# CAMPAIGN FOR CONTRACT AGRICULTURE REFORM

*a voice for contract farmers, ranchers and their communities*

April 11, 2016

Regulatory Analysis and Development, PPD,
APHIS,
Station 3A-03.8,
4700 River Road Unit 118,
Riverdale, MD 20737-1238

Re: Comments on Interim Rule
Conditions for Payment of Highly Pathogenic Avian
Influenza Indemnity Claims
Docket No. APHIS-2015-0061
81 FR 6745, pages 6745 -6751

To whom it may concern:

I am providing these comments on behalf of the member organizations of the Campaign for Contract Agriculture Reform (CCAR). CCAR is an alliance of farmer advocacy and consumer organizations with a shared concern about the effects of agricultural vertical integration on farmers and consumers, with a particular focus on production contracting in the livestock and poultry sectors.

We would like to thank APHIS for recognizing that contract poultry growers are on the front lines of economic impact as a result of any highly pathogenic avian influenza (HPAI) event, and should therefore be part of the compensation loop for any HPAI indemnity payments from USDA. However, we are writing to raise concerns about the formula used to compensate the contract grower for losses, which underestimates the harm suffered by the grower during a HPAI event on their farm, relative to the poultry integrator company.

The current structure of most poultry production contracts leaves poultry contract growers operating on a very thin margin. In fact, a 2001 study by the National Contract Poultry Growers Association and the USDA found that more than two-thirds (71 percent) of poultry growers without off-farm jobs lived below the poverty line.[1] This is in spite of the huge capital investments they are required to make in order to secure a poultry production contract. The nature of the poultry contract production business makes it difficult for growers to work off farm to supplement their income, because they are required to be on-call at all times in case of a problem in their chicken houses, and they do not receive much advance notice about when they will receive chickens from their

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[1] Gay, Malcolm. "Many Growers Live Below Poverty Line." Richmond Times Dispatch. September 15, 2002.

poultry integrators.

In order to secure a poultry production contract, the grower must usually borrow in excess of $1 million to build sole-purpose chicken houses on their own property, based on the poultry integrator company's exact specifications. This capital investment is borne totally by the grower and the lender. The poultry company makes no capital investment in these production houses at all. It has been estimated that contract growers make at least 50 percent of the capital investment in the poultry industry collectively. Sally Lee, in her joint Applied Economics and International Rural Development Masters dissertation regarding farmer risk in U.S. poultry production contracts, noted the following:

> *Another explanation for the existence of production contracts as a form of economic organization is discussed by Goodwin (2005). He explains that the capital invested by growers "greatly limit the amount of capital necessary to provide slaughter-weight birds" on the part of the integrator (2005, p.340). Goodwin indicates that farmer investment is roughly ½ of the total investment involved in opening a processing plant. He estimates for a complex of 500 chicken houses, a total investment to produce the 1.2 million chickens per week of $180 million is necessary – and roughly $90 million will be invested by the farmers in themselves in building the chicken houses.*[2]

Even after these large capital investments, the growers receive very little return on that investment, and very little security beyond the life of one six-or-seven-week flock of broilers.

While some broiler production contracts may, at first glance, appear to provide some security for a specified length of time, usually those contracts include other clauses that allow the company to terminate the growers' contract for any reason at any time. As a result, most broiler production contacts operate on a flock-to-flock basis, leaving growers very vulnerable economically.

The method of grower payment commonly used in the poultry sector is called the "ranking" or "tournament" system. It is described by the industry as a competition where the grower with the best performance relative to other growers is rewarded with a payment rate higher than the "base" pay. But the reality is that the majority of factors that determine a grower's performance are controlled by the poultry company itself, not the farmer. The farmer's own effort is a factor, but the main factors that determine a growers' "performance" and their payment for each flock of birds are:

1) the quality of the day-old chicks provided to the grower from the company's

[2] Goodwin, H.L. (2005). Location of Production and Consolidation in the Processing Industry: The Case of Poultry. *Journal of Agricultural and Applied Economics*, Vol. 37, No. 2, p339-346

hatchery;

2) the quality of the feed provided by the company to the growers' farm; and

3) the timing of delivery of chicks to a grower's farm, and the timing of pick-up of chickens for processing, relative to other growers.

In addition, the length of time between flocks can vary greatly, and is entirely based on decisions made by the poultry integrator.

Because of the variability and unpredictability of these factors controlled by the poultry integrator, a poultry grower's income stream is also very unpredictable. Understanding these core economic factors facing poultry growers is critical to crafting an HPAI compensation formula that is fair to both growers and integrators.

Proposed Revisions to the Indemnity Formula

The formula provided under §53.11(a) of the Interim Rule specifies a two-step process as follows:

1) The dollar value of the contract the owner entered into with the contractor will be divided by the duration of the contract in days as it was signed prior to the HPAI outbreak.

2) The resulting figure will then be multiplied by the time in days between the date the contractor began to provide services relating to the destroyed poultry or eggs under the contract and the date the poultry or eggs were destroyed.

Unfortunately, this formula does not take into account the fact that the broiler contract grower's entire income from the flock is lost, even if the birds are destroyed 2 weeks into a 6-week grow-out cycle. In fact, often the loss to the contact grower will be far in excess of the value of that particular flock because of the biosecurity layout that may be required of that farm following an HPAI outbreak. In addition, given the unpredictability of the income growers receive from each flock of birds, it can be difficult to ascertain the "dollar value of the contract."

Therefore, we recommend that an alternative indemnity formula be considered. Specifically, in determining the value of the loss to the contract poultry grower as a result of the HPAI event, APHIS should use a 5-flock average for each impacted contract grower operation, based on the settlement sheets provided by the poultry integrator to the contract grower for each of the previous 5 flocks. If the grower is new and does not have a 5-flock history, the Administrator should use discretion to calculate the average based on the grower's history.

Because the settlement value provided to the contract grower at the end of each flock is a fraction of the overall value of the birds, this formula would better reflect the relative losses incurred by both the contract grower and the poultry integrator company, in contrast to the formula provided in §53.11(a). In addition, this formula is simpler because it does not require a separate (and difficult to ascertain) calculation of the "value of the contract."

In addition, growers are often directly involved with the bird disposal. Therefore, the bigger picture of the "non-production" time growers will suffer after a HPAI event must also be taken into account. While not having their production will impact the poultry integrators somewhat, they can increase placement with unaffected growers to make up most of that.

In contrast, affected growers will not only lose the income from the flock affected by the HPAI, but for one or more flocks after that, due to the shutdown time required for disposing of the birds and clean up. This should also be factored into the formula governing the division of the indemnity between poultry integrators and poultry contract growers.

Breeder Hen and Pullet Contract Growers

Specific provisions should be added to the rule to address HPAI loses experienced by breeder hen and pullet contract growers as well. In any broiler complex, the same poultry integrator that contracts with broiler growers also contracts with breeder hen and pullet growers as part of the overall integrated complex.

While pullet and breeder hen growers are typically paid every two weeks, their flocks are much longer in duration than a broiler flock. For instance, in some cases, the life of a breeder hen flock may be as long as 50-to-56 weeks. The indemnity for these growers should take into account the loss of income for the full length of the flock, as well as layout time related to remediation.

We note that §53.11(d) of the Interim Rule provides the Administrator with the flexibility to use any other method of compensation that the Administrator deems appropriate to determine the amount of indemnity due a contractor, if the formula specified in the rule is inappropriate. As stated in the preamble to the rule, "[t]his paragraph provides the Administrator with the flexibility to distribute indemnity payments equitably between owner and contractor in unusual or especially complex cases."

In the event of future HPAI outbreaks, the Administrator should use the §53.11(d) authority to implement an HPAI indemnity formula that more equitably distributes payments between the poultry grower and the poultry integrator based on the relative impact of the lose at the particular poultry growing operation.

By focusing on a division of the indemnity based on the relative economic impact of the HPAI event between the poultry contract grower and the poultry integrator company, APHIS would more effectively achieve the "equitable distribution" goal referenced in the preamble to this Interim Rule.

In addition, we recommend that APHIS consider modifying the Low Pathogenic Avian Influenza (LPAI) indemnity formula to reflect these changes as well.

Sincerely,

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