whose bill was ultimately enacted with only minor modification, introduced the conference report to the House on August 9, 1921. In his discussion of the rejected Senate amendments he indicated that buying or selling "in commerce live stock at the stockyard" was equivalent to being a buyer or seller of "live stock in commerce".

Representative Jones from Texas, a strong supporter of the Act, most clearly stated the importance of open, competitive markets for the producer:

The producer must always sell in a market that he does not control. He buys at the other man's price. *His only hope of securing a fair price lies in an open, competitive market.*<sup>55</sup>

Congress knew well that the only way open, competitive markets for livestock and meat could be maintained was if the Secretary was given the authority to regulate practices of one sector of the industry that could adversely affect other sectors. Congress recognized that one of the most significant aspects of this legislation was that it authorized regulation of unfair practices as between the packer and the producer and between the packer and the consumer. In response to a question as to how this Act strengthened the authorities under the Federal Trade Commission Act, Representative Anderson stated:

As to the intent of "unfair competition" [in the FTC Act] it only includes acts which constitute a violation of the rights of the competitor, and it must be a method which is used by a competitor on the same plane. ... For instance, the method of competition used by a manufacturer which we might think was a violation of the moral rights of the wholesaler would not be a violation of the Federal Trade Commission Act, because the interpretation of that is that it must be unfair as between competitors who stand on the same plane. This goes further than that, as it affects the public interest to a large extent, and the unfair competition or unfair practice as between the packer

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<sup>55</sup> 61 Cong. Rec. 1861 (9121).

and the general public, the packer and the producer, or the packer and any other agency connected with the marketing of livestock.<sup>56</sup>

Congressional commitment to maintaining open and competitive markets for livestock was reemphasized throughout the amendments to the Act in later years. In 1924 the Act was amended to increase the authority of the Secretary to sanction violators. The House Report notes that the Secretary personally appeared to the committee and urged strengthening the law to enable him to confront “conditions that are detrimental to the *open, competitive marketing of livestock.*”<sup>57</sup>

When enacting the 1958 amendments Congress noted significant changes in the meatpacking industry and the environment in which it operates. The House report stated “[e]qually significant (as the development of 1400 to 1500 country auctions and markets) is the growth which has taken place in country buying—buying by packers or livestock dealers direct from the producer . . . today a common practice in almost every part of the country and more than 40 percent of all livestock sold moves in this manner.”<sup>58</sup> This report also makes clear that Congress intended the 1958 Act amendments to ensure that the Secretary had jurisdiction over “*all livestock marketing involved in interstate commerce including country buying of livestock.*”<sup>59</sup>

In 1976, Congress again strengthened the Act to give the Secretary greater powers in regulating the packers. Further changes in the pattern of livestock marketing between 1958 and 1976 led to these amendments. Following the 1958 amendment, “packers continued to push to acquire slaughter livestock at its source,” and by 1976 it was estimated that “well over 80% of all slaughter livestock is purchased by the packers directly from producers and custom feedlots.”<sup>60</sup>

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<sup>56</sup> 61 Cong. Rec. 1805 (1921).

<sup>57</sup> H.R. Rep. 77 on Packer Act Amendment of 1924 at 3.

<sup>58</sup> HR Rep No 1048, 85th Cong., 1st Sess 3 (1957).

<sup>59</sup> *Id.* at 5.

<sup>60</sup> Sen. Rep. No. 94-932, 94th Cong, 2d Sess. 4 (1976).

In 1978, when Congress amended the Act with regard to rates and charges at auction markets, it again expressed the importance of securing competitive livestock markets for producers. *“The continued availability of competitive, reasonably priced, and conveniently located livestock marketing channels is essential, particularly for small producers.”*<sup>61</sup>

The legislative history clearly establishes that Congress intended to grant the Secretary the authority to regulate packer practices necessary to ensure open, competitive markets for livestock. When marketing conditions changed over time, Congress amended the Act to ensure the Secretary would continue to be able to address packer practices even in the context of country buying direct from feedlots or producers.

### **7. Obligation to Adjust Rules to Changes in Industry Structure**

While in 1921 the stockyards were the public market which Congress wanted to ensure would be made open and competitive, Congress had the foresight to recognize that in the long-term industry marketing practices might change. It structured the Act to grant the Secretary authority to take action that would ensure open, competitive markets as the industry changed over time. In doing so Congress intentionally placed the obligation on the Secretary of Agriculture to monitor the packing industry and adjust regulatory controls to ensure compliance with the purposes of the Act as industry structure changed. Congress recognized that enacting a statutory list of specific prohibited packer practices would not further one of its primary goals—to structure an act that would keep pace with the changing structure of the livestock industry. Congressman Anderson of Minnesota, a member of the House Committee on Agriculture and a sponsor of one of the bills that led to the Act, stated during the debates in the House that:

Industry is progressive. The methods of industry and the manufacture and distribution change from day to day, and no positive iron-clad rule of law can be written upon the statute books which will keep pace with the progress of industry. So we have not sought to write into this bill arbitrary and iron-clad rules of law. We have rather chosen to lay down certain more or less definite rules, rules which are sufficiently flexible to enable the

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<sup>61</sup> 1978 USCAAN 2204, Senate Report.

administrative authority to keep pace with the changes of methods in distribution and manufacture and in industry in the country.<sup>62</sup>

Congressman Anderson later noted that “the provisions of this legislation as to the packers must be more or less elastic in order that they may *keep pace with the state and development of the industry.*”<sup>63</sup>

## 8. Legislative History Conclusion

The legislative history establishes that Congress intended that the Secretary use his authority under the Act to protect the interests of livestock producers through regulation of packer practices that threaten an open, competitive markets for livestock. It also shows that Congress intended that the Secretary do this in part through issuance of substantive rules that will prevent packer practices prohibited by the Act and compel lawful action by packers. Congress expected the Secretary to vigorously enforce the Act according to these principles, adjusting the rules and enforcement policies to keep pace with the state and development of the industry even as numbers of cattle purchased directly from feedlots and producers increased. The legislative history demonstrates that Congress clearly intended the Secretary to issue substantive rules of the nature proposed in this petition.

## B. Statutory Authority for Rule Making

The statutory language granting the Secretary of Agriculture these extraordinarily comprehensive regulatory powers, including the authority to issue substantive regulations regarding packer practices, is found at 7 U.S.C. §§ 228(a) and 222. Section 228 states:

*The Secretary may make such rules, regulations and orders as may be necessary to carry out the provision of the Act . . .*<sup>64</sup>

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<sup>62</sup> 61 Cong. Rec. 1887 (1921).

<sup>63</sup> 61 Cong. Rec. 1888 (1921).

<sup>64</sup> 7 U.S.C. § 228(a) (emphasis added).



Section 222 grants the Secretary of Agriculture all of the enforcement powers held by the Federal Trade Commission under Title 15 Section 46, 48, and 50.<sup>65</sup> Section 46(a) authorizes the Secretary “to make rules and regulations for the purpose of carrying out the provisions” of the Act.

When issuing regulations in 1974, the Packers and Stockyards Administration acknowledged that these two statutory sections granted it the authority to issue substantive rules:

The position of the Administration is that the general rule-making authority contained in section 407 of the Packers and Stockyards Act (7 U.S.C. § 228) and section 6(g) of the Federal Trade Commission Act (15 U.S.C. § 46) authorizes the Secretary to issue *substantive* as well as procedural and advisory regulations necessary to carry out the provisions of the Act.<sup>66</sup>

Courts have also recognized that the Secretary has the authority to issue legislative rules under the Packers and Stockyards Act. These legislative rules have the force and effect of law. See, e.g., *United States v. Marshall Durbin & Co.*, No. CV 84-PT-1920-S (ND Ala Sept. 11, 1985), where the court recognized that the Secretary has the authority to issue legislative rules having the force and effect of law, but held that a poultry weighing regulation should be regarded as an interpretive rule, since the Secretary did not comply with the notice and comment procedures of the Administrative Procedure Act.

One court has specifically addressed the Secretary’s rule-making authority under Section 202 of the Act. In *Central Coast Meats v. USDA*, 541 F.2d 1325 (1976), the court held that USDA did not have the authority under § 202(a) to enforce a rule that made it a *per se* violation for a packer to own a dealer or vice-versa. The court based this holding on its understanding that 202 (c) and (d) specifically addressed the evils of packers’ acting as dealers and it clearly contemplated that packers could act as dealers in certain circumstances.<sup>67</sup> This decision would not prohibit the issuance of the rules proposed in this petition. The rules proposed here do not create the type of *per se* prohibition the court was concerned with in the *Central Coast Meats* decision. These proposed rules do not make

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<sup>65</sup> 7 U.S.C. § 222.

<sup>66</sup> 39 Fed. Reg. 17529, 17537 (May 17, 1974) (emphasis added.)

<sup>67</sup> *Id.* at 1327.

packers' use of forward contracts a *per se* violation. Nor do they make packer feeding a *per se* violation. Rather, these rules identify the circumstances under which forward contracts and packer feeding result in violations of the Act.

Forward contracts that are formula-priced fail to establish the value paid for an animal on the day it is committed. This allows an opportunity for the manipulation of the price between the day the livestock is committed and the date it is delivered. Forward contracts which are not traded publicly create preferences for those producers offered those contracts over those not offered such contracts. Such preference of one producer over others is likely to injure the competitive position of those not receiving the offer and this violates Section 202 (b) of the Act.

The proposed rule's requirement that all forward contracts contain a firm-base price and be trade in an open, public manner eliminates the circumstances under which forward contract use violates § 202 of the Act. Similarly, packer feeding of its own slaughter supplies can have the effect of reducing prices paid to producers on the cash market. Such practice also provides a preference to the persons owning the packer as well as owning the cattle. Thus a packer's feeding of its own slaughter supplies is likely to affect a manipulation of price and also likely to injure the other cattle producers' ability to compete with the packer. The proposed rule that packer owned and fed cattle be sold in public markets eliminates the circumstance in which packer feeding results in violations of the Act. Rather than establishing a *per se* violation of the Act, the proposed rules are explicitly designed to address the specific circumstances under which forward contracts and producer ownership and feeding of cattle result in violations of the Act.

Both the legislative history and the statutory language of the Packers and Stockyards Act make it clear that the Secretary has extraordinarily broad authority to issue substantive rules regulating packer practices.

### **C. Statutory Authority for Captive Supply Rules**

The types of packer practices that are to be regulated through the Secretary's rulemaking authority were set out in Section 202 of the Act, 7 U.S.C. § 192. This section establishes that:

It shall be unlawful with respect to livestock . . . for any packer . . . to:

- (a) Engage in or use any unfair, unjustly discriminatory, or deceptive practice or device; or

(b) Make or give any undue or unreasonable preference or advantage to any particular person or locality in any respect whatsoever, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever; or . . .

(e) Engage in any course of business or do any act for purpose or with the effect of manipulating or controlling prices, or of creating a monopoly in the acquisition of, buying, selling, or dealing in, any article, or of restraining commerce.

#### **D. Assertion that Secretary Lacks Rule-making Authority is Wrong**

Despite the Congressional grant of extraordinarily broad rule-making authority and its intent that the Secretary amend its rules as necessary to ensure packer compliance with the Act as industry structure changes, the Secretary has asserted that he has no authority to issue rules prohibiting packer captive supply procurement practices. In Secretary Glickman's letter dated October 3, 1995, to Representative Pat Williams, he asserts that the Grain Inspection and Packers and Stockyards Administration's policy is "to promote fair and open competition among packers and not to dictate or regulate the specific methods and terms of sale to be utilized." The Secretary cites *Swift & Co. v. Wallace*, 105 F.2d 848 (7th Cir. 1939), to support this policy. He states that the court in that case noted that Section 202 "does not purport to confer upon the Secretary of Agriculture any authority directly to regulate prices, or discounts, or sales methods; and clearly does not contemplate the exercise of any authority to establish uniformity of practice with respect thereto."

This was the Secretary's response to a request from several congressmen to fully consider the Western Organization of Resource Councils' request that rules of the nature proposed in this petition be issued.

The Secretary's reliance on the *Swift* case as justification for not issuing rules prohibiting these practices is misplaced. The *Swift* decision does not support his assertion that he has no authority to regulate these packer practices. In fact, the court in *Swift* explicitly states that the Secretary has the authority to restrict packer practices that violate Section 202 of the Packers and Stockyards Act.<sup>68</sup> This decision makes clear that the only limitation on the Secretary's authority to regulate packer practices is that restricted practices must be in violation of the Act.

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<sup>68</sup> *Swift & Co. v. Wallace*, 105 F.2d 848, at 853 and 863.

## 1. Swift Case Analysis

### a. Holdings in *Swift* Decision

In the *Swift* case, Swift had been granting longer credit terms and better discounts to the institutional trade (hotels, restaurants, clubs, steamship lines, and public institutions) than it offered to purveyors (those businesses which buy meat products from packers and then resell them to the institutional trade). USDA issued a cease and desist order that required Swift to:

[C]ease and desist from engaging in the unfair, unjustly discriminatory and deceptive practice and device of denying to any buyer of packer products the same terms of credit that are extended to any other buyer, of substantially the same credit rating purchasing packer products of like kind, quantity and quality, under substantially the same circumstances.<sup>69</sup>

The Court of Appeals found a problem with the form of the cease and desist order issued by USDA. It held that USDA acted outside its authority under the Packers and Stockyards Act in issuing an order that required Swift to grant uniform terms of credit and discounts to all customers.<sup>70</sup>

## 2. Legal Analysis

### a. *Swift* Decision Is Not Controlling Law in Most of the Country

The *Swift* decision cited by the Secretary is controlling law only in the Seventh Circuit, which includes Wisconsin, Illinois, and Indiana. While other courts may consider the *Swift* decision when deciding similar issues, it is not controlling law in other federal circuits. Other federal courts may decide the issue differently.

Since the *Swift* decision was issued in 1939, it has been cited only once by the Seventh Circuit for the proposition the Secretary uses it for.<sup>71</sup> However, the *Armour* decision does not give any more incite into what the *Swift* court meant by the quote Secretary Glickman now cites. No other courts have cited the case for this specific proposition. However, the case is cited often to support other principles regarding the Packers and Stockyards Act.

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<sup>69</sup> *Swift & Co. v. Wallace*, 105 F.2d 848, at 862 (7th Cir. 1939).

<sup>70</sup> *Id.* at 863.

<sup>71</sup> *See Armour & Co. v. United States*, 402 F.2d 712 (7th Cir. 1968).

b. In Context, the Quote Does Not Support the Secretary's Position

When the quote cited by the Secretary is read in its proper context in the *Swift* decision, it is clear that it does not support the Secretary's general refusal to prohibit the packer practices as requested. Two important principles expressed by the court shed light on the intent of the quoted language. First, the court of appeals recognized the Secretary's authority to prohibit and restrict practices that are found to violate Section 202 of the Packers and Stockyards Act. Second, the reference to the lack of authority to establish uniformity of practice is to the court's finding that the form of the cease and desist order in that case was improper because the Act does not authorize the Secretary to change an unjustly discriminatory or unreasonably preferential practice into a fair practice through an affirmative mandate that the practice be applied uniformly to all affected.

(1) USDA Has the Authority to Restrict Unlawful Packer Practices

The quote cited by the Secretary is as follows:

The foregoing language does not purport to confer upon the Secretary of Agriculture any authority directly to regulate prices, or discounts, or sales methods; and clearly does not contemplate the exercise of any authority to establish uniformity of practice in respect thereto.<sup>72</sup>

The sentence immediately following this quote recognizes that the Secretary does have the authority to regulate practices if "in fact" they constitute unfair, unjustly discriminatory, or deceptive practices, or if they provide undue or unreasonable preference or advantage as between persons or localities. The court states:

Differences or variations in prices, or in the terms of credit, or amounts of discount, or in practices do not come within the ban of the act unless they in fact constitute engaging in or using an unfair or unjustly discriminatory or deceptive practice or device in commerce or unless they constitute a making or giving, in commerce, of an undue or unreasonable preference or advantage, or result in undue or unreasonable prejudice or disadvantage as between persons or localities.<sup>73</sup>

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<sup>72</sup> *Swift & Co. v. Wallace*, 105 F.2d 848, at 853 (7th Cir. 1939).

<sup>73</sup> *Id* at 853.

Later in the decision, the court makes clear that the Secretary has the authority to restrict packer practices that violate Section 202. The court states:

If a practice in respect to the giving of discount or terms of credit in fact constitutes an undue and unreasonable preference or advantage, or subjects some person or locality to undue and unreasonable prejudice or disadvantage, then clearly the Secretary of Agriculture has the power to restrict the practice to the point where it is fair and reasonable . . .<sup>74</sup>

Clearly, the court recognized that once USDA finds that a particular packer practice violates Section 202, it has the authority to restrict that practice until it is fair and reasonable. The economic studies discussed above demonstrate that current use of formula-priced forward contracts and packer ownership and feeding of its own slaughter supplies likely affect a manipulation of prices paid to producers and provide certain producers competitive advantages and preferences that are in violation of § 202 of the Act. The proposed rule restricts these practices only to the extent necessary to make them fair and reasonable and to prevent violation of the Act.

#### (2) Regulating Uniform Packer Practices

The court in the *Swift* case also held that the cease and desist order issued by the Secretary went beyond his authority because it was in effect an affirmative command to require “uniformity” of discount terms, terms of credit, and trade practices.<sup>75</sup> The court interpreted the cease and desist order issued by USDA to affirmatively require Swift to give discounts and particular terms of credit to any customer as a condition to being permitted to continue giving terms of credit or discounts that were found unreasonable and prejudicial. The court held that once a discount, term of credit, or practice was found to be undue or unreasonable preference, or unjustly discriminatory, the Secretary did not have the authority to change the practice into a proper practice by requiring it to be extended to all others who may be affected thereby. *It held that the Secretary does have the power to restrict a practice to the point where it is fair and reasonable but does not have the power to change the unreasonable preference into a fair practice by*

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<sup>74</sup> *Id.* at 863.

<sup>75</sup> *Id.* at 862-63.

*affirmatively mandating that it be applied uniformly to all affected.*<sup>76</sup> The court states:

If a practice in respect to the giving of discount or terms of credit in fact constitutes an undue and unreasonable preference or advantage, or subjects some person or locality to undue and unreasonable prejudice or disadvantage, then clearly the Secretary of Agriculture has the power to restrict the practice to the point where it is fair and reasonable; but we do not believe that the Secretary has the power to change a practice, which is assumed to be unreasonable and to create an unreasonable preference, into a proper practice by requiring it to be extended to all others who may be affected.<sup>77</sup>

The reference to the lack of authority to establish uniform practices in the quote used by Secretary Glickman is explained by this statement. All that the *Swift* court meant was that the Secretary does not have the authority to affirmatively mandate that for an unlawful practice to become lawful, it must be applied uniformly.

The Secretary's assertion that the *Swift* case supports his decision not to issue rules prohibiting the packer practices requested by the Western Organization of Resource Councils is wrong. The proposed rule restricts packer captive supply procurement methods only to the extent necessary to stop violation of the Act. The proposed rule does *not* mandate terms of sale through forward contracts or packer-owned cattle. Unlike the cease and desist order in the *Swift* case which required offering the *same* terms of credit to all buyers, the proposed rule does not require packers to buy all cattle on the same price terms. Forward contracts must be traded publicly, but the firm-base price does not have to be the *same* for all cattle. Similarly, packer-owned and fed cattle must be sold in a public market, but the cattle do not all have to be sold on the same terms.

## **E. Inciency Theory of Enforcement**

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<sup>76</sup> *Id.*

<sup>77</sup> *Id.* at 863.

The legislative history of the Packers and Stockyards Act indicates that the Act seeks “to prohibit the particular conditions under which monopoly is built up, and to prevent a monopoly in the first place and to induce healthy competition.”<sup>78</sup>

Such legislative history has been interpreted by courts to mean that one of the purposes of the Packers and Stockyards Act is to prevent “potential injury by stopping unlawful practices in their incipiency” and that “proof of a particular injury is not required” to permit regulation of packer practices.<sup>79</sup>

Several courts have affirmed the principle that the Secretary has the authority to prevent unlawful practices in their *incipiency* but require that before doing so he must find either some non-competitive intent or some *likelihood* of competitive injury.<sup>80</sup> These cases *do not require* the Secretary to find *actual injury*. He is *only required* to demonstrate a *likelihood* that injury of the sort the Act is designed to prevent will occur. As the Court of Appeals for the Ninth Circuit has stated:

Unfair practices under Section 202 are not confined to those where competitive injury has already resulted, but include those where there is a *reasonable likelihood* that the purpose will be achieved and that the result will be an undue restraint of trade.<sup>81</sup>

In *Bosma v. USDA*, the Ninth Circuit Court of Appeals quoted its *Central Coast Meats, Inc.* holding that the department must show that the challenged conduct “is *likely* to produce the

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<sup>78</sup> Hearings on H.R. 14, H.R. 232, H.R. 5032, and H.R. 5692 Before the House Committee on Agriculture, 67th Cong, 1st Sess., ser. D, 26 (1921).

<sup>79</sup> *Daniels v. United States*, 242 F.2d 39, 42 (7th Cir. 1957), *cert. denied*, 354 U.S. 939, *reh’g denied*, 355 U.S. 852 (1957); *Bowman v. USDA*, 363 F.2d 81, 185 (5th Cir. 1966), quoting *Daniels*.

<sup>80</sup> *See Armour & Company v. United States*, 402 F.2d 712, 717 (7th Cir. 1968), which describes how several previous Seventh Circuit opinions incorporated this concept, including *Swift & Co. v. Wallace*, 105 F.2d 848 (7th Cir 1939); *Wilson & Co. v. Benson*, 286 F.2d 891 (7th Cir. 1961); *Swift & Co. v. United States*, 408 F.2d 849 (7th Cir. 1962); *see also* *Corona Livestock v. USDA*, 607 F.2d 811, 815 (9th Cir. 1979).

<sup>81</sup> *De Jong Packing Co. v. USDA*, 618 F.2d 1329, 1336-37 (9th Cir. 1980) (emphasis added).



sort of injury the Act is designed to prevent.”<sup>82</sup> The court found that actual harm resulted when an auction operator purchased livestock from consignments for speculation.<sup>83</sup> However, the court also held that the failure of the auction operator to inform consignors that he was the actual purchaser of the livestock was “inherently unfair” and “it may be considered an ‘unfair’ or ‘deceptive’ practice absent a more specific showing of actual harm.”<sup>84</sup>

Similarly, in a case involving an agreement by two competitors not to compete for certain cows at an auction market, the Eighth Circuit Court of Appeals held that “actual injury” need not be proven because the “purpose of the Act is to halt unfair trade practices in their incipiency, before the harm is suffered.”<sup>85</sup> The court stated that “the Secretary need only establish the *likelihood* that an arrangement will result in competitive injury to establish a violation.”<sup>86</sup> The court agreed with the judicial officer that “a practice which is likely to reduce competition and prices paid to farmers for cattle can be found an unfair practice under the Act.”<sup>87</sup> The court concluded that “this is so even in the absence of evidence that the participants made their agreement for the purpose of reducing prices to farmers or that it had that result.”<sup>88</sup>

These cases firmly establish that the Secretary may take action to prevent unlawful packer practices in their incipiency if he finds that these practices are reasonably likely to produce the sort of injury the Act is intended to prevent. The economic studies discussed above provide a sufficient factual basis for finding that the packers current use of forward contracts and

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<sup>82</sup> *Bosma v. USDA*, 754 F.2d 804, 808 (9th Cir. 1984), (emphasis added).

<sup>83</sup> *Id.* at 808-809.

<sup>84</sup> *Id.*

<sup>85</sup> *Farrow v. USDA*, 760 F.2d 211, 215 (8th Cir. 1985).

<sup>86</sup> *Id.*

<sup>87</sup> *Id.* at 214.

<sup>88</sup> *Id.*

packers' feeding of their own slaughter supplies in today's concentrated markets are *likely* to cause reductions in prices paid to producers and result in undue preferences for certain producers over others.

The incipency theory of enforcement of the Packers and Stockyards Act can be applied in the rule-making process as well as in an administrative complaint proceeding. In the rulemaking process the Secretary makes the necessary findings with regard to the packer practices in general, whereas in an administrative complaint proceeding the necessary finding would be made as to a particular situation. The captive supply procurement practices addressed by the proposed rule are so widespread that restrictions on USDA's resources will not permit them to be addressed effectively through individual administrative complaints. These practices can only be addressed effectively through issuance of a rule.

#### **F. The Relevance of Competition in an Undue Preference Case**

The Seventh Circuit Court of Appeals has held that when considering whether a packer practice provides an undue and unreasonable preference or is unjustly discriminatory, the effect on competition as between the party alleged to have obtained the preferential treatment and the party alleged to have been discriminated against is of primary importance. Even good faith competition between packers will not prevent a finding of discrimination or unreasonable preference if the parties preferred or discriminated against are not other packers.<sup>89</sup>

In this Seventh Circuit case, Swift had been granting longer credit terms and better discounts to the institutional trade (hotels, restaurants, clubs, steamship lines, and public institutions) than it offered to purveyors (those businesses which buy meat products from packers and then resell them to the institutional trade). The Seventh Circuit Court of Appeals set aside USDA's ruling that the discounts and terms of credit at issue were in violation of Section 202 of the Packers and Stockyards Act.<sup>90</sup> The court found that USDA had not properly taken into account the issue of competition when making its decision.<sup>91</sup> Under the court's analysis, the purveyors that

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<sup>89</sup> *See, e.g.*, *Swift & Co. v. Wallace*, 105 F.2d 848, at 855-857 (7th Cir. 1939).

<sup>90</sup> *Id.* at 857.

<sup>91</sup> *Id.* at 854-57.

claimed they were being discriminated against were competitors of the packer, not competitors of the institutional trade. Both the packers and the purveyors sold meat to the institutional trade. The preferential credit terms and discounts, however, were given to the institutional trade. The court found that an important aspect of “competition” to be concerned about in an unjustly discriminatory or unreasonable preference case would be that between the party preferred and the party claiming prejudice. The court stated:

Normally the lack of competition between the parties preferred and the parties claiming to be subjected to discrimination would be a fact of substantial significance for the determination of the existence of “any undue and unreasonable preference or advantage.”<sup>92</sup>

Because the purveyors were not competing with the institutional trade, the court found no discrimination between competitors. Thus, it found that USDA had not provided an adequate factual basis for holding the practices to be violations of the Act.

When considering whether the packers’ captive supply procurement methods result in undue and unreasonable preferences or unjust discrimination, their effect on the competition between livestock producers must be considered. Because captive supply agreements are offered selectively to livestock producers and provide preferential access to slaughter plants for those who enter into them, they injure the ability to compete of those producers who are not offered such agreements for the sale of their livestock. The proposed rule is designed to restrict use of forward contracts and packer owned and fed cattle only to the extent necessary to prevent unjust discrimination or undue preferences between competing producers. It does so by requiring forward contracts and producer owned and fed cattle to be traded in a public market.

#### **G. Secretary Has the Authority to Issue the Proposed Captive Supply Rules**

The legislative history discussed above demonstrates that a primary purpose of the Packers and Stockyards Act was to ensure that producers received full value for their livestock. The Secretary was granted the authority to regulate packers to ensure open, competitive livestock markets and, thereby, prevent arbitrary depression of prices through the oligopsonistic powers of the packers. See pp. 25-29. This history and the language of the Act also demonstrates that the Secretary has the authority to issue substantive rules to prevent packers from taking any

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<sup>92</sup> *Id.* at 857.

actions prohibited by Section 202 of the Act. See pp. 23-25. The courts have held that Congress intended to give the Secretary the authority to regulate packers' activities so as to stop practices that are *likely* to cause the type of harm to producers that the Act is designed to address in their incipiency – before the harm is suffered. See pp. 37-39 above.

The above described economic evidence provides a substantial factual basis for finding that the current use of formula-priced forward contracts and direct packer feeding of cattle for slaughter in today's highly concentrated markets is likely to cause the type of harm to producers that Congress intended to prohibit under Section 202 of the Act.

Section 202(e) expressly prohibits packers from engaging in “any course of business” or doing “any act” with “the effect of manipulating or controlling prices.”<sup>93</sup> Numerous economic studies cited above indicate that, in general, when packer concentration levels increase producers prices decrease. See pp. 8-13 above. Recent studies support a finding that packers' oligopsonistic power does have a negative impact on producers' prices, costing producers millions of dollars a year. See pp. 8-13 above. For example, one important study found, through statistical analysis that, between 1972 and 1986, fed cattle prices were significantly below their marginal value during 39 of 51 quarters. On average the mark-down was 1.31 percent, or 17 percent of the marketing margin, amounting to \$1.54 per hundredweight of retail meat. The authors estimate that this was worth about \$62 million dollars to the packers. See p. 13 above. While these studies do not identify any specific practices that cause the reduction in prices, they do demonstrate that oligopsonistic packer buying practices, in general, have *the effect of manipulating prices* paid to producers. These studies establish a substantial factual basis for finding a strong likelihood that general buying practices of oligopsonistic packers will result in producers receiving less than the full value of their livestock. They provide substantial evidence for finding that oligopsonistic packers' buying practices should be restricted under Section 202 of the Act.

Economic studies have also attempted to isolate specific livestock procurement practices to determine their effect on producer prices. One study found that packers' feeding of their own cattle for slaughter has a depressing effect on prices other producers are paid for their livestock. See, pp. 13-15 above. Other studies have shown that packers' use of forward contracts also has depressing effect on prices paid to producers for their livestock. See pp. 15-19 above. *Concentration in the Red Meat Packing Industry*, issued by the Grain Inspection and the Packers and Stockyards Administration in February, 1996, demonstrates that the use of captive supply procurement methods in the cattle industry is associated with a decline in cash-market price for cattle. It shows that packers increase their captive supply

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<sup>93</sup> 7 U.S.C. § 192(e).

inventories when cash-market prices increase, and as they increase captive supply deliveries from these inventories, cash-market prices decline. See p. 18 above. These studies provide sufficient evidentiary support for a finding that packer feeding of their own slaughter supplies and their use of forward contracts are *likely* to have *the effect of manipulating prices* paid to producers in violation of Section 202(e) of the Act. Such practices should, thus, be restricted by regulation.

Section 202(a) of the Act prohibits packers from engaging in any “unjustly discriminatory” practice or device.<sup>94</sup> Section 202(b) prohibits packers from giving any person an “undue or unreasonable preference or advantage” “in any respect whatsoever.”<sup>95</sup>

When considering whether packers’ feeding of their own slaughter supplies and use of forward contracts constitute undue preferences or unjust discrimination in violation of Section 202(a) and (b) of the Act, the effect of these practices on competition between livestock producers must be considered. See pp. 39-40 above. Packer feeding of their own slaughter supplies and use of forward contracts are very likely to injure competition between livestock producers. By definition, packers that own and feed cattle for their slaughtering plants provide preferential treatment for their stockholders over other livestock producers. Packer-owned cattle enjoy preferential access to the slaughtering facility; thus the packer-owned cattle are guaranteed a market. This type of activity does injure competition between, the packers and their shareholders on the one hand, and other livestock producers on the other. Similarly, forward contracts which are not traded publicly but offered to certain livestock producers selectively also provide preferential access to slaughter plants for those who enter into them. Livestock producers who are not offered the forward contracts are at a significant competitive disadvantage. That these practices may make the packers more competitive with each other does not control the determination of whether they violate the “undue and unreasonable preference” or “unjustly discriminatory” language of the Act. Packer feeding of its own cattle for slaughter and forward contracts as they are used today are likely to result in undue preferences and unjust discrimination in violation of Sections 202(a) and (b) of the Act. Their use should thus be restricted through regulation.

This discussion demonstrates that there is substantial factual and legal basis for issuing rules under Section 202 of the Act restricting the use of forward contracts and packer feeding of its own slaughter supplies. The rules proposed in this petition offer the least intrusive form of restriction on these practices that will ensure compliance with the purposes of the Act. These proposed rules do not prohibit the use of forward contracts, but merely require that the contracts contain a firm-base price and be traded in an open public market. The proposed rules also do not prohibit packers from owning and feeding cattle. The proposed rule only requires that packer-owned cattle be traded in a public market.

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<sup>94</sup> 7 U.S.C. § 192(a).

<sup>95</sup> 7 U.S.C. § 192(b).

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These restrictions are designed to protect producers' interests by encouraging open, competitive markets for livestock. They are designed to take advantage of what economic studies suggest encourage competitive markets for livestock - that more bidders for livestock mean higher prices to producers and that electronic or telemarkets markets also increase prices paid for livestock. See pp. 18-20 above. They are designed to provide equitable access to markets for all livestock producers preventing unjust discrimination between livestock producers by packers.

For these reasons WORC requests that Secretary Glickman issue the rule set out above at pp. 2-4.

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