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COMMENT

November 11, 2002

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Commodity Futures Trading Commission:

I am writing this letter to express my opinion in the matter in front of the CFTC, the proposed amendment to the spot month speculative position limits for the live cattle futures contract.

I am a fourth generation cattle feeding and farming operation. We feed cattle for ourselves as well as on a custom basis, with most our customers being ranch owners that retain ownership of the cattle they raise all the way to slaughter.

Over the past several years, nearly all of our clients and ourselves, have been using the futures markets more and more as a way to reduce our risk and price our products. We use them from both the long and short sides, to capitalize on opportunities that the futures markets have to offer. This has been growing, much to the credit of all Futures Exchange efforts and promotions.

I was quite baffled when I heard about the proposed change to reduce the speculative limit by 50%, in order to be "more in balance with deliverable supplies". Upon investigating this proposed change, I was told that there were not enough deliverable supplies and therefore, a problem with the basis that could be solved with the rule change.

What? Your kidding, right? Where is that in economics 101? If that were the case, there wouldn't be any deliveries. After giving the situation a great deal of thought, I came to several likely conclusions.

Those that requested the change, most likely were bear biased or outright short. And, most likely they were packers/processors, or hedged feeders, that had to deal with a large, strong speculator that was on the other side of their position. They did not like this speculator making them compete in the cash market for the best cattle available. If there would not have been large speculator willing to take those deliveries, the packers would have been able to keep control of those deliverable cattle, therefore being able to apply downward pressure on the futures and cash markets. What happened was, they lost control of those supplies and were unable to manipulate the price and force it lower. This is exactly why the speculator is such a extremely important part of any market. Without the large speculator, the futures and cash pricing systems would collapse, as we would all stop using it because of lack of speculators to sell to, or buy from. That is exactly what some in this industry want, a lack of buyers. You need to continuously work to INCREASE LIQUIDITY, not reduce it.

Beside the bogus statement that there is a shortage of deliverable cattle, it is also being suggested that the specifications should be changed to create more deliverable cattle by increasing the weight limits. Both of those proposals are misleading and intended to improve the bear bias on livestock prices. This will also only strengthen the oligopoly structure that exists .

Over the past two decades, the cow/calf producer has needed to produce more than ever before. This has been necessary in order to survive ever increasing costs, trying to get more return from each cow, by increasing the size of the offspring. What has happened over the last 20 years, is the fact that we very seldom have a problem with over fat cattle, yield grade 4's or 5's. We are now able to make them too big to fit the packers specifications, that have not changed with the increased production size. They would like you to change the delivery specifications, but they won't change their discount structure. We don't have to feed them too long, but we do because the packer figured out how to make us feed them too long.

Here is just one example of what happens. This just happened to a customer and close friend of mine that had his cattle in our feedyard. I will refer to this rancher as GVR. The summer of 2002 was the driest on record in most of Nebraska. Back in June, GVR was very concerned about the weather pattern so, the astute rancher decided he should send a good portion of his yearlings to the feedyard 60 days early to save grass and avoid buying feed for his other cattle in case it stayed dry. The cattle, 225 steers, arrived in our feedyard June 12, 2002. The projected finish date, after 120 days on feed, was October 10, 2002. In his marketing plans, it was decided to forward sell 55% of the cattle to a packer using the futures price and a basis contract, the balance of the cattle would stay in the cash market. On September 30, the unpriced part of his cattle were offered for sale. The telephone calls were made and the packer buyers came to look at the cattle. As I explained to the cash cattle buyers that there are only 100 head out of the 225 for sale, that evidently did not set too well with the buyers or something, as I could not get a bid. The 125 head were shipped on schedule, October 9. Finally, we were able to get the other 100 head sold and delivered October 15. But, here's what happened. We shipped 98 head to slaughter, ( 2 head were kept for the owner) and 46 out of 98 (47%) of his cattle were "heavies" (over 950 LB carcasses). The discount was $247.80 per head, or a total of $11,398.75, was deducted from his check because the average weight was 4.13% over the maximum weight. In other words, the extra 41lbs. of production per animal he produced, backfired. We wonder who got that $247.80 per head that GVR felt was stolen from him? Was that passed on to the consumer? Or, was the profit just put into the packers or retailers pocket? Unfortunately, GVR told me "I will never feed cattle again." It is not anything that we did. It is just that GVR feels there is no way to have a decent chance for the little guy of getting a fair price for his livestock, with the cash pricing system that exist today. You wouldn't believe the enormous number of cattle producers that this happened to this year.

Some would say, "Well, they are lucky to find anyone that would buy them." Ok, then why wouldn't they buy them when they didn't have the "heavies". Its not like we didn't try to get them sold. We were trying, but no one would buy them at that time. It was not until the speculator started taking the control away from the packers did we get them sold. Do you understand what has happened here? Do you realize that it is a common practice for the packers to cut kills schedules 20% per week? All they have to do is kill 32 hour per week instead of 40. They stay out of labor problems by killing 32 hours and do so quite often just to avoid stepping into the cash market when they are short of live inventory. All the while, backing up supplies 20% for the week! I am convinced if it would not have been for these people willing to step in and take those deliveries, we would have collapsed the live cattle prices, right then and there.

As I write this letter, it becomes more obvious to me than ever before, that the livestock cash pricing system is broken, not the futures system. There is a powerful group that want to see the futures that way too. All that would happen if the speculator limit is cut in half, would be to make it that much worse. If you allow this amendment to pass, the futures system will become worthless and we will stop using it.
I suggest you talk to some South Dakota cattle producers, to help you understand what has happened to the cash market. It is an incredible story and you need to understand how this oligopoly is overpowering the United States producers. There are a great number of operations that no longer have buyers coming to their feed yards. They are forced to take their cattle to an auction barn and be at the mercy of one or two bidders. There is substantial risk here to food production in this great country.

It would be especially devastating to the cash market of you allowed the weight limit to be increased. Who in their right mind would be willing to except delivery cattle if the chances for $247 per head discounts at the slaughter house would be applied. If you allow the weights to be increased, you will break the cattle industry and make the futures delivery points a huge dumping ground for undesirable cattle.
Ladies and Gentlemen, I implore you to veto these proposed amendments. You have done a great job of not caving into the pressure of the few and powerful, standing up for what is right for the markets and this free country. Too bad that cannot be said about the SEC, as they did not see it early enough to take action. It is only a matter of time before they discover that the livestock industry is in a worse oligopoly situation that in the 1940's, when they broke up the packers the first time. Please be part of the solution, not the problem. Veto the amendments to the live cattle contracts.
Thank you for your time.
Sincerely,

Lane N. Kugler

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