

# Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## DEPARTMENT OF AGRICULTURE

### Grain Inspection, Packers and Stockyards Administration

#### 9 CFR Part 201

RIN 0580-AB27

#### Unfair Practices and Undue Preferences in Violation of the Packers and Stockyards Act

**AGENCY:** Grain Inspection, Packers and Stockyards Administration, USDA.

**ACTION:** Proposed rule.

**SUMMARY:** The Department of Agriculture's (USDA) Grain Inspection, Packers and Stockyards Administration (GIPSA), Packers and Stockyards Program (P&SP) is proposing to amend the regulations issued under the Packers and Stockyards Act, 1921, as amended and supplemented (P&S Act). The proposed amendments will clarify the conduct or action by packers, swine contractors, or live poultry dealers that GIPSA considers unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) of the P&S Act. The proposed amendments will also identify criteria that the Secretary will consider in determining whether conduct or action by packers, swine contractors, or live poultry dealers constitutes an undue or unreasonable preference or advantage and a violation of section 202(b) of the P&S Act.

This proposed rule identifies the conduct or action that is a per se violation of section 202(a) of the P&S Act, includes an illustrative list of conduct or action, absent demonstration of a legitimate business justification, GIPSA believes is unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) of the P&S Act regardless of harm to competition, and clarifies that any conduct or action that harms or is likely to harm competition is a violation of section 202(a) of the P&S Act. The proposed rule also includes criteria the Secretary will consider in determining whether conduct or action constitutes an undue

or unreasonable preference or advantage and a violation of section 202(b) of the P&S Act.

**DATES:** We will consider comments we receive by February 21, 2017.

**ADDRESSES:** We invite you to submit comments on this proposed rule. You may submit comments by any of the following methods:

- *Mail:* M. Irene Omade, GIPSA, USDA, 1400 Independence Avenue SW., Room 2542A-S, Washington, DC 20250-3613.
- *Hand Delivery or Courier:* M. Irene Omade, GIPSA, USDA, 1400 Independence Avenue SW., Room 2542A-S, Washington, DC 20250-3613.
- *Internet:* <http://www.regulations.gov>. Follow the on-line instructions for submitting comments.

*Instructions:* All comments should make reference to the date and page number of this issue of the **Federal Register**. Regulatory analyses and other documents relating to this rulemaking will be available for public inspection in Room 2542A-S, 1400 Independence Avenue SW., Washington, DC 20250-3613 during regular business hours. All comments received will be included in the public docket without change, including any personal information provided. All comments will be available for public inspection in the above office during regular business hours (7 CFR 1.27(b)). Please call the Management and Budget Services staff of GIPSA at (202) 720-8479 to arrange a public inspection of comments or other documents related to this rulemaking.

**FOR FURTHER INFORMATION CONTACT:** S. Brett Offutt, Director, Litigation and Economic Analysis Division, P&SP, GIPSA, 1400 Independence Ave. SW., Washington, DC 20250, (202) 720-7051, [s.brett.offutt@usda.gov](mailto:s.brett.offutt@usda.gov).

#### SUPPLEMENTARY INFORMATION:

##### Background on Prior Proposed Rule

In June 2010, GIPSA proposed a new regulation designated as § 201.210. Paragraph (a) in that regulation introduced a list of examples of conduct that GIPSA considered unfair, unjustly discriminatory, or deceptive under section 202(a) of the P&S Act. GIPSA intended the first seven examples in the list to exemplify conduct that would violate section 202(a) regardless of proof of harm or likely harm to competition.

The seven (7) examples proposed were as follows: (1) An unjustified material breach of a contractual duty or an action or omission that a reasonable person would consider unscrupulous, deceitful, or in bad faith in connection with any transaction in or contract involving the production, maintenance, marketing or sale of livestock or poultry; (2) a retaliatory action or omission, such as coercion, intimidation, or disadvantage, by a packer, swine contractor, or live poultry dealer in response to the lawful expression, association, or action of a poultry grower, livestock producer, or swine production contract grower; (3) a refusal to provide to a poultry grower or swine production contract grower statistical information and data (*e.g.*, feed conversion rates, feed analysis, and origin and breeder history) used to determine compensation paid under a production contract; (4) an action or attempt to limit by contract a poultry grower, swine production contract grower, or livestock producer's legal rights and remedies afforded by law; (5) paying premiums or applying discounts on a swine production contract grower's payment or the purchase price received by the livestock producer from the sale of livestock without documenting the reason and substantiating the revenue and cost justification associated with the premium or discount; (6) terminating a poultry growing arrangement or a swine production contract based only on allegations that the poultry grower or swine production contract grower failed to comply with an applicable law, rule or regulation; and (7) a representation, omission or practice that is fraudulent or likely to mislead a reasonable poultry grower, swine production contract grower, or livestock producer regarding a material condition or term in a contract or business transaction. These seven (7) examples of conduct were followed by one last example, number eight (8), that read, "Any act that causes competitive injury or creates a likelihood of competitive injury."

Comments in opposition to proposed § 201.210 argued that the regulation was unclear, vague, and ambiguous. Some questioned whether the lack of clarity would make it impossible to determine whether a company was behaving in compliance with § 201.210. Other comments questioned whether it allowed for a balancing of interests. As

a result of the comments, GIPSA has restructured and revised proposed § 201.210.

### Summary of Changes From the 2010 Proposed Rule

In this new proposed rule, GIPSA restructured § 201.210 into three paragraphs designated by letters (a) through (c). Paragraph (a) addresses “per se” violations of section 202(a), which are those behaviors specifically identified with the P&S Act as unfair, unjustly discriminatory, or deceptive practices or devices. A delay in payment or attempt to delay payment for livestock purchases by a market agency, dealer, or packer is specifically identified as an “unfair practice” in Section 409(c) of the P&S Act. When a packer violates section 409(c) of the P&S Act (7 U.S.C. 228b), the conduct is also a “per se” violation of section 202(a) of the P&S Act. Likewise, delays in payment or attempts to delay payment by a live poultry dealer are “per se” violations because such conduct is identified as an “unfair practice” in section 410(b) of the P&S Act (7 U.S.C. 228b–1). Paragraph (b) provides a list of examples of conduct or action that absent demonstration of a legitimate business justification, GIPSA considers as unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) of the P&S Act whether or not the conduct harms or is likely to harm competition. Paragraph (c) states that any conduct or action that harms or is likely to harm competition is unfair, unjustly discriminatory, or deceptive and is a violation of section 202(a).

Proposed § 201.210 is consistent with USDA’s long held position that a showing of harm or likely harm to competition is not required for all violations of section 202(a) of the P&S Act and with the scope of section 202(a) as set forth in the aforementioned interim final rule, § 201.3(a), which also appears in this edition of the **Federal Register**.

GIPSA is proposing § 201.210(a) to affirmatively assert that any conduct or action by a packer, swine contractor, or live poultry dealer that the P&S Act explicitly deems to be unfair, unjustly discriminatory, or deceptive is a violation of section 202(a) without a showing of harm or likely harm to competition. Examples of such conduct or action that would fall under this section are in sections 409(c) and 410(b) of the P&S Act, which state that a packer and live poultry dealer, respectively, have engaged in an “unfair practice” when they fail to pay timely for livestock or poultry.

GIPSA is proposing § 201.210(b) as a non-exhaustive list of the types of conduct or action that GIPSA believes is unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) of the P&S Act regardless of whether the conduct harms or is likely to harm competition. Neither the P&S Act nor the regulations have ever specifically defined the terms “unfair,” “unjustly discriminatory,” or “deceptive.” This list is intended to reduce confusion regarding conduct that is unfair, unjustly discriminatory, or deceptive, without harming or the likelihood of harming competition. This list provides a sufficient number of examples to convey an understanding of this category of conduct and is not intended to list all conduct that would fit this category. These examples are violations if there is no legitimate business justification for the conduct. Legitimate business justifications would allow certain conduct that otherwise would be deemed a violation of section 202(a).

Proposed § 201.210(b)(1) identifies retaliatory action or threat of retaliatory action by a packer, swine contractor or live poultry dealer as violations of section 202(a) when done in response to lawful communication, association, or assertion of rights by a livestock producer, swine production contract grower, or poultry grower. The threat of terminating a contract in retaliation for some action may be sufficient unfair conduct to violate the P&S Act. These retaliatory acts or threats of retaliatory action may be directed toward a single grower or small group of growers, causing them harm, but not having significant effects on competition. For this reason, we propose to include both “retaliatory action” and the “threat of retaliatory action” in proposed § 201.210(b)(1), as an example of conduct or action that is unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) of the P&S Act regardless of whether the conduct harms or is likely to harm competition.

Proposed § 201.210(b)(2) identifies conduct or action that attempts to contractually limit the legal rights or remedies afforded by law to a livestock producer, swine production contract grower, or poultry grower as unfair, unjustly discriminatory or deceptive in violation of section 202(a) of the P&S Act. This proposed paragraph only contains an illustrative list of examples of such conduct or action limiting the legal contractual rights and remedies afforded to livestock producers, swine production contract growers, or poultry growers. This list is intended to provide a sufficient number of examples of the

types of legal rights and remedies intended to be protected under this section. It is an illustrative list and is not intended to list all applicable legal rights and remedies.

Under proposed § 201.210(b)(2)(i), GIPSA considers conduct or action that contractually limits a livestock producer, swine production contract grower, or poultry grower’s right to a trial by jury as unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) of the P&S Act. Proposed § 201.210(b)(2)(i) provides for an exception when the livestock producer, swine production contract grower, or poultry grower has agreed to be bound by arbitration provisions in a contract that complies with § 201.218(a) and that provides a meaningful opportunity to participate fully in the arbitration process after applying the criteria outlined in § 201.218(b).

The 2008 Farm Bill added section 209, *Choice of Law and Venue*, to the P&S Act. Section 209(a) provides that the forum to resolve any dispute among the parties to a poultry growing arrangement or swine production or marketing contract that arises out of that arrangement or contact must be located in the Federal judicial district where the principal part of the performance took place. GIPSA is proposing to add § 201.210(b)(2)(ii), which makes clear that requiring a trial, arbitration, or other means of dispute resolution to be held in a location other than the Federal judicial district where a grower or producer performs their contractual obligations is unfair and a violation of § 202(a) of the P&S Act. Due to differences in resources between the live poultry dealer, swine contractor or packer and the poultry grower, swine production contract grower or livestock producer, the growers and producers are at a disadvantage if required to travel great distances to resolve disputes. This conduct has the potential to impact a single grower or producer or a small group of growers or producers without harming competition. This proposed regulation interprets and implements a statutory requirement that does not include a harm to competition component.

Under proposed §§ 201.210(b)(2)(iii) and (iv), GIPSA considers any conduct or action that contractually limits a livestock producer’s, swine production contract grower’s, or poultry grower’s right to pursue all damages available under applicable law, or right to seek an award of attorney fees, if such an award is available, under applicable law, respectively, as unfair, unjustly discriminatory, or deceptive in violation

of section 202(a) of the P&S Act. Livestock producers, swine production contract growers, and poultry growers commonly have little or no opportunity to negotiate the terms of their contracts with packers, swine contractors, and live poultry dealers. The livestock producers, swine production contract growers, and poultry growers are offered a contract and are typically expected to accept the terms as offered. If the livestock producer, swine production contract grower, or poultry grower has assumed considerable debt to finance their farming operation, the producer or grower may feel they have no choice but to accept the terms as offered. GIPSA believes that it is unfair, unjustly discriminatory or deceptive to limit a producer or grower from recovering damages that would otherwise be available, but for the limitations in the contract.

Proposed §§ 201.210(b)(3) through (7) identify the failure to act in compliance or in accordance with other specified regulations as conduct or action that is unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) of the P&S Act. Section 201.210(b)(3) clarifies that failing to comply with the requirements of § 201.100 is unfair, unjustly discriminatory or deceptive in violation of section 202(a) of the P&S Act. Regulation § 201.100 specifies certain information and notices that must be provided to poultry growers. The live poultry dealer has control over most, if not all, of the information relevant to the grower's operations. This information is critical to the grower in operating his or her business and places the grower at a great disadvantage without this information. The 2008 Farm Bill directed GIPSA to, among other things, promulgate regulations establishing criteria the Secretary will consider in determining: (1) Whether a live poultry dealer has provided reasonable notice to poultry growers of any suspension of the delivery of birds under a poultry growing arrangement; (2) when a requirement of additional capital investments over the life of a poultry growing arrangement or swine production contract constitutes a violation of the P&S Act; (3) whether a live poultry dealer or swine production contractor has provided a reasonable period of time for a poultry grower or a swine production contract grower to remedy a breach of their arrangement or contract that could lead to the termination of the poultry growing arrangement or swine production contact; and (4) whether the arbitration process provided in a contract provides

a grower or producer a meaningful opportunity to participate fully in the arbitration process. As directed by the 2008 Farm Bill, GIPSA published the regulations establishing the criteria in a final rule on December 9, 2011 [76 FR 76874]. The regulations are codified in 9 CFR part 201 as 9 CFR 201.215,<sup>1</sup> 201.216, 201.217 and 201.218, respectively. These criteria, when applied, allow the Secretary to determine whether certain conduct has occurred, specifically whether reasonable notice of suspension of delivery of birds has been given (201.215), whether requiring additional capital investments violates the Act (201.216), whether a reasonable period of time has been given to remedy a breach of contract (201.217), and whether the grower or producer is given the option to decline arbitration and provided a meaningful opportunity to participate in the arbitration process if they so choose (201.218). After applying the criteria in each of these four (4) regulations, the Secretary could determine that a violation of the P&S Act has occurred. This proposed regulation makes clear that such violations are considered unfair, unjustly discriminatory or deceptive in violation of section 202(a) of the P&S Act.

Existing regulations under the P&S Act govern the weighing of livestock, poultry, and feed (§§ 201.55, 201.71, 201.72, 201.73, 201.73–1, 201.76, 201.82, 201.99, 201.108–1). The regulations at § 201.71 also address the proper use of carcass merit evaluation systems and devices. Packers, swine contractors, and live poultry dealers use sophisticated scales and electronic devices to determine weight and quality characteristics of live animals and carcasses. The weights and quality measurements are used in formulas that determine payment to livestock producers and poultry growers. Failure to properly use these devices can affect producer and grower payment. GIPSA has always considered inaccurate weighing and the use of inaccurate scales to be unfair conduct. This proposed rule sets forth GIPSA's position on these practices as unfair, unjustly discriminatory or deceptive in violation of section 202(a) of the P&S Act.

The regulations regarding the weighing of livestock, poultry, and feed

<sup>1</sup> The criteria regarding suspension of delivery of birds § 201.215 included "(a) Whether a live poultry dealer provides a grower written notice at least 90 days prior to the date it intends to suspend the delivery of birds under a poultry growing arrangement". This criterion was rescinded effective February 5, 2015 [80 FR 6430].

require that packers, swine contractors, and live poultry dealers properly install, maintain, inspect, and operate scales to ensure livestock producers, swine production contract growers, and poultry growers are paid on accurate weights. Inaccurate weighing and inaccurate scales can have a significant impact on a poultry grower or livestock producer. Even slight inaccuracies can result in large financial losses when applied over an entire flock or large number of livestock. GIPSA considers, and now proposes for clarification, the failure to accurately weigh poultry and livestock to be a violation of section 202(a) of the P&S Act.

In 2014, GIPSA incorporated by reference applicable requirements of the 2013 edition of the National Institute of Standards and Technology (NIST) Handbook 44. The referenced requirements include standards for livestock, meat, and poultry evaluation systems and/or devices. These standards reference specifications established by the American Society for Testing Materials (ASTM) International. By incorporating the standards in Handbook 44, GIPSA requires regulated entities to comply with the standards. Misuse of these systems and devices or use of inaccurate devices can cause significant harm to a single producer or group of producers without necessarily harming competition. GIPSA considers such harm to producers unfair, unjustly discriminatory or deceptive in violation of section 202(a) of the P&S Act. GIPSA is therefore proposing to add, as a final example of an unfair practice that violates section 202(a) of the P&S Act that does not require a showing of harm or likely harm to competition, a failure to ensure accurate evaluation systems or devices at § 201.210(b)(9).

The specific conduct listed in this proposed rule violates section 202(a) of the P&S Act regardless of whether the conduct or action harms or is likely to harm competition. This list does not imply that conduct that harms competition or is likely to harm competition would not also violate the P&S Act. To make this clear, GIPSA is proposing to add § 201.210(c), which clarifies that, absent demonstration of a legitimate business justification, any conduct or action that harms or is likely to harm competition is an "unfair," "unjustly discriminatory," or "deceptive" practice or device and a violation of section 202(a) of the P&S Act. However, nothing in this provision would apply to mergers and acquisitions by packers, swine contractors, or live poultry dealers.

Section 11006(1) of the 2008 Farm Bill directed GIPSA to amend the

regulations under the P&S Act to establish criteria that the Secretary will consider in determining whether an undue or unreasonable preference or advantage has occurred in violation of the P&S Act. In June 2010, GIPSA published a proposed rule, which included a new regulation addressing this Congressional mandate, § 201.211.

Throughout the history of the P&S Act, an “undue or unreasonable preference or advantage” has been determined according to the facts of each case within the purposes of the P&S Act. In proposed § 201.211, GIPSA proposed the following three (3) criteria the Secretary could consider to determine if an undue or unreasonable preference or advantage, or an undue or unreasonable prejudice or disadvantage, had occurred in violation of the P&S Act: (1) Whether contract terms based on number, volume or other condition, or contracts with price determined in whole or in part by the volume of livestock sold are made available to all poultry growers, livestock producers or swine production contract growers who individually or collectively meet the conditions set by the contract; (2) whether price premiums based on standards for product quality, time of delivery and production methods are offered in a manner that does not discriminate against a producer or group of producers that can meet the same standards; and (3) whether information regarding acquiring, handling, processing, and quality of livestock is disclosed to all producers when it is disclosed to one or more producers.

Many commenters supported proposed § 201.211 and specifically the criterion related to contract terms based on number, volume or other conditions. These commenters saw this section as a way to address potential disadvantages to small and medium-scale producers.

GIPSA received several comments expressing concerns regarding the practicality of the proposed criteria on contract distribution by the packer, swine contractor, or live poultry dealer to all livestock producers, swine production contract growers, or live poultry dealers. Some commenters also expressed a concern with the ambiguity and lack of clarity in certain criteria.

Many commenters expressed concerns that the proposed criterion related to price premiums and related types of contracts would have the unintended consequence of either directly or indirectly eliminating alternative marketing arrangements (AMA) Livestock producers use AMAs to market their livestock to a packer at least 14 days prior to slaughter under a verbal or written agreement. Many

commenters opined that the proposed regulations would increase the potential for litigation thereby jeopardizing the continued use of these arrangements. The rapid growth of value-added segments of the livestock industry (e.g., breed certifications, source verification, and production method certification) has benefitted many producers and supported consumer demand. GIPSA did not intend to limit the use of AMAs. Commenters also expressed concern about privacy issues in disclosing information regarding acquiring, handling, processing, and quality of livestock to all producers as discussed in proposed § 201.211(c). In response to the comments, GIPSA has revised proposed § 201.211. We do not intend for the current proposed provisions to affect value-added production and premiums, but commenters are encouraged to explain any concerns about how the proposed text will affect value-added production and how we might alter our rule to correct that.

In this new proposed rule, GIPSA would add new § 201.211, “*Undue or unreasonable preferences or advantages*,” which is consistent with Congress’ instruction to the Secretary in the 2008 Farm Bill. The proposed regulation identifies five criteria the Secretary will consider in determining whether an undue or unreasonable preference or advantage has occurred in violation of the P&S Act. This list is not exhaustive and other criteria may be considered depending on the circumstances of a particular situation.

In response to concerns raised in comments received in 2010 about ambiguity and clarity, GIPSA deleted the criterion regarding contract terms based on number, volume, or other conditions. The originally proposed criteria related to price premiums and disclosing information have also been deleted. Additionally, we propose to add criteria addressing types of conduct considered to be favorable toward some producers and growers as compared to others.

Under proposed § 201.211(a), the Secretary will consider whether a packer, swine contractor, or live poultry dealer treats one or more livestock producers, swine production contract growers, or poultry growers more favorably as compared to others similarly situated who have engaged in lawful communication, association, or assertion of their rights. Producers and growers are entitled to exercise their rights of speech and association, such as forming or joining a contract growers’ union, without fear of experiencing disparate treatment. Packers, swine contractors or live poultry dealers who

treat some producers and growers more favorably than producers or growers who choose to exercise their rights are giving an undue preference or advantage to a group of producers or growers to the detriment of others. GIPSA believes this conduct violates section 202(b) of the P&S Act and is proposing this regulation to clarify its position.

Under proposed § 201.211(b), the Secretary will consider whether a packer, swine contractor, or live poultry dealer treats one or more livestock producers, swine production contract growers, or poultry growers more favorably as compared to others similarly situated who the packer, swine contractor, or live poultry dealer contend have taken an action or engaged in conduct that violates any applicable law, rule or regulation related to the livestock or poultry operation without a reasonable basis to determine that the livestock producer, swine production contract grower, or poultry grower committed the violation. GIPSA has become aware of situations in which a packer, swine contractor, or live poultry dealer has terminated a contract with a producer or grower based on an allegation that some law or regulation was violated. For example, a live poultry dealer might terminate a poultry grower’s contract on the basis that the live poultry dealer believes the poultry grower violated some aspect of the Clean Water Act. Unless there is some reasonable basis for such a determination, such as a finding by a government agency charged with enforcing the Clean Water Act, GIPSA believes treating growers differently under these circumstances would violate the prohibition of section 202(b) against giving undue preferences or advantages to some producers and growers as compared to other producers and growers.

Under proposed § 201.211(c), the Secretary will consider whether a packer, swine contractor, or live poultry dealer treats one or more livestock producers, swine production contract growers, or poultry growers more favorably as compared to others similarly situated for an arbitrary reason unrelated to the livestock or poultry operation. This is necessary to prevent disparate treatment for any reason unrelated to the sale or production of livestock or poultry. If the packer, swine contractor, or live poultry dealer demonstrates a legitimate business reason for the action, the action would not violate section 202(b) of the P&S Act.

Under proposed § 201.211(d), the Secretary will consider whether a packer, swine contractor, or live poultry

dealer treats one or more livestock producers, swine production contract growers, or poultry growers more favorably as compared to others similarly situated on the basis of race, color, national origin, sex, religion, age, disability, political beliefs, sexual orientation, or marital or family status. Disparate treatment due to any of these bases could constitute a violation of one or more person's civil rights. GIPSA considers conduct that treats some producers or growers more favorably than others or to the detriment of a producer or grower because of the producer's or grower's status as a member of a class to be prohibited conduct in violation of section 202(b) of the P&S Act.

Finally under proposed § 201.211(e), the Secretary will consider whether the packer, swine contractor, or live poultry dealer has demonstrated a legitimate business justification for conduct or action that may otherwise constitute an undue or unreasonable preference or advantage. A packer, swine contractor, or live poultry dealer may have a legitimate business reason for treating some livestock producers, swine production contract growers, or poultry growers more favorably. In evaluating the criteria proposed above, the Secretary will also consider the proffered justification for the conduct in determining whether the packer swine contractor, or live poultry dealer has violated section 202(b) of the P&S Act.

#### Required Impact Analyses

##### *Executive Order 12866 and Regulatory Flexibility Act*

This rulemaking has been determined to be significant for the purposes of Executive Order 12866 and, therefore, has been reviewed by the Office of Management and Budget. GIPSA is proposing to make two changes to the regulations. The first will help to clarify the types of conduct considered unfair, unjustly discriminatory, or deceptive in violation of § 202(a) of the P&S Act. The second provides criteria, in response to requirements of the 2008 Farm Bill, to consider in determining whether a packer, swine contractor, or live poultry dealer has engaged in conduct resulting in an undue preference or advantage to one or more livestock producers or poultry growers in violation of § 202(b) of the P&S Act. As a required part of the regulatory process, GIPSA prepared an economic analysis of proposed §§ 201.210 and 201.211. The first section of the analysis is an introduction and a discussion of the prevalence of contracting in the cattle, hog, and poultry industries as well as a

discussion of potential market failures. Next, GIPSA discusses three regulatory alternatives it considered and presents a summary cost-benefit analysis of each alternative. GIPSA then discusses the impact on small businesses.

#### Introduction

GIPSA issued a proposed rule on June 22, 2010, which included §§ 201.3, 201.210, and 201.211. GIPSA has revised the 2010 versions of §§ 201.210 and 201.211 and is now proposing new §§ 201.210 and 201.211 and issuing § 201.3(a) as an interim final rule. Section 201.3(a) states that certain conduct or action can be found to violate sections 202(a) and/or 202(b) of the P&S Act without a finding of harm or likely harm to competition. Section 201.3(a) formalizes GIPSA's longstanding position that, in some cases, violations of sections 202(a) and 202(b) can be proven without demonstrating harm or likely harm to competition. Section 201.210, among other things, provides clarity to the industry regarding the conduct or action, absent demonstration of a legitimate business justification, that constitutes an unfair, unjustly discriminatory, or deceptive practice or device and a violation of section 202(a) regardless of harm to competition. Section 201.211 provides clarity to the industry regarding the conduct or action that constitutes an undue or unreasonable preference or advantage and a violation of section 202(b) by establishing criteria that the Secretary will consider in making such a determination. GIPSA believes the proposed regulations will serve to strengthen the protection afforded the nation's livestock producers and growers while promoting fairness and equity among industry segments.

Proposed § 201.210(a) specifies that any conduct or action by a packer, swine contractor, or live poultry dealer that is explicitly deemed to be an "unfair," "unjustly discriminatory," or "deceptive" practice or device by the P&S Act is a per se violation of section 202(a). Section 201.210(b) provides examples of conduct or action that, absent demonstration of a legitimate business justification, are "unfair," "unjustly discriminatory," or "deceptive" and a violation of section 202(a) regardless of whether the conduct or action harms or is likely to harm competition. Section 201.210(c) specifies that any conduct or action that harms or is likely to harm competition is an "unfair," "unjustly discriminatory," or "deceptive" practice or device and a violation of section 202(a). Many of the examples provided

in § 201.210(b) relate to conduct or action that limits, by contract, the legal rights and remedies afforded by law to poultry growers, swine production contract growers, and livestock producers. Other examples include conduct or action that could be violations of section 202(a) of the P&S Act upon application and consideration of criteria contained within other specified regulations.

As required by the 2008 Farm Bill, proposed § 201.211 specifies criteria the Secretary will consider when determining whether an undue or unreasonable preference or advantage has occurred in violation of section 202(b). The first four (4) criteria require the Secretary to consider whether one or more livestock producers, swine production contract growers, or poultry growers is treated more favorably as compared to other similarly situated livestock producers, swine contract growers, or poultry growers. The fifth criterion in § 201.211 requires the Secretary to consider whether the packer, swine contractor, or live poultry dealer has demonstrated a legitimate business justification for conduct or action that may otherwise be an undue or unreasonable preference or advantage.

Sections 201.210 and 201.211 focus heavily on contracts between livestock producers and packers, swine production contract growers and swine contractors, and poultry growers and live poultry dealers. A discussion of contracting in these industries is, therefore, useful in explaining the need for these additional regulations.

#### Prevalence of Contracting in Cattle, Hog, and Poultry Industries

Contracting is an important and prevalent feature in the production and marketing of livestock and poultry. Several provisions in §§ 201.210 and 201.211 affect livestock and poultry grown or marketed under contract. For example, under § 201.210(b)(2), absent demonstration of a legitimate business justification, GIPSA considers conduct or action by packers, swine contractors, or live poultry dealers that limit or attempt to limit, by contract, the legal rights and remedies of livestock producers, swine production contract growers, or poultry growers as unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) regardless of whether the conduct or action harms or is likely to harm competition. Section 201.211 establishes criteria the Secretary will consider in determining whether conduct or action by a packer, swine contractor, or live poultry dealer

constitutes an undue or unreasonable preference or advantage and a violation of section 202(b).

The type of contracting varies among cattle, hogs, and poultry. Broilers, the largest segment of poultry, are almost exclusively grown under production contracts, in which the live poultry dealers own the birds and provide poultry growers with feed and medication to raise and care for the birds until they reach the desired

market size. Poultry growers provide the housing, labor, water, electricity, fuel, and provide for waste removal. Cattle production contracts are not subject to the jurisdiction of the P&S Act. Hog production falls between these two extremes. As shown in Table 1 below, over 96 percent of all broilers and over 40 percent of all hogs are grown under contractual arrangements. Similarly, swine contractors typically own the slaughter hogs and sell the finished hogs

to pork packers. The swine contractors typically provide feed and medication to the swine production contract growers who own the growing facilities and provide growing services. With the exception of turkey production, the use of contract growing arrangements has remained relatively stable over the last years that the Census of Agriculture has published data on commodities raised and delivered under production contracts as Table 1 shows.

TABLE 1—PERCENTAGE OF POULTRY AND HOG RAISED AND DELIVERED UNDER PRODUCTION CONTRACTS<sup>2</sup>

Species	2002	2007	2012
Broilers .....	98.0	96.5	96.4
Turkeys .....	41.7	67.7	68.5
Hogs .....	42.9	43.3	43.5

Another contract category is marketing contracts, where livestock producers market their livestock to a packer for slaughter under a verbal or written agreement. These are commonly referred to as Alternative Marketing Arrangements (AMA). Pricing mechanisms vary across AMAs. Some AMAs rely on a spot market for at least one aspect of its price, while others involve complicated pricing formulas with premiums and discounts based on

carcass merits. The livestock producer and packer agree on a pricing mechanism under AMAs, but usually not on a specific price.

USDA's Agricultural Marketing Service (AMS) reports the number of cattle sold to packers under formula, forward contract, and negotiated pricing mechanisms. The following table illustrates the prevalence of contracting in the marketing of fed cattle. Formula pricing methods and forward contracts

are two forms of AMA contracts. Thus, the first two columns in Table 2 are cattle marketed under contract and the third column represents the spot market for fed cattle. The data in Table 2 show that the contracting of cattle has increased since 2005. Approximately 35 percent of fed cattle were marketed under contracts in 2005. By 2015, the percentage of fed cattle marketed to packers under contracts had increased to almost 75 percent.

TABLE 2—PERCENTAGE OF FED CATTLE SOLD BY TYPE OF PURCHASE<sup>3</sup>

Year	Formula	Forward contract	Negotiated
2005 .....	30.4	5.0	64.6
2006 .....	31.5	6.8	61.7
2007 .....	33.2	8.3	58.5
2008 .....	37.4	9.9	52.7
2009 .....	43.7	7.0	49.3
2010 .....	44.9	9.5	45.6
2011 .....	48.4	10.9	40.7
2012 .....	54.7	11.4	33.8
2013 .....	60.0	10.2	29.8
2014 .....	58.1	14.2	27.6
2015 .....	58.2	16.5	25.3

As previously discussed and illustrated in Table 1 above, over 40 percent of hogs are grown under production contracts. These hogs are

then sold by swine contractors to packers under marketing contracts. The prevalence of marketing contracts in the sale of finished hogs, which includes

production contract and non-production contract hogs, to packers is even more prevalent as shown in the table below.

TABLE 3—PERCENTAGE OF HOGS SOLD BY TYPE OF PURCHASE<sup>4</sup>

Year	Other marketing arrangements <sup>5</sup>	Formula <sup>6</sup>	Negotiated
2005 .....	39.3	49.7	11.0

<sup>2</sup> Agricultural Census, 2007 and 2012. [https://www.agcensus.usda.gov/Publications/2012/Full\\_Report/Volume\\_1\\_Chapter\\_1\\_US/](https://www.agcensus.usda.gov/Publications/2012/Full_Report/Volume_1_Chapter_1_US/) and [https://www.agcensus.usda.gov/Publications/2007/Full\\_Report/Volume\\_1\\_Chapter\\_1\\_US/](https://www.agcensus.usda.gov/Publications/2007/Full_Report/Volume_1_Chapter_1_US/).

<sup>3</sup> USDA's Agricultural Marketing Service. <https://mpr.datamart.ams.usda.gov/menu.do?path=Products/Cattle/Weekly>. Accessed on September 9, 2016.

<sup>4</sup> USDA's Agricultural Marketing Service.

<sup>5</sup> Includes Packer Owned and Packer Sold, and Other Purchase Arrangements.

<sup>6</sup> Includes Swine Pork Market Formula, and Other Market Formula.

TABLE 3—PERCENTAGE OF HOGS SOLD BY TYPE OF PURCHASE <sup>4</sup>—Continued

Year	Other marketing arrangements <sup>5</sup>	Formula <sup>6</sup>	Negotiated
2006	44.0	46.4	9.6
2007	44.8	46.5	8.7
2008	43.9	47.6	8.5
2009	42.8	50.4	6.8
2010	45.4	49.4	5.2
2011	47.6	48.2	4.2
2012	47.7	48.6	3.6
2013	48.3	48.4	3.2
2014	45.9	51.4	2.7
2015	46.0	51.4	2.6

Similar to cattle, the percentage of hogs sold under marketing contracts has increased since 2005 to over 97 percent in 2015. The spot market for hogs has declined to 2.6 percent in 2015. As these data demonstrate, almost all hogs are marketed under some type of marketing contract.

Benefits of Contracting in Cattle, Hog, and Poultry Industries

Contracts have many benefits. They help farmers and livestock producers manage price and production risks, elicit the production of products with specific quality attributes by tying prices to those attributes, and facilitate the smooth flow of commodities to processing plants encouraging more efficient use of farm and processing capacities. Agricultural contracts can also lead to improvements in efficiency throughout the supply chain for products by providing farmers with incentives to deliver products consumers desire and produce products in ways that reduce processing costs and, ultimately, retail prices.

In 2007, RTI International conducted a comprehensive study of marketing practices in the livestock and red meat industries from farmers to retailers (the RTI Study).<sup>7</sup> The RTI Study analyzed the extent of use, price relationships, and costs and benefits of contracting, including AMAs. The RTI Study found

that AMAs increased the economic efficiency of the cattle and hog markets and yielded economic benefits to consumers, livestock producers and packers.

The RTI Study found that increased economic efficiencies came from less volatility in volume and more intensive use of production and processing facilities, meaning less capital, labor, and feed per pound of meat produced. Increased economic efficiencies also came from reduced transaction costs and from sending price signals to better match the meat attributes to consumer demand. Consumers benefit from lower meat prices and from getting meat with desired attributes. In turn, the consumer benefits increase livestock demand, which provides benefits to livestock producers.

Structural Issues in the Cattle, Hog, and Poultry Industries

As the above discussion highlights, there are important benefits associated with the use of agriculture contracts in the cattle, hog, and poultry industries. However, if there are large disparities in the bargaining power among contracting parties resulting from size differences between contracting parties or the use of market power by one of the contracting parties, the contracts may have detrimental effects on one of the

contracting parties and may result in inefficiencies in the marketplace.

For example, a contract that ties a grower to a single purchaser of a specialized commodity, even if the contract provides for fair compensation to the grower, still leaves the grower subject to default risks should the contractor fail. Another example is a contract that covers a shorter term than the life of the capital (a poultry house, for example). The grower may face the hold-up risk that the contractor may require additional capital investments or may impose lower returns at the time of contract renewal. Hold-up risk is a potential market failure and is discussed in detail in the next section. These risks may be heightened when there are no alternative buyers for the grower to switch to, or when the capital investment is specific to the original buyer.<sup>8</sup> Some growers make substantial long-term capital investments as part of livestock or poultry production contracts, including land, poultry or hog houses, and equipment. Those investments may tie the grower to a single contractor or integrator. Costs associated with default risks and hold-up risks are important to many growers in the industry. The table below shows the number of integrators that broiler growers have in their local areas by percent of total farms and by total production.

TABLE 4—INTEGRATOR CHOICE FOR BROILER GROWERS <sup>9</sup>

Integrators in grower's area <sup>10</sup> (number)	Farms (% of total)	Birds (% of total)	Production (% of total)	Can change to another integrator (% of farms)
1	21.7	23.4	24.5	7

<sup>7</sup> RTI International, 2007, GIPSA Livestock and Meat Marketing Study, Prepared for GIPSA.

<sup>8</sup> See Vukina and Leegomonchai, *Oligopsony Power, Asset Specificity, and Hold-Up: Evidence From The Broiler Industry*, *American Journal of Agricultural Economics*, 88(3): 589–605 (August 2006).

<sup>9</sup> MacDonald, James M. Technology, Organization, and Financial Performance in U.S. Broiler Production. USDA, Economic Research Service, June 2014.

<sup>10</sup> Percentages were determined from the USDA Agricultural Resource Management Survey (ARMS), 2011. "Respondents were asked the number of

integrators in their area. They were also asked if they could change to another integrator if they stopped raising broilers for their current integrator." Ibid. p. 30.

TABLE 4—INTEGRATOR CHOICE FOR BROILER GROWERS<sup>9</sup>—Continued

Integrators in grower's area <sup>10</sup> (number)	Farms (% of total)	Birds (% of total)	Production (% of total)	Can change to another integrator (% of farms)
2 .....	30.2	31.9	31.7	52
3 .....	20.4	20.4	19.7	62
4 .....	16.1	14.9	14.8	71
>4 .....	7.8	6.7	6.6	77
No Response .....	3.8	2.7	2.7	Na

The data in the table show that 52 percent of broiler growers, accounting for 56 percent of total production, report having only one or two integrators in their local areas. This limited integrator choice may accentuate the contract risks. A 2006 survey indicated that growers facing a single integrator received 7 to 8 percent less compensation, on average, than farmers located in areas with 4 or more integrators.<sup>11</sup> If live poultry dealers already possess some market power to force down prices for poultry growing services, some contracts can extend that power by raising the costs of entry for new competitors, or allowing for price discrimination.<sup>12</sup>

Many beef, pork, and poultry processing markets face barriers to entry including; (1) Economies of scale; (2) high asset-specific capital costs with

few alternative uses of the capital; (3) brand loyalty of consumers, customer loyalty to the incumbent processors, and high customer switching costs; and (4) governmental food safety, bio-hazard, and environmental regulations. Consistent with these barriers, there has been limited new entry.

However, an area where entry has been successful is in developing and niche markets, such as organic meat and free-range chicken. Developing and niche markets have a relatively small consumer market that is willing to pay higher prices, which supports smaller plant sizes. Niche processors are generally small, however, and do not offer opportunities to many producers or growers.

Economies of scale have resulted in large processing plants in the beef, pork, and poultry processing industries. The

barriers to entry discussed above may have limited the entry of new processors, which limits the expansion of choice of processors to which livestock producers market their livestock. Barriers to entry also limit the expansion of choice for poultry growers who have only one or two integrators in their local areas with no potential entrants on the horizon. The limited expansion of choice of processors by livestock producers, swine production contract growers, and poultry growers may limit contract choices and the bargaining power of producers and growers in negotiating contracts.

One indication of potential market power is industry concentration.<sup>13</sup> The following table shows the level of concentration in the livestock and poultry slaughtering industries for 2005–2015.

TABLE 5—FOUR-FIRM CONCENTRATION IN LIVESTOCK AND POULTRY SLAUGHTER<sup>14</sup>

Year	Steers & heifers (%)	Hogs (%)	Broilers (%)	Turkeys (%)
2005 .....	80	64	n.a.	n.a.
2006 .....	81	61	n.a.	n.a.
2007 .....	80	65	57	52
2008 .....	79	65	57	51
2009 .....	86	63	53	58
2010 .....	85	65	51	56
2011 .....	85	64	52	55
2012 .....	85	64	51	53
2013 .....	85	64	54	53
2014 .....	83	62	51	58
2015 .....	85	66	51	57

The table above shows the concentration of the four largest steer and heifer slaughterers has remained relatively stable between 79 and 86 percent since 2005. Hog and broiler slaughter concentration has also remained relatively steady at over 60 percent and 50 percent, respectively.

The data in Table 5 are estimates of national concentration and the size differences discussed below are also at the national level, but the economic markets for livestock and poultry may be regional or local, and concentration in regional or local areas may be higher than national measures. For example,

while poultry markets may appear to be the least concentrated in terms of the four-firm concentration ratios presented above, economic markets for poultry growing services are more localized than markets for fed cattle or hogs, and local concentration in poultry markets is greater than in hog and other livestock

<sup>11</sup> MacDonald, J. and N. Key. "Market Power in Poultry Production Contracting? Evidence from a Farm Survey." *Journal of Agricultural and Applied Economics*. 44(4) (November 2012): 477–490.

<sup>12</sup> See, for example, Williamson, Oliver E. *Markets and Hierarchies: Analysis and Antitrust Implications*, New York: The Free Press (1975);

Edlin, Aaron S. & Stefan Reichelstein (1996) "Holdups, Standard Breach Remedies, and Optimal Investment," *The American Economic Review* 86(3): 478–501 (June 1996).

<sup>13</sup> For additional discussion see MacDonald, J.M. 2016 "Concentration, contracting, and competition

policy in U.S. agribusiness," *Competition Law Review*, No. 1–2016: 3–8.

<sup>14</sup> The data on cattle and hogs were compiled from USDA's NASS data of federally inspected slaughter plants. Data on broilers and turkeys were compiled from Packers and Stockyards industry annual reports. Both data sources are proprietary.



markets.<sup>15</sup> The data presented earlier in Table 4 highlight this issue by showing the limited ability a poultry grower has to switch to a different integrator. As a result, national concentration may not demonstrate accurately the options poultry growers in a particular region actually face.

Empirical evidence does not show a strong or simple relationship between increases in concentration and increases in market power. Other factors matter, including the ease of entry by new producers into a concentrated industry and the ease with which retail food buyers or agricultural commodity sellers can change their buying or marketing strategies in response to attempts to exploit market power.

For example, in 2009, the Government Accountability Office (GAO) reviewed 33 studies published since 1990 that were relevant for assessing the effect of concentration on commodity or food prices in the beef, pork, or dairy sectors.<sup>16</sup> Most of the studies found no evidence of market power, or found that the efficiency gains from concentration were larger than the market power effects. Efficiency gains would be larger if increased concentration led to reduced processing costs (likely to occur if there are scale economies<sup>17</sup> in processing), and if the reduced costs led to a larger effect on prices than the opposing impact of fewer firms. For example, with respect to beef processing, the GAO report concluded that concentration in the beef processing sector has been, overall, beneficial because the efficiency effects dominated the market power effects, thereby reducing farm-to-wholesale beef margins.

Several studies reviewed by the GAO did find evidence of market power in the retail sector, in that food prices exceeded competitive levels or that commodity prices fell below competitive levels. However, the GAO study also concluded that it was not clear whether market power was caused by concentration or some other factor. In interviews with experts, the GAO report concluded that increases in concentration may raise greater concerns in the future about the potential for market power and the manipulation of commodity or food prices.

<sup>15</sup> MacDonald and Key (2012) Op. Cit. and Vukina and Leegomonchai (2006) Op. Cit.

<sup>16</sup> United States Government Accountability Office. Concentration in Agriculture. GAO-09-746R. Enclosure II: Potential Effects of Concentration on Agricultural Commodity and Retail Food Prices.

<sup>17</sup> Scale economies are present when average production costs decrease as output increases.

Another factor GIPSA considered in proposing §§ 201.210 and 201.211 is the contrast in size and scale between livestock producers, swine production contract growers, and poultry growers and the packers, swine contractors, and live poultry dealers they supply. The disparity in size between large oligopsonistic buyers and atomistic sellers may lead to market power and asymmetric information. The 2012 Census of Agriculture reported 740,978 cattle and calf farms with 69.76 million head of cattle for an average of 94 head per operation. Ninety-one percent of these were family or individually-owned operations.<sup>18</sup> The largest one percent of cattle farms sold about 51 percent of the cattle sold by all cattle farms.

There were 33,880 cattle feeding operations in 2012 that sold 25.47 million head of fed cattle for an average of 752 head per feedlot. The 607 largest feedlots sold about 75 percent of the fed cattle, and averaged 32,111 head sold. About 80 percent of feedlots were family or individually owned.<sup>19</sup> As Table 5 shows, the four largest cattle packers processed about 85 percent, 25.47 million head, for an average of 5.41 million head per cattle packer. This means the average top four cattle packers had 57,574 times the volume of the average cattle farm, and 1,054 times the volume of the largest one percent of cattle farms. It also means the average top four cattle packers had 7,197 times the volume of the average feedlot, and 169 times the volume of the very largest feedlots.

The USDA, National Agricultural Statistics Service 2012 livestock slaughter summary reported that in 2012, 113.16 million head of hogs were commercially slaughtered in the United States.<sup>20</sup> Table 5 shows that the top four hog packers processed about 64 percent of those hogs, which comes to an average of about 18.1 million head of hogs per top four packer. The 2012 Census of Agriculture reported 55,882 farms with hog and pig sales.<sup>21</sup> About 83 percent of the farms were family or individually owned. Of the 55,882 farms with hog and pig sales, 47,336 farms were independent growers raising hogs and pigs for themselves (sold an average of 1,931 head), 8,031 were swine production contract growers raising hogs and pigs for someone else (an average of 10,970 head per swine production contract grower), and 515

<sup>18</sup> Census of Agriculture, 2012.

<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

<sup>21</sup> A pig is a generic term for a young hog.

were swine contractors (sold an average of 38,058 head per swine contractor).<sup>22</sup>

The National Chicken Council states that in 2016, approximately 35 companies were involved in the business of raising, processing, and marketing chicken on a vertically integrated basis, while about 25,000 family farmers had production contracts with those companies.<sup>23</sup> That comes to about 714 family-growers per company. Collectively, the family-growers produced about 95 percent of the nearly 9 billion broilers produced in the United States in 2015. The other 5 percent were grown on company-owned farms. That means the average family-grower produced about 342,000 broilers. As Table 5 shows, the four largest poultry companies in the United States accounted for 51 percent of the broilers processed. That means the average volume processed by the four largest poultry companies was about 1.15 billion head, which was 3,357 times the average family grower's volume.

As the above discussion highlights, there are large size differences between livestock producers and meat packers. There are also large size differences between poultry growers and the live poultry dealers which they supply. These size differences may contribute to unequal bargaining power due to monopsony market power or oligopsony market power, or asymmetric information. The result is that the contracts bargained between the parties may have detrimental effects on livestock producers, swine production contract growers, and poultry growers due to the structural issues discussed above and may result in inefficiencies in the marketplace.

#### Hold-Up as a Potential Market Failure

Integrators demand investment in fixed assets from the growers. One example is specific types of poultry houses and equipment the integrator may require the grower to utilize in their growing operations. These investments may improve efficiency by more than the cost of installation. Typically, the improved efficiency would accrue to both the integrator and the grower. The integrator has lower feed costs, and the grower performs better relative to other poultry growers in a settlement group. If the grower bears the entire cost of installation, then the grower should be further compensated for the feed conversion gains that accrue to the integrator. The

<sup>22</sup> Agricultural Census, 2012.

<sup>23</sup> <http://www.nationalchickencouncil.org/about-the-industry/statistics/broiler-chicken-industry-key-facts/>.

risk is that after the assets are installed, the cost to the grower is “sunk.” This means that if the integrator reneges on paying compensation for the additional capital investments, and insists on maintaining the lower price, the grower will accept that lower price rather than receive nothing. This allows the integrator to get the benefit of efficiency gains, at no expense to them, with the grower bearing all of the cost. This renegeing is termed “hold-up” in the economic literature.<sup>24</sup>

Hold-up can have two consequences that result in a misallocation of resources. If the growers do not anticipate hold-up, then growers will spend too much on investments because the integrator who demands them is not incurring any cost. That is inefficient. If the grower does anticipate hold-up, they will act as if the integrator were going to renege even when they were not, resulting in too little investment and loss of potential efficiency gains.

Hold-up can be resolved with increased competition. If an integrator developed a reputation for renegeing, and growers could go elsewhere, the initial integrator would be punished and disincentivized from renegeing in the future. Unfortunately, in practice, many growers do not have the option of going elsewhere.

Data shown above in Table 4 indicate that there are few integrators in these markets, and that growers have limited choice. Table 5, above, indicates the level of concentration in the livestock and poultry slaughtering industries and shows that integrators and livestock packers operate in concentrated markets.

This rule would allow growers to file complaints against integrators that renege, giving some of the incentive benefit of competition, without compromising the efficiency of having a few large processors.

#### Contracting, Industry Structure, and Market Failure: Summary of the Need for Regulation

There are benefits of contracting in the livestock and poultry industries, as well as structural issues that may result in unequal bargaining power and market failures. These structural issues and market failures will be mitigated by relieving plaintiffs from the requirement to demonstrate competitive injury. Because proving competitive injury is difficult and costly, removing that burden will facilitate the use of

litigation by producers and growers to address violations of the Packers and Stockyards Act. If growers are able to seek legal remedies, then their contracts are easier to enforce. This will incentivize packers, swine contractors, and integrators to avoid exploitation of market power and asymmetric information, as well as behaviors that result in the market failure of hold-up. The result will be improved efficiency in the livestock and poultry markets.

GIPSA has a clear role to ensure that market failures are mitigated so that livestock and poultry markets remain fair and competitive. Moreover, even assuming that the market organization is efficient from a societal perspective, the disparity in bargaining power between the regulated entities and the producers from whom they purchase may lead to individual cases of unfair, unjustly discriminatory, deceptive, or undue or unreasonable prejudice or disadvantage that result in harm to individual producers but not harm to competition at a market level. Sections 201.210 and 201.211 promote fairness and equity for livestock producers, swine production contract growers, and poultry growers regardless of whether or not harm rises to the level of harm to competition.

#### Costs of the Regulations Proposed on June 22, 2010

GIPSA issued a proposed rule on June 22, 2010, which included §§ 201.3, 201.210, and 201.211. GIPSA considered thousands of comments before proposing the current versions of §§ 201.210 and 201.211. Many of the provisions that contributed to the costs estimated by the Informa Study and the Elam Study are not in the current proposed regulations. The following provisions were in the 2010 rule, but are not in the currently proposed regulations.

- Requirement that packers, live poultry dealers, and swine contractors maintain records justifying differences in prices (§ 201.210(a)(5)).
- Provision prohibiting packers from purchasing livestock from other packers (§ 201.212(c)).
- Requirement that packers offer the same terms to groups of small producers as offered to large producers when the group can collectively meet the same quantity commitments (§ 201.211(a)).
- Requirement that packers refrain from entering into exclusive agreements with livestock dealers (§ 201.212(b)).
- Requirements that packers and live poultry dealers submit sample contracts to GIPSA for posting to the public (§ 201.213).

Additionally, GIPSA adjusted the rule proposed in 2010 to give live poultry

dealers more flexibility in suspending the delivery of birds and requiring capital improvements and those adjustments are reflected in current §§ 201.215 and 201.216, respectively, which were finalized in 2011 and modified in 2015. Although many thousands of the comments submitted contained general qualitative assessments of either the costs or benefits of the proposed rule, only two comments systematically described quantitative costs across the rule provisions. Comments from the National Meat Association (NMA) included cost estimates by Informa Economics (the Informa Study). The Informa Study projected costs of \$880 million, \$401 million, and \$362 million for U.S. cattle and beef, hogs and pork, and poultry industries respectively.<sup>25</sup> However, these cost estimates were for all of the 2010 proposed changes, many of which do not apply. The Informa Study estimated \$133.4 million to be one-time direct costs resulting from rewriting contracts, additional record keeping, etc.<sup>26</sup> In the study, the majority of the costs would be indirect costs. The Informa Study estimated \$880.9 million in costs due to efficiency losses and \$459.9 million in costs due to reduced demand caused by a reduction in meat quality resulting from fewer AMAs.

Comments from the National Chicken Council included cost estimates prepared by Dr. Thomas E. Elam, President, FarmEcon LLC (the Elam Study).<sup>27</sup> The Elam Study estimated that the entire 2010 rule would cost the chicken industry \$84 million in the first year increasing to \$337 million in the fifth year, with a total cost of \$1.03 billion over the first five years.<sup>28</sup> The Elam Study identified \$6 million as one-time administrative costs. The study states that most of the costs would be indirect costs resulting from efficiency losses,<sup>29</sup> while more than half of the costs estimated would be due to a reduced rate of improvement in feed efficiency. Again, these cost estimates were for all of the 2010 proposed changes, many of which do not apply.

Estimates of the costs in the Informa Study and the Elam Study were largely due to projections that packers, swine contractors, and live poultry dealers would alter business practices in

<sup>25</sup> Informa Economics, Inc. “An Estimate of the Economic Impact of GIPSA’s Proposed Rules,” prepared for the National Meat Association, 2010, Tables 7 to 9, Pages 51 to 53.

<sup>26</sup> *Ibid.* Page 53

<sup>27</sup> See Elam, Dr. Thomas E. “Proposed GIPSA Rules Relating to the Chicken Industry: Economic Impact.” FarmEcon LLC, 2010.

<sup>28</sup> *Ibid.* Page 24

<sup>29</sup> *Ibid.* Page 24

<sup>24</sup> See for example, Benjamin Klein, Robert G. Crawford, and Armen A. Alchian, “Vertical Integration, Appropriable Rents, and the Competitive Contracting Process,” *The Journal of Law and Economics* 21, no 2 (Oct., 1978): 297–326.

reaction to the proposed rule. For example, the Informa Study projected that packers would reduce the number and types of AMAs to avoid potential litigation,<sup>30</sup> and the Elam Study expected live poultry dealers to evaluate each load of feed delivered to growers to avoid litigation.<sup>31</sup>

The studies relied on interviews that queried the willingness of packers, swine contractors, or live poultry dealers to alter their business practices. The estimates, based on interviews, may overstate costs because the packers, swine contractors, live poultry dealers, and other stakeholders would face adjustment costs from the rule proposed in 2010 and had incentives to respond that they would discontinue current practices.

There also may have been some confusion concerning GIPSA's administrative enforcement authority. The Informa Study indicated that 75 percent of the costs of the rule proposed in 2010, were directly related to proposed § 201.3(c) enabling a finding of a violation of sections 202(a) or (b) of the P&S Act without a finding of harm or likely harm to competition.<sup>32</sup>

However, with respect to packers buying livestock for the purpose of slaughter, proposed § 201.3(c) would not cause a change with respect to GIPSA's enforcement activities. For several decades, GIPSA has brought administrative enforcement actions against packers for violations of the regulations under the P&S Act without demonstrating harm or likely harm to competition. It is only in the poultry industry that, with the exception of timely payment to growers (section 410), GIPSA does not have the authority to bring administrative enforcement actions. Though GIPSA has administratively enforced section 202(a) and/or 202(b) violations in the livestock industry without demonstrating harm or likely harm to competition, some federal courts have held that it is necessary to demonstrate harm or likely harm to competition in some livestock cases and in many poultry cases.

Given the changes made in response to comments, GIPSA does not expect that either new proposed § 201.210 or new proposed § 201.211 will cause packers to reduce their use of AMAs.

#### Cost-Benefit Analysis of Proposed §§ 201.210 and 201.211

##### Regulatory Alternatives Considered

Executive Order 12866 requires an assessment of costs and benefits of

potentially effective and reasonably feasible alternatives to the planned regulation and an explanation of why the planned regulatory action is preferable to the identified potential alternatives.<sup>33</sup> GIPSA considered three regulatory alternatives. The first alternative that GIPSA considered was to maintain the status quo and not propose the regulations. The second alternative that GIPSA considered was revising the versions of §§ 201.210 and 201.211 that were published in 2010 and proposing new versions. This is GIPSA's preferred alternative as will be explained below. The third alternative that GIPSA considered was proposing new versions of §§ 201.210 and 201.211, but instituting a phased implementation of the proposed regulations. Under this alternative, proposed §§ 201.210 and 201.211 would only take effect when a written or verbal livestock marketing, swine growing, or poultry growing contract expires, is replaced, or is modified. The costs and benefits of these alternatives are discussed in order below.

##### Regulatory Alternative 1: Status Quo

If §§ 201.210 and 201.211 are never finalized, there are no marginal costs and marginal benefits as industry participants will not alter their conduct. This alternative would not address the 2008 Farm Bill requirement to promulgate regulations establishing criteria the Secretary would consider in determining whether an undue or unreasonable preference or advantage has occurred in violation of the P&S Act, nor would it connect the criteria established in 2011 to a violation of the P&S Act. From a cost standpoint, this alternative costs the least as compared to the other two alternatives. This alternative also has no marginal benefits. Since there are no changes from the status quo under this regulatory alternative, it will serve as the baseline against which to measure the other two alternatives.

##### Regulatory Alternative 2: The Preferred Alternative

###### A. Cost Estimation of the Preferred Alternative

GIPSA believes that the costs of §§ 201.210 and 201.211 will mostly consist of the costs of reviewing and re-writing marketing and production contracts to ensure that packers, swine contractors, and live poultry dealers are not engaging in conduct or action that is unfair, unjustly discriminatory, or deceptive or that in any way gives an

undue or unreasonable preference or advantage to any livestock producer, swine production contract grower, or poultry grower or subjects any livestock producer, swine production contract grower, or poultry grower to an undue or unreasonable prejudice or disadvantage.

Sections 201.210 and 201.211 do not impose any new requirements and mainly serve as guidance for compliance with sections 202(a) and 202(b). GIPSA does not expect the proposed regulations will result in a decrease in the use of AMAs or other incentive payment systems, or decreased efficiencies in the cattle, hog, and poultry industries. The only indirect costs that GIPSA anticipates are the effects of the increase in administrative costs on supply and demand and the resulting quantity and price impacts on the retail markets for beef, pork, and chicken and the related input markets for cattle, hogs, and broilers.

To estimate costs, GIPSA divided costs into two major categories, direct and indirect costs. GIPSA expects the direct costs to be comprised of administrative costs. Administrative costs for regulated entities include items such as review of marketing and production contracts, additional record keeping, and all other associated administrative office work to demonstrate that they are not engaging in conduct or action that is unfair, unjustly discriminatory, or deceptive or that in any way gives an undue or unreasonable preference or advantage to any livestock producer, swine production contract grower, or poultry grower or subjects any livestock producer, swine production contract grower, or poultry grower to an undue or unreasonable prejudice or disadvantage.

Indirect costs include costs caused by changes in supply and/or demand in the markets for beef, pork, and chicken and the related input markets for cattle, hogs, and poultry resulting from the proposed rule.

###### 1. Direct Costs—Administrative Costs of the Preferred Alternative

To estimate administrative costs of the proposed rule, GIPSA relied on its experience reviewing contracts and other business records commonly maintained in the livestock and poultry industries for compliance with the P&S Act and regulations. GIPSA has data on the number of production contracts between swine production contract growers and swine contractors and poultry growers and live poultry dealers. GIPSA estimated the number of

<sup>30</sup> Informa, page 30.

<sup>31</sup> Elam, page 18.

<sup>32</sup> Informa, page 71.

<sup>33</sup> See section 6(a)(3)(C) of Executive Order 12866.

marketing contracts between producers and packers based on the number of feedlots and the percentage of livestock procured under AMAs. GIPSA then multiplied the hourly estimates of the administrative functions of reviewing and revising contracts by the average annual wages to arrive at the total estimated administrative costs for implementation of §§ 201.210 and 201.211. Since packers, swine contractors, and live poultry dealers have to review their contracts to ensure that they are not engaging in conduct or action that is unfair, unjustly discriminatory, or deceptive or that in any way gives an undue or unreasonable preference or advantage to any livestock producer, swine production contract grower, or poultry grower or subjects any livestock producer, swine production contract grower, or poultry grower to an undue or unreasonable prejudice or disadvantage, GIPSA estimates that the regulated entities will only review the contract once and split the contract review time between the two regulations.

Based on GIPSA’s experience, it developed time estimates for the number of hours for attorneys and company managers to review and revise marketing and production contracts and for staff to make changes, copy, and obtain signed copies of the contracts. For poultry contracts, GIPSA estimates that each unique contract type would require 12 hours of attorney time to

review and rewrite a contract, 20 hours of company management time, and for each individual contract, 4 hours of administrative time, and 6.5 hours of additional record keeping time. GIPSA estimates that each of the 133 live poultry dealers who report to GIPSA rely on 10 unique contract types on average. For cattle marketing contracts, GIPSA estimates that each contract would require 4 hours of attorney time to review and rewrite a contract, 4 hours of company management time, 2 hours of administrative time, and 8 hours of additional record keeping time. For hog production and marketing contracts, GIPSA estimates that each contract would require 2 hours of attorney time to review and rewrite a contract, 2 hours of company management time, 1 hour of administrative time, and 6.5 hours of additional record keeping time.

GIPSA multiplied estimated hours to conduct these administrative tasks by the average hourly wages for managers at \$58/hour, attorneys at \$83/hour, and administrative assistants at \$34/hour as reported by the U.S. Bureau of Labor Statistics in its Occupational Employment Statistics to arrive at its estimate of contract review costs for regulated entities.<sup>34</sup>

GIPSA recognizes that contract review costs will also be borne by livestock producers, swine production contract growers, and poultry growers. GIPSA estimates that each livestock producer, swine production contract grower, and

poultry grower will spend two hours of time reviewing a contract and will spend two hours of their attorney’s time to review the contract. GIPSA multiplied two hours of livestock producer, swine production contract grower, and poultry grower time and two hours of attorney time to conduct the marketing and production contract review by the average hourly wages for attorneys at \$83/hour and managers at \$58/hour as reported by the U.S. Bureau of Labor Statistics in its Occupational Employment Statistics to arrive at its estimate of contract review costs for livestock producers, swine contract growers, and poultry growers. GIPSA then applied this cost to the estimated 2,355 cattle marketing contracts, 1,290 hog marketing contracts, 8,031 hog production contracts, and 21,925 poultry growing contracts that have been reported to GIPSA.

After determining the administrative costs to both the regulated entities and those they contract with, GIPSA then added the administrative costs of the regulated entities and the livestock producers, swine production contract growers, and poultry growers together and subsequently split them in half to arrive at the first-year total estimated administrative costs attributable to each of the two regulations. A summary of the first-year total estimated administrative costs for implementation of §§ 201.210 and 201.211 appear in the following table:

TABLE 6—FIRST-YEAR ADMINISTRATIVE COSTS OF §§ 201.210 AND 201.211

[Indirect costs include costs caused by:]

Regulation	Cattle (\$ millions)	Hogs (\$ millions)	Poultry (\$ millions)	Total (\$ millions)
201.210 .....	1.39	3.81	8.40	13.60
201.211 .....	1.39	3.81	8.40	13.60
Total .....	2.79	7.61	16.79	27.19

The first-year total administrative costs are \$27.19 million and are the same for §§ 201.210 and 201.211 for cattle, hogs, and poultry because packers, swine contractors, live poultry dealers, livestock producers, swine production contract growers, and poultry growers must conduct the same administrative functions of contract review and record keeping in response to both regulations. The administrative costs are the highest for poultry, followed by hogs and cattle. This is due to the greater prevalence of contract

growing arrangements in the poultry industry.

2. Direct Costs—Litigation Costs of the Preferred Alternative

Interim final regulation 201.3(a) will be in effect when §§ 201.210 and 201.211 become effective. GIPSA expects that § 201.3(a) will result in additional litigation as this rule states that certain conduct or action can be found to violate sections 202(a) and/or 202(b) of the P&S Act without harm or likely harm to competition in all cases.

Section 201.3(a) formalizes GIPSA’s longstanding position that, in some cases, violations of sections 202(a) and 202(b) can be proven without demonstrating harm or likely harm to competition in all cases. Section 201.210 provides clarity to the industry regarding the conduct or action, absent demonstration of a legitimate business justification that constitutes an unfair, unjustly discriminatory, or deceptive practice or device and a violation of section 202(a) regardless of harm to competition. Section 201.211 provides

<sup>34</sup> All salary costs are based on mean annual 2015 salary adjusted for benefit costs, set to an hourly

basis. <http://www.bls.gov/oes/>. Accessed on August 26, 2016.

clarity to the industry regarding the conduct or action that constitutes an undue or unreasonable preference or advantage and a violation of section 202(b) by establishing criteria that the Secretary will consider in making such a determination.

Regulation 201.3(a) is broad in nature. Sections 201.210 and 201.211 provide additional clarity. Thus, GIPSA considers the additional litigation under

§ 201.3(a) to be the baseline litigation costs for §§ 201.210 and 201.211 and that the litigation costs for § 201.3(a) already include the litigation costs of §§ 201.210 and 201.211. Since those litigation costs have already been counted under § 201.3(a), GIPSA does not allocate any additional litigation costs to §§ 201.210 and 201.211. For the purposes of this RIA, the marginal

litigation costs of §§ 201.210 and 201.210 are zero.

3. Total Direct Costs of the Preferred Alternative

The total first-year direct costs of §§ 201.210 and 201.211 are the sum of administrative and litigation costs from above and are summarized in the following table.

TABLE 7—DIRECT COSTS OF §§ 201.210 AND 201.211

Cost Type	Cattle (\$ millions)	Hogs (\$ millions)	Poultry (\$ millions)	Total (\$ millions)
Admin Costs .....	2.79	7.61	16.79	27.19
Litigation Costs .....	0.00	0.00	0.00	0.00
<b>Total Direct Costs .....</b>	<b>2.79</b>	<b>7.61</b>	<b>16.79</b>	<b>27.19</b>

GIPSA estimates that the total direct costs of proposed §§ 201.210 and 201.211 to be \$27.19 million. As the above table shows, the costs are highest for the poultry industry, followed by hogs and cattle. The primary reason is the high utilization of growing contracts and the estimated higher administrative costs in the poultry industry.

4. Indirect Costs of the Preferred Option

As previously discussed, GIPSA does not expect that proposed §§ 201.210 and 201.211 will result in a decreased use of AMAs, use of grower ranking systems or other incentive pay, reduced capital formation, or decreased efficiencies in the meat and poultry industries because the regulations simply clarify conduct and action that are unfair, unjustly discriminatory, and deceptive and a violation of section 202(a) and clarify the conduct or action that constitutes an undue or unreasonable preference or advantage and a violation of section 202(b) by establishing criteria the Secretary will consider in making such a determination. The only indirect costs that GIPSA expects are the effects of the increase in total industry costs from the administrative costs on supply and demand, and the resulting quantity and price impacts of the retail markets for beef, pork, and poultry, and the related input markets for cattle, hogs, and poultry.

GIPSA modeled the impact of the increase in total industry costs resulting

from the direct costs of implementing §§ 201.210 and 201.211 in a Marketing Margins Model (MMM) framework.<sup>35</sup> The MMM allows for the estimation of changes in consumer and producer surplus and the quantification of deadweight loss or gain caused by changes in supply and demand in the retail markets for beef, pork, and poultry and the input markets for cattle, hogs, and poultry.

GIPSA modeled the increases in industry costs resulting from higher direct costs as an inward (or upward) shift in the supply curves for beef, pork, and poultry. This has the effect of increasing the equilibrium prices and reducing the equilibrium quantity traded. This also has the effect of reducing the derived demand for cattle, hogs, and poultry, which causes a reduction in the equilibrium prices and quantity traded. Economic theory suggests that these shifts in the supply curves and derived demand curves and the resulting price and quantity impacts will result in a reduction in social welfare through a deadweight loss.

To estimate the output and input supply and demand curves for the MMM, GIPSA constructed linear supply and demand curves around equilibrium price and quantity points using price elasticities of supply and demand from the GIPSA Livestock Meat and Marketing Study and from USDA's Economic Research Service.<sup>36</sup>

GIPSA then shifted the supply curves for beef, pork, and chicken up by the amount of the increase in total cost for each industry and calculated the new equilibrium prices and quantities. GIPSA calculated the new equilibrium prices and quantities in the input markets resulting from the decreases in derived demand. GIPSA also calculated the resulting social welfare changes in the input and output markets for each industry.

The calculation of the price impacts from the increases in industry costs from §§ 201.210 and 201.211 resulted in price increases of approximately one-hundredth of a cent or less in retail prices for beef, pork, and poultry. This is because the increase in total industry costs is very small in relation to overall industry costs.<sup>37</sup> The result is that the resulting deadweight losses from the increases in total industry costs are indistinguishable from zero and, therefore, GIPSA concludes that the indirect costs of §§ 201.210 and 201.211 for each industry are zero.

5. Total Costs of the Preferred Alternative

GIPSA added all direct costs to the indirect costs (equal to zero), to arrive at the estimated total first-year costs of §§ 201.210 and 201.211. The total first-year costs are summarized in the following table.

<sup>35</sup> The framework is explained in detail in Tomek, W.G. and K.L. Robinson "Agricultural Product Prices," third edition, 1990, Cornell University Press.

<sup>36</sup> RTI International "GIPSA Livestock Meat and Marketing Study" prepared for Grain Inspection, Packers and Stockyards Administration, 2007.

ERS Price Elasticities: <http://www.ers.usda.gov/data-products/commodity-and-food-elasticities/demand-elasticities-from-literature.aspx>.

<sup>37</sup> The \$27.19 million increase in total industry costs from §§ 201.210 and 201.211 is only 0.02 percent of total industry costs of approximately \$178 billion for the beef, pork, and poultry industries.

TABLE 8—TOTAL COSTS OF §§ 201.210 AND 201.211

Cost type	Cattle (\$ millions)	Hogs (\$ millions)	Poultry (\$ millions)	Total (\$ millions)
Admin Costs .....	2.79	7.61	16.79	27.19
Litigation Costs .....	0.00	0.00	0.00	0.00
Total Direct Costs .....	2.79	7.61	16.79	27.19
Total Indirect Costs .....	0.00	0.00	0.00	0.00
<b>Total Costs .....</b>	<b>2.79</b>	<b>7.61</b>	<b>16.79</b>	<b>27.19</b>

GIPSA estimates that the total costs of §§ 201.210 and 201.211 will be \$27.19 million in the first year of implementation.

6. Ten-Year Total Costs of the Preferred Option

To arrive at the estimated ten-year costs of §§ 201.210 and 201.211, GIPSA expects the costs of the regulations to be constant for the first five years while courts are setting precedents for the interpretation of the regulations. GIPSA expects that case law with respect to the regulations will be settled after five years and by then, industry participants will know how GIPSA will enforce the regulations and how courts will interpret the regulations. Once courts establish precedents in case law, GIPSA expects the direct administrative costs of reviewing and revising contracts to decrease rapidly as contracts will already contain any language modifications necessitated by implementation of the regulations.

To arrive at the estimated ten-year costs of §§ 201.210 and 201.211, GIPSA estimates that in the first five years, 20 percent of all contracts will either expire and need to be renewed each year or new marketing and production contracts will be put in place each year. As discussed above, GIPSA expects the costs of reviewing and revising contracts will remain constant in the first five years. However, the overall costs will be lower because the direct administrative costs of reviewing and revising contracts will only apply to the 20 percent of expiring contracts or new contracts. GIPSA estimates that in the second five years, the direct administrative costs of reviewing and revising contracts will decrease by 50 percent per year as the courts establish precedents and contracts already contain any language modifications necessitated by implementation of the regulations.

The total ten-year costs of the regulations appear in the table below.

TABLE 9—TEN-YEAR TOTAL COSTS OF §§ 201.210 AND 201.211

Year	Total direct (\$ millions)
2018 <sup>38</sup> .....	27.19
2019 .....	5.44
2020 .....	5.44
2021 .....	5.44
2022 .....	5.44
2023 .....	2.72
2024 .....	1.36
2025 .....	0.68
2026 .....	0.34
2027 .....	0.17
<b>Totals .....</b>	<b>54.21</b>

Based on the analysis, GIPSA expects the ten-year total costs of §§ 201.210 and 201.211 will be \$54.21 million.

7. Net Present Value of Ten-Year Total Costs of the Preferred Alternative

The total costs of §§ 201.210 and 201.211 in the table above show that the costs are highest in the first year, decline to a constant lower level over the next four years, and then gradually decrease again over the subsequent five years. Costs to be incurred in the future are less expensive than the same costs to be incurred today. This is because the money that will be used to pay the costs in the future can be invested today and earn interest until the time period in which the cost is incurred.

To account for the time value of money, the costs of the regulations to be incurred in the future are discounted back to today's dollars using a discount rate. The sum of all costs discounted back to the present is called the net present value (NPV) of total costs. GIPSA relied on both a three percent and seven percent discount rate as discussed in Circular A-4.<sup>39</sup> GIPSA measured all costs using constant dollars.

GIPSA calculated the NPV of the ten-year total costs of the regulations using both a three percent and seven percent

<sup>38</sup> GIPSA uses 2018 as the date for the proposed rule to be in effect for analytical purposes only. The date the proposed rule becomes final is not known.

<sup>39</sup> [https://www.whitehouse.gov/sites/default/files/omb/assets/regulatory\\_matters\\_pdf/a-4.pdf](https://www.whitehouse.gov/sites/default/files/omb/assets/regulatory_matters_pdf/a-4.pdf).

discount rate and the NPVs appear in the following table.

TABLE 10—NPV OF TEN-YEAR TOTAL COSTS OF §§ 201.210 AND 201.211

Discount rate	(\$ millions)
3 Percent .....	50.33
7 Percent .....	45.95

GIPSA expects the NPV of the ten-year total costs of §§ 201.210 and 201.211 will be \$50.33 million at a three percent discount rate and \$45.95 million at a seven percent discount rate.

8. Annualized Costs of the Preferred Alternative

GIPSA then annualized the NPV of the ten-year total costs (referred to as annualized costs) of §§ 201.210 and 201.211 using both a three percent and seven percent discount rate as required by Circular A-4 and the results appear in the following table.<sup>40</sup>

TABLE 11—ANNUALIZED COSTS OF §§ 201.210 AND 201.211

Discount rate	(\$ millions)
3 Percent .....	5.90
7 Percent .....	6.54

GIPSA expects the annualized costs of §§ 201.210 and 201.211 will be \$5.90 million at a three percent discount rate and \$6.54 million at a seven percent discount rate.

B. Impacts on Costs of Interim Final § 201.3(a)

Concurrent with proposing §§ 201.210 and 201.211, GIPSA is issuing an interim final version of § 201.3(a). Section 201.3(a) states that conduct or action can be found to violate sections 202(a) and/or 202(b) of the P&S Act without a finding of harm or likely harm to competition. As a stand-alone regulation, § 201.3(a) formalizes GIPSA's longstanding position that, in some cases, violations of sections 202(a) and 202(b) can be proven without

<sup>40</sup> Ibid.

demonstrating harm or likely harm to competition.

In its Regulatory Impact Analysis, GIPSA estimated the annualized costs of § 201.3(a) to range from \$6.87 million to \$96.01 million at a three percent discount rate and from \$7.12 million to \$98.60 million at a seven percent discount rate. The range of potential costs is broad and GIPSA relied on its expertise to arrive at a point estimate of expected annualized costs. GIPSA expects the cattle, hog, and poultry industries to primarily take a “wait and see” approach to how courts will interpret § 201.3(a) and only slightly adjust its use of AMAs, and incentive or performance-based payment systems. GIPSA estimates that the annualized costs of § 201.3(a) at the point estimate will be \$51.44 million at a three percent discount rate and \$52.86 million at a seven percent discount rate based on an anticipated “wait and see” approach by the cattle, hog, and poultry industries.

GIPSA recognizes that courts, after the implementation of § 201.3(a), may opt to continue to apply earlier precedents of requiring the showing of harm or potential harm to competition in section 202(a) and 202(b) cases. This has the potential to affect the costs of §§ 201.210 and 201.211 should they become finalized. GIPSA expects that even if courts continue to require showing of harm or potential harm to competition in section 202(a) and 202(b) cases, that firms will likely still incur costs of complying with §§ 201.210 and 201.211. Even if regulated entities expect that courts will require showing of a harm to competition for §§ 201.210 and 201.211 violations, the regulated entities may still expect litigation as private parties test the courts application of § 201.3 as it relates to §§ 201.210 and 201.211 violations. To reduce this threat of litigation, regulated entities may still incur the administrative costs detailed above. Should §§ 201.210 and 201.211 become finalized and courts still require a showing of harm or potential harm to competition, regulated entities may still voluntarily undertake the adjustment costs detailed above.

GIPSA expects proposed §§ 201.210 and 201.211 to reduce the costs of implementing § 201.3 by providing more clarity in the appropriate application of sections 202(a) and (b) of the P&S Act. Section 201.210 provides illustrative examples of conduct or action, absent demonstration of a legitimate business justification, that GIPSA considers as unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) regardless of whether the conduct or action harms or is likely to harm competition. Section

201.211 provides criteria the Secretary will consider in determining whether conduct or action constitutes an undue or unreasonable preference or advantage and a violation of section 202(b).

#### C. Benefits of the Preferred Alternative

GIPSA was unable to quantify the benefits of §§ 201.210 and 201.211. However, there are qualitative benefits of §§ 201.210 and 201.211 coupled with § 201.3(a) that merit discussion.

An important qualitative benefit of § 201.210 coupled with § 201.3(a) is the increased ability for the enforcement of the P&S Act for violations of 202(a) that do not result in harm or likely harm to competition. An illustrative example is the inaccurate weighing of live poultry grown to a target slaughter weight by a poultry grower under contract for a live poultry dealer. The weight of poultry is used as one factor to determine the payment to growers under most contract growing arrangements. The poultry grower is harmed if the true weight is more than the inaccurate weight used to compensate the poultry grower. The harm to the poultry grower is very small when compared to the entire industry and there is no discernible or provable harm to competition from this one instance. Because there is no discernible or provable harm or likely harm to competition, courts have been reluctant to find a violation of section 202(a) of the P&S Act in such a situation, despite the harm suffered by the individual poultry grower. However, if similar, though unrelated, harm is experienced by a large number of poultry growers, the cumulative effect does result in significant harm to competition. The individual harm is inconsequential to the industry, but the sum total of all individual harm has the potential to be quite significant when compared to the poultry industry. Under proposed § 201.210(b)(8), failing to ensure accurate weights of live poultry, absent a legitimate business justification, will constitute unfair, unjustly discriminatory, or deceptive practices or devices and a violation of section 202(a) of the P&S Act. Whether or not the conduct harms or is likely to harm competition becomes irrelevant.

The sum of all individual harm is likely to increase total industry costs of producing beef, pork, and chicken due to inefficiencies through the production and marketing complex due to an inefficient allocation of resources. The costs of all unfair, unjustly discriminatory, or deceptive practices or devices are reflected in higher costs of producing cattle, hogs, and poultry at the producer/grower level of the industry and of producing beef, pork,

and chicken in the packing/wholesale level of the industry, with some portion of these costs passed along to consumers in the form of higher prices.

GIPSA expects proposed §§ 201.210 and 201.211 coupled with interim final § 201.3(a) to increase enforcement actions against packers, swine contractors, and live poultry dealers for violations of sections 202(a) and/or 202(b) when the conduct or action does not harm or is not likely to harm competition. Several appellate courts have disagreed with USDA’s interpretation of the P&S Act that harm or likely harm to competition is not necessary in all cases to prove a violation of sections 202(a) or 202(b). In some cases in which the United States was not a party, these courts have concluded that plaintiffs could not prove their claims under sections 202(a) and/or 202(b) without proving harm to competition or likely harm to competition. One reason the courts gave for declining to defer to USDA’s interpretation of the statute is that USDA had not previously formalized its interpretation in a regulation. Section 201.3(a) addresses that issue and §§ 201.210 and 201.211 provide further clarity.

GIPSA expects the successful litigation of enforcement actions brought under proposed §§ 201.210 or 201.211 combined with interim final § 201.3(a) to deter violations of sections 202(a) and (b). Successful deterrence will result in lower overall costs throughout the entire production and marketing complex of all livestock, poultry, and meat.

Sections 201.210 and 201.211 also contain several provisions that GIPSA expects will improve efficiencies in the regulated markets for cattle, hogs, and poultry and reduce market failures. For regulations to improve efficiencies for market participants and generate benefits for consumers and producers, they must increase the amount of relevant information to market participants, protect private property rights, and foster competition.

Section 201.210(b) will increase the amount of relevant information to market participants by providing notice to all market participants of specific examples of conduct or action that, absent demonstration of a legitimate business justification, are unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) of the P&S Act regardless of whether the conduct or action harms or is likely to harm competition. Market participants will all know, for example, that absent demonstration of a legitimate business justification, retaliatory conduct and the

limiting, by contract, the legal rights and remedies afforded by law to livestock producers, swine production contract growers, or poultry growers is a violation of § 201.210 and section 202(a) regardless of whether the conduct or action harms or is likely to harm competition. Additionally, market participants will all know that absent demonstration of a legitimate business justification, failure to ensure accurate scales and weights, and failing to ensure the accuracy of electronic evaluation systems and devices is a violation of § 201.210 and section 202(a) regardless of whether the conduct or action harms or is likely to harm competition. Ensuring the accuracy of weighing and grading devices serves to increase economic efficiency. Inaccurate weighing and grading reduces economic efficiency by effectively distorting per-unit prices and harms livestock producers, swine production contract growers, and poultry growers, even though the resulting harm may not have an overall effect on competition if the conduct is directed at only one livestock producer, swine production contract grower, or poultry grower.

Similarly, § 201.211 increases the amount of relevant information to market participants and offsets any potential abuse of market power by clearly stating to all contracting parties the criteria that the Secretary will consider in determining whether conduct or action constitutes an undue or unreasonable preference or advantage and a violation of 202(b) of the P&S Act.

Both regulations may also serve to reduce the risk of violating sections 202(a) and 202(b) because they provide clarification to the livestock and poultry industries as to the conduct or action that, absent demonstration of a legitimate business justification, is unfair, unjustly discriminatory, or deceptive and violates section 202(a) of the Act regardless of whether the conduct or action harms or is likely to harm competition and the criteria that the Secretary will consider in determining whether conduct or action constitutes an undue or unreasonable

preference or advantage and a violation of section 202(b) of the P&S Act. Less risk through the clarification provided in the regulations will likely foster competitiveness and fairness in contracting and provide protections for livestock producers, swine production contract growers, and poultry growers against unfair, unjustly discriminatory, and deceptive practices and devices and undue or unreasonable preferences or advantages.

Benefits to the livestock and poultry industries and the cattle, hog, and poultry markets also arise from establishing parity of negotiating power between packers, swine contractors, and live poultry dealers and livestock producers, swine production contract growers, and poultry growers by reducing the ability to use market power with the resulting deadweight losses.<sup>41</sup> Establishing parity of negotiating power in contracts promotes fairness and equity and is consistent with GIPSA's mission [t]o protect fair trade practices, financial integrity, and competitive markets for livestock, meats, and poultry.”<sup>42</sup>

D. Cost-Benefit Summary of the Preferred Alternative

GIPSA expects the annualized costs of §§ 201.210 and 201.211 will be \$5.90 million at a three percent discount rate and \$6.54 million at a seven percent discount rate. GIPSA expects the costs to be highest for the poultry industry due to its extensive use of poultry growing contracts, followed by the hog industry and the cattle industry, respectively.

GIPSA was unable to quantify the benefits of the regulations, but explained numerous qualitative benefits that will protect livestock producers, swine production contract growers, and poultry growers from retaliation, promote fairness and equity in contracting, increase economic efficiencies, and reduce the negative effects of market failures throughout the entire livestock and poultry value chain. The primary benefit of § 201.210 and § 201.211 is the increased ability for the

enforcement of the P&S Act for violations of sections 202(a) and (b) that do not result in harm or likely harm to competition. This, in turn, will reduce instances of unfair, unjustly discriminatory, or deceptive practices or devices, unfair advantages and increased efficiencies in the marketplace. This benefit of additional enforcement of the P&S Act will accrue to all segments of the value chain in the production of livestock and poultry, and ultimately to consumers.

Regulatory Alternative 3: Contract Duration—Phased Implementation

GIPSA considered a third regulatory alternative of phased implementation. Under this third alternative, §§ 201.210 and 201.211 would only apply to marketing and production contracts when they expire, are altered, or new contracts are put in place. Consider for example, a poultry growing contract with three years remaining in the contract when the regulations become effective. The provisions of the regulations that apply to contracts would not be applicable to this contract until the contract expires after three years and is either renewed or replaced.

A. Cost Estimation of Phased Implementation

GIPSA estimated the costs of phased implementation by multiplying the costs of §§ 201.210 and 201.211 for the preferred alternative (Table 8) for each year of the first 10 years the regulations would be effective starting in 2018 by the percentage of contracts expiring or altered in the same year. USDA's Economic Research Service Agricultural Resource Management Surveys conducted in 2003 and 2011 provided data about the length of hog and broiler production contracts. GIPSA relied on its knowledge of hog and cattle marketing contracts based on regular reviews of packer procurement practices to estimate contract lengths for hog and cattle marketing contracts. The data on contract length appear in the following table:

TABLE 12—PRODUCTION AND MARKETING CONTRACT DURATIONS

Contract duration	Broilers production <sup>43</sup> (percent)	Hogs production <sup>44</sup> (percent)	Hogs marketing (percent)	Cattle marketing (percent)
Short Term <= 12 months	65.20	40.50	100.00	100.00

<sup>41</sup> Nigel Key and Jim M. MacDonald discuss evidence for the effect of concentration on grower compensation in “Local Monopsony Power in the Market for Broilers? Evidence from a Farm Survey” selected paper American Agri. Economics Assn. meeting Orlando, Florida, July 27–29, 2008.

<sup>42</sup> See additional discussion in Steven Y. Wu and James MacDonald (2015) “Economics of Agricultural Contract Grower Protection Legislation,” *Choices* 30(3): 1–6.

<sup>43</sup> USDA's Economic Research Service Agricultural Resource Management Survey (ARMS) 2011.

<sup>44</sup> USDA's Economic Research Service Agricultural Resource Management Survey (ARMS) 2003.



TABLE 12—PRODUCTION AND MARKETING CONTRACT DURATIONS—Continued

Contract duration	Broilers production <sup>43</sup> (percent)	Hogs production <sup>44</sup> (percent)	Hogs marketing (percent)	Cattle marketing (percent)
Medium Term 13–60 months .....	19.20	3.50	0.00	0.00
Long Term > 60 months .....	15.60	56.00	0.00	0.00

The data in the table show that 65.2 percent of broiler production contracts have a duration of 12 months or less. GIPSA estimates that 100 percent of all hog and cattle marketing contracts expire or are altered every 12 months or less. Even if the contracts do not expire, GIPSA expects changes every year to the base prices, premiums and discounts, lean percentages, etc. of hog and cattle marketing contracts and GIPSA would consider a change to any one of these items in the contract as an alteration to the contract, which would trigger the application of the new regulations.

For the first year of the regulations, GIPSA multiplied the poultry costs of the regulations by 65.20 percent, the percentage of the hog costs attributable to hog production contracts by 40.5 percent, the percentage of the hog costs attributable to hog marketing contracts by 100 percent, and the cattle costs by 100 percent. For years two through five, GIPSA followed the same procedure, but adjusted poultry and hog production costs by the number of contracts that are five years or less. For broilers, 84.4 percent are five years or less in duration and 44 percent of all hog production contracts are five years or less years in duration. For years six through ten, GIPSA applied 100 percent of the preferred alternative costs to reflect full implementation costs.

The following table shows the ten-year total costs for each year of the phased implementation alternative. The ten-year total costs for each year of the preferred alternative (Table 9) are also shown for convenience.

TABLE 13—PHASED IMPLEMENTATION TOTAL COSTS OF §§ 201.210 AND 201.211

Year	Preferred option (\$ millions)	Phased implementation (\$ millions)
2018 .....	27.19	17.45
2019 .....	5.44	4.18
2020 .....	5.44	4.18
2021 .....	5.44	4.18
2022 .....	5.44	4.18
2023 .....	2.72	2.72
2024 .....	1.36	1.36
2025 .....	0.68	0.68
2026 .....	0.34	0.34
2027 .....	0.17	0.17

TABLE 13—PHASED IMPLEMENTATION TOTAL COSTS OF §§ 201.210 AND 201.211—Continued

Year	Preferred option (\$ millions)	Phased implementation (\$ millions)
Totals	54.21	39.43

GIPSA estimates that the first-year total costs of §§ 201.210 and 201.211 under the phased implementation alternative will be \$17.45 million and the ten-year total costs will be \$39.43 million. As the table shows, the costs in the first five years are lower under the phased implementation alternative than under the preferred alternative because the regulations apply to fewer contracts until the time period in which all contracts are phased in.

B. NPV of Ten-Year Total Costs of Phased Implementation

GIPSA calculated the NPV of the ten-year total costs of §§ 201.210 and 201.211 under phased implementation using both a three percent and seven percent discount rate and the NPVs are shown in the following table.

TABLE 14—NPVS OF TEN-YEAR TOTAL COSTS OF §§ 201.210 AND 201.211—PHASED IMPLEMENTATION

Discount rate	(\$ Millions)
3 Percent .....	36.33
7 Percent .....	32.86

GIPSA expects the NPV of the ten-year total costs of §§ 201.210 and 201.211 under the phased implementation option to be \$36.33 million at a three percent discount rate and \$32.86 million at a seven percent discount rate.

C. Annualized Costs of Phased Implementation

GIPSA then annualized the costs of §§ 201.210 and 201.211 using both a three percent and seven percent discount rate as required by Circular A-4 and the results appear in the following table.

TABLE 15—ANNUALIZED COSTS OF REGULATIONS—PHASED IMPLEMENTATION

Discount rate	(\$ millions)
3 Percent .....	4.26
7 Percent .....	4.68

GIPSA expects the annualized costs of §§ 201.210 and 201.211 under phased implementation will be \$4.26 million at a three percent discount rate and \$4.68 million at a seven percent discount rate.

D. Benefits of the Phased Implementation Alternative

The benefits of phased implementation are identical to the benefits of the preferred alternative with the exception of when the benefits will be received and the amount of the benefits. Like the costs, the benefits will be received only when contracts expire, are altered, or new contracts are put in place. Moreover, benefits to be received in the future are worth less than benefits received today. The benefits will be received in the same proportion of the total costs and are based on contract durations. The benefits of the phased implementation alternative are less than under the preferred alternative, because the full benefits will not be received until all contracts have expired, been altered, or replaced by new contracts. The full benefits of phased implementation will be received beginning in year six.

E. Cost-Benefit Summary of Phased Implementation

GIPSA expects the annualized costs of §§ 201.210 and 201.211 under phased implementation will be \$4.26 million at a three percent discount rate and \$4.68 million at a seven percent discount rate. The benefits will be received in the same proportion as total costs and are based on contract durations. The benefits of the phased implementation alternative are less than under the preferred alternative because the full benefits will not be received until all contracts have expired, been altered, or replaced by new contracts.

Cost-Benefit Comparison of Regulatory Alternatives

The status quo alternative has zero marginal costs and benefits as GIPSA does not expect any changes in the livestock and poultry industries. GIPSA compared the annualized costs of the preferred alternative to the annualized costs of the phased implementation alternative by subtracting the annualized costs of the phased implementation alternative from the preferred alternative and the results appear in the following table.

TABLE 16—DIFFERENCE IN ANNUALIZED COSTS OF §§ 201.210 AND 201.211 BETWEEN PREFERRED ALTERNATIVE AND PHASED IMPLEMENTATION ALTERNATIVE

Discount rate	(\$ millions)
3 Percent .....	1.64
7 Percent .....	1.86

The annualized costs of the phased implementation alternative is \$1.64 million less expensive using a three percent discount rate and \$1.86 million less expensive using a seven percent discount rate. As is the case with costs, the benefits will be highest for the preferred alternative because the full benefits will be received immediately and not when contracts have expired, been altered, or replaced by new contracts as is the case under the phased implementation alternative.

Though the phased implementation alternative would save between \$1.64 million and \$1.86 million on an annualized basis, this alternative would deny the benefits offered by §§ 201.210 and 201.211 to a substantial percentage of poultry growers and swine production contract growers for five or more years based on the length of their production contracts. As the data in Table 12 show, 15.6 percent of poultry growers and 56 percent of swine production contract growers have contracts with durations exceeding five years. Under the phased implementation alternative, these poultry growers and swine production contract growers would continue to be exposed to the potential market failures discussed above in the section on *Contracting, Industry Structure, and Market Failure: Summary of the Need for Regulation* until an alteration to an existing contract or the entering of a new contract triggered application of §§ 201.210 and 201.211. GIPSA considered all three regulatory alternatives and believes that the preferred alternative is the best

alternative as the benefits of the regulations will be captured immediately by all livestock producers, swine production contract growers, and poultry growers, regardless of the length of their production or marketing contracts.

Regulatory Flexibility Analysis of the Preferred Option

The Small Business Administration (SBA) defines small businesses by their North American Industry Classification System Codes (NAICS).<sup>45</sup> SBA considers broiler and turkey producers and swine contractors, NAICS codes 112320, 112330, and 112210 respectively, to be small businesses if sales are less than \$750,000 per year. Live poultry dealers, NAICS 311615, are considered small businesses if they have fewer than 1,250 employees. Cattle and hog packers, NAICS 311611, are defined as small businesses if they have fewer than 1,000 employees.

The Census of Agriculture (Census) indicates there were 558 farms that sold their own hogs and pigs in 2012 and that identified themselves as contractors or integrators. The Census provides the number of head sold from their own operations by size classes for swine contractors, but not the value of sales nor number of head sold from the farms of the contracted production. Thus, to estimate the entity size and average per-entity revenue by the SBA classification, the average value per head for sales of all swine operations is multiplied by production values for firms in the Census size classes for swine contractors. The estimates reveal that although about 65 percent of swine contractors had sales of less than \$750,000 in 2012 and would have been classified as small businesses, these small businesses accounted for only 2.8 percent of the hogs produced under production contracts. Additionally, there were 8,031 swine producers in 2012 with swine contracts and about half of these producers would have been classified as small businesses.

GIPSA maintains data on live poultry dealers from the annual reports these firms file with GIPSA. Currently, there are 133 live poultry dealers that would be subject to the proposed regulations. According to U.S. Census data on County Business Patterns, there were 74 poultry slaughter firms that had more than 1,250 employees in 2013. The difference yields approximately 59 poultry slaughterers that have fewer than 1,250 employees and would be considered as small businesses that

would be subject to the proposed regulations.

Another factor that is important in determining the economic effect of the regulations is the number of contracts held by a firm. GIPSA records for 2014 indicated there were 21,925 poultry production contracts in effect, of which 13,370, or 61 percent, were held by the largest six poultry slaughterers and 90 percent (19,673) were held by the largest 25 firms. These 25 firms are all in the large business SBA category, whereas the 21,925 poultry growers holding the other end of the contracts are almost all small businesses by SBA's definitions.

Live poultry dealers classified as large businesses are responsible for about 89.7 percent of the poultry contracts. Assuming that small businesses will bear 10.3 percent of the costs, in the first year the regulations are effective, \$1.7<sup>46</sup> million would fall on live poultry dealers classified as small businesses. This amounts to average estimated costs for each small live poultry dealer of \$29,200.

As of June 2016, GIPSA records identified 359 beef and pork packers actively purchasing cattle or hogs for slaughter. Many firms slaughtered more than one species of livestock. Of the 359 beef and pork packers, 161 processed both cattle and hogs, 132 processed cattle but not hogs, and 66 processed hogs but not cattle.

GIPSA estimates that small businesses accounted for 19.3 percent of the cattle and 17.8 percent of the hogs slaughtered in 2015. If the costs of implementing §§ 201.210 and 201.211 are proportional to the number of head processed, then in 2018, the first year the regulations would be effective, GIPSA estimates that \$538,000<sup>47</sup> in additional costs would fall on beef packers classified as small businesses. This amounts to estimated costs of \$1,900 for each small beef packer.

On average, \$188,000<sup>48</sup> in additional first-year costs would be expected to fall on pork packers classified as small businesses, and \$184,000<sup>49</sup> would fall on swine contractors classified as small businesses. This amounts to average

<sup>46</sup> Estimated cost to live poultry dealers of \$16.79 million × 10.27 percent of firms that are small businesses = \$1.7 million.

<sup>47</sup> Estimated cost to beef packers of \$2.79 million × 19.3 percent of firms that are small businesses = \$538 thousand.

<sup>48</sup> Estimated cost to hogs and pork of \$7.61 million × 17.8 percent of slaughter in small businesses × 13.8 percent of costs attributed to packers = \$188 thousand.

<sup>49</sup> Estimated cost to hogs and pork of \$7.61 million × 2.8 percent of contracted hogs produced by swine contractors that are small businesses × 86.2 percent of costs attributed to contractors = \$184 thousand.

<sup>45</sup> See: [http://www.sba.gov/idc/groups/public/documents/sba\\_homepage/serv\\_sstd\\_tablepdf.pdf](http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_sstd_tablepdf.pdf).

estimated costs for each small pork packer of \$860, and average estimated costs for each small swine contractor of \$506 in the first year the regulations would be effective. To the extent that smaller beef and pork packers rely on AMA purchases less than large packers, the estimates might tend to overstate costs.

Annualized costs discounted at a three percent interest rate would be \$117,000 for the cattle industry, \$80,500 for the hog industry, and \$374,000 for

the poultry industry. This amounts to annualized costs of \$410 for each beef packer, \$190 for each pork packer, \$110 for each swine contractor, and \$6,300 for each live poultry dealer that is a small business. The total annualized costs for small businesses would be \$571,500.

Annualized costs at a seven percent discount rate would be \$129,400 for the cattle industry, \$89,300 for the hog industry, and \$415,000 for the poultry industry. This amounts to annualized

costs of \$450 for each beef packer, \$206 for each pork packer, \$122 for each swine contractor, and \$7,000 for each live poultry dealer that is a small business. The total annualized costs for small businesses would be \$633,800.

The table below lists the estimated additional costs associated with the proposed regulations in the first year. It also lists annualized costs discounted at three percent and seven percent discount rates.

TABLE 17—ESTIMATED COSTS TO SMALL BUSINESSES FROM §§ 201.210 AND 201.211

Estimate type	Cattle (\$ millions)	Hogs (\$ millions)	Poultry (\$ millions)	Total (\$ millions)
First-Year Costs .....	0.538	0.371	1.725	2.634
10 years Annualized at 3 Percent .....	0.117	0.081	0.374	0.572
10 years Annualized at 7 Percent .....	0.129	0.089	0.415	0.634

In considering the impact on small businesses, GIPSA considered the average costs and revenues of each small business impacted by §§ 201.210

and 201.211. The number of small businesses impacted by §§ 201.210 and 201.211, by NAICS code, as well as the per entity, first-year and annualized

costs at both the three percent and seven percent discount rates appear in the following table.

TABLE 18—PER ENTITY COSTS TO SMALL BUSINESSES OF §§ 201.210 AND 201.211

NAICS	Number of small business	First year (\$)	Annualized Costs—3% (\$)	Annualized Costs—7% (\$)
112210—Swine Contractor .....	363	506	110	122
311615—Poultry .....	59	29,236	6,344	7,035
311611—Cattle .....	287	1,874	407	451
311611—Hogs .....	219	856	186	206

The following table compares the average per entity first-year and annualized costs of §§ 201.210 and 201.211 to the average revenue per

establishment for all firms in the same NAICS code. The annualized costs are slightly higher at the seven percent rate than at the three percent rate, so only

the seven percent rate is shown as it is the higher annualized cost.

TABLE 19—COMPARISON OF PER ENTITY COST TO SMALL BUSINESSES OF §§ 201.210 AND 201.211 TO REVENUES

NAICS	Number of small business	Average first-year cost per entity (\$)	Average annualized cost per entity (\$)	Average revenue per establishment (\$)	First-year cost as percent of revenue	Annualized cost as percent of revenue
112210—Swine Contractor .....	363	506	122	485,860	0.10	0.03
311615—Poultry .....	59	29,236	7,035	13,842,548	0.21	0.05
311611—Cattle .....	287	1,874	451	6,882,205	0.03	0.01
311611—Hogs .....	219	856	206	6,882,205	0.01	0.00

The revenue figures in the above table come from Census data for live poultry dealers and cattle and hog slaughterers, NAICS codes 311615 and 311611, respectively.<sup>50</sup> As discussed above, the Census provides the number of head sold by size classes for farms that sold their own hogs and pigs in 2012 and

that that identified themselves as contractors or integrators, but not the value of sales nor the number of head sold from the farms of the contracted production. Thus, to estimate average revenue per establishment, GIPSA used the estimated average value per head for sales of all swine operations and the production values for firms in the Census size classes for swine contractors.

As the results in Table 19 demonstrate, the costs of §§ 201.210 and 201.211 as a percent of revenue are small as they are less than one percent, with the exception of the upper boundary for swine contractors.<sup>51</sup>

<sup>50</sup> Source: <http://www.census.gov/data/tables/2012/econ/susb/2012-susb-annual.html>. Accessed on November 29, 2016.

<sup>51</sup> There are significant differences in average revenues between swine contractors and cattle, hog, and poultry processors, resulting from the difference in SBA thresholds.

Annualized cost savings of exempting small businesses would be about \$570,000 using a three percent discount rate and about \$634,000 using a seven percent discount rate.

One purpose of § 201.3(a) is to mitigate the risks of potential market failures or unequal bargaining power to all livestock producers, swine production contract growers, and poultry growers, not just the livestock producers, swine production contract growers, and poultry growers selling or growing livestock and poultry for large packers, swine contractors, and poultry dealers. Exempting small businesses would continue to subject the livestock producers, swine production contract growers, and poultry growers with contractual arrangements with small packers, swine contractors, and live poultry dealers to the contracting risks and potential market failures discussed above. GIPSA believes that the benefits of §§ 201.210 and 201.211 should be captured by all livestock producers, swine production contract growers, and poultry growers.

Based on the above analyses regarding §§ 201.210 and § 201.211, GIPSA certifies that this rule is not expected to have a significant economic impact on a substantial number of small business entities as defined in the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*). While confident in this certification, GIPSA acknowledges that individual businesses may have relevant data to supplement our analysis. We would encourage small stakeholders to submit any relevant data during the comment period.

#### *Executive Order 12988*

This proposed rule has been reviewed under Executive Order 12988, Civil Justice Reform. These actions are not intended to have retroactive effect, although in some instances they merely reiterate GIPSA's previous interpretation of the P&S Act. This proposed rule will not pre-empt state or local laws, regulations, or policies, unless they present an irreconcilable conflict with this rule. There are no administrative procedures that must be exhausted prior to any judicial challenge to the provisions of this proposed rule. Nothing in this proposed rule is intended to interfere with a person's right to enforce liability against any person subject to the P&S Act under authority granted in section 308 of the P&S Act.

#### *Executive Order 13175*

This proposed rule has been reviewed in accordance with the requirements of Executive Order 13175, "Consultation

and Coordination with Indian Tribal Governments." Executive Order 13175 requires Federal agencies to consult and coordinate with tribes on a government-to-government basis on policies that have tribal implications, including regulations, legislative comments or proposed legislation, and other policy statements or actions that have substantial direct effects on one or more Indian tribes, on the relationship between the Federal Government and Indian tribes or on the distribution of power and responsibilities between the Federal Government and Indian tribes.

GIPSA has assessed the impact of this rule on Indian tribes and determined that this rule does not, to our knowledge, have tribal implications that require tribal consultation under EO 13175. If a tribe requests consultation, GIPSA will work with the Office of Tribal Relations to ensure meaningful consultation is provided where changes, additions, and modifications identified herein are not expressly mandated by Congress.

#### *Paperwork Reduction Act*

This proposed rule does not contain new or amended information collection requirements subject to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*). It does not involve collection of new or additional information by the federal government.

#### *E-Government Act Compliance*

GIPSA is committed to compliance with the E-Government Act, to promote the use of the Internet and other information technologies to provide increased opportunities for citizen access to Government information and services, and for other purposes.

#### **List of Subjects in 9 CFR Part 201**

Contracts, Poultry, Livestock, Trade Practices.

For the reasons set forth in the preamble, we propose to amend 9 CFR part 201 as follows:

#### **PART 201—REGULATIONS UNDER THE PACKERS AND STOCKYARDS ACT**

■ 1. The authority citation for Part 201 continues to read as follows:

**Authority:** 7 U.S.C. 181–229c.

■ 2. Section 201.210 is added to read as follows:

**§ 201.210 Unfair, unjustly discriminatory, or deceptive practices or devices by packers, swine contractors, or live poultry dealers.**

Any packer, swine contractor, or live poultry dealer is prohibited from

engaging in conduct or action that constitutes an unfair, unjustly discriminatory, or deceptive practice or device in violation of section 202(a) of the Act. Such conduct or action includes, but is not limited to:

(a) *Per se violation of section 202(a).*

Any conduct or action explicitly deemed to be an "unfair," "unjustly discriminatory," or "deceptive" practice or device by the Act is a violation of section 202(a) of the Act.

(b) *Violation of section 202(a) regardless of harm to competition.*

Absent demonstration of a legitimate business justification, the following is an illustrative list of conduct or action that constitutes an "unfair," "unjustly discriminatory," or "deceptive" practice or device and a violation of section 202(a) of the Act regardless of whether the conduct or action harms or is likely to harm competition:

(1) A retaliatory action or the threat of retaliatory action in response to lawful communication, association, or assertion of rights by a livestock producer, swine production contract grower, or poultry grower. A retaliatory action or the threat of retaliatory action against any livestock producer, swine production contract grower, or poultry grower includes, but is not limited to, coercion, intimidation, or unjust discrimination;

(2) Conduct or action that limits or attempts to limit by contract the legal rights and remedies afforded by law of a livestock producer, swine production contract grower, or poultry grower:

(i) The right to a trial by jury except when the livestock producer, swine production contract grower, or poultry grower has agreed to be bound by arbitration provisions in a contract that complies with § 201.218(a) and that provides a meaningful opportunity to participate fully in the arbitration process after applying the criteria in § 201.218(b);

(ii) The right, pursuant to section 209(a) of the Act, to resolve any dispute among the parties to a poultry growing arrangement, or swine production or marketing contract, in the Federal judicial district in which the principal part of the performance took place under the arrangement or contract;

(iii) The right to pursue all damages available under applicable law; or

(iv) The right to seek an award of attorney fees available under applicable law;

(3) Failing to comply with the requirements of § 201.100;

(4) Failing to provide reasonable notice to a poultry grower before suspending the delivery of birds after applying the criteria in § 201.215;

(5) Requiring unreasonable additional capital investments from a poultry grower or swine production contract grower after applying the criteria in § 201.216;

(6) Failing to provide a reasonable period of time to remedy a breach of contract before termination of the contract after applying the criteria in § 201.217;

(7) Failing to provide a meaningful opportunity to participate fully in the arbitration process after applying the criteria in § 201.218;

(8) Failing to ensure accurate scales and weighing of livestock, livestock carcasses, live poultry, or feed for the purposes of purchase, sale, acquisition, payment, or settlement as required by the regulations under the Act; or

(9) Failing to ensure the accuracy of livestock, meat, and poultry electronic evaluation systems and devices for the purposes of purchase, sale, acquisition, payment, or settlement as required by the regulations under the Act.

(c) *Conduct or action that harms competition.* Absent demonstration of a legitimate business justification, any conduct or action that harms or is likely to harm competition is an “unfair,” “unjustly discriminatory,” or “deceptive” practice or device and a violation of section 202(a) of the Act. ■ 3. Section 201.211 is added to read as follows:

**§ 201.211 Undue or unreasonable preferences or advantages.**

The Secretary will consider the following criteria when determining whether a packer, swine contractor, or live poultry dealer has engaged in conduct or action that constitutes an undue or unreasonable preference or advantage and a violation of section 202(b) of the Act. These criteria include, but are not limited to:

(a) Whether a packer, swine contractor, or live poultry dealer treats one or more livestock producers, swine production contract growers, or poultry growers more favorably as compared to one or more similarly situated livestock producers, swine production contract growers, or poultry growers who have engaged in lawful communication, association, or assertion of their rights;

(b) Whether a packer, swine contractor, or live poultry dealer treats one or more livestock producers, swine production contract growers, or poultry growers more favorably as compared to one or more similarly situated livestock producers, swine production contract growers, or poultry growers who the packer, swine contractor, or live poultry dealer contends have taken an action or engaged in conduct that violates any

applicable law, rule, or regulation related to the livestock or poultry operation without a reasonable basis to determine that the livestock producer, swine production contract grower, or poultry grower committed the violation;

(c) Whether a packer, swine contractor, or live poultry dealer treats one or more livestock producers, swine production contract growers, or poultry growers more favorably as compared to one or more similarly situated livestock producers, swine production contract growers, or poultry growers for an arbitrary reason unrelated to the livestock or poultry operation;

(d) Whether a packer, swine contractor, or live poultry dealer treats one or more livestock producers, swine production contract growers, or poultry growers more favorably as compared to one or more similarly situated livestock producers, swine production contract growers, or poultry growers on the basis of race, color, national origin, sex, religion, age, disability, political beliefs, sexual orientation, or marital or family status;

(e) Whether the packer, swine contractor, or live poultry dealer has demonstrated a legitimate business justification for conduct or action that may otherwise constitute an undue or unreasonable preference or advantage; and

(f) Whether the conduct or action by a packer, swine contractor, or live poultry dealer harms or is likely to harm competition.

**Larry Mitchell,**

*Administrator, Grain Inspection, Packers and Stockyards Administration.*

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**DEPARTMENT OF AGRICULTURE**

**Grain Inspection, Packers and Stockyards Administration**

**9 CFR Part 201**

**RIN 0580-AB26**

**Poultry Grower Ranking Systems**

**AGENCY:** Grain Inspection, Packers and Stockyards Administration, USDA.

**ACTION:** Proposed rule.

**SUMMARY:** The Department of Agriculture’s (USDA) Grain Inspection, Packers and Stockyards Administration (GIPSA), Packers and Stockyards Program (P&SP) is proposing to amend the regulations issued under the Packers and Stockyards Act, 1921, as amended and supplemented (P&S Act). The

proposed amendments will identify criteria that the Secretary may consider when determining whether a live poultry dealer’s use of a poultry grower ranking system for ranking poultry growers for settlement purposes is unfair, unjustly discriminatory, or deceptive or gives an undue or unreasonable preference, advantage, prejudice, or disadvantage. The proposed amendments will also clarify that absent demonstration of a legitimate business justification, failing to use a poultry grower ranking system in a fair manner after applying the identified criteria is unfair, unjustly discriminatory, or deceptive and a violation of section 202(a) of the P&S Act regardless of whether it harms or is likely to harm competition.

**DATES:** We will consider comments we receive by February 21, 2017.

**ADDRESSES:** We invite you to submit comments on this proposed rule. You may submit comments by any of the following methods:

- *Mail:* M. Irene Omade, GIPSA, USDA, 1400 Independence Avenue SW., Room 2542A-S, Washington, DC 20250-3613.
- *Hand Delivery or Courier:* M. Irene Omade, GIPSA, USDA, 1400 Independence Avenue SW., Room 2542A-S, Washington, DC 20250-3613.
- *Internet:* <http://www.regulations.gov>. Follow the on-line instructions for submitting comments.

*Instructions:* All comments should make reference to the date and page number of this issue of the **Federal Register**. Regulatory analyses and other documents relating to this rulemaking will be available for public inspection in Room 2542A-S, 1400 Independence Avenue SW., Washington, DC 20250-3613 during regular business hours. All comments received will be included in the public docket without change, including any personal information provided. All comments will be available for public inspection in the above office during regular business hours (7 CFR 1.27(b)). Please call the Management and Budget Services staff of GIPSA at (202) 720-8479 to arrange a public inspection of comments or other documents related to this rulemaking.

**FOR FURTHER INFORMATION CONTACT:** S. Brett Offutt, Director, Litigation and Economic Analysis Division, P&SP, GIPSA, 1400 Independence Ave. SW., Washington, DC 20250-3601, (202) 720-7051, [s.brett.offutt@usda.gov](mailto:s.brett.offutt@usda.gov).

**SUPPLEMENTARY INFORMATION:**