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COMMENT

The CME Cattle Futures Contract has evolved to the point that it impacts the pricing of all fed cattle, feeder cattle, calves, and breeding stock, directly affecting millions of Americans. Only 4% of all cattle are hedged through the CME, however this pricing mechanism sets the market for the remaining 96% as well (see attachment). The cattle market is largely lacking a predictable and legitimate long hedger. This role is filled in the futures market by the long speculator. Unequal limitations to the detriment of the long speculator impart a downward bias to prices for the entire cattle industry.

If prices stay low for so long that they begin to structurally destroy an industry, there is something wrong with the pricing mechanism. The cattle industry's problems are deeply rooted and structural, not merely cyclical. This is evident by the lack of any rebuilding of the Southern cowherd in the wake of the drought which ended two years ago. The destruction of the cow-calf industry is caused by a process that systemically produces prices that are too low to sustain our producers. "High-low" retailer behavior is a major culprit, and it has been complimented by a regulatory bias favoring short hedgers to the disadvantage of speculative longs and the unhedged small producers they effectively represent.

If the newly formed Ad Hoc Live Cattle Advisory Group at the CME is going to efficiently, effectively, and equitably govern the futures market it needs a written charter, which provides for reasonable and proportionate representation of all segments of the industry. It is tragic that unhedged producers, the backbone of our industry, have been excluded from any input whatsoever into rule making at the CME. It should also recognize the necessity for equal rights for longs and shorts, a prerequisite for any legitimate market.

It is time the entire cattle industry, including the CFTC and CME, move to control the relentless forces, many emanating from large commercial interests, which have worked to pressure independent cattle producers in recent years. The CFTC could take one small, but symbolic, step to limit these oppressive trends by denying the CME their request to change the rules governing the liquidation of the December 2002 Live Cattle Futures Contract.

Comments submitted by:

Charles D. McVean
Chairman

Past Performance Is Not Necessarily Indicative Of Future Results.

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Exhibit A

ESTIMATED NUMBER OF FED CATTLE HEDGED AT CME (SEP '01 - AUG '02)

A	AVERAGE MONTH END CFTC COMMITMENT OF TRADER'S SHORT COMMERCIAL POSITION:	42,742
B	AVERAGE MONTH END CFTC COMMITMENT OF TRADER'S NON-REPORTABLE SHORT POSITION (@ 50%):	14,021
C	AVERAGE MONTH END ESTIMATED NUMBER OF SHORT HEDGED OPEN CONTRACTS (A+B):	56,763
D	AVERAGE NUMBER OF HEAD PER CME CONTRACT (40,000 lbs / 1229 lbs):	32.5
E	NUMBER OF HEAD ESTIMATED TO BE HEDGED AT ANY GIVEN TIME AT CME (C x D):	1,844,798
F	ESTIMATED ANNUAL TOTAL HEAD HEDGED AT CME - ASSUMING AVG ANNUAL TURNOVER RATE OF 2.1 (E x 2.1):	3,874,075
G	ANNUAL STEER AND HEIFER SLAUGHTER	29,329,000
H	ESTIMATED NATIONAL PERCENTAGE OF SLAUGHTER STEERS AND HEIFERS THAT ARE HEDGED AT CME (F / G):	13.2%

ESTIMATED PERCENTAGE OF THE TOTAL VALUE PRODUCED BY THE U.S. CATTLE INDUSTRY THAT THIS HEDGED 13.2% OF SLAUGHTER STEERS AND HEIFERS REPRESENTS (SEP '01 - AUG '02)

TOTAL STEER AND HEIFER SLAUGHTER WAS 61% STEERS AND 39% HEIFERS. ALL PRICE AND WEIGHT DATA IS WEIGHTED AS SUCH.

I	ANNUAL STEER AND HEIFER SLAUGHTER	29,329,000
J	ANNUAL WEIGHTED AVERAGE STEER AND HEIFER SLAUGHTER PRICE (CENTS PER LIVE POUND):	0.6630
K	WEIGHTED AVERAGE STEER AND HEIFER SLAUGHTER WEIGHT (lbs):	1229
L	ANNUAL TOTAL VALUE OF SLAUGHTERED STEERS AND HEIFERS (I x J x K):	$23,898,061,083
M	ANNUAL NUMBER OF CATTLE PLACED INTO FEEDLOTS WEIGHING LESS THAN 700 lbs: *	13,403,353
N	ANNUAL WEIGHTED AVERAGE 650 lb STEER AND HEIFER PRICE (CENTS PER LIVE POUND):	0.9056
O	ANNUAL VALUE OF CATTLE PLACED IN FEEDLOTS WEIGHING LESS THAN 700 lbs (M x N x 550):	$6,677,416,431
P	ANNUAL NUMBER OF CATTLE PLACED INTO FEEDLOTS WEIGHING MORE THAN 700 lbs: *	15,925,647
Q	ANNUAL WEIGHTED AVERAGE 750 lb STEER AND HEIFER PRICE (CENTS PER LIVE POUND):	0.8070
R	ANNUAL VALUE OF CATTLE PLACED IN FEEDLOTS WEIGHING MORE THAN 700 lbs (P x Q x 750):	$9,638,997,847
S	TOTAL ANNUAL ESTIMATED VALUE OF STEERS AND HEIFERS PLACED INTO FEEDLOTS (O + R):	$16,316,414.278
T	TOTAL ANNUAL ESTIMATED VALUE PRODUCED BY THE FEEDLOTS (L - S):	$7,581,646,805
U	ESTIMATED PERCENTAGE OF TOTAL VALUED PRODUCED IN CATTLE INDUSTRY BY FEEDLOTS (T / L):	32%

ESTIMATED PERCENTAGE OF THE TOTAL VALUE PRODUCED IN THE CATTLE INDUSTRY THAT WAS COVERED BY SHORT HEDGES AT THE CME SEP '01- AUG '02 (U x H): 4.2%

* USDA 13 STATES USED AS PROXY FOR ENTIRE FEEDLOT SYSTEM

Mr. Chairman,

I am Charles McVean and I am privileged to address you and your fellow commissioners personally today. We know you are a knowledgeable cattleman who shares our love for the industry. We are also aware, Chairman Newsome, that you are deeply concerned over the great importance of the trend setting decision your commission must make on the matters to be discussed today.

I am Chairman and CEO of McVean Trading & Investments, LLC in Memphis, TN. You may have heard of us. We have offices in Houston, Birmingham, Green Bay, Des Moines, Lexington, KY and Westcliffe, CO, and clients in all 50 states. We have 121 clients in your home state of Mississippi, 322 clients in President Bush's home state of Texas (the largest cow calf state in America), and 52 in the state of Nebraska (by far the largest marketer of grain fed cattle in the United States).

At McVean we conduct extensive research in three broad and interrelated areas: livestock and meats, grains and oilseeds, and global macroeconomics. With me today are Mike Wharton, Sam Gilmore, Roy Wallace, Llewellyn Hall, and Alison Bridgforth.

Only Mike and I will present to you today, but of course everyone is available for any questions you might have. I'd like to tell you a bit about Mike, the President of McVean Trading & Investments. Now Mike is from Nebraska, and Nebraskans as a group tend to be a bit hard headed. Mike's dad, Jim Wharton, was head cattle buyer of Spencer Packing Company (then the third largest beef packer in the country and owned by our good friend, Bud Pearson of Spencer Iowa). Mike grew up in the cattle business and took every advantage of the opportunity to learn from it from the ground up. His first job, while in high school, was on the kill floor.

Nebraska is our nation's largest marketer of grain fed cattle, marketing 10% more over the average of the last four years than the #2 state of Texas. Most analysts don't realize this because they do not consider the hundreds of small farmer feeders in Nebraska who are not counted in the monthly USDA Cattle and Feed Report. We have an interesting shoot out here, as you know Mr. Chairman. The #1 marketer of grain fed cattle, Nebraska, is opposed to the proposed CME rules change, whereas, the nation's #2 marketer of grain fed cattle, Texas, supports the change. With the sorry state of the cattle industry, along with that of the Cornhusker football program, these Nebraskans, as a group, are not happy campers. I know this is not new news to you Mr. Chairman, but I am sure that Mike speaks for a very large number of Nebraska cattle feeders (and Kansas cattle feeders too for that matter) who are not pleased with the CME. So, I thought it might be best for you and the commission to get the hard part of our presentation behind you and then I will speak.

Well at least you've got the hard part behind you now Mr. Chairman. My report to you today for the record is entitled:

<u>We propose an idealized two-step process to achieve equitable pricing of the fed cattle, feeder cattle and calves produced by our surviving independent cow calf men, grass men and cattle feeders. Our envisioned system would be driven by the implementation of cutting edge, real time, on-line retail price reporting by the USDA, interfaced through the CFTC, with a newly created, open, unbiased properly governed cattle futures market at the CME. As a byproduct, the implementation of this system would significantly improve the standard of living of the average American consumer by empowering them to shop more efficiently for perishable food items with the benefit of nearly perfect information as opposed to virtually no information of the values available in the marketplace at the moment.</u>

Well, at least we know we are in the USA, Mr. Chairman. You would never hear such a proposal in the EU or Japan. This is a uniquely American proposal. Let me clarify myself. To map a strategy for dealing with complex and interrelated problems, it is often best to construct a theoretically ideal solution. We can then take small steps as they become possible in the real world toward that ideal solution. I am a philosopher by academic background and also, I am afraid by nature. I hope you will bear with me through this process. We will lay out our ideal solution and then evaluate its impact on our primary objective. Our first purpose is to restore equity and dignity to the process of pricing fed cattle, feeder cattle, and calves produced by our nation's small independent ranchers and farmers. Secondly, we will evaluate the microeconomic efficiencies which we believe would accrue to our industry as a result of our proposals. Thirdly, we will address how our plan would fit into the overall macroeconomic agenda of our nation in consideration of the challenges we face in today's global environment.

At any rate, the current cattle pricing system in the US is obviously broken. I don't believe there is one man on the supply side of the beef cattle industry in the US (except for a couple of big hedgers) who would take issue with the validity of that statement. Believe it or not, this tragic situation creates a unique opportunity for the CME futures market to step in and provide a great service, not only to our industry, but as we shall see Mr. Chairman, to our country as well. We believe that a fair, unbiased futures market, working in tandem with readily available retail price data, would solve 90% of the marketing problems suffered by our cattle industry today. It would do so in a very cost effective fashion without prying into the internal affairs of packers or chain stores. On our models, its complete implementation would add five cents per pound live weight to the price of fed cattle all else being equal.

To understand how this idealized two-step process would work, we, as analysts often do, must construct a simple model. First of all, we picture a long, dark tunnel. This tunnel represents everything that goes on after the pricing of the remaining truly "open market" fed cattle and before the actual price paid at the retail register. These "open market" cattle, to be safely outside the entrance of the tunnel and in the light of day, must be absolutely unencumbered by written deals, word of mouth deals, winks and nods or whatever. We assume, but don't know, that the open market cattle represent 40% of the total fed cattle marketed as we speak. Flowing out of the back end of the tunnel and back into the light of day, we can observe the retail prices that shoppers actually pay. Contained deep within the dark tunnel, we therefore have all controlled or packer owned cattle, all packinghouse operations, all distribution and warehouse operations, and all retail operations prior to pricing in the meat case. Our central thesis is that we don't need to spend the time and money to try to figure out what all is going on inside the tunnel. We can learn all we need to know through careful observation above ground. Then through processes of deduction, we will readily infer what must be happening inside the tunnel. Simple example: when the packers are trying to break the live cattle market, they invariably tell us they can't sell the beef. Are they lying or not? Let me cite a personal experience of mine. Years ago in Memphis, TN a young man worked for me by the name of John Montesi. His family owned Montesi's (then the largest food chain in Memphis). One January day, his dad told me "son, you guys do too much figuring. If we don't have a snowstorm in the first week of February I'll be able to tell you almost exactly how many chucks I'll sell that week by about the middle of January." I said, "How does that work, John?" He answered "I'll know as soon as we decide whether to run a feature or not." How much difference does that make John?" I asked. "If we feature them, we'll easily sell forty percent more than if we don't" he informed me. I couldn't believe it and I never forgot it. Let's go back to our first question. What if John had decided not to feature chucks, and Kroger had decided not to sell chucks at the same time? Believe it or not, our packer friend would not have been lying when he said that he couldn't sell the chucks. He <u>couldn't</u> sell the chucks. But, next question, was it an accident that Kroger decided at the same time not to feature chucks? In other words, is there a pattern of these guys running these "high-low" cycles in concert. The data is all there in broad daylight. All we've got to do is capture it and analyze it in excruciating market-by-market detail. That's easy to do with computers.[1]

Wal-Mart is a different deal. They're cranking it out with everyday low prices. They know how much more efficient that is for in-store operations. They're gaining market share like crazy. It really makes a guy wonder what the rationale behind retail "high-low" pricing strategies is in the first place, doesn't it? Think about it.

For our ideal system to work perfectly, it requires two conditions to be met unequivocally. If we are compromised in the real world, we will still do a lot of good.

A. The futures market must be safe and secure in the daylight outside of the front end of the dark tunnel. This is not true today. Furthermore, powerful currents are trying to pull the futures market deeper into the dark tunnel.

B. We must have hard, detailed, specific, accurate, real time, on-line Internet data available showing retail prices city-by-city, individual store (not chain) by store. Today nothing could be further from the truth. The price of 90% of the beef cuts available today can be discovered

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[1] John Montesi, himself, was a wonderful man and certainly would never have participated in misconduct.

only by walking up to the meat case and even then it's cut up so many different ways and given so many different names that it is difficult for most people to tell what the true values are even standing at the meat case. Any progress at all toward current market specific and cut specific retail price information would yield substantial benefits to the analysis of cattle market volatility, and to the efficiency with which the average American shops as well.

Once our two prerequisite conditions are met, we plug the "new futures market" and the "new retail price data" into our long, dark pipeline model. We will think of them as two bright lights, the "new futures market" at the front end of the tunnel joining the 40% open market cattle and the "new retail prices" at the back end of the tunnel.

Next, we have two analysts, not necessarily PhD's. One of them shines one bright light in the front of the tunnel directly at the other facing in the opposite direction, and the other shines his light back through the dark tunnel in the opposite direction. If they can see each other, and identify the interior walls of the pipe, then we know there are no obstacles inside. If they can't see each other, and make out the walls of the pipe, then we know there is one or more pronounced obstructions inside. For example, what if John Montesi and Kroger have a pronounced pattern of not featuring chucks at the same time? If that's the case, we then call the appropriate obstruction removal contractor right down the street here in Washington, D.C. and we have him remove the obstruction and/or obstructions. He is good at his work and he loves to do it when he gets a big contract. As a matter of fact, the bigger the obstacle the better. Our contractor just needs some hard data on the exact location of the problem. That will be very easy for us to provide with our new IT system. These engineers just like to work with numbers, rather than words. We will have plenty of numbers.

Point A: We don't have to go into the dark tunnel (which represents the controlled cattle, packing and distribution operations, and pre-shelf wholesaling and retailing industries) to see if there are obstacles in the tunnel. It is unfathomably complex in there, and we could get lost. All we need is a bright light, the "new futures market" at the front end of the tunnel, and a big bright light the "new retail price data" at the back end of the tunnel. We've got some light at the front end of the tunnel, the 40% open market cattle, but we need a lot more wattage to be provided by the futures market. Although the new USDA retail scanner data is certainly a step in the right direction, there is no timely data whatsoever available on retail prices. This is a shame, because today's retail price is the most important price in the whole system.

Point B: Detailed on-line real time price data will empower shoppers to shop more efficiently. They'll get more for their money in less time so they'll buy more beef. Our models show that timely and specific retail price data would add 5 cents per pound live weight to the price of all open market cattle sold in this country, all else being equal.

So as not to be too logical, we will begin with the light at the back end of the tunnel. Sam Gilmore directs our retail chain store pricing observation efforts and I'd like to tell you a little more about him.

In a former life, Sam was the largest cattle banker in the US. With his many financial connections he can tell you exactly how bad things are in the cattle industry today. Sam is also an expert butcher and gourmet chef. He has run feed yards, restaurants, ranches, meat processing plants, meat distribution facilities and was CFO of a major beef genetics company. He is an expert on the cattle delivery process and has some film to present to you today.

Sam's retail price fieldwork was a major part of our contribution to R-Calf's seminal study of "High-Low Retailer Induced Price Distortions" which they provided to you last week. Sam's current work further substantiates what we learned from our former employee, Augustus Ring, now deceased. Auggie was a Vice President of Iowa Beef Packing who worked extensively in the introduction of boxed beef. Prior to joining us, he was Director of Meat merchandising for Ralph's Foods in Los Angeles. At that time, Ralph's was the largest grocery chain on the West Coast.

Now Sam loves to go out and watch the retailer's fun and games almost as much as he likes to go look at feeder cattle. He is one of my closest friends. Sam was furious at me Friday afternoon for not going out to two Kroger stores in Memphis which he had visited the night before so that I could personally report to you today. He obviously did not like what he saw. As R-calf noted, it's not the prices in the paper that we worry about; it's those that we don't see that bother us. Studies indicate that in a typical "high-low" store, these unmentioned prices are at least 30% to 40% above featured prices. Sam really feels that it is an understatement. At any rate to quote from the R-Calf study:

> "The price makers for beef are the large grocery store chains. These large corporations generally have impressive market shares on a city-by-city basis. Characteristically, this market share allows them sufficient power to enforce their pricing strategies. These chains actively change retail beef prices, by large amounts, on a week-to-week basis, and thereby micro-manage the amount of beef that they sell to the final consumer. This is called either "featuring" (selling at a reasonable price) or "not featuring" (selling at an obscenely high price). These gyrating retail prices, called "high-low" strategies in the trade, are enforced through strong city-by-city market share. These "high-low" prices determine whether the marginal unit of beef clears the market or stacks up in inventory to subsequently depress prices. If the "high-low" retailer wants to try to buy an inventory of beef cheaper, they raise their retail prices sharply and temporarily choke off consumer purchases. Through the short-term manipulation of their prices, these large retailers have

positioned themselves as the dominant price makers in the wholesale beef market."

With all of their inherent power as the final commercial buyer of a perishable product, backed by sometimes unconscionably high local market shares, our retailer "friend" has one obvious and glaring weakness. That single most important price in the system is out of the back end of the tunnel and in broad daylight. This final retail price is more important than all the numbers back in the dark tunnel put together. And now we have the technology to look at these prices in real time, on line and available to everyone. It is these prices taken collectively that drive changes in the demand for and prices of feed yard cattle more than any other single factor in the whole system. No matter how much smoke and how many mirrors the retailer uses in his pricing strategies, whether it's his gyrating "feature-no feature price cycles," or using dozens of different names for very similar cuts of meat, these prices are in broad daylight and outside of the dark tunnel. By refusing to feature, the retailer has the packer between a rock (his foot dragging) and a soft place (the feed yard). The packer has to have running time for his fixed cost intensive empire. After the retailer stalls him for a while, the packer usually capitulates, dumping product at cheap prices, enabling the retailer to set feature ads and book volume (remember what John Montesi told me). The packer then turns to take it out on the "soft place", the cattle feeder. It is this micro-management process that we want our scanners and computers and Internet surfers locked into. As R-Calf points out, *remember, it is the final price to the retail consumer that drives his or her quantity demanded in any given time frame.* It is this quantity demanded at the point of purchase, which feeds back through the system to drive feed yard demand. We are confident that this data is the missing link that causes 75% of the confusion in the pricing of cattle. Its availability would also reveal practices that if totally exposed and corrected through the power of more perfect information provided to final consumers, would mean five cents per pound to producers on every steer and heifer sold. Over the last year, on round numbers, this would be

29.5 million head X 1252 average live weight X $.05 per lb = $1.475 billion.

To again quote R-Calf:

> **"These "high-low" prices determine whether the marginal unit of beef clears the market or stacks up in inventory to subsequently depress prices."** Our industry sold over 25 billion dollars in live cattle to packing plants last year. Every pound of it in the final analysis was priced off of the marginal unit of beef the chain store bought or did not buy on the basis of their "high-low" strategies.

This is the problem that needs more attention than any other single subject. If certain good friends of mine were determined to crawl through the dark tunnel, they might be disappointed to find a "paper tiger" inside. It is the big retailers who have the hammer in this game, and don't let any one try to tell you otherwise.

At the end of the day, the pricing power of a perishable commodity processor/seller is inherently weak. The margins of our nation's beef packers have been inflated by the massive number of heifers being dumped on the market place through the process of wholesale herd liquidation. Many in the cattle business are confused by this cyclical inflation of packing house margins, thinking of it as a structural or sustainable phenomenon when nothing could be further from the truth. This structural liquidation of the beef cow herd, in due course, will drive an equally structural implosion in packing house margins. As they say in the trade, "there will be darkness." By their nature, Mr. Chairman, our packer friends can't see beyond the ends of their noses. Their attitude is "let's worry about tomorrow, tomorrow." In due course, because of their short sightedness, our packer friends will be revealed as the "paper tiger" in the dark tunnel.

Remember, all PhD theoretical supply demand models assume perfect information by buyers in the market place. In the real world of the retail beef market, we have almost the exact opposite. We have almost perfectly imperfect information, and that is by careful design by the retailers. The only way to learn the price of 90% of the cuts is to drive to the store and look. Even then, many different names for very similar cuts are used. It is terribly difficult for the average consumer to determine exactly what it is that he or she is buying. Many families are two worker families and they don't have time to drive around. Our "new retail prices" are not only important to seeing through the dark tunnel, but in addition on-line, real time, store-by-store prices, would empower the consumer to be a much more efficient shopper. Our estimate is that the "empowered consumer" would buy 8 to 10% more beef every month than today's "blind consumer" and get it bought on much more favorable terms. We are talking about bringing efficiency to this market by using the Internet to bring shopping power to the final consumer of beef. Overnight we are talking about shifting the trading advantage from the retailers to the consumers. At one and the same time, this will raise the price of open market cattle by several cents a pound, all else being equal, and raise the standard of living for our nation's consumers. Importantly, we are saving a working mom both time and money.

It is time for a modest prediction. We believe on-line, real time, store-by-store retail prices provided by the USDA might make the greatest contribution to the public good per tax dollar spent of any single investment ever made by the agency. In fact, for the consumer sector, this investment might be second, only to the development of the Internet itself, in the hierarchy of the all-time great investments ever made by the US government. Once our infrastructure is in place, naturally our pork, poultry and perishable produce friends will want to join in the game.

Now this is Roy Wallace of Select Sires in Columbus, Ohio. Roy is a world-renowned expert on cattle genetics and cowherd operations. He has field reps working in all 50 states. Roy has provided invaluable input into our proprietary US Beef cowherd model. Sam Gilmore has also contributed extensively to this ongoing project. The model is based strictly on slaughter data, the only thing we measure with any precision in this industry. It is flows of cattle to slaughter by sex class after allowing for trend rates of change in the age thereof, which drive the model. Our cow model says unequivocally that the cowherd is being devastated by what might best be described as a supply side depression. The USDA does not understand the impact of the genetically driven process of age compression on slaughter to inventory ratios. Roy and I think they are badly mistaken on their inventory estimates.

The model is obviously confidential but Roy, Sam, and I would enjoy discussing it with you, Mr. Chairman. We know your extensive background in animal science. Unfortunately, in all the many deliberations regarding this proposed rules change there are no more than one or two people in Chicago involved in this process that know enough about a cowherd to wad a shotgun.

At any rate, Mr. Chairman, you might enjoy visiting with Roy. He is from Columbus, Ohio. He never misses a Buckeye game and he looks exactly like Woody Hays. The only way you can tell for sure its Roy is by the cheap cigars he smokes.

Speaking of experts, and to further establish our credentials in the beef industry, I must mention Bill Nicholson, who is back in the office in Memphis today. Bill is the former president and CEO of Excel packing company, the nation's second largest beef packer. We believe that McVean Trading has the broadest and deepest knowledge of the beef cattle industry of any investment firm in the world.

Old generalities:

Before talking about the new futures market, let's make sure we understand a few things about trading cattle that have been true since Methuselah was a pup.

1. If there is one steer left on the North American continent, the packer will try to steal him. It is their job, you know. Furthermore, they can't see beyond the end of their collective noses and never have. Their attitude is "lets worry about tomorrow tomorrow." We are here to talk about tomorrow today, Mr. Chairman.

2. There is an old joke about packers; if the discussion concerns money, the way you tell if a packer is lying is by checking to see if his lips are moving. Now, a lot of these fellows are friends of mine and good guys. We are not talking about explicit lies here; we are talking about implicit lies and errors of omission.

3. A cash settlement contract for fed cattle would be like shooting craps over the phone long distance with Suddam Hussein in Baghdad. He is going to roll the dice and let you know what you've got.

If I made one statement today that is 1000% correct this is it. We would never trade a cash settlement fed cattle contract; not the first one.

Back to the light at the front end of the tunnel. Given the concentrations of controlled cattle we have out there and the small number of packers, the only way in the world to keep the packers honest is through an open, unbiased and unfettered futures market. What that means is that if you are going to have a bunch of big sellers in a futures market, you had better figure out how to throw some big buyers in there with them. Otherwise you won't have a fair fight on your hands. Americans really do prefer a fair fight. Whether you like it or not, the futures market has to stand up and be counted for the overall price making process to work fairly, given the small number of packers and the large number of non-market cattle. Like it or not, there is simply no other way to bring some balance to the front lines of the pricing battle other than to draft some speculators and give them a little room to operate.

Now let's talk about what it would take on behalf of the CME to make the transition from the "old futures market" to the "new futures market." In our "ideal solution scenario" the Merc would have to face up to three fundamental issues that have conveniently been swept under the rug in the past:

1. **Learning to call an apple an apple.**
2. **Accepting a first principle of good governance.**
3. **Recognizing a fundamental law of microeconomics.**

Without coming to grips with these issues, the light at the front end of the tunnel won't be as bright as we would like it to be.

Learning to Call an Apple an Apple.

It is vitally important for the CME and the CFTC to understand three distinguishing characteristics of the cattle market that set it apart from all other futures markets.

A. Cattle are essentially a perishable commodity. This means that bear raids by final buyers are much easier to pull off than they are in other markets. It is sell it or smell it, you know. This creates a whole different dynamic from trading a bin full of corn that can just stay in the bin. I explain it this way. Trading fat cattle is more like trading ripe watermelons on the 4th of July than it is like trading a bale of cotton on the 10th of November. If there really are too many, watch out below because they can't be stored; they must be dumped. By extension, this means that spot month longs deserve some respect, rather than the constant contempt. They take a lot more risks than a spot long in the corn market.

B. In no way are cattle a homogenous commodity. This means buyers will try to beat you on the specifications like they are trying to do by raising the weights on the futures contract. This idea is a travesty. If a feeder makes a steer too big, that is his problem. If the specs are changed and he gets dumped on the futures contact, then he becomes every unhedged producer in this country's problem. The futures impact all cattle prices.

Furthermore, again quoting R-Calf:

"There is very little visibility in the foggy world of fed cattle pricing. This fog is so deep that no one at the CME or the CFTC has any chance of knowing with any accuracy what packers are actually paying for cattle. The market features country prices, auction prices, delivered prices, formula prices, grid prices, basis prices, controlled prices, unreported prices, quality premiums and discounts, weight discounts, freight adjustments, time premiums, breed premiums and special weighing conditions. This fog is thick indeed."

Therefore, the traditional concept of convergence to the determinate price of a homogenous commodity is only marginally applicable relative to its use in most other agricultural markets. R-Calf's pioneering concept of "fair market value" is highly relevant in this regard. We believe the concept of "fair market value" is a true watershed from a regulatory perspective. We want to mention a quick use of "fair market value" here and then return to a more detailed discussion of this important principle later.

Quoting R-Calf:

"The concept of "fair market value" as opposed to cash price deserves serious attention at the CME and the CFTC. Simply put, if packers are not fully replacing the inventory they are slaughtering during a given period of time, we have sufficient reason to suspect that the cash price is below the "fair market value." We all know that thin markets often give rise to price distortion. This test should be applied to alleged basis distortions to determine whether it is the cash or the futures that is out of line with "fair market value"". Furthermore a careful look should be given to determine whether or not there is a "significant high-low retailer induced price distortion" at play in the market place at this particular time.

C. The cattle market is largely lacking of legitimate and predictable long hedgers. What this really means is that well financed and knowledgeable spot month specs with the infrastructure to deal with deliveries are at a premium. Somebody has got to be long the spot month, don't they? If it is a small spec, or a computer, which doesn't know a steer from a heifer, what have we got? We all know what we've got. We've got exactly what the large hedgers are lobbying for... a turkey shoot.

Accepting a First Principle of Good Governance

The influence of CME futures has evolved to the point that it impacts the pricing of all fed cattle, feeder cattle, calves and breeding stock, whether they are hedged or unhedged. Therefore, the CME cattle futures directly influence the well being of several million Americans. So far, a rule making process based on any set of acknowledged principles commensurate with this growing public responsibility has yet to develop. We recognize the urgency that necessitates the revival of the cattle committee in an ad hoc fashion. After all we never knew why it disappeared in the first place.

However, as we try to move forward perhaps we should consider the foresight of our founding fathers. Had they simply begun making rules, with no rules for the making of rules, we can only imagine where we would be today. If the New Cattle Committee is going to efficiently, effectively, and equitably govern the futures market it obviously needs some form of written charter from the CME. This document should include for example, but not inclusively, the following:

A. The limits of the grant of authority from the CME and under what conditions might it be overridden.
B. Will we recognize the right to reasonably proportionate representation for all segments of the industry e.g. cow calf men, grazers, unhedged feeders etc, or won't we?
C. Will we recognize the necessity for equal rights for longs and shorts which are prerequisite to a legitimate market in the face of a quasi legitimate at best cash market and a lack of long hedgers, or won't we?

This is a short-list but we hope it illustrates our point.

Whether we like it or not, the cattle futures market has incurred a broader responsibility through its growing influence over the lives of others. To shirk this responsibility, through the continued pandering of special interest groups, is to invite the inevitable politicalization of our current disagreements. The lobbying position at the NCBA supporting the hedgers in direct opposition to the interest of the vast majority of the industry, who are unhedged producers, is another shining example of failure to recognize the reality of the growing influence of the CME futures market in the pricing of all fed cattle, feeder cattle, calf and breeding stock prices in the United States, Canada, and Mexico for that matter.

Recognizing a Fundamental Law of Microeconomics

If prices stay so low for so long that they begin to structurally destroy an industry then either there is no need for the industry in the first place or there is something structurally wrong with the pricing mechanisms within that industry.

Again McVean Trading & Investments was proud to contribute to a recent research effort by the R-Calf organization of Billings, Montana. R-Calf, of course, represents a large number of cattle producers and we are very impressed with their knowledge of our industry and their research capabilities. We would like to again refer to their extensive report to President Bush, Chairman Newsome, and Secretary Veneman submitted last week, and to quote from it. In our opinion the R-Calf report is a watershed piece of fundamental analysis.

> "We are concerned that cattle prices have been far too low for far too long already. The drought is obviously not our only problem. If it were, the Southwest and Southeast would already have begun to rebuild their herds, given their improved moisture conditions over the last two years. We ask you, Mr. President, a rancher from Texas, and you, Chairman Newsome, a cattleman from Florida and Mississippi, to check your industry connections to see if herd rebuilding has kicked in along with improved pasture conditions in your home regions. Our many trade connections in your areas tell us there is no appreciable heifer retention in the South. If anything, we are told that the herd liquidation is continuing. **By implication, therefore, our industry problems are deeply rooted and structural in nature; they are not merely cyclical. The South had already experienced its longest liquidation in history as of two years ago. The structural problem driving the destruction of our cow-calf industry is that the system of pricing cattle in the United States is systemically biased toward prices that are too low to sustain our producers. "High-low" retailer behavior is a major culprit, and it has been complimented by regulatory bias favoring short hedgers in the futures market."**

The report goes on to present a brilliantly detailed analysis of the retailers' bear raid on the cattle market.

> "Under these conditions, the "cash price" is driven below what we will call fair market value by a "high-low" retailer induced price distortion. The futures hold in line with fair market value but above the current cash prices. Under the existing regulatory regime, this situation is deemed to be a basis distortion, and the futures market is arbitrarily held to be out of line with the presumed to be legitimate "cash market." The traditional remedy for this situation is to threaten longs in the futures with punishment, and one way or another force them to reduce their positions. This brings pressure on the futures market, which in turn will put downward pressure on the cash market. **Thereby, the bear raid by the retailers has been validated by the CME surveillance staff. The losers are the sellers of unhedged fed cattle, feeder cattle and calves.**

Along with retailer behavior it continues '**this systemic downward bias to prices deriving from the traditional favoring of short hedgers is the second meaningful component of our industry's structural pricing problems. It has in effect, though certainly not through intent, acted in concert with "high-low" retailer behavior to impose structurally lower prices on the unhedged producers who comprise 96% of our industry."**

We agree 100% with this point. It is tragic that unhedged producers, the backbone of our industry, have been excluded from any input whatsoever into rule making at the CME. Rules making has been dominated by vocal minorities known very well to you in this room, I am sure. Additionally, The NCBA is of course on the record to the effect that their role in all of this is strictly and exclusively in support of the interest of the short hedger. They are diligently and aggressively representing 4% of the industry with their official position.

In Summary

I have two personal reasons for feeling strongly about these issues, Mr. Chairman. First, we can trace our McVean family involvement in the cattle industry over five generations. Second, I personally operated what I believe to have been the largest ranching operation in the state of Missouri; the nation's second largest beef cow state. If Sam hadn't been my banker and closed his eyes at the right time, I would have most certainly gone broke. For me, there is a very clear lesson learned directly from that exercise. **I am convinced of the utter and complete impossibility of commercializing the cow industry on the model of the chicken industry of Mr. Tyson, or on the model of the hog industry of Mr. Leuter, or on the model of the grain industry of Mr. Bartlett. Furthermore, of the major cattle feeders and packers that I know, not a one owns enough cows to worry about**. This is further evidence of the impossibility of ever rebuilding the cowherd with absentee capital. We are afraid, Mr. Chairman, that our nation's surviving beef cowmen and cowwomen should best be thought of as a non-replenishable national resource. Once destroyed, they cannot be replaced. As Sam says, "Once those fences come down, they are never going back up". Maybe I feel a bit like the Indian with a tear in his eye watching the destruction of his beloved landscape.

We ask you Mr. Chairman, to be the one who finally draws the line in the sand. It is time that we move to control the relentless forces, many emanating from large commercial interests, which have worked to pressure our independent cattle producers in recent years. Mr. Chairman, please take one small, but symbolic, step to limit these oppressive trends. Let us begin the process of restoring some dignity to the lives of our surviving independent cattlemen. Without the cowmen, Mr. Chairman, there is no future for our industry. You can begin all of this, Mr. Chairman, by denying the CME their request to change the rules governing the liquidation of the December 2002 Live Cattle Futures Contract.

Furthermore, Mr. Chairman, we sincerely hope that the CFTC, the USDA, and the CME will give serious attention to our broader proposals for improving the efficiencies of our beef distribution systems and the regulatory supervision thereof. We believe that by eliminating waste and inefficiency in the distribution network, we could significantly increase the price of open market cattle, while at the same time improving the standard of living of everyday Americans. They would also save valuable personal time. This would be particularly beneficial to any two-worker families who must shop hard to stay within a budget.

The US economy is faced with growing pressure from lower cost producers around the world. Profit margins are being eroded and American jobs lost overseas due to the global glut of low cost labor. To maintain and improve our current standard of living the US must rely on its technological prowess to constantly improve productivity. Improvements in efficiency are particularly rewarding when they come in large-scale service sectors, like medical care. In such cases, international competition is unable to quickly shift the benefits of American invention offshore. Increasing efficiencies in the pricing and distribution of perishable foodstuffs presents precisely such a substantial opportunity. Without massive long-lasting productivity gains, the US is faced with a ballooning federal deficit and a blowout in the trade gap, or a return to the failed policies of trade barriers with all its resulting inflationary consequences and geopolitical repercussions. Given the undesirable alternatives, it is clear the US must strive to nurture greater productivity wherever possible by continually identifying opportunities for large-scale applications of Information Technology Systems to previously unconsidered areas like the distribution and marketing of perishable foods. Like Jack Welch said just last week, "We have got to innovate, innovate, and innovate some more -- we really don't have any other choice".

Dated: November 12, 2002

Reference: R-Calf USA
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cc: President George W. Bush
Secretary of Agriculture Ann M. Veneman
Senator Thad Cochran