December 5, 2003

Mr. A. J. Yates
Administrator, Agricultural Marketing Service
Room 2092-S
United States Department of Agriculture
STOP 0249
1400 Independence Avenue, S.W.
Washington, DC 20250-0249

Re: Mandatory Country of Origin Labeling of Beef, Lamb, Pork, Fish, Perishable Agricultural Commodities, and Peanuts (68 Fed. Reg. 61944, October 30, 2003).

Dear Administrator Yates:

The Office of Advocacy of the U.S. Small Business Administration submits this comment letter in response to the above-referenced notice of proposed rulemaking. Shortly after the enactment of the legislation giving rise to the proposed rule,[1] small entities contacted the Office of Advocacy with concerns about the potential economic impact of regulations to implement mandatory country-of-origin labeling (COOL). Advocacy's comment letter represents the views of small entities and economic impact data shared with our office pursuant to the Office of Advocacy's small entity roundtables on COOL held in May and November 2003.

## I. Advocacy Background

Congress established the Office of Advocacy (Advocacy) under Pub. L. 94-305 to represent the views of small business before Federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or of the Administration. Section 612 of the Regulatory Flexibility Act (RFA) requires Advocacy to monitor agency compliance with the RFA, as amended by the Small Business Regulatory Enforcement Fairness Act.[2]

[1] The Farm Security and Rural Investment Act of 2002 (Farm Bill), and other laws, mandated that the U.S. Department of Agriculture (USDA) issue regulations to implement a mandatory country-of-origin labeling (COOL) program. The laws, and resulting regulations, require retailers to notify their customers of the country-of-origin of covered commodities beginning on September 30, 2004.

[2] Pub. L. No. 96-354, 94 Stat. 1164 (1981) (codified at 5 U.S.C. §§ 601-612) amended by Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. § 612(a).

On August 13, 2002, President George W. Bush enhanced Advocacy's RFA mandate with Executive Order 13272, which directs Federal agencies to implement policies protecting small entities when writing new rules and regulations.[3] Executive Order 13272 instructs Advocacy to provide comment on draft rules to the agency that has proposed the rule, as well as to the Office of Information and Regulatory Affairs (OIRA) of the Office of Management and Budget.[4] Executive Order 13272 also requires agencies to give every appropriate consideration to any comments provided by Advocacy. Under the Executive Order, the agency must include, in any explanation or discussion of a final rule accompanying publication in the *Federal Register*, the agency's response to any written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.[5]

## II. The RFA Requires AMS to Identify Economic Impacts on Small Entities Affected by the Mandatory COOL Regulations

Section 603 of the RFA requires agencies to consider the economic impact a proposed rulemaking will have on small entities. Unless the head of the agency certifies that the proposed rule will not have a significant economic impact on a substantial number of small entities, the agency is required to prepare an initial regulatory flexibility analysis (IRFA). In preparing its IRFA, an agency may provide a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable.

Advocacy agrees with AMS' determination that the proposed rule is likely to have a significant economic impact on a substantial number of small entities, triggering the need for an IRFA. Advocacy reached out to AMS and the affected small entities early in the rulemaking process. Advocacy sought to help ensure that the IRFA on the proposed rule would capture the economic impacts on the wide array of small entities affected by mandatory COOL requirements. In the preamble, AMS states "that despite the numerous comments that USDA received on the voluntary guidelines and on this rulemaking, there is surprisingly little quantitative evidence on the likely costs of mandatory COOL."[6] Based on the impact information provided to Advocacy from industry, Advocacy encourages AMS to further study its economic analysis and consider significant alternatives to minimize the rule's impact on small entities while accomplishing AMS' legislatively mandated policy goals.

### A. <u>The definition of "retailer" under PACA does not significantly reduce the number of small entities affected by the mandatory COOL regulations.</u>

Section 603 of the RFA requires that AMS describe the impact of the proposed rule on small entities, including, *inter alia*, a description and estimate of the number of small entities to which the proposed rule will apply. Advocacy acknowledges that the IRFA of the proposed rule

[3] Exec. Order No. 13272 § 1, 67 Fed. Reg. 53461 (Aug. 13, 2002).
[4] E.O. 13272, at § 2(c).
[5] Id. at § 3(c).
[6] 68 Fed. Reg. at 61960.

estimates the number of small entities that will be affected by the rule. However, Advocacy questions AMS' assertion that the number of affected small entities is significantly reduced by the definition of "retailer."

As required by the authorizing statutes, the term "retailer" for the mandatory COOL regulations is defined under the Perishable Agricultural Commodities Act of 1930 (PACA),[7] which applies to retailers that handle fresh and frozen fruits and vegetables with an invoice value of at least $230,000 annually. AMS asserts that the PACA definition greatly reduces the number of food retail stores covered by the rule. Based on the 1997 Economic Census data, AMS estimates that of the 67,916 food retail stores in the United States (including food stores, warehouse clubs and superstores), 66,868 of the food retail stores are considered small under the SBA's size definition.[8] According to AMS, most of those stores will be excluded from compliance with the rule because the PACA definition of "retailer" does not include all food retailers. In support of this assertion, AMS estimates that there are 4,512 retail firms as defined by and licensed under PACA (of which 3,464 are small).

While Advocacy does not dispute the validity of the data, AMS' conclusion that the majority of retail stores in the U.S. will be excluded from the rule (and its economic impacts) is a source of concern for two reasons. First, the 4,512 retail firms licensed under PACA are made up of tens of thousands of establishments that must comply with COOL and will incur any associated costs. The majority of these establishments are small. Second, many of the PACA-exempt retail firms and establishments will be directly affected by the rule. The rule requires producers/growers and suppliers to provide PACA-licensed retailers with the information needed for the retailers to label the covered commodities correctly.[9] This will require producers and suppliers to incur costs (e.g. labeling, recordkeeping and storage), and these costs will flow to all retailers, because it does not make economic sense for the producers and suppliers to bifurcate their handling and labeling to segregate products potentially destined for those retailers exempt from COOL by the PACA definition. All retailers will receive a more expensive product because of the added costs of complying with COOL at the production/supply stage. The percentage of the cost increase that can be passed on to consumers will depend on the elasticity of demand in each market. Industry representatives participating in Advocacy's roundtables were doubtful that the total cost increases could be passed on to their consumers. Consequently, all food retailers stand to suffer economic losses as a result of the costs of complying with the mandatory COOL regulations. Those losses will most likely be in the form of lower profit margins, and small entity representatives told Advocacy that grocery retailers currently operate on narrow profit margins.

Also, increased costs are likely to flow from retailers through suppliers to producers/growers. Retailers will impose a cost of compliance on their suppliers by requiring them to better label their products. The proposed rule does not provide a small business or small volume exemption for producers/growers. Most producers/growers seek to maximize their revenues by selling to

[7] 7 U.S.C. 499 *et seq.*

[8] The SBA considers as small those grocery stores with less than $23 million in annual sales and specialty food stores with less than $6 million in annual sales.

[9] Based on data from the 2000 Statistics of U.S. Businesses, AMS states that approximately 94% of wholesalers are classified as small businesses (68 Fed. Reg. at 61974), and that approximately 95% of manufacturers are small businesses (68 Fed. Reg. at 61976).

retailers, suppliers, food services, convenience stores and small specialty markets. As suppliers respond to the demands of retailers, they too will exert compliance pressure and costs on producers/growers in an effort to comply with COOL. As a result, unless a producer/grower decides to stop growing certain products, it will have to comply with the COOL regulations across the board, regardless of whether some of its product is sold to retailers exempted by the PACA definition.

Roundtable participants were skeptical of AMS' belief that the PACA definition would limit the overall impact of the rule on small businesses. One of the fresh produce representatives was particularly concerned with the prospect that retailers will dictate to producers/manufacturers (who are not PACA-licensed) the terms necessary to comply with mandatory COOL. The individual was particularly concerned about the potential for increased labeling costs. Advocacy was told that a small tomato producer recently priced a labeling machine at $25,000. Labeling cost concerns were also raised by meat processors who attended the roundtable. A meat processor representative told Advocacy that meat processors currently buy labels in bulk in order to save considerable printing costs. They will not be able to do so under the proposed rule because the specific labeling requirements of the rule are not conducive to bulk purchases of uniform labels. He estimated that this will cost businesses in his industry between $100,000 and $200,000 a year. AMS projected that this scenario was a possibility when it stated that, "most manufacturers of covered commodities will likely print country-of-origin labeling information on retail packages supplied to retailers."[10] These industry representatives questioned AMS' conclusion that the costs for producers will be "relatively limited" and will generally include costs involved in establishing and maintaining a recordkeeping system for country-of-origin information.

One roundtable participant, a small meat producer, described how retailers are already exerting pressure on the supply chain in preparation for the mandatory COOL program. Retailers are reacting to the potential liability that attaches for failure to comply with the rule's food documentation requirements. The small meat producer stated that retailers are requiring him to sign a hold-harmless agreement in connection with his country-of-origin labeling documentation, but suppliers refuse to sign the hold-harmless document, which leaves him in a precarious liability position. He stated that it is unreasonable for AMS to assume that he could simply stop selling to retailers covered by the proposed regulation and still remain in business.

Advocacy believes that AMS should expand its analysis to take into consideration that the rule will likely have an economic effect on all entities along the supply chain, from producer/grower through distributors and retailers, and not just those PACA-licensed retailers described in the IRFA and preamble to the proposed rule. Such an expanded analysis will better capture the costs of the proposed rule on the broad array of affected entities, many of which operate on relatively small profit margins.

[10] 68 Fed. Reg. at 61976.

**B. <u>Allowing market participants to decide how to best implement COOL in their operations does not offer the degree of flexibility that AMS asserts in the proposed rule.</u>**

AMS suggests in the IRFA and preamble to the proposed rule that it has provided some flexibility in the mandatory COOL regulations by allowing market participants to decide how best to implement the provisions of mandatory COOL in their operations.[11] While Advocacy understands that the 2002 Farm Bill gives AMS little latitude to provide flexibility to small businesses affected by the proposed rule, the flexibility provided by AMS is not particularly helpful to small entities.

Participants in Advocacy's roundtables voiced concern about their industries' ability to comply with the recordkeeping requirements of the proposed rule by September 30, 2004. There is not currently an infrastructure in place to communicate COOL requirements and information among retailers, suppliers, and producers/growers. For example, representatives from the beef and cattle industry stated that while electronic tags are now available and used in an effort to track cattle, there is no infrastructure in place for producers to communicate the tracking information to supplier and retailers. There are 800,000 cow/calf producers in the United States, most of which are small businesses. According to industry, to build the information infrastructure, the 1500 stockyards in the United States will have to purchase $100,000-$200,000 worth of equipment to scan tags and create a recordkeeping database. Electronic tags are about $2 each. The required infrastructure and data will increase the cost of compliance with COOL to $5 to $7 per animal.

Meat processors/packers voiced concerns about the need and associated cost to segregate product under mandatory COOL. Industry representatives estimated that it will cost small meat packers approximately $15 per head to change their slaughter and fabrication departments so they can track carcasses and primals, and an estimated nine cents per pound to maintain the identity of the products in retail facilities. Small meat processors/packers believe that they already operate at a price disadvantage compared with their larger counterparts and wholesalers in straight commodity (beef and pork) pricing. They are worried that the costs of the COOL program will be disproportionately higher per pound for smaller operations, either requiring them to go to an even higher pricing disadvantage, or putting them out of business altogether.

Roundtable participants were also concerned that the "implementation" flexibility would create inefficiencies as affected entities have to comply with numerous differing implementation approaches in the absence of a standardized practice on how best to implement the COOL provisions. While the affected industries understand that the governing statute does not allow AMS to mandate a standardized identification system, they would welcome AMS providing guidance to affected industries (especially small entities that do not have the resources of large businesses) on ways to minimize the rule's commodity identification and recordkeeping burden.

[11] 68 Fed. Reg. at 61974.

Section 212 of the Small Business Regulatory Enforcement Fairness Act (SBREFA) requires agencies to publish compliance guides for rules requiring a final regulatory flexibility analysis pursuant to the RFA.[12] By issuing compliance guides, AMS can explain the rule, provide compliance scenarios to illustrate and clarify any complexities, lessen small businesses' anxiety about complying with the rule's complexities, and provide suggestions on how to structure COOL data collection and recordkeeping systems.

## C. The alternatives contained in the IRFA will not lessen the burden on small entities. AMS should consider reducing the rule's recordkeeping burden.

Section 603(c) of the RFA requires that the IRFA contain a description of any significant alternatives to the proposed rule to accomplish the stated objectives of the applicable statutes and minimize any significant economic impact of the proposed rule on small entities. The roundtable participants agreed that AMS' alternative suggesting that "market participants other than those retailers defined by statute may decide to sell products through marketing channels not subject to the proposed rule,"[13] was not realistic as far as market conditions were concerned. Advocacy was told that under the alternative, producers/growers would be left having to sell to food services where current sales are small. Any argument that producers/growers could sell only to exempted retailers is not reasonable. Producers/growers are going to have to comply with the regulation because profit-maximizing principles dictate that they sell product to both PACA-licensed and PACA-exempt retailers; it would be uneconomical for them to segregate their business practices to accommodate each type of retailer.

As another alternative, AMS suggests that "retailers may seek to limit the number of entities from which they purchase covered commodities."[14] According to small entity representatives, this alternative is unworkable for the same reasons that the producers/growers alternative is impracticable. Both of these alternatives would create a situation in which the marketplace is artificially limited and where market disincentives and disruptions could result. Neither alternative would minimize the significant economic burden on small entities as contemplated by the RFA.

AMS acknowledges in the preamble to the proposed rule that both the suppliers and retailers have commented that the two year recordkeeping requirement was too onerous, given the short amount of time the product is on the shelf. AMS solicited comment on whether a shorter record retention would still afford adequate time to conduct compliance activities. Advocacy recommends that AMS give careful consideration to crafting a significant alternative to reduce the record retention requirements of the rule. Advocacy encourages AMS to conform the COOL regulations to the 1-year record retention requirement utilized by the U.S. Food and Drug Administration (FDA) in its bioterrorism rule. This would significantly reduce compliance costs because many of the entities affected by the COOL regulations will also have to comply with the FDA's rule.

[12] Subtitle II of the Contract with America Advancement Act, Pub. L. No. 104-121, 110 Stat. 857 (1996). 5 U.S.C. §612(a).
[13] 68 Fed. Reg. at 61974.
[14] 68 Fed. Reg. at 61977.

## D. The definition of "processed" confuses small businesses and may increase economic burden on those entities.

The 2002 Farm Bill excludes a covered commodity from COOL when it is an "ingredient in a processed food item." However, the 2002 Farm Bill does not define "processed food item," leaving AMS to define the term for the purposes of the mandatory COOL program. Advocacy commends AMS for discussing in the rule's preamble numerous public comments regarding what the definition of "processed food item" should be. Because small entities continue to voice considerable confusion over the definition, Advocacy was pleased that AMS is seeking further public comment on the definition of "processed food item."

Advocacy recommends that AMS continue to work with affected industries in an effort to derive a workable definition of "processed food item." One roundtable participant offered that the meat industry is constantly creating new and different products based on consumer demand. He thought that AMS' belief that a product is "processed," if it "undergoes a physical or chemical change such that the product no longer retains the characteristics of the covered commodity" was too vague.[15] He stated that if a product has more than one ingredient, it should be viewed as "processed." If AMS does not use such a bright line standard that producers and others can follow, it will not be in a position to enforce what products are covered, or not, under the definition of processed.

Further clarification of the term "processed" will result in a better regulation and could greatly reduce the rule's economic effect on small entities. To the extent that Advocacy can facilitate AMS' outreach with small entities on this issue, we would be happy to do so.

## III. The Cost of the COOL Regulations May Exceed AMS Estimates

During Advocacy's COOL roundtables, several participants shared information derived from their best efforts to assess the cost of compliance with the mandatory COOL regulations. Advocacy found the following information to be very informative, and hopes that each of the following small entities or their association representatives will provide their detailed analysis and assessments to the AMS record.

### Retail and Wholesale Groceries

Joseph Colalillo, the owner of four Shop Rite grocery stores and a cooperative (coop) wholesaler in New Jersey, implemented the COOL rules in his stores as a demonstration project to determine the costs of compliance.[16] The demonstration was limited to produce, seafood, meats and frozen foods. He discussed the impact of the COOL rule's requirements on the stores' and wholesalers' handling of bananas as an example to demonstrate the difficulties labeling and tracking covered commodities would cause in conducting day-to-day business. Prior to the study, all bananas from all origins were in one bin consisting of a wrapped section and an

[15] 68 Fed. Reg. at 61946.

[16] Mr. Colalillo's study and related documentation is on file at Advocacy and it will be made available upon request by AMS.

unwrapped section; under COOL, he needed a bin with 14 areas (he currently receives bananas from 7 countries). He concluded that COOL will increase the cost of doing business because of increased labeling costs, training of labor (with a thirty percent turnover rate), signage, display allocation, recordkeeping, equipment purchase, increased storage space and liability costs (customers never return goods to the proper place).

Mr. Colalillo further suggested that more concrete data were available from his analysis. All his stores would experience increased costs of $7,000 on a weekly basis due to segregation and labeling of covered commodities. In the coops that his Shop Rite stores purchase from and help manage, costs are broken down as follows: $9 million for equipment costs, $5 million for recordkeeping, and $75 million for facility upgrade to increase product handling ability.

On the wholesale side, the impact is restricted to "slotting." According to Mr. Colallilo's experience, wholesalers will need to increase the number of slots (dictated by increased segregation of products). That translates into an estimate of $4 million annually for hiring more labor to do the job, $140,000 a year for record keeping, and a possible one-time expenditure of $65 million to build a bigger facility with more available slots.

**Cattlemen and Beef Packers**

There are 6,000 beef dealers and 339 packing companies. According to industry representatives, it will cost these industries approximately $10-$20 million in increased cooler capacity to segregate products in order to comply with the COOL regulations.

**Meat Processors/Wholesalers**

Chris Huff, a small meat/frozen hamburger producer with 140 employees, shared his analysis of the cost of complying with mandatory COOL. Mr. Huff purchases six to seven truckloads of meat per week for hamburger processing. In order to comply with the proposed regulation, Mr. Huff's business will have to add six to seven bins in the truck that delivers the meat and 50 percent more freezer space in his plant. He concluded that this will result in an additional cost of nine cents per pound for the product during the first year. Mr. Huff doubted that the retailers he contracts with will agree to absorb a nine cent increase per pound. Mr. Huff suggested that if the retailers were to absorb the nine cent cost it would result in a twelve cent per pound cost increase to the consumer. Mr. Huff calculated that compliance with mandatory COOL will cost his small company $2.7 million annually, which eradicates his profit.

## VI. Conclusion

Advocacy appreciates being given the opportunity to comment on the proposed rule. Advocacy requests that as AMS proceeds from proposed to final rule, it take the necessary steps to minimize the regulation's impact on small businesses while it fulfills its statutory mandate under the 2002 Farm Bill.

Thank you for your attention to the above matters. If you have any questions about this correspondence, please do not hesitate to contact Linwood Rayford or Radwan Saade at (202) 205-6533.

Sincerely,

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