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ContiGroup Companies, Inc.
Cattle Feeding Division
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OFFICE OF THE SECRETARIAT

February 7, 2000

Jean A. Webb, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
21st Street NW.
Washington, DC 20581

Re: RIN 3038-ZA04 CME Proposed Amendments to the Live Cattle Contract

Dear Ms. Webb:

The purpose of this letter is to state the views of ContiGroup Companies, Inc. relative to the proposed amendments to increase speculative position limits in the Chicago Mercantile Exchange (CME) live cattle futures and options contracts.

ContiGroup Companies (formerly Continental Grain Company) has existed as an agribusiness firm for over 185 years. We have been clearing members of the Chicago Board of Trade since 1922. We use the futures markets extensively to reduce the commodity price risk associated with the commodities that we trade or produce.

Our sole purpose in using the futures markets is to use them as a hedging vehicle; therefore, any position we take relative to proposed changes in our hedging instruments is ground in the question: Will this proposed change increase or decrease the hedging effectiveness and risk of the futures contract or option contract?

With that as our frame of reference, we **strongly oppose** the increasing of the speculative limits in the CME live cattle contract for the following reasons:

1) Increasing speculative limits has not made for a better hedging vehicle

Attachments 1-5 deal with this question. We compared the behavior of the basis over the last 8 years in 3 different live cattle contracts:

June 1992 to April 1995	(period with 300 contract spec limit)
June 1995 to April 1998	(period with 300 contract spec limit)
June 1998 to December 1999	(period with 600 contract spec limit)

The June 1995 to April 1998 period saw 18 different contract expirations. The June 1992 to April 1995 expirations are included for comparison, as well as the June 1998 to December 1999 expirations. For the last year and a half, the speculative limits have been increased from 300 contracts to 600 contracts.

In each delivery period during the "spot" futures month, we identified the spot cash market the USDA reported as the weighted average steer price in their 5 Area region: Texas/Oklahoma, Kansas, Nebraska, Colorado, and Iowa/Southern Minnesota. (See Attachment 5.) Only the steer price was used, since the delivery specifications call for delivery of steers only. We subtracted this daily cash steer price from the midpoint of the high and low prices for the futures contract. This gave a basis for each day.

For each delivery month, we calculated the average basis for the month, the standard deviation of those daily averages, the high basis price, the low basis price, and the range between the high and low basis for the month.

Tables 1-3 give the detail information for each of the 3 periods we looked at and Table 4 summarizes our findings. The average number of deliveries increased 89%. The CME has continuously argued that if the futures and the cash markets get "out of line," market participants will deliver against the contract and force the markets to converge. This has not been the case over the last 10 delivery periods.

The number of speculative positions that can be held in the expiring month doubled from 300 to 600 beginning with the June 1998 contract. Over the 10 contract expirations after the change, the number of deliveries made against the futures contract doubled.

In theory then, with many more people delivering to force the futures and cash market together, this should provide for more efficient markets -- markets where the absolute value of the basis is reduced (convergence) and where the basis should become less volatile.

Just the opposite happened.

Since the June 1998 delivery period:

- the average basis has become 5% more negative (futures premium to the cash market) -- moving further away from true convergence
- the volatility of the basis, as measured by the daily standard deviation, has increased 12%
- the average range of the basis during the 10 delivery periods has increased by 20%

The basis become more negative (futures premium to cash), more volatile over the last year and a half, and the cash and futures have converged less. This reduction in convergence between the cash and futures markets and the increase in basis volatility have made the live cattle futures contract a less attractive hedging vehicle.

We hedge to reduce our risk, not to increase it.

We feel certain that if the number of contracts that speculators can hold is increased, the number of deliveries will also increase. The last 10 delivery periods have shown us that allowing more deliveries will NOT make the live cattle contract a more hedger-friendly contract; in fact, it will make it a less useful hedging instrument.

2. <u>Limited Supply of Deliverable Cattle</u>

The rules of the CME severely limit the supply of cattle that can be delivered against the live cattle contract. The what follows is the cattle that are currently excluded from delivery and their percentage of the US cattle population:

1. Contract Specifications:

    The CME contract specifications limit the number of cattle that can be delivered against the contract. They will not allow heifers, Holstein steers, or *Bos indicus* cattle. Three classifications eliminate about 60% of the US cattle population. The specifications are also geographically skewed, effectively eliminating the vast majority of cattle found in the southern regions of the US.

2) Economic Limitations:

a) The contract specifications are higher than the industry averages.
b) The dollar discounts in the contract for sub-par cattle are more severe than industry discounts.
c) The average grade is 55% choice. While this is the approximate industry average, 35% of the cattle traded in the industry are heifers. Heifers typically grade 10 percentage points better than steers, so the industry average grade for steers is actually less than the CME contract's par specifications.
d) Currently the live weights of steers is at an all-time high. A large and growing percentage of the cattle on feed weigh over 1300 pounds and therefore would not be deliverable under the current CME specs.
e) Over 30% of the cattle on feed are outside of live delivery point areas and because of freight and shrinkage charges are not economically deliverable.
f) By definition, half the cattle are less than average! Half of the cattle slaughtered are less than the average in quality and value. Hence, the lower half of the deliverable cattle population, if delivered, would be discounted below the average cash market; therefore, cattle feeders would not deliver these cattle against the CME contract.

3. <u>Market Distortions</u>

Allowing larger positions to be taken by speculators in a thinly trading market will add to market distortions and potential manipulation of the futures contract. Over the last 5 years, the average daily volume of the live cattle futures contracts in the expiration months has only been 2,800 contracts. Allowing a large speculator to come in with up to 900 contracts will only lead to erratic markets, greater price volatility, and increased basis risk in the delivery period.

Erratic futures markets that are disconnected from the underlying cash market turn off would-be hedgers. ContiGroup Companies' Cattle Feeding Division is the second largest cattle feeder in the world. Even so, we only feed 4% of US cattle. The cattle feeding industry is very fragmented and is composed of mostly small producers.

ContiGroup Companies, with six feedlots in four states markets an average of 20,000 cattle per week, an equivalent of less than 600 futures contracts. (But because of the economic and contract limitations listed in #2 above, the actual contracts that ContiGroup could deliver would be much smaller than 600.) Allowing speculator position limits that are significantly larger than the regulated and allowable hedge limits of even the largest cattle feeders in the country will only add to market distortions and possible manipulations of the contract during the delivery period.

The USDA seems to be moving toward wanting producers to take more and more responsibility for their risk management. This is the whole idea behind the Freedom to Farm Bill. If the government wants producers to take more of the responsibility for doing their own risk management, then it seems ill-advised to allow large speculators into what is already a very thinly traded market.

In summary, we are opposed to the proposed amendments because the changes would make the live cattle futures a less viable hedging vehicle. We appreciate the opportunity to express our views with the Commission and would be willing to answer any questions you may have relative to the position of our Company.

Sincerely,

John Rakestraw

John Rakestraw, Vice President
General Manager, Cattle Feeding Division

Robert Dix

Robert Dix
Option Programs Manager

Tommy Beall

Tommy Beall
Marketing Manager

June 1992 to April 1995 Live Cattle Delivery Periods
(18 Delivery Periods BEFORE the June 1995 Contract Change)

	Trading Days in the Delivery Period	Number of Futures Deliveries	Average Basis in Delivery Period	Basis Standard Deviation in the Delivery Period	High Basis in Delivery Period	Low Basis in Delivery Period	Range of Basis in Delivery Period
Jun 1992	12	18	0.659	0.351	1.055	-0.013	1.068
Aug 1992	11	4	-0.099	0.144	0.105	-0.360	0.465
Oct 1992	15	37	-0.244	0.277	0.275	-0.725	1.000
Dec 1992	12	14	-0.115	0.553	1.193	-0.928	2.120
Feb 1993	9	13	-0.823	0.364	-0.343	-1.498	1.155
Apr 1993	14	28	0.135	0.260	0.603	-0.473	1.075
Jun 1993	13	0	0.647	0.405	1.165	-0.153	1.318
Aug 1993	12	0	-0.251	0.268	0.178	-0.698	0.875
Oct 1993	15	0	-1.208	0.527	-0.120	-2.283	2.163
Dec 1993	12	64	-0.760	0.525	0.113	-2.098	2.210
Feb 1994	10	10	-0.998	0.300	-0.600	-1.513	0.913
Apr 1994	15	13	-0.708	0.238	-0.280	-1.053	0.773
Jun 1994	14	72	-0.291	0.640	1.005	-1.138	2.143
Aug 1994	13	361	-1.841	0.654	-0.753	-3.163	2.410
Oct 1994	11	415	-1.923	0.754	0.190	-2.670	2.860
Dec 1994	14	31	-0.599	0.318	-0.130	-1.340	1.210
Feb 1995	11	55	-1.387	0.618	-0.613	-2.878	2.265
Apr 1995	9	20	-0.744	0.352	0.060	-1.083	1.143
AVERAGE	12.3	64	-0.586	0.419	0.172	-1.337	1.509

*** Basis calculation: national cash steer price minus CME Live Cattle futures price
Cash price used: USDA daily weighted average 5 Area steer price (USDA report AM LS724)
Futures price used: average of the high and low futures price for the day.

ATTACHMENT 1

June 1995 to Apr 1998 Live Cattle Delivery Periods
(18 Delivery Periods OF the June 1995 Contract Change)

	Trading Days in the Delivery Period	Number of Futures Deliveries	Average Basis in Delivery Period	Basis Standard Deviation in the Delivery Period	High Basis in Delivery Period	Low Basis in Delivery Period	Range of Basis in Delivery Period
Jun 1995	15	95	0.494	0.632	1.415	-0.943	2.358
Aug 1995	14	630	-0.257	0.547	0.678	-1.735	2.413
Oct 1995	12	254	-1.086	0.383	-0.175	-1.500	1.325
Dec 1995	14	495	-1.159	0.332	-0.633	-1.605	0.973
Feb 1996	13	151	-1.196	0.489	-0.340	-2.153	1.812
Apr 1996	12	238	-0.845	0.420	-0.233	-1.445	1.213
Jun 1996	10	212	-1.319	0.564	-0.653	-2.813	2.160
Aug 1996	15	691	-1.861	0.322	-1.398	-2.315	0.918
Oct 1996	14	92	-1.330	0.796	-0.405	-2.910	2.505
Dec 1996	10	4	-1.065	0.977	0.780	-1.938	2.718
Feb 1997	9	60	-1.115	0.553	-0.458	-2.215	1.758
Apr 1997	13	154	-1.347	0.496	-0.605	-2.603	1.998
Jun 1997	11	101	-1.008	0.397	-0.235	-1.690	1.455
Aug 1997	15	1054	-1.138	0.687	0.100	-2.250	2.350
Oct 1997	15	271	-1.637	0.420	-0.935	-2.365	1.430
Dec 1997	12	104	-1.296	0.663	-0.203	-2.245	2.043
Feb 1998	9	309	-1.783	0.692	-0.635	-2.760	2.125
Apr 1998	13	236	-1.852	0.778	-0.883	-3.993	3.110
AVERAGE	12.6	286	-1.156	0.564	-0.268	-2.193	1.926

*** Basis calculation: national cash steer price minus CME Live Cattle futures price
Cash price used: USDA daily weighted average 5 Area steer price (USDA report AM LS724)
Futures price used: average of the high and low futures price for the day.

ATTACHMENT 2

June 1998 to December 1999 Live Cattle Delivery Periods
(10 Delivery Periods OF the June 1998 Contract Change)

	Trading Days in the Delivery Period	Number of Futures Deliveries	Average Basis in Delivery Period	Basis Standard Deviation in the Delivery Period	High Basis in Delivery Period	Low Basis in Delivery Period	Range of Basis in Delivery Period
Jun 1998	17	849	-0.817	0.409	-0.023	-1.500	1.478
Aug 1998	16	597	-0.871	0.492	-0.245	-2.175	1.930
Oct 1998	20	1500	-2.015	0.554	-0.975	-3.115	2.140
Dec 1998	18	166	-1.014	0.619	0.225	-2.410	2.635
Feb 1999	14	1030	-2.371	0.923	-1.263	-4.500	3.238
Apr 1999	20	1020	-1.728	0.759	-0.703	-3.325	2.623
Jun 1999	18	21	-0.105	0.473	0.573	-0.960	1.533
Aug 1999	17	34	-0.874	0.621	0.063	-2.050	2.113
Oct 1999	20	175	-1.738	0.789	-0.418	-3.175	2.758
Dec 1999	18	11	-0.559	0.698	0.928	-1.783	2.710
AVERAGE	17.8	540	-1.209	0.634	-0.184	-2.499	2.316

*** Basis calculation: national cash steer price minus CME Live Cattle futures price
Cash price used: USDA daily weighted average 5 Area steer price (USDA report AM LS724)
Futures price used: average of the high and low futures price for the day.

ATTACHMENT 3

3 Time Period Comparison of Averages

Delivery Contract Periods	Trading Days in the Delivery Period	Number of Futures Deliveries	Average Basis in Delivery Period	Basis Standard Deviation in the Delivery Period	High Basis in Delivery Period	Low Basis in Delivery Period	Range of Basis in Delivery Period
Jun 1992 to Apr 1995	12.3	64	-0.586	0.419	0.172	-1.337	1.509
Jun 1995 to Apr 1998	12.6	286	-1.156	0.564	-0.268	-2.193	1.926
Jun 1998 to Dec 1999	17.8	540	-1.209	0.634	-0.184	-2.499	2.316

Have We Been Better Off Since the June 1998 Contract Change?

DELIVERIES have almost doubled 89%

There been 5% less CONVERGENCE in the basis 5%

The VARIABILITY of the daily basis has increased 12% 12%

The average BASIS RANGE (high basis minus low basis) during that month has increased 20% 20%

ATTACHMENT 4

AM_LS724
Amarillo, Texas Fri, Feb 4, 2000 USDA Dept of Ag Market News

5 Area Daily Weighted Average - Texas/Oklahoma; Kansas; Nebraska; Colorado; and Iowa/So. Minnesota Feedlots for: Thu, Feb 3, 2000

Confirmed: 110,590		Week Ago: 119,963	Last Year: 163,644
Week to Date: 418,175		Week Ago: 278,690	Last Year: 359,898

Live Basis Sales	Weight Range	Price Range	Weighted Averages	
Slaughter Steers (Beef Breeds)				
265 CH 80-100%	1325 lbs	$68.63	1325 lbs	$68.63
3,643 SE/CH 65-80%	1309 -1336 lbs	$68.28 - $68.29	1319 lbs	$68.28
37,786 SE/CH 35-65%	1249 -1328 lbs	$67.98 - $69.48	1258 lbs	$69.37
1,904 SE/CH 20-35%	1227 -1230 lbs	$68.27 - $68.76	1228 lbs	$68.50
Slaughter Heifers (Beef Breeds)				
1,466 CH 80-100%	1238 lbs	$68.88	1238 lbs	$68.88
5,004 SE/CH 65-80%	1193 -1233 lbs	$68.55 - $68.70	1220 lbs	$68.65
30,215 SE/CH 35-65%	1108 -1230 lbs	$68.50 - $69.53	1132 lbs	$69.39
149 SE/CH 20-35%	1116 lbs	$68.36	1116 lbs	$68.36

Dressed Basis Sales	Weight Range	Price Range	Weighted Averages	
Slaughter Steers (Beef Breeds)				
623 CH 80-100%	1328 lbs	$108.85	1328 lbs	$108.85
5,217 SE/CH 65-80%	1290 -1327 lbs	$108.67 -$108.90	1310 lbs	$108.77
3,484 SE/CH 35-65%	1229 -1338 lbs	$108.41 -$109.72	1307 lbs	$108.75
Slaughter Heifers (Beef Breeds)				
1,231 CH 80-100%	1228 lbs	$109.00	1228 lbs	$109.00
5,064 SE/CH 65-80%	1191 -1228 lbs	$108.73 -$108.83	1213 lbs	$108.79
5,468 SE/CH 35-65%	1025 -1224 lbs	$108.79 -$109.00	1143 lbs	$108.87

Thursday's Daily Weighted Averages (Beef Breeds)

Live Steer	: 1262 lbs	- 69.24	- 43,598 Hd.
Live Heifer	: 1148 lbs	- 69.26	- 36,834 Hd.
Dressed Steer	: 1310 lbs	- 108.77	- 9,324 Hd.
Dressed Heifer	: 1182 lbs	- 108.85	- 11,763 Hd.

STEER PRICES

Total Other: 9,071 Hd. Total Weighted -101,519 Hd.

Week Ago Weighted Averages:

Live Steer	: 1302 lbs	- 67.59
Live Heifer	: 1164 lbs	- 67.68
Dressed Steer	: 1317 lbs	- 107.39
Dressed Heifer	: 1198 lbs	- 107.54

Year Ago Weighted Averages:

Live Steer	: 1258 lbs	- 62.44
Live Heifer	: 1148 lbs	62.49
Dressed Steer	: 1297 lbs	- 98.36
Dressed Heifer	: 1188 lbs	- 98.39

Other includes contracted sales, formula sales, Holsteins, heiferettes, and cattle sold earlier in the week but data not collected day of sale.

Source: USDA-TX Dept of Ag Market News, Amarillo, TX
806/372-6361 - 24 hour markets 806/372-3494
www.ams.usda.gov/mncs/mn_reports/am_ls724.txt

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Attachment 5