United States Department of Agriculture

2012 Annual Report

Packers and Stockyards Program

Our Mission:

> "To protect fair trade practices, financial integrity, and competitive markets for livestock, meat, and poultry."

March 2013

Grain Inspection, Packers and Stockyards Administration

EXECUTIVE SUMMARY

Overview—The Packers and Stockyards Program (P&SP) operates under the authority of the Packers and Stockyards Act (P&S Act). P&SP is administered by a Deputy Administrator, who reports to the Administrator of the Grain Inspection, Packers and Stockyards Administration (GIPSA) of the U.S. Department of Agriculture (USDA). The Deputy Administrator provides leadership to five program directors—two in the Washington, D.C., headquarters and three in regional offices located in Atlanta, Georgia; Aurora, Colorado; and Des Moines, Iowa.

Each regional office director manages a Business Practices Unit, a Financial Unit, and two Resident Agent Units, which enforce the P&S Act through regulatory actions and investigations. The director also oversees the administrative Program Support Unit, and the Western Regional Office director oversees the Central Reporting Unit, which processes industry entities' annual reports filed with P&SP.

Unit Level Activities—To ensure compliance with the P&S Act, P&SP agents conduct two broad types of activities: investigative and regulatory. Investigations are carried out when a violation of the Act appears to be occurring. Regulatory activities are monitoring activities to determine if a regulated entity is complying with the P&S Act and result in correction of identified deficiencies.

Program Management—P&SP measures its overall performance by annually measuring the regulated entities' compliance with the P&S Act. The performance measure encompasses activities P&SP conducts that directly or indirectly influence industry compliance. In 2012, industry compliance with the P&S Act increased significantly to 87 percent. Related to the increased level of industry compliance has been a decline in the number of financial failures of regulated entities and the total amount owed per year resulting from financial failures. Statistical analysis of the data show that the increased numbers of closed field inspections and investigations as well as formal complaints were significant predictors of the decreased financial failures. The data strongly indicate that the Program can be proactive in limiting financial troubles in the regulated industries.

P&SP measures its efficiency at achieving industry compliance by the number of days it takes to complete the investigative phase (the time from complaint until a decision is made whether to refer the case to the Office of General Counsel (OGC) or the Department of Justice (DOJ) for possible enforcement action) of investigations. The time decreased from 104 days in 2011 to 99 days for investigations closed in 2012, including investigative time spent on cases eventually referred to USDA's OGC and DOJ.

Industry Assessment—P&SP completed the annual assessment of the industries regulated under the P&S Act, which is based on data from the annual reports filed by regulated firms covering the firms' 2011 fiscal year.

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1. OVERVIEW OF THE PACKERS AND STOCKYARDS PROGRAM

This section provides a brief overview of the Packers and Stockyards Program's (P&SP) authority and responsibilities under the Packers and Stockyards Act of 1921 (P&S Act), P&SP's position within the organizational structure of the USDA, and P&SP's own internal organization.

1.1 Authorities and Responsibilities

Under the P&S Act, the Secretary of Agriculture (Secretary) has authority over businesses engaged in the marketing of livestock, wholesale meat, and poultry. The Secretary has delegated this authority to the Packers and Stockyards Program for regulation and enforcement. Regulated business entities include livestock market agencies (which include auction markets), livestock dealers, stockyards, packers, swine contractors, and live poultry dealers (this includes most poultry slaughterers or "poultry integrators"). These businesses assemble and process livestock and poultry, and move their products through the first manufacturing, or meatpacking, phases of the livestock and poultry marketing channel. Livestock producers, feedlots, and poultry growers at the originating or upstream ends of the market channels and most retailers at the opposite downstream end of the market channel are not under P&SP's jurisdiction.

The P&S Act prohibits unfair, unjustly discriminatory, and deceptive practices. It also prohibits regulated businesses from engaging in specific anti-competitive practices.

In addition to describing unlawful behavior, the P&S Act mandates certain business practices by regulated industries. For example, market agencies and dealers must be registered; market agencies, packers (except those whose average annual livestock purchases do not exceed $500,000), and dealers must be bonded to protect livestock sellers; and buyers must make prompt payment for livestock. To protect unpaid cash sellers of livestock, packers are also subject to trust provisions that require that livestock inventories and receivables or proceeds from meat, meat food products, or livestock products be held in trust for unpaid cash sellers until payment is made in full. A similar provision applies to live poultry dealers.

P&SP uses its statutory authority to investigate alleged violations of the P&S Act and regulations, and prosecutes violations identified through those investigations in administrative actions prosecuted by USDA's Office of the General Counsel or through referrals to the Department of Justice (DOJ).

Under the Food Security Act of 1985, States may establish central filing systems to pre-notify buyers, commission merchants, and selling agents about security interests against farm products. P&SP administers the section of the statute commonly referred to as the "Clear Title" provision by certifying the filing systems of States that apply to P&SP for certification. P&SP does not have authority to decertify States unless a State requests such decertification, and it does not have the authority to determine if States are maintaining certification standards.

1.2 Packers and Stockyards Program's Business Organization

The Packers and Stockyards Program is administered by a Deputy Administrator, who reports to the Administrator of the Grain Inspection, Packers and Stockyards Administration (GIPSA). In addition to the P&SP, the GIPSA Administrator oversees the Federal Grain Inspection Service (FGIS). Within the USDA, the GIPSA Administrator reports to the Under Secretary for Marketing and Regulatory Programs (Figure 1). P&SP's allocated portion of the GIPSA appropriation for 2012 was $21.3 million compared to $22.5 million in 2011.

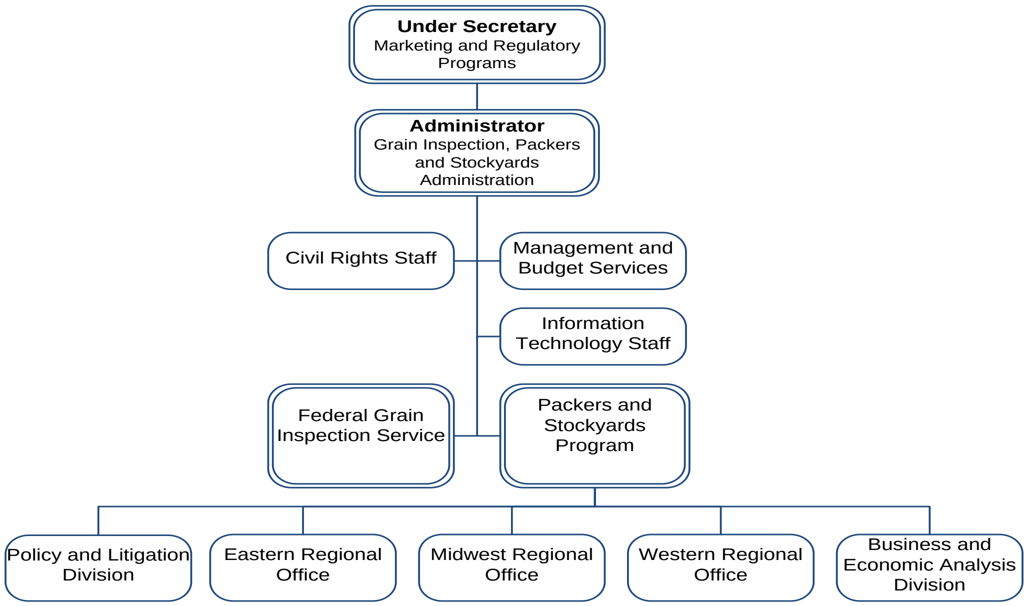

Figure 1. GIPSA Administration Organizational Structure

The Deputy Administrator of the P&SP provides strategic leadership to five program directors—two at headquarters in Washington D.C., and three in regional offices: the Eastern Regional Office in Atlanta, Georgia; the Western Regional Office in Aurora, Colorado; and the Midwestern Regional Office in Des Moines, Iowa (Figure 2). As of October 2012, P&SP had 149 full-time staff.

Each regional director manages an administrative Program Support Unit and four program units: a Business Practices Unit, a Financial Unit, and two Resident Agent Units. The units are organized based on responsibilities under the P&S Act and are designed to capitalize on the tactical advantages of placing staff in the field. Each unit is comprised of 5 to 10 staff members. Each unit has a supervisor who reports to the Regional Director. Staff members supervised in the regional offices are responsible for conducting investigations and regulatory activities such as business audits, weighing verifications, and day-to-day industry monitoring. These activities are described in greater detail in the next section. Additional information on the P&SP structure is available on the P&SP web page at http://www.gipsa.usda.gov/psp.html.

Each regional office maintains expertise in one or more species of livestock or in poultry. The Eastern Regional Office focuses on poultry, the Midwestern Office on hogs, and the Western Regional Office on cattle and sheep. Fifty resident agents, who report to the regional offices, are located throughout the country to provide core services nationwide (Figure 2). The geographically dispersed resident agents enable P&SP to maintain close contact with the entities that it regulates, which are similarly dispersed throughout the United States (Figures 3 through 6).

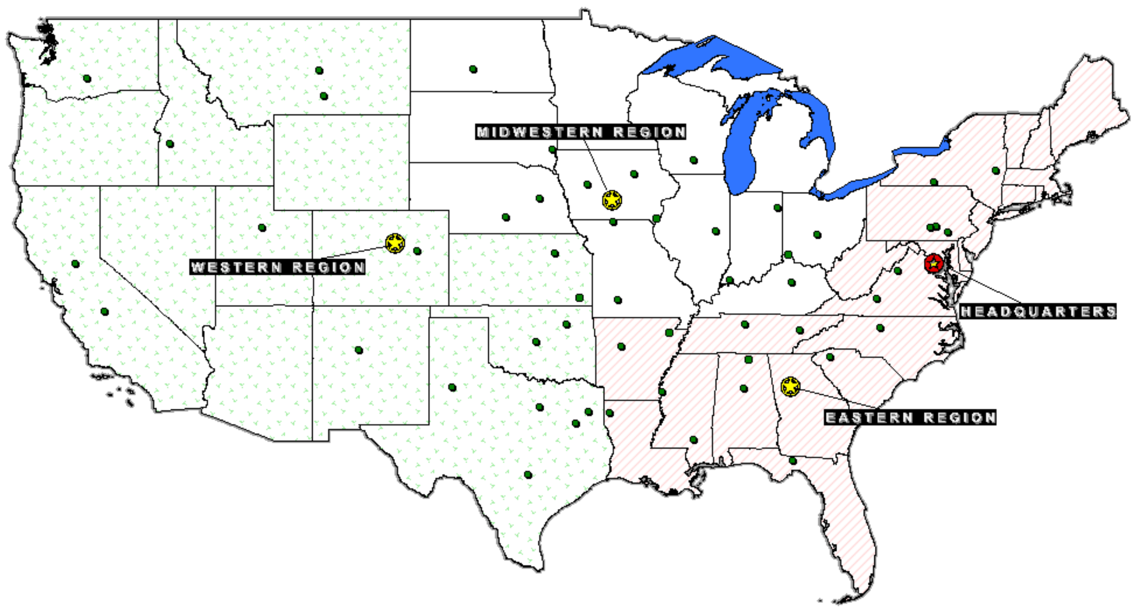

Figure 2. P&SP Regional Offices and Resident Agent and Auditor Locations

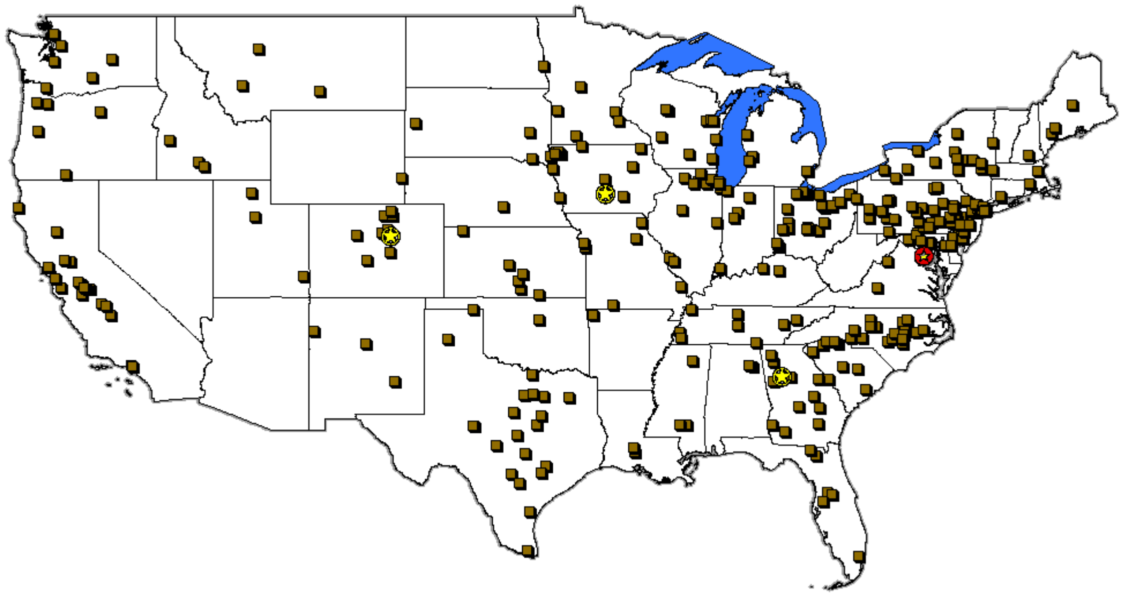

Figure 3. Location of Livestock Packers Headquarters Subject to the P&S Act

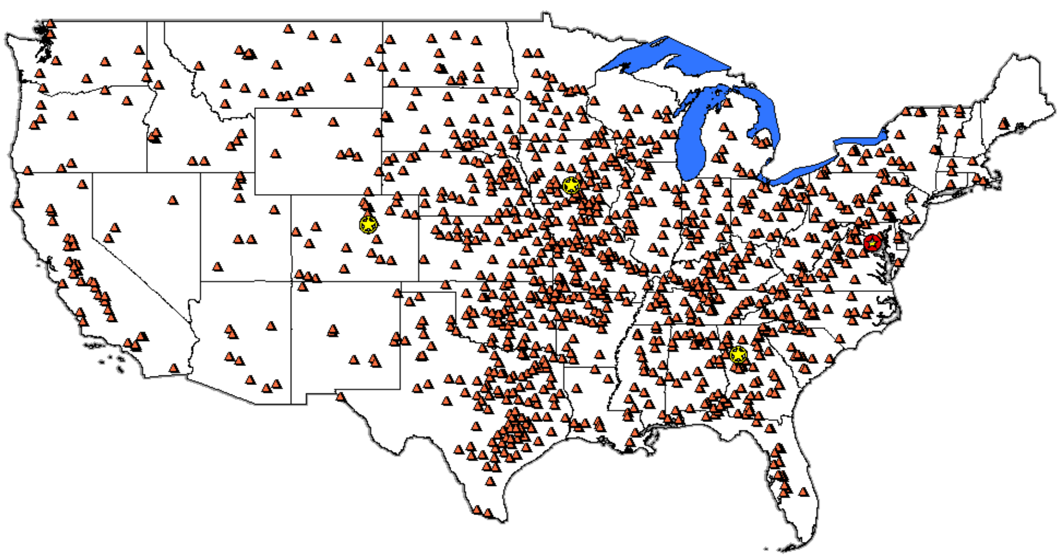

Figure 4. Location of Livestock Markets and Firms Selling on Commission Subject to the P&S Act

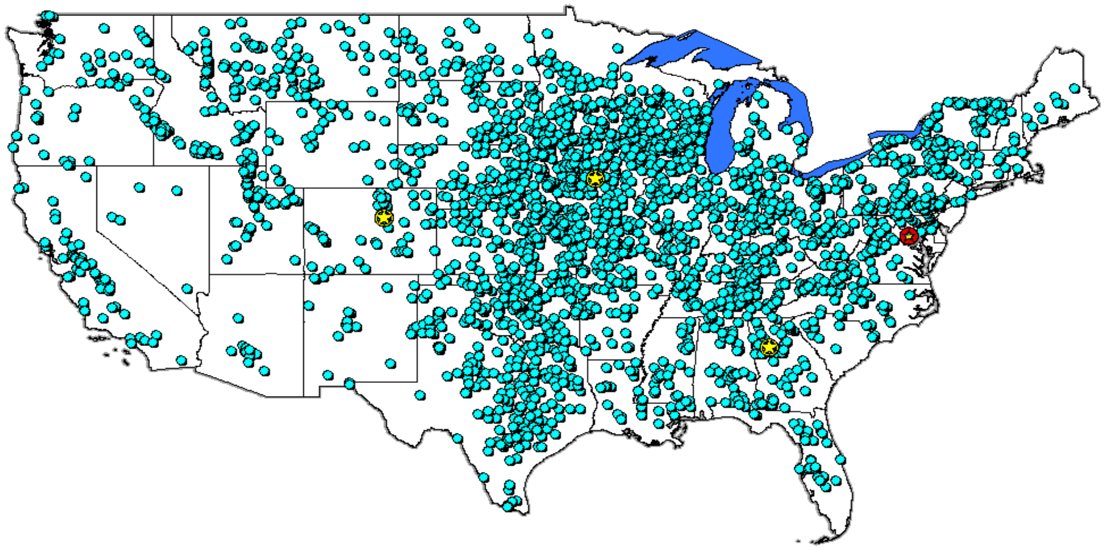

Figure 5. Location of Livestock Dealers Subject to the P&S Act

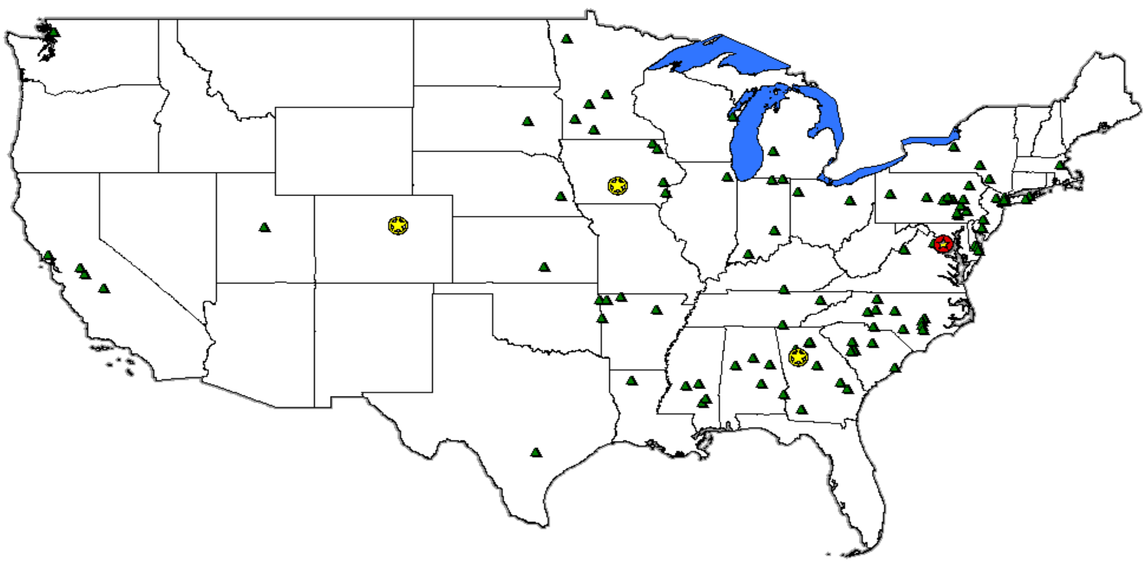

Figure 6. Location of Live Poultry Dealers Headquarters Subject to the P&S Act

2. PACKERS AND STOCKYARDS PROGRAM UNIT-LEVEL ACTIVITIES

P&SP conducts two broad types of activities at the unit level to enforce the P&S Act: investigative and regulatory. Investigations are conducted when there is reason to believe a violation of the P&S Act is occurring or has occurred. Regulatory activities are monitoring activities carried out to determine if a regulated entity is complying with the Act. Agency resident agents, staffed with marketing specialists located in the field, are the agency's frontline staff who work daily with regulated entities as well as livestock producers and poultry growers. They are typically the first responders for complaints and because of their daily contact with the industry a source of primary market intelligence.

Besides conducting routine regulatory activities, because of their situational awareness the resident agents often are the initiators of more complex investigations and regulatory activities. Support to the resident agents is provided by the regional offices' Business Practices or Financial units. The Business Practices units include legal specialists, economists, and marketing specialists who focus on competition and trade practice issues. The Financial units are staffed with auditors who investigate and undertake regulatory activities related to enforcing the financial requirements of the Act. Investigations at a firm level may be a follow-up to previously identified violations of the P&S Act. In other instances, investigations may be initiated in response to complaints from industry participants, possible violations found while conducting regulatory activities on a business's premises, or possible violations found through other monitoring. Investigations may be conducted as rapid response actions to prevent irreparable harm to the regulated industries.

Members of the livestock and poultry industries and the public may report complaints at 1(800) 998-3447 or by e-mail at PSPComplaints@usda.gov. Individuals or firms with complaints about the livestock and poultry industries also are encouraged to call the appropriate regional office to discuss their concerns, anonymously if desired. P&SP responds to all of these external contacts. P&SP also initiates investigations independently, for example, as a result of information obtained from monitoring industry behavior.

Regulatory activities include, but are not limited to, check-weighing; custodial account and prompt payment audits; procurement and marketing business practice reviews; registering market agencies, dealers, and packer buyers who operate subject to the P&S Act; assisting producers in filing bond and trust claims; analyzing trust and bond claims; and conducting orientations for new dealers, markets, and packers.

Regulatory activities also include market-level monitoring, which is generally conducted using data that are available in the public domain. Examples include, but are not limited to, monitoring fed cattle and hog prices and analyzing structural changes in the livestock, meat, and poultry industries. Monitoring activities have led to firm-level investigations. Regulatory activity may occur entirely or partially at an entity's place of business or at a Regional Office.

P&SP regulatory and investigative activities are categorized as generally addressing areas of competition, trade practice, or financial concerns. Program expenditures were greatest within the trade practice area of investigation and enforcement in 2012, whereas expenditures within the financial area were the largest part of expenditures on regulatory activities (Table 1).

Table 1. Total Regulatory and Investigation Expenditures, 2009-2012

	Regulatory ($000)			Investigation ($000)		
Fiscal Year	Competition	Trade Practice	Financial	Competition	Trade Practice	Financial
2009	205	2,047	3,281	245	3,330	9,244
2010	81	1,342	4,463	388	4,928	8,621
2011	183	924	2,141	414	8,909	6,464
2012	129	1,494	2,614	431	8,588	5,414

***Table Note**: Estimated expenses of regulatory and investigative activities include headquarters participation and direct support, but exclude general administrative and other overhead expenses.

P&SP's regulatory and investigative actions frequently find that entities are in compliance with the P&S Act. When violations are discovered, P&SP levies agency-established fines (stipulations) for admitted violations or pursues litigation through USDA's Office of the General Counsel (OGC) before a USDA Administrative Law Judge or through the U.S. Department of Justice (DOJ). Litigation may result in a fine against the offending entity, or in suspension of the entity's P&S registration. Not all cases result in monetary penalties. In 2012, P&SP levied $305,390 in stipulations and an additional $1,473,093 in penalties through Administrative Law Judge decisions for a total of $1,778,483, an average of $ 8,311 per case (Table 2). Penalties obtained through DOJ actions averaged about $42,554 for a total of an additional $425,540.

Table 2. Penalties Levied for P&S Act Violations, 2008-2012

Type Judgment	2008	2009	2010	2011	2012
Administrative Penalties ($)	657,770	364,700	341,027	662,470	1,473,093
DOJ Civil Penalties ($)	51,240	59,580	346,705	70,480	425,540
Total Civil Penalties($)	709,010	424,280	687,732	732,950	1,898,633
Stipulations ($)	23,275	30,775	127,787	364,800	305,390
Complaints Issued	46	40	50	38	124
Suspensions	0	19	6	9	24

2.1 Enforcing Business Practice Provisions

The regional business practices units have responsibility for inspections and investigations of trade practice and competition provisions of the P&S Act. Supported by resident agents, the units conduct investigations of alleged anti-competitive practices and unfair and deceptive trade practices by market agencies, livestock dealers and order buyers, slaughtering packers, live poultry dealers, and meat dealers and brokers.

Economists and legal specialists in the units conduct competition investigations and regulatory activities. For example, an economist might monitor market and firm prices for indications of anti-competitive firm behavior. Marketing specialists conduct trade practice investigations and regulatory actions related to inaccurate weighing practices or carcass evaluation instruments and compliance with contracts. The competition and trade practice work conducted by these units is discussed in more detail below.

2.1.1 Competition

Investigations are a central activity of our competition program. P&SP investigates complaints alleging anti-competitive behavior such as attempted restriction of competition, failure to compete, buyers acting in concert to purchase livestock, apportionment of territory, price discrimination, price manipulation, and predatory pricing. P&SP's economists, legal specialists, and investigative attorneys collaborate with USDA's OGC on all competition investigations. When the results of an investigation indicate that the evidence and circumstances support legal action, P&SP formally refers the case file to OGC for action.

P&SP conducts many activities that monitor changes in industry behavior in order to understand the nature of and reasons for changes, and to anticipate potential competitive issues that may result from those changes. Details of specific, ongoing individual monitoring efforts are described in the next three sections.

2.1.1.1 Fed Cattle and Hog Market Price Monitoring

The current fed cattle and hog market price monitoring program was first implemented in 2004, but has since evolved into an enhanced program that includes a weekly internal reporting regime based on statistical models, one for the fed cattle markets and the other for hog markets. The statistical models rely on USDA's Agricultural Marketing Service (AMS) publicly reported price data to assess regional price differences. If a statistically significant price difference is detected, P&SP initiates a regulatory review work plan to determine whether those price differences are caused by an undue or unreasonable preference or disadvantage in violation of section 202 (b) of the Act or by uncontrollable external factors, such as weather or other external macroeconomic conditions. If the initial regulatory reviews of price differences do not clarify whether they were caused by external market factors, a field investigation is opened into the incident.

Whether P&SP is monitoring fed cattle or hog prices, when the statistical model reports an outlier, an economist from the Business and Economic Analysis Division in headquarters reviews the suspect price and makes a recommendation report, which is reviewed by an economist in the regional office. Based on the report and reviewer comments, the supervisor either closes the review or opens an investigation and requests individual firm transactions data from AMS.

2.1.1.2 A Regime Switching Model Evaluated for Price Monitoring

During 2012 P&SP evaluated an econometric model for potential use in monitoring price behavior in oligopsonistic markets.[1] An oligopsonistic market is a market with few buyers who may face countervailing power from few sellers or the market may have many sellers. The reported model examined oligopsonistic behavior in beef packer fat cattle purchasing for the national and the Kansas regional market. In particular the researchers examined how packer procurement behavior affects cattle prices, beef packer margins, and packers' synchronized behavior. The researchers hypothesized that packers operate across time in one of two pricing regimes. In one case packers' actions are synchronized, reducing cattle prices and in the other phase they act independently or competitively, resulting in higher cattle prices. When packers' behavior is synchronized their profit margins rise and when they are acting independently margins are lower. The correspondence between packer margins and synchronized behavior is evident in the national negotiated hog market (Figure 7). External supply and demand factors are integrated into the packers' profit margin, which in turn act as the economic signal to synchronize bidding behavior and trigger alternate pricing behaviors.

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[1] Cai, X., K. Stiegert and S.R. Koontz. (2011) "Regime Switching and Oligopsony Power: The Case of U.S. Beef Processing." *Journal of Agricultural Economics.* 42, 99-109. and "Oligopsony Fed Cattle Pricing: Did Mandatory Price Reporting Increase Meatpacker Market Power?" *Applied Economic Perspectives and Policy*. 33 (4), 606-622.

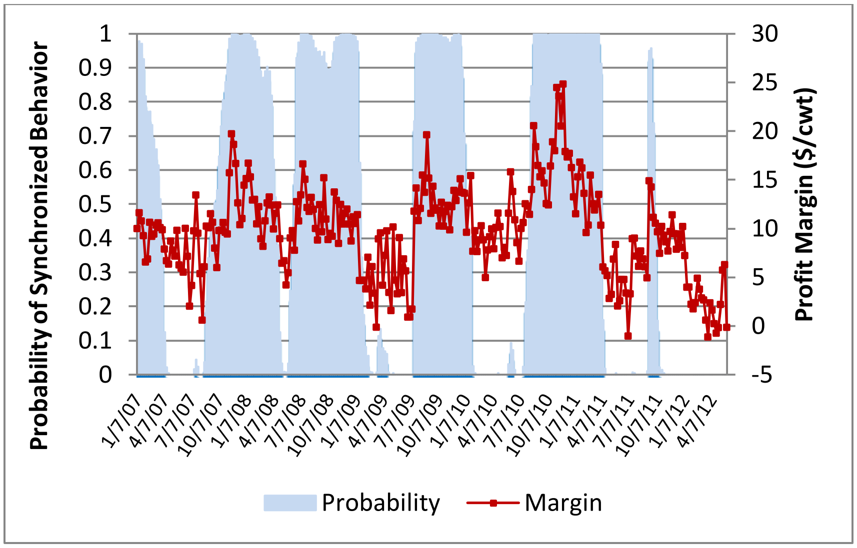

Figure 7. National Negotiated Hog Market Probability of Synchronized Behavior and Packer Profit Margins

Examining the Texas-Oklahoma-New Mexico Agricultural Marketing Service price reporting area, for fed cattle the cycle is not as apparent (Figure 8) as for the national negotiated hog market but nonetheless appears to follow the general pattern. An external supply event such as livestock producers supplying a higher volume is observed by packers. The packers in turn synchronize a relaxed bidding phase and cattle prices decline, leading to higher packer margins. At the lower price, producers will supply a lower quantity in the next cycle. Now packers must bid more aggressively for the lower quantity, which leads to a higher market price than in the previous cycle and thus a decline in packers' margins, bringing an end to the synchronized behavior.

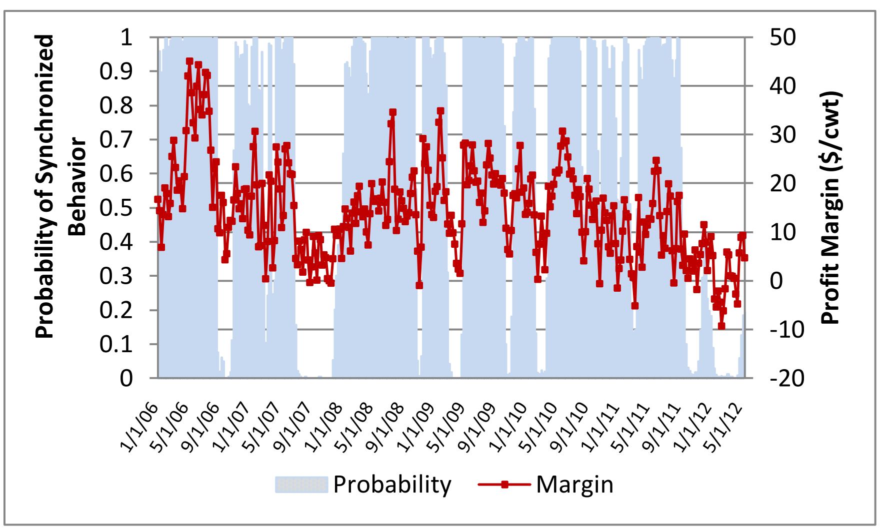

Figure 8. Texas-Oklahoma Negotiated Cattle Market Probability of Synchronized Behavior and Packer Profit Margins

2.1.1.3 Committed Procurement Review and Audit

P&SP monitors the use of "committed procurement" arrangements, which commit cattle and hogs to a packer more than 14 days prior to delivery. Each year, P&SP economists obtain fed-cattle and hog procurement data for the previous calendar year from the four largest beef packers and four largest hog packers. If the packers change their procurement arrangements with suppliers from previous years, P&SP also collects any new or modified written marketing agreements or contracts. P&SP economists review the contracts and, if necessary, discuss them with the packers to determine how the terms of the agreements relate to committed procurement categories of interest. Economists then classify, review, and tabulate the individual transactions data and calculate the reliance of the top packers on committed procurement methods. Finally, P&SP economists reconcile the calculations based on the detailed transaction data on committed procurement as reported by the packers in their Packer Annual Reports.

If there are significant differences between the transaction data and the Packer Annual Report submissions on committed procurement, the economists contact the packers to identify the cause of the discrepancy. If necessary, P&SP meets with the packers in person to discuss the packers' procurement methods and explain how they should be reported on the Packer Annual Report. These meetings foster a mutual understanding of the reporting requirements for committed procurement and more reliable reporting and calculation of the packers' reliance on committed procurement methods.

Relying on written contracts and other information collected during the committed procurement reviews, P&SP agents analyze the various procurement and pricing methods used by hog and fed-cattle packers. Agents obtain and review contracts and agreements as necessary to determine if there have been any competition violations of the Act. The contracts are also used in procurement reviews of the packers to help determine if proper payment practices are being followed.

2.1.1.4 Poultry Contract Compliance Review Process

In FY 2012 P&SP conducted 44 poultry reviews, 34 of these reviews were based on a random sample. These reviews are based on standard operating procedures established in 2009 and are now included as a component of P&SP's performance measure (see Performance and Efficiency Measurement section). Poultry contract reviews may be initiated based on industry intelligence or complaints in addition to those conducted based on random samples.

The standard operating procedure for conducting poultry contract reviews is electronically documented with links to Packers and Stockyards Automated System (PAS), the P&SP's automated workflow software. P&SP agents follow these procedures when conducting poultry contract reviews. In general, the agent will collect relevant background information on the firm that is under review prior to conducting a site visit. Once on-site, the agent will conduct an interview and obtain copies of the grower contract being used at the plant location and 3 months of weekly ranking sheets for the contract. These documents are reviewed for consistency and adherence to P&S Act regulations. One week of payment data from the settlement sheet is selected as a random sample for a detailed review for accuracy and completeness. The results are compared to the firm's ranking sheets, settlement sheets, and payments to the growers to ensure consistency with the contract. If discrepancies are found, an investigation is opened. If the firm's practices are determined to be free of violation, the agent provides an exit interview indicating this to the firm's management.

2.1.2 Trade Practices

Firms that furnish stockyard services in commerce are required to post a notice that informs the public that the stockyard meets the definition of a stockyard under the P&S Act. Once posted, the stockyard remains posted until it is de-posted through public notice. P&SP meets with new auction market owners and managers as the market begins operations to ensure that market operators understand their fiduciary responsibilities under the P&S Act.

These visits in the early stages of a market's operation also provide important protection to livestock producers who rely on the market to provide a nondiscriminatory and competitive marketplace. Similarly, P&SP conducts orientations for hog and poultry growout contractors who operate feed mills to ensure they understand the regulatory requirements for feed weights used to calculate producer/grower payments.

P&SP reviews procurement practices to determine if unfair or deceptive trade activities are occurring in the procurement of livestock, meat, and poultry. The reviews assess pricing methods; payment practices; weighing of livestock, carcasses, and poultry; carcass grades used for payment; and accounting issued to sellers.

The P&S Act and regulations require markets, dealers, and packers to test scales at least semi-annually and file scale-test reports as evidence of scale maintenance. State or local government entities and private companies test scales. In addition, P&SP conducts several types of regulatory and investigative inspections to ensure scale operators and firms subject to the P&S Act are properly using their scales and properly recording weights in the purchase and sale of livestock and poultry (Table 3).

These inspections include check weighing plus all other activities conducted by P&SP to ensure accurate weights of livestock, poultry, and poultry feed. Market, dealer, and packer inspections are conducted for scales weighing live animals. Carcass and poultry inspections are conducted on scales that weigh carcasses in slaughter plants, and feed inspections are conducted on scales at feed mills.

Table 3. Weighing Inspections and Violations, 2009-2012

Type	2009	2010	2011	2012
Inspections				
Market	245	215	223	307
Dealer	41	61	132	208
Packer	18	5	35	34
Carcass	148	242	104	115
Poultry	74	74	70	77
Feed	63	74	62	55
Total	589	671	626	796
Violations				
Markets	15	23	33	48
Dealers	3	6	23	30
Packers	1	2	15	8
Carcass	25	30	17	13
Poultry	11	7	7	7
Feed	14	9	9	12
Total	69	77	104	118

A transaction made on false or inaccurate weights, including instances in which a dealer modifies the actual weight of the livestock or fails to pass on a shrink allowance, is an unfair and deceptive practice. Anyone who believes that an action of a stockyard, market agency, or dealer caused personal loss or damage in violation of the P&S Act may file a complaint seeking reparation (damages) with P&SP within 90 days of learning of the action that caused damages. The Act does not provide for reparation complaints to be filed against packers, live poultry dealers, or swine contractors.

2.2 Enforcing Financial Provisions

P&SP's financial units enforce the financial provisions of the P&S Act and regulations. These enforcement actions support the financial integrity and stability of the livestock, poultry, and meatpacking industries. Enforcement is carried out through reviews of annual and special reports, and onsite financial compliance reviews and investigations. Financial compliance reviews and investigations address solvency issues, payment to livestock sellers and poultry growers, bond claims, trust claims, and maintenance of custodial accounts. When P&SP identifies a potentially serious financial situation that may cause imminent and irreparable harm to livestock producers, rapid response teams are deployed immediately to conduct an investigation.

Under the P&S Act, most regulated entities must be solvent (current assets must exceed current liabilities). P&SP monitors the solvency of regulated entities by reviewing financial data in annual and special reports, and by onsite financial compliance reviews and investigations. P&SP notifies entities of their insolvencies and the immediate need to correct them. P&SP requires special reports from firms whose annual reports disclose insolvencies. In addition, P&SP conducts onsite financial investigations to ensure correction of reported insolvencies or other financial issues. Formal disciplinary action is initiated against firms when appropriate.

Market agencies selling livestock on commission (auction markets) must establish and maintain a bank account designated as a “custodial account for shipper’s proceeds” to hold proceeds from the sale of consigned livestock. The commission firm or auction market acts as a fiduciary depositor to the account, and the funds in the account are trust funds held for the benefit of livestock sellers. P&SP monitors custodial accounts by reviewing annual reports from market agencies, analyzing special custodial account reports, and conducting onsite custodial account audits. When the monitoring reveals shortages in the account, P&SP acts to have the account balance corrected (Table 4).

Table 4. Number of Market Reviews and Shortages Corrected Through On-Site Investigations, Fiscal Years 2006-2012

Year	Reviews	Under Funded Accounts	Corrections ($)
2006	347	140	7,256,052
2007	296	99	2,037,080
2008	176	62	5,022,966
2009	383	181	2,581,725
2010	297	79	3,402,608
2011	318	96	2,861,471
2012	331	105	5,960,677

The P&S Act also establishes a statutory trust on certain assets of packers and live poultry dealers for the benefit of unpaid cash sellers of livestock and unpaid cash sellers or contract growers of live poultry grown for slaughter. Packer trust assets include all livestock purchased in cash sales, inventories, receivables, and proceeds from meat, meat food products, and livestock products derived from the purchase of livestock in cash sales. Poultry trust assets include all poultry obtained by live poultry dealers in cash poultry purchases or by poultry growing arrangements, inventories, receivables, or proceeds from such poultry or poultry products. Valid trust claims come before secured creditor claims in bankruptcy.

To be eligible for payment under the trust, a seller must file a claim with the packer or live poultry dealer and the Secretary within 30 days of the unpaid transaction. When a trust claim is filed, P&SP and OGC analyze the claim to assess whether it is timely and supported by adequate documentation. P&SP then makes the analysis available to the packer or live poultry dealer (the statutory trustee) and to trust claimants so that they can take any necessary action.

Additionally, all market agencies, dealers, and slaughtering packers purchasing over $500,000 of livestock annually are required to file and maintain bonds or bond equivalents for the protection of livestock sellers. To be eligible to receive payment under the bond, a seller (cash or credit) who does not receive payment for a transaction must file a bond claim within 60 days of the transaction. P&SP analyzes the claim to ensure it was filed within the timeline and supported by adequate documentation. P&SP provides its analysis to the principal and to the bond surety or trustee on a bond equivalent. In some instances the analysis is made available to all claimants to facilitate joint legal action. In some cases, claims may be made against and paid by both bond and trust assets.

Bonding requirements usually do not cover the entire loss sustained when a firm fails financially. Further, livestock sellers do not always determine the current bond status of smaller packers, dealers, and market agencies before selling livestock to them, making those sellers vulnerable to insufficient bond protection if the smaller firms fail. A large packer's failure may impact auction markets and dealers from whom it purchased livestock and failed to pay.

Since 2006, an average of 18 dealers failed each year, with a range of 3 to 31 failures per year. During that same time period, producers received an average 26 percent payment of amounts owed to them, with recovery ranging from 5 to 56 percent (Table 5).

Table 5. Total Dealer Financial Failures and Restitution, 2006-2012

	Open		Closed		Restitution on Closed Cases		
Year	No.	Owed ($)	No.	Owed ($)	Bonds ($)	Other ($)	Return (%)
2006	NA	NA	13	3,018,131	134,936	26,856	5
2007	NA	NA	31	6,941,930	257,634	549,303	12
2008	NA	NA	20	2,054,647	843,682	301,916	56
2009	NA	NA	25	3,134,145	348,018	411,133	24
2010	2	NA	7	213,332	20,000	0	9
2011	6	23,632,101	14	878,620	407,105	4,479	47
2012	3	718,166	3	512,255	100,000	40,600	27

Starting in 2010 entries show the number of firms that have claims open at year-end and those cases that have closed at year-end; for past years, only total number of failures is shown. Dollar amounts for all years are for failures with claims closed as of most recent year-end, so historical data may have been updated to reflect any settlements after the year the failure occurred. Bond claims processing by P&SP has been submitted to the bonding surety companies in the 2011 Eastern Livestock Market failure, however, it is being classified as open as most claims have not settled pending final outcome of proceedings in bankruptcy court.

Auction markets may be especially vulnerable to a domino effect from dealer failures since many dealers purchase livestock from auction markets. The failure of a large dealer may impact every auction market that it failed to pay. Since 2006 an average of 7 auction markets failed per year. Consignors received average restitution of 40 percent payment of amounts owed to them, with a range of 8 to 98 percent (Table 6). Starting in 2010, table entries show the number of firms that have claims open at year-end and those cases that have closed at year-end; for past years, only total number of failures is shown. Dollar amounts for all years are for failures with claims closed as of most recent year-end, so historical data may have been updated to reflect any settlements after the year the failure occurred.

Table 6. Total Auction Market Financial Failures and Restitution, 2006-2012

	Open		Closed		Restitution on Closed Cases		
Year	No.	Owed ($)	No.	Owed ($)	Bonds ($)	Other ($)	Return (%)
2006	NA	NA	9	979,543	267,174	19,380	29
2007	NA	NA	11	511,704	37,252	155,890	38
2008	NA	NA	6	602,100	237,734	352,111	98
2009	NA	NA	7	981,189	261,498	1,365	27
2010	1	NA	4	20,901	4,547	0	22
2011	0	0	4	158,279	0	89,586	57
2012	3	858,322	2	326,178	25,000	0	8

To maximize recovery, bond claims filed against packers are normally paid after claims made against the packer trust are dispensed. Since 2006 an average per year of 16 packers suffered financial failures owing livestock sellers an average of $4,391,000 per year, or $272,000 per each failure (Table 7).

Table 7. Total Packer Financial Failures, Bond Payout, and Payout From Other Sources, 2006-2012

	Open		Closed		Restitution on Closed Cases		
Year	No.	Owed ($)	No.	Owed ($)	Bonds ($)	Other ($)	Return (%)
2006	NA	NA	13	755,550	35,267	683,834	95
2007	NA	NA	31	4,118,456	40,000	4,083,946	100
2008	NA	NA	20	3,498,895	0	1,588,620	45
2009	NA	NA	25	15,676,349	196,208	9,999,228	65
2010	5	NA	7	5,960,684	748,435	3,825,518	77
2011	1	80,000	10	647,986	0	62,195	10
2012	0		1	4,422	0	0	0

The bond payout for packers averaged $145,701 per year or 4 percent of the valid bond claims. Additional restitution from packer trust assets and other sources bring the average recovery over the 7 years to 69 percent of total amounts owed, ranging from 0 to 100 percent each year.

As the livestock and meat industries evolve, P&SP continues to examine alternate ways to effectively regulate and monitor the industries and to effectively allocate its resources for planning and conducting regulatory compliance reviews. For example, P&SP adopted a statistical model to identify characteristics that place a livestock dealer, market, or packer at risk of financial failure. The characteristics identified are used, along with other firm information and market intelligence, to assess the need for financial audits.

3. PACKERS AND STOCKYARDS PROGRAM MANAGEMENT

The P&SP executes its management function through strategic, broad, multi-year goals and shorter term tactical annual objectives and activities. The next section addresses how P&SP improves its performance and efficiency, and the results P&SP is demonstrating.

3.1 Performance Measurement

P&SP measures its overall performance by annually measuring the regulated entities' compliance with the P&S Act. The performance measure encompasses activities P&SP conducts that directly or indirectly influence industry compliance. P&SP calculates the percent of industry entities in compliance using random samples designed to provide an estimate of compliance with a 90-percent confidence level. In 2012, P&SP increased industry compliance to 87 percent.

3.1.1 Performance Results

P&SP's overall performance rate is a composite index of five program-wide audit and inspection activities based on a scientifically-drawn random sample of subject entities. Note that this sampling approach provides estimates of industry-wide compliance among all subject entities, which will generally differ from simple ratios of number of violations found to number of entities investigated or inspected as illustrated in some previous tables in this report.

In 2012 the index included: 1) the financial components of the poultry contract compliance; 2) financial reviews of custodial accounts; 3) financial reviews of prompt payments of a random sample of firms; 4) inspection of scales and weighing practices at markets, dealers, and poultry integrators, and 5) inspection of all carcass evaluation devices and carcass evaluation practices for packing plants purchasing more than 1,000 head per year.

The sampling process is designed to yield 90-percent confidence for the estimated population compliance. The compliance rate increased to 87 percent last year after declining to 76 percent in 2011 year and was 7 percentage points higher than the rate from 2008 through 2010 (Figure 9).

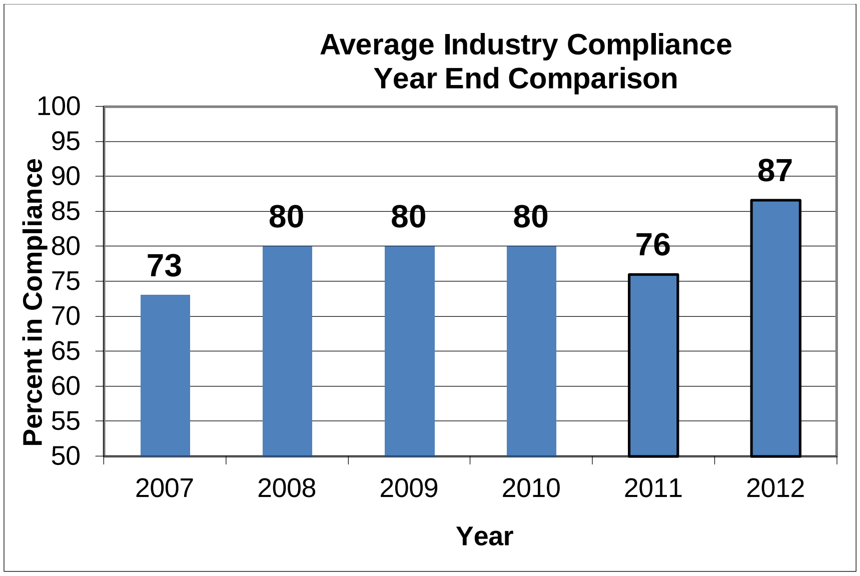

Figure 9. Aggregated Industry Compliance 2008-2012

Financial reviews are conducted and overseen by P&SP staff auditors and supervisors, many of whom are licensed Certified Public Accountants. The reviews are carried out in accordance with general accounting standards. Business practice inspections of scales and weighing practices are conducted based on standards established by the National Institute of Standards and Technology and supervised by staff trained in inspection procedures.

P&SP validates reviews and inspections through internal compliance reviews, which were designed in conjunction with a private consultant, and adhere to the P&SP Standard Operating Procedures.

While there has been additional focus on activities to achieve industry compliance, general economic conditions within the industry also affect year-to-year compliance. Weak economic conditions may increase the incentive for industry non-compliance in the financial components to a larger degree than in the business practice enforcement areas. The full effect of these external conditions on the compliance rate are not known, and to the degree that this measure only has a 5-year history, understanding the interaction of these variables on the overall compliance rate will be a challenge GIPSA confronts in future years. Additionally, GIPSA is just beginning to use the data to make internal adjustments to ensure resources are effectively deployed to meet changing industry conditions that result from external factors such as liquidity concerns.

The results of the individual component inspections and audits that comprise the aggregate index showed a year-to-year increase in compliance rates in 2012 for all of the five areas reviewed. Improvement in the poultry payment review has been especially steady, increasing from the initial rate of 60 percent in 2009 to 85 percent in 2012 (Figure 10).

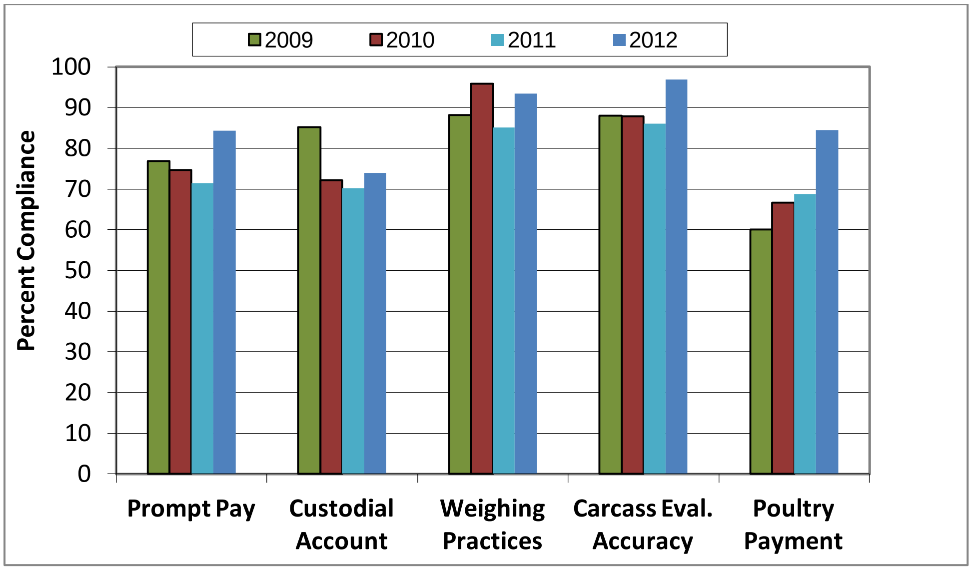

Figure 10. Compliance Performance Measure Components 2009 – 2012.

3.1.2 Relationships between Closed Field Activities, Industry Compliance, Number of Industry Financial Failures, and Dollar Amount of Financial Failures

Two key P&SP resources, the number of employees and budget, held relatively constant from 2002 to 2012 while key output performance measures dramatically improved over the same time period. These relations show a significant increase in the capacity of the program to do more with approximately the same level of resources (Figure 11).

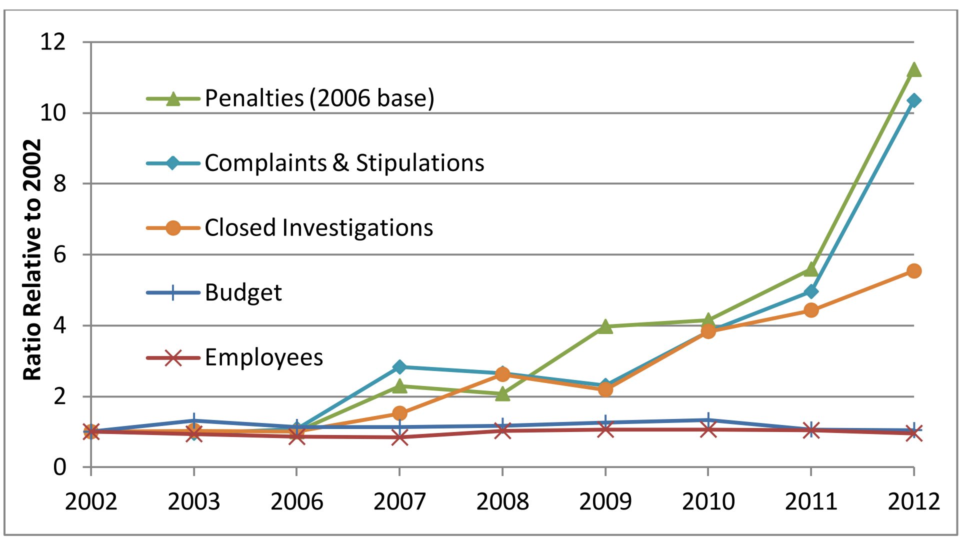

Figure 11. Trends in Key P&SP Resource And Performance Outcome Indices, 2002 To 2012.

These data along with the annual declines in the total number of financial failures (defined as a payment from a regulated entity's bond or trust funds) and in the total dollar amount of financial failures raise the question as to whether there is a direct relationship between P&SP activities and the incidence and dollar amounts of financial failures. To examine this question, agency activity and performance data as well as industry compliance data from 2000 to 2012 were statistically analyzed.

The statistical analysis involved estimating four regression equations as a system of simultaneous equations using three-stage least squares. The dependent variables in the four equations were annual measures of 1) Closed Field Activities, 2) Industry Compliance, 3) Number of Failures, and 4) Dollar Amount of Failures. Explanatory variables for the first equation are Budget and Number of Field Employees; for the second equation are Closed Field Activities and Formal Complaints (complaints filed by P&SP with the office of the Administrative Law Judge); for the third equation the variables are Industry Compliance. Dollar Amount of Failures, the London Interbank Offered Rate (LIBOR), and the Total Livestock Head Traded; and for the last equation the variables are Compliance, Number of Failures, Total Head Traded, and Year.

The endogenous variables for the system are Closed Field Activities, Budget, Number of Field Employees, and Compliance. The exogenous variables are Amount of Failure, Total Head Traded, Complaints, Year and the LIBOR index. The respective R-squared values for the equations are 0.95, 0.90, 0.85, and 0.66. The F-statistics for the equations are all significant at the 99 percent probability level. With the exception of Budget, all the explanatory variables have one-tailed t-statistic significance above the 90 percent probability level, and all but two variables were significant at more than 95 percent on a two-tailed test.

Graphical analysis of the results illustrates the change in agency performance over time and the effect of key agency activities on the regulated industry. For example in 2006 roughly 979 field activities were closed, along with 38 formal complaints filed with the Administrative Law Judge office. Substituting these values into the equations yields a predicted industry compliance of about 70 percent (Figure 12). To simulate conditions approximating 2012, the number of complaints increased to 124 and closed field activities had increased to approximately 1,918 at the time of the analysis. These two activities, increased closed field activity and increased complaints, explained 89 percent of the variation in the data for predicting industry compliance. Also, changing these levels in the prediction equation from the 2006 to the 2012 values resulted in an increased predicted compliance of roughly 18 percentage points, from 70 percent to 88 percent, almost identical to the actual compliance attained in 2012 (87 percent) (Figure 12).

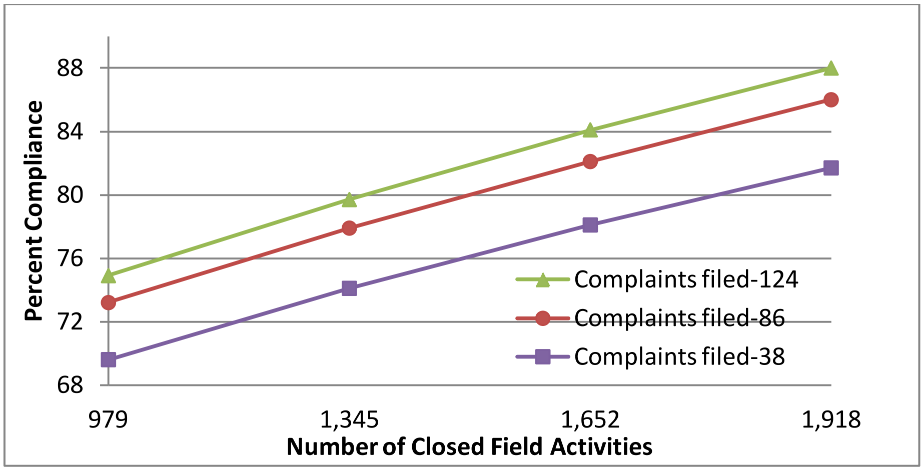

Figure 12. Percent Compliance with the P&S Act as Number of Closed Field Activities and Formal Complaints Increase.

The non-linear curvature in the responses to field activities reflects diminishing returns and also that natural logarithms of the variable provided better statistical results than the non-logged data. The number of predicted financial failures, on average, declined from roughly 28 to 4 when comparing 2006 to 2012 levels of closed field activities and complaints (Figure 13). Multiple payouts from the same bond or trust fund are counted as one financial failure.

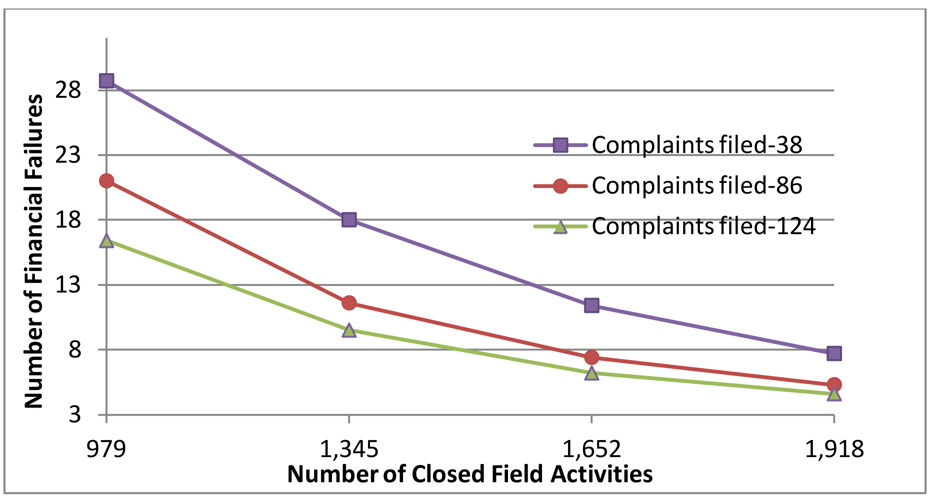

Figure 13. Average Number of Industry Financial Failures per Year as the Number of Closed Field Activities and Formal Complaints Increase.

Total amounts of predicted failures also declined from an average of $5.5 million per year to roughly $0.2 million per year when comparing simulated levels of closed field activities and complaints at the 2006 and 2012 levels (Figure 14).

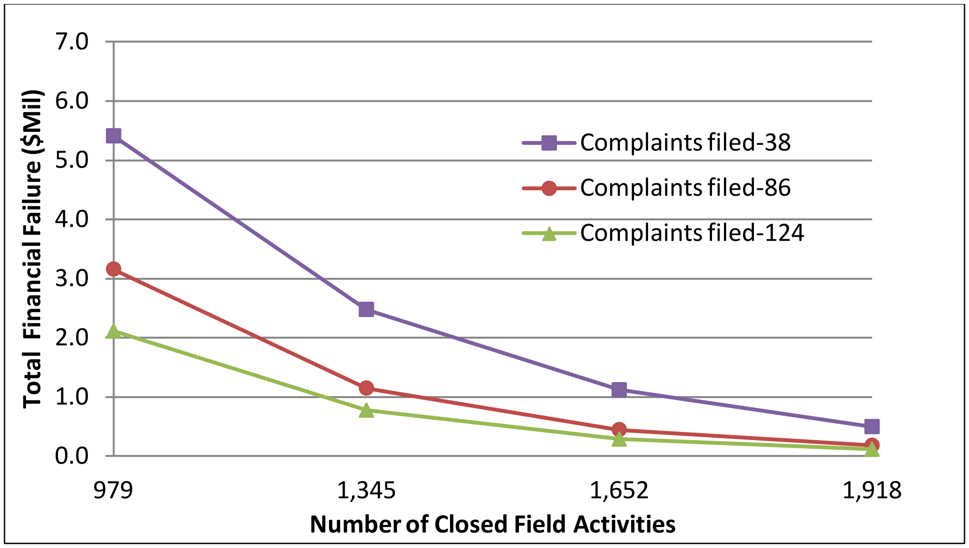

Figure 14. Average Total Amount Owed ($ Millions) per Year Prior to any Reimbursement from Financial Failures as the Number of Closed Field Activities Increases and Number of Formal Complaints Filed Increases.

As with closed field activities, there is a non-linear response to the number of complaints, illustrated in this case by the lines being closer together as the complaints increased by fixed increments of 48 complaints (from 38 to 86 to 124). That is each additional increment of complaints has a diminishing effect on reducing failures.

While the model predicts the average values for compliance, number of failures, and annual dollar amount of the financial failures, the mean squared error for an equation can be used to simulate the predicted values of alternate probability bands. For example, using the mean squared error from the Amount of Failure equation, the 90 percent probability band upper boundary drops from roughly $18 million to less than $2 million per year when comparing the 2006 and 2012 levels of closed field activities (979 versus 1918 closed field activities) with the number of formal complaints set at 86 (Figure 15). Alternately stated there is only a 5 percent probability that the failures would exceed $2 million at the 2012 level of compliance and closed field activities (the other 5 percent is below the 90 percent probability boundary line).

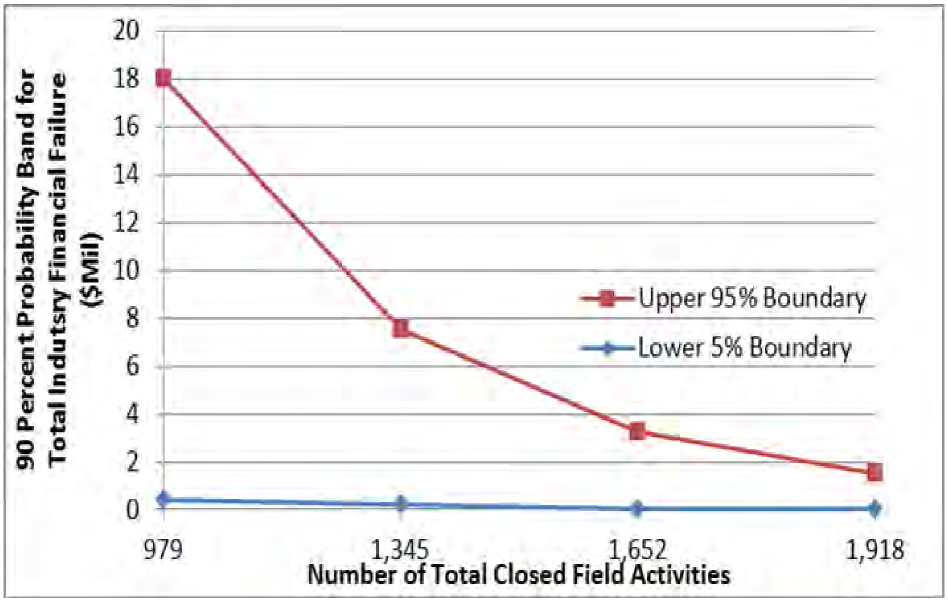

Figure 15. 90 Percent Probability Band for Total Amount Owed Per Year With 86 Formal Complaints Filed, Prior To Any Reimbursement From Financial Failures As Number of Total Closed Field Activities Increases.

The first equation in the system of equations established a link between number of employees and agency behavior, specifically closed field activities. The result indicated that the number of field employees explained 95 percent of the variation in closed field activities, while only 5 percent of the variation in closed field activities was explained by other factors. The combinations of total number of closed field activities and the number of field employees were 979 closed activities with 34 field employees; 1,345 activities with 41 field employees; 1,652 activities with 48 field employees; and 1,918 activities with 55 field employees.

3.2 Efficiency Measurement

P&SP measures its efficiency at achieving industry compliance by the number of days it takes to complete the investigative phase (the time from complaint until the investigation is closed by P&SP or a decision is made whether to refer the case to OGC or DOJ for possible enforcement action) of investigations. The time to conduct the investigative phase is only one measurement in the complex process of conducting an investigation and potentially building a case. After referral, P&SP and OGC typically work together to develop adequacy and quality of evidence, determine witness availability, and complete final case preparation. The average days to conduct an investigation and close the case decreased in 2012, after increasing in 2011 (Figure 16).

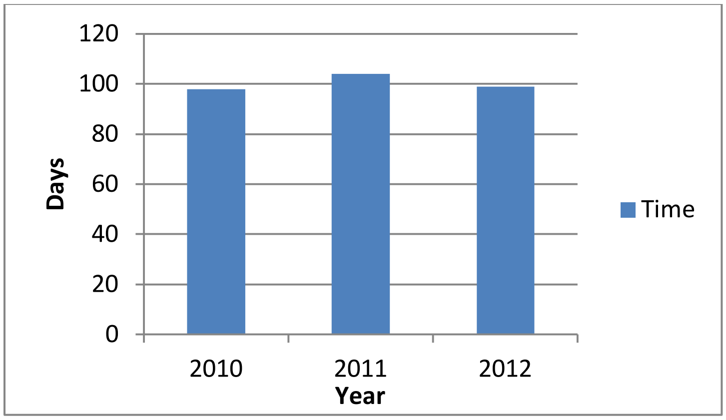

Figure 16. Average Days to Conduct Investigation from Opening to Closing or Referral to OGC, 2010 – 2012

The data in Table 8 show total days to completion of investigative and regulatory field and office activities, averaged across activities completed by P&SP regional offices. Field activities are conducted at the location of the regulated business entity. Office activities are conducted in GIPSA offices and are typically filing violations, e.g., failure to submit required documentation. Data in Table 8 do not include additional time spent on case development and processing for any investigative files forwarded to Headquarters.

Table 8. Field and Office Investigations and Regulatory Activities Closed and Activities Open at End of the Fiscal Year, Fiscal Year 2012

	Field Activities		Office Activities	
Type	No.	Avg. Days Open	No.	Avg. Days Open
Investigative Activities				
Closed during year	806	137	1782	59
Open end of year	69	151	623	85
Regulatory Activities				
Closed during year	1310	22	843	18
Open end of year	40	16	25	15

Investigations address a broad range of potential violations under the P&S Act and are grouped into three categories of competition, trade practice, or financial violations. Competition violations often involve preferential treatment or restriction of competition, such as through apportionment of territory. Examples of trade practice violations include offenses such as unfair or deceptive practices, failure to register properly, tariff misrepresentation, and misuse of scales and improper weighing practices, including at any location where scales are used to weigh feed when feed is a factor affecting payment to livestock producers or poultry growers. Examples of financial violations include misuse of custodial accounts, failure to pay, and failure to pay when due (Table 9).

Table 9. Number of Investigations Closed at Regional Level in 2012 by Investigative Category

Investigative Category	Number
Competition	
Restriction of Competition	12
Preferential Treatment	6
Concentration/Industry Structure	1
Financial	
Bond Activities	712
Failure to Pay/Pay When Due	283
Custodial Accounts	153
Solvency	70
Annual Report	6
Packer/Poultry Trust	8
Trade Practice	
Registration/Jurisdiction	686
Weighing Practices and Scales	423
Unfair/Deceptive Practices	145
Contract Poultry Arrangements	32
Inadequate or False Records	13
Grower Termination	13
Procurement or Sales Review	14
Reparations	4
Merchandising	3
Tariff	1
Total*	2588

* Includes investigations for which regional-level work was completed in 2012 and the cases were referred to headquarters, but may have remained open at headquarters at year-end. Thus the total differs from the total in Table 10.

P&SP's regulatory and investigative actions often find that entities are in compliance with the P&S Act. When non-compliance is identified, P&SP either assesses fines or stipulations for admitted violations or pursues enforcement litigation with OGC. After referral but before filing, OGC works with P&SP to prepare the referred cases for filing and litigation before a USDA Administrative Law Judge or for referral to DOJ.

In fiscal year 2012, P&SP opened 3,044 investigations, of which 3,020 were alleged violations for financial or trade practice behaviors. During the fiscal year, P&SP closed 2,545 cases without referring them to OGC (Table 10).

Investigations resolved by P&SP are closed either through a finding of no violation, a Notice of Violation letter issued to the entity, or a stipulation settlement in which the respondent admits the violation and voluntarily agrees to a penalty. Notice P&SP closes cases that are not referred to

Table 10. Number of Investigations Opened and Closed by Category and Enforcement Action, with Average Days to Complete Stages for Closed Cases, Fiscal Year 2012

	Average Days				
Status & Type	In P&SP	Referral to Filing	Filing to Resolution	Start to Resolution	Number
A. Total Investigations Opened					
Livestock					
Competition					22
Financial					1,493
Trade Practice					1,408
Poultry					
Competition					2
Financial					21
Trade Practice					98
Total Opened					**3,044**
B. Total Investigations Resolved and Closed by P&SP					
Livestock					
Competition	114			114	17
Financial	81			81	1,197
Trade Practices	90			90	1,212
Poultry					
Competition	88			88	1
Financial	98			98	13
Trade Practices	169			169	105
Weighted Averages & Sub Total	**89**			**89**	**2,545**
C. Total Referred to OGC and Closed					
Livestock					
Competition w/o Admin Action	135			805	1
Financial w/ Enforcement Action	177	347	226	749	69
Financial w/o Admin Action	254			667	22
Trade Practice w/ Enforcement Action	244	465	261	970	30
Trade Practice w/o Admin Action	264			762	13
Poultry					
Financial w/Enforcement Action	190	316	63	696	1
Financial w/o Admin Action	192			575	5
Trade Practice w/Enforcement Action	337	323	247	906	1
Trade Practice w/o Admin Action	375			785	10
Weighted Averages & Sub Total	**223**	**382**	**235**	**714**	**152**
D. Total Referred to DOJ and Closed					
Livestock					
Financial w/Enforcement Action	328	161	363	1,012	7
Financial w/o Admin Action	293			1,160	9
Poultry					
Trade Practice w/Enforcement Action	344	158	296	854	6
Trade Practice w/o Admin Action	685			914	3
Weighted Averages & Sub Total	**362**	**83**	**173**	**811**	**25**
Overall Weighted Averages and Total	**99**	**339**	**226**	**131**	**2,722**

Table Note: Investigations opened during the fiscal year are not necessarily closed by year end. The number of days per stage applies only to cases closed during the fiscal year. Typically some closed cases were opened in prior years. Cases closed by P&SP after referral to OGC without a formal administrative action are indicated by "w/o Admin Action." The "Referral to Filing" column in section C is the time that the case is in OGC prior to filing. The "Filing to Resolution" is the time from when a complaint is formally filed with the court clerk until a judicial decision.

OGC or DOJ within an average of 89 days, significantly shorter than cases that enter into the enforcement channel for a hearing before an Administrative Law Judge or a Federal Court as would be expected.

Another 177 cases were resolved that had been referred to OGC, including 25 that had been referred further to DOJ. Cases are referred to OGC when P&SP determines that the investigation requires cooperation with OGC. Frequently in competition and cases involving large financial failures, OGC and P&SP continue to develop evidence with the goal of filing a complaint.

The average number of days for cases referred to OGC is calculated based on whether the cases were referred to DOJ for prosecution. Cases not referred to DOJ required an average of 223 days in P&SP; cases referred to DOJ required an average of 362 days in P&SP.

Table 10 represents only cases that were closed in 2012, and includes some cases that were initiated in years prior to 2012. As a result of referrals from P&SP, 101 administrative actions that had been filed by OGC were closed in 2012, and OGC closed an additional 51 cases after determining that evidence did not support formal administrative action. DOJ closed 12 cases that OGC had referred to it without formal action, and 13 cases with formal action.

4. ASSESSMENT OF THE INDUSTRIES

This section contains an assessment as requested by Congress of the industries that P&SP regulates. The first subsection provides an assessment of the general economic state of the regulated industries, including trends in the number of firms, financial conditions, and the percentage of the market held by the four largest firms of a particular sector (market concentration). The second subsection examines changing business practices of firms in the regulated industries, including pricing methods, and particularly pricing on live weight versus carcass weight; procurement methods, with a focus on commitments to procure more than 14 days before slaughter versus transactions conducted on a cash-carry or spot basis; and trends related to the volume marketed through market agencies via commissions versus direct purchases. Finally, this section outlines specific concerns about the behavior or conduct of the entities regulated under the P&S Act and P&SP's actions to address those concerns.

Data in this section are generally from regulated industry annual reports to P&SP. Since those reports for the 2012 reporting year are not due until April 15, 2013, most statistics in this section are for entities' 2011 reporting year. Exceptions are statistics on firms currently bonded and/or registered as recorded in P&SP databases and types of procurement methods.

The number of entities subject to the P&S Act shows some sign of stabilizing in recent years with small increases in number of entities of each type except for a decline in the number of poultry dealers in 2012.

The four largest slaughter firms' share of the total value of livestock purchases (i.e., aggregate industry concentration) remained constant in 2011 after declining nearly four percentage points in 2010. Patterns of concentration in the purchase of different types of livestock, however, have exhibited varying trends.

The four-firm concentration ratio by volume of steer and heifer slaughter was relatively stable in recent years until an increase by four percentage points in 2010, but declined by one point in 2011. Cow and bull slaughter concentration remained unchanged after declining slightly in 2009 and again in 2010.

Concentration in hog slaughter increased sharply in 2003, declined in 2006, increased in 2007, remained essentially steady through 2011. Concentration in sheep slaughter declined in the first half of the decade then increased in 2005 and remained steady through 2009, then declined by five percentage points in 2010 and six points in 2011.

Carcass-basis purchases were fairly constant in cattle and hogs at 59 and 76 percent of total purchases, respectively, but increased for calves and lambs. Carcass-basis pricing tends to correlate with trends in increased contracting for procurement and reductions in the volume of transactions through market agencies. These trends started over 10 years ago in the livestock/meat sector and will be resistant to change, even in the face of economically stressful conditions since they are related to cost-saving motives for increased coordination of livestock, poultry, and meat production and marketing.

The use of formula pricing methods for fed cattle increased in 2011 and into 2012, as the use of negotiated pricing declined. Packer feeding increased slightly, and forward contracting declined slightly. Packer feeding and forward contracting represent about 6 percent and 11 percent, respectively, of total fed cattle procurement. Patterns of use of alternative procurement and pricing methods for hogs were relatively unchanged in 2011 and 2012, with about 68 percent purchased through various types of marketing arrangements, about 28 percent fed by packers, and the balance of just under four percent purchased on the negotiated spot market.

Concentration in poultry slaughter changed little in 2011. Unlike the livestock industry, which relies on contract procurement to coordinate the market supply channel, the poultry industry has been almost completely vertically integrated for several decades. As a result, the use of spot markets for poultry is virtually nonexistent.

At the end of fiscal year 2012, there were 295 bonded livestock slaughter firms, 133 live poultry dealers, 4,619 registered dealers, and 1,234 market agencies that were subject to the P&S Act (Table 11). There were also 1,238 posted stockyards.

- Bonded slaughter firms include firms operating Federally-inspected plants as well as some firms operating plants that are not Federally-inspected. Some firms with smaller volume purchases voluntarily bond but do not file annual reports. All packers operating in interstate commerce are subject to the P&S Act, which requires firms that purchase $500,000 or more of livestock for slaughter to be bonded and to file annual reports.
- Livestock dealers purchase livestock for resale on their own accounts and take title to the animals. They may also purchase or sell as the agent or vendor of another entity.
- Market agencies are entities engaged in the business of buying or selling livestock in commerce on a commission basis, furnishing stockyard services, or, in rare cases, an entity providing State brand inspection services.
- Live poultry dealers, commonly called poultry integrators, contract with producers for grower services to raise chicks to slaughter size and weight. The integrator slaughters and further processes the poultry.
- Posted stockyards are physical facilities and are not necessarily separate businesses. For example, a county fairground may be registered as a posted stockyard. Terminal market agencies and auction market agencies are located at posted stockyards, but may or may not be the same entities that own and operate the stockyards.

Table 11. Number of Slaughterers, Live Poultry Dealers, Bonded Dealers, Bonded Market Agencies, and Posted Stockyards Subject to the P&S Act, 2003-2012

Year	Bonded slaughter firms	Live poultry dealers	Bonded dealers	Bonded market agencies	Posted stockyards
2003	338	NA	4,675	1,575	1,429
2004	314	NA	4,152	1,457	1,443
2005	312	NA	4,100	1,447	1,426
2006	304	NA	3,984	1,433	1,400
2007	296	NA	3,883	1,410	1,413
2008	281	126	4,685	1,326	1,392
2009	284	125	4,529	1,225	1,170
2010	233	117	4,468	1,205	1,209
2011	258	136	4,572	1,220	1,218
2012	295	133	4,619	1,234	1,238

4.1 General Economic State of the Livestock Industry

This section addresses slaughter volume, changes in plant size, and industry concentration based on data obtained from annual reports filed by the industry with P&SP. The volume of business of packers and the dollar volume for firms selling on commission and for firms operating as dealers or purchasing on commission basis continued to increase in 2011, following increases in 2010. The temporary decline in these measures in 2009 may have reflected a changeover in GIPSA's data tracking system (Figure 17).

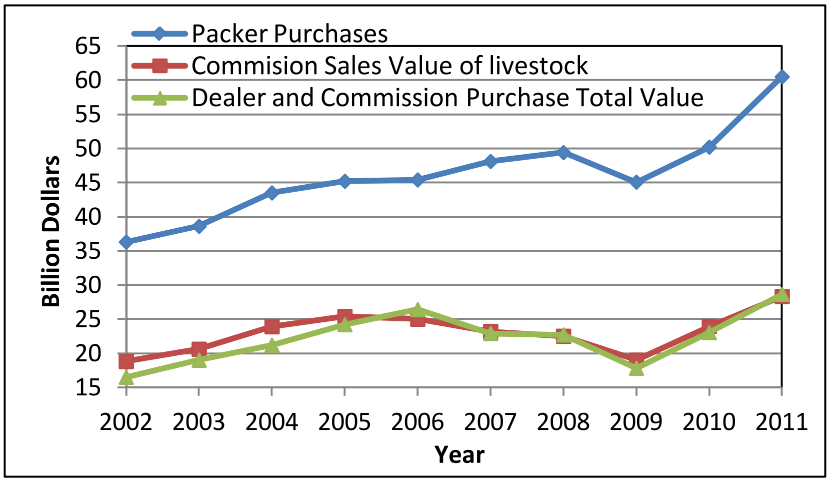

Figure 17. Dollar Volume of Slaughter Firms, Dealers, and Market Agencies Selling and Buying on Commission Subject to P&S Act, 2002-2011.

The volume of hogs slaughtered by firms reporting to P&SP trended upward through most of the last decade, but declined by around 3 percent or 3.1 million head in 2010 and another 2 percent or 1.2 million head in 2011 (Table 12).

The volume of cattle slaughtered by firms reporting to P&SP (firms with livestock purchases that equal or exceed $500,000 per year) has been more variable, as it fluctuates with the cattle cycle. Total cattle slaughter by firms reporting to P&SP trended downward from 2000 through 2005 then increased in 2006, but has remained within a 1 million head band since. Total cattle includes steers and heifers (often collectively called "fed cattle"), cows, and bulls, but excludes calves. In most but not all cases, individual plants operated by firms that report to P&SP tend to slaughter either fed cattle or cows and bulls.

By contrast, the volume of sheep and lambs slaughtered by packers reporting to P&SP declined from 1998 through 2008, with the sharpest single year decline between 2007 and 2008. The volume increased in 2009 but resumed decline in 2010 and 2011, with total slaughter of just over 1.8 million head in 2010. Although these year-to-year changes would be relatively large on a percentage basis, sheep and lamb slaughter has been a very small number for many years in comparison to other types of livestock slaughter.

Table 12. Purchases for Slaughter by Type of Livestock, Firms Reporting to P&SP, 2002-2011 (Thousand Head)

Year	Cattle	Hogs	Sheep and Lambs
2002	33,713	97,080	2,669
2003	35,124	97,161	2,179
2004	32,460	98,588	2,464
2005	31,254	101,183	1,988
2006	32,106	104,549	2,033
2007	33,023	108,582	2,504
2008	31,959	109,002	1,847
2009	32,145	113,222	1,955
2010	32,988	110,106	1,927
2011	33,780	108,941	1,819

The pattern of changes in slaughter plant numbers demonstrates the increasing size of slaughter plants, especially with respect to hog slaughter (Table 13). While total volume of hog slaughter increased, the total number of plants decreased by over 30 percent from 2000 through 2008. The number of hog slaughter plants was somewhat stable from 2004 through 2007, but in 2008, economic conditions, mergers and acquisitions, and efforts to approve efficiencies resulted in a large decline in the number of plants. The number of hog slaughter plants increased in 2009, and has remained relatively stable since.

The number of cattle slaughter plants reporting to P&SP declined by approximately 60, or 27 percent, from 1998 through 2003, as plant sizes increased and smaller plants closed. The number of slaughter plants remained stable until 2008, when there was a decline of 30 plants. The number of plants again remained relatively stable until an increase in 2011, but a gradual reduction in total numbers is expected as financial conditions make larger firms look for ways to reduce costs and operate more efficiently.

The number of plants slaughtering sheep and lambs was relatively constant from 2002 through 2010, with a small decline from 2005 through 2008 offset by an equal increase through 2010. The number of slaughter plants increased by 11 in 2011. However, many of these are small multispecies plants that slaughter only a few sheep and lambs.

Table 13. Number of Slaughter Plants Operated by Type of Livestock, Firms Reporting to P&SP, 2002 - 2011

Year	Cattle	Hogs	Sheep and Lambs
2002	171	175	55
2003	164	154	55
2004	173	166	56
2005	172	163	58
2006	168	159	55
2007	165	165	56
2008	135	126	52
2009	133	134	54
2010	135	129	59
2011	147	136	70

While four-firm procurement concentration is relatively high in some types of livestock, e.g., steers and heifers, the major slaughter firms tend to be multispecies firms. The various meat outputs, especially beef and pork, compete as substitutes in their product markets. When evaluated on a multispecies basis, concentration is relatively moderate. The four largest slaughter firms' share of total industry expenditures on livestock for slaughter remained at 67 percent in 2011, about the same as the 2008 level after an increase in 2009 to about 71 percent (Table 14). Cross-species competition among the firms in output, e.g. beef versus pork, may tend to limit the effects of concentration in procurement.

The percentage of the total volume of steer and heifer purchases accounted for by the four largest firms that slaughter steers and heifers dropped slightly to 84 percent following an increase to 85 percent in 2010. Prior to 2010, concentration in steer and heifer purchases had remained around 81 percent since the mid-90's. Concentration in cow and bull slaughter has always been less than fed-cattle slaughter concentration. Although it trended upward from 1999 through 2008 as a result of smaller packers ceasing operations and consolidation among remaining firms, the share subsequently declined slightly and remained unchanged in 2011.

The four-firm concentration ratio for hog slaughterers was roughly 56 percent in the late 1990s and then increased to near 65 percent in 2003. It remained in the mid 60's range through 2011.

Due to the small total slaughter volume sheep and lambs, relatively moderate volume adjustments by any of the largest four firms result in relatively large changes in the percent of total slaughter accounted for by those firms. The combined market share of the four largest sheep and lamb slaughter firms trended steadily downward from 1998 through 2004. The long-term trend reversed in 2005, declined in 2006, returned to 2005 levels in 2007 through 2009, but decreased by five percentage points in 2010 and six in 2011. Throughout these years, changes in shares represented only a few thousand head of slaughter lambs.

Table 14. Four-Firm Concentration in Livestock Slaughter by Type of Livestock, Selected Years, 2002-2011

Year	Total Value Purchases (%)	Steers & Heifers (%)	Cows & Bulls (%)	Sheep & Lambs (%)	Hogs (%)
2002	64	79	39	65	55
2003	69	80	44	65	64
2004	67	79	43	65	64
2005	67	80	48	70	64
2006	66	81	54	68	61
2007	66	80	55	70	65
2008	68	79	55	70	65
2009	71	81	54	70	63
2010	67	85	53	65	65
2011	67	84	53	59	64

Future changes in concentration are expected to follow the patterns of the last 5 years, subject to possible changes due to uncertainties about developments in the overall economy that began in 2008. Future changes in sheep slaughter concentration will continue to be variable due to adjustments among the four largest firms, but will likely remain in the 65-70 percent range.

4.2 Changing Business Practices in the Livestock Industry.

4.2.1 Procurement and Pricing Methods

The pricing method that sellers and purchasers agree to use for a transaction is a fundamental characteristic of any market transaction. For livestock and for cattle transactions in particular, pricing methods are most often divided into two categories: live-weight and carcass pricing methods.

In live-weight purchasing of livestock, the price is quoted and the final payment is determined based on the weight of the live animal. Transactions that use some variation of live-weight purchasing are usually on an "as-is" basis with a single price per pound for all animals in the entire transaction. The price may be fixed by negotiation in advance, or established from prices reported by a market price reporting service after the animals are delivered or slaughtered. In some instances, provisions may be made for paying different prices for animals that differ significantly from other animals in the transaction (e.g., animals that are much smaller than the average for the transaction may receive a lower price).

In a "carcass-based" purchase, the price is quoted and the final payment is determined based on each animal's hot weight, which is the weight of the carcass after it has been slaughtered and eviscerated. Carcass-based purchase methods often involve schedules of premiums or discounts based on animal quality and other features, such as time of delivery and number of animals in the transaction. The price before premiums or discounts is referred to as the "target" or "base" price. Carcass-based pricing typically rewards sellers with livestock that meet or exceed the target standard. Livestock carcasses graded below the target result in the seller receiving discounts.

The proportion of cattle purchased on a carcass basis has varied since 2001 with no obvious trend, ranging from around 53 percent to 63 percent of total purchases (Table 15). The proportion of cattle purchased on a carcass basis is expected to remain near 60 percent with modest fluctuation year over year, with some potential for increase if contracting and formula pricing continue to increase.

The proportion of calves purchased on a carcass-weight basis is considerably less than other types of livestock, but has exhibited a mixed pattern with increases in 2010 and 2011 nearly offsetting a large decline in 2009.

Table 15. Percentage of Livestock Purchased on Carcass-Weight by Packers Reporting to P&SP, 2002-2011

Year	Cattle	Calves	Hogs	Lambs
2002	62.8	42.7	74.2	60.4
2003	59.8	40.6	76.9	53.0
2004	53.4	50.4	76.6	46.1
2005	56.3	36.3	78.8	52.3
2006	53.3	33.7	76.6	48.1
2007	57.2	38.9	78.6	46.6
2008	62.3	46.1	87.8	55.2
2009	61.8	27.5	76.5	30.6
2010	59.1	36.2	77.5	31.6
2011	59.2	44.0	76.0	40.8

Carcass-based purchases have become the predominant method used for hogs purchased for slaughter. Some carcass-based purchases, often known as “carcass-merit” purchases, include a base price that applies to all carcasses in the transaction, with premiums or discounts for individual carcasses based on quality or other attributes of each carcass, such as quality grade, yield grade, yield, or percentage of lean meat in the carcass. Some carcass merit transactions use USDA grades to determine carcass quality. A growing number of transactions include price adjustments for quality characteristics that are not covered by USDA grades, such as percent of lean meat in the carcass and depth of the loin.

The proportion of sheep and lambs purchased on a carcass basis declined through the last decade to about 31 percent of the total in 2009 after peaking at about 70 percent of slaughter in 2001. The volume and proportion purchased on a carcass basis appear to have plateaued in 2009 and 2010, but increased by nearly 11 percentage points in 2011.

Another business practice affecting transactions involves the location in the market channel of the transaction. P&SP monitors two major transaction location points in livestock marketing. One major transaction point is exchange between the livestock producer and an assembly point, usually a market that accepts the livestock on a commission basis. The buyer procures the livestock through the market, generally with no direct contact between seller and buyer.

Although the volume of cattle handled by commission firms declined through 2008, these firms continue to play an important role in the cattle industry, particularly for cull cows (Table 16). The number of cattle marketed through commission firms increased since 2008 to near 2006 level in 2010 with only a small decline in 2011.

Table 16. Volume of Livestock Marketed Through Firms Selling on Commission, by Type of Livestock, Firms Reporting to P&SP, 2002-2011 (Thousand Head)

Year	Cattle	Hogs	Sheep and Lambs
2002	37,704	6,514	4,172
2003	38,319	7,274	3,444
2004	37,746	7,317	3,560
2005	37,284	7,573	3,145
2006	35,696	7,846	3,144
2007	35,263	8,395	2,772
2008	32,792	7,553	2,872
2009	33,214	9,047	2,883
2010	35,623	8,471	2,974
2011	34,956	8,919	3,046

The volume of hogs marketed by firms selling hogs on commission declined between 1999 through 2002, but trended steadily upward from 2002 through 2007. The pattern has varied in the last four years, and it remains to be seen whether this component of the industry will attain a stable level of activity.

Use of commission firms for the sale of sheep and lambs has followed a pattern similar to that of cattle with a slight increase since 2007, and will likely remain steady in the near term.

The second transaction location point monitored by P&SP is direct exchange between the livestock seller and the packer. Packers use multiple direct exchange procurement methods to obtain live cattle for slaughter. The methods commonly fall into two categories: (1) cash or "spot" sales for immediate delivery or normally delivery within at most 14 days, and (2) "committed procurement" arrangements that create an assured exchange and commit the cattle to a particular packer more than 14 days prior to delivery. Cash sales generally are priced on a negotiated basis, although various formulas may exist to establish premiums and discounts after the transfer. Committed procurement usually uses some form of formula pricing.

P&SP defines "packer fed" livestock as all livestock obtained for slaughter that a packer, a subsidiary of the packer, the packer's parent firm, or a subsidiary of the packer's parent firm owns, in whole or part, for more than 14 days before the packer slaughters the livestock. Marketing arrangements termed "forward contracts" are agreements between packers and sellers for deliveries more than 14 days in the future of specific lots or quantities of livestock. The price of the cattle in a forward contract can be set at the time of the contract or determined upon delivery based upon an agreed pricing arrangement.

The term “marketing agreements” includes a variety of arrangements that establish an ongoing relationship for trading multiple lots of cattle rather than negotiating single lots. In these arrangements, the seller agrees to deliver cattle to the packer at a future date, with the price generally being determined by some type of formula pricing mechanism. The price is often based on the current cash market at the time of delivery, with premiums or discounts determined by evaluation of carcass characteristics.

USDA’s Agricultural Marketing Service (AMS) publishes prices and volumes of livestock purchased under alternative pricing methods as reported under the provisions of the Mandatory Price Reporting Act (http://mpr.datamart.ams.usda.gov). The use of formula pricing methods and forward contracting for fed cattle increased in 2011 and continued to increase in 2012, as the use of negotiated pricing declined. Packer feeding remained relatively constant. Packer feeding and forward contracting represent about 6 percent and 11 percent, respectively, of total cattle procurement (Table 17).

Like beef packers, pork packers use multiple procurement methods. For all pork slaughter firms reporting to USDA’s Agricultural Marketing Services, 4.4 percent of hogs were obtained on the negotiated spot market in 2011 compared to 8.5 percent in 2008. Available data suggest that the proportion fell slightly in 2012. About 28 percent were packer-owned hogs in 2011 and 2012, which were normally supplied from a packer-owned farrowing operation and were often fed by an independent operation under contract for the packer. The rest were purchased using various types of other marketing arrangements, usually either some variation of marketing agreement or forward contract. Marketing agreements for hogs generally are based on multi-year contracts under which the producer agrees to deliver a set number of pigs per year to a packer. Some of these arrangements are verbal agreements. “Forward contracts” for hogs are typically simple one-time contracts for a given number of hogs to be delivered within a certain time window, with price based on a futures contract. Other modes of procurement for hogs are largely verbal contracts.

Table 17. Percent of Purchases by Type of Procurement Method, Fed Cattle versus Hogs, Firms Reporting to P&SP, 2008-2012

Method	2008	2009	2010	2011	2012
Fed Cattle					
Packer Owned	4.4	4.7	5.0	5.3	5.9
Forward Contract	10.8	8.4	10.6	12.1	10.9
Formula	34.4	36.5	39.3	43.2	49.2
Negotiated	50.5	50.4	45.1	39.4	34.0
Hogs					
Packer Sold	6.2	5.8	5.6	4.7	4.3
Packer Owned	24.4	25.2	26.7	27.8	28.0
Negotiated	8.5	6.8	5.2	4.4	3.6
Other Arrangements	60.9	62.1	62.5	63.1	64.1

Procurement methods used by individual packers vary significantly among packers, ranging from packers that are fully integrated to packers that rely primarily on the open market. Most hog packers use some combination of packer-fed hogs, marketing agreements, forward contracts, and negotiated spot market procurement. These combinations typically vary by plant for multi-plant packers.

Procurement methods used to purchase sheep and lambs for slaughter are similar to those used for other species and include purchase in spot markets, use of marketing agreements, use of various other forms of advance sales contracts, and packer feeding.

Some producers who feed their own lambs market their lambs through a lamb feeding operation or feedlot that has a supply contract agreement with a packer. There also are business arrangements in which individuals who have financial interests in large lamb packing companies also have lamb feeding operations and supply lambs to the packing company. Some producers participate in cooperatives, associations, or pools of lamb producers to collectively market their lambs and lamb products. As with other species, the various procurement methods used for lambs continue to evolve, but P&SP has not observed major changes in the methods in recent years and expects this stability to continue.

4.2.2 Changes in Operations and Organization

Information about business practices at the plant level such as intensity of operations (e.g., one or two shifts per day), along with number of plants in business at any given time and ownership of them, is also significant in describing industry trends.

Plant closures or re-openings can have direct competitive effects by shifting supply and demand patterns. The P&S Act does not provide authority to the Secretary for pre-merger review. Rather, that is the responsibility of either the DOJ or Federal Trade Commission under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (Public Law 94-435, known commonly as the HSR Act). Mergers and acquisitions, however, cause changes in business practices that may impact competition. P&SP monitors these industry events for any competitive effects.

In December 2011, investment firm Leucadia National Corporation agreed to acquire 79 percent of National Beef Packing Co., LLC (National) for $1.304 billion. US Premium Beef retained a 15.1 percent ownership interest in National. National Beef Packing Co. retained 5.3 percent of ownership, and CEO Tim Klein and family through TMK Holdings owns 0.65 percent of National.

In March 2012, JBS SA increased its majority ownership interest in poultry processor Pilgrim's Pride Corp. from 68 percent to 75.3 percent. JBS purchased 64 percent of Pilgrim's Pride shares at the end of 2009 from company founder Bo Pilgrim and associates.

In March 2012, Beef Products, Inc. (BPI) suspended operations at three of its plants that manufacture lean finely textured beef (LFTB). BPI continued running its fourth plant, in South Sioux City, Iowa only three days per week.

In April 2012, AFA Foods, Inc., a ground beef producer that also manufactured LTFB, declared bankruptcy. AFA, based in King of Prussia, Pennsylvania, had been one of the five largest producers of ground beef in the United States. From May to July, AFA sold four of its five processing plants to separate buyers. In May, AFA sold its Thomasville, Georgia facility to FPL Food LLC, and it sold its plant in Los Angeles, California to Tri West Investments which is affiliated with Central Valley Meat Co., Inc. In July 2012, AFA sold its King of Prussia, Pennsylvania plant to CTI Food Holding Co., LLC, and it sold its plant in Fort Worth, Texas to Cargill Meat Solutions, Inc. AFA's plant in Ashville, New York was closed in September 2012.

Also in April, Conagra Foods, Inc. purchased sausage producer Odom's Tennessee Pride, including plants in Arkansas and Tennessee, then in October announced intentions to close the Arkansas plant.

In July 2012, the North American Meat Association was formed as a merger of the National Meat Association and the North American Meat Processors Association.

In October, 2012, JBS USA assumed management of XL Foods of Canada's Brooks, Alberta plant, which had been shut down on September 27 due to an E coli-related recall of beef products. The plant re-opened October 29. JBS USA negotiated an exclusive option to purchase the Canadian and U.S. operations of XL Foods which includes the Brooks plant (4,000 head per day capacity); a beef packing plant in Calgary (1,000 head per day – closed since May, 2011); a feedlot in Brooks (70,000 head of one-time capacity); 6,600 acres of farmland adjacent to the Brooks feedlot; a cow processing plant in Omaha, Neb. (1,200 head per day capacity); and a cow processing plant in Nampa, Idaho (1,000 head per day capacity- closed since June, 2011).

Throughout 2012, continued widespread drought that negatively impacted grain production and thus increased prices of livestock feedstuffs had significant effects on production and prices in the livestock sector. According to USDA's Economic Research Service (ERS), as of mid-October 2012 producers faced significantly higher feed prices and heat stress on feedstuffs and livestock that will likely restrain growth of U.S. cattle and hog breeding herds. Lack of pasture and higher grain prices that further reduce prices of feeder cattle in the near term result in placing cattle on feed at lower weights than usual, leading to greater production declines in 2013 than in 2012 and higher prices in 2013 and beyond. Beef production in 2012 was projected to decline 2.3 percent from 2011 levels, and another 3.9 percent in 2013. Hog farrowings (litters of pigs) are expected to decline in the second-half of 2012 and the first three quarters of 2013 because of anticipated high feed prices. Pork production for 2013 is expected to be 1.3 percent below 2012 at 23.0 billion pounds.[2] Pork producers have been especially hard-hit by high feed prices due to

[2] http://www.ers.usda.gov/topics/in-the-news/us-drought-2012-farm-and-food-impacts.aspx

the drought and are expected to continue to suffer large losses through early 2013 after already operating in the red for several months, with one analyst estimating eventual total losses to accumulate to as much as three billion dollars.[3]

4.3 General Economic State of the Poultry Industry

In 2011, poultry processors reporting to P&SP slaughtered an estimated 49.0 billion pounds of chickens. By comparison, in 2011, the federally inspected (FI) volume was 50.4 billion pounds. This continues to reflect an upward trend in poultry slaughter since 1996, when FI volume was approximately 26 billion pounds. Turkey slaughter was an estimated 7.1 billion pounds by firms reporting to P&SP for 2011, slightly more than the reported FI volume of 7.1 billion pounds for 2011. Note that P&SP and FI statistics differ in part due to the fact that the reporting years for some P&SP firms are not the same as the calendar year represented by the FI statistics.

Concentration in broiler and turkey slaughter trended upwards from 2000 through 2008, but in 2009, the four largest broiler slaughterers posted a 4 percent decline to 53 percent of the market share compared to 57 percent in 2008. Their share has remained about constant since, at 52 percent in 2011. The share of the four largest turkey slaughterers similarly declined in the last two years, to a 55 percent market share in 2011. Concentration in poultry slaughter is expected to remain relatively stable when data for 2012 are available.

Table 18. Four-Firm Concentration in Poultry Slaughter, 2008 – 2011

Year	Broilers	Turkeys
2008	57	51
2009	53	58
2010	51	56
2011	52	55

4.4 Changing Business Practices in the Poultry Industry

On April 9, 2011 Omtron USA LLC, doing business as Townsends, had notified growers holding roughly 120 poultry growing contracts that economic conditions were causing Omtron to close its Siler City, North Carolina production plant and all grower contracts would be terminated. Omtron in fact closed the facility just prior to fiscal year 2012 was beginning, with the facility's last day of operation on September 28, 2011.

[3] http://www.agecon.purdue.edu/extension/prices/hogs/october2012.asp

In October 2011, Cagles, Inc. of Atlanta had declared chapter 11 reorganization bankruptcy, but with no immediate change in operations. In May 2012, Cagle's won court approval to sell its assets for about $93 million to JCG Foods LLC, an affiliate of Koch Foods Inc. JCG's officers announced intentions to invest in the infrastructure and expand production.[4] Also in October 2011, Industrias Bachoco S.A.B. de C.V. of Mexico entered the U.S. market by buying O.K. Industries, Inc., of Fort Smith, Arkansas.

In February 2012, Case Farms finalized acquisition of Ohio-based Park Farms. In March, Horizon Foods, LLP, an Arkansas limited partnership formed by a group of California investors, purchased a former poultry (broiler) plant in Pine Bluff, Arkansas, with plans to open it by June for spent fowl primarily for foreign markets. The plant was formerly owned by Tyson, which sold it in 2008.

In March 2012, JBS S.A. increased its majority ownership interest in poultry processor Pilgrim's Pride Corp. from 68 percent to 75.3 percent. JBS purchased the shares from company founder Bo Pilgrim and associates. JBS had purchased 64 percent of Pilgrim's Pride shares at the end of 2009.

As with cattle and hogs discussed above, drought-induced prospects for significantly higher feed prices and heat stress on crops are likely to continue to have negative impacts on poultry, with broiler production also expected to decline in 2013. USDA's Economic Research Service (ERS) reported that broiler production estimates for 2012 and 2013 have been reduced to 36,889 and 36,445 million pounds, respectively, down from 37,201 million pounds in 2011, due to higher feed costs.[5]

4.5 Industry Concerns

4.5.1 Transition in Cattle Markets from Commodity to Added Value Marketing

Ongoing changes in the marketing of cattle reflect some of the changes in hog marketing that took place in the 1990s. Additionally some of the changes in the cattle and hog industries reflect the marketing approach developed by the poultry industry as it developed in the 1960s. While differences in each industry ensure that the marketing of cattle, hogs, and poultry will likely remain unique there are nonetheless trends in the cattle industry towards greater levels of producer services being marketed along with the commodity. Producers and processors alike refer to those additional services as "added product values". The added product values vary

[4] http://www.businessweek.com/news/2012-05-15/cagle-s-wins-court-approval-to-sell-assets-to-koch-affiliate

[5] http://www.ers.usda.gov/publications/ldpm-livestock,-dairy,-and-poultry-outlook/ldpm-221.aspx

widely from commitments to deliver specific quantities of livestock at given dates, to agreements on use of antibiotics or growth hormones, to specific animal genetics, or agreements to provide services that produce product attributes with combinations of all these added qualities.

The cattle industry, particularly at the processor and producer level, has widely stated that the results achieved from adding value to a basic non-differentiated commodity benefit not just processors and producers, but benefit consumers also. These benefits arise in part from a market channel that is more efficient in responding to changes in consumer demand and in reducing costs of transactions throughout the market channel. Concurrent with an increase in the marketing of added value differentiated products by the producer has been an increase in the use of contracts. Within cattle contracts a frequent method of pricing the "added values" of the product is through a formula that applies premiums or discounts to the price paid in the negotiated spot market. The concern expressed by industry participants to P&SP is whether the resulting contract price is accurate or not.

In its general aspects the complaint is not unlike a producer's complaint regarding the accuracy of a scale used to weigh livestock when the scale reports an underweight. The producer is most likely to state that they were not fairly compensated due to the scale inaccuracy. In the case of the formula pricing mechanisms applied under cattle and hog contracts the most frequent complaint has been related to the low volume in the negotiated spot market being subject to price distortions of either an intentional or unintentional nature. And as a consequence, once the negotiated price fails to accurately reflect supply-demand conditions then the prices paid under contracts that reference the price would also be inaccurate. Before mentioning some of the other ways that contract pricing mechanisms have been expressed as potentially being inaccurate it is worthwhile to consider some of the trends in the cattle industry.

Nationally and regionally, cattle marketing has trended toward a much larger use of contracted marketing arrangements. For example, in 2000 the national negotiated spot market was roughly 62 percent of total volume on a head basis and by 2012 the share had dropped to 34 percent. Regionally the Texas-Oklahoma-New Mexico AMS price reporting region was lowest with a trend line through weekly data indicating a value of approximately 17 percent on a head basis as being sold through negotiated spot or grid transactions the first week of September 2012. Lower costs of transactions and additional revenues seem to be driving the trend towards increased contracting.

A sign of the economic incentives pulling the industry towards increased levels of added value transactions and contracting in general are programs being developed between the cow-calf producer and the feedlot. While there are many different types of programs, one example in southeastern Oklahoma in being fostered by the Samuel Roberts Noble Foundation and is called

Integrity Beef Alliance.[6] Analysis of the 2010 Integrity Beef commingled calf sale, provided by Oklahoma State University, revealed premiums of $6 to $20/cwt over calves marketed through other mechanisms.

Shifting from the upstream end of the market channel to the downstream end, retailers see benefits from distinguishing retail products by providing consumers with information about how the retail product was grown and manufactured. A force in potentially determining future access by packers to wholesale-retail markets is The Sustainability Consortium (TSC) initiated by Wal-Mart.[7] TSC has developed Key Performance Indicators (KPI) in the form of questions that can be used to assess and track performance in meeting sustainability issues related to a consumer product. For example, a question a processor would need to agree to answer and answer in a manner acceptable to TSC on beef productivity is: "What percent of cattle supply comes from suppliers that track productivity of cattle, set goals and have a program in place to optimize productivity while minimizing methane emissions and manure?" How processors and producers are able to answer such questions and agree to answer such questions would potentially determine their access to consortium member downstream distribution outlets.

Based on these trends increased levels of contracting and subsequent increased use of compensation setting mechanisms for product attributes or production services under contracts would seem to be the rule rather than the exception in future cattle marketing. Considering some of the potential inaccuracies in compensation setting mechanisms under contracts, it is useful to consider the poultry industry. Within poultry the marketing of service by poultry growers developed along with the industry itself, and is reflected in a highly integrated industry with poultry companies owning poultry hatcheries, feed mills, the slaughtering and processing facilities, and in some cases wholesale distribution capabilities for the processed retail-ready product. Outside of the integrated poultry market channel, poultry growers provide a service to the poultry companies through production contracts, raising company-owned chicks to a weight and size specified by the poultry company. Of the roughly 8.5 billion head slaughtered each year in poultry all but 2 percent on a per pound basis are raised through service production agreements, so in the case of poultry there is virtually no commodity market for slaughter-ready birds.

Compensation under the poultry production contract is set through administrative pricing mechanisms rather than marketing pricing mechanisms involving price discovery by buyers and sellers of a commodity.[8] The administrative pricing mechanism used in poultry is a relative performance system where the average cost of production for inputs provided to growers by the

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[6] http://www.noble.org/ag/economics/integrity-beef

[7] http://www.sustainabilityconsortium.org/

[8] See for example Chapter 11, Mechanisms for Discovering Farm Prices, in Agricultural Product Prices 3rd ed. William G. Tomek and Kenneth L. Robinson (1995) Cornell University Press.

poultry company (typically feed and chicks) for a particular lot of chicks is compared to a benchmark average cost set by a larger group of growers, which includes the grower. If the grower's average cost is lower than the benchmark, then the grower receives a premium. Alternately, if the grower's average cost of production is above the benchmark then the grower incurs a reduction or penalty in the payment received for raising the birds.

This commonly used relative performance administrative pricing mechanism has been termed a "tournament system" because the growers compete with other growers in relative small groups of 7-15 growers. Recently, however, one of the largest protein producing companies has revised its administrative pricing mechanism for compensating poultry growers so that the reference group is all growers providing poultry to a processing facility and the reference average cost is the 52-week moving average cost of all the growers supplying the facility. In poultry the growers tend to have limited mobility and the reference group is relatively static.

In assessing each of the two pricing mechanisms it appears that there exist a gradient between pure market pricing mechanisms and pure administrative pricing mechanisms with contract cattle pricing being closer to the market mechanism and poultry being a pure administrative pricing system. Cattle price differences are in large part based on quality in contrast to poultry, which is based on selected inputs' average cost. Additionally cattle producers have greater mobility in selecting comparable sellers they will compete against than does a poultry grower; however there are restrictions on that mobility, which make the comparison pool in both cases sellers who supply to a particular processing facility. And lastly, the cattle producer faces a pricing benchmark that in most cases is still set nationally rather than locally so that the comparison frame is anonymous.

Despite these differences, the similarities may place cattle producers into some of the same situations as poultry growers as they seek accurate compensation. In particular GIPSA frequently hears complaints that a poultry grower was disadvantaged in their compensation because they received inferior inputs, such as chicks or feed, which results in their being at a competitive disadvantage in the relative production rankings. Another complaint is that growers will be pooled into groups where they are disadvantaged because of the other grower's assets.

As the cattle market continues to evolve, cattle producers' sense of being placed at competitive disadvantages due to contract terms that require services or product attributes that are not required of other producers under the same compensation formula may emerge as a concern. Or the current complaint that formulas tied to negotiated market prices when the market price is distorted may be more analogous to the poultry complaint of being compensated based on being pooled with growers of dissimilar endowments. In fact many of the complaints that GIPSA receives from institutional players that are focused on market structural concerns such as concentration or use of alternative marketing arrangements generally, may be more directly related to inaccuracies in the pricing mechanism of the contract itself as opposed to concentration or the effect of contract cattle procurement on negotiated cattle prices.

Within cattle the question becomes more when and less if the movement into administrative pricing will inoculate regulated entities from certain anti-competitive provisions of the P&S Act. The second concern is related to enforcement of the P&S Act and to claims made regarding the accuracy, or equity, or fairness of pricing under administrative pricing mechanisms. Although P&SP has not received the level of complaints from cattle and hog producers as it has from poultry growers about the accuracy of prices paid under contract pricing mechanisms, long term industry trends suggest they may increase and current regulations and the P&S Act itself were designed to protect producers primarily under market based pricing systems. To the extent that cattle and hog producers see concerns developing within this area, the agency and the affected industry segments will need an increased amount of dialogue to discover appropriate regulatory policies.

5. STATUTORY TEXT COMMISSIONING REPORT

This report provides the annual assessment of the cattle and hog industries as required by Section 415 of the P&S Act. In addition, the report includes data and analyses for fiscal year 2012 that are consistent with the information included in previous years' reports.

Section 415. Annual Assessment of Cattle and Hog Industries. (f.n.)

Not later than March 1 of each year, the Secretary shall submit to Congress and make publicly available a report that—

(1) assesses the general economic state of the cattle and hog industries;

(2) describes changing business practices in those industries; and

(3) identifies market operations or activities in those industries that appear to raise concerns under this Act. (7 U.S.C. 228d)

f.n. P.L. 106-472, Nov.9, 2000

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Packers and Stockyards Program
1400 Independence Avenue, S.W.
Washington DC 20250-3601

www.gipsa.usda.gov

GIPSA Toll-Free HOTLINE

1-800-998-3447