November 18, 2010

Ms. Tess Butler
GIPSA
United States Department of Agriculture
1400 Independence Avenue, S.W.
Room 1643-S
Washington, DC 20250-3604

RE: Farm Bill Comments of the National Pork Producers Council (NPPC) on Proposed Farm Bill Regulations, 75 Fed. Reg. 35338-35354 (June 22, 2010)[1]

Dear Ms. Butler:

We are writing on behalf of the National Pork Producers Council ("NPPC") to present its comments on the proposed rules contained in Implementation of Regulations Required Under Title XI of the Food, Conservation and Energy Act of 2008; Conduct in Violation of the Act (the "Proposed Rules"). The Proposed Rules assert that they have been issued by the Grain Inspection, Packers and Stockyards Administration ("GIPSA") pursuant to the provisions of the Packers and Stockyards Act, 1921 (the "PSA"), 7 U.S.C. § 181 et seq., and Title XI of the Food, Conservation and Energy Act of 2008, P.L. 110-246 (the "Farm Bill") .

The NPPC is a national association representing 43 affiliated state associations and America's pork producers who annually generate approximately $15 billion in farm gate sales. The U.S. pork industry supports an estimated 550,000 domestic jobs and generates more than $97 billion annually in total U.S. economic activity.

The hog producers represented by the NPPC include swine contractors[2] who own hogs bred and raised for slaughter by packers. Swine contractors may be parties to marketing agreements relating to the sale of livestock to packers which slaughter and process the hogs. Swine contractors may also be parties to swine production contracts[3] with swine production contract

[1] Notice of Proposed Rulemaking, Implementation of Regulations Required Under Title XI of the Food, Conservation and Energy Act of 2008; Conduct in Violation of the Act ("NPRM").

[2] A "swine contractor" is defined in the PSA as "any person engaged in the business of obtaining swine under a swine production contract for the purpose of slaughtering the swine or selling the swine for slaughter if—(A) the swine is obtained by the person in commerce; or (B) the swine (including products from the swine) obtained by the person is sold or shipped in commerce." 7 U.S.C. § 182(a)(12).

[3] A "swine production contract" is defined in the PSA as "any growout contract or other arrangement under which a swine production contract grower raises and cares for the swine in accordance with the instructions of another person." 7. U.S.C. § 182(a)(13). The definition of "production contract" contained in proposed § 201.2(s) is not consistent with the statutory definition.

growers.[4] Packers, swine contractors and swine production contracts are subject to regulation under the PSA.[5] Swine production contract growers are not. As a result, many NPPC members are subject to regulation under the PSA with respect to any swine production contract to which they are a party because the PSA does not include any thresholds in defining a "swine contractor." A single production contract with a neighbor for the raising and feeding of hogs results in regulation and exposure to liability under the PSA for hog producers. Swine producers are thus unique in the manner in which they are treated under the PSA.

Simultaneously, hog producers are not subject to regulation with respect to the marketing agreements by which they dispose of their livestock. However, the counterparties to their marketing agreements, the packers to whom they sell their livestock, are subject to the PSA.[6]

The NPPC is concerned that the Proposed Rules, if adopted, "would drastically change the way that producers, packers, dealers and contractors raise, buy, and sell livestock and poultry"[7] and that the Proposed Rules were written without apparent consideration for their effect upon the industry or appreciation for the differences between the multiple species of livestock and the effect of such differences on the production and marketing of livestock. By combining concepts of marketing agreements with production contracts, redefining terms to eliminate business justification defenses to allegations of market place improprieties and overtly attempting to rewrite the PSA and judicial precedent, GIPSA has created a regulatory quagmire that will stifle the swine industry and place swine producers at a competitive disadvantage to other protein suppliers. In addition, the Proposed Rules are arbitrary and capricious and exceed the authority granted GIPSA by Congress. Finally, as a public policy matter, the NPPC contends the Proposed Rules are unwise.

Specifically, the NPPC opposes the Proposed Rules for at least the following substantive reasons:

A. GIPSA lacks authority to declare that no showing of injury to competition is necessary to establish a violation of sections 202(a) and (b) of the PSA.
B. The Proposed Rules are arbitrary and capricious because they hinder, rather than advance, the purposes of the PSA, are not supported by an adequate record or economic analysis, and ignore GIPSA's own industry studies.
C. The Proposed Rules violate the Data Quality Act and GIPSA's own implementing guidelines for the Act.

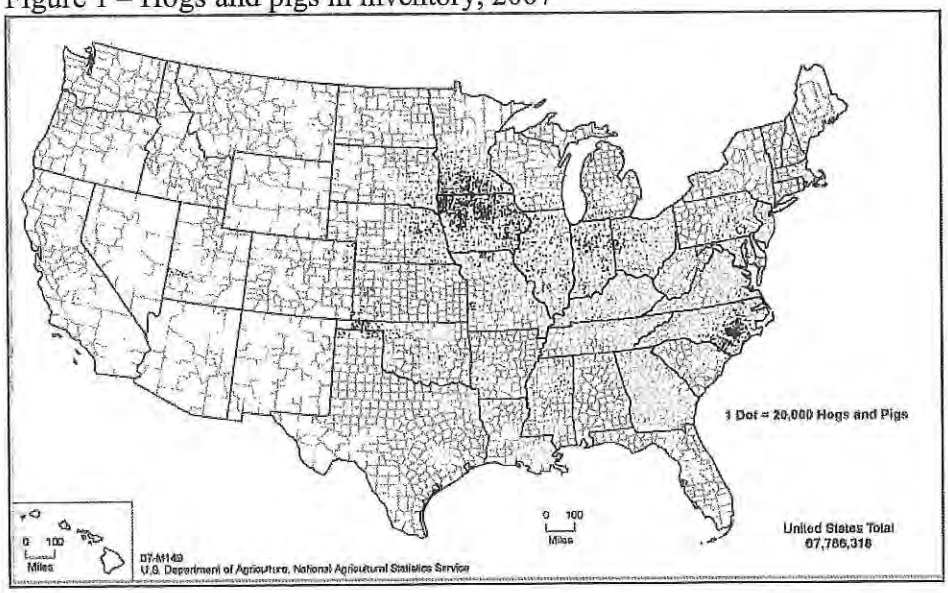
[4] A "swine production contract grower" is defined in the PSA as "any person engaged in the business of raising and caring for swine in accordance with the instructions of another person." 7 U.S.C. § 182(a)(14).
[5] For example, Section 202 of the PSA expressly applies to both packers and swine contractors.
[6] For more detailed discussion on marketing and production contract see section Section II.A of these comments.
[7] The National Agricultural Law Center, www.nationalaglawcenter.org/gipsaworkshops (9/10/2010).

OVERVIEW OF THE PORK INDUSTRY[8]

A. U.S. Pork Industry Location and Ownership Structure

The U.S. pork industry is national in scope with hogs being raised in all 50 states. Commercial hog production is centered, though, in three primary areas: the Cornbelt states, ranging from Nebraska and South Dakota in the west to Ohio in the east, the eastern seaboard, ranging from South Carolina northward to Pennsylvania, and centered on a large industry in North Carolina, and the Panhandle region of Texas and Oklahoma. See Figure 1.

Figure 1 – Hogs and pigs in inventory, 2007[9]



The markets for pork and hogs are national in that prices for hogs, whether sold by producers to packers live or in carcass form, and pork cuts are primarily determined in the Cornbelt where the vast majority of hogs are raised, slaughtered and processed into pork. Prices in other production regions are based on these Midwestern prices, generally differing by the amount of transportation costs, just as economic theory predicts. Prices in regions with smaller hog numbers may also be affected by factors other than transportation costs since they are far more dependent on local demand conditions.

Based on USDA data, hogs are produced by 63,300 owners operating 71,450 operations (2009 data) across the U.S., but the number of hogs owned and produced within these operations is heavily skewed toward large operations that can capture the significant economies of scale that are available by using modern technologies and practices. Eighty percent of the 63,300 owners had fewer than 100 pigs in inventory in 2009, and 88.5 percent had fewer than 500 pigs in

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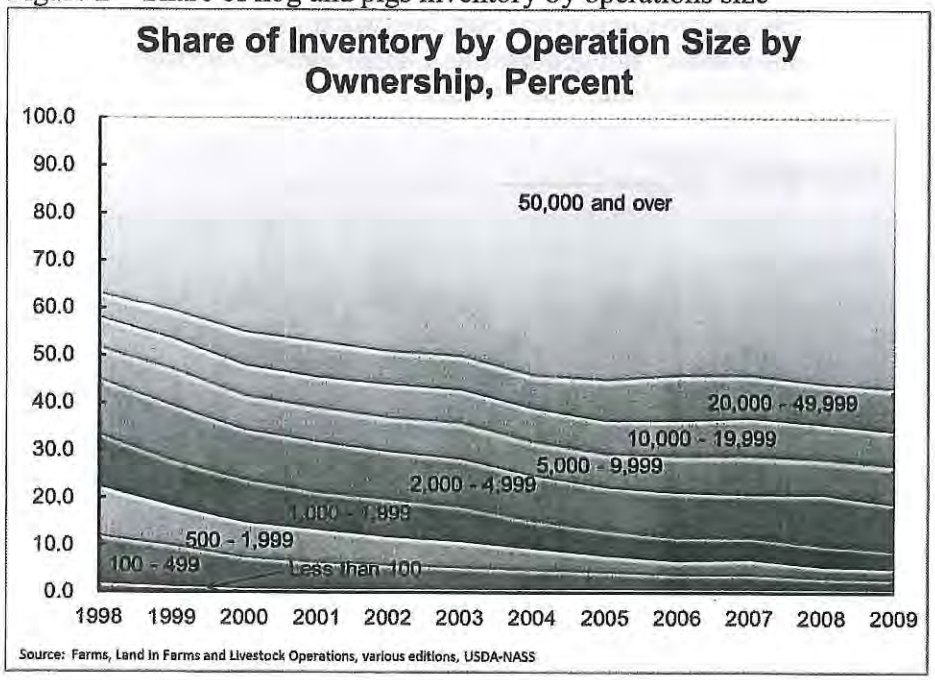
[8] *See also generally* GIPSA Livestock and Meat Marketing Study, RTI Project Number 0202230, Volume IV, (January, 2007), page ES-3 (the "GIPSA LMMS"). A copy of the GIPSA LMMS can be found on GIPSA's website at http://www.gipsa.usda.gov/GIPSA/webapp?area=home&subject=lmp&topic=ir-mms.

[9] USDA, Census of Agriculture, 2007.

inventory. Those 55,740 operations owned only 3.1 percent of the nation's hogs. The vast majority of pork consumed by Americans and international customers comes from large, very efficient farms. The 1,410 owners (2.2 percent of the total owners) who had inventories of 5,000 head or more pigs in 2009, owned 81 percent of the total pigs in the U.S.[10]

Figure 2 – Share of hog and pigs inventory by operations size



Pigs are produced in a variety of ways in the U.S. Some are still produced on diversified farms that involve several enterprises while others are produced by specialized companies in specialized facilities. Some are produced outdoors in either pasture or woodlands while others spend their entire lives indoors in climate-controlled buildings. Some pigs are from genetic lines known for superior meat quality that provide superior flavor, marbling or other characteristics determined in "white table cloth restaurants," while others are from lines designed to produce lean pork that meets the preferences of today's health-conscious consumer. Virtually all U.S. pigs are fed diets based on corn and soybean meal though some regions use other ingredients such as milo, barley and peas as well as by-products from ethanol plants, bakeries, cereal makers and others. There is no right or wrong way to raise a hog – just better or worse ways depending on the local climate, available feedstuffs and specific end uses.

The business organizations that produce hogs vary as much as the hogs themselves. These range from 4-H and FFA projects that involve only a few purchased feeder pigs each year to regionally diverse divisions of large production companies. There are sole proprietorships, partnerships, corporations of every type and limited liability companies. The vast majority of hog operations –

[10] Farms, Land in Farms and Livestock Operations, USDA, National Agricultural Statistics Service, Washington, D.C. (February 2010) available at http://usda.mannlib.cornell.edu/MannUsda/viewDocumentInfo.do?documentID=1259.

even large ones – are owned and operated by individual families and usually involve several members of those families. Such family operations are full-time, commercial scale hog producers.

B. Business Practices in Today's Pork Industry

During the past 30 years, the industry has moved from hundreds of thousands of small operations that sold pigs by the pickup or trailer load through auction barns and buying stations to far fewer operations that sell pigs by the semi-trailer load directly to packers. This increase in the volume of animals handled by individual operators has led to new business practices in the pork industry. Contract production, open market production and vertically owned production are business choices that depend on factors such as transactions costs, risks and uncertainty in markets. No single solution is best for all circumstances. Today's demands for higher quality and verified production require improved information through the supply chain. Contracts provide the ability to improve that information.[11]

1. Production Contracts

The 1980s saw the advent of contract production where the owner of sows would contract with others to provide buildings, labor, utilities and waste management for a fee. Contract grower-finish facilities were the most common but contract nurseries and breeding-gestation-farrowing units were also used.

The use of production contracts accomplishes several important goals for hog producers. First, they allow a hog producer to expand rapidly because the owner does not have to raise the capital to build all of the needed buildings. Using contracts allows those buildings to be built with the contract grower's capital and credit and to be placed on the contract grower's balance sheet. The trade-off, of course, is that the contract grower obtains the opportunity to build equity in barns, feeders, hog sorters, and other production facilities, with a useful life that, in many cases, goes well beyond the terms of the initial contract.

Second, they allow swine production operations to be geographically dispersed, reducing the risk of loss that would exist if all animals were on one site and placing valuable waste nutrients (manure) near growing crops. Dispersion of facilities helps swine producers to address potential risks such as disease and casualty from weather or fire. Having nutrients as fertilizer near their point of use reduces transportation costs and risks as well.

Third, the growth of swine production contracts coincided with the development of "separate-site swine production" systems that segregated pigs of differing ages to control disease, increase pig health and enhance production efficiencies. Production contracts facilitated the widespread adoption of these systems by giving pig owners access to land in different areas. The benefits have been tremendous and have resulted in healthier animals, lower-cost production, higher

[11] *See generally,* Brian L. Buhr, *Evaluating the Economic Consequences of Proposed Rules for Implementation of Regulations Required Under Title XI of the Food, Conservation and Energy Act of 2008; Conduct in Violation of the Act Considering the Role of Vertical Coordination in Livestock Market Development* (November 5, 2010) (unpublished comment) (attached and incorporated as Appendix A).

output, more affordable pork products for U.S. and foreign consumers, and ready access to organic fertilizers that many crop farmers use.[12]

Finally, production contracts allow thousands of rural residents to remain on family farms making a full-time living in agriculture. Production contracts provide repayment assurance for bankers and, in turn, allow growers to finance, upgrade and modernize buildings. They provide steady sources of income without the grower having to face output or market risk. Once paid for in 8 to 12 years, contract buildings provide substantial cash flow that can provide for building replacement or expansion of facilities. Many growers have eventually become independent hog producers thanks to the opportunity provided by a sound production contract.

Contract hog production payments were initially made on a per-head basis with premiums paid for superior performance such as low death loss, low feed conversion rate and more pigs per sow per year. But these types of payments did not perform well if weather conditions were bad or a disease challenge was encountered. In addition, early marketing or delayed pig deliveries meant that growers were without pigs – and thus without payments – for periods of time, a situation that obviously reduced their incomes and ability to repay loans.

Other payment systems were tried but the industry finally adopted, in general, a system that pays growers a fixed amount per animal space per year with, in many, but not all, cases premiums for performance that exceeds pre-specified levels. Hypothetically, the owner of a 1,000-head finishing barn may receive $36 per pig space per year (i.e. $36,000 annually). In addition, the swine production contract grower may receive a premium if the feed conversion rate is less than 2.9 lbs. of feed per pound of gain or if death losses are less than 2.4 percent of delivered pigs. This payment system guarantees a minimum income level to growers, provides incentives to improve pig performance and, thus, profitability for pig owners and allows owner flexibility in the timing of placing and marketing pigs without imposing a consequence on the grower. The system has worked very well for swine contractors and swine production contract growers. In fact, GIPSA does not cite one instance of "unfair" treatment of swine production contract growers by swine contractors.

2. Marketing Agreements

The other business practice that has developed over the past 25 years is the use of marketing agreements to transfer ownership of pigs from producers to packers. Marketing agreements, like production contracts, have evolved over time to meet the needs of both packers and producers.

Early marketing agreements were offered by packers as a way of securing leaner hogs that would yield higher proportions of saleable cuts. In the 1980s and 1990s, the U.S. hog populations contained a large number of animals with too much fat and not enough lean muscle. As

[12] There have been three technological changes that affected this structural change: bio-security, genetics and feeding/nutrition. Bio-security/health led to multi-site production system and genetics led to improved pork quality. Both required coordinated systems to capture their maximum benefits (i.e., knowing which pigs were healthy and which had the best genetics before they were purchased. Although the Proposed Rules imply that the structural changes were a market-power driven change, many of these changes can be attributed to the natural evolution of technical change.

consumers began demanding lean pork products, packers identified producers who had lean, good cutting hogs. They would offer a premium if the producer would make a long-term (as much as 5 to 7 years in some cases) commitment to sell to that packer. An additional benefit is management and assurance of throughput levels that maximize plant efficiencies. This allows producer-to-consumer price spreads to be as small as possible, keeping producer prices high and/or consumer prices low.

Another incentive for using marketing contracts -- guaranteed and timely access by producers to packing capacity -- was driven primarily by the hog price crash of 1998. In that year, hog supplies increased sharply even while packing capacity declined primarily because of the bankruptcy of Thorn Apple Valley Packing in Detroit. Timely marketings were impossible during November and December of 1998, and prices fell to record lows. The inability to sell hogs on a timely basis drove many producers and their lenders to enter into marketing agreements to guarantee access to packing capacity or "shackle space" at a packer. Few producers or lenders wanted to take the risk of having no market for their pigs, even over a very short period of time. Most "shackle space" contracts have prices tied by formulas directly to the spot or negotiated market and thus have no risk mitigating characteristics – the price may be $1 or $2 higher than the spot price in return for a long-term supply commitment, but the variance (i.e. risk) of the formula price will be the same as the variance of the spot price. Producers who use these kinds of contracts to guarantee shackle space can (and many do) use futures, options and cash contracts with packers – the same tools used by producers selling on the spot/negotiated market -- to manage risk.

Some marketing agreements, though, have price-stabilizing or risk-mitigating components. Most of these do not attempt to raise or lower long-run prices as much as they attempt to reduce price variation, preventing steep downturns in revenues and helping manage cash flows. These contracts stabilize producer financial performance and enhance their access to capital. In addition, they result in a more stable supply of hogs for packers, creating a win-win-win situation for all three parties.

While some data on the prevalence of marketing contracts was available prior to 2002, the advent of the mandatory price reporting system provided the first ongoing data on how U.S. producers and packers were pricing the pigs they traded. The annual data for 2002 through 2009 appear in Figure 3.

Figure 3

Percent of MPR Barrows & Gilts Purchased by Pricing Mechanism

	2002	2003	2004	2005	2006	2007	2008	2009
Hog/meat market formula	44.5	41.4	41.4	39.9	41.8	38.3	37.1	41.2
Other market formula	11.8	5.7	7.2	10.3	8.8	8.5	11.0	7.9
Other purchase arrangement	8.6	19.2	20.6	15.4	16.6	15.2	13.4	11.6
Packer-sold	2.1	2.2	2.1	2.4	2.6	6.7	6.1	5.6
Packer-owned	16.4	18.1	17.1	21.4	20.0	22.7	23.1	25.7
Negotiated/spot	16.7	13.5	11.6	10.6	10.2	8.6	9.2	8.1

Source: USDA, AMS, Data from LM_HG201

There are three noticeable trends in these data. First, the percentage of total supplies that are packer-owned has trended upward over time and has made quantum jumps that correspond to acquisitions of hog production companies by major packers.

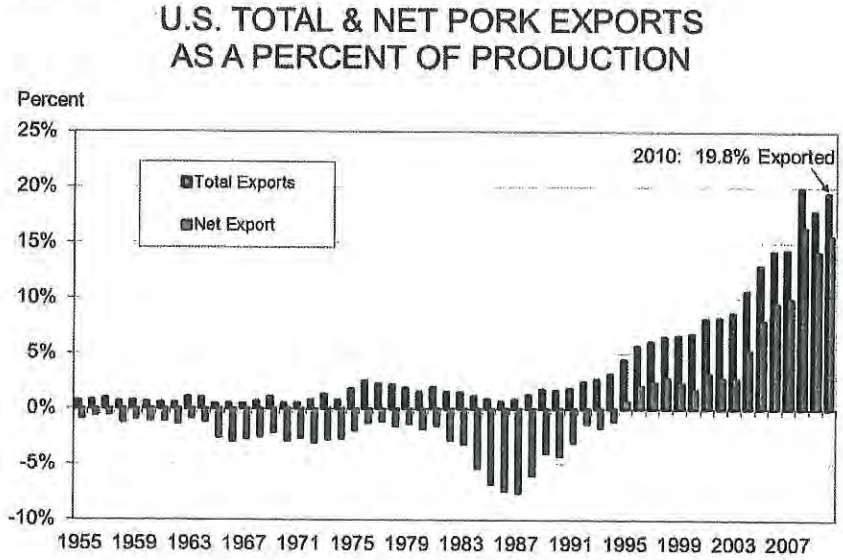
Second, the percentage of hogs for which prices are negotiated daily has fallen steadily. This decline reflects the rising confidence in mandatory reported prices and the increased transaction costs to both producers and packers of negotiating the price of each load of pigs. Less frequent negotiations to determine a differential from the negotiated price result in the same relative price being paid with far less time and effort expended.[13]

Third, there is a smaller but still apparent downtrend in the number of animals priced using "Other Purchase Agreements," which is, under today's mandatory price reporting rules, a catch-all category for agreements that do not fit the other three descriptions. The contracts in this category are primarily those that base hog prices on feed costs, or share price deviations outside a prescribed range (i.e., window contracts) or have a set price floor.

C. Increasing Dependence Upon Exports

Another key development over the past 20 years is the emergence of the U.S. as the world's largest exporter of pork and pork variety meats. As recently as 1988, the U.S. was the largest pork importer in the world. The U.S. became a net exporter for the first time in 1995, and will export a near-record 19.7 percent of total production this year (See Figure 4).

Figure 4



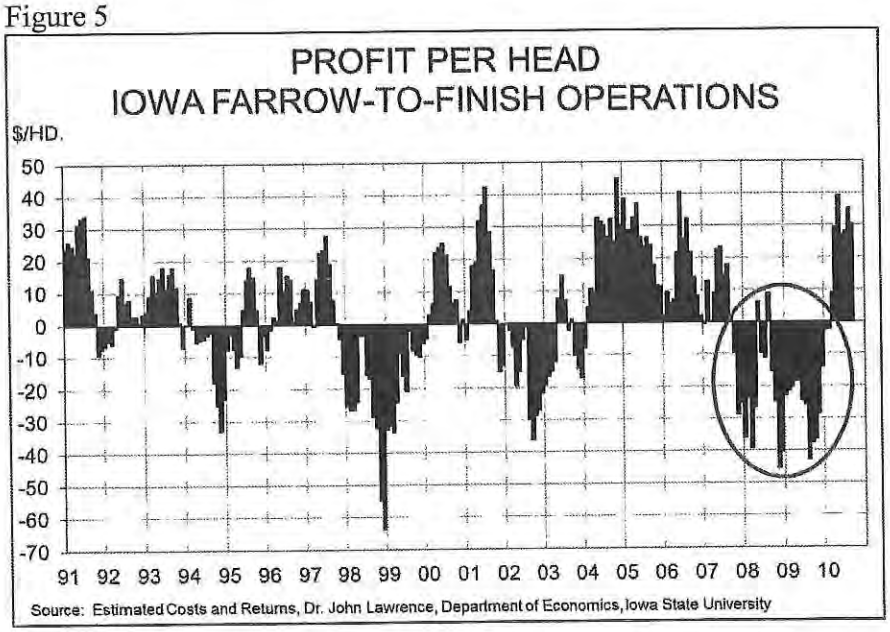
[13] The use of marketing agreements by swine producers does not necessarily mean that the price of market hogs covered by such agreements is not negotiated between swine producers and packers. Rather, all terms of marketing agreements are heavily negotiated between the parties and, in fact, there may well be significant opportunities available to swine producers to negotiate with multiple packers.

The importance of the export market has been a factor in the adoption of production contracts and marketing agreements, and cannot be overlooked by policy makers. The steady growth of exports has given rise to steady growth of U.S. output, and these business practices provide a way to access much needed resources (land, capital, labor), spread risk and coordinate production and processing. With nearly 20 percent of total production now being shipped to international consumers, any forced change in hog procurement and pricing practices will negatively affect pork industry coordination and run the very real risk of reducing U.S. pork exports. Such a reduction would, in the short run, leave more product on the domestic market and decrease prices paid to all U.S. pork producers. In the long run, it is likely the industry would downsize to once again balance supply with demand. Lower output means fewer hog operations, fewer packing/processing jobs, fewer feed suppliers, veterinarians, truckers, builders, etc. -- fewer people working and living in rural America.

D. Recent Economic Performance of the Production Sector

The decade of the 2000s was the best of times and the worst of times for U.S. pork producers (see Figure 5). According to Iowa State University's Estimated Costs and Returns for Iowa farrow-to-finish hog operations, hog production was profitable in all but one month from February 2004 through September 2007, the longest profitable period on record. Further, the profits earned during that period were not small, exceeding $30/head in 11 months and $40 head twice. Producers entered the fall of 2007 with unprecedented levels of owner equity many as high as 80-90 percent.

Figure 5



But producers' accumulated wealth quickly eroded between October 2007 and February 2010 as production costs rose to unprecedented levels, driven by higher corn and soybean meal prices which coincided with the implementation of the 2007 Energy Act – Renewable Fuel Standards. Today, over one-third of the U.S. corn crop is being used as an ethanol feedstock. Over 80

percent of the estimated pork producer profits of the 2003-2007 period were lost by February 2010, and many producers remain in a very precarious financial position.

As a result, the U.S. breeding herd was reduced by 7.4 percent from December 2007 through September 2010. The resulting lower pig output and slaughter drove prices high enough to provide a profit to some producers even with higher costs from March through October of this year. But another explosion of corn and soybean meal prices since August 2010, driven by disappointing corn crop reports and little wiggle room for corn usage because of ethanol mandates and world feed-grain demand, has dampened the profit outlook for the rest of 2010 and all of 2011. Futures markets for hogs, corn and soybean meal, which offered average 2011 profits of $9/head as recently as August, are now offering an average loss of $0.38/head for 2011.

E. Pork Production Differs Significantly from Poultry and Beef Production[14]

The Proposed Rules hardly recognize that there are any differences in the ways that we produce pigs, chickens and cattle, lumping all three together and ascribing problems and challenges to all three. The NPPC believes that these Proposed Rules take a "one size fits all" approach. The Proposed Rules are a disservice to U.S. pork producers because they fail to recognize that all livestock are produced and marketed very differently. Treating all livestock the same ignores the species and animal differences that drive the production and marketing practices of the various protein sources. NPPC submits that species differences should be acknowledged and considered in the promulgation of any rules that address competition in the meat industry.

1. The Hog/Pork Industry Uses Both Production Contracts and Marketing Agreements[15]

Regardless of the industry, it is important to note the nature of the contractual arrangements between the parties. As discussed above, there are fundamental differences between a "marketing agreement" and a "production contract" that affect the nature of the relationships. The Proposed Rules appear to use "forward contract," "marketing agreement," "marketing arrangement" and "production contract" interchangeably.[16] A marketing agreement is a sales contract. Under a marketing agreement the owner of the livestock sells the animals to a packer. A marketing agreement is governed by state law, principally Article 2 of the Uniform Commercial Code. The UCC also fills any gaps in the terms of the contract between the producer/seller and packer/buyer. Marketing agreements are typical in the cattle and swine industries.

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[14] For additional information on the industry differences see Clement E. Ward, *Beef, Pork, and Poultry Industry Coordination* (Oklahoma Cooperative Extension Service piece) (attached and incorporated hereto as Appendix B). *See also* GIPSA, 2009 Annual Report, Packers & Stockyards Program, at 43 (March 2010); and GIPSA, 2008 Annual Report, Packers & Stockyards Program, at 42 (March 2009) available at http://www.gipsa.usda.gov/GIPSA/webapp?area=newsroom&subject=landing&topic=cc-ar.

[15] For a more detailed discussion on the marketing agreements and the Proposed Rules see Section III.A., *infra*.

[16] For example, proposed § 201.213(a) includes production contracts within its description of "marketing arrangement[s]" notwithstanding that a production contract does not involve the transfer of ownership or title to livestock. See also Section II.A.1 and 2 of these comments.

In contrast, a production contract is not a sales contract and is not subject to the Uniform Commercial Code. A production contract does not result in a sale of or transfer of title to livestock. Rather, the grower generally provides facilities, equipment and labor for the production of the livestock. The rights, duties and responsibilities of the parties to a production contract must be set forth in the contract. Production contracts are common in the swine and poultry industries.

The poultry industry is vertically integrated from production through processing and uses production contracts to get its birds grown from chicks/poults to slaughter weight. There is little place for marketing agreements in either the chicken or turkey sectors. The cattle industry uses some short-term production agreements for pasturing stocker cattle but, in general, makes no significant use of production contracts. It does, however, utilize many different marketing agreements as well as differential pricing mechanisms to secure cattle with desired physical, breed or rearing characteristics.

The pork industry uses both types of coordination mechanisms extensively without being vertically integrated like the poultry industry. Marketing agreements were used for 62.4 percent of all barrows and gilts sold in 2009. Packers sold another 5.8 percent of all barrows and gilts in 2009, and many of those were likely priced by a formula contract as well.

Research at the University of Missouri and Iowa State University indicates that, in 2006 (the latest year for which data are available), 20 percent of all pigs were farrowed and 46 percent of all hogs were finished under a production contract. A portion of those numbers are the same pigs (i.e., pigs that were both farrowed and finished under contract), so the two numbers cannot be added together to get a total. It is widely believed that the proportion of pigs finished in contract facilities has grown substantially since 2006 and may now be closer to two-thirds of all U.S. pigs.

The production contracts used in pork production differ significantly from those used by poultry production companies in the following ways:

1. Hog contracts are almost all long-term, often running from 3 to 10 years in length.

2. Because of their physiology and genetics, weaned pigs, feeder pigs and market hogs can be shipped hundreds of miles without serious problem. This means that a grower with a good hog barn and good reputation will not be automatically tied to just the nearest swine contractor. He/she can feed pigs for just about any swine contractor.

3. As described earlier, hog contract payments are often not tied to the number of animals that go through a barn in a year but rather involve objective performance criteria and have been, in general, quite amenable to special circumstances such as differential payments for pigs that are not of top-level health.

4. As measured by published judicial opinions, the pork industry has not encountered widespread dissatisfaction with swine production contracts.[17]

There is one additional important feature that has contributed to the good performance to-date of hog production contracts: The industry was growing and the capacity of contract barns was, until just recently, less than the amount needed by producers. This under-supply of contract barns/services placed barn owners in an advantageous position. The industry has moved, at least temporarily, into a situation where there is now an excess supply of contract barns and services. The situation may be temporary since it is believed that the breeding herd and pig output will increase after a time of profits. But the historical good relationships between contractors and growers may be tested in the interim.

NPPC COMMENTS ON PROPOSED RULES

The NPPC and its members have serious concerns about many of the Proposed Rules. In promulgating the Proposed Rules, GIPSA has ignored Congress, the long-standing legal precedent established by the federal courts, industry economics, the marketing desires of producers and the public interest.

As a part of the reconciliation of competing bills during consideration of the Farm Bill, Congress directed GIPSA to promulgate certain regulations under the PSA. Specifically, GIPSA was directed to "establish criteria that the Secretary will consider" in determining:

(a) whether an undue or unreasonable preference or advantage has occurred in violation of [the] Act;

(b) whether a live poultry dealer has provided reasonable notice to poultry growers of any suspension of the delivery of birds under a poultry growing arrangement;

(c) when a requirement of additional capital investments over the life of the poultry growing arrangement or a swine production contract constitutes a violation of [the] Act; and

(d) if a live poultry dealer or swine contractor has provided a reasonable period of time for a poultry grower or a swine production contract grower to remedy a breach of contract that could lead to termination of the poultry growing arrangement or swine production contract.[18]

In addition, the Secretary was directed to promulgate regulations to "establish criteria that the Secretary will consider in determining whether the arbitration process provided in a contract

[17] See *Wheeler*, 591 F.3d 355; *Been v. O.K. Indus., Inc.*, 495 F.3d 1217, 1230 (10th Cir.2007); *London v. Fieldale Farms Corp.*, 410 F.3d 1295, 1303 (11th Cir.2005), *cert. denied*, 546 U.S. 1034, 126 S.Ct. 752, 163 L.Ed.2d 574 (2005); *Philson v. Goldsboro Milling Co.*, Nos. 96-2542, 96-2631, 164 F.3d 625, 1998 WL 709324, at *4-5 (4th Cir. Oct.5, 1998) (unpublished table decision); *Jackson v. Swift Eckrich, Inc.*, 53 F.3d 1452, 1458 (8th Cir. 1995).

[18] Title XI of the Food, Conservation and Energy Act of 2008, P.L. 110-246, § 11006.

provides a meaningful opportunity for the grower or producer to participate fully in the arbitration process."[19]

The Proposed Rules purport, in part, to respond to the mandate of Congress in the Farm Bill. However, GIPSA has also proposed several additional regulations purportedly relying on its general rulemaking authority under the PSA.

The NPPC has no comments on those provisions of the Proposed Rules that affect suspension of delivery of birds to poultry growers. However, the NPPC has serious concerns with the agency's rewriting of the PSA and long-standing case law.

I. GIPSA LACKS AUTHORITY TO DECLARE THAT NO SHOWING OF INJURY TO COMPETITION IS NECESSARY TO ESTABLISH A VIOLATION OF SECTIONS 202(a) and (b) OF THE PSA.

A. PSA § 407 and the Farm Bill Contain Limited Authorizations to GIPSA to Issue Proposed Rules Under the PSA.

The PSA was enacted in 1921 to regulate the business of packers. As noted by the United States Supreme Court in upholding the constitutionality of the PSA:

> The object to be secured by [the PSA] is the free and unburdened flow of live stock from the ranges and farms of the West and the Southwest through the great stockyards and slaughtering centers on the borders of that region, and thence in the form of meat products to the consuming cities of the country in the Middle West and East, or, still as livestock, to the feeding places and fattening farms in the Middle West or East for further preparation for the market.
>
> 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. Congress thought that the power to maintain this monopoly was aided by control of the stockyards. Another evil which it sought to provide against by the act, was exorbitant charges, duplication of commissions, deceptive practices in respect of prices, in the passage of the live stock through the stockyards, all made possible by collusion between the stockyards management and the commission men, on the one hand, and the packers and dealers on the other. Expenses incurred in the passage through the stockyards necessarily reduce the price received by the shipper, and increase the price to be paid by the consumer. If they be exorbitant or unreasonable, they are an undue burden on the commerce which the stockyards are intended to facilitate. Any unjust or deceptive practice or combination that unduly and directly enhances them is an unjust obstruction to that commerce.

[19]Title XI of the Food, Conservation and Energy Act of 2008, P.L. 110-246, § 11005.

Stafford v. Wallace, 258 U.S. 495, 514, 42 S.Ct.397, 401 (1922).

In keeping with the fundamental purpose of the PSA, § 202 of the PSA provides, in relevant part:

> [I]t shall be unlawful for any packer or swine contractor with respect to livestock, meats, meat food products, or livestock products in unmanufactured form, or for any live poultry dealer with respect to live poultry, 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, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect; . . .

7 U.S.C. § 192(a) and (b).

The PSA may be enforced by any person damaged by the conduct of a regulated party by means of a private cause of action.[20] Section 308 of the PSA provides:

> (a) If any person subject to this act violates any of the provisions of this act, or of any order of the Secretary under this Act, relating to the purchase, sale, or handling of livestock, the purchase or sale of poultry, or relating to any poultry growing arrangement or swine production contract, he shall be liable to the person or persons injured thereby for the full amount of damages sustained in consequence of such violation.
>
> (b) Such liability may be enforced either (1) by complaint to the Secretary as provided in Section 309, or (2) by suit in any district court of the United States of competent jurisdiction; but this section shall not in any way abridge or alter the remedies now existing at common law or by statute, but the provisions of this Act are in addition to such remedies.

7 U.S.C. § 209.

The PSA grants limited rulemaking authority to the Secretary of Agriculture and GIPSA. Section 407(a) of the PSA authorizes the Secretary of Agriculture to "make such rules, regulations and orders as may be necessary to *carry out the provisions of this Act* . . ." 7 U.S.C. § 407(a) (emphasis added).

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[20] The fact that a violation of the PSA may give rise to a private cause of action distinguishes the PSA from the Federal Trade Commission Act, 15 U.S.C §§ 41-58, as amended, which does not provide for such a private cause of action.

B. The Federal Courts of Appeals Have Held Consistently and Correctly That Proof of Injury to Competition or the Likelihood Thereof is a Prerequisite to Finding a Violation of Sections 202(a) and (b).

For several decades, the federal courts of appeals have consistently and correctly ruled that Sections 202(a) and (b) are violated only if the practice in question has had, or is likely to have, an adverse effect on competition as understood in the antitrust context. Numerous circuits have so held: "All told, seven circuits—the Fourth, Fifth, Seventh, Eighth, Ninth, Tenth, and Eleventh Circuits—have now weighed in on this issue, with unanimous results." *Terry v. Tyson Farms, Inc.*, 604 F.3d 272, 277-79 (6th Cir. 2010).[21] The consistency with which the federal appellate courts have required a showing of likely injury to competition in cases under Sections 202(a) and (b) is undeniable and striking. It reflects, above all, the courts' understanding of the intent of Congress in enacting and amending the PSA: that it should serve to protect competition in the livestock industry, not that the Secretary of Agriculture should be free to ban any practice he might think "unfair."

By the Proposed Rules, GIPSA now attempts to repeal the PSA's established competition standard and ignore the rulings of eight Courts of Appeals.[22] The Proposed Rules expressly provide that proof of injury to competition is no longer an essential element of a claim under Sections 202(a) and (b). *See* proposed § 201.3(c), which provides in part: "A finding that the challenged act or practice adversely affects or is likely to adversely affect competition is not necessary in all cases. Conduct can be found to violate section 202(a) and/or (b) of the Act without a finding of harm or likely harm to competition."[23] The Proposed Rules then go on to carry out GIPSA's new policy by declaring that several specified practices constitute violations of Section 202(a), without requiring proof that they have harmed, or are likely to harm, competition.[24]

In addition, the Proposed Rules ignore the direction provided by Congress in the Farm Bill. Those portions of the Proposed Rules addressing the PSA's injury to competition requirement have not been issued pursuant to any Congressional directive contained in the Farm Bill. Rather, they have purportedly been issued under the general rulemaking authority of the agency. However, Section 407 of the PSA, which grants general rulemaking authority to the agency, authorizes GIPSA to issue rules to carry out the PSA, not to change its meaning.

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[21] See *Wheeler v. Pilgrim's Pride Corp.*, 591 F.3d 355 (5th Cir. 2009) (en banc); *Been v. O.K. Indus., Inc.*, 495 F.3d 1217, 1230 (10th Cir.2007); *Pickett v. Tyson Fresh Meats, Inc.*, 420 F.3d 1272, 1280 (11th Cir.2005), *cert. denied*, 547 U.S. 1040, 126 S.Ct. 1619, 164 L.Ed.2d 333 (2006); *London v. Fieldale Farms Corp.*, 410 F.3d 1295, 1303 (11th Cir.2005), *cert. denied*, 546 U.S. 1034, 126 S.Ct. 752, 163 L.Ed.2d 574 (2005); *IBP, Inc. v. Glickman*, 187 F.3d 974, 977 (8th Cir.1999); *Philson v. Goldsboro Milling Co.*, Nos. 96-2542, 96-2631, 164 F.3d 625, 1998 WL 709324, at *4-5 (4th Cir. Oct.5, 1998) (unpublished table decision); *Jackson v. Swift Eckrich, Inc.*, 53 F.3d 1452, 1458 (8th Cir. 1995); *Farrow v. United States Dep't of Agric.*, 760 F.2d 211, 215 (8th Cir.1985); *De Jong Packing Co. v. United States Dep't of Agric.*, 618 F.2d 1329, 1336-37 (9th Cir. 1980), *cert. denied*, 449 U.S. 1061, 101 S.Ct. 783, 66 L.Ed.2d 603 (1980); and *Pac. Trading Co. v. Wilson & Co.*, 547 F.2d 367, 369-70 (7th Cir.1976).

[22] The Sixth Circuit Court of Appeals concurred in *Terry*.

[23] 75 Fed. Reg. at 35351.

[24] Proposed § 201.210(a)(1)-(7); (a)(8) is discussed at Section I.C. below. The specified practices include certain breaches of contract; certain fraudulent representations; terminating a production contract for a violation of law that had not been reported immediately to the authorities; and failure to document justification for a premium paid. The rule does not assert that any of the practices harms competition, or proscribe them only if they are likely to do so.

The Proposed Rules plainly exceed GIPSA's statutory authority. They are therefore not entitled to any deference under *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

1. The PSA incorporates long-standing antitrust policy.

The judicial rulings confirming the principle that a likelihood of injury to competition must be shown to prove a violation of Sections 202(a) and (b) have been issued in a wide variety of settings. Some courts have applied the principle in affirming the dismissal of a claim under Section 202 for want of an allegation or proof of injury to competition. *London v. Fieldale Farms Corp.*, 410 F.3d 1295 (11th Cir. 2005); *Terry v. Tyson Farms, Inc.*, 604 F.3d 272 (6th Cir. 2010). The principle was also applied in an answer to a certified question in an interlocutory appeal under 28 U.S.C. § 1292(b). *Wheeler v. Pilgrim's Pride Corp.*, 591 F.3d 355 (5th Cir. 2009) (en banc). The injury to competition requirement has been applied in an appellate court's affirmance of the legal standard adopted by the district court (*Been v. O.K. Industries, Inc.*, 495 F.3d 1217 (10th Cir. 2007)) and of instructions given to a jury (*Philson v. Goldsboro Milling Co.*, 1998 U.S. App. LEXIS 24630 (4th Cir. Oct. 5, 1998) (not for publication)). Finally, in *Armour and Co. v. United States*, 402 F.2d 712 (7th Cir. 1968), the court of appeals applied the competitive injury requirement in setting aside an order of a Judicial Officer of the Department of Agriculture.[25]

It is widely accepted that "long-time antitrust policies . . . formed the backbone of the PSA's creation." *London v. Fieldale Farms Corp.*, 410 F.3d 1295, 1304 (11th Cir. 2005). Congress felt a "need for specialized regulation [by the Department of Agriculture] of the many-tiered packing industry," but "the legislative history does not show that the Secretary was to have carte blanche in prohibiting whatever practices he pleased." *Armour*, 402 F.2d at 721. "[I]n Section 202(a) Congress gave the Secretary no mandate to ignore the general outline of long-time antitrust policy by condemning practices which are neither deceptive nor injurious to competition nor intended to be so by the party charged." Id. at 722. Moreover, "the purpose behind the act 'was not to so upset the traditional principles of freedom of contract,' as to require an entirely level playing field for all." *IBP, Inc. v. Glickman*, 187 F.3d 974, 977 (8th Cir. 1999) (citation omitted.)

2. Competitive injury must be shown even though the scope of the PSA may be somewhat broader than the antitrust statutes.

A number of courts have indicated that the PSA may be somewhat broader than the antitrust statutes from which it was derived. They have stressed, however, that this means only that a practice may be found to violate the PSA even if it would not be found to violate the Sherman Act, owing to the lack of some collateral element required under that statute, such as the degree of intent, or the power to exclude competitors, or market power or whether injury to competition had yet occurred; a showing of the fundamental element of likely injury to competition is nonetheless required in cases under Sections 202(a) and (b). For example, *Been v. O.K.*

[25] The USDA itself has challenged practices under Sections 202(a) and (b) on the basis of their alleged effects on competition. See, e.g., *De Jong Packing Co. v. USDA*, 618 F.2d 1329 (9th Cir. 1980) (conspiracy against auction stockyards); *IBP, Inc. v. Glickman*, 187 F.3d 974 (8th Cir. 1999) (packer's use of right of first refusal).

Industries, Inc., 495 F.3d 1217 (10th Cir. 2007), involved a claim under Section 202(a) against an alleged monopsonist for its contracting practices. The court afforded the plaintiff the benefit of a less demanding standard than under the Sherman Act but held that Section 202(a) required proof of likely injury to competition:

> [C]ongress intended the PSA to have a broader scope than the antitrust laws. The antitrust requirement that monopoly power be acquired willfully and include the power to exclude competitors does not apply in the context of the PSA. By holding that § 202(a) requires proof that a practice has injured or is likely to injure competition, we have not required a showing that the defendant engaged in the unfair practice with the intent to cause the injury or other unlawful effect. Instead, the Growers need only prove that specific practices have the *effect* of injuring competition or are likely to do so. . . . .

Been, 495 F.3d at 1231 (emphasis in original).

Similarly, in *De Jong Packing Co. v. USDA*, 618 F.2d 1329, 1335-37 and n.7 (9th Cir. 1980), in which the government challenged under Section 202(a) an alleged packer conspiracy to change auction stockyards' terms of sale, the court held that a violation of Section 202 could be found even if "petitioners' lack of market power would preclude our finding that they had violated the Sherman Act" and even if competitive harm had not yet actually occurred but was reasonably likely. The court noted that "[w]hile § 202 of the Packers and Stockyards Act may have been made broader than antecedent antitrust legislation in order to achieve its remedial purpose, it nonetheless incorporates the basic antitrust blueprint of the Sherman Act and other pre-existing antitrust legislation."

In *Armour and Co. v. United States*, 402 F.2d 712, 717 (7th Cir. 1968), the court held that the coupon promotion program at issue "does not violate Section 202(a), absent some predatory intent or some likelihood of competitive injury." The court noted that the scope of the PSA was sufficient to confer on the Secretary "broad powers under Section 202(a) with regard to trade practices which are 'unfair' in that they conflict with the basic policies of the various antitrust statutes, even though the practices may not actually violate those statutes." The court emphasized that the broader scope accorded the PSA was not intended to sever it from the policies of the antitrust laws but to further those policies and protect competition:

> When viewed together, the antitrust laws, although not completely harmonious and frequently overlapping, express a basic public policy distinguishing between fair and vigorous competition on the one hand and predatory or controlled competition on the other. Normally the twin solvents for determining when the boundaries of fair competition have been exceeded are the existence of predatory intent and the likelihood of injury to competition . . . . The fact that a given provision [of a statute] does not expressly specify the degree of injury or the type of intent required, does not imply that these basic indicators of the line between free competition and predation are to be ignored. Surely words such as 'unfair' and 'unjustly' in Section 202(a) and 'undue' and 'unreasonable' in Section 202(b) require some examination of the seller's intent and the likely effects of its acts or

> practices under scrutiny, even though these tests under Section 202(a) and (b) be less stringent than under some of the antitrust laws. These adjectival qualifications expressed in the statutory language enjoin the Department and courts to apply a rule of reason in determining the lawfulness of a particular practice under Section 202(a) and (b).

Armour and Co., 402 F.2d at 717.

3. The competitive injury requirement is consistent with Congress' intent and the words Congress used.

The consistent rulings of the appellate courts requiring proof of likely injury to competition in cases under Sections 202(a) and (b) have been acquiesced in by Congress. As the court stated in *Wheeler v. Pilgrim's Pride Corp.*, 591 F.3d 355, 361-62 (5th Cir. 2009) (en banc) (footnote and citation omitted):

> After 1921 [when the PSA was enacted] and up to 2002, Congress has amended [Section 202] seven times without making any changes that would affect the many court interpretations cited above. It is reasonable to conclude that Congress accepts the meaning of [§ 202(a)] to require an effect on competition to be actionable because congressional silence in response to circuit unanimity "after years of judicial interpretation supports adherence to the traditional view."

Most recently, in passing the 2008 Farm Bill, Congress rejected an invitation to adopt the very standard that GIPSA now proposes. During consideration of the Farm Bill, Senator Harkin introduced an amendment (the "Harkin Amendment") that would have added the words "regardless of whether the practice or device causes a competitive injury" to section 202(a) of the PSA.[26] Under the Harkin Amendment, that section would have read:

> [i]t shall be unlawful for any packer or swine contractor with respect to livestock, meats, meat food products, or livestock products in unmanufactured form, or for any live poultry dealer with respect to live poultry, to:
>
> > (a) engage in or use any unfair, unjustly discriminatory, or deceptive practice or device regardless of whether the practice or device causes a competitive injury.

The Harkin Amendment was rejected by the conference committee and was not enacted.[27]

The courts' rulings have been faithful to the words Congress used in Sections 202(a) and (b) and to their intended meaning. Concurring in *Wheeler*, Chief Judge Jones explained:

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[26] H.R. 2419, Amendment No. 3667, 110th Cong. (2007).

[27] H.R. Rep. No. 110-627, at 469-477 (2008) (Conf. Rep.); Title XI of the Food, Conservation and Energy Act of 2008, P.L. 110-246, § 11006.

> The words we are asked to interpret were terms of art, and their meanings were fixed by judicial definition and consistent usage . . . . Read in the proper context, these provisions concern only those business dealings that have an actual or potential effect on competition.
> * * *
> "Unfair" was not an inkblot in 1921. Congress could not have expected, then, that its use of the term would occasion a free-ranging inquiry into the equities of business practices; rather, Congress intended, and made plain by its choice of language, that injury to competition would be an element of the inquiry.
> * * *
> In sum, the evidence of Congress' intent, while not itself dispositive, confirms, and does not repudiate, the view that the broad words of § 202 were to be considered in light of their established meanings, as terms of art limited to competitive wrongs.

Wheeler, 591 F.3d at 364, 367, 370 (Jones, C.J., concurring).

The consistent rulings of the courts of appeals that a claim under Sections 202(a) and (b) requires a showing of a likely adverse effect on competition are correct. GIPSA's attempt to nullify that requirement exceeds the authority given to it by Congress.

C. "Competitive injury" as Redefined by GIPSA Does Not Satisfy the Injury to Competition Requirement of Sections 202(a) and (b).

Although they purport to eliminate the injury to competition element of an offense altogether, the Proposed Rules also contain a provision that declares any act causing or threatening "competitive injury," as redefined by GIPSA to be an "unfair, unjustly discriminatory and [sic] deceptive practice or device" under Section 202. Proposed § 201.210(a)(8); § 201.2(t),(u). On its face, the provision may seem consistent with Congress' mandate. In fact, however, it does not satisfy the PSA's injury-to-competition requirement for two distinct reasons.

First, all claims under Sections 202(a) and (b) require a showing of injury to competition. The Proposed Rules do not incorporate such a requirement; indeed, they expressly repudiate it. See Proposed § 201.3(c). Specifically, the provision does not stipulate that all claims under Sections 202(a) and (b) require a showing of "competitive injury" even as that term is newly defined by GIPSA. Thus, under the Proposed Rules, no showing of an adverse effect on competition, however defined, would be required. GIPSA lacks the authority to promulgate such a provision.

Second, the term "competitive injury" as used in the Proposed Rules bears little resemblance to the antitrust law approach to competition that has been held to be embedded in the PSA. Therefore, even if a showing of "competitive injury" as newly defined by GIPSA *were* mandatory, it would not meet the statutory standard.

The Supreme Court has made it clear that antitrust law protects competition, not competitors. Thus, the "competitive injury" with which the Court (and antitrust law) is concerned is injury to

the overall functioning of markets, not some form of disadvantage to particular market participants. Accordingly, in determining whether an alleged restraint of trade causes this kind of "competitive injury," a court applying the antitrust law's basic Rule of Reason typically analyzes three issues. First, what are the relevant product and geographic markets in which the restraint's effect on competition should be assessed? Second, does the defendant have a high share of the relevant market and would the restraint enhance that market power? Third, do the restraint's adverse effects on competition outweigh the offsetting competitive benefits of the restraint, such as facilitating risk management, creating operating efficiencies, enhancing or controlling quality or increasing consumer choice? Only if the adverse effects predominate is the restraint unlawful. This assessment calls for a very careful and discerning inquiry because, without a proper balancing of competitive interests, antitrust law could come to stifle the innovation and efficiency that Congress intended it to promote. See, e.g., *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977); *Leegin Creative Leather Prods. v. PSKS, Inc.*, 551 U.S. 877 (2007).

In contrast, GIPSA's redefinition of "competitive injury" does not appear to share the fundamental aim of antitrust law -- protection of competition, not particular competitors -- or to ask any of these three basic questions, let alone all of them. Rather, the provision seems to implement GIPSA's present view of what constitutes "unfair" treatment of particular market participants, not a concern with the effect of such treatment on the market as a whole.[28] Thus, it turns longstanding U.S. antitrust law on its head. GIPSA's new "competitive injury" scheme would not provide the accommodation of potential pro-competitive arrangements required under Sections 202(a) and (b) even if it were made mandatory for all claims under those sections.[29]

D. GIPSA's Attempted Removal of the Injury-to-Competition Requirement From Sections 202(a) and (b) is Not Entitled to *Chevron* Deference.

In some circumstances, an agency's interpretation of a statute it administers is entitled to judicial deference under the principles of *Chevron*. Those circumstances do not exist here.

As an initial matter, where an agency's own statutory authority is at issue, as here, *Chevron* does not apply at all. *See United States v. Mead Corporation*, 533 U.S. 218, 226-27 ("administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority") (2001); *Am. Library Ass'n v. FCC*, 406 F.3d 689, 699 (D.C. Cir. 2005) ("crucial threshold consideration" in determining the applicability of *Chevron* deference is "whether the agency acted pursuant to delegated authority"); *AT&T v. FCC*, 323 F.3d 1081, 1086 (D.C. Cir. 2003) (*Chevron* deference is warranted "only when 'Congress has left a gap for the agency to fill pursuant to an express or implied delegation of authority to the agency' ") (quoting *Railway Labor Executives Ass'n v. NMB*, 29 F.3d 655, 671 (D.C. Cir. 1994) (en banc); *MPAA v. FCC*, 309 F.3d 796, 801 (D.C. Cir. 2002) ("The agency's interpretation of [a] statute is not entitled to deference absent a *delegation of authority* from Congress to regulate in the areas at issue. . . . *Mead* reinforces *Chevron*'s command that deference to an agency's interpretation of a

[28] *See* § 201.2(u), listing seven practices included within GIPSA's term "likelihood of competitive injury"; § 201.210, enumerating eight practices said to violate Section 202(a).

[29] The extent of GIPSA's departure from antitrust principles is discussed further in Section I.E. below.

statute is due only when the agency acts pursuant to 'delegated authority.' "(emphasis in original)). As shown above, Congress has not delegated to GIPSA the general authority to police contracts in the absence of a showing of injury to competition and, accordingly, there is no delegation of authority here in the first place.

In addition, where an agency's interpretation of a statute raises constitutional concerns, *Chevron* does not apply. *E.g., Edward J. DeBartolo Corp. v. Florida GulfCoast Bldg. & Constr. Trades Council*, 485 U.S. 568, 574–75 (1988); *Hernandez Carrera v. Carlson*, 547 F.3d 1237, 1249 (10th Cir. 2008) ("It is well established that the canon of constitutional avoidance does constrain an agency's discretion to interpret statutory ambiguities, even when *Chevron* deference would otherwise be due."); *University of Great Falls v. NLRB*, 278 F.3d 1335, 1340–41 (D.C. Cir. 2002) ("the constitutional avoidance canon of statutory interpretation trumps *Chevron* deference"). Here, the agency's construction stretches the limits of the Commerce Clause because, as the Fifth Circuit found in *Wheeler*, 591 F.3d at 357-358, 362, the Supreme Court's decision upholding the Act in *Stafford* was predicated on the competitive purposes of the Act.

E. Even Under *Chevron*, GIPSA's Proposed Rules Are Invalid Because Congress' Intent is Clear And, in Any Event, the Agency's Construction is Unreasonable in Numerous Respects.

1. Congress Clearly Intended to Require A Showing of Competitive Injury In Claims Under Section 202(a).

Even where Congress has delegated authority to an agency to act, the first step in judicial interpretation of such a delegation is to ask "whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter." *Chevron*, supra, 467 U.S. at 842. A court "must reject administrative constructions which are contrary to clear congressional intent." Id. at 843 n. 9. In determining whether the intent of Congress is clear, the courts are not confined to "examining a particular statutory provision in isolation" but should also consider the statute's context and the likelihood that Congress would have entrusted a decision of such magnitude to the agency. *Food and Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000).

Under these standards, it is clear that Congress intended claims under Sections 202(a) and (b) to carry an obligation to show competitive injury, and GIPSA's Proposed Rules to the contrary are thus contrary to the plain meaning of the statute. The unanimity of appellate court rulings on the point -- rulings that Congress has chosen not to disturb -- bespeaks the firmness with which Congress has spoken. "Because Congress plainly intended to prohibit 'only those unfair, discriminatory or deceptive practices adversely affecting competition,' . . . a contrary interpretation of Section 202(a) deserves no deference." *London*, supra, 410 F.3d at 1304 (emphasis added; citation omitted). See also *Wheeler*, supra, 591 F.3d at 362 (*Chevron* deference is "unwarranted where Congress has delegated no authority to change the meaning the courts have given to the statutory terms").

As Judge Jones explained in her concurring opinion in *Wheeler*:

> The entirety of [Section 202(a)], as well as the specific terms 'unfair' and 'deceptive' are a slight variation of § 5 of the FTCA: 'That unfair methods of competition in commerce are hereby declared unlawful.'
>
> Not only is the language of the PSA nearly identical to that of its predecessors, but this choice of terms was deliberate. Their meaning had been firmly established in numerous court decisions that placed definite limits on the authority of, respectively, the Interstate Commerce Commission and Federal Trade Commission. . . .
>
> The words 'unfair method of competition' are not defined by the statute and their exact meaning is in dispute. It is for the courts, not the commission, ultimately to determine as a matter of law what they include. . . .
>
> Because of their provenance, the words of § 202(a) and (b) of the Packers and Stockyards Act are susceptible to a plain meaning: To provide that a practice is 'unfair,' 'unjustly discriminatory,' or an 'undue or unreasonable preference,' a plaintiff must demonstrate an actual or potential adverse impact on competition.

Wheeler, 591 F. 3d at 367 (Jones C.J., concurring) (citing *Federal Trade Commission v. Gratz*, 253 U.S. 421, 427-28, 40 S. Ct. 572, 575 (1920) (emphasis added). [30]

NPPC submits that it is the role of Congress to write statutes. It is the role of the judiciary to interpret those statutes. It is the role of the executive branch to implement the laws. The federal appellate courts have consistently held that Congress in the PSA required that a plaintiff to demonstrate injury to competition. GIPSA cannot now eliminate that requirement by administrative action.

2. In any event, GIPSA's proposed "competitive injury" scheme is unreasonable because it rejects the values and methodology of the national competition policy as reflected in the U.S. antitrust laws and would create differing judicial and administrative enforcement schemes for claims under Section 202(a).

a. The Proposed Rules' "competitive injury" scheme.

The Proposed Rules declare that "[a]ny act that causes competitive injury or creates a likelihood of competitive injury" is an "unfair, unjustly discriminatory, or deceptive practice or device" that is unlawful under Section 202(a). Proposed § 201.210(a)(8). "Competitive injury" is then defined as arising "when conduct distorts competition in the market channel or marketplace."

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[30] Contrary to the contention of the NPRM, *National Cable & Telecomm. Ass'n v. Brand X Internet Services*, 545 U.S. 967, 982-984 (2005), does *not* mean that issuance of new regulations would require "judicial reexamination of the issue." 75 Fed. Reg at 35341. *Brand X* held that judicial precedent may not foreclose interpretation of an ambiguous statute because "*Chevron*'s premise is that it is for agencies, not courts, to fill statutory gaps." 545 U.S. at 982. As demonstrated above, however, there has been no delegation of authority on this question to the agency in the first place, and the statutory language here is clear.

Proposed § 201.2(t). An act creates "a likelihood of competitive injury" when "there is a reasonable basis to believe that a competitive injury is likely to occur in the market channel or marketplace." Proposed § 201.2(u).

The rule then specifies that the term "likelihood of competitive injury" "includes but is not limited to" seven particular situations,[31] those in which a packer, swine contractor or live poultry dealer: --

- "raises rivals' costs";
- "improperly forecloses competition in a large share of the market through exclusive dealing";
- "restrains competition";
- engages in conduct that "represents a misuse of market power to distort competition";
- "wrongfully depresses prices paid to a producer or grower below market value";
- "impairs a producer's or grower's ability to compete with other producers or growers"; or
- impairs "a producer's or grower's ability to receive the reasonable expected full economic value from a transaction in the market channel or marketplace."

b. The Proposed Rules' "competition" policy.

Whatever is intended by this scheme, it bears little resemblance to the national competition policy embodied in the U.S. antitrust laws which, as the courts have held, constitutes an integral element of Sections 202(a) and (b). The principle tool for assessing alleged unlawful restraints of trade under Section 1 of the Sherman Act is the Rule of Reason. It has three basic elements. First, the plaintiff has the burden of proving that the restraint "has had or is likely to have a substantially adverse effect on competition." ABA Section of Antitrust Law, Antitrust Law Developments (hereinafter "ALD"), at 58 (6th ed. 2007). Second, if the plaintiff satisfies the first burden, the defendant is free "to produce evidence of the procompetitive virtues of the conduct." Id. And third, the ultimate issue "is whether the restraint's anticompetitive effect substantially outweighs the procompetitive effect for which the restraint is reasonably necessary." Id.

GIPSA's proposed "competition" regime largely dispenses with all three elements. First, it declares that seven specific situations, among others, are unlawful *per se*. The principal

[31] Proposed § 201.2(u); 75 Fed. Reg. at 35351. In fact, many of the practices GIPSA condemns may actually benefit competition. *See* Jerry Hausman, *Report of Professor Jerry Hausman* (November 16, 2010), at 5-8 (attached and incorporated as Appendix C).

characteristic that marks the Supreme Court's approach to *per se* rules in the antitrust field is extreme caution. This high degree of caution arises from the fact that "applying the *per se* rule to particular conduct risks sweeping potentially procompetitive activity within a general condemnation and may prohibit a defendant from justifying its conduct." ALD, supra, at 52 (emphasis added). GIPSA's approach to *per se* rules seems untouched by the Supreme Court's spirit of caution or by the concerns that animate it. Rather, GIPSA seems to view *per se* rules as a convenient means of reducing the burden of proof that the agency and private litigants would otherwise confront in actions invoking Sections 202(a) and (b).[32]

Although *per se* rules play a very limited and declining role under the antitrust laws;[33] GIPSA would put them center stage under the PSA. This approach is incompatible with the purpose of Congress in enacting the PSA.

The Proposed Rules also reflect GIPSA's abandonment of the second core element of the Rule of Reason: examination of the procompetitive virtues a practice may have. The Proposed Rules contain no requirement that the tribunal -- whether the Secretary or a district court -- must afford a defendant the opportunity to present, and must consider, the procompetitive virtues of a practice.[34]

The third departure from the Rule of Reason flows from the second. Having failed to ensure consideration of a practice's procompetitive virtues, the rule also fails to stipulate that only if the adverse effects of a practice on competition clearly outweigh its procompetitive virtues may the practice be found to "distort competition." A careful balancing of favorable and unfavorable competitive effects is simply not part of the Proposed Rules' DNA.

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[32] The basis on which GIPSA decided that the enumerated practices deserve *per se* condemnation (presumably because they always, or almost always, "distort competition") is not obvious. For example: Does wrongfully depressing prices (whatever that means) paid to "a producer" invariably "distort competition" in a relevant market as a whole, or in GIPSA's view is it enough that it may be unfavorable to a single producer? What about impairing a single grower's ability to compete (whatever that means)? What about depriving a single grower of his or her expected economic value from a single transaction -- is that invariably a distortion of competition in a market viewed as a whole? And if not, why is it given *per se* condemnation?

[33] In recent years, the Supreme Court has removed several vertical practices (those involving parties at different levels of the distribution chain, which is what we are dealing with here) from the *per se* unlawful category and has remitted them to the Rule of Reason. See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977) (vertical territorial and customer restraints); *State Oil Co. v. Khan*, 522 U.S. 3 (1997) (maximum resale price maintenance); *Leegin Creative Leather Products v. PSKS, Inc.*, 551 U.S. 877 (2007) (minimum resale price maintenance). The *per se* rule today has very limited reach beyond the core offenses of price fixing and market division between competitors.

[34] Nor does any such inference arise from the rule's use of the term "distorts competition." The inadequacy of GIPSA's statement, in the NPRM, that it "would consider . . . whether there is a legitimate justification" for a pricing disparity (75 Fed. Reg. at 35343) is discussed below. It is very unlikely that Congress would approve of ignoring a practice's procompetitive effects. Congress has stipulated that, under Section 5 of the Federal Trade Commission Act, an act or practice may not be declared "unfair" by the FTC and therefore unlawful "unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." 15 U.S.C. § 45(n). Considering procompetitive effects should promote the public interest and would seem even more in order under the PSA, which authorizes private rights of action, than under the FTC Act, which may be enforced only by the FTC.

c. The Proposed Rules' protection of competitors, not competition.

This wholesale rejection by GIPSA of the analytic approach of the Rule of Reason is not accidental. It reflects a fundamental divergence -- indeed, opposition -- between the established national antitrust regime and GIPSA's proposal: The former seeks to protect competition, while the latter seems focused on protecting certain groups of competitors, regardless of the effect of that protection on competition as a whole.[35]

A buyer becomes dissatisfied with Supplier A and replaces it with Supplier B. No matter how costly the switch may be to Supplier A, Supplier A ordinarily has no antitrust claim; the substitution may have injured a competitor, but it did not injure competition.[36] Indeed, the substitution was presumably made to enhance competition.

By contrast, GIPSA seems bent on helping certain producers and growers at the expense not only of packers, swine contractors and live poultry dealers but of competition in the livestock market itself. To take but one example: The Proposed Rules make it unlawful under Section 202 for a packer, swine contractor or live poultry dealer "to impair a producer's or grower's ability to receive the reasonable expected full economic value from a transaction in the market channel or marketplace." This provision is not comprehensible,[37] but its objective is evident: to regulate the terms of every covered transaction so as to protect only the interests of producers and growers, not those of packers, swine contractors or live poultry dealers. The Proposed Rules put GIPSA squarely in the position of picking, and giving advantage to, one segment of the meat industry over another. In short, to protect certain competitors, not competition -- the very antithesis of the national antitrust policy. This is also contrary to the purpose of the PSA: "[T]he PSA was not enacted to protect the independence of producers from market forces . . . . The PSA was enacted to ensure that the market worked, and markets are notoriously unromantic." *Pickett*, 420 F.3d at 1287.

d. The Proposed Rules' treatment of commercial discrimination.

Similarly, in enumerating the criteria the Secretary "may consider" in evaluating preferences with respect to contract terms, price provisions or information to decide whether they are "unreasonable" under Section 202(b), the Proposed Rules opt for a basic egalitarian standard: make the same terms and information available to all.[38] Missing from the enumerated criteria are the standards developed over 70 years under the Robinson-Patman Act, the principal federal

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[35] *See* Jerry Hausman, *supra* note 31, at 5.

[36] See, e.g., *NYNEX Corp. v. Discon, Inc.*, 528 U.S. 128, 137 (1998) ("freedom to switch suppliers lies close to the heart of the competitive process that the antitrust laws seek to encourage"); *Crane & Shovel Sales Corp. v. Bucyrus-Erie Co.*, 854 F.2d 802, 804-05 (6th Cir. 1988) (terminated distributor had no Sherman Act Section 1 claim against manufacturer that "jilted" it to award exclusive distributorship to another).

[37] For example: What is meant by "impair . . . ability to receive"? "Receive" from whom? "Reasonable" to whom, and measured by what standard? "Expected" by whom, and when and how is that expectation to be evidenced? Does "full" value mean something different from "reasonable" value, and if so, what is the difference? Does GIPSA assert that impairment of a grower's receipt of proper value from a transaction invariably produces a likelihood of competitive injury as defined by GIPSA? If so, how and why? How, if at all, would the provision be applied to commercial arrangements that involve more than single purchase and sale transactions?

[38] Proposed § 201.211; 75 Fed. Reg. at 35352.

antitrust law dealing with commercial discrimination.[39] Moreover, this same deal-for-all impulse is foreign to the objectives of the PSA. As the Court of Appeals for the Eighth Circuit stated in *IBP*, 187 F.3d at 977:

> [T]he purpose behind the Act "was not to so upset the traditional principles of freedom of contract," as to require an entirely level playing field for all. *Jackson v. Swift Eckrich, Inc.*, 53 F.3d 1452, 1458 (8th Cir. 1995) (finding that the Act does not statutorily create an entitlement to have the same type of contract as that offered to other independent growers). . . .

e. The prospect of two conflicting "competition" regimes under the PSA.

Finally, GIPSA's refashioned "competitive injury" scheme threatens to generate confusion in the administration of the PSA. A party seeking to enforce Sections 202(a) and (b) would have at its disposal two conflicting "competition" regimes: GIPSA's new one and the traditional one the courts have held is embedded in the statute. GIPSA, as well as private litigants, could invoke either, or even both. GIPSA has not foresworn its right to use traditional antitrust concepts when it suits GIPSA's purposes; it only denies having an obligation to use them in every case under Sections 202(a) and (b). Efforts by persons covered by the PSA to comply with their statutory duties would be correspondingly challenging. Sorting it all out would fall to the federal courts and, in administrative proceedings, to the Secretary. To have two conflicting "competition" regimes operating under the same statute, a statute that authorizes both agency and private enforcement action, is a recipe for confusion.

For all these reasons, the new "competition" regime for the PSA proposed by GIPSA not only exceeds GIPSA's authority but is unreasonable. Accordingly, it does not enjoy *Chevron* deference.

II. THE PROPOSED RULES ARE ARBITRARY AND CAPRICIOUS.

A. The Proposed Rules Hinder, Rather than Advance, the Purposes of the PSA in Numerous Ways.

The purpose or purposes of the PSA have been described by the courts in various forms. According to the Ninth Circuit, the primary purpose of the PSA is "to assure fair competition and fair trade practices in livestock marketing . . ." *Spencer Livestock Com'n v. Dept. of Agriculture,*

[39] Under Section 2(a) of the Robinson-Patman Act (15 U.S.C. § 13(a)), price discrimination in the sale of commodities may be unlawful only if it may substantially injure competition, that is, "where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them." By statute and case law, several defenses to a charge of unlawful price discrimination are available: meeting competition, cost justification, changing conditions and functional availability. (See ALD, *supra* at 507-20.) The Proposed Rules do not indicate that the Secretary will or a court should consider any of these elements of Robinson-Patman price discrimination law in determining whether an undue preference under Section 202(b) has occurred (§ 201.211), although GIPSA appears to acknowledge in the NPRM that there may be some unspecified "legitimate justification" for a pricing disparity (75 Fed. Reg. at 35343.)

841 F.2d 1451, 1455 (9th Cir. 1988). According to the Sixth Circuit, the purpose of the PSA is simply to protect competition. See *Terry*, 604 F.3d at 277, 279 (stating only those practices that will likely affect competition adversely violate the Act). According to the Eighth Circuit, one of the purposes of the PSA is to "protect the owner and shipper of live stock, and to free him from the fear that the channel through which his product passed, through discrimination, exploitation, overreaching, manipulation, or other unfair practices, might not return to him a fair return for his product." *United States v. Donahue Bros.*, 59 F.2d 1019, 1023 (8th Cir. 1932). The Eighth Circuit also held that one of the purposes "behind § 202 of the PSA . . . was not to so upset the traditional principles of freedom of contract. The PSA was designed to promote efficiency, not frustrate it." *Jackson v. Swift Eckrich, Inc.*, 53 F.3d 1452, 1458 (8th Cir. 1995); *I.B.P., Inc. v. Glickman*, 187 F.3d 974 (purpose behind the Act was not to so upset the traditional principles of freedom contract, as to require an entirely level playing field for all). With these concepts in mind, the NPPC submits that the Proposed Rules hinder, rather than advance, these purposes of the PSA.

1. The Proposed Rules Will Likely Limit Marketing Options Available to Producers.

a. The significance of marketing agreements.

While the Proposed Rules do not expressly preclude the use of marketing agreements in the pork industry, it is clear that GIPSA has targeted such agreements. In explaining the Proposed Rules, GIPSA made this apparent:

> In recent years, there has been an increased use of contracting in the marketing and production of livestock and poultry by entities under the jurisdiction of the P & S Act. This increased contracting coupled with the market concentration has significantly changed the industry and the rural economy as a whole, making proposed regulation necessary, especially in those situations in which packers, live poultry dealers or swine contractors use their market power to harm producers or impair private property rights of growers and producers.[40]

However, such agreements have been critical for U.S. swine producers, packers, retailers and consumers. As recognized by the GIPSA Livestock and Meat Marketing Study ("GIPSA LMMS"), the use of alternative marketing arrangements ("AMAs"),[41] including marketing agreements, is beneficial to the entire pork industry: "In aggregate, restrictions on the use of AMAs for sale of livestock to meat packers would have negative economic effects on livestock producers, meat packers and consumers."[42] In fact, James E. Link, GIPSA's Administrator at the time of the release of the GIPSA LMMS on February 28, 2007, concluded,"use of AMAs in the livestock and meat industries provides benefits to not only meat packers, but also to livestock

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[40] 75 Fed. Reg. at 35338.

[41] Under the GIPSA LMMS, alternative marketing arrangements are defined as "[p]urchase or sales methods other than the cash or spot market. These include procurement or marketing contracts, production contracts, forward contracts, marketing agreements, packer-fed/owned arrangements, custom feeding/backgrounding, and custom slaughter." See GIPSA LMMS, *supra* note 8, Glossary of Terms, at 3.

[42] GIPSA LMMS, *supra* note 8, Volume I, at ES-3.

producers and meat consumers. Restricting their use would have negative economic consequences on most segments of the industry."[43] The conclusions of the GIPSA LMMS for swine illustrate the desirability and scope of AMA use.[44] Producers and packers use marketing agreements as a means to buy/sell higher quality hogs, improve supply management and obtain better prices.

The Hog and Pork Industries section of the GIPSA LMMS conducted on behalf of GIPSA contained several key findings.[45] They include:

- There are substantial differences in hog prices paid by packers. The differences could not be fully explained by region, quality or plant size. The authors concluded that the unexplained differences must be due to organizational issues related to supply chain management but raised questions regarding potential price discrimination or timeliness of price reporting.

- There are significant regional differences in the types of alternative marketing arrangements (AMAs) used in the pork industry. There is stronger reliance on cash/spot pricing and marketing contracts in the Midwest and more production contracts and packer ownership in the Southeast.[46]

- The pattern of AMA use is not expected to change dramatically, leading the authors to conclude that the hog industry will not emulate the industrialization (i.e., complete vertical integration) of the poultry sector.

- The study found a statistically significant presence of market power in live hog procurement but could find no conclusive evidence that AMAs were the practice that caused the market power. In fact, one approach could not conclude that AMAs were the source of the market power, and another approach found that the benefits of AMAs out-weighed their market power harm.

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[43] GIPSA's press release of February 16, 2007, noted that the GIPSA LMMS study found that the use of AMAs "increased the economic efficiency" of cattle, hog and lamb markets, and that these "economic benefits" are distributed to consumers, as well as to producers and packers. A copy of GIPSA's press release of February 16, 2007, can be found at http://www.gipsa.usda.gov/GIPSA/newsReleases?area=home&subject=mc&topic=nr&type=detail&item=nr_20070216_lmms_2207.html.

[44] GIPSA simply ignored this study in promulgating the Proposed Rules. *See Motor Vehicle Mfrs. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)(agency action is arbitrary and capricious if the agency "offered an explanation for its decision that runs counter to the evidence before the agency."). According the Supreme Court in *State Farm*, a rule is arbitrary if the agency:

> relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. (Id.)

[45] *See generally* GIPSA LMMS, *supra* note 8, Volume IV.

[46] In the Midwest, the cash market is more active. In general, southeastern packers depend on Midwestern negotiated prices to determine the base prices of their contracts.

- Relative to using spot market procurement alone, all other combinations of AMAs improved the efficient scale of packing operations.

- AMAs affect the risk faced by contracting parties. Producers using AMAs are more risk averse than those who use spot/cash sales. Different types of marketing arrangements show different volatilities, and the availability of these arrangements allows producers to choose the risk exposure with which they are most comfortable.

- Different AMAs are associated with different levels of quality of hogs. Marketing contracts are consistently associated with higher quality hogs than are negotiated (i.e., spot market) purchases.

- Higher AMA use is also associated with higher quality pork products.

The GIPSA LMMS also analyzed the impacts of three different restrictions on the use of AMAs. The three scenarios were: 1) a 25 percent reduction in the number of both contracted and packer-owned hogs; 2) increasing the spot/cash market share to 25 percent; and 3) a complete ban on packer ownership. The key findings were:

- Hog producers would gain due to reduced market power but lose due to efficiency losses from reducing the proportion of hogs sold through contracts and packer-owned channels. **The net impact would be negative for hog producers.**

- **Consumers would lose as the lost efficiencies drive wholesale and retail pork prices higher.** In all three scenarios, the spread between farm and wholesale prices increases because of an increase in the cost of processing. Higher wholesale prices cause higher retail prices, increasing the cost of pork to consumers (and making it less competitive with other proteins).

- **Packers would gain in the short run but neither lose nor gain in the long run**.

The GIPSA LMMS also provides some insight into the losses that lower usage of marketing contracts might cause. The LMMS investigated three different limitations on the use of AMAs: a 25 percent reduction in the number of hogs procured through contracts and packer ownership relative to the 2001-2005 LMMS baseline; a requirement that 25 percent of all hogs be purchased through daily negotiations; and a ban on packer ownership. Of these, the second one would be analogous to a policy that caused a reduction in marketing contracts large enough to leave 25 percent of all hogs on the spot market. We note that nothing in these rules requires 25 percent or any other percentage of hogs to be purchased in the spot market. In fact, nothing in these rules requires a reduction in the use of marketing contracts. But the incentives to reduce their use are clear, and the LMMS provides an estimate of the impacts of a reduction of this magnitude.

In the LMMS, reducing the number of hogs purchased through contracts and packer-owned pigs both by 14 percent would have resulted in 25 percent of the hogs being purchased on the spot market in the 2001-2005 time period. Such a move would have the impacts shown in Table 1.

Table 1: Changes in revenues and expenditures due to a required increase of spot/negotiated purchases to 25 percent of total purchases.[47]

	Producer Revenues	Packer/Processor Revenues	Consumer Expenditures
	(Million Dollars)		
Short Run	-1,003	-222	+277
Long Run	-642	+77	+425

From the fact that producers and consumers lose when the use of AMAs is limited, it is clear that AMAs help the industry create and capture value. The results show clearly that packers/processors, being "middlemen," can pass along any cost changes to other parties, leaving them neither better nor worse off in the long run.

In addition, Congress recently rejected attempts to amend the PSA to restrict the use of marketing agreements. Bills were introduced in the last Congress to ban marketing agreements and forward contracts unless they contained a "firm base price that may be equated to a fixed dollar amount on the day on which the forward contract is entered into." S. 1017, 110th Cong., 1st Sess. § 2(a)(6)(A); *see also* H.R. 2213, 110th Cong., 1st Sess. § 2(a)(6)(A) (2007). The bill also sought to prohibit forward contracts that were (1) "not offered for bid in an open, public manner under which— '(i) buyers and sellers have the opportunity to participate in the bid'; '(ii) more than 1 blind bid is solicited;' and '(iii) buyers and sellers may witness bids that are made and accepted' or that are based on a formula price. S. 1017 at § 2(a)(6)(B)-(C); H.R. 2213 at § 2(a)(6)(B)-(C). The bill also would have limited the number of livestock covered by such an agreement to 40 cattle or 30 swine. S. 1017 at § 2(a)(6)(D); H.R. 2213 at § 2(a)(6)(D). Neither bill passed, indicating that Congress did not intend the PSA to be used as a mechanism that restrains agreements that are beneficial to competition.

b. The Proposed Rules and marketing agreements.

By discouraging the use of marketing agreements by packers, the Proposed Rules ignore the industry reality that these marketing agreements have been initiated by producers as a means to capture returns on investments in innovation.[48] Several provisions of the Proposed Rules, when implemented together, will discourage the use of marketing agreements, specifically by packers and swine contractors. Proposed § 201.94(b) provides as follows:

> A packer, swine contractor or live poultry dealer must maintain written records that provide justification for differential pricing or *any* deviation from standard price or contract terms offered to poultry growers, swine production contract growers, or livestock producers. . . . (Emphasis added.)

[47] *See generally* GIPSA LMMS, *supra* note 8, Volume IV.

[48] *Pickett v. Tyson Fresh Meats, Inc.*, 420 F.3d 1272, 1275-76 (11th Cir. 2005) (discussion of marketing agreements).

Under this section, packers will be required to keep and maintain written documentation to explain any differences in price, no matter how small, for livestock purchased from different producers.

Proposed § 201.210(a)(5) would render "[p]aying a premium or applying a discount on the swine production contract grower's payment or the purchase price received by the livestock producer from the sale of livestock without documenting the reason(s) and substantiating the revenue and cost justification associated with the premium or discount" an unfair, unjustly discriminatory or deceptive practice or device under § 202(a) of the PSA. Under this provision, any price differences for livestock must be justified by a cost or revenue explanation.[49] Prior course of dealing, reliability, volume, negotiating skill, food safety considerations, traceability or other intangible factors are not an appropriate justification under this rule.[50]

Proposed § 201.211(b) would require any such price premiums to be offered in a "manner that does not discriminate against a producer or group of producers that can meet the same standards." This section will require that packers make available all premiums to all producers. Any requirement that a packer must deal with groups of producers in the same manner in which it deals with a single producer will result in additional costs for the packer. Such a requirement will, by definition, require multiple negotiations and more complex scheduling, thereby eliminating market efficiencies.

c. Immediate impacts of the Proposed Rules upon packers and pork producers.

The Proposed Rules are thus very clear: Any deviation in prices or terms must be "justified" by a packer or swine contractor on a cost revenue basis.[51] Failure to so justify any such deviation will be deemed to be an "undue or unreasonable preference" by GIPSA and may result in liability under the PSA to either GIPSA or a disgruntled producer or swine production contract grower. The Proposed Rules will likely cause packers to withdraw marketing agreements from the pork industry.[52] As stated earlier, any reduction in marketing agreements will have a negative impact on the industry.

As an initial matter, the Proposed Rules will require additional documentation to be kept by all packers and swine contractors to justify any price differentials or variance in contract terms. GIPSA has intimated a "legitimate business reason" *may* constitute the "justification" required by Proposed §§ 201.94 and 201.210(a)(5):

> If a packer, swine contractor, or live poultry dealer believes it can justify disparate treatment of poultry growers, swine production contract growers or livestock producers, it must have a legitimate business reason for that

[49] No other industry that NPPC is aware of is required to produce this type of justification for every transaction.
[50] The net effect for pork producers is to extinguish their accumulated goodwill.
[51] In fact, under the Proposed Rules a livestock purchaser that buys livestock at a public auction would be required to maintain written documentation justifying the difference in prices paid for two lots of livestock even if the price differential was based only on the buyer's willingness to outbid the competing bidders.
[52] Hausman, *supra* note 31, at 13.

> differential treatment. GIPSA is proposing to add a new paragraph (b) to Sec. 201.94 that would require packers, swine contractors or live poultry dealers to maintain records that justify their treatment of poultry growers, swine production contract growers, or livestock producers. This justification need not be extensive but should be enough to identify the benefit-cost basis of any pricing differentials received or paid, and may include increased or lower trucking costs; market price for meat; volume; labor, energy, or maintenance costs, etc. For example, a packer's participation in a branded program for a particular type of beef that returns a premium to the packer could be used to justify a higher price paid to producers that sell the type of cattle that meets the specifications of the branded program. In general, the data needed to justify a different treatment would identify those pecuniary costs and benefits associated with the treatment that demonstrate its decreased costs or increased revenues from a standard business practice. Therefore, GIPSA would consider the particular circumstances of any pricing disparity in determining whether a violation of the P&S Act occurred, including whether there is a legitimate justification for the disparity.[53]

Unfortunately, the Proposed Rules do not reflect the agency's more benign description of the documentation necessary to sustain differences in pricing or contract terms set forth in the NPRM. And such declarations are not binding on any private plaintiff who asserts a cause of action based on perceived discrimination. Accordingly, packers and swine contractors will be required to attempt to comply with the Proposed Rules in the face of an absolute declaration from the agency that any such differentials are presumptively invalid under the PSA. It is reasonable to assume their responses will be very conservative lest they be sued for providing an "undue or unreasonable preference."[54]

The Proposed Rules are unworkable for several other reasons. Proposed § 201.94 requires packers and swine contractors to maintain written records that provide justification for differential pricing or any "deviation from standard price or contract terms...offered to livestock producers." This provision raises several practical questions that need clarification for the industry. What will be "justifications" for a price differential? Will any of the following factors be justifications:[55]

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[53] 75 Fed. Reg. at 35344.

[54] Indeed, the only safe harbors available to a packer under the Proposed Rules are to: (i) pay the same price for all hogs since it does not appear such a payment program would violate the rules; (ii) purchase all hogs on a "grade and yield" basis with nominal premiums that may be easily justified; or (iii) forward contract for all hogs using a formula price based on a recognized commodity market. In any case, it is likely prices for hogs will be reduced for all producers on implementation of the Proposed Rules.

[55] In Section 11006 of the Farm Bill, GIPSA was directed to "establish criteria that the Secretary *will consider*" in determining: (a) whether an undue or unreasonable preference or advantage has occurred in violation of [the] Act . . . ." Congress was very clear: GIPSA was instructed to provide guidance to the livestock industry so that packers and swine contractors would be provided a meaningful opportunity to conform to the Proposed Rules. GIPSA has failed to comply with the Congressional directive. Rather, it has chosen to merely suggest what factors may be relevant to assessing whether an undue or unreasonable preference has occurred. It is incumbent on GIPSA to address each of these factors with specificity to provide any semblance of notice to the industry and to comply with the directions from Congress.

- Hog weights – Obviously, pigs are more valuable since they are sold by the pound but the weight of the pig also affects the price per pound. Different packers have different weight ranges that they deem optimal given their product lines and processes. Pigs outside of these weights garner lower per-pound prices.

- Lean content of the carcass – Lean meat is much more valuable than fat, especially external fat, so pigs with low backfat and heavy muscling earn premiums of as much as $8-$10/cwt., depending again on individual packers' product mixes and processes.
- Genetic line – This can be used as an indicator of leanness or of muscle quality. Some genetic lines have characteristics such as darker lean or more marbling that packers pay premiums for. This again depends on the packers' customers, products and processes.

- Animal care/welfare raising method – Pigs produced outdoors or in free-range systems or in other supposedly high-welfare facilities usually receive significant premiums. The premiums are necessary since these systems result, generally, in higher average costs than do modern confinement systems.

- Feed ingredients – Japanese buyers have paid premiums for pigs fed barley instead of corn because barley causes whiter fat. Other feeding practices may be punished with discounts because of problems that may occur.

- Use of antibiotics or other feed additives – Pork from pigs that have never had antibiotics (and other additives such as Paylean, a non-antibiotic growth and leanness promoter) are favored by some consumers and command premium prices. Therefore, packers pay more for hogs that will yield those cuts. As was the case for alternative rearing methods, premiums are required to get producers to raise these pigs since they cannot benefit from the health and efficiency improving effects of antimicrobials or other animal health products.

- Volume – The number of pigs delivered in a load or during a given period of time matters, especially when the seller is willing to make a long-term commitment. Transaction costs are reduced since multiple negotiations are no longer required. Risk is reduced since the producer and packer both know for certain that they have a customer and supplier, respectively. Plant and farm throughput can be optimized. Higher volume is worth more.

- Time – As with many things economic, timing can be everything. A load of pigs sold later on a day when packers are scrambling to fill a second shift will garner a higher price than pigs sold earlier in the day. Conversely, ample hog offerings can cause prices to fall during a day.

- Supplier dependability, reputation and helpfulness – Producers willing to go an extra mile to meet unique needs are frequently rewarded. This factor would include delivering early in the morning to start a day's operations, delivering late in an

afternoon to fill a shift and delivering when weather is bad because other shipments are delayed. Suppliers over time develop reputations that tend to qualify or disqualify them for these price differences.

What is a "standard price"? What economic or regional factors will be used to determine a standard price? What is the time frame for a standard price? Who determines what the "standard price" is? How will the "standard price" be reported? On the day that this regulation becomes effective, what will be the "standard price"? When and under what conditions will the "standard" price change? Could a packer purchasing hogs in the cash market use "compliance with this regulation" as justification for paying a price different from the cash market? Could a packer purchasing hogs through a marketing agreement offer a price different from the contract price but equal to the "standard price" and use this regulation as a justification? What economic or legal analysis can the agency offer producers to ensure that packers will not use this regulation as a basis to depress prices to a "standard" unknown price? Has the agency considered the immediate market impact the implementation of this regulation will have on the marketplace? If so, NPPC requests a copy of such analysis.

Given the virtually nonexistent cash market for poultry growers,[56] it seems reasonable to conclude that the regulation will affect pork and beef markets more than poultry. What action will the agency take to ensure this regulation will not have an immediate effect on cash market transactions and benefit one protein source over another?

How quickly after completion of a sale of hogs must the packer provide the agency with its price justification? What steps will the agency use to ensure that the information provided regarding justification of pricing will not be used by a competitor to undercut a particular market? Who will have access to the justification documents filed by packers? What economic factors will be used to determine whether a particular transaction was justified? If the parties are willing buyers and willing sellers and the parties agree to a price that deviates from a standard price, will the transaction be automatically justified?

This section illustrates fundamental misconceptions behind the Proposed Rules: that there is or shall be perfect competition in livestock markets with "standard terms and conditions" and standard livestock. There is no standard "hog." Rather, hogs are unique. As a result, concepts of "standard price or contract terms" have no legal or economic underpinnings in this industry. This simply invites second-guessing by GIPSA, private litigants and the courts.

The regulation ignores transaction costs which are reduced in high volume transactions. The regulation requires written documentation for *de minimis* price differentials or "any deviation" from standard price or contract terms, which seems overly burdensome. It is impossible to know what reasons will, in GIPSA's view, "justify" a price variation. The regulation will create a

[56] A fact recognized by GIPSA in its 2008 and 2009 Annual Reports. See GIPSA, 2009 Annual Report, Packers & Stockyards Program, at 43 (March 2010); and GIPSA, 2008 Annual Report, Packers & Stockyards Program, at 42 (March 2009) available at http://www.gipsa.usda.gov/GIPSA/webapp?area=newsroom&subject=landing&topic=cc-ar.

substantial record-keeping burden for regulated entities.[57] Finally, a very real practical problem is that the justification requirement will force packers to return to "grade and yield" pricing for hogs and refrain from entering into marketing agreements or offering premiums to avoid the risks of litigation. By stifling marketing agreements and burdening the markets with "justification" requirements, this provision destroys marketing opportunities for producers and guts the progress the U.S. swine industry has made in growing pork demand in the U.S. and in international markets. This is inconsistent with the stated goals of the USDA of doubling exports in the next five years.

In addition to record-keeping expenses, the proposed requirement relating to justifying price differences will lead to increased litigation risks for packers and swine contractors. Such litigation may, under the PSA, be brought by any person who claims to be damaged by any conduct of a regulated person (i.e., a packer or swine contractor). This litigation risk is only magnified by the Proposed Rules. No threshold amounts or exceptions for cash market purchases are set forth in the Proposed Rule. In fact, no exceptions of any types are set forth in the Proposed Rules.

The magnitude of this litigation risk can best be illustrated by *Pickett v. Tyson Fresh Meats, Inc.*, 315 F.Supp.2d 1172 (M.D. Ala. 2004), rev'd, 420 F.3d 1272 (11th Cir. 2005). There, the plaintiffs challenged the livestock procurement practices of the defendant packer through the use of alternative marketing arrangements. At trial, the plaintiffs' expert testified that the damages sustained by the cattle producers were in excess of $2.1 billion.[58] The jury disagreed with the plaintiffs' expert but nonetheless returned a verdict of $1,281,690,000. While the district court ultimately refused to enter a judgment against the defendant in the amount of the jury verdict, the case nonetheless establishes a benchmark for potential liability under Proposed § 201.94(b).

In considering the effect of the Proposed Rules on the hog industry, it is instructive to consider the experience in Missouri.[59] In 1999, the Missouri legislature passed Mo. Stat. § 277.201, which prohibited packers from discriminating among livestock sellers based on price, unless such price differentials were based on quality, carcass merit premiums or discounts, transportation costs or agreements for specific delivery times. The law also provided for treble damages, costs and attorneys' fees. The implementation of the statute resulted in an immediate and negative impact on the purchase of livestock in Missouri. In fact, the negative impact was so dramatic that the legislature was forced to make significant revisions to the statute in a special session.

The Proposed Rules are likely to reduce the options of producers to market their livestock in a manner that will provide economic incentives to livestock producers for increased efficiency, innovation, responsiveness, course of dealing or other non-economic considerations. Packers will do their best to avoid possible claims such as those asserted in *Pickett.* The result will be lower premiums, lower prices and decreased revenues for all hog producers.

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[57] See Informa Economics, *An Estimate of the Economic Impact of GIPSA's Proposed Rules* (November 8, 2010), at 26-27, 53 (attached and incorporated as Appendix D) (the "Informa study").

[58] 315 F.Supp. 2d 1172, 1178.

[59] Ron Plain and Bruce Bullock, *The Missouri Livestock Marketing Law*, Missouri Farm Financial Outlook 2002, Agricultural Economics Department, University of Missouri, November 2001.

2. Numerous Provisions of the Proposed Rules are Unreasonable Because of Their Likely Adverse Effect on Market Operations.

In addition to striking at contractual relationships between producers and packers, the Proposed Rules would disrupt the functioning of existing markets in ways that undermine, instead of advance, the purposes of the Act.

Section 201.212(c) of the Proposed Rules provides as follows:

> A packer shall not purchase, acquire, or receive livestock from another packer or another packer's affiliated companies, including, but not limited to, the other packer's parent company and wholly owned subsidiaries of the packer or its parent company.

The justification for the Proposed Rules is difficult to discern, particularly since it will apply to the swine industry without any apparent reason. By way of explanation, GIPSA offers the following:

> Proposed new Sec. 201.212(c) would prohibit packers from purchasing, acquiring, or receiving swine or livestock from another packer or packer-affiliated companies. Packer-to-packer acquisitions have historically been restricted to purchases from other packers of "off" animals that did not fit with the other packers' specifications but were procured in a larger lot of animals. The practice was primarily restricted to hog packers. Since 2006, GIPSA has observed that the practice has been expanded considerably and GIPSA believes it to be contributing to significant price distortions. *In one instance*, the price distortion was almost 3 percent of the reported base price for hogs. These price distortions in the swine negotiated cash market have larger price effects than just the cash market as many contracts including formula pricing often refer to the reported base price. . . . [60]

We believe this provision is unnecessary since any packer-to-packer sales that have an affect on the marketplace are already explicitly prohibited by Section 202(d) and (e) of the Act. If this behavior has been a problem, why has GIPSA not filed a complaint and prosecuted the offenders under this long-standing statute?

This particular provision is extremely problematic for pork producers and dealers, including what we believe to be the two largest dealers of cull-sows in the U.S., who are direct owners of packing plants. Under the Proposed Rules, other packers would be prohibited from buying livestock from these owners of cull-sows, which would significantly affect their businesses and the U.S. market.

There are two possible reactions to this provision. The first would be for owners of packing plants to ship all of their animals only to their own plants. This is apparently what GIPSA

[60] 75 Fed. Reg. at 35346 (emphasis added). This anecdote is a good illustration of the "record" upon which these Proposed Rules appear to be based.