UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

In re:	)	P. & S. Docket No. D-99-0010
	)	
Excel Corporation,	)	
	)	
Respondent	)	**Decision and Order**

This disciplinary proceeding was instituted under the Packers and Stockyards Act, 1921, as amended and supplemented, (7 U.S.C. § 181 *et seq.*)("Act") by a complaint filed on April 9, 1999, by the Deputy Administrator, Packers and Stockyards Programs, Grain Inspection, Packers and Stockyards Administration, United States Department of Agriculture. An amended complaint was filed on April 21, 1999, and the complaint was further amended at the hearing. The complaints (referred to hereafter as the "complaint") allege that Respondent Excel Corporation wilfully violated the Act and regulations promulgated thereunder by the Secretary of Agriculture.

Specifically, Respondent (hereafter referred to as "Excel") is alleged to have violated Section 202(a) of the Act (7 U.S.C. § 192(a)) and Section 201.99 of the regulations (9 C.F.R. § 201.99) by failing to make known to hog sellers the details of its purchase contracts, including the calculation of price, prior to purchasing hogs on a carcass grade, carcass weight, or carcass grade and weight basis.

A hearing was held on July 18-21 and July 25-28, 2000, in Wichita, Kansas; September 25-27, 2000, in Chicago, Illinois, and March 27-29, 2001, in Wichita, Kansas. Complainant was represented by Patrice Harps, Esq., and Eric Paul, Esq. Excel was represented by John Fleder, Esq., Brett Schwemer, Esq., and Jeff P. DeGraffenreid, Esq.

Statement of the Case

Excel Corporation, a meat packer, buys livestock for slaughter which it then manufactures into meat products for sale in commerce. Its corporate address is P.O. Box 2519, Wichita, Kansas 67201. It is estimated to be the fourth or fifth largest hog slaughterer in the United States. (Tr. 2329.)

Excel acquires its hogs from over 2,000 producers/sellers. (Tr. 1548.) The record does not indicate the total number of hogs processed by Excel, but at one of its three facilities it slaughters up to ten thousand a day. (RX 55; Tr. 131.) Some animals are bought on a "spot" market basis, that is, the price is negotiated for that particular lot of hogs. Others are obtained through short and long term contracts whereby producers agree to sell a given number of hogs to Excel for a set base price. Not all contracts are in writing. (Tr. 128.)

Most hogs are sold to Excel under its "carcass merit" program which rewards producers who raise hogs having a greater percent of lean meat. These hogs have a higher market value. The process starts with a producer delivering his/her hogs to one of Excel's buying stations where the hogs are put into a holding pen, tattooed for identification, given a lot number, weighed, and inspected. They are then transported to one of Excel's slaughtering facilities which are located in Beardstown, Illinois, Ottumwa, Iowa, and Marshall, Missouri. After a hog is killed, bled, eviscerated, de-haired, washed, and inspected, the carcass is evaluated for its estimated percentage of lean (red) meat. Excel then applies this percentage figure to a pricing

table called the "lean percent matrix" to determine whether the hog seller receives a discount for the carcass -- a deduction from the base price -- or a premium -- an addition to the base price. The higher the lean percent the higher the premium.

There are various ways of determining lean percent but there is no industry standard. (Tr. 947.) The most accurate (but obviously also the most impractical method for large scale operations) is to dissect a carcass and examine it for its fat and lean meat content. (Tr. 654, 671, 1500.) Other methods are less accurate and provide only estimates or predictions of lean percent. These methods are called Ultrasound, ToBEC, AutoFom, and the Fat-O-Meter. (RX 20.) The method used by Excel is the Fat-O-Meter ("FOM").

The FOM, developed in Denmark from a study of European hogs, has been used by Excel for about ten years. It is a hand-held device with a probe that is inserted in the carcass. A light measures the difference between the loin-eye and back fat depth. A regression formula or equation imbedded in the FOM, commonly referred to as the "Danish Formula" (Lean Meat = 58.86 - 0.61 x Back Fat + 0.12 x Loin Eye Depth), then uses these measurements to estimate the carcass' lean percent. (CX 4, p. 12.) A representative for SFK, Inc., the company manufacturing the Fat-O-Meter, testified that the device is used world-wide and that it is a USDA approved grading system. He said it is used by thirty-two U.S. packers, but he did not know how many rely solely on the Danish Formula to determine lean percent. He said the FOM provides data to a packer and that the packer then determines how the information is used. Formulas vary from packer to packer with at least three using the Danish Formula. (Tr. 1187-1188.) Some use a hog's hot carcass weight (the weight after the slaughtering process is completed but before chilling) together with the Danish Formula to estimate lean percent. (Tr. 60, 63, 76-77, 80.)

Scott Eilert, Excel's research director, and Gary Kohake, former president of Excel's Pork Division, testified that they considered the Fat-O-Meter to be a grading system. (Tr. 105, 948.) Steve Meyer, an economist with the National Pork Producers Council, testified that grading is a system to categorize carcasses and that an equation to estimate lean percent is part of the grading process. (Tr. 654-679.) David Meisinger, an assistant vice president with the National Pork Producers Council, opined that grading includes all carcass evaluation systems. (Tr. 1498.) USDA no longer has a grading system. Packers use their own grading system to evaluate carcasses which, as discussed later, must be disclosed to producers.

After a producer's lot of hogs is evaluated for lean percent a computer determines the payment the producer will receive. The check sent to the producer is accompanied by a "kill sheet." This sheet contains such pertinent information as the date and number of hogs purchased, trim loss, lean percent, and value of each hog. (CX 6, p. 30; Tr. 252.) It is in the producer's economic interest to raise lean hogs and as one Excel representative put it, the kill sheet tells a producer how his/her hogs "performed." (Tr. 140, 994, 1487.)

Producers selling hogs on a carcass merit basis were aware that Excel used the FOM to determine lean percent and that, based on the lean percent, the matrix determined the price they received. (Tr. 430, 927, 1552.) Excel provided its buyers with an explanation of the formula that they could use to explain it to producers, and some producers were told the formula. However, Excel did not generally inform producers of the details of the formula. (Tr. 314, 441, 769, 1071, 1084, 1208, 1552, 1481, 1604, 1648.)

Complainant was aware prior to 1997 that Excel did not tell producers the formula. Its May 12, 1993, audit report on Excel's use of the FOM stated: "The formula to convert probe millimeter readings to percentage of lean is not relayed to producers." (RX 55, p. 2; Tr. 441, 445-

446, 1604). The record further indicates that other packers in the industry that used the FOM also did not tell producers about their lean percent formulas. (Tr. 672, 1214, 1372, 1345, 1648, 2455.) One packer developed a brochure explaining its formula but it was not established that it had been prepared prior to the year 2000 or distributed to producers.. (Tr. 985-986.)

In 1997 Excel began an effort to improve on the accuracy of FOM's Danish Formula to determine lean percent which it estimated was only about 72-73% accurate. (Tr. 910, 1633.) After studying various methods, it adopted a formula developed by Purdue University and promoted by the National Pork Producers Council (NPPC). This formula used hot carcass weight as a variable with the Danish Formula to determine lean percent (2.827 + (.469*Hot Carcass Weight) - (18.47*Backfat Depth*.0393701) + (9.824*Loineye Depth*0.0393701)/HotCarcass Weight). (CX 6, p. 13.) The Purdue/NPPC formula was estimated to improve the accuracy in measuring lean percent to about 90 percent. (Tr. 910, 1771.)

The NPPC is a contractor with the National Pork Board which is funded under a USDA program through an assessment on each hog.sold. The mission of the NPPC is to improve the profitability of hog producers and provide consumers with a lean, wholesome and nutritious product. It believes that accuracy in the evaluation and measurement of the lean percent of carcasses leads to better pricing for producers. (Tr. 668, 673, 1202, 1456, 1487, 1513.)

Excel, knowing the formula change could affect hog pricing, considered the economic effect of the new formula on producers. (Tr. 115.) It concluded, based on a study of 1.5 million hogs, that there would be only a "minimal impact" on producers. (Tr. 910-911, 969, 1645, 1843.) Scott Eilert, Excel's research director, testified that the company estimated that there would be a one percent difference in what producers received between the Danish Formula and

the new equation and that, overall, "Some hogs would receive a higher lean percent as measured by our new equation, and some would receive a lower lean percent as measured by the new equation, and some would not change." (Tr. 966.)

Excel decided not to tell producers about the change in the formula because, while it was not a secret, company officials believed that the formula, like the processing methods and technology it used, was not a factor that interested the producers or formed a basis for whether they sold hogs to Excel. (Tr. 1645, 1649, 1725.) One of its procurement managers equated the formula change with using a more accurate scale. (Tr. 1548.) Another consideration was the corporate belief that producers who received more because of a change to a more accurate formula would be unhappy because they had been selling in the past under an inaccurate formula, while those who got less because of the change would be upset. (RX 47; Tr. 1689-1692.) Don Brandt, formerly an assistant buyer at the Ottumwa facility, testified that sometime in the fall of 1997 he overheard a telephone conversation between Gary Baack, the facility's procurement manager, Ted Fritz, the Beardstown procurement manager, and Richard Gallant, Excel's vice president for procurement, and that after the call Baack told Brandt that the producers were not to be told about the formula change. (Tr. 146.) Baack, however, testified that he was never told by Gallant not to tell producers about the formula change. (Tr. 1044.) Fritz testified that Gallant had told him that there was no need to tell producers about the change but that he was not told not to tell producers. (Tr. 1521.) Gallant said he had called all his procurement managers in the fall of 1997 about the formula change, except for Baack, who was on vacation at the time. (Tr. 1852.)

Before implementing the formula change, Excel examined its written contracts with producers to determine if any required notice of the change. It concluded that its agreement with

Tyson Foods, which supplied the majority of the hogs for its Marshall, Missouri, slaughtering facility, required that Tyson be notified of the formula change. The contract provided that, while Excel had the right to change its method of carcass evaluation, it had to conduct statistically sound tests to verify that Tyson did not suffer any adverse economic effects from such change and that if it did Tyson could terminate the contract. (CX 10, p. 283.) Tyson was notified of the change. When it objected to the change Excel did not apply the new formula to Tyson's hogs. (Tr. 746-750.) There was a similar provision in Excel's contracts with some of the other producers, including Heartland, and Hog, Inc., except that these producers, while having the right to have the matter submitted to arbitration, did not have the option to terminate the contract. (CX 11, p. 7; CX 12, p. 11.) Excel did not notify these producers or the others of its intention to change the formula. (Tr. 314, 1075.) Excel implemented the change at its Ottumwa and Beardstown slaughtering facilities in October 1997 and at Marshall in April 1998. (Tr. 126.)

About fifty percent of the producers supplying hogs to Excel always sold to Excel. (Tr. 1589.) Others sold trial lots to Excel and to other packers to determine where they could get the best price. (Tr. 662, 1180, 1192, 1379, 1587.) Depending on where they were located, producers could sell to from three to seven packers including Excel. (Tr. 1068, 1186, 1241, 1328, 1337, 1368.) All packers appear to base their prices on base price, lean percent, and a matrix. (Tr. 1103, 1379, 1380, 1589.) The result for a producer, as one testified, was that "Unfortunately, it's not straightforward and it's not really an apples and oranges comparison within the industry. Every packer has a slightly different grading program. They use slightly different means of getting to the same point for the end value. And so it's just not a cut and dry answer, yes or no, that one pays more than the other. It depends on the base price and the grade premium, and you add all those together to determine where is the best place to market the

hogs." (Tr. 1103.) Thus, for a producer, "my net dollars per hog is my main concern." (Tr. 1380.)

Beginning in late 1997, after the formula change was implemented, some producers noticed a difference in the prices they were receiving for the hogs they sold to Excel. They discovered this by comparing Excel's prices with those of other packers or even with the price they received at the Marshall facility, which did not change to the new formula until April 1998. Those who kept records from information on their kill sheets for past sales also knew the price they should receive for the quality of their hogs. (Tr. 142, 148, 406, 772, 1074-1075, 1328, 1363, 1379, 1591, 1594.)

One producer estimated the change to be a deficiency of about $1.25 a head. (Tr. 1087.) Producers initially thought the change might be attributable to a seasonal fluctuation or a change in operations. (Tr. 319, 1075.) Producers also began asking Excel's managers at its slaughtering facilities about the matter. (Tr. 142-143, 1075, 1201.) The record indicates that producers who asked were told about the formula change. (Tr. 402, 1202.) This included Hog, Inc., a cooperative with over 100 producer members. It was faxed a copy of the new formula in February 1998 after contacting Excel. (Tr. 1075-1077, 1411.) Gene Fangmann, the procurement manager at the Marshall facility, testified that he notified all the hog suppliers for the Marshall facility by phone of the formula change in April 1998 after the change was implemented at that plant. (Tr. 1619.)

Also in April 1998 Complainant initiated what appears to have been a routine investigation of Excel's use of the Fat-O-Meter. The record indicates that Complainant had started these FOM investigations, or audits, of the industry in 1993 at NPPC's request. A NPPC representative testified that prior to 1992 Complainant lacked a working knowledge of the Fat-O-

Meter which, while relatively new, was a device the industry was beginning to use as part of the purchasing process. It requested in 1992 that Complainant develop a program to monitor the use of the FOM and that producers should be made aware of the way lean percent is determined. (Tr. 1308-1313, 1496.)

In 1993, Complainant instituted such a compliance program. (Tr. 2460.) It conducted its first investigation of Excel that year to "review the accuracy of Excel's Fat-O-Meter; proper application of the payment formula; and the proper application of the Fat-O-Meter." (RX 55.) As noted earlier, Complainant's report of the 1993 audit stated that the FOM formula used by Excel was not relayed to producers. It made a similar comment in its 1994 report. (RX 57.) Gene Fangmann, the manager at the Ottumwa facility at that time, testified that when asked by investigators in 1994 if producers were told the formula and he replied that they had not, they responded that their audit indicated that "everything was up to snuff" and "looks fine." (Tr. 1605.) Complainant conducted four audits between 1993 and 1997. Bryice Wilke, one of the investigators in 1994, testified that Complainant found no violations as a result of these FOM investigations. (Tr. 217, 288.)

Wilke, while conducting the 1998 audit, found that the prices that producers should have been paid using the Danish Formula were not those that appeared on the kill sheets. Richard Gallant, Excel's vice president, told Wilke that Excel had changed the formula. (Tr. 255-256, 403, 1856.) Wilke then learned from some producers that they had not been told of the formula change. (Tr. 441.)

Wilke stated he believed that under the Department's regulations Excel was required to disclose its formula for lean percent to producers and that he was of the same belief when he prepared the report in 1994 which noted that Excel had not disclosed the formula to producers.

(Tr. 439-440.) He did not tell Excel at the time that he believed the failure to disclose the formula was a violation. (Tr. 1604-1605.) He explained that as an investigator he is an information gatherer and prepares reports and that it is for his superiors to determine whether a violation was committed. (Tr. 446.) His superior, Jay Johnson, Supervisor of Complainant's Des Moines Regional Office, testified when asked about the 1994 report that "There are many times that we may find a violation and not file a formal administrative action. I do not know if the conclusion was made that there were no violations." (Tr. 2456.)

In 1997 Excel was unaware of any requirement by Complainant to notify producers of the formula or its change when not requested. (Tr. 1653, 1861-1864.) NPPC was also unaware. (Tr. 1481.) Complainant said it had given Excel such notice in a 1992 letter that stated "Regulation 201.99 issued under the provisions of the Packers and Stockyards Act (1921, as amended) requires that a packer make known to the seller, prior to the purchase the details of the purchase contract, and then provide a true written account of such purchase including all information affecting final payment and accounting." This letter related to a matter of accounting for lost or misidentified hog carcasses rather than to the FOM. (CX 17.)

As a result of the 1998 investigation Complainant decided that Excel's failure to disclose the formula to producers when it was changed in 1997 was a violation of section 201.99 of the Department's regulations. Excel was told of the alleged violation in June 1998. (Tr. 1858.) In July 1998 Excel sent a letter to producers notifying them that the formula had been changed. (Tr. 1400.) It also adjusted the matrix so that producers received the same price under the new formula as they would have received under the old formula. (Tr. 1624-1625.) Excel said that it received no complaints from producers and that none stopped selling hogs to it because of the formula change. (Tr. 1046, 1586, 1601.) However, among producers there was a mixed

reaction. Some favored the change to a more accurate formula, some were indifferent, and some were upset with Excel's failure to notify them of the change. (Tr. 633, 1046, 1084, 1091, 1099, 1159, 1203, 1207, 1365.)

Excel reached a settlement with Heartland and Hog, Inc., on their contract dispute relating to the formula change and sent checks to other producers containing amounts that it calculated was the difference between what the producers received under the new formula and what they would have received under the old formula from the time of the formula change to the date they were notified of the change. Excel did not try to recover from those producers who were paid more because of the change. (RX 51; Tr. 1006-1007.)

Complainant, like Excel, determined that the difference in the estimate of lean percent between the new and old formulas was about one percent. (Tr. 735.) However, the differential had a greater disparate impact on producers than Excel expected. Complainant estimated that the difference resulted in eighty-seven percent of the producers receiving less and thirteen percent receiving more because of the formula change and that Excel paid producers approximately $1,841,585.34 less under the new formula then they would have been paid under the old formula, or an average of about $90.20 less per lot. (CX 9; Tr. 814-821.)

When Excel responded that it had paid producers $3,093,581 (including interest at 5.85 percent) as the difference between the new and old formulas (RX 51), Complainant recalculated its estimate and determined that Excel had still underpaid producers by $635,345.52 and that some producers had not received a payment. (Tr. 2051.)

The initial complaint alleging that Excel's unannounced change in the formula violated the Act and regulations was filed on April 9, 1999. Complainant seeks a penalty of eight million dollars.

Law

Section 201 of the Packers and Stockyards Act (7 U.S.C. § 191) provides:

When used in this Act the term "packer" means any person engaged in the business (a) of buying livestock in commerce for purposes of slaughter, or (b) of manufacturing or preparing meats or meat food products for sale or shipment in commerce, or (c) of marketing meats, meat food products, or livestock products in an unmanufactured form acting as a wholesale broker, dealer, or distributor in commerce.

Section 202 of the Act (7 U.S.C. § 192):

It shall be unlawful for any packer with respect to livestock, meats, meat food products, or livestock products in unmanufactured form, or for any live poultry dealer with respect to live poultry, to:

(a) Engage in or use any unfair, unjustly discriminatory, or deceptive practice or device;

. . . .

Section 407 of the Act (7 U.S.C. § 228) provides:

(a) The Secretary may make such rules, regulations and orders as may be necessary to carry out the provisions of this Act and may cooperate with any department or agency of the Government, any State, Territory, District, or possession, or department, agency, or political subdivision thereof, or any person;

. . . .

GIPSA Regulations (9 C.F.R. § 201.99) provide:

(a) Each packer purchasing livestock on a carcass grade, carcass weight, or carcass grade and weight basis shall, prior to such purchase, make known to the seller, or to his duly authorized agent, the details of the purchase contract. Such details shall include, when applicable, expected date and place of slaughter, carcass price, condemnation terms, description of the carcass trim, grading to be used, accounting, and any special conditions.

. . . .

(e) Settlement and final payment for livestock purchased by a packer on a USDA carcass grade shall be on an official (final - not preliminary) grade. If settlement and final payment are based upon any grades other than official USDA grades, such other grades shall be set forth in detailed written specifications which shall be made available to the seller or his duly authorized agent. . . .

Discussion

The issue in this case is whether Excel had a duty under section 202(a) of the Act and section 201.99 of the regulations to notify producers when it changed its formula for estimating lean percent and, if it had such a duty, what penalty is appropriate for a violation of that duty. The salient facts are not in dispute. The parties are in agreement that Excel did not tell all producers when it changed the formula and did not disclose details of the formula to all producers.

Complainant's theory expressed in its complaint is that the Fat-O-Meter's formula for the measurement of lean percent is a method to calculate the purchase price of hogs and that Excel violated section 201.99 of the regulations when it failed to notify producers of the changed formula because "every packer must make known to sellers the details of purchase contracts, including the calculation of price, prior to purchasing hogs on a carcass grade, carcass weight, or carcass grade and weight (i.e., carcass merit) basis (9 C.F.R. § 201.99)." Complainant argues in its brief that the formula, as a method to measure lean percent, is an "essential element" of the "grading to be used" by Excel and that "it is extremely important that the producer know the process and elements involved in estimating the lean percent of each hog. The price depends on it. Without this information the price cannot be 'discovered' by the producer. . .; the producer cannot determine or estimate the price offered by one packer in order to compare it to the price offered by another packer."

Complainant further contends in its brief that Excel had a contractual good faith duty to tell producers of any changes in the formula and that in the case of Heartland it had the duty under section 201.99(e) to provide, on request, "any specific information about when and why

the change occurred." Complainant argues that Excel's treatment of Tyson Foods (excluding it from the formula change) was unfair disparate treatment of the other producers and that its failure to notify producers of the formula change constituted a false statement that was analogous to short-weighing which violated the producers' trust. It alleges that Excel's action constituted an unfair and deceptive practice in violation of section 202(a) of the Act and caused producers to suffer substantial economic harm.

Excel denies that it violated the Act and regulations. It contends, inter alia, that Complainant has not met its burden of proving a violation of the Act, that the complaint was politically motivated, that Complainant's interpretation of the Act is not entitled to deference, that the Act must be narrowly construed, that section 201.99 of the regulations is not a substantive regulation and lacks the force and effect of law, that the regulation is vague and does not refer to formulas to estimate lean percent or define "grading to be used," that notice to producers of the formula change was a contractual matter, that producers did not care whether the formula was changed, that Excel did not have legal duty to give notification of the change, that Excel was not given prior warning or notice of Complainant's interpretation of the Act and regulations or the penalty it seeks, that the Act does not authorize a penalty for a violation of the regulations, that the proposed penalty is excessive and violates the Eighth Amendment, and that the proposed cease and desist order is not appropriate.

When Congress enacted the Packers and Stockyards Act it intended that the Department of Agriculture have flexibility in the Act's administration. One sponsor stated:

> Industry is progressive. The methods of industry and of manufacture and distribution change from day to day, and no positive ironclad rule of law can be written upon the statute books which will keep pace with the progress of industry. So we have not sought to write into this bill arbitrary and iron-clad rules of law. We have rather chosen to lay down certain more or less definite rules, rules which are sufficiently flexible to enable the

> administrative authority to keep pace with the changes of methods in distribution and manufacture and in industry in the country.

61 Cong. Rec. 1887 (1921); 10 Agriculture Law (Matthew Bender), Packers and Stockyards Act, § 71.07, n.15.

Courts have held that Congress intended for the the Act to be remedial legislation.

> The Act is remedial legislation and is to be construed liberally in accord with its purpose to prevent economic harm to producers and consumers at the expense of middlemen. *Stafford v. Wallace*, 258 U.S. 495, 521, 42 S.Ct. 397, 66 L.Ed. 735; *Safeway Stores, Inc. v. Freeman*, 125 U.S.App.D.C. 175, 369 F.2d 952, 956 (1966).

Swift & Company v. United States, 393 F.2d 247, 253 (7th Cir. 1968.)

In 1967 the Department published in the Federal Register a notice of proposed rulemaking relating to livestock purchases. (32 Fed.Reg. 7858, May 30, 1967.) After receiving and considering comments from the industry, the Department adopted the rule as section 201.99 of the Packers and Stockyards Administration's regulations. It stated that "it is the view of the Packers and Stockyards Administration that settlement and final payment for livestock purchased by a packer on a carcass weight or carcass grade and weight basis should be on the actual (hot) carcass weights. It is the view of the Administration that such basis for settlement and final payment is fair, reasonable, and nondiscriminatory and is necessary to avoid unfair, unjustly discriminatory and deceptive practices in connection with such purchases." (33 Fed.Reg. 2760, Feb. 9, 1968.) Section 201.99(a) of the new regulation provided that prior to purchasing livestock a packer shall make known to the seller "details of the purchase contract" such as "carcass price" and the "grading to be used." Section 201.99(e) provided the added requirement that if payment is based on any grade other than USDA grades the packer shall make available to the seller detailed written specifications of such grades.

The Packers and Stockyards Administration provided answers to questions by industry members on the new regulations. On the matter of the details about grading that a packer was to provide to producers (sellers) it said:

> Q. Does the buyer have to furnish the seller on each transaction a set of written specifications for his house grades if they agree to use house grades?
>
> A. A set of detailed written standards must be established for each house grade used in this type of marketing. These must be kept on file by the packer and made available to the seller or his duly authorized agent for review upon request. It is not necessary to furnish a copy of these standards to each seller or his duly authorized agent, but they must be available for their inspection.

(RX 50, p. 71.)

The Department also announced that section 201.99 "sets forth the official position of the Packers and Stockyards Administration that to engage in the practices prohibited by the regulation is a violation of the statute." (RX 50, p. 35.)

However, at the time section 201.99 took effect in 1968, regulations promulgated under the Packers and Stockyards Act were advisory only. *Finger Lakes Livestock Exchange, Inc., et al.*, 48 Agric. Dec. 390, n. 3 (1989). Then, in 1974 the Administration stated that it could issue substantive regulations (i.e., having the force and effect of law) as well as advisory regulations and that whether a particular regulation was advisory or substantive was to be determined on a case by case basis. *Wilkes County Stock Yard, Inc.*, 48 Agric. Dec. 1015, 1040 (1989). In 1984, the Department reviewed certain of its regulations, including 201.99, and stated that, except for a proviso in 201.99(d) (not relevant to this proceeding), it was retaining 201.99 because the reasons in 1968 for adopting the section "remain equally valid today." (49 Fed. Reg. 37371, Sept. 24, 1984.)

Complainant contends that section 201.99 is a substantive rule that it has enforced many times. It states that since 1986 it has filed thirty complaints alleging a violation of section 201.99, with most dealing with false weighing. Excel contends that because section 201.99 was adopted in 1968 when such regulations were considered advisory the regulation continues to be advisory and therefore non-binding.

Although promulgated in 1968, section 201.99 was adopted after notice was published in the Federal Register for public notice and comment as required for rulemaking under the Administrative Procedure Act. The Department has authority under the Packers and Stockyards Act to issue regulations to implement the Act. Section 201.99 was such a regulation as it "legislated" a new standard of conduct for members of the industry relating to disclosure of information rather than merely explaining the meaning of the Act. Non-compliance with section 201.99 is considered to be a violation of the Act, and the Department considered and specifically retained the regulation in 1984. In these circumstances, I find that section 201.99 is a substantive rule having the force and effect of law.

Excel contends that notice of the formula change was a contractual rather than a legal matter between it and producers and that they in effect waived whatever right they had to notice because they did not care whether the formula was changed. The argument that producers did not care when the formula was changed is belied by the reaction by such producers as Tyson Foods, Hog Inc., and Heartland. It is also a tenuous argument to suggest that over 2,000 producers whose livelihood depends on marketing hogs do not care about matters that affect hog pricing. The argument, moreover, is irrelevant. A person cannot waive a right that "implicates institutional and societal values that transcend the individual's interest." *U.S. v. Ready*, 82 F.3d 551, 555 (2nd Cir. 1996); *cf. Tony & Susan Alamo Foundation v. Sec. of Labor*, 471 U.S. 290

(1985). The Packers and Stockyards Act was enacted in the public's interest to provide statutory protection to producers and consumers against unfair economic harm. Rights extending from that Act and its regulations cannot be contractually or otherwise waived.

Excel also argues that institution of the complaint was politically motivated. Complainant has discretion, regardless of motive, to be selective in its enforcement of the Act. Its motives are immaterial as long as its action is not arbitrary. *American Fruit Purveyors*, 38 Agric. Dec. 1372, 1385 (1979). I do not find that institution of this proceeding was arbitrary. Rather I find that Complainant's stated concern for the impact on producers of technological changes that affect the prices they receive was consistent with Complainant's Congressionally mandated mission to have the flexibility "to keep pace with the changes of methods of distribution and manufacture" in the industry.

Excel further argues that section 201.99 is too vague to be enforceable. It contends that the regulation does not define formula, grading or calculation of price and that it was entitled to notice from Complainant that it had a duty to tell producers of changes in the formula.

The regulation is not vague or ambiguous. The record is clear that all parties considered the Fat-O-Meter to be a form of grading. The formula was also a part of the grading system within the meaning of section 201.99 as it was an element of Excel's carcass evaluation process.

As for notice, its purpose, when required in administrative adjudicatory proceedings, is to allow the party affected an opportunity to come into compliance before enforcement proceedings are instituted. (5 U.S.C. § 558.) However, it is well settled that an agency does not have to give notice prior to instituting an enforcement proceeding when the action involves clarification or an interpretation of a statute or regulation. *Blattner v. Sec. of Labor*, 152 F.3d 1102, 1109 (9th Cir. 1998). If notice were required in this case, Complainant contends that it had given Excel notice

in 1992 and again in June 1998. The 1992 notice, however, would be inadequate as it was merely a restatement of Excel's general obligation under sections 201.99(a) and 201.99(e) and it was given even before Complainant was aware of Excel's use of the Fat-O-Meter. The notice in June 1998 was specific but Complainant still instituted this enforcement proceeding even though Excel attempted to come into compliance after receiving notice.

Notice, of course, is required by The Administrative Procedure Act when an agency engages in rulemaking. (5 U.S.C. § 553.) Excel does not directly raise the rulemaking issue but does so indirectly by arguing that it was entitled to notice because section 201.99 is too vague to support Complainant's theory of the case. Complainant, for its part, seems to have anticipated the possibility of the rulemaking issue being raised by pointing out that it is well established that it can "set forth standards of conduct" by adjudication as well as by notice and comment rulemaking. (Reply brief, p. 13.) *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294 (1974). It notes that it is also well established that its interpretation of its regulations is entitled to great deference. *Chevron v. National Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

An agency, such as Complainant, engages in rulemaking rather than interpretation when it legislates new rights or duties.

> Generally speaking it seems to be established that "regulations," "substantive rules" or "legislative rules" are those which create law, usually implementary to an existing law, whereas interpretative rules are statements as to what the administrative officer thinks the statute or regulation means.

Gibson Wine Co. v. Snyder, 194 F.2d 329, 331 (D.C. Cir. 1952)[1]

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[1]See also *General Motors Corp. v. Ruckelshaus*, 742 F.2d 1561, 1565 (D.C. Cir. 1984): "[I]f by its action the agency intends to create new law, rights or duties, the rule is properly considered to be a legislative rule."

Complainant interprets section 201.99(a) in this proceeding as meaning that, whether producers request such information or not, "anything that affects payment to producers must be made known to producers prior to sale." (Reply brief, p. 12, Emphasis added; Tr. 2326.) While Complainant is entitled to great deference in its interpretation of its regulations, a reading of section 201.99(a) and (e) provides questionable support for its sweeping interpretation. Section 201.99(a) does relate to details to be disclosed in the purchase contract including, among other things, identification of the grading system that the packer uses. However, section 201.99(e) then proceeds to deal specifically with the packer's duty to disclose details of its grading system. In other words, section 201.99(e) provides that if a producer requests more specific information than the packer provides under 201.99(a) about the type of grading the packer uses, it is then that the packer's duty under section 201.99(e) is triggered to provide the producer with "detailed written specifications" about its grading system. Excel, pursuant to section 201.99(a), had disclosed to producers its grading system (i.e., the Fat-O-Meter) and it made available, pursuant to section 201.99(e), details of that system (i.e., the formula) if requested by a producer. This had been the Packers and Stockyards Administration's interpretation of a packer's disclosure duty under section 201.99 since 1968: "It is not necessary to furnish a copy of those [grading] standards to each seller or his duly authorized agent, but they must be available for their inspection." (RX 50, p. 71.)

This interpretation has been changed in this proceeding. Detailed specifications about grading (i.e., the formula) must now be provided to producers pursuant to section 201.99(a) as part of the purchase contract whether requested or not. The effect of this change not only makes section 201.99(e) redundant, it even exceeds that section's requirement that such information be disclosed only on request. In order to accommodate this revision of section 201.99 the regulation

has in effect been rewritten. Rather than being an interpretation, the revised regulation significantly expands the duty of packers to disclose information. It thereby creates a new standard of conduct for packers and a corresponding new right to know for producers. The revision thus legislates a new substantive rule.[2]

Even though Complainant is engaging in rulemaking, it can, as it points out, revise section 201.99 through this adjudicatory proceeding without complying with the notice and comment rulemaking requirement of the Administrative Procedure Act. *NLRB v. Bell Aerospace Co., supra*. I accordingly find that Complainant's new disclosure rule is valid. A packer that changes its grading formula without providing notice and disclosing details of the formula to producers violates section 201.99(a) of the regulations and section 202(a) of the Packers and Stockyards Act.

However, this presents the crucial issue, which the parties did not address, whether the new rule should be given retroactive effect. Ordinarily an order in an adjudicatory proceeding is effective retroactively whereas a new rule is effective prospectively. But that is not so in every case. "That such action [adjudicatory rulemaking] might have a retroactive effect was not necessarily fatal to its validity. Every case of first impression has a retroactive effect, whether the new principle is announced by a court or by an administrative agency. But such retroactivity must be balanced against the mischief of producing a result which is contrary to a statutory

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[2]Complainant contends that Excel's transgression under this new disclosure rule was in failing to tell producers the formula when it was changed. The rationale is that the formula is an "essential element" in the grading process and that it is "extremely important" that producers know the formula in order to compare prices offered by packers. If such information is essential to a producer's ability to make an informed choice, the force of the argument would give all producers a right to know the formula. The duty to disclose thus would logically extend to all packers and not just to those who change a formula.

design or to legal and equitable principles. If that mischief is greater than the ill effect of the retroactive application of a new standard, it is not the type of retroactivity which is condemned by law." *Securities and Exchange Commission v. Chenery Corp.*, 332 U.S. 194, 203 (1947).

"Nevertheless, a retrospective application can properly be withheld when to apply the new rule to past conduct or prior events would work a 'manifest injustice.' *See Thorpe*, 393 U.S. at 282, 89 S.Ct. At 526. The *Retail Wholesale* court [*Retail Wholesale & Department Store Union v. NLRB*, 466 F.2d 380 (D.C. Cir. 1972)] set forth a non-exhaustive list of five factors to assist courts in determining whether to grant an exception to the general rule permitting 'retroactive' application of a rule enunciated in an agency adjudication:

> (1) whether the particular case is one of first impression, (2) whether the new rule represents an abrupt departure from well established practice or merely attempts to fill an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and 'the statutory interest in applying a new rule despite the reliance of a party on the old standard."

Clark-Cowlitz Joint Operating Agency v. FERC, 826 F.2d 1074, 1081 (D.C. Cir. 1987). See also *Bowen v. Georgetown University Hosp.*, 488 U.S. 468, 471 (1988), "Retroactivity is not favored in the law."

The issue in this case involving a rule that changes a packer's disclosure duty is one of first impression. Complainant's stated policy in 1968 when section 201.99 was adopted was that grading details had to be made available but did not have to be disclosed by a packer unless requested. Complainant was aware in 1993 that Excel, and inferentially other packers, did not disclose the formula, a grading detail, to producers. Complainant took no action and did not warn Excel that failure to provide this information to producers would henceforth be considered a violation. The new rule, announced in June 1998, that the failure to disclose was a violation of section 201.99(a), was therefore a departure from Complainant's established policy. I also

infer from the circumstances that in 1997 when Excel changed the formula it relied on Complainant's policy at that time that a packer had to disclose such grading details as the formula only on request under section 201.99(e).

Complainant's reason for the new rule requiring disclosure is nevertheless still entitled to great deference. The rule seeks to provide producers, which are the persons the Act is intended to protect, with information that is essential to their ability to compare prices to assure that they obtain the best price when they market their livestock. Notwithstanding that the new rule is a departure from Complainant's previous policy and that Excel had relied on the previous policy, Excel has not demonstrated that providing details to producers about its grading system, including its formula, would be burdensome. Indeed, Excel does not appear to object to providing this information. On balance, comparing the "mischief" of making this order retroactive against its "ill effects," I find that because of its benefit to producers the new rule shall have retroactive effect and that Excel therefore violated section 201.99(a) of the regulations and section 202(a) of the Packers and Stockyards Act when it changed the formula without notifying producers.

Complainant seeks a penalty of eight million dollars. It contends that such penalty is necessary because of the great harm done to producers when Excel "unilaterally" changed the formula. (Tr. 2323.) It contends the measure of harm was the difference in what producers were paid between the new and old formulas. However, this is not necessarily the most accurate method of measuring harm.

Even under Complainant's new rule Excel continues to have the right (unless a contract provides otherwise) to "unilaterally" change the formula as long as it notifies producers and provides them with the formula. Since Excel, or any other packer, has the right, after notice, to

alter the price it pays by changing its formula, producers would not be legally harmed by the change. They can compare prices and choose to continue to sell to Excel or sell to a competitor. However, Excel impeded that choice in this case when it made an unannounced change in the formula. It thereby altered the price it offered producers without the producers knowing that the price structure had changed. Had they been alerted to the change they could have shopped their hogs to other packers to see if they could beat Excel's price under its changed formula. As Complainant states in its brief, the purpose of section 201.99 under its new rule "is to provide some basic level of similarity to allow sellers to evaluate the different purchase offers." (Brief, p. 91.) The assessment of harm to producers because of the change would therefore have been whatever higher market price they might have been able to obtain from Excel's competitors. Complainant, however, offered no evidence on the prices that producers could have received from other packers. The true extent of harm is therefore unknown.

Even assuming that the measure of harm is, as Complainant maintains, the difference in the price paid to producers under the new and old formulas, this harm was still minimized. Excel has paid the difference to producers, with interest. For those who may not have recouped the difference a remedy is provided below.

Excel, furthermore, voluntarily sought to come into compliance with the new rule and, while its action was unlawful, it was not wilful. At the time the action occurred in 1997 Complainant's policy was that a packer's duty under section 201.99 was to disclose such grading details as the formula only on request. Complainant was not given notice prior to 1998 that this policy was changed and that a new rule was being instituted. This factor significantly impacts any proposed penalty. "Traditional concepts of due process incorporated into administrative law preclude an agency from penalizing a private party for violating a rule without first providing

adequate notice of the substance of the rule." *Satellite Broadcasting Co., Inc. v. F.C.C.*, 824 F.2d 1, 3 (D.C. Cir. 1987). I accordingly find that a monetary penalty is not appropriate in the circumstances of this case.

For those producers who may not have been compensated for any shortfall because of the formula change, Complainant shall provide their names to Excel and Excel shall notify such producers in writing that, for purposes only of remedying the matter, Excel shall offer to allow the matter to be submitted to arbitration for resolution as this was a means of dispute resolution that Excel had agreed to with some of the other producers..

Complainant argues in its brief that Excel also violated section 201.99(e) when it failed to tell Heartland of the "when and why" of the formula change. Although this was not specifically alleged in the complaint, the argument will be considered under the general allegation in the complaint that Excel violated section 201.99 when it failed to notify producers of the change in the formula. Complainant, however, does not specify in its allegation what details of the "when and why" Excel failed to disclose. The allegation is therefore too ambiguous to serve as a basis for a finding of a violation.

Complainant also contends that Excel's agreement with Tyson Foods to exempt it from the formula change constituted disparate treatment of other producers who had agreements similar to Tyson's. Disparate treatment was not alleged in the complaint. I therefore do not find this to be a violation. I also do not find that Excel's adoption of a more accurate formula constituted a false statement.

Complainant further contends that Excel's failure to notify producers of the formula change violated its good faith duty to producers to notify them of changes in the terms of their contracts. However, it acknowledges that it did not allege in the complaint that a breach of

contract was a violation of the Act. (Reply brief, p. 15.) Accordingly, as it was not alleged in the complaint, I do not find a violation based on an alleged breach of contract.

Complainant seeks a "broad" cease and desist order. An order must bear a "reasonable relation to the unlawful practice found to exist." (*Swift & Company v. United States*, 317 F.2d 53, 56 (7th Cir. 1963)). The order will therefore reflect the conduct found unlawful herein.

Findings of Fact

1. Respondent, Excel Corporation, is a corporation whose mailing address is P.O. Box 2519, Wichita, Kansas 67201.

2. Respondent is a packer as defined by the Packers and Stockyards Act ("Act") and engaged in the business of buying livestock including hogs in commerce for purposes of slaughter and manufacture into meat products.

3. Respondent buys hogs from producers/sellers.

4. After hogs are slaughtered Respondent uses an instrument called the Fat-O-Meter and a formula or equation imbedded in the Fat-O-Meter to predict the lean meat percent of hog carcasses.

5. The estimated lean percent is used to calculate the price that hog producers will be paid for their hogs.

6. On or about October 1997 Respondent changed the formula for calculating the lean meat percent of hogs.

7. The Fat-O-Meter and the formula and the change in the formula are all "grading to be used" within the meaning of section 201.99 of the Regulations (9 C.F.R. § 201.99).

8. Respondent did not notify producers prior to changing the formula on or about October 1997 that it was changing the formula.

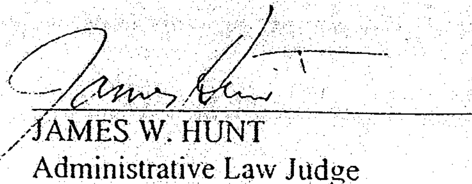
Conclusion of Law

Respondent, Excel Corporation, violated section 201.99(a) of the Regulations (9 C.F.R. § 201.99(a) and section 202(a) of the Packers and Stockyards Act, as amended (7 U.S.C. § 192(a)), when it failed to notify producers of the change in the formula to estimate lean percent.

Order

Respondent, Excel Corporation, its agents and employees, directly or through any corporate or other device, shall cease and desist from failing to notify livestock sellers, or their duly authorized agents, of the details of any change in the formula used to estimate lean meat percent. Upon receipt from Complainant of the names of sellers who sold hogs to Respondent between October 1997 and July 1998 under Respondent's changed formula and who may have received less than they would have received under the formula before it was changed and who have not otherwise been compensated or who otherwise have not resolved the matter through agreement with Respondent, Respondent shall promptly notify such sellers in writing that Respondent agrees to allow such sellers to submit the matter to arbitration for resolution.

This Decision and Order will become final and effective without further proceedings 35 days after service hereof, unless appealed to the Judicial Officer by a party to the proceedings within 30 days after service as provided in Sections 1.139 and 1.145 of the Rules of Practice (7 C.F.R. §§ 1.139 and 1.145).



JAMES W. HUNT
Administrative Law Judge

February 7, 2002