September 19, 2016

The Honorable Thomas Vilsack
Secretary
United States Department of Agriculture

Larry Mitchell
Administrator
Grain Inspection, Packers and Stockyards Administration
United States Department of Agriculture

Re: Request to Reopen Comment Period for June 22, 2010, Proposed "Implementation of Regulations Required Under Title XI of the Food, Conservation and Energy Act of 2008; Conduct in Violation of the Act," 75 *Fed. Reg.* 35338, Docket ID Number 2010-14875

Dear Secretary Vilsack and Administrator Mitchell:

In March of 2016 Secretary Vilsack announced the Grain Inspection, Packers and Stockyards Administration (GIPSA or the agency) was again working on the above-referenced Proposed Rule and intended to move forward with certain elements of that proposal. The undersigned organizations submitted comments in 2010 voicing their significant opposition to the Proposed Rule. The opposition expressed six years ago remains as staunch as ever and we urge the agency to abandon the Proposed Rule because of the significant adverse effect adopting it would have on the meat and poultry industry, particularly the producer community who will be disproportionately affected. Should you move forward with this effort we respectfully request that the agency reopen the rulemaking docket associated the Proposed Rule. Reopening the comment period will allow interested stakeholders to provide additional comments regarding the significant changes and developments in the livestock, meat, and poultry industry in the more than six years since the Proposed Rule was published.

The administrative record has grown stale and does not include significant and substantial changes that have occurred within the livestock marketplace in the years since the rulemaking docket was closed to comment. To afford interested stakeholders an opportunity to participate in an effective manner and enable the agency to consider the changes to the industry and the impact the Proposed Rule could have on those changes the agency should reopen the comment period. This action would enable the agency to update the information in its possession so any rule that might issue would be based on a complete record.

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Law and Policy Require a Meaningful Opportunity to Comment.

Based on press reports and discussions with GIPSA and other United States Department of Agriculture (USDA) officials, we understand the agency is developing a final rule or rules based on the 2010 Proposed Rule. When published in June 2010, the Proposed Rule was the subject of significant public debate and eventual Congressional action in response to numerous concerns about it. In the six years since publication in the *Federal Register* many elements of the Proposed Rule languished and the flawed rationale offered by the agency in June 2010 is less applicable today given the notable changes in the livestock, meat, and poultry industry. The agency should not rely on obsolete data about a livestock marketplace that has undergone notable change. Before publishing any final rule GIPSA must ensure the information it intends to use as the basis for any rule is current and reliable. The easiest and best way to accomplish that goal is to provide an additional window of opportunity for the regulated community to provide the agency additional updated information, data, and comments about the Proposed Rule.

The White House's Memorandum on Transparency and Open Government articulates three main directives for agencies to follow to achieve a more open government:

- Government should be transparent.
- Government should be participatory.
- Government should be collaborative.[1]

The President's policy on open government and enhanced opportunity for meaningful participation in the regulatory process is not new. Section 6(a)(1) of Executive Order 12866 (E.O. 12866) provides:

> Each agency **shall-(consistent with its own rules, regulations, or procedures) provide the public with meaningful participation in the regulatory process**. In particular, before issuing a notice of proposed rulemaking, each agency should, where appropriate, seek the involvement of those who are intended to benefit from and those expected to be burdened by any regulation (including, specifically, State, local, and tribal officials). **In addition, each agency should afford the public a meaningful opportunity to comment on any proposed regulation**, which in most cases should include

[1] https://www.whitehouse.gov/the_press_office/TransparencyandOpenGovernment

a comment period of not less than 60 days. (Emphasis added.).[2]

And section 6(a)(3) provides:

> In addition to adhering to its own rules and procedures and to the requirements of the Administrative Procedure Act, the Regulatory Flexibility Act, the Paperwork Reduction Act, and other applicable law, **each agency shall-develop its regulatory actions in a timely fashion** ...[3] (Emphasis added.)

On January 19, 2011, President Obama signed Executive Order 13563, Improving Regulation and Regulatory Review, which supplements the requirements of E.O. 12866 and provides in Section 2(a) that:

> (a) Regulations shall-be adopted through a process that involves public participation. To that end, regulations shall be based, to the extent feasible and consistent with law, on the open exchange of information and perspectives among State, local, and tribal officials, experts in relevant disciplines, affected stakeholders in the private sector, and the public as a whole.[4]

Although GIPSA provided an opportunity for affected stakeholders to comment on the Proposed Rule, more than six years have passed since its publication. If the agency relies only on the administrative record as it existed when the comment period closed in November 2010, it is affirmatively choosing to ignore the many changes in and evolution of the livestock, meat, and poultry industry during the past six years and would publish a rule on a record that can only be described as stale and not developed in a "timely fashion." Conversely, if the agency crafts a rule that recognizes and accounts for those changes without affording the affected industry an opportunity to provide comment and explain how those changes affect interested stakeholders the agency is denying those stakeholders the "meaningful opportunity to comment" required by E.O. 12866.

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[2] Executive Order 12866 of September 30, 1993, 58 *Fed. Reg.* No. 190 (Oct. 4, 1993)
[3] *Id.*
[4] https://www.whitehouse.gov/the-press-office/2011/01/18/executive-order-13563-improving-regulation-and-regulatory-review

Significant Change has occurred in the Livestock, Meat, and Poultry Sector.

The livestock, meat, and poultry sector is notably different than when the Proposed Rule was published in 2010. That evolution is such that it demands interested stakeholders be given the chance to submit additional comment about how elements of the Proposed Rule, if adopted, would affect the industry. For example, since June 2010 new markets have emerged and there is enhanced competition for sourcing livestock for slaughterhouses and packing plants. In the hog and pork industry there are at least three large, "greenfield" plants in various stages of construction or development.[5] Importantly, some of these plants are not owned by traditional meat packing companies, but by livestock producers. Likewise, since 2010 there have been even more rapid changes in retail consumer and food service sector demands for specific animal raising and handling practices, almost all which are accomplished on farm. These new demands have created new marketing and revenue opportunities for poultry and livestock producers and the meatpackers with which they partner, often through marketing agreements or other arrangements. Given these substantial developments, GIPSA cannot reasonably adopt a Final Rule at this time without conducting its own new assessment of the changes in the market since the Proposed Rule was issued,[6] and when it does, it must provide an opportunity for public comment on its new assessment.[7]

The economic consulting firm Informa Economics conducted a comprehensive analysis of the Proposed Rule's impact on the beef and pork sectors as part of the 2010 rulemaking process. The pork and beef sector contracted to have Informa provide an updated version of that study, which sheds light on many of the changes that have occurred during the nearly six years since the comment period closed.[8] Informa's updated review shows additional costs associated with the GIPSA rule of nearly $200 million caused by market changes that occurred since 2010, bringing the total cost for the beef and pork sector of this unnecessary rule to nearly $1.5 billion.

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[5] Clemens Food Group is building a "green field" plant in Coldwater, Michigan with plans to begin operations in the fall of 2017. Seaboard Foods and Triumph Foods have a joint venture with a new plant expected to begin operations in July 2017 in Sioux City, Iowa. Prestage Foods of Iowa has plans to build a plant in Wright County, Iowa and expects to be operational in mid-2018. In addition, two other facilities have undergone renovations expanding capacity.

[6] *Small Refiner Lead Phase-Down Task Force v. U.S. EPA*, 705 F.2d 506, 534 (D.C. Cir. 1983)(Agency "retains a duty to examine [its] key assumptions as part of its affirmative burden of promulgating and explaining a non-arbitrary, non-capricious rule." Internal quotations and citations omitted.)

[7] *Sierra Club v. Costle,* 657 F.2d 298, 398 (D.C. Cir. 1981)(If documents or studies on which the agency intends to rely for the final rule are placed in the docket "too late for any meaningful public comment," then there has been no effective means for public participation.) *See also Kennecott Copper v. EPA*, 684 F.2d 1007, 1019 (D.C. Cir. 1982)(When new data was placed in the rulemaking record a week before promulgation of the final rule and after the close of the public comment period, the public was deprived of the opportunity for comment on the new data.)

[8] See Attachment A.

Aggregate Economic Impacts Across Beef & Pork Sectors

	2010			2016		
	Pork	Beef	Total	Pork	Beef	Total
One Time Direct Costs	$ 68.70	$ 38.70	$ 107.40	$ 98.00	$ 19.60	$ 117.60
Ongoing Direct Costs	$ 73.80	$ 61.50	$ 135.30	$ 93.60	$ 44.50	$ 138.20
Cost Increase Due to Efficiency Loss	$ 176.70	$ 401.90	$ 578.60	$ 187.90	$ 517.10	$ 705.00
Revenue Loss	$ 82.20	$ 377.70	$ 459.90	$ 141.90	$ 373.60	$ 515.50
Total Supply Chain Loss	$401.40	$879.80	$1,281.20	$521.40	$954.80	$1,476.20

Likewise, the poultry industry commissioned a similar update to the study it submitted in 2010.[9] In addition to having its own duty to assess the developments in the industry since 2010, the agency would benefit from considering those beef, pork and poultry sector studies and others that would be part of the comments submitted by stakeholders addressing the changes in the industry.

We also understand the Office of the Chief Economist (OCE) has not participated in the work being done. That office did not initially participate when the Proposed Rule was prepared, but when subsequently provided the opportunity to do so, OCE concluded the economic impact was considerably greater than originally estimated. If the agency considers developing any rulemaking, the OCE should be engaged to ensure the analysis is comprehensive.

Not only do the facts dictate reopening the rulemaking if GIPSA elects to do anything, so does the law. "The Administrative Procedure Act, which governs the proceedings of administrative agencies and related judicial review, establishes a scheme of reasoned decision-making."[10] It is well established that an agency acts arbitrarily and capriciously in violation of this scheme where it "fail[s] to respond to substantial problems raised" in a proceeding.[11] It is not uncommon for an agency to

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[9] See Attachment B.

[10] *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 374 (1998) (internal quotation marks omitted).

[11] *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148-49 (D.C. Cir. 2011); *see also FiberTower Spectrum Holdings, LLC v. FCC*, 782 F.3d 692, 700 (D.C. Cir. 2015) (vacating order as arbitrary and capricious where "FiberTower alerted the Commission to its argument of factual error" and the Commission

recognize on its own that a rulemaking record has grown stale due to the passage of time and to either re-open the comment period to refresh that record or terminate the rulemaking process altogether.[12] And courts will remand a rulemaking to an agency if, in light of changed circumstances, the record has grown stale.[13]

Given the time that has passed since the agency published the Proposed Rule six years ago, the undersigned organizations respectfully request that, if the agency still believes one or more of the elements of the Proposed Rule should be considered, the rulemaking on those issues begin anew or at the very least the comment period be reopened to afford stakeholders a meaningful opportunity to gather and provide updated information about the current state of the livestock industry and everyone who would be affected by the Proposed Rule.

We look forward to discussing this request and await the opportunity to continue to work with you and your staff.

Respectfully submitted,

Kendal Frazier
National Cattlemen's Beef Association

Mike Brown
National Chicken Council

Neil Dierks
National Pork Producers Council

Joel Brandenberger
National Turkey Federation

Barry Carpenter
North American Meat Institute

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failed to address it); *Sorenson Commc'ns Inc. v. FCC*, 755 F.3d 702, 709-10 (D.C. Cir. 2014) ("The Commission left these serious concerns unaddressed. Accordingly, its decision . . . was arbitrary and capricious."); *Int'l Union, United Mine Workers of Am. v. Mine Safety & Health Admin.*, 626 F.3d 84, 94 (D.C. Cir. 2010) ("MSHA's failure to address these comments, or at best its attempt to address them in a conclusory manner, is fatal[.]").

[12] *See, e.g.*, *Verizon Telephone Co. v. FCC*, 453 F.3d 487, 493-94 (D.C. Cir. 2006) (describing re-opening of rulemaking record); *Southwestern Bell Telephone Co. v. FCC*, 19 F.3d 1475, 1482-83 (D.C. Cir. 1994) (describing agency's termination of rulemaking process based on staleness of six-year-old record).

[13] *See, e.g.*, *American Optometric Ass'n v. FTC*, 626 F.2d 896, 907 (D.C. Cir. 1980) ("[T]here are occasionally times in which the equities of a situation militate in favor of returning a rule to an agency for further consideration in light of new evidence."); *Greater Boston Television Corp. v. FCC*, 463 F.2d 268, 283 (D.C. Cir. 1971)

Attachment A

Informa Economics IEG
Agribusiness intelligence | informa

An Estimate of the Economic Impact of GIPSA's Proposed Rules on the Cattle and Hog Sectors

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September 2016

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Disclaimer

This report was produced for the National Cattlemen's Beef Association and the National Pork Producers Council. Informa Economics IEG ("Informa") and its partners have used the best and most accurate information available to complete this study. Informa is not in the business of soliciting or recommending specific investments. The reader of this report should consider the market risks inherent in any financial investment opportunity. Furthermore, while Informa has extended its best professional efforts in completing this analysis, the liability of Informa to the extent permitted by law, is limited to the professional fees received in connection with this project.

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I. EXECUTIVE SUMMARY

The 2008 farm bill included new provisions that amended the Packers and Stockyards Act (PSA) to give poultry and livestock growers the right to cancel contracts, to decline arbitration as a means to resolving contract disputes, and to require processors to clearly disclose additional required capital investments. In June 2010 USDA's Grain Inspection, Packers and Stockyards Administration (GIPSA) published a proposed rule to implement these regulations as mandated by the 2008 farm bill. But, the proposed rule, commonly referred to as the "GIPSA rule", added new regulations to clarify conduct that violates the Packers and Stockyards Act of 1921 (P&S Act). Some saw the resulting rule as going far beyond the intent of Congress, and contended that the rule altered business practices in a manner that was detrimental to producers, and limited consumer choice.

Before the USDA finalized the GIPSA Rule, Congress passed the Consolidated and Further Continuing Appropriations Act, 2012 which prohibited USDA from finalizing or implementing the most contentious parts of the GIPSA rule. Congress continued instituting appropriations riders to block these parts of the GIPSA rule but an appropriations rider was not included in the 2016 funding bill that passed in December 2015. As a result, in March 2016, Secretary of Agriculture's Tom Vilsack indicated the USDA will move forward with implementing the GIPSA rule, possibly finalizing it in September.

Informa Economics IEG was commissioned to conduct a study estimating the cost and revenue loss of implementing the rule to the beef and pork industries. As new language for the updated rule has not been released yet, it was assumed to be the same as the proposed rule from 2010 (not including aspects of the rule that have been approved and are currently enforced).

These estimates were aggregated to an industry-wide basis and worked through a simple supply-demand framework to arrive at an estimate of the change in output that was expected for each supply chain. This work indicates that the beef and pork industries will suffer significant economic damage should the proposed rules be implemented (Exhibit 1). Impacts were estimated to be nearly $1.5 billion to the beef and pork industries combined through direct and indirect costs. Specifically, the beef costs totaled approximately $955 million and the pork costs totaled $521 million. The fact that the estimated economic loss to beef and pork is high highlights the potential magnitude of the unintended consequences.

Exhibit 1: Aggregate Economic Impacts Across Beef and Pork Sectors

	Million $
One Time Direct Costs	$117.6
Ongoing Direct Costs	$138.2
Cost Increase Due to Efficiency Loss	$705.0
Revenue Lost Due to Quality/Demand Impact	$515.5
Total Supply Chain Loss	$1,476.20

It is worth noting that during the course of this study, it became clear to us that the provision in the rule that relieves plaintiffs from the burden of proving competitive injury is by far the most damaging. The expected efficiency losses and demand decline that forms the basis for the largest portion of the costs are tied back directly to the packer/processors' concerns regarding increased litigation and an increased likelihood that a very large financial judgment will be rendered against them. Additionally, as a result of the combination of new justification measures with this lower legal hurdle, there will likely be a strong incentive for further vertical integration as a way to mitigate this risk.

II. STUDY BACKGROUND AND OBJECTIVES

The 2008 farm bill included new provisions that amended the Packers and Stockyards Act (PSA) of 1921 related to livestock and poultry production and marketing. The farm bill required the U.S. Department of Agriculture (USDA) to propose rules to implement these provisions. In June 2010 USDA's Grain Inspection, Packers and Stockyards Administration (GIPSA) published a proposed rule to implement these regulations as mandated by the 2008 farm bill. But, the proposed rule, commonly referred to as the "GIPSA rule", added new regulations to clarify conduct that violates the Packers and Stockyards Act of 1921 (P&S Act). Some of the most contentious parts of the GIPSA rule are:

- Section 201.210 which describes actions that the USDA considers unfair, unjustly discriminatory or deceptive practices that would be violations of the P&S Act. The USDA specifically notes that these actions do not require a finding of harm or likely harm to competition to be a PSA violation. This section included examples of unfair practices by meat packers and poultry dealers including:
  - Actions that a reasonable person would consider unscrupulous or deceitful;
  - Retaliatory actions, such as coercion or intimidation, in response to a lawful action by a producer or grower;
  - Refusal to provide statistical data used to determine contract payments;
  - Actions to limit producers' or growers' legal rights;
  - Paying premiums or discounts without documenting a reason;
  - Terminating a production contract based only on allegations of misconduct by a producer or grower;
  - Practices that are fraudulent or likely to mislead a producer or grower; and
  - Broadly any act that cause or creates a likelihood of competitive injury.

- Section 201.211 addresses undue or unreasonable preference or advantage; that is when producers who produce the same or similar livestock product receive different treatment or payment from contractors. This includes proposed regulations for differential pricing, recordkeeping and packer-dealer relationships. The Secretary of Agriculture would use three criteria to determine if livestock producers have been treated with undue or unreasonable preference in violation of PSA.
  - Whether contract terms were available to any producer or grower who could meet the terms of the contract;
  - Whether premiums for product standards were offered to a producer or group of producers who meet the standards; and
  - Whether information about handling, processing and the quality of livestock was made available to all producers if made available to one.

Before the USDA finalized the GIPSA Rule, Congress passed the Consolidated and Further Continuing Appropriations Act 2012 in November 2011 which prohibited USDA from finalizing or implementing the most contentious parts of the GIPSA rule. Congress continued instituting appropriations riders to block these parts of the GIPSA rule but an appropriations rider was not included in the 2016 funding bill that passed in December

2015. As a result, in March 2016, Secretary of Agriculture's Tom Vilsack indicated the USDA will move forward with implementing the GIPSA rule, possibly finalizing it in September. For example, sections 201.210 and 201.211 of the GIPSA rule are currently at the White House Office of Information and Regulatory Affairs, the last step before rules are proposed final or become final.

Technically it appears that the farm bill allows GIPSA a fairly broad interpretation in writing the regulations, but it also is readily apparent that the intent of Congress was for the regulations not to go beyond some relatively specific poultry and swine contract issues.

With this as a background, a heated debate continues within the livestock and poultry industries regarding the implications and economic impacts of these proposed regulations should they be implemented. While the rules have not yet been made public, the 2010 proposed GIPSA Rule could fundamentally change and negatively impact the livestock industry. Marketing arrangements currently used today would need to be changed. For example, the rule would require meat packers to justify and document price differences paid for livestock making it difficult for producers to negotiate premiums based on certain production practices or accept lower prices for livestock of lesser quality. One of the issues would be whether contracts between packers offering producers special premiums or pricing create undue pricing advantages for those producers. The rule would set criteria for USDA to decide if elements of these contracts violate the PSA. International competitiveness of livestock industry will be harmed and on-farm and processing jobs will likely be affected.

Objectives

This study estimates the costs to the pork and beef industries from the implementation of the 2010 GIPSA rule since the new rules have not yet been made public (not including those aspects of the proposed rule that have already been finalized such as the arbitration opt out option). These include direct costs (both one-time and ongoing), cost increases due to efficiency loss, and revenue lost due to quality/demand impact. This study does not address impacts on the poultry sector.

As one might expect, the task at hand is extremely complex in nature as the packing sector can be impacted by one or more of the proposed rules and each entity could be affected differently than others in the same segment of the supply chain. Since several of the proposed rules are rather vague in terms of what changes will actually be required of industry participants and how the regulations might actually be implemented, quantification of the ultimate effects becomes somewhat open-ended and hazardous. In some cases, the vagueness of the rule and the lack of any similar precedent forced Informa to utilize the knowledge and expertise of the study team to make "best estimates" of the economic impacts.

III. PROJECT METHOLODOGY

A. Industry Interviews

Gaining first-hand input from industry stakeholders was considered to be essential for identifying and measuring the financial and business impacts from the proposed GIPSA rules. Consequently, numerous interviews were conducted with stakeholders. Attempts were made to get specific input and data from companies and individuals as well as from different sized operations.

A list of contacts was provided to Informa representing entities that had agreed in advance to participate. Interviews were conducted by telephone and the issues and concerns raised during these interviews were taken into consideration when developing the analytic approach for estimating the impacts and costs of the proposed rules. The information and business intelligence gathered through the interview process was essential to the results presented in this report.

B. Industry Cost Survey

The proposed rules developed by GIPSA are extremely complex and, consequently, identifying all of the business process changes or new business activities that would be required to comply with the rules was difficult. Part of that difficulty is that many of the requirements related to the rule do not have a "clear business precedence" so often companies were uncertain as to how they were going to deal with changes and the costs of those changes had limited basis for comparison.

Informa dissected the various elements of the proposed rules and organized these elements into categories. A cost matrix survey was developed and sent to several companies. The rules are directed at these companies and they will experience the most significant changes in business practices and hence incur the bulk of the costs originating from this change. All industry participants were guaranteed that their cost estimates would be kept in strict confidence and only reported in aggregate for the study.

Informa industry experts were also challenged to provide estimates of the cost of implementing and complying with the various elements of the rule and these professional opinions were synthesized with those provided by industry participants. A consensus cost range for each of the various element categories was transformed into a cost-per-unit of production for each supply chain and then aggregated into an industry-wide cost.

C. Desk Research

Informa conducted a thorough literature search seeking other sources of industry data that might provide analytical guidance to the needed estimation process. One can

certainly expect that companies themselves have a relatively good feel for how costs break down in their own operations but this data tends to be proprietary and consequently, little is available in the public sector.

Informa does have experience in evaluating industry costs. Informa did a similar study in 2010, "An Estimate of the Economic Impact of GIPSA's Proposed Rules," for the National Meat Association in cooperation with the National Cattlemen's Beef Association, the National Pork Producers Council, and the National Turkey Federation. That study interviewed beef, pork and poultry industry participants to determine expected responses to the proposed rule and expected costs and then used the information to determine impacts on the industries and U.S. economy. That study made one-time estimates of direct costs (associated with compliance to the proposed rule) to the beef sector of $39 million and to the pork sector $69 million. The ongoing direct annual costs were projected at $62 million for beef and $74 million for pork. The estimated indirect costs (losses due to reductions in product quality and/or efficiencies) were substantially higher, at $780 million for beef and $259 million for pork. Thus the total impact of direct and indirect costs on the pork sector were $401 million and $880 million for beef. Due to changes in the beef and pork industries and their structures over the past six years, an update of the previous study was necessary.

The 2010 Informa study and its results, in addition to other studies, were referenced in a 2015 report by the Congressional Research Service on the proposed GIPSA rule, and regulations based on the GIPSA rule that have since been added to the Code of Federal Regulations (CFR). These rules were published on December 9, 2011 in document 76 *Federal Register* 76874.

Among the recent CFR additions include sections on capital investment criteria, requirements, and prohibitions; criteria for time to remedy a breach of contract; and arbitration:

- Section 201.216 of the proposed rule was finalized in the CFR in §201.216, and incorporates section 201.217 of the proposed rule as criteria to determine violations of this section. In part, the finalized rule established criteria to consider whether or not additional capital investments required of a swine producer are to be considered "unfair" and in violation of the P&S Act.

- Section 201.218 in the proposed rule was finalized in §201.217, and in part sets forth criteria used to determine whether a packer, or swine contractor has provided a swine contract grower a reasonable period of time to remedy a breach of contract that could lead to contract termination.

- Section 201.219 of the proposed rule was finalized in §201.218, and in part provides contract livestock producers the ability to decline to be bound by arbitration clauses in contracts, and for producers to have the right to participate fully in arbitration.

Additionally, in March Secretary Vilsack indicated that the USDA was moving forward with implementing the GIPSA rule, which up until the FY 2016 appropriations bill had been prevented by Congress. As of the writing of this report, provisions of the GIPSA rule are under review with the White House Office of Information & Regulatory Affairs. Included in the provisions is a rule titled "Undue Preference and Advantage" which is in the proposed rule stage. This rule corresponds to section 201.211 of the proposed GIPSA rule of 2010 which set forth to establish criteria to be considered in determining if actions pertaining to undue preference and advantage violate the P&S Act.

Also being reviewed by the White House Office of Information & Regulatory Affairs is another rule titled "Scope and Unfair Practices" which is in the final rule stage. This rule corresponds to sections 201.3 and 201.210 of the 2010 proposed rule. Section 201.3 of the 2010 proposed rule set to establish that conduct may be found to violate sections 202(a) and 202 (b) of the P&S Act without being found to harm, or likely harm competition. Section 201.210 of the 2010 proposed rule would have established examples of what actions would be considered unfair, unjustly discriminatory and deceptive practices.

IV. IMPORTANT ELEMENTS OF THE PROPOSED RULE

The proposed rule changes described earlier will require multiple changes to how US beef and pork industry stakeholders conduct their business activities. Some of the potential changes in business activities could actually lead to changes in a company's asset structure as well as a broader change in industry structure.

A forensic review of the proposed rules was conducted and an attempt was made to identify all of the provisions that have economic significance and would require business process and supply chain alterations in order for supply chain participants to adhere to the rules as proposed. Informa finds the rules as written to be very open-ended and vague and thus a high degree of uncertainty exists at this point as to intent and interpretation from an implementation and enforcement perspective. Nonetheless, the study team identified the following broad areas described by the rule as those which have economic significance.

A. Justification of Differential Pricing

An important element of the proposed rules is a requirement for documentation to justify differential pricing. This would put increasingly more scrutiny on packer purchases of cattle and hogs in an attempt to ensure that the prices they are paying for those animals are reasonable and fair. As it stands right now, packers are able to use considerable discretion in paying premiums for livestock that meet certain quality thresholds or production practices and discounts for animals that are of a poorer quality. Requiring documentation to justify those price differentials would place a significant cost burden on packers as they would be forced to invest in technology to adequately and accurately maintain written and/or electronic records. A packer who chooses to absorb those costs may find themselves in an uncompetitive situation in the market and they will at least be forced to pass on those additional record-keeping costs to consumers and producers. Some packers may avoid these costs by simply paying one standard price for all animals, regardless of quality. Without the premiums associated with higher-quality cattle or hogs, livestock producers will likely put less effort into raising a higher-quality animal. The result of this would be lower quality beef and pork products, which would translate into reduced consumer choice.

Packers expressed concerns about the interpretation of this provision. While the quality-related differentials may be relatively straightforward, packers worry about differing prices paid simply because the market has "moved". For example, a packer may pay more for animals in the afternoon than in the morning simply because he wasn't getting enough animals at the lower price to fill his kill schedule. It is unclear whether or not the packer might be subject to a violation of the Act in such a case. Documenting this type of market differential will be much more onerous for packers than the documenting quality-related differentials.

B. Prohibition of Livestock Transactions between Packers

The proposed rules include a stipulation that "packers shall not purchase, acquire, or receive livestock from another packer or another packer's affiliated companies." This is critical because this is a common practice among beef and pork packers and would significantly change the nature of business transactions in the livestock industry. Take, for example, a pork packer who also owns and manages a live production unit as well. Right now, in situations where that packer-producer is caught running with an excess of hogs in the supply chain compared to their processing capacity, they can sell those hogs directly to another packer at the prevailing market price. With the proposed rule, that kind of transaction would not be allowed and would be forced through a third party or independent livestock dealer. Given that an independent dealer is not going to take on that role without being properly compensated, there will be a transactional cost associated with getting those hogs from the initial packer to their final destination. The increase in costs will eventually be accounted for by higher pork prices at a cost to the consumer and lower live animal prices paid to producers. Similar situations can be found in the cattle and beef industry.

Of special interest is the situation where producers may also be the owners of packing plants. There are several examples of this in both the beef and pork supply chains. For example, producers that own shares in a producer alliance, which may itself own a large proportion of shares in a packer, might meet the legal definition of packers and be prohibited from marketing their animals to another packer. Many of these producer/owners will sell large volumes of cattle to other packers because those cattle do not meet the specifications that their producer alliance requires. If those producers can no longer transact with other packers directly, a middleman would need to be inserted into the transaction. This would lower the price that the producer receives.

C. Limits on Livestock Dealers and Packer Buyers

Limits are placed on livestock dealers and packer buyers by the proposed rule. It states that dealers who operate as packer buyers must purchase livestock only for the packer that identifies that dealer as its packer buyer. Also, a packer may not enter into an exclusive arrangement with a dealer except those dealers the packer has identified as its packer buyers and reported to the Secretary of Agriculture on approved forms. It is common at many auctions, particularly at smaller ones, to find packer buyers bidding on cattle for multiple packers. This rule's intent appears to target the buying side of the market and encourage more bidders for those animals, possibly increasing the likelihood that sellers are receiving a "fair market price". However, if packer buyers were forced to purchase livestock for only one packer, it could be prohibitively expensive for packers to send individual buyers to every auction market. Over time, some business would dry up at the smaller markets because there would actually be fewer buyers attending those auctions. Livestock producers would then be forced to send their cattle to larger auction markets that are farther away. The increased transportation costs would be borne by the producer, thus lowering the effective price they receive for their cattle.

D. Changes to Hog Contracts

The proposed rule addresses other issues of fairness between swine contractors and contract growers. Much of this was initially included in the 2008 Farm Bill. Some of these requirements will apply in the pork industry, where entities designated as swine contractors enter into production agreements with swine growers.

While the estimated costs associated with restructuring contracts to comply with these proposed rules is dwarfed by potential costs associated with loss of efficiency, they are still significant and would be another added cost passed on to consumers over time.

Some swine contracts have risk-sharing components that allow for ledger accounts where producers can essentially receive a loan from packers when the market price is below a reference or breakeven price and this loan gets paid back when prices are above the reference price. Producers place a high value on this contract feature. Packers benefit from this type of contract as well because it keeps valued producers operating at a less variable rate, thus limiting throughput risks. It is doubtful that packers could afford to finance these contracts for all of the hogs that they process. If they decide that offering such contracts to some, but not all producers puts them at risk for a violation of the Act as a result of the proposed rules, then these contracts may disappear.

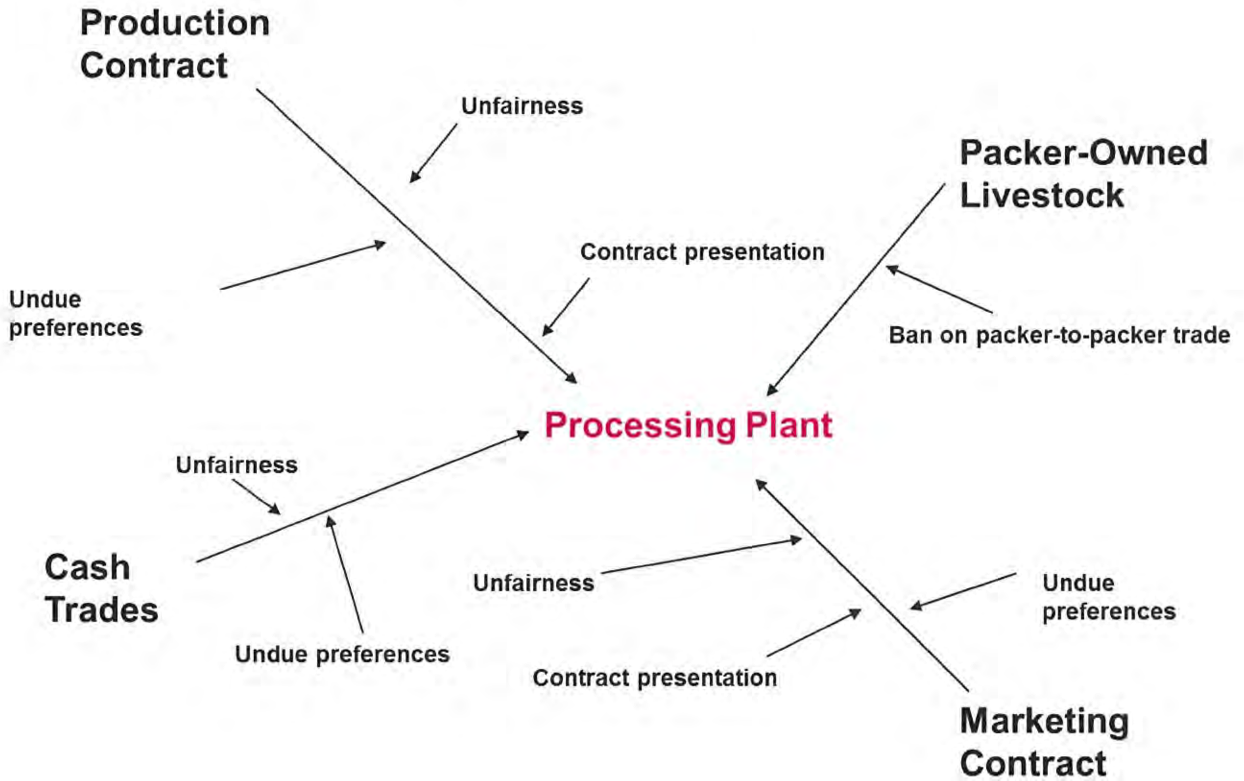
E. Abolishment of the Need to Prove Competitive Injury

Perhaps the most contentious provision of the proposed rule is one that would no longer require producers who bring complaints under the Packers and Stockyards Act to show that the actions of the accused packer caused competitive injury. In many past legal proceedings damages have not been allowed because the plaintiffs have been unable to demonstrate that the actions of the defendant caused harm to competition in the market. With these rules, GIPSA is proclaiming that condition is no longer necessary to find damages under the Act. This provision was far and above the one that respondents claimed would cause the most harm. It was clear that many thought their company's overarching concern would be to limit legal liability first ahead of all other company concerns. For many of them, this could result in a reduction in the use of Alternative Marketing Agreements (AMAs), and moving to paying more of a standardized price regardless of production practices or quality. This would take away much of the progress that the industry has accomplished over the past several decades that has largely been consumer driven as producers altered production practices to deliver more consumer choice.

Exhibit 2 provides a visual representation of how the many rule elements will impact various business functions such as production contracts, cash transactions/trades, marketing agreements/contracts and packer-owned livestock. The segment of the supply chain that receives most of the focus is the livestock processing plant as most of

the rules are directed toward issues related to the sale of live animals to slaughter/processing facilities.

Exhibit 2: Proposed GIPSA Rule, Areas of Impact



V. HOW RULE ELEMENTS WILL AFFECT INDUSTRIES

Not all of the elements that create a market or economic impact will occur in the pork and beef supply chains. Similarly, the rules that contain high levels of regulative authority related to livestock market transactions including a ban on packer-to-packer trade and restrictions on use of livestock buyers will impact the cattle and hog sectors in a major way. The rule dealing with market "fairness", undue market "preference" and market "discrimination" will impact all meat protein sectors as it exposes businesses in these supply chains to potential litigation issues. A discussion follows of some of the key business practices and supply chain processes that will require change based on a literal interpretation of the proposed rules.

In the pork supply chain, both production and marketing contracts exist and will be affected and the packer-to-packer and cash market issues will apply. In the beef vertical, production contracts are not a factor but all of the remaining areas will be affected: cash trades, packer-to-packer, livestock dealers, marketing contracts.

A. Cattle & Beef

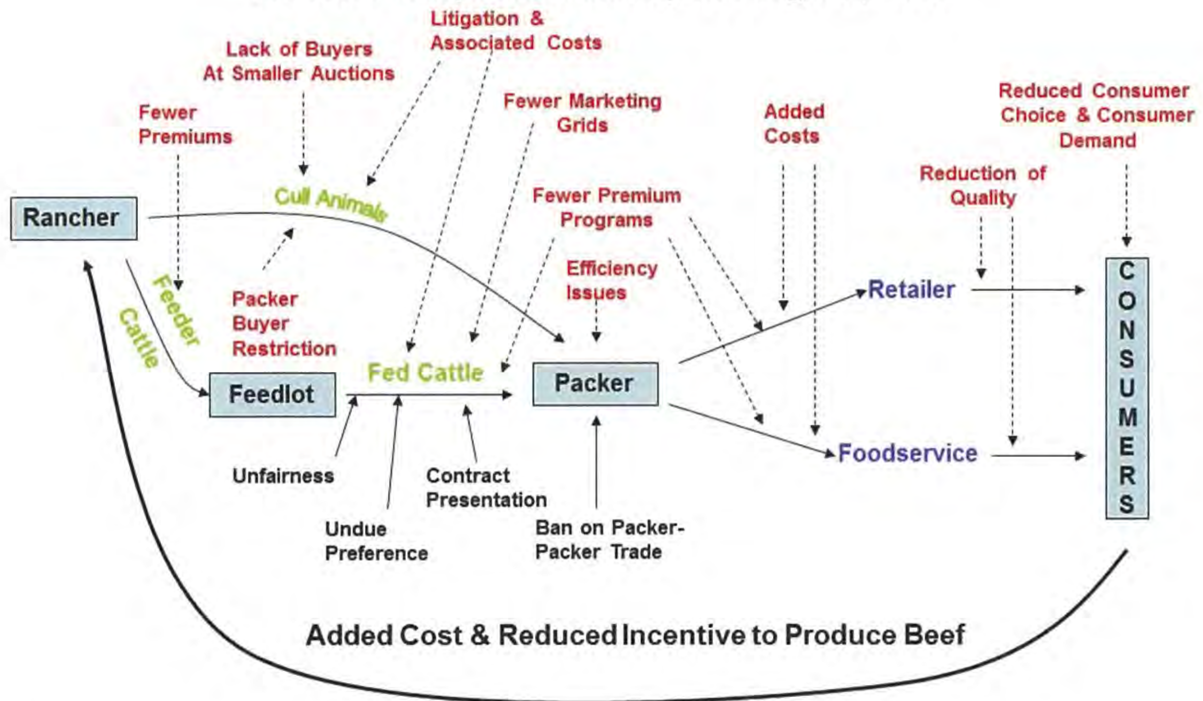
Exhibit 3 provides a view of the cattle and beef supply chain and focuses on those segments of the chain that will be directly affected by various elements of the proposed rules. Since the proposed rules are directed at business transactions between the sellers of cattle and cattle slaughter/processing operations, the supply chain economic impact will have its primary origins in the center of the supply vertical. Cattle sold by cattle feeding entities (large and small) will be directly affected as will other entities that assemble cattle for sale to packers such as dealers and auction sale operations. Packers that have direct or partial ownership of feedlot and/or backgrounding operations will be affected by the proposed rule that restricts packer-to-packer sales of live cattle as in many instances such cattle are not sold strictly within the packer's own vertically integrated system.

Given the broad nature of the proposed regulations, there will be supply chain impacts (both costs and sales prices) that affect stakeholders in the industry right from the cow calf/ranching sector all the way through the supply chain to consumers. In Exhibit 3 below, we attempt to reflect where these effects will occur and the nature of the business impact. In the end, implementation of the rules will add cost to the US beef supply chain as well as reduce incentives for industry participants to enhance quality and value added offerings. The methods by which businesses react to regulatory requirements will ultimately determine the magnitude of supply chain value loss that will occur.

Much of the direct impact of the rules as they relate to the beef supply chain will fall on the feedlot and the steer and heifer slaughter sector with likely pushback toward the cow-calf producer. Individual producers and other entities selling cull cows and bulls to cow/bull slaughter operations will be directly affected by the proposed rules as well.

New costs are anticipated as a result of the regulations that address market transactions between buyers and sellers of cull animals.

Exhibit 3: Proposed Rule Impact Diagram, Beef



In addition to the direct economic impacts on supply chain participants involved in the buying and selling of cattle for processing, changes in the rules will also have an indirect effect on supply chain participants who operate on both sides of the packer interface in the beef vertical. Of major interest and concern is whether implementation of the rules, as proposed, would seriously impact current cattle marketing agreements and other formalized quality-based programs that are built upon enhanced live animal and animal production specifications that provide premiums back to the producer. This study attempts to identify and quantify, where possible, both direct and indirect cost and revenue impacts related to the proposed rules.

The cattle and beef supply chain holds the most potential to be affected by the proposed rules as it is much more complex than the pork supply chain. There are many breeds and cross breeds of cattle that results in a broad range of animal quality. Genetic variability, which can result in a wide variety of carcass attributes, has given rise to multiple breed-oriented programs. Further, many quality-oriented specification programs, as well as premiums for alternative production practices have evolved as supply chain participants attempted to differentiate beef products to meet a broad range of consumer tastes and preferences (differentiated demand).

In addition to quality differentiation in live animal and beef products, the beef supply chain has multiple transaction points with many animals that progress through the

supply chain being bought and sold three or four times before the animals are processed. Differentiated consumer beef demands result in a broad range of price premiums (and in some cases, discounts) relative to a benchmark cattle price. This mix of pricing differentials seems to be one of the targets of some components of the proposed rules. There is a notion that not all cattle being transacted receive "fair" market value and portions of the proposed rules are focused at regulating what "fair" means and that in itself creates huge issues for the industry to deal with.

The beef industry is also relatively concentrated as very significant economies of scale have driven the industry toward a structure that is dominated by a few large firms. The top four cattle slaughter operations in the US account for approximately 80% of the annual steer and heifer processing. There are other slaughter operations (mostly single plant firms) that compete in this segment of the beef supply chain and yet another group of operations that specialize mostly in the slaughter of cull animals (cows and bulls). Proposed restrictions on packer-to-packer cattle sales will be particularly onerous on several of the industry's slaughter operations.

The US cattle and beef industry has a modest degree of vertical integration with some slaughter operations also whole or part owners of cattle feeding operations. For those firms that are involved at multiple levels of the beef supply chain, the new rules would prohibit them from selling their feedlot cattle to slaughter operations other than their own. In order to avoid violating the rule, additional transportation costs might need to be incurred or there could be added costs for selling these cattle to a third party who would then sell the animals to a slaughter operation. Companies that are integrated between the feedlot segment and the slaughter segment of the industry may find business reasons to become even more integrated or alternatively, to divest of assets in one of the business segments.

The schematic of the cattle and beef supply chain (Exhibit 3) and the schematic of the proposed rule elements (Exhibit 2) provide the broad basis from which Informa developed economic impact measures. The complexity of the rules and how they would impact the cattle and beef industry resulted in segmenting the economic analysis into multiple components. It was determined that there would be a host of one-time costs associated with putting in place processes and measuring mechanisms to deal with some aspects of the rule. There would also be on-going costs associated with these business process changes.

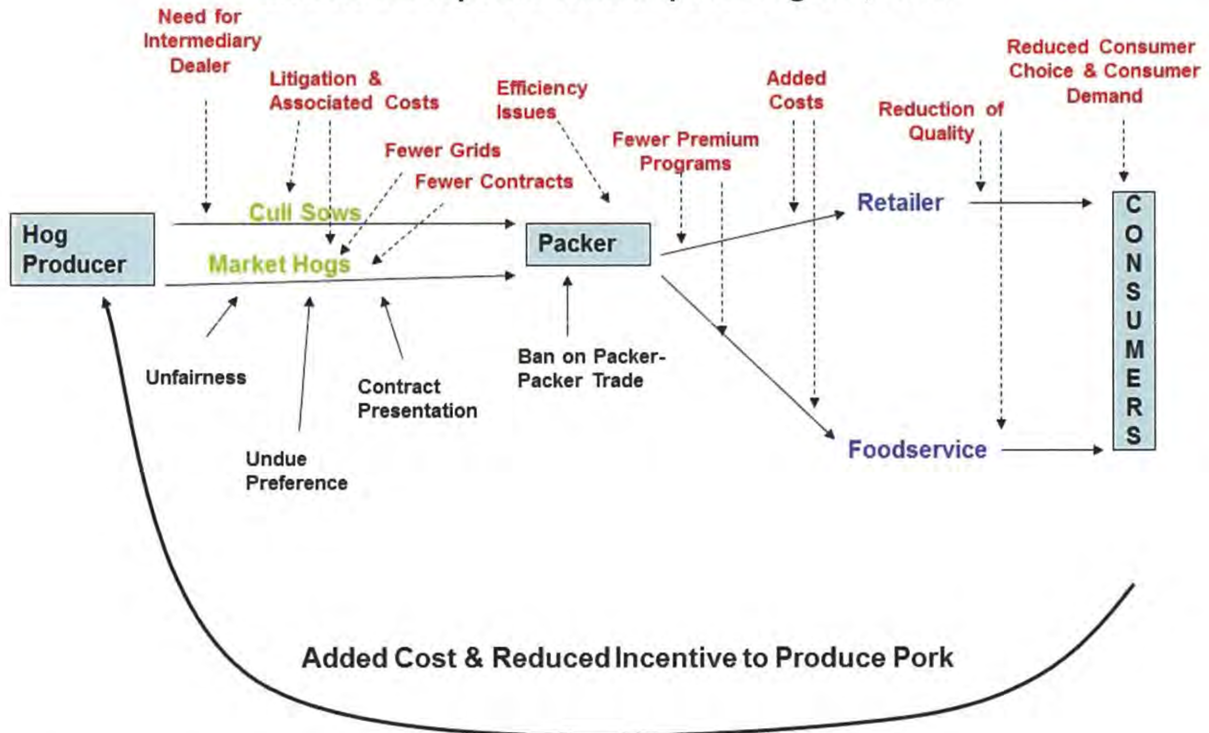
B. Hogs & Pork

Exhibit 4 provides a very simplified schematic of the US hog and pork supply chain. The pork supply chain is much simpler than the one for beef, but it is much more concentrated and integrated. This creates the potential for enhanced regulatory impacts should the proposed rule changes be implemented. This is particularly the case as it relates to issues of competition, fairness and litigation issues.

As with the beef supply chain, the pork supply chain will be affected primarily at the interface of financial transactions between producers and slaughter operations. Certain features of the proposed rules will also impact producer-to-producer business arrangements as some independent hog feeding operations do have contractual relationships with growers even though they do not have direct financial linkages to a slaughter facility. Regulations relating to contracting activities will have impacts on these business relationships that fall outside of packer transactions.

Vertically integrated hog systems will be impacted less than will independent hog production systems. The contracting of hog production whether by integrators or independents will be affected by those rules that relate to market fairness. Market hog transactions as well as the sale of cull sows and boars will be affected by the ban on packer-to-packer trade. Such a ban will require reorganizing businesses to either utilize all internally produced market hogs within the vertical system or, if this is not possible or feasible, sell such animals to independent third party entities. Such a requirement will add costs and inefficiencies to the flow of hogs to market. For cull animals, integrators will be banned from selling these culls (or market hog outliers) to other packers so, in essence, the rules will infuse another cost; another margin and added inefficiencies into that portion of the hog trade that involves sales of animals between slaughter entities not owned by the same firm.

Exhibit 4: Proposed Rule Impact Diagram, Pork



Due to the geographical dispersion of the US hog production sector and a rather complicated network of vertically integrated operations and small/medium/large independent hog production facilities, there will be industry organization challenges

should the proposed rules be implemented as written. Packers do sell hogs to other packers but there are generally strong economic and geographical reasons why such trade with sow slaughter operations occurs to handle the disassembly of their cull sows. All of these business transactions will need to change and such change will lead to higher direct industry costs, lost efficiencies—and in all likelihood—reduced revenue opportunities for the seller of the sows.

C. Retail and Food Service Sectors

At this point in time food retailers and food service operators appear to still be largely unaware of the proposed rules and the possible ramifications for their operations. The rules have received very little if any coverage in the retail trade press and to date has been seen as an issue between packers and producers only.

This is unfortunate in that the rules could have a significant effect on retail and food service if either premium programs are reduced or if they are maintained but at significantly higher cost due to supply chain inefficiencies.

As of August 9, 2016, the Agriculture Marketing Service of USDA listed 143 Certified Beef Programs but these do not include many producer, packer and retailer brands that are not registered with USDA. The 2015 National Meat Case Study[1] indicated that the percentage of packages in retail stores carrying a production claim (USDA Organic, all natural, grass fed) surged in 2015. Store branding rose to 51% in 2015, compared to 36% in the 2010 survey. There is also a considerable amount of branded beef sold through foodservice distributors. All of the major packers have branded beef programs, along with several of the midsized and smaller firms. Freshlook data indicates 2015[2] annual retail beef sales dollars of $24.9 billion and annual beef sales in tonnage of almost 4.5 billion lbs. At 46% of sales, the retail branded beef (supplier brand, non-store brand) would account for 2.1 billion lbs as of 2015.

These branded programs at retail and food service have added incremental sales as the wholesale premiums are passed through to the consuming public and margins at retail have increased due to these premium prices as a significant number of US consumers show a willingness to pay a premium price for high quality meat products that deliver a great eating experience.

The 46% of beef sold in retail food stores is branded either under a premium brand such as Certified Angus Beef, a packer brand such as Cargill's Sterling Silver or a house or retail brand such as Publix Premium Certified Beef. These branded programs are dependent on the packer/suppliers ability to acquire enough cattle of the specified grade and quality to satisfy the retail demand for the product.

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[1]http://www.meatconference.com/sites/default/files/books/Jerry%20Kelly%20-%20Dynamics%20of%20the%20Meat%20Case.pdf

[2]http://www.beefretail.org/CMDocs/BeefRetail2/Sales%20Data/Sales%20Featuring/1_16-Top-Line-Final.pdf

Should the rules reduce the number of cattle available that meet the required specifications some retailers may lose their branded program and therefore lose their competitive differentiation in the marketplace. Any reduction in qualifying cattle can be expected to increase the cost of the product, an added cost many retailers may be unable to pass through to the consumer due to the competitive nature of the retail marketplace. Either a reduction in program availability or increased product costs due to limited supplies of quality cattle or higher prices due to supply chain inefficiencies will have a negative effect on retail sales and on retail profit margins.

The same situation exists in food service where an increasing number of operators have moved to certified/branded programs and market those programs on their menus and in their advertising as a point of differentiation and a sales and margin enhancement strategy. In addition, it is the food service sector that is the current primary user of Prime, natural, grass fed, hormone free and other premium programs being demanded by and introduced to certain consumer groups.

Pork is likely less subject to direct impacts of the rules at retail and food service in that typical supermarket and food service product needs have historically been more consistent and standardized than for beef. However, the growing market share in natural and/or organic programs; hormone free, and increasing state regulations concerning animal welfare are also creating carcass premiums that are inconsistent in definition, standard or state to state requirement. Until these standards and definitions are applied universally there is great risk that under the proposed rules these programs could be eliminated or watered down in an effort to avoid potential legal liability resulting in similar outcomes to those of beef but on a somewhat smaller scale.

The retailers most at risk to the unintended consequences of the proposed rules are those retailers who have invested the most time, effort and money into providing their customers with high quality meat at competitive prices and are therefore the leading food companies in terms of sales, profitability and customer satisfaction. Those operators that have done the least to provide quality food at fair prices will see much less impact than the industry leaders.

VI. DIRECT COSTS

Costs imposed by the proposed GIPSA rules were divided into two categories: direct costs and indirect costs. Direct costs are those that will require an outlay on the part of a company in its effort to comply with the rules. An example would be new computer software or the hiring of additional staff. Indirect costs refer to those costs that will impact the industry in a broad way and are more likely to develop over time than at the rule's inception. Examples would include costs associated with losses in efficiency and declining product quality. Direct costs are further divided into two sub-categories: one-time and ongoing. This section provides a brief description of the direct costs considered.

Exhibit 5: Specific Direct Cost Categories

	Beef	Pork
1.Cost Areas Associated with Differential Pricing		
• Information systems for tracking	✓	✓
• Contract review for compliance	✓	✓
• Re-writing and Renegotiating contracts	✓	✓
• Documentation of quality differentials	✓	✓
• Documentation of market differentials	✓	✓
2.Cost Areas Associated with Submitting Sample Contracts to GIPSA		
• Collecting Contracts	✓	✓
• Obliterating identifying information	✓	✓
• Transmission of sample contracts	✓	✓
3.Cost Areas Associated with Limits on Livestock Dealers		
• Retaining dealers to work exclusively with the company	✓	✓
• Additional internal labor	✓	✓
4. Cost Areas Associated with Packer-to-Packer Transactions		
• Route transactions through broker or other third party	✓	✓
• Additional transportation	✓	✓
• Asset divestiture costs	✓	✓
5. Cost Areas Associated with Increased Litigation Potential		
• Additional legal staff	✓	✓
• Court costs, filing fees, research and investigation	✓	✓
• Restructuring to limit legal exposure	✓	✓

A. Cattle & Beef

Exhibit 5 provides a listing of the specific business activities that were identified by the study team based on the team's knowledge of the cattle and beef supply chain as well as from input gathered from interviews with supply chain participants. The objective of preparing such a list was to provide a structure around which cost estimates would be made measuring one-time supply chain costs as well as cost estimates that would be ongoing. Industry stakeholders were asked to provide specific input relative to these business process changes and, while it was not possible to get data from all firms operating at the primary slaughter level of the beef supply chain, sufficient primary data was collected to provide a consensus estimate of the costs companies would incur to position themselves for complying with the proposed rules.

Asset divestitures may be the best option for some packers in response to provisions of the rule and a category was included to capture those costs. A feedyard owned by a packer but located far away from the packer's processing facility might need to be sold should the packer-to-packer sale ban be implemented.

B. Hogs & Pork

Not unlike the cattle and beef industry, the hog and pork industry is going to be impacted by the various elements of the proposed GIPSA rules in a multitude of ways. Businesses will need to construct or upgrade information systems that will allow them to track individual market transactions. That might require installing new computer systems with software that will provide an automated way of documenting the payment of market price differentials. With the requirement to justify the payment of price differentials (premiums and/or discounts), comes the need to track these transactions and then harmonize those with quality and performance differentials in order to document that the prices paid are legitimate and consistent with the incremental value of the hog. It is easy to see that just putting in place the tracking mechanisms for justifying differential pricing will be a timely and costly activity.

Exhibit 5 categorizes the major cost areas that will need to be addressed by the pork supply chain to comply with the proposed rules. The areas are similar to those listed for the cattle and beef sector. The integrated nature of a portion of the hog and pork sector suggests that not all market hogs will be impacted by some of the process requirements and in those cases, adjustments were made to the cost estimates to reflect these structural issues.

There are six major business components or functions that will require business process changes by the hog and pork sector. In addition to setting up processes for dealing with recording the differential pricing issue, there may also be a need to review and/or re-negotiating current contracts that spell out in very specific terms the pricing elements of these contracts. Since many packers utilize packer buyers or dealers to procure some percentage of their ongoing slaughter requirements, costs will be incurred to rearrange this business activity. New personnel and new business arrangements may

be required and failure to actually operate as effectively may result in increased costs associated with reduced slaughter plant efficiencies.

Hog slaughter operations will be affected by the ban on packer-to-packer transactions as presently some hog production operations owned in an integrated production system sell some or all of their production to other packers. This is normally due to geographic location of the hog production unit relative to location of the integrator's slaughter facilities.
To minimize transportation costs and optimize overall revenues, these hogs are sold to the "competition". We believe GIPSA's concern is that packer-to-packer sales provide packers the opportunity to influence prices and/or have better price intelligence than others in the market. With mandatory price reporting on live hog sales, it is unlikely that such an advantage actually exists.

The packer-to-packer restrictions will also have a major impact on the merchandising and pricing of cull animals (sows and boars). Those involved in slaughter of these cull animals typically procure their sows in a variety of ways and have established procurement systems that allow for optimization of the value of these residual animals. Many integrated hog production systems sell their sows directly to sow slaughter operations or through a company-owned marketing firm. Such activity would be restricted and, while other business structures would surely evolve, costs associated with the cull segment of the industry would be increased.

The elements of the proposed rule that deal with competition and the added threat of litigation are high on the list of potential disruptive and costly factors associated with the proposed rules. Those in the business recognize that they might be subjected to litigation whether or not there is due cause and this threat may very well cause companies to change dramatically the way they are conducting business.

Finally, we included a category for the cost of asset divestitures if it is obvious route that a company would need to take upon rule implementation. For example, a pork packer may own a hog production facility in a particular geographic region but no processing plant. Historically that packer has sold the production from the facility to other area packers. With the packer-to-packer ban that could no longer occur and given that transport to the packer's own facilities is infeasible, the packer might determine that divesture of the production asset is the best course of action.

C. One-Time Direct Costs

The analysis conducted by Informa utilized input from industry stakeholders as well as internally generated cost estimates with consensus forecasts being developed. One-time direct costs as shown in Exhibit 6 ranged from an estimated $20 million for the beef sector to an estimated $98 million for the pork industry. The per-head one-time costs for the two industries are comparable but the larger annual hog slaughter volume does raise the overall pork industry direct costs above beef.

Exhibit 6: Meat Industry One Time Direct Costs

Supply Chain	Million $
Beef	$19.6
Pork	$98.0
Total	$117.6

D. On-Going Direct Costs

Exhibit 7 provides estimates by species and in total for ongoing direct costs. These are costs that the industry will be burdened with year after year as business practices change to allow for compliance with the proposed rules. As can be seen, the ongoing direct costs are larger than the one time direct costs for beef and marginally smaller for pork, and for the two species add up to a total economic impact of approximately $138 million on an annualized basis.

Exhibit 7: Meat Industry Ongoing Direct Costs

Supply Chain	Million $
Beef	$44.5
Pork	$93.6
Total	$138.2

VII. INDIRECT COSTS

A. Cattle & Beef

Importantly, the proposed rules could have a major impact on the multitude of branded beef programs as well as other beef merchandising programs with quality differentials. Industry participants made it abundantly clear that to limit legal liability, companies in the packing sector would strongly consider reducing the number and types of Alternative Marketing Agreements (AMAs) that they are involved with. This in turn, would make it more difficult to reward producers for raising cattle that meet the specifications of branded and specialty beef programs. The US cattle and beef industry has spent the past 20 years improving the quality of the beef being brought to market and much of this improvement has been the result of proprietary business programs and supply chain alliances which have allowed added value from the programs to be shared by those creating that value. This typically involves premiums for the cow calf producer, the backgrounder, the feedlot as well as the slaughter operation. At the extreme, many of these programs might be threatened as the potential for litigation because of “fairness” or “preferential treatment” is elevated due to certain elements of the proposed rules that deal with competition. Much of this progress in the beef supply chain has resulted in increased benefits to the producer, and firms made it clear that if they had to minimize legal risks by limiting the number and variety of AMAs that this would ultimately hurt the producer. Much of this variety in the agreements has been the at the request of progressive producers, and this portion of the rule has the potential to remove much of the progress the industry has made the last two decades. Some interview respondents suggested that they may be forced to move away from these agreements altogether and operate only in the cash market.

All of the packer respondents indicated that the number of AMAs offered to producers would decline dramatically with implementation of the proposed rule. Also, potential premiums would be adjusted, likely downward, as the elements of marketing agreements would shift toward "the lowest common denominator" in order to avoid accusations of unfairness and to avoid the possibility of litigation. This would reduce the incentive for producers to go to the extra effort, management and costs of producing higher quality animals. Ultimately, this would jeopardize several of the branded meat programs that have been developed over the years to increase meat quality and improve consumer demand. But these higher quality animals do not disappear right away. In the short run, packers will "cream the coolers", doing more sorting of carcasses to meet the needs for the various branded programs. Over time, the lack of incentive to produce the higher quality animals will lead to more commodity-style beef and pork being produced, with overall average quality declining. Packers will assess the various branded meat programs to identify those providing them with the best return. To keep from diluting or losing those selected programs, they would tend to feed more of their own animals (increase packer ownership of livestock) to fit the branded program specifications.

B. Branded Beef Programs

Evidence from the interviews and surveys suggested that branded and specialty beef programs could be endangered if beef packers reduce the number and complexity of AMAs. Therefore, the study team evaluated the branded beef market to more accurately quantify the potential indirect costs that loss of these programs would imply.

In the 2008 Livestock Mandatory Reporting Final Rule, USDA defines "branded" beef as follows:

"The term 'branded' means boxed beef cuts produced and marketed under a corporate trademark (for example, products that are marketed on their quality, yield, or breed characteristics), or boxed beef cuts produced and marketed under one of USDA's Meat Grading and Certification Branch, Certified Beef programs."[3]

As of August 14, 2016, the Agricultural Marketing Service of USDA listed 143 Certified Beef Programs. But this is not a complete list of the branded beef programs existing in the US. There are several producer brands, packer brands and retail brands that are not registered with USDA. Additionally, the branded product reported by USDA under livestock mandatory reporting is a subset of the total branded beef products sold in the US, being limited to negotiated sales for delivery within 0-21 days and product grading upper two-thirds of the Choice grade. At least 52 of the 143 listed branded beef programs allow beef from cattle grading Select or lower. Still, the data provides the opportunity for a partial analysis of the value of branded beef programs.

The weekly National Comprehensive Boxed Beef Cutout (LM_XB463) provides cutout values for the various categories of boxed beef. The difference between branded boxed beef and non-branded beef is shown below:

Since the start of mandatory livestock reporting in 2002, the premium at which branded beef has sold over non-branded beef (on a carcass cutout basis) has ranged from approximately $3/cwt to nearly $25/cwt (Exhibit 8). On a per head basis, the calculated premium has averaged just over $68 per head.

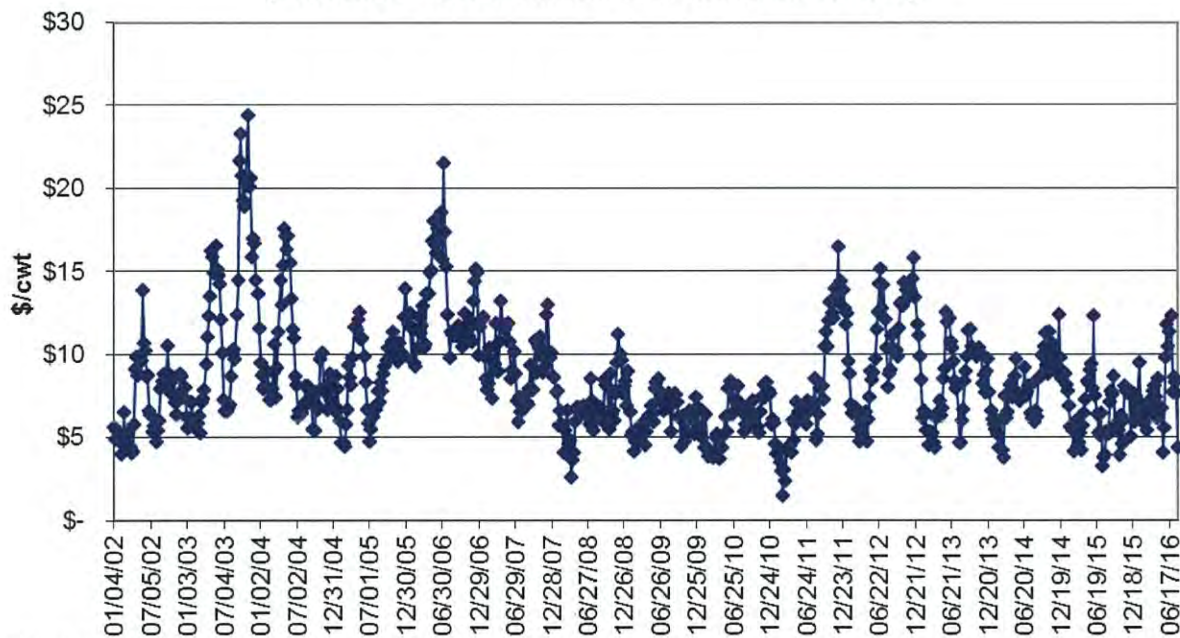
Using average steer and heifer carcass weights, the average annual premium on boxed beef sales reported by USDA over non-branded beef is shown in Exhibit 8. Even with 2014 and 2015 being the two highest years for wholesale beef prices, the premiums on branded beef programs were not very different from the long run average, and equal to or above the recessionary years. This is not only the case for branded beef, but also for the premium of Prime grade beef over Choice grade beef. Still, consumers have shown willingness to pay significant premiums on branded beef products.

The figures reported by USDA are based on packer sales into the wholesale beef market. For producers involved in supplying cattle to packers for branded beef

[3] Federal Register /Vol. 73, No. 96 / Friday, May 16, 2008 /Rules and Regulations, page 28635

programs, a portion of the premiums achieved by the packers will be passed back to the producer. The amount will vary by program and by the quality attributes required by the programs. BEEF magazine recently published a listing of 23 producer alliances[4]. Where available, descriptions of desired characteristics, production practices, premium amounts and number of cattle involved in the programs were provided. In many cases, the average premium paid was described as variable by packer and grid being used. Where dollar amounts were reported, they varied considerably, with many running in a range from $20
per head to $200 per head. One of the largest programs for which some details are available was for U.S. Premium Beef, LLC. The number of cattle in the alliance for 2015 was reported at more than 754,000 head with an average premium of $49.25 per head. The number of cattle involved in the various alliances amounted to more than 6.6 million head, not including those programs where the numbers were not available or considered confidential. The feedlots involved in these various alliances are not the only ones eligible for premiums. There are at least 10 programs that provide post-harvest premiums back to cow-calf operators.

Exhibit 8: Premium on Branded Boxed Beef Sales
(Branded Cutout minus Unbranded Product)



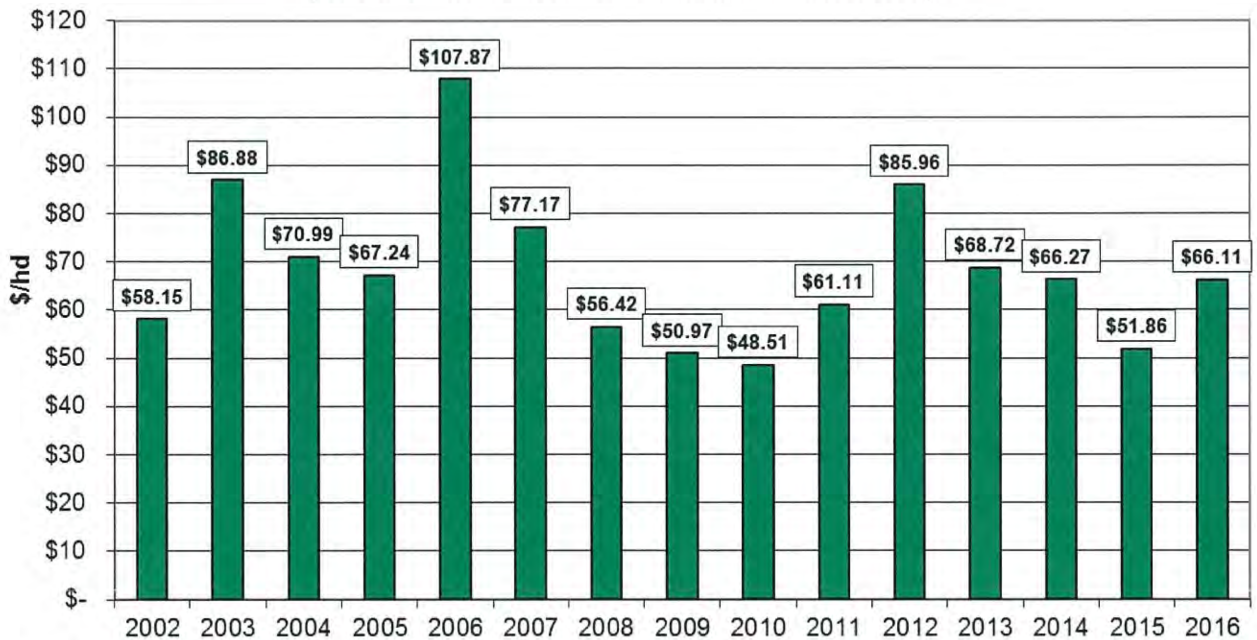
Source: USDA, National Comprehensive through Jul. 29, 2016

Some of the largest premiums listed in the 2015 Alliance Yellow Pages involved the production of "natural" cattle, where the premiums could be as high as $200 per head. As is the case with the Certified Beef Programs listed with USDA-AMS, the 2015 Alliance Yellow Pages is not an exhaustive list of producer alliance programs in the US beef industry.

[4] http://beefmagazine.com/site-files/beefmagazine.com/files/uploads/2015/06/2015%20Beef%20Magazine%20Value%20Based%20Program%20Listing.pdf

The 2015 National Meat Case Study indicated that the percentage of packages in retail stores carrying a production claim (USDA Organic, all natural, grass fed) surged in 2015. Store branding rose to 51% in 2015, compared to 36% in the 2010 survey. There is also a considerable amount of branded beef sold through foodservice distributors. All of the major packers have branded beef programs, along with several of the midsized and smaller firms. While the proportion of fed beef sold as branded beef varies by company, Informa estimates that at least one-third of the beef from steer and heifer slaughter is sold under a branded beef program. The value added from the various branded beef programs, including organic beef and natural beef, is estimated at approximately $730 million per year.

Exhibit 9: Annual Premium on Branded Boxed Beef Sales (Branded Value minus Unbranded Product)



Source: USDA, National Comprehensive through Jul. 29, 2016

To reiterate, this is only a partial analysis of the value of branded beef programs to the US cattle industry. The available data does not cover all of the programs, producers and animals that are involved in producer alliances and branded beef programs. The premiums that are attained by cattle producers can be substantial. If packers reduce their reliance on AMA's, this could reduce the number of branded programs and/or the size of premiums paid by packers, resulting in a significant revenue reduction for producers as a whole. For the millions of cattle sold through these programs and the numerous producers who are working on improving the quality of their animals to better fit these programs and maximize their premiums, the losses in revenue would be several tens of dollars per animal and amount to several hundreds of millions of dollars in lost revenue to the industry.

C. Hogs & Pork

Optimal use of slaughter facilities is considered to be a major issue for slaughter operations in the hog/pork sector. In many interviews, industry stakeholders stressed the importance of getting first shift slaughter operations off to a seamless start and with the daily volume that many top level hog slaughter operations have, efficiency of throughput is critical for keeping costs down.

Threats to the optimal utilization of hog slaughter and processing operations was a key concern of many of the industry stakeholders interviewed during the course of this study. In the former report, slaughter/processing firms were asked to provide their estimates of the impact of the proposed rules on their company's operational efficiency. These estimates covered a rather broad range on a per head basis. In the end, a consensus forecast was developed reflecting input from the impacted companies as well as business intelligence from the study team. It was determined that a 3% negative impact on operational efficiency would be a conservative estimate of the economic impact relative to efficient operations of most plants. This impact from the former report was held steady in the report update.

An aggregate of costs associated with efficiency loss to the pork industry was estimated somewhat in excess of $187 million.

While potential revenue loss in the pork sector due to quality issues will be substantially less than in the beef industry, it is still a major factor for the pork industry. There are many programs within the hog/pork sector where marketing agreements are in place and which pay differential prices for meeting certain quality specifications. Several slaughter/processing operations indicated that they may be required to scale back on premium based programs due to the added costs of documenting these and the uncertainties of the legal exposure that continuing these programs creates. Organic and natural programs operate under a higher cost structure than do other commercially based production systems and cost justification for such entities producing this product is possible but will occur with some added cost to the processor.

An estimate was made of the value creation resulting from various quality requirements and associated premiums and, like beef, the potential lost revenue for such programs was set at a portion of the total potential costs.

D. Supply Chain Efficiency Costs

Based on the discussion provided earlier in this document, there would appear to be a large potential cost across the two meat protein verticals related to loss of supply chain efficiencies. These costs are estimated to give a total efficiency-related impact of $705 million to the beef and pork industries as shown in Exhibit 10 below.

Exhibit 10: Meat Industry Efficiency Impact

Supply Chain	Million $
Beef	$517.1
Pork	$187.9
Total	$705.0

E. Quality Demand Revenue Impacts

One of the primary concerns raised by industry stakeholders during the active debate on the costs and merits of the proposed GIPSA rules was the impact such rules would have on the broad array of livestock alternative marketing agreements (AMAs) and other quality-oriented programs that provide product differentiation in the marketplace. Informa analyzed the potential economic impact that changes or loss of these programs might have on the meat sector and the aggregate results are presented in Exhibit 11. These impacts do not attempt to quantify the number of AMA's that might be altered or lost; they merely reflect an estimate of the economic impact that could occur depending upon how the rules were implemented and enforced and how supply chain participants might respond to the added burdens of cost justification and the threat of litigation regarding the premium price structures that exist to validate these programs. The largest economic impact will occur in the beef industry as the beef supply chain has spent many years and significant investment dollars developing a broad range of quality-driven programs that differentiate beef products and which have highly differentiated pricing incentives and supply chain participant rewards. The pork industry also has worked hard to create value differentiation in many programs whether it be for Natural pork or for products differentiated for the export market.

Exhibit 11: Meat Industry Quality/Demand Impact

Supply Chain	Million $
Beef	$373.6
Pork	$141.9
Total	$515.5

F. Livestock Auction Markets

Several interviewees suggested that the provision banning order buyers from working for more than one packer could have a significant impact on livestock auction barns throughout the country. It is well known that most barns auction a wide variety of animal types and any one individual packer is often only interested in purchasing a small subset of the animals that might be offered on any given day. Further, sales volumes at smaller, geographically isolated barns can be low which also reduces the number of

animals in a daily sale that might be of interest to a particular packer. Thus a system has developed where order buyers contract with several packers to procure animals and then visit a barn on sale day to purchase animals according to each packer's needs and specifications.

GIPSA's proposed rule prohibits order buyers from purchasing livestock on behalf of more than one packer. It is immediately obvious that packer costs of animal procurement through livestock auction barns would be increased considerably if they were no longer able to "share" in the cost of putting a buyer in the smaller barns. Packer representatives were questioned about this during the interview process and several concluded that the increase in cost due to having a buyer work exclusively for them would be prohibitive and that they would very likely reduce the number of order buyers that they utilize. It then follows that those remaining order buyers would focus on the high volume sales in attempt to minimize the packer's per unit cost of procuring animals in this fashion. Informa judges this argument to be economically sound and believes that it would likely play out in the following fashion. If the rule were to be implemented as written, smaller auction barns in difficult to reach places would see an immediate decline in the number of buyers attending sales while larger, more centrally located sales would see less of an impact. Over time, prices at the smaller volume locations would decline due to the lack of competition as a result of having fewer buyers present. Eventually, livestock producers in remote locations would become discouraged by the lower prices and seek to transact their livestock at the larger barns where better buyer attendance results in higher prices. To the extent that the higher prices in large barns could offset the increased transportation cost that would be incurred to get them there, the producers would abandon their local sale barn and move animals to a bigger central barn. This sets off a death spiral as now smaller numbers will be available for sale each week and that will cause fewer buyers to incur the expense of attending. Eventually, the smaller sale barns will close their doors. The closing of these smaller sale barns would be detrimental to the local economies given the importance of them to these smaller towns. Additionally, producers that used to utilize these smaller sale barns would have to travel greater distances to other barns, causing greater stress on their animals and impacting their value.

There is another angle on the proposed rule that could impact livestock auction barns. Some respondents felt like the provision that requires packers to document all price differentials combined with the potential for litigation posed by eliminating the need to prove competitive injury would cause buyers to move away from purchasing animals on a live basis. Packers see risk in purchasing animals live because judging the economic value of animals before they are dressed is an inexact science. They fear that paying less for one animal relative to another simply because the buyer "thought" the economic value would be less could expose them to a legal claim should the animal in question actually grade better than expected once it was in carcass form. Packers have, in other circumstances, moved away from live purchasing when the risk of misjudging an important economic characteristic is too great. An example is carcass pricing that is practiced in northern cattle feeding areas where muddy feedyard conditions can make it difficult to accurately estimate carcass yield. In fact, it would be rational to argue that on

average we should expect packers to pay more for the same animal in carcass form than live simply because he faces less uncertainty in the carcass transaction. Now, with the proposed rule packers have a new (and potentially very large) risk added to the live procurement process. It makes sense that would drive them in the direction of dressed pricing.

Movement to dressed pricing would imply that animals bypass the livestock auction segment of the marketing channel and move directly to the packer from the producer. This risk would likely affect all livestock auction barns regardless of size.

Both of these potential consequences (the movement away from live pricing and the death spiral at smaller barns) will have a negative impact on the livestock auction barn segment of the economy. We think that the economic impact will be far larger in small communities than in larger ones. In many smaller rural communities, the local sale barn is a hub of economic and social activity. Loss of this asset could be devastating for some small towns.

VIII. TOTAL INDUSTRY COST ESTIMATES

A. Cattle & Beef

In previous sections of this report, information was provided that identified the methodology employed in pulling together estimates of the direct and indirect costs associated with the proposed rules. This section provides the results of the analysis and, as can be seen, there will be a rather significant potential cost burden placed on the cattle and beef supply chain. For purposes of simplicity in presenting the results, supply chain costs have been aggregated into four primary categories. There will be costs incurred by the beef supply chain that are of a one-time nature and basically reflect actual cost outlays. These one-time costs for the beef industry were aggregated up from a rather large matrix of individual costs elements based on primary data submissions provided by commercial supply chain participants and supplemented by knowledge and experience based estimates provided by business consultants at Informa.

A similar process was used to develop a consensus estimate of ongoing direct costs. These costs reflect estimates developed for sustained business adjustments that would be required to comply with the proposed rules as currently written. While the one time direct costs were estimated at nearly $20 million, the ongoing direct costs were estimated to total approximately $45 million.

In addition to direct beef industry costs, two other major areas of economic impacts were identified and estimated. The US beef packing sector is a complex and highly differentiated business with optimal efficiency in the slaughter/processing sector very dependent upon the entire live animal procurement, slaughter/processing and beef product merchandising process. Disruptions in this process whether due to the wrong type of cattle arriving at the plant; too few cattle to operate at a high level of capacity or the wrong quality of product to meet various merchandising programs will all have a negative impact on operational efficiencies. This can be a major cost to the industry; estimated in this study to total over $517 million.

In addition to efficiency losses, the beef industry has spent the past 20 years developing a broad range of quality based programs; some breed specific and some branded in nature while others reflect specific product attributes that qualify the product as organic or natural. Most of these value enhanced programs center around marketing agreements that specify how the animals are going to be produced and in most cases, priced. Virtually all of these programs have imbedded in the requirements a higher cost structure and this necessitates higher prices to be paid for the animals. The premiums that are paid cover the added costs and provide an additional margin incentive to the cattle producer to assure that supplies continue to be produced.

An effort was made to calculate the value that various beef production and marketing programs have generated for the industry and a description of this evaluation is provided earlier in the report. An aggregate measure of the value enhancement to the

US beef industry was made and this totaled an estimated $734 million. While the adjustment to marketing agreements that will occur is very uncertain given the vague wording of the proposed rules, it is most certainly to be less than the maximum value-added estimate and just as certain to be greater than zero. Thus, our estimate of the quality impact (lost revenue opportunity) in the beef sector is nearly $374 million.

For the cattle and beef supply chain, these four cost components aggregate to a total industry cost of roughly $955 million. In addition to this cost, there will be costs at the sales barn/auction market level of the supply chain and possibly company-specific costs related to asset divestitures, business reorganizations and possibly acquisitions. It was noted in several industry interviews that, should the rules as written be implemented, there may be a strong incentive for further vertical integration as a counter measure to the increased exposure that the rules are certain to create from a litigation perspective.

Exhibit 12: Beef Industry Supply Chain Cost

	Million $
One Time Direct Costs	$19.6
Ongoing Direct Costs	$44.5
Cost Increase Due to Efficiency Loss	$517.1
Revenue Lost Due to Quality/Demand Impact	$373.6
Total Supply Chain Loss	$954.8

B. Hogs & Pork

For the hog and pork sector, the same analytic framework was used whereby one-time and ongoing direct costs were estimated as were costs associated with efficiency losses and revenue loss associated with quality programs. The process changes leading to direct cost impacts (both onetime and ongoing) were similar to those for the cattle and beef sector with costs totaling $98 million for one-time costs and approximately $94 million for ongoing costs.

For the hog and pork supply chain in aggregate, the potential costs associated with implementation of the proposed rules summed to $521 million. This is lower than the estimated cost for the beef industry but still a significant cost burden for the US industry to bear. The supply chain lacks sufficient margin for such an economic cost to be absorbed so ultimately, such costs will need to be borne by the consumer through higher prices; the producer through lower prices or, more likely, a combination of both. Costs of this magnitude ultimately will lead to a downsizing of the production base and, given the enhanced threat for expanded litigation, there would be incentives for industry to vertically integrate beyond current levels.

Exhibit 13: Pork Industry Supply Chain Cost

	Million $
One Time Direct Costs	$98.0
Ongoing Direct Costs	$93.6
Cost Increase Due to Efficiency Loss	$187.9
Revenue Lost Due to Quality/Demand Impact	$141.9
Total Supply Chain Loss	$521.4

C. Aggregate Beef and Pork Industry Costs

Pulling all of the cost and revenue components together, the aggregate impact of the proposed GIPSA rule for the US beef and pork industries is estimated to be $1.48 billion. This reflects a significant burden for this sector of the US economy and the impacts do not stop here.

Exhibit 14: Aggregate Economic Impacts Across Beef and Pork Sectors

	Million $
One Time Direct Costs	$117.6
Ongoing Direct Costs	$138.2
Cost Increase Due to Efficiency Loss	$705.0
Revenue Lost Due to Quality/Demand Impact	$515.5
Total Supply Chain Loss	$1,476.20

IX. SUMMARY

In 2010, Informa was commissioned to conduct a study because GIPSA had proposed a rule to implement directives in the 2008 Farm Bill without conducting a careful and credible cost analysis. This update was commissioned because this year Secretary of Agriculture's Tom Vilsack indicated the USDA will move forward with implementing the GIPSA rule, possibly finalizing it in September. With this work, we begin to fill the gap from the missing cost analysis and provide the industry and indication of the costs that are likely to arise if the rule were to be implemented as written. The rule as it currently stands strikes us as very vague and ill-defined. This has created considerable uncertainty among industry players as to what to expect once the rule is implemented.

Our original report began in 2010 with in-depth interviews of industry participants in all segments of the beef, pork and poultry supply chains. These interviews were recompleted with beef and pork packing industry participants for this update. Through these interviews we were able to gain an understanding of how companies were planning to respond to the rule and collect their thoughts on the potential costs they would incur in their response. To help quantify the cost aspect, surveys were sent directly to companies involved in each supply chain asking them to provide cost estimates on a long list of potential actions that might be required to deal with the rule. These included everything from costs associated with additional computer systems and the personnel to support them to projected costs associated with defending their firms from increased litigation as a result of the rule. These survey results were combined with professional expertise at Informa to arrive at a reasonable cost estimate for several broad categories of costs. This process also involved having the Informa study team prepare estimates of financial losses that could be expected from reduced efficiency and declining demand that was expected to arise as a consequence of the rule.

These cost and revenue loss estimates were aggregated to an industry-wide basis and worked through a simple supply-demand framework to arrive at an estimate of the change in output that was expected for each supply chain.

This work indicates that the beef and pork industries will suffer significant economic damage should the proposed rules be implemented. The fact that the estimated economic loss to beef and pork is so high highlights the potential magnitude of the unintended consequences.

Through this analysis, the Informa team came to believe that this rule could also have a substantial impact on livestock auction markets throughout the country. The rule will prohibit order buyers from purchasing cattle for more than one packer and we believe that this will cause a decline in buyers at smaller sale barns that likely set off a "death spiral" that will ultimately lead to many small rural auction barns ceasing business operations thus forcing ranchers in remote rural areas to ship animals further for sale at larger barns.

Finally, we do not expect all of the impacts described by this study to occur immediately. They will take time to evolve. In particular, the decline in beef and pork quality and the subsequent damage to consumer demand will take time to materialize and time for the full impact to be felt. For beef and pork, the full impact might not be felt until three or four years after the rule is implemented. The economic damage resulting from the rule would likely stretch for many years into the future.

It is worth noting in closing that during the course of this study, it became clear to us that the provision in the rule that relieves plaintiffs from the burden of proving competitive injury is by far the most damaging. All of the expected efficiency losses and demand decline that forms the basis for the largest portion of the costs are tied back directly to the packer/processors' fear of increased litigation and an increased likelihood that a very large financial judgment will be rendered against them. That is the factor that will drive the packers to sharply reduce their use of AMAs, which in turn creates large costs in terms of efficiency and product quality. Effects from this portion of the rule also may incentivize further vertical integration of the livestock industry. If this portion of the rule were not enacted the costs of implementation would decrease substantially.

Attachment B

Proposed GIPSA Rules Relating to the Chicken Industry: Economic Impact

Disclosures: This study was prepared for the National Chicken Council. FarmEcon LLC was compensated for the preparation of this study.

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November 16, 2010

Updated: April, 2016

Proposed GIPSA Rules: Economic Impact: Revised April, 2016

Introduction

In 2010 the United States Department of Agriculture (USDA), Grain Inspection, Packers and Stockyards Administration (GIPSA) proposed regulations that would affect chicken company contracts with independent chicken growers. These proposals would significantly expand both the scope of GIPSA oversight of grower contracts, and the legal definition of "unfair practices". The purpose of this study revision is to update the likely economic impact of the 2010 GIPSA proposals on chicken companies, their independent contract growers, and consumers.

GIPSA's Proposed Rules would alter long-standing contractual and business relationships between chicken companies and independent growers. The changes that are proposed are, in part, designed to broaden the scope of GIPSA authority, reduce the latitude to pay growers based on their performance, limit the ability of chicken companies to seek grower investments, and set new requirements for cessation or reduction of delivery of birds to growers. The most likely economic effects would be a reduction of performance-based competition among growers, a reduced rate of capital investment, a reduced rate of efficiency gains, higher chicken prices, and reduced chicken exports.

The GIPSA proposal has been put forward without meaningful evidence of harm done by current or historic practices. To the contrary, the current organization of the chicken industry has resulted in efficiency advances that benefit contract growers, chicken companies, and consumers. GIPSA also failed to present empirical evidence that the proposed rules would result in improved economic performance of the chicken industry. Indeed, based upon an analysis of the proposed rules and application of basic economic theory, it is likely that the proposed rules would increase production costs by reducing incentives for efficient chicken production, adversely affecting competition, chicken companies, efficient and effective chicken growers, and consumers.

GIPSA has also proposed new rules that specifically relate to pork and beef production, pricing and marketing practices. This study does not address those proposals. The proposals affecting chicken companies could also affect other types of poultry production. However, only the potential economic effects of the proposed rules on the chicken industry were considered in preparing this study.

Summary of the Proposed Rules

For purposes of this study, GIPSA's proposed rules that would likely affect chicken industry economics materially will be grouped into six broad categories.

1. **Suspension of Bird Delivery:** A 90-day written notice for suspension of delivery of birds to growers would be required. In addition, written reason for the suspension of delivery, the length of the suspension of delivery, and the date the delivery of birds will resume would be required.

2. **Required Records:** Several proposed changes are related to records that chicken companies would be required to maintain and make available to growers and/or GIPSA. These include:

    a. A specific statistical basis for determining grower pay for each flock raised;

    b. Justification for differentials in grower pricing and payment;

    c. Provision to GIPSA of a copy of each unique contract to growers, and;

    d. Furnishing growers with written documentation of expected costs and returns for many company-sought capital improvements to grower facilities.

3. **Limits on Base Pay and Tournament Compensation:** These proposed changes are designed to regulate compensation of growers by establishing:

    a. A uniform grower base pay rate based on type and kind of poultry; and

    b. Pay-for-performance sub-groups based on grower housing type.

4. **Capital Improvements:** The proposals are designed to affect the terms under which a chicken company may seek capital improvements to be made by growers to their facilities. The Proposed Rules would require:

    a. Contracts of sufficient length for a grower to recover 80% of the cost of the improvement;

    b. Capital improvements made as a result of poultry company coercion be deemed an unfair practice;

    c. The age and upgrade history of a grower's facilities could be the basis for a finding of an unfair practice for capital improvements;

    d. Growers be able to "reasonably expect" the recovery of the cost of capital improvements sought by poultry companies;

    e. A prohibition on reduced placements or termination of a grower for refusing a capital improvement if the grower's facility is in "good working order"; and

    f. A prohibition on poultry companies reducing or ending processing at a facility within 12 months of a bargained for capital improvement for any of the growers supplying that facility. Emergency relief from this rule would require GIPSA approval.

5. **Expanded Enforcement Authority:** GIPSA's proposals would significantly expand GIPSA's enforcement authority to include:

    a. A broad definition of breach of contract;

b. A broad definition of retaliatory action or omission,

c. A broad definition of fraudulent representation, by practice or omission, that would, or could, create competitive injury, or a "likelihood of competitive injury"; and

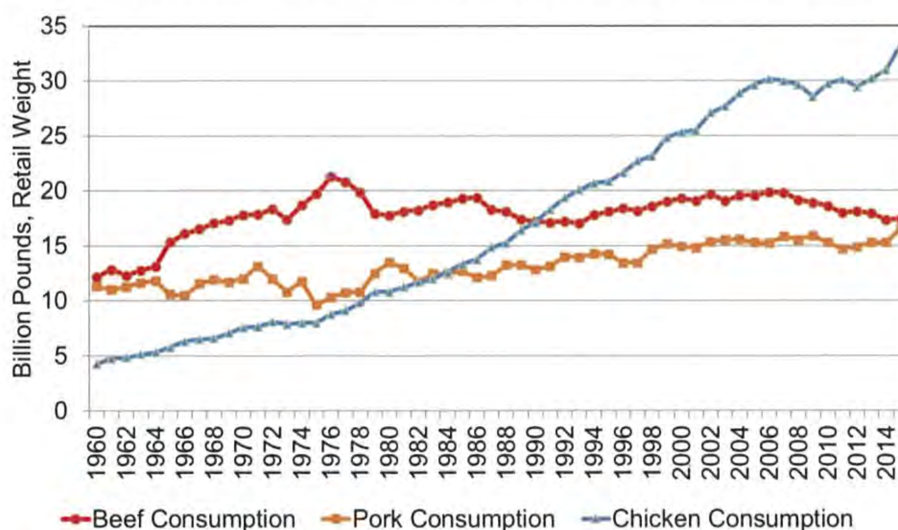
d. Expanded authority eliminating the test of competitive injury that applied to the Packers and Stockyards Act. Specifically, the Proposed Rules state "Conduct can be found to violate section 202(a) and/or (b) of the Act without a finding of harm or likely harm to competition."

6. **Effective Date:** The Proposed Rules would apply to any poultry growing arrangement or contract entered into, amended, altered, modified, renewed or extended after the effective date of the final rule. Thus, flock-to-flock and expiring contracts would likely be immediately affected by the Proposed Rules. Longer term contracts may pose significant issues for implementation of the Proposed Rules as currently written.

Background – Chicken Industry Economic Performance

Market Performance: The U.S. chicken industry has an exemplary record of technological and management advances that have translated into lower real costs, lower real chicken prices, and increased chicken production and exports. As a direct result of innovation, since 1960 chicken has come from a distant #3 ranking in the U.S. meat industry to become the premier leader in both meat consumption and exports. To a great extent the growth of the industry can be attributed to its vertically integrated, effectively structured, production system. That system has enabled the chicken industry to compete aggressively with producers of beef and pork.

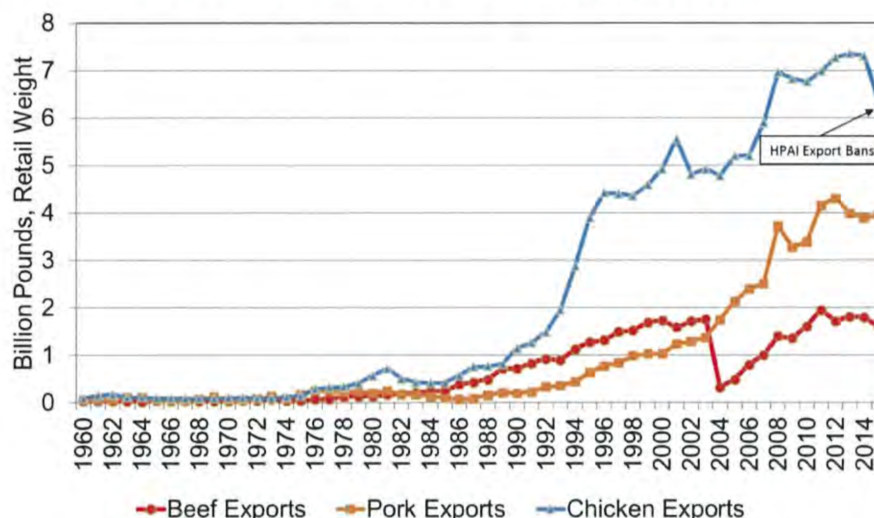
U.S. Consumption of Chicken, Beef and Pork, 1960-2015



Source: USDA/FAS. PS&D database found at http://www.fas.usda.gov/psdonline/psdQuery.aspx. Accessed 4-20-2016.

Over the last 25 years chicken export volume has grown rapidly to about equal the combined total of beef and pork exports. Chicken export growth is a direct result of vertical integration, innovation, improved genetics, and investments that have made the U.S. chicken industry a premier competitor on the global market. Exports in 2015 were reduced by Avian Flu issues.

U.S. Exports of Chicken, Beef and Pork, 1960-2015



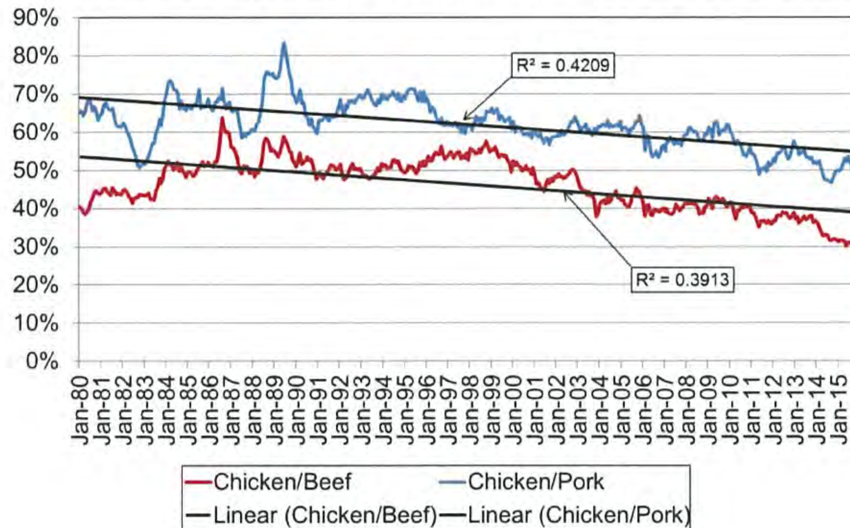
Source: USDA/FAS. PS&D database found at http://www.fas.usda.gov/psdonline/psdQuery.aspx. Accessed 4-20-2016

Chicken Price Trends: Since 1990, retail chicken prices have declined about 30 percentage points against both beef and pork (chart, next page). The decline in relative price was a significant factor behind the increased volume of U.S. chicken consumption relative to beef and pork. The fact that prices have declined relative to beef and pork is a direct function of a faster rate of cost-reducing innovation in chicken production. Innovation in chicken production has also driven increased rates of innovation in beef and pork, and helped lower their costs and prices as well. This result is exactly what economic theory would suggest in a well-functioning, highly competitive, marketplace.

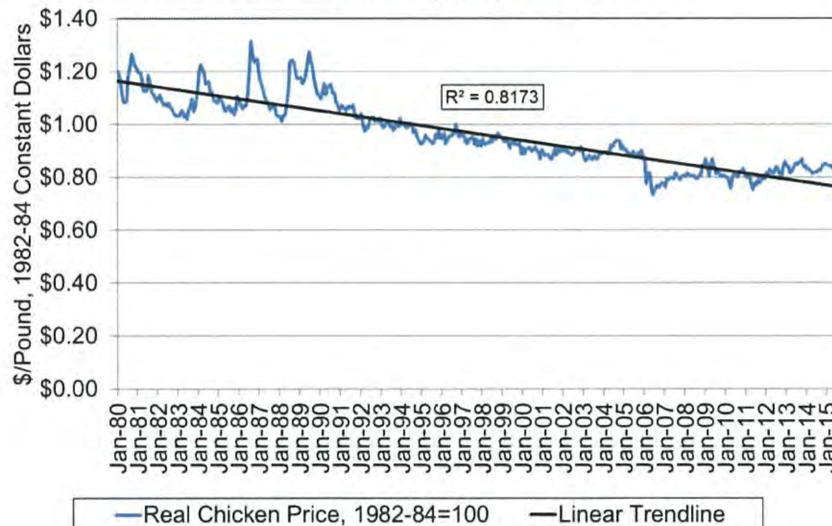
Retail chicken prices, in 1982-84 constant dollars, declined from about $1.20 per pound in 1980 to only about $0.80 in 2015. The only way real prices can decline to this extent is the adoption of cost reducing, innovative, technology in a highly competitive market where cost reductions are passed along as lower consumer prices. Real chicken prices are likely to decline further if feed costs remain at the lower level seen since 2012-13.

The chart on the next page showing constant dollar retail chicken prices demonstrates that the primary beneficiary of increased chicken industry efficiency has been the U.S. consumer. Real retail chicken prices have declined by 33% in the last 30 years, while chicken company profitability has not changed significantly. Cost-saving technology and investments that chicken companies and their contract growers have deployed since 1980 have been competitively transferred to consumers via lower real retail prices. Again, this result is consistent with

economic theory. In competitive markets, as real costs decline the benefit is passed along to consumers in the form of lower real prices and expanded output.



Source: Retail meat data found at http://www.ers.usda.gov/Data/meatpricespreads/. Accessed 4-20-2016.



Sources: Chicken, beef and pork prices found at http://www.ers.usda.gov/Data/meatpricespreads/. Consumer Price Index, base years 1982-1984, found at http://data.bls.gov/cgi-bin/dsrv. Accessed 4-20-2016.

Value of Innovation: One way to approximate the actual savings of chicken sector value chain innovation is to calculate the actual retail value of chicken production (average retail price times volume produced) versus retail value calculated as if average retail prices had increased with inflation. The gap between the two total retail values is what would have happened if

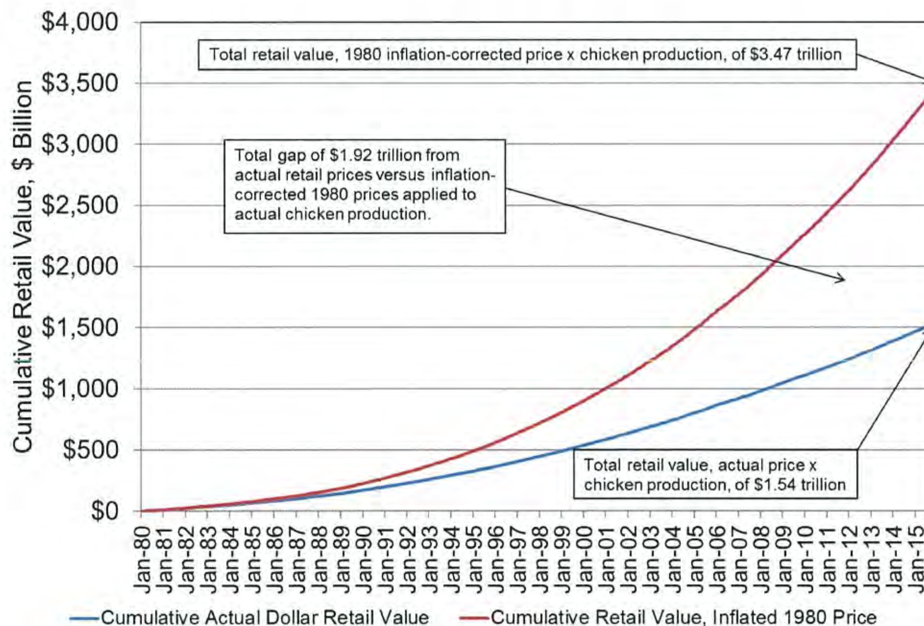
innovation had not kept increases in costs and prices to below the rate of general inflation, versus what actually happened with innovation-driven prices.

Had retail chicken prices since 1980 increased with general inflation, the actual value of production would have increased much faster than was the case with lower actual prices that capture the value of cost-reducing innovation. The value gap is shown in the chart below.

The total 1980 to August, 2015 value gap between inflation-corrected 1980 and actual retail prices is $1.92 trillion. In other words, since 1980, chicken consumers have saved almost $2 trillion from the lower retail prices made possible by investments in cost reducing technology.

Not all of those savings were due to investments made by chicken companies. Investments in crop production, feed processing and optimization, grower housing, genetics, chicken processing equipment, distribution, and many other areas involved in chicken production all contributed to the decline in costs and prices relative to overall consumer price inflation. Improved efficiency of live chicken production has been one key driver in these overall cost savings.

Estimated Cumulative Retail Value of U.S. Chicken Production
1980 Inflation-Corrected Retail value versus Actual Retail Value



Sources: Retail chicken prices found at http://www.ers.usda.gov/Data/meatpricespreads/. Chicken production found at http://www.nass.usda.gov/QuickStats/Create_Federal_All.jsp. Consumer Price Index found at http://data.bls.gov/cgi-bin/dsrv. Accessed 4-20-2016.

Contract Grower Compensation: Contract growers have also benefited from improvements in chicken production efficiency. Actual records of inflation-adjusted average chicken company payments to growers, per square foot of their housing, show an increase since 1990 (table, next page). Those increased payments reflect, in part, returns on the investments made by growers

that have increased the efficiency and value of their operations. Increased payments also reflect freely negotiated chicken company current dollar pay rate increases to offset increasing grower costs for construction, maintenance, and operation of their chicken growing facilities.

Contract Chicken Grower Pay: U.S. Industry Average, 1990 through 2015

(Average Grower Payment Inflation-Adjusted by Implicit GDP Price Deflator, 2009 Base Year)

Year	Average Grower Payment, Cents/Lb., Current Dollars	Average Grower Payment, Cents/Lb., $2009	Live Young Chicken Production, Million Pounds	Total Grower Payments, $2009, Million	% Change, $2009 Grower Payments	Live Pounds Per Sq. Foot	Average Grower Payments, Per Sq. Foot, $2009
1990	4.08	6.10	25,549,696	$1,559,563	13.2%	33.12	$2.02
1991	4.11	5.95	27,170,780	$1,617,098	3.7%	33.44	$1.99
1992	4.14	5.86	28,997,878	$1,699,672	5.1%	33.77	$1.98
1993	4.22	5.84	30,474,243	$1,778,349	4.6%	34.09	$1.99
1994	4.23	5.73	32,765,941	$1,876,751	5.5%	34.77	$1.99
1995	4.32	5.73	34,352,980	$1,968,417	4.9%	34.93	$2.00
1996	4.30	5.60	36,034,815	$2,018,442	2.5%	34.75	$1.95
1997	4.46	5.71	37,207,401	$2,125,103	5.3%	34.87	$1.99
1998	4.53	5.74	38,054,849	$2,183,929	2.8%	35.26	$2.02
1999	4.68	5.85	40,444,167	$2,364,063	8.2%	36.09	$2.11
2000	4.78	5.84	41,293,525	$2,410,344	2.0%	36.23	$2.11
2001	4.87	5.81	42,335,507	$2,461,631	2.1%	36.03	$2.09
2002	4.81	5.66	43,715,247	$2,472,605	0.4%	34.64	$1.96
2003	4.90	5.65	44,317,531	$2,503,671	1.3%	37.22	$2.10
2004	5.04	5.66	46,109,201	$2,607,670	4.2%	38.56	$2.18
2005	5.24	5.70	47,578,696	$2,710,359	3.9%	39.15	$2.23
2006	5.39	5.68	48,332,516	$2,747,672	1.4%	38.97	$2.22
2007	5.43	5.58	49,089,999	$2,738,429	-0.3%	38.56	$2.15
2008	5.64	5.68	49,780,767	$2,829,764	3.3%	38.84	$2.21
2009	5.62	5.62	47,613,466	$2,675,877	-5.4%	38.19	$2.15
2010	5.67	5.60	49,314,757	$2,762,281	3.2%	38.48	$2.16
2011	5.78	5.59	49,559,126	$2,772,606	0.4%	39.40	$2.20
2012	5.85	5.56	49,350,169	$2,743,761	-1.0%	39.07	$2.17
2013	5.93	5.55	50,357,463	$2,792,535	1.8%	39.12	$2.17
2014	6.19	5.69	51,225,964	$2,917,261	4.5%	39.52	$2.25
2015	6.27	5.71	53,168,160	$3,036,603	4.1%	40.03	$2.29
% Increase	53.7%	-6.4%	108.1%	94.7%	NA	20.9%	13.1%

Sources: Average grower payment and pounds/sq. foot: Agri Stats, 4/20/2016. Average grower payment is computed as total grower payments made by chicken companies to, or on the behalf of, growers, divided by total live pounds produced.
Live chicken production from USDA/NASS, found at http://www.nass.usda.gov/QuickStats/, accessed 4/20/2016.
1990-1992 and 2010 pounds/sq. foot estimated based on 1993-2009 trend.
Implicit GDP Price Deflator from Bureau of Economic Analysis found at http://www.bea.gov/national/nipaweb/Index.asp, accessed 4/20/2016

Although inflation-adjusted average pay rate per pound has declined slightly since 1990, inflation-adjusted payments per square foot of grower housing increased by an estimated 13.1%. Improved chicken performance, made possible largely by chicken company genetics investments, more than offset a decline in the inflation-adjusted pay rate per pound. As a result

of improved bird performance the annualized average pounds marketed per square foot of a grower's house has increased almost 21%.

Since it accounts for the grower investment in housing space, inflation-adjusted pay rate per square foot is a better indicator of average grower return on housing than payment per pound.

Increased inflation-adjusted grower payments are what would be expected from a competitive market. Chicken companies, faced with increasing demand and production requirements, have increased average current dollar payment rates to offset increasing costs, and to encourage growers to expand and improve their facilities. Without the participation of their contract growers and improved chicken performance, chicken companies would not have been able to meet increasing demand, while simultaneously reducing real costs and retail prices.

Chicken companies and growers have shared the benefits of improved performance. To stimulate the necessary grower production and investment to meet increasing demand, chicken companies have not had to increase their current dollar average payment rate per pound as much as would have been needed without these performance gains. At the same time, due in large part to performance improvements made possible by chicken company investments in genetics, growers have received higher inflation-adjusted payments per square foot of their housing.

Economic Growth and Employment: Expansion of the U.S. chicken sector has enabled chicken companies to contribute to overall U.S. economic and job growth. Direct employment effects have been seen in the chicken companies themselves, and among their contract growers. The industry currently directly employs about 280,000 people in its U.S. operations. In addition, about 30,000 growers produce hatching eggs and live birds.

Indirect job and economic benefits from chicken company growth have occurred in food retailing, grain/soybean/feed ingredient production, export services, foodservice providers, equipment suppliers, packaging suppliers, transportation, animal health suppliers, and many other sectors.

Since 1960, chicken has been the fastest growing sector in both U.S. and global animal protein production. That growth is largely accounted for by an efficient and effective business model that has innovated, reduced costs, increased product quality, and dramatically increased product offerings.

Imposition of regulations that would reduce the industry's ability to innovate and increase efficiency would damage not only the chicken industry, but also live chicken producers and the entire U.S. economy. Growers would be asked to producer less chicken, consumers would pay higher prices, potential job creation would be lost, and export competitiveness would be at risk.

GIPSA Proposed Rules – Estimates of Economic Impact

The GIPSA Proposed Rules would impose significant added costs on chicken companies. It is likely that the Proposed Rules would, in their individual parts and entirety, have a substantial adverse impact on costs and risks of raising live chickens under contract arrangements with independent growers, to the detriment of the entire chicken industry and consumers.

Potential costs can be broken out into the following categories ***(Proposed Rules sections that are related to the effect)***. These categories are illustrative, and not intended to be exhaustive.

1. *Reduced Rate of Efficiency Improvements:* Directly and indirectly, the Proposed Rules are very likely to have a negative effect on the level of future productivity gains, and could cause costs to increase above what they otherwise could have been in the absence of the Proposed Rules. To the extent that costs are higher than they would have been in the absence of the Proposed Rules, retail chicken prices will also be higher. ***(201.215, Suspension of Delivery; 201.94, Required Records on Pricing Differentials and Contract Terms; 201.216, Capital Investment Requirements; 201.217, Capital Investment Requirements; 201.214, Tournament Compensation Requirements; 201.3, Expansion of Authority)***

2. *Increased Administrative Overhead:* The Proposed Rules would require significant additions to documentation for contract terms, grower payment rates, and negotiated capital improvements made to grower facilities. Tournament compensation systems would require additional documentation and increased overhead from segregation by housing type. Termination of a grower that fails to perform under a contract would entail additional documentation. All unique contracts would have to be submitted to GIPSA, with confidential information identified. All of these new requirements would add costs to chicken company overhead. ***(201.94, Required Records on Pricing Differentials and Contract Terms; 201.210, Records Related to Contract Payments; 201.213, Contracts to be Submitted to GIPSA; 201.216, Capital Investment Requirements; 201.214, Tournament Compensation Requirements)***

3. *Increased Cost of Litigation:* The Proposed Rules contain numerous requirements and terms that are vague, poorly defined, or defined differently from long standing practice. The lack of clear definition of requirements and terms invites litigation. Even if litigation does not occur, uncertainty about the scope and meaning of the Proposed Rules create disincentives for investment or the introduction of innovative contractual arrangements. In addition, the Proposed Rules would extend USDA's enforcement authority well beyond its historical reach defined in numerous court decisions. The Proposed Rules would impose a set of requirements that may be impossible for chicken companies to meet without breaking and re-drafting existing long term grower contracts, inviting further litigation. The Proposed Rules contain rules and prohibitions in areas of activity that have never been regulated in any other sector of agriculture. Added litigation imposes an unknown, and unpredictable, added cost burden to the

industry. More significantly, the risk of litigation is a disincentive for investment and innovation in the production of live chickens by contract growers. ***(All sections of the Proposed Rules are included in this cost category.)***

1. Reduced Rate of Efficiency Improvements

Several historical productivity and efficiency trends in live chicken production are shown in the tables on the next page. Improvements in feed conversion, average daily gain, live production per square foot of grower house and mortality are major driving forces behind growth in chicken production, and lower real costs and prices for chicken products. Productivity gains have come primarily from improvements in genetics, feeds, and grower housing.

Feed Conversion (FCR): Feed accounts for most of the cost of raising live chickens. Chicken companies have made significant investments in genetics and feed formulations in order to increase the efficiency of feed conversion and chicken production. Feed conversion is highly correlated with other performance measures. As a result, compared to 1925, in 2015 the amount of feed required to produce a pound of live chicken is less than half, daily gain has increased by more than 5 times, and mortality dropped from 18% to 4.8%.

U.S. Live Chicken Performance, 1925 to Present

Year	Average Days to Market	Market Weight, Pounds, Live	ADG, Grams	FCR	Feed/Bird, Pounds	Mortality, Percent
1925	112	2.50	10.12	4.70	11.75	18
1935	98	2.86	13.24	4.40	12.58	14
1940	85	2.89	15.42	4.00	11.56	12
1945	84	3.03	16.36	4.00	12.12	10
1950	70	3.08	19.96	3.00	9.24	8
1955	70	3.07	19.89	3.00	9.21	7
1960	63	3.35	24.12	2.50	8.38	6
1965	63	3.48	25.06	2.40	8.35	6
1970	56	3.62	29.32	2.25	8.15	5
1975	56	3.76	30.46	2.10	7.90	5
1980	53	3.93	33.63	2.05	8.06	5
1985	49	4.19	38.79	2.00	8.38	5
1990	48	4.37	41.30	2.00	8.74	5
1995	47	4.67	45.07	1.95	9.11	5
2000	47	5.03	48.54	1.95	9.81	5
2005	48	5.37	50.75	1.97	10.58	5
2010	47	5.70	55.01	1.95	11.12	4.0
2011	47	5.82	56.17	1.96	11.41	3.9
2012	47	5.95	57.42	1.91	11.36	3.7
2013	47	6.01	58.00	1.88	11.30	3.7
2014	47	6.12	59.06	1.89	11.57	4.3
2015	48	6.24	58.97	1.89	11.79	4.8
%1925-2015	**-57%**	**150%**	**482%**	**-60%**	**0%**	**-73%**
2020 est	48	6.57	62.08	1.85	12.15	4.0

*2020 estimated 4/20/16. Source: National Chicken Council, found at 4/20/2016
http://www.nationalchickencouncil.org/about-the-industry/statistics/u-s-broiler-performance/

Chicken companies supply chicks and feeds to contract growers. Chicken companies are able to take advantage of economies of scale, and reduce costs of feed production, chick production, and genetics research. Independent growers could not duplicate chicken company cost economies or genetics research programs. Chicken companies also offer a stable market for their growers' chickens, and assume all risks of feed cost variation. In recent years that risk has been substantial.

Contract growers supply labor, housing, feeders, water, and the utilities to operate their chicken growing houses. This partnership has resulted in lower costs and increased efficiency for the entire industry.

To realize the potential efficiency of genetics and feeds supplied by the chicken companies, housing and related equipment used to raise live chickens must be regularly improved. However, chicken companies generally contract with growers who own the housing and equipment in it. Thus, chicken companies do not directly determine the quality of facilities or equipment that they depend on to efficiently convert feed into chicken meat, and optimize investments in improved genetics.

To encourage growers to improve their facilities, most chicken companies have put incentives in their contract compensation plans that reward improved feed conversion. In many cases, improving feed conversion has required capital investment in grower housing. In some cases, chicken companies have bargained for improvements in housing as a term in their contracts with independent growers. Growers have also benefited from improved feed conversion. With improved conversion comes higher daily gain. Improved gains increase the pounds per year that a grower can raise in a house, increasing the grower's gross income potential. Since 1990 the average pounds raised per square foot of grower house space has increased by 20.9%.

25 Years of Chicken Company Live Bird Efficiency Improvements

Year, Item	Market Age, Average Days	Market Weight, Pounds, Liveweight	Average Daily Gain, Grams	Feed Conversion, Pounds of Feed for 1 Pound of Broiler, Liveweight	Live Pounds Produced Per Square Foot of Grower House	Mortality, Percent
1990 Actual	48	4.37	41.30	2.00	33.1	5
2015 Actual	48	6.24	58.97	1.89	40.0	4.8
Actual 1990-2015 Difference	0	1.87	17.6714	-0.11	6.9	-0.4
Actual % Difference	0%	43%	43%	-6%	20.9%	-8%
2015 Performance at 1990 Liveweight	34	4.37	58.97	1.51	--	--
Difference	-14	0.00	17.67	-0.49	--	--
% Difference	-29%	0%	43%	-25%	--	--

Sources: NCC performance history and Ross 708 days and feed conversion ratio performance standards found at http://en.aviagen.com/assets/Tech_Center/Ross_Broiler/Ross-708-Broiler-PO-2014-EN.pdf

As chickens gain weight the efficiency of feed conversion declines. Actual gains in average feed conversion have thus been significantly masked by the trend in increasing average market

weights. As shown in the table above, at the 1990 average market weight of 4.37 pounds, the 2015 feed conversion standard is about 1.5 pounds of feed per pound of live gain, much lower than the actual average of 1.89 at an average 6.24 pounds of market weight. Over time, feed conversion has improved significantly across the entire spectrum of chicken market weights. Competition among chicken companies has translated these gains into consumer benefits of lower inflation-corrected chicken prices, and increased chicken production.

Summary: Since 1990, and corrected for constant market weights, the improvements in both gain rates and improved feed conversion have been significant. Compared to 1990, raising a 6.24 pound live bird now takes 14 (29%) fewer days. Feed conversion has declined from 2.0:1 to 1.89:1 (-6%; lower is better) for a much heavier 6.24 pound market weight chicken. Average daily gains increased by 43%. Live pounds produced per square foot of grower house increased by almost 21%. These increases in efficiency benefited contract growers (increased gross income per pound and per square foot, and more live pounds produced), chicken companies (lower feed costs and increased sales volume), and consumers (lower inflation-adjusted chicken prices and more chicken consumption).

Gain from Feed Conversion Improvement: Feed consumption per bird is calculated as feed conversion times live weight. In 1990 it took 8.74 pounds of feed to produce a 4.37 pound chicken. In 2015 it took only 6.56 pounds of feed to produce that same live weight chicken, 24.9% less. The difference of 2.18 fewer pounds of feed has a current cost of about 27 cents per 4.37 pound bird (at a feed cost of $260/ton), or 6.2 cents per pound of live chicken.

Had the improvements in feed efficiency in the table on the prior page not occurred, the current conversion rate would be about 25% higher than the actual 2015 of 1.89, or about 2.36 at a 6.24 pound live weight. At 2015 feed costs of about $260 per ton, improved feed conversion since 1990 will save $3.3 billion in 2015 feed expense. This cost reduction is a direct result of chicken company innovation and investment. Savings of this magnitude would not have been possible without ongoing improvements in contract grower-owned facilities. The primary beneficiaries of lower costs have been chicken consumers who have enjoyed lower inflation-corrected prices and expanded chicken production. However, chicken growers have also benefited from increased production per square foot of their houses.

At 2015 feed cost per ton, every 0.01 improvement in feed conversion is worth about $69 million in lower feed costs (table, below). Every loss of 1 point of feed conversion would increase feed costs by that same $69 million

Value of 1 Point of Feed Conversion at 2015 Production and Costs

Item	Units	2015	1 Point Higher Feed Conversion	Difference
Total Liveweight Production	Bill. Pounds	53.13	53.13	0
Feed Conversion	Ratio	1.89	1.9	0.01
Total Feed Used	Mill. Tons	50.20866	50.474317	0.266
Cost/Metric Ton	$/Metric Ton	260	260	0
Feed Cost	Million Dollars	$13,054	$13,123	$69

Average Daily Gain and Pounds Raised per Square Foot of Grower House: The 43% increase in average daily gain since 1990 has also been important to lowering chicken production costs. Increasing gain rates by 43% has helped increase the average housing productivity by about 21% since 1990. Housing investments in ventilation, temperature control, feeders, water distribution and lighting were important contributors to the increase in pounds produced per square foot of grower house. Since growers are typically compensated based on pounds produced, the increase in daily gain has translated directly to improved inflation-corrected grower pay, and improved gross return on house investment.

Put another way, absent the improvement in average daily gain, 2015 chicken production level would require about 21% more housing than is actually the case. For both the grower and the chicken company, the increase in average daily gain has meant that housing is more productive, enabling more pounds of chicken to be raised per year, per square foot. Significant investment in building square footage of houses has been avoided. Both investment costs and the operating costs required for additional housing have also been avoided.

2015 Vs. 1990: Housing Cost Savings for a 20.9% Increase in Pounds Produced Per Square Foot

Based on recent building and operating costs for modern, tunnel ventilation housing

Item	Live Production, 000 Kilos	Live Production, Kilos/Sq. Foot	Square Feet Required, 000
1990 Actual	25,549,690	33.12	771,428
2015 Actual	53,168,160	40.03	1,328,208
2015 at 1990 Kilos/Sq. Foot	53,168,160	33.12	1,605,319
Difference in 1,000 Square Feet Required for 2010 Production			277,111
Total Running Cost Savings at Estimated $1.61/Sq. Foot ($Million)			$446
Investment Avoided at Estimated $10.95/Sq. Foot ($Million)			$3,034

Source: Based on University of Maryland data found at http://extension.umd.edu/lesrec/marylands-poultry/broiler-budget Accessed 4/20/2016

A 2016 University of Maryland study (http://extension.umd.edu/lesrec/marylands-poultry/broiler-budget Accessed 4/20/2016) estimates that a modern, tunnel ventilation, broiler house costs $10.95 per square foot to build and equip. At 1990 house productivity rates, it would take about an extra 277 million square feet of housing to produce the 2015 chicken supply. At current costs, adding those additional square feet would increase the investment cost for chicken housing needed in 2015 by over $3 billion.

In addition, operating costs for that extra housing are also avoided. The University of Maryland study estimated $1.61 per square foot for such costs. The estimated 2015 cost reduction for not requiring the additional square footage is about $446 million.

Potential Impact of Specific Sections of the GIPSA Proposed Rules: Several areas of the Proposed Rules could adversely affect future chicken performance trends, and cause costs to be higher than would be the case under current practices. These are:

201.215: Suspension of delivery. The Proposed Rules could make it more difficult to suspend or reduce delivery of birds to growers. In many instances suspensions and reductions promote the interests of both the grower and the chicken company. Hot summer weather, for example, may increase death loss and cause lower performance if birds are placed at normal density. Adverse business developments, such as the 2008-2009 recession or the 2012 drought, may indicate that placements for a company be reduced or suspended in order to better balance supply with expected demand. If the Proposed Rules force chicken companies to temporarily produce in excess of demand, the market value of chicken products could be reduced below cost. Producing chicken at a loss is not in the best interest of chicken companies, or contract growers.

201.94: Required records on pricing differentials and contract terms. The Proposed Rule could cause companies to change payment rates, contract terms and reduce incentive payments, all in order to avoid increased administrative costs and litigation risks. To the extent that current payment rate and contract terms promote increased growers' efficiency, those gains could be impinged.

201.216 And 201.217: Capital investments criteria. The Proposed Rules would add to the cost of capital improvements, and the risk of litigation by either growers or GIPSA. Companies would be required to maintain additional records on all capital improvements that are negotiated or requested by chicken companies. Chicken companies would also likely feel compelled by litigation risks to maintain additional records on suggested improvements. This section of the Proposed Rules would likely reduce investments by growers to upgrade their facilities. Restrictions and additional recordkeeping requirements add to the costs of improvements, and litigation risks increase if investments do not meet chicken company expectations made known to growers. In addition, restrictions on reducing bird deliveries contained in this section could endanger the welfare of birds, cause increased death loss, adversely affect grower payments to the best performing growers, and increase costs of production.

In summary, adding to costs and complexity of improvements would likely discourage the technical progress that led to the innovation, efficiencies, and cost savings shown above.

201.214: Tournament systems. Parts (a) and (b) of this proposed rule could significantly reduce incentives for chicken growers to invest in their facilities. Part (a) could cause substantial changes in payment rate schedules that could alter incentives and cause loss of goodwill between chicken companies and their growers. Part (b) could also mean that growers with less-efficient housing would not have to compete with more modern, efficient, facilities. The incentives for grower improvements could therefore be significantly reduced.

The Proposed Rules would distort market-based prices and terms contained in chicken company contracts with growers. The proposed rules could distort economic signals for both growers and chicken companies. The result would likely be reduced rates of efficiency improvements and innovation that benefit the entire chicken industry and consumers.

201.94: Required records on pricing differentials and contract terms: The added cost burdens imposed by the Proposed Rules could cause chicken companies to make sub-optimal decisions on grower payments in order to avoid administrative costs and risks of having documented differentials litigated. That is, chicken companies may elect to reduce grower payment differentials in order to avoid administrative costs and potential litigation. To the extent that these differentials reflect true underlying costs and efficiencies, distortions caused by the Proposed Rules could cause payment rates that deviate from underlying costs of production. The most effective producers could be under-compensated, and the least effective could receive compensation in excess of the true market value of their services.

201.214: Tournament compensation requirements: The equal base pay requirements of this section would create incentives for chicken companies to change the definition of "Base Pay" from current use, often "expected pay for average performance", to a minimum pay rate of the lowest performing grower. Under the PR all growers would likely see lower base payments. All growers would receive either the base pay, or base pay plus a premium.

Current payment scales have been established over many decades of negotiation between growers and chicken companies. Imposing regulatory rigidity and forcing the re-writing of base pay and performance payment scales could be difficult, and entail substantial investment in time and resources. Long standing relationships between growers and chicken companies could also be damaged.

Growers across a chicken company's trade area may also face cost differentials for utilities, construction, land and other inputs. In the current environment, base pay is often adjusted to reflect these local cost differentials. The equal base pay requirement could cause growers with relatively high costs to be at a competitive disadvantage to growers in lower cost areas unless chicken companies document differentials and incorporate them into contracts.

Taken together, sections 201.94 and 201.214 could require detailed examination, documentation, and re-drafting, of all current grower contracts. The costs for these changes is expected to be substantial, and would likely result in litigation by those who feel that they have been damaged by changes in contract terms.

Potential Cost Impact: FarmEcon projects that reduced incentives for investment in grower housing, potential distortions caused by changes in tournament incentive systems, and increased risk of litigation could cause performance gains to slow, but not stop. Chicken companies will likely continue to improve genetics and feeds, but housing investment and grower management needed to optimize chicken performance improvement potential will suffer. Based on historic trends the following effects of the Proposed Rules are used to estimate the cost of lost performance:

1. For the first five years of Proposed Rules' enforcement, feed conversion gains at forecast (increasing) market chicken liveweights are projected to slow from 1 point (0.01) per year under current conditions to 0.2 points (0.002) under the Proposed Rules.

2. The trend increase in pounds produced per square foot of grower housing could decrease from 0.32 pounds per year to 0.16 pounds per year, for the first five years of enforcement.

3. Mortality could increase by 0.08% per year over the long term trend for the first five years of enforcement.

Impact on Feed Costs: The Proposed Rules' potential effect on live production feed costs, at $260/ton cost of feed, is shown in the table below. In the 5th year additional feed costs would be $318 million. The total feed cost impact over the first 5 years of enforcement is estimated to be $923 million.

Estimated Impact on Feed Conversion and Feed Expense

Year	Chickens Marketed	Average Liveweight, Pounds/Chicken	Live Marketings, Million Tons	No PR FCR	PR FCR	FCR Loss	No PR Feed Cconsumed, Tons	PR Feed Consumed, Tons	Feed Cost/Ton	Cost of Lost FCR
2017	8,800,000,000	6.299018	27,715,679.20	1.910	1.918	0.008	52,936,947	53,158,673	$260	$57,648,613
2018	8,932,000,000	6.359018	28,399,374.39	1.900	1.916	0.016	53,958,811	54,413,201	$260	$118,141,397
2019	9,065,980,000	6.419018	29,097,344.40	1.890	1.914	0.024	54,993,981	55,692,317	$260	$181,567,429
2020	9,201,969,700	6.479018	29,809,863.66	1.880	1.912	0.032	56,042,544	56,996,459	$260	$248,018,066
2021	9,339,999,246	6.539018	30,537,211.59	1.870	1.910	0.040	57,104,586	58,326,074	$260	$317,587,001
Total 5 Year Cost										$922,962,505

PR = Proposed Rules; FCR = Feed Conversion Ratio

Impact on Cost of Housing: Projected lower pounds produced per square foot of grower housing caused by the Proposed Rules would increase the housing area required. Based on the University of Maryland's study's estimated costs, variable housing costs would increase by about $48 million per year in the 5th year of enforcement. In addition, about $926 million in added grower capital investment would be required over the 5 years. All annual recurring costs for that investment are included in the estimated additional fixed and variable costs.

Estimated Impact on Housing Requirements, Expense and Grower Investment

Year	Live Chicken Production, Tons	No PR Live Pounds Per Sq. Foot	PR Live Pounds Per Sq. Foot	No PR Required Sq. Feet, Millions	PR Required Sq. Feet, Millions	Added Square Feet Required, Millions, Annual	Fixed and Variable Costs at $1.61/Sq. Foot,	Grower Housing Investment at
2017	27,715,679	40.6	40.4	1,365	1,371	5.46	$8.78	$59.74
2018	28,399,374	40.9	40.6	1,388	1,399	11.05	$17.79	$120.98
2019	29,097,344	41.2	40.8	1,411	1,428	16.78	$27.02	$183.74
2020	29,809,864	41.6	40.9	1,434	1,457	22.65	$36.47	$248.05
2021	30,537,212	41.9	41.1	1,458	1,487	28.67	$46.16	$313.94
Total Added Cost and Grower Housing Investment						84.61	$136.22	$926.45

PR = Proposed Rules

Impact on Mortality Costs: The estimated 0.08% per year increase in mortality due to the Proposed Rules would increase live production bird mortality cost by about $37 million in the 5th year of Proposed Rules enforcement. The estimated cost for increased mortality over 5 years is about $110 million.

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Estimated Impact on Mortality and Costs

Year	Chickens Marketed	No PR Mortality, Percent	PR Mortality, Percent	Increased Mortality, Birds	Increased Mortality Cost @ $1/Bird
2017	8,800,000,000	4.00%	4.08%	7,040,000	$7,040,000
2018	8,932,000,000	3.90%	4.06%	14,291,200	$14,291,200
2019	9,065,980,000	3.80%	4.04%	21,758,352	$21,758,352
2020	9,201,969,700	3.70%	4.02%	29,446,303	$29,446,303
2021	9,339,999,246	3.60%	4.00%	37,359,997	$37,359,997
Total 5 Year Cost				109,895,852	$109,895,852

PR = Proposed Rules

Total Bird Performance, Housing and Mortality Cost Impact: In the first 5 years of the Proposed Rules' enforcement, reduced bird performance and increased mortality are estimated to increase live chicken production costs by about $1.2 billion.

Impact on Ownership of Housing: Due to capital investment costs, and the past performance of capable independent growers, chicken companies have been reluctant to own or lease live production assets. However, the Proposed Rules do not apply to fully integrated, company-owned or leased, live production facilities. Chicken companies, at some point, may find that owning, or leasing, their live production assets will more effective than contract production.

The extent of any conversion to company-owned facilities would depend on chicken company experience in the first few years of implementation of the Proposed Rules. Companies may choose to operate under the Proposed Rules, and still attempt to remain competitive. However, benchmarking and performance monitoring systems used by chicken companies would reveal any competitive disadvantage of operating under the currently Proposed Rules.

If companies determine that compliance with the Proposed Rules would cause a cost disadvantage, it is likely that some contract live production would move to company-owned or leased housing. For the most part, company housing would likely be larger, and more efficient, than contract houses replaced. To the extent that this conversion takes place, any impact of fully integrated housing investment would likely fall on smaller, lower productivity growers who depend on contracting for a secure and predictable income source.

If only 10% of 2015 production were to be moved from contract growers to company-owned facilities it would require about 3,700 modern chicken houses and about $1.3 billion of invested capital. Most of the housing would likely be new construction to replace grower's older facilities, but some could also be purchased or leased from contract growers. Ongoing live production costs, and risks of litigation, would likely be somewhat reduced by the investment.

2. Increased Administrative Costs

Under the Proposed Rules there are significant additions to the records that chicken companies would be required to generate and retain. Several specific sections of the Proposed Rules would likely increase administrative costs. The analysis below focuses on only the most significant of the potential costs.

***201.94 (b):* Records justifying pricing differentials:** Chicken companies would be required to document, in writing, the business case for any differentials in payment rates or contract terms for their contract growers.

Administrative Cost Burden: Without detailed knowledge of all current chicken company records systems it is difficult to estimate the additional administrative costs. However, to the extent that chicken companies would choose to not pay growers based on the true value of their services, this requirement would likely impose a lost performance cost burden far in excess of any administrative burden.

***201.210 (a) (3):* Unfair, unjustly discriminatory and deceptive practices or devices:** Chicken companies would be required to offer each grower, upon request, detailed statistical information documenting the calculation of payment rates for each delivery of birds. Though not entirely clear, required information would apparently include, but not be limited to, feed conversion, feed analysis and history of the breeder flock supplying the contractor.

Administrative Cost Burden: Most companies already offer detailed settlement statements, including feed conversion, which would come close to meeting most of the requirements for grower payments. However, feed analysis and breeder records are not generally included in the data available to growers. Assuming these items are required, the costs would be substantial.

Currently, chicken companies do not routinely assay feed loads delivered to growers. FarmEcon estimates that including a very basic feed assay for each load of feed delivered to a grower would cost about $15 per sampled load for an assay, and $2 for administrative expenses (table, next page). The average load of feed delivered to a grower is estimated to be a full truck, 24 tons. In some cases growers may receive partial truck loads, but 24 tons is the maximum allowed load normally delivered. The calculation in the table is for the minimum number of feed loads required for the estimated chicken production, and for a basic assay only. Partial feed loads, or a more extensive assay requirement, would significantly increase costs.

It is conservatively estimated that assay of every feed batch would increase industry costs by about $40 million per year and almost $200 million over the first 5 years of the new rules.

Cost of Compliance with Proposed Rules Requirement for Delivery of Feed Analysis Data

Year	PR Feed Consumed, Tons	Average Feed Load, Tons	Feed Load Samples to be Assayed	Assay Cost per Sample	Administrative Cost Per Feed Load	Total Cost
2017	53,158,673	24	2,214,945	$15	$2	$37,654,060
2018	54,413,201	24	2,267,217	$15	$2	$38,542,684
2019	55,692,317	24	2,320,513	$15	$2	$39,448,725
2020	56,996,459	24	2,374,852	$15	$2	$40,372,492
2021	58,326,074	24	2,430,253	$15	$2	$41,314,303
Total 5 Year Cost						$197,332,263

PR = Proposed Rules

Breeder history is available in many companies' records. Including those records in grower settlements would add a cost burden for revising the payment system to include that information. The administrative cost is not known, but would not be expected to be material. However, breeders typically produce chicks in a 40 life week cycle. Growers receiving chicks at the beginning of a cycle would have little or no history. Growers receiving chicks at later points in the cycle would have more history. The difference in records is unavoidable, and could lead to increased risk of litigation between growers and chicken companies. The Proposed Rules also do not define the exact details of the breeder or feed records to be made available, also possibly leading to litigation.

201.213 (a through e): **Livestock and poultry contracts:** Chicken companies would be required to submit to GIPSA a copy of every unique contract, with business-sensitive language indicated.

Administrative Cost Burden: The administrative costs of submitting contracts to GIPSA is not expected to be material to chicken companies, but publicly disclosing individual contract terms and formats could adversely affect competition.

201.214 (a) (b): **Tournament systems:** Chicken companies operating tournament pay incentive programs would be required to pay all growers the same base pay, and group growers by housing type. Administrative costs for re-drafting contracts and running several tournament sub-systems could be incurred.

Administrative Cost Burden: All contracts could need to be eventually re-drafted to accommodate Proposed Rules-specific arbitration language. However, the Proposed Rules would impose additional requirements that imply changing base pay. Incentive payment programs are also likely to be revised.

Companies could add specific guaranteed premiums to base pay for prior contractual agreements, especially for capital improvements and cost differentials. In fact, such documented premiums to base pay are likely required under the Proposed Rules.

Companies may also choose to make extensive changes in their incentive payments programs so as to avoid over-payment for below-average grower performance. Companies will likely

decide to guarantee less of the grower payment as base pay, and make more subject to performance incentives.

An estimate of the cost of amending all contracts is on page 21.

201.216 (e through h) And 201.217 (a): **Capital investments criteria:** For any negotiated capital investment a chicken company would be required to maintain complex records to show the business case for the investment, and that the grower can be expected to recover at least 80% of the investment cost. Such a business case entails many factors, some of which are subject to variation beyond the control of both the chicken company and the contract grower.

Administrative Cost Burden: Most companies already present growers with estimates of expected costs and returns for both negotiated and suggested improvements. However, maintaining detailed records, including a business case and tracking actual results, for each capital improvement for each grower could entail a significant administrative cost burden.

201.3 (d) And 201.214 (a): **Implementation Administrative Costs:** As written, the Proposed Rules would also likely be difficult and expensive to implement. Existing contracts would apparently not come under the Proposed Rules until they are entered into, amended, altered, modified, renewed or extended. The provisions of the Proposed Rules are thus potentially tied to the various lengths of approximately 20,000 individual grower contracts.

To the extent that there are existing long term, multi-year, grower contracts the effect of the Proposed Rules would be potentially to spread out over a multi-year time horizon. For a considerable period of time chicken companies could have some growers that are covered by the Proposed Rules, and others that would operate under current rules.

For live production, some companies could need to operate their production programs as if they were two separate entities. One entity would operate under existing rules, the other under the Proposed Rules. As contracts meet the criteria for inclusion under the Proposed Rules, growers would move from the entity operating under current rules to one using the new rules. In the meantime, the chicken company would need to duplicate its live production contract compensation administrative systems and costs.

Growers and companies could mutually agree to amend long term contracts, and comply with the Proposed Rules, but there is no guarantee that this would be the case.

A 2015 National Chicken Council survey showed a wide range for length of grower contracts. Some existing contracts extend as far as 20 years, and almost 60% are longer than flock-to-flock. It is assumed that flock-to-flock contracts are construed to be "extended" when the next flock is delivered, and the Proposed Rules would become effective at that time.

Section *201.214* of the Proposed Rules poses a particularly difficult and significant set of implementation issues for chicken companies with diverse or multi-year contract lengths. This section of the Proposed Rules dealing with tournament incentive programs states:

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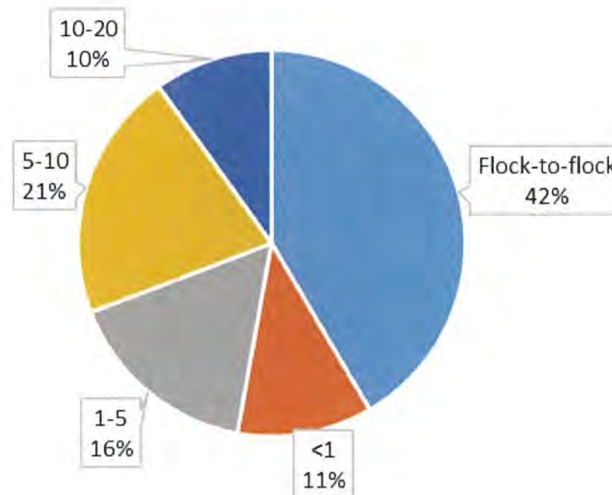
"If a live poultry dealer is paying growers on a tournament system, all growers raising the same type and kind of poultry must receive the same base pay. No live poultry dealer shall offer a poultry growing arrangement containing provisions that decrease or reduce grower compensation below the base pay amount."

Lengths of Grower Contracts, in Years, September, 2015

(20 Companies, 92% of U.S. Production, 13,723 Contracts)



Source: National Chicken Council Survey, September, 2015

This Proposed Rule related to base pay clearly states that all growers raising the same type and kind of poultry will receive the same base pay. Elsewhere in the Proposed Rules, existing contracts with different pay rates are allowed to remain in effect until they are amended, altered, modified, renewed or extended. A chicken company attempting to implement the rule is faced with a contradiction. The company must either be in violation of the Proposed Rules, or amend existing long term contracts to bring them into compliance.

Assuming that contracts longer than flock-to-flock must be amended prior to expiration to be in compliance, for the 20 companies there are approximately 7,960 contracts (58% of 13,723 total contracts) affected. Each long term contract will require negotiation with a grower, and re-drafting to include grower-specific language pertaining to past negotiated payment differentials, and the new housing type segregation requirement. It is estimated that amending each contract will require 1 hour of attorney time at $350 and 2 hours of administrative time at $30 per hour, for a total cost of $380 per contract. The one-time cost is estimated to be $3.02 million.

In addition, approximately 5,765 flock-to-flock contracts would also need to be immediately re-drafted at an estimated administrative cost of $350 each, for a total cost of $2.02 million. The total cost of re-writing all grower contracts is estimated to be about $5.04 million. To the extent

that affected growers, or GIPSA, might perceive that amended contracts would not be as favorable as existing contracts, there is further increased risk of litigation and costs.

3. Increased Litigation Costs

Substantially increased litigation costs would likely be incurred by chicken companies as a result of the Proposed Rules. Those costs would come from a combination of proposed expansion of regulatory authority, ambiguous language and contradictory requirements. The cost of potential litigation is unknown, but likely to be material.

These specific sections of the Proposed Rules could materially increase litigation costs:

201.219: Arbitration rights, costs and limits. The proposed arbitration requirements would discourage the use of arbitration and substitute litigation for conflict resolution. Companies have frequently experienced higher costs for litigation than arbitration. In addition, only contract disputes could be arbitrated under the Proposed Rules. Disputes frequently involve both contract and non-contract issues. Even if arbitration was offered and accepted, litigation for non-contract issues would be necessary. The cost of potential litigation is unknown, but likely to be material.

201.94: Records justifying pricing differentials. The proposed requirement invites litigation for the purpose of examination of detailed chicken company records on contract payment terms, costs and payment rates. The cost of potential litigation is unknown, but likely to be material.

201.214: Tournament systems. The Proposed Rules would require significant adjustments in existing contract base pay, incentive pay, and tournament groupings. Growers who feel that they have been harmed by contract revisions are likely to seek remedy through the courts and through GIPSA. The cost of potential litigation is unknown, but likely to be material.

201.216 And 201.217: Capital investments criteria. Growers who see capital investment results that do not meet documented expectations are likely to litigate. The cost of potential litigation is unknown, but likely to be material.

201.3 Applicability of regulations. This section seeks to significantly enlarge the scope of GIPSA enforcement authority. It can be expected that this section of the Proposed Rules would engender substantial litigation. The costs of litigation are expected to be material.

Vague Language: The Proposed Rules incorporate vaguely defined new requirements using imprecise language that invites litigation to determine the limits of meaning of the Proposed Rules in the context of the chicken company/contract grower relationship. Terms that are not well-defined include, but are not limited to (*Relevant Section*):

- *201.20:* "reasonable person": What is the definition and limit of reasonable? Because of changing context, determinations made by GIPSA or lay juries could effectively decide business questions on the basis of rough-cut judgments as to what is considered fair and

equitable. Those decisions could vary by time and place, and thus fail to establish a meaningful standard.

- *201.94:* "written records": What are the standards for details of these records? How extensive do they need to be?

- *201.214:* "base pay": This term is redefined by the Proposed Rules from current common usage. The most common current definition is a pay rate based on average grower performance. Actual pay rates for individual growers may vary, and be above or below the current definition of base pay. The Proposed Rules redefine "base pay" as a minimum pay rate that all growers must be paid, regardless of performance. This redefinition is likely to result in litigation from disgruntled growers who might see their contract base pay reduced to accommodate the Proposed Rules.

- *201.214:* "like house types": There is no current industry-wide standard definition for the term "house type". The lack of a standard invites litigation to determine the limits of the meaning of the Proposed Rule.

- *201.216:* "similarly situated": What is the limit on permissible differences that are in excess of "similar?" The lack of a standard invites litigation to determine the limits of the meaning of the Proposed Rules.

- *201.216:* "reasonably be expected": Determination of "reasonably" will vary from time to time, and will depend on numerous, changing, assumptions. What are the limits of "reasonably?"

- *201.217:* "reasonable time period" Determination of "reasonable time" will vary from time to time. What are the limits of "reasonable time?"

- *201.217:* "adequate compensation incentives": What is the definition of adequate? Is it 80%, 90%, 95%, or 110% of expected costs?

- *201.217:* "good working order" What are the limits of "good working order?" For example, if 90% of a house's design ventilation is being achieved, is that "good working order", or is it 85%, 95%, or 100%, or some other percentage?

- *201.218:* "include, but are not limited to": What other criteria can be used to determine compliance? The Proposed Rules in several places do not clearly state the limits of the proposed regulations, inviting litigation to enlarge the scope of regulatory authority. The Proposed Rules invite GIPSA to enforce compliance based on criteria that are not written into the Proposed Rules.

- *201.219:* "reasonable discovery": Determination of "reasonable discovery" may vary from time to time and case to case. What are the limits of "reasonable discovery" with respect to company records?

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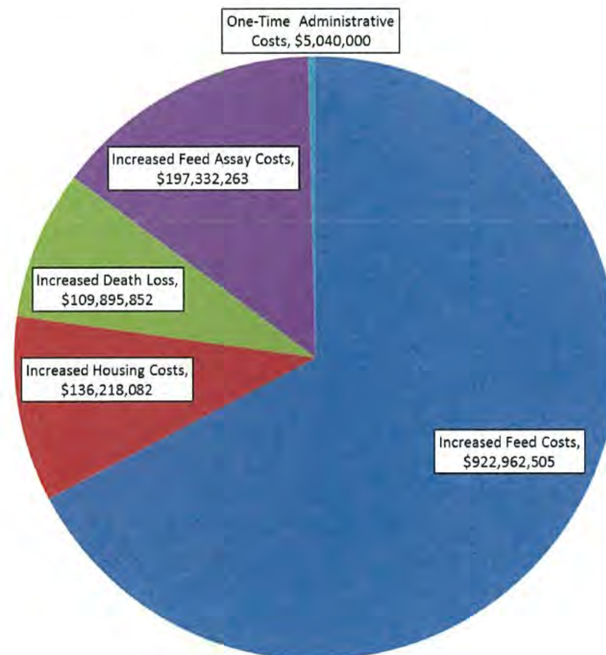
Cost Burden: If adopted in their current form the Proposed Rules would expose chicken companies and growers to large, unknown, and unknowable, risks of increased litigation costs. The business environment under the Proposed Rules would be one of greatly increased risk and uncertainty that discourages investment and innovation.

The Proposed Rules could also encourage chicken companies to escape GIPSA regulation altogether by investing in company-owned or leased growing facilities. The Proposed Rules may increase the incentives for chicken companies to make investments solely to escape the risks and cost burdens of the rules. Such decisions, driven by regulations, are not likely to be economically efficient to the extent that they are driven by other than market forces. Decisions to move to full vertical integration with company-owned or leased facilities are also likely to do significant harm to the very growers that the proposal is intended to protect.

Total Cost Burden:

Identified Cost Burden: The total identified Proposed Rules cost burden is shown in the table and pie chart below. The identified cost burden increases over time, reaching about $442 million in 2021. The total identified cost over the first 5 years is about $1.37 billion. Costs would continue to increase beyond the 5 year horizon of this study.

Identified Total 5 Year Cost Increases Associated With the GIPSA Proposed Rules



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The identified costs in the graph and the table below do not include an estimated $926 million in capital investment required for additional housing during the first 5 years of the new rules.

Identified Cost Increases Associated with the GIPSA Proposed Rules

Year	Increased Feed Costs	Increased Housing Costs	Increased Death Loss	Increased Feed Assay Costs	One-Time Administrative Costs	Total
2017	$57,648,613	$8,783,836	$7,040,000	$37,654,060	$5,040,000	$116,166,509
2018	$118,141,397	$17,787,793	$14,291,200	$38,542,684		$188,763,075
2019	$181,567,429	$27,015,716	$21,758,352	$39,448,725		$269,790,222
2020	$248,018,066	$36,471,524	$29,446,303	$40,372,492		$354,308,385
2021	$317,587,001	$46,159,212	$37,359,997	$41,314,303		$442,420,512
Total	**$922,962,505**	**$136,218,082**	**$109,895,852**	**$197,332,263**	**$5,040,000**	**$1,371,448,703**

Unidentified Cost Burden: There are significant additional costs that are also likely to be imposed by the Proposed Rules. These costs either cannot be estimated at this time, or are beyond the scope of the comments.

Litigation costs: In addition to the identified costs above, the Proposed Rules would also impose substantial, but unknown, risks of increased litigation and attendant legal costs. The extent and cost of increased litigation is impossible to identify with any degree of certainty, but would very likely be material to the financial health of the entire industry. Higher litigation costs alone could have a negative effect on growers, chicken companies, USDA and consumers. Indirectly, the increased threat of litigation will have a chilling effect on innovation and investment. To the extent that the Proposed Rules slow innovation and investment, the entire chicken industry, including its growers, would suffer, and consumers will experience higher prices.

Reduced Competition in Related Product Markets: The Proposed Rules are likely to reduce competitive forces both among chicken companies and within the entire meat and poultry production system. Increased costs and reduced rates of chicken production innovation could lower the incentives that an efficient and price competitive chicken industry create for beef and pork producers. The result could be higher costs, and higher retail prices, of competing meats.

Reduced Competitiveness in Export Markets: To the extent that the Proposed Rules would unilaterally apply to only U.S. chicken producers, they would likely result in reduced global competitiveness, and long term loss of export market volume and value, and increased pressures for U.S. chicken imports. Export losses and/or import increases would reduce demand for, and production of, U.S. chicken. Lower exports and/or higher imports would damage the U.S. trade position and result in job losses in chicken production and allied industries. Included in those job losses would be fewer chicken growers. Brazil, our major chicken export competitor, would likely become the only major economic beneficiary of the Proposed Rules.

Summary: Unidentified cost burdens are likely to add significantly to the overall cost of the Proposed Rules. Higher costs could lead to higher consumer prices, loss of competitive

advantage, and a substantial loss of U.S. chicken exports. Associated with these increased costs and lower exports, there likely would be a loss of jobs in the chicken industry, its supplier companies, and among its contract growers.

Summary and Conclusions

Without proof of economic harm, GIPSA has proposed a set of rules that basic economic analysis strongly suggests could result in significant increases in chicken production costs. In addition, GIPSA is proposing to significantly increase its enforcement powers beyond the "proof of competitive harm" limits that courts have applied to actions brought under the Packers and Stockyards Act.

The proposed rule changes are likely to slow the pace of innovation, increase the costs of raising live chickens, and result in costly litigation. Identifiable cost increases for lost performance, increased bird mortality, and feed assays total an estimated $442 million in the 5th year of Proposed Rules enforcement. Total identifiable cost increases over the first 5 years of enforcement total $1.37 billion. Higher costs would put upward pressures on chicken prices, and economic theory strongly suggests that consumers would ultimately bear those costs.

Additional, but unknown, costs could arise from increased litigation and difficulties in phasing in the new rules on a contract-by-contract basis. These added, but unknown, expenses would be forecast to be material to the industry, and ultimately consumers.

To the extent that the rate of introduction of cost reducing chicken production innovation would be slowed by the Proposed Rules, competitive pressures on other meat producers would also be reduced. Costs of producing competing meat could also be increased, harming those industries, consumers, and the U.S. trade balance.

The Proposed Rules place cost burdens and regulatory restrictions on U.S. broiler companies that do not apply to foreign competitors. To the extent that U.S. chicken company competitiveness in global markets is reduced, U.S. chicken net exports would likely decline. Export competitor countries such as Brazil could reap significant benefits from the Proposed Rules.

GIPSA has not identified any economic benefit gains, or cost reductions, that would arise from the Proposed Rules and justify changes in current grower contract arrangements. Neither has GIPSA identified any significant abuse of market power nor proof of harm that would justify increasing the reach of its regulatory authority beyond the damage to competition that courts have repeatedly, and consistently, ruled apply to the Packers and Stockyards Act.