NATIONAL CHICKEN COUNCIL

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December 18, 2018

Submitted electronically via regulations.gov

Kimberly Chuday
Office of Financial Assistance
Office of Capital Access
Small Business Administration
409 Third Street SW
Washington, DC 20416

Re: National Chicken Council Comments on the Small Business Administration Proposed Rule for Express Loan Programs; Affiliation Standards; Docket No. RIN: 3245–AG74 (September 28, 2018)

Dear Sir or Madam:

The National Chicken Council (NCC) appreciates the opportunity to provide comments on the U.S. Small Business Administration (SBA or the agency) Proposed Rule, Express Loan Programs; Affiliation Standards (Proposed Rule).[1] NCC is the national, non-profit trade association that represents vertically integrated companies that produce and process more than 95 percent of the chicken marketed in the United States. Although NCC member companies do not participate in the SBA Section 7(a) loan program, many independent, small family farmers that raise broiler chickens do. These farms would be severely and unfairly harmed by the proposed rule, which threatens to cut off a vital source of financing for small rural businesses.

NCC urges SBA to reconsider its proposal on the Express Loan Programs and Affiliation Standards. We are deeply concerned that this Proposed Rule would drive small family farmers out of SBA's loan programs and threaten rural economies. Small family farms are the lifeblood of many rural communities and remain the backbone of American agriculture, and they rely on loan guarantee programs like the SBA 7(a) loan program for critical financing. The 7(a) loan program is one of the primary federal programs helping small family farmers get the financing needed to build, operate, and maintain modern farms, backing $1.8 billion in loans to poultry growers between 2012 and 2016. SBA's abrupt proposal, based on a fundamentally flawed report from the Office of Inspector General (OIG), threatens to drive many small family farmers out of the 7(a) loan program, cutting off a vital source of financing and jeopardizing rural communities across America.

[1] 83 Fed. Reg. 49001 (Sept. 28, 2018) https://www.gpo.gov/fdsys/pkg/FR-2018-09-28/pdf/2018-20869.pdf.

Background on the Office of Inspector General Report and the SBA Proposed Rule

On March 6, 2018, the Office of the Inspector General (OIG) to SBA released a report titled *Evaluation of SBA 7(a) Loans Made to Poultry Farmers* (OIG Report).[2] OIG's objective was to determine whether 7(a) loans made to poultry farmers (growers) met statutory, regulatory, and SBA requirements for eligibility. Ultimately, OIG reported that 7(a) loans made to growers did not meet regulatory and SBA requirements for eligibility. OIG reasoned that, based on an analysis of only eleven samples, the chicken processors (integrators) exercised "such comprehensive control over the growers" that the growers could not operate their businesses independent of integrator mandates, causing the business concerns to be considered affiliated.

Under SBA's Proposed Rule, SBA is proposing to expand the affiliation principles applicable to financial assistance programs. Specifically, SBA is proposing to amend 13 C.F.R § 121.301(f)(4) to cause two businesses to be considered affiliated if they have "an identity of interest" or if one is economically dependent on the other, with economic dependence defined as deriving more than 85 percent of receipts from another concern over the past three years.

SBA also specifically addressed poultry growing contracts:

> SBA recognizes that, if the proposed identity of interest rule is adopted as final, SBA Lenders may need assistance in applying the rule to certain agricultural business relationships or agreements. In particular, the agreement between a poultry farmer and a large poultry producer (integrator) may be critical to the determination of whether the farmer is an independent small business but, due to the complexity of the typical integrator agreement, SBA Lenders may be uncertain as to the correct outcome of the affiliation analysis for such a business relationship. SBA is considering reviewing these agreements and making the affiliation determination itself so that SBA Lenders will not be reluctant to make loans to small poultry farmers operating under such agreements. SBA will provide further information on this in the final rule, if necessary.[3]

NCC Comments on the Proposed Rule

The OIG report reached erroneous conclusions about the relationship between poultry farmers and poultry processors, backtracked on over two decades of clear and successful SBA policy, and unnecessarily jeopardized the financial livelihood of thousands of small family farms across rural America. Although analyzing only eleven of the thousands of SBA 7(a) loans made to poultry growers, the OIG concluded the loans did not meet SBA requirements for eligibility because processors purportedly exercised control over the growers through contracts, operating procedures, and other mandates such that the family farmers should be viewed as "affiliated" with poultry processors.[4] In practice, the OIG drastically mischaracterized the relationship between the growers and integrators, therefore creating a false premise for the basis of the Proposed Rule.

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[2] US SBA OIG Evaluation Report: Evaluation of SBA 7(a) Loans Made to Poultry Farmers (Mar. 6, 2018) https://www.sba.gov/sites/default/files/oig/SBA-OIG-Report-18-13.pdf.

[3] 83 Fed. Reg. at 49009.

[4] *See* pg. 7 of the OIG Report.

In reality, growers are independent, registered businesses in their respective states that can control their own successes almost entirely on how efficiently and effectively that grower raises the birds. Many operate diversified farming operations, with poultry growing representing but one income stream. While poultry processors provide some of the inputs and assume some of the market risks, based on quality control and market efficiencies (*e.g.*, an integrator is better positioned to absorb feed cost fluctuations than a small family farmer), the success of the small family farmer raising broiler chickens ultimately turns on how well the farmer cares for the birds and how efficiently he or she can manage the farm. In other words, the small family farmer "bears the risk of loss commensurate with ownership."[5] Farmers who manage their farms well receive incentive payments, and unfortunately some farmers are unable to succeed and exit the poultry farming business altogether.

Importantly, a key component of SBA's mission is to maintain and strengthen the nation's economy by enabling the establishment and vitality of small businesses. Given the at-times long delay between entering farming and generating income, capital access represents one of the most significant barriers to entry for individuals who want to start a small farming business, which is why Congress specifically included agriculture in the SBA's mandate. Lenders work hard to fill this gap by providing competitive loan products to small agricultural businesses. However, the SBA 7(a) program fulfills its mandate by facilitating this essential capital access for small family farmers, allowing farmers to grow their operations, and in some cases continue to pass down multi-generational family farming legacies.

In testimony to the House Small Business Committee, the SBA stated that the performance of poultry loans in the 7(a) portfolio were very good, with a delinquency rate of less than one-half of one percent and lower than the overall 7(a) portfolio. The SBA's Office of Capital Access stated that the loans examined in the OIG report were "correctly made" with SBA policy.[6] Additionally, poultry loans represent only one percent of the entire 7(a) portfolio and are not crowding out other small businesses' participation in the program. While these loans are a small part of the overall program, they have an outsized impact on America's farmers.

Finally, the precedent of establishing an inflexible rule targeting broiler chicken farmers creates the potential for unfair advantage for differing industries. We must maintain a level playing field for all industries to locate the capital they need to grow and continue their businesses. This proposed regulation is not required by any recently passed law or Congressional action, yet if finalized, it would be overwhelmingly detrimental to our family poultry farmers. NCC is concerned that the Proposed Rule based on a flawed OIG report would in fact place even more obstacles in the path of rural American businesses. Although NCC believes the existing 7(a) program is functioning as Congress intended and is appropriately supporting small agricultural businesses, if SBA feels that further clarity is needed for poultry farmers, NCC suggests drawing on SBA's approach to franchise agreements, by which franchisees would not be considered affiliated with franchisors if the franchisee "has the right to profit from its efforts and bears the risk of loss commensurate with ownership," even if the franchisor exercises substantial control over the franchisee.[7]

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[5] 83 Fed. Reg. 49017

[6] US SBA Press Release (March 12, 2018) https://www.sba.gov/about-sba/sba-newsroom/press-releases-media-advisories/sba-comments-loans-poultry-farmers

[7] 83 Fed. Reg. 49017.

Conclusion

NCC appreciates the opportunity to provide this perspective. SBA 7(a) loans play a vital role in supporting American agriculture and rural economies across the country, and NCC urges SBA to retain its existing approach toward “affiliation,” which is sound, practical, and lawful.

Please do not hesitate to contact me if I can provide any additional information.

Sincerely,

Mike Brown
President, National Chicken Council