

# MEMORANDUM

November 5, 2002

**TO:** Leslie G. Sarasin  
Mike Gill

**FROM:** Timothy C. Stanceu

**RE: USDA Guidelines Implementing Country of Origin Labeling Provisions in the 2002 Farm Bill**

The U.S. Department of Agriculture (“USDA”) has issued voluntary country of origin labeling guidelines for meat (beef, pork and lamb), fish, shellfish, peanuts, and produce, including frozen produce. USDA’s action responds to recent legislation requiring such voluntary guidelines and also requiring USDA to issue mandatory country of origin labeling regulations by September 30, 2004. The legislation was enacted recently as part of this year’s Farm Bill (formally known as “Farm Security and Rural Investment Act of 2002”).

This memorandum describes the effect that the USDA guidelines, if adopted as regulatory requirements, would have on members of the frozen food industry who process and distribute frozen produce and frozen seafood products. As discussed in this memorandum, USDA has taken an expansive view of its authority in this area. The result is country of origin labeling that would depart from current law and practice and that raises important issues concerning compliance burdens. In some cases, the contemplated regulations would work to the competitive disadvantage of U.S. growers and processors and encourage the relocation of processing to foreign countries.

USDA is soliciting public comment on the voluntary guidelines and, specifically, on suggested changes prior to the issuance of mandatory country of origin labeling regulations for the affected products (known as “covered commodities”). Comments must be submitted to USDA by *April 9, 2003*.

## **I. BACKGROUND ON THE FARM BILL COUNTRY OF ORIGIN LABELING PROVISIONS**

The 2002 Farm Bill added a new subtitle, “Subtitle D—Country of Origin Labeling,” to the Agricultural Marketing Act of 1946. The statute directed the U.S. Department of Agriculture to issue voluntary guidelines by September 30, 2002, and mandatory country of origin labeling regulations by September 30, 2004, for the covered commodities. USDA did not achieve its goal of issuing the voluntary guidelines by the statutory deadline; the guidelines were published in the Federal Register on October 11, 2002 (copy attached).

The regulations to be issued in 2004 will require country of origin labeling for each of the covered commodities, which are defined in the statute as muscle cuts of beef (including veal), lamb and pork; ground beef, lamb and pork; fish and shellfish; and perishable agricultural commodities (defined according to the Perishable Agricultural Commodities Act (“PACA”), which includes fresh and frozen produce). Country of origin labeling may be accomplished by labeling the package or the individual item, or by the displaying of signs at the retail point of sale.

The USDA implementation of the Farm Bill labeling provisions will directly regulate food retailers (except food service establishments, which are exempted by the statute) but will affect food producers as well. When fully implemented, the new law will require persons supplying covered commodities to retailers to provide the retailers with information “indicating the country of origin of the covered commodity.” The statute also empowers the Agriculture Department to issue regulations (to be effective after the two-year “voluntary” period) requiring producers and distributors of covered commodities for retail sale to “maintain a verifiable recordkeeping audit trail that will permit the Secretary [of Agriculture] to verify compliance with this subtitle” and regulations thereunder; the guidelines indicate that the recordkeeping period will be two years. Even absent such regulations, producers will be affected by the new law, as food retailers will demand that products supplied to them be accompanied by labeling in compliance with the new law, and if supplied in bulk, by the origin information necessary for compliance by the retail establishments.

The Farm Bill country of origin labeling provisions contain two important exclusions. First, it excludes from coverage any product that “is an ingredient in a processed food item.” Under the second exclusion, a retailer is not required to provide any additional information “if the covered commodity is already individually labeled for retail sale regarding country of origin.”

## **II. EFFECTS OF THE FUTURE USDA REGULATIONS ON FROZEN FOOD PRODUCTS**

Because muscle cuts of meat and ground meat typically are not sold at retail as frozen products unless further processed by combining with other ingredients (and thereby excluded from coverage under the Farm Bill provision), the USDA guidelines affect the frozen food industry principally in the labeling of frozen produce and frozen seafood products. With respect to both of these classes of products, the USDA guidelines, if promulgated in the future as binding regulations, would impose country of origin labeling requirements extending well beyond those in effect under existing law.

Under current law (Section 304 of the Tariff Act of 1930, as amended), a good is required to be labeled, or “marked,” for country of origin if it is an “article of foreign origin.” Section 304 requires generally that all articles of foreign origin be marked to inform the ultimate purchaser of the country of origin; certain limited exceptions apply by statute and regulation. The responsibility for interpreting and implementing the country of origin marking provisions of the Tariff Act have been vested in the Treasury Department and its bureau, the U.S. Customs Service, for a century or more. The Farm Bill departed from this long-standing practice by delegating country of origin labeling authority to the Department of Agriculture.

### **A. Treatment of Frozen Produce under the USDA Guidelines**

In approaching the country of origin labeling of frozen produce, the USDA took an expansive view of the authority granted to it under the Farm Bill. Because frozen produce of foreign origin already is required to be labeled for country of origin under Section 304, the USDA arguably had the option of excluding all such foreign origin produce from coverage under its guidelines and its future regulatory scheme. While USDA still has the option of modifying its interpretations during the two-year “voluntary” labeling period, the guidelines it has issued indicate that USDA currently does not intend to take this approach and instead intends to modify the country of origin labeling rules for foreign-origin frozen produce in a number of ways. Frozen produce that is a product of the United States, which is not now subject to country of origin labeling under Section 304, also would be affected.

#### **1. The Current Labeling Requirement for Frozen Produce under Section 304**

Under Section 304 as interpreted according to current Customs Service practice, fresh fruits and vegetables that undergo cutting, sorting, steam blanching and freezing, but not further processing such as cooking or combining with a sauce, are considered to retain the origin of the country in which they were grown for country of origin marking purposes. Under this interpretation, most types of frozen

produce that are of “foreign origin” are required to display country of origin marking on the containers on which the product reaches the ultimate purchaser.

If a package of a single type of frozen fruit or vegetable resulted from the processing of the raw fruit or vegetable grown in different countries, Customs requires generally that the package list all the foreign source countries. For example, broccoli grown in Chile and Guatemala could comply with Section 304 with a label stating “Product of Chile and Guatemala.” If a foreign source country is Canada or Mexico, Customs allows additional flexibility through the optional use of an “inventory management method.” Under this method, the producer could commingle the broccoli from different source countries and use the first-in/first out method, the last-in/first out method, or an “average” inventory method to determine the country to list on the label as the country of origin. Regardless of inventory method, it is not necessary to list the United States as a country of origin for purposes of marking compliance under Section 304. Nor is it required that the countries be listed in the order of predominance.

Frozen produce that was not grown in any foreign country need not be labeled as a product of the United States. Due to the longstanding practice of the Customs Service’s regulation of marking under the Tariff Act provisions, consumers have become accustomed to presuming that a product bearing no country of origin marking is a product of the United States.

Under Section 304, mixed fruit and vegetable products that have not been further processed beyond cutting, steam blanching, mixing, and freezing are considered to have the country or countries of origin of the countries in which the produce was grown. For example, a mixture of broccoli grown in Chile and cauliflower and carrots grown in the United States could be labeled “Product of Chile” (or, if preferred by the producer, “Product of Chile and the United States”). Marking of “Product of Chile” would still suffice if the sourcing of the ingredients changed, provided that Chile was the only source country for any of the three ingredients. For such mixtures, it is not necessary under Section 304 to identify the country or countries of origin of individual fruit or vegetable ingredients, nor is it necessary to list the countries in the order of predominance.

## **2. General Effect of the USDA Guidelines on Frozen Produce, If Adopted as Regulations in 2004**

The USDA guidelines, if promulgated as regulatory requirements with an effective date of September 30, 2004, substantially would complicate the country of origin labeling of frozen produce, in various ways. The changes are summarized below.

Under the USDA approach, frozen produce would be required to be labeled for country of origin even if entirely U.S.-grown. Thus, implementation of

the changes in 2004 would require new labeling for all domestic-origin frozen produce. If the United States is one of multiple source countries for a commingled fungible good or a mixed produce product, the country of origin label would be required to list the United States as a source country. In either case, all source countries would be required to be listed in the order of their predominance by weight. This would require numerous labeling changes in the event of sourcing changes in the composition of the product.

The USDA guidelines further depart from current country of origin marking practice under Section 304 by requiring country or origin labeling for produce ingredients in a mixed produce product. The country, or countries, of origin would be required to be listed in a way that identifies the source countries, including the United States, on an ingredient-by-ingredient basis. If there are multiple source countries for an ingredient, the source countries would be required to be listed on the label, in the order of predominance by weight. Here also, changes in sourcing would require frequent changes in the retail labeling of the finished product.

Further complicating the origin labeling changes for U.S.-grown produce is USDA's interpretation of the Farm Bill's limitation of U.S. origin designations to produce that is "exclusively produced in the United States." Produce grown in the United States and exported for processing to, for example, Canada, would be required under the USDA labeling scheme to identify the role of each country, *e.g.*, "Grown in the United States, Processed in Canada."

### **3. Examples of Different Country of Origin Labeling Depending on the Location of Blending Operations and the Origin of Source Material**

To address issues involving the potential for conflict between Section 304 marking and the contemplated USDA country of origin labeling scheme, USDA officials have adopted an approach under which imported "covered commodities," whether imported as finished products or as ingredients in products to be processed in the United States, retain the country of origin that was determined for tariff purposes at the U.S. border at the time of importation. This approach, although apparently intended to help eliminate confusion, in many cases would produce anomalous and trade-distorting results.

For example, a commingled fungible frozen produce product consisting of broccoli grown in Mexico and broccoli grown in the United States would be subject to different labeling requirements depending on the location of the processing. If any processing occurred in the United States, the label would be required to identify both source countries in the order of predominance by weight (as well as the fact that processing occurred in the United States). If, as a result of seasonal variations or other commercial reasons, a package of the product contained

more U.S.-grown broccoli than Mexican broccoli, the label would need to be revised to modify the order of the listing of the countries. Each such sourcing change would require a label change. The USDA contemplates “direct identification”; *i.e.*, no inventory management method of the type permitted by Customs under the NAFTA regulations, could be used to reduce the number of labeling changes.

In contrast, if all processing occurred in Mexico, USDA would regard the product as having retained the country of origin as determined for Customs purposes at the time of importation, *i.e.*, as determined for purposes of Section 304. The product described above, a commingled fungible good containing U.S.-grown and Mexican-grown broccoli combined in Mexico and exported to the United States, could be labeled “Product of Mexico” in all cases. Alternatively, it could be labeled “Product of the United States and Mexico” or “Product of Mexico and the United States,” at the option of the producer. The predominance of either source country by net weight, or fluctuations in the sourcing percentages, would have no effect on the country of origin label requirement.

USDA officials have confirmed to us their present intention that the Farm Bill labeling requirements would be triggered by blending or mixing in the United States, or by processing in the United States. According to these officials, the Farm Bill labeling requirements would not be triggered by mere repackaging in the United States of imported bulk product. In the above example, broccoli from the United States could be exported to Mexico (in fresh or frozen form, cut or uncut), and in Mexico further processed to yield a commingled fungible frozen produce product, in bulk. It could then be packaged for retail sale in the United States and still retain the country of origin it had at the time of crossing the border into the United States. Such a product could be labeled according to the requirements of Section 304. Because only repackaging, and not blending, combining or other processing, occurred in the United States, the product would not be subject to the more complicated country of origin labeling scheme that would be established under the Farm Bill. If information were available under a verifiable recordkeeping system to allow the more detailed origin labeling, the producer would have the option of labeling the product in this way, but that would be an option, not a requirement.

The disparity between the complex scheme of country of origin labeling required for the broccoli blended in the United States and the much more simplified labeling for the bulk or retail-packed imported broccoli reveals that the labeling scheme currently contemplated by USDA will discourage blending operations in the United States. If the same operation were conducted in Mexico, the result will be significantly less onerous country of origin labeling requirements. Similarly, U.S. processors will have a disincentive to source product from U.S. growers if the same produce is available from abroad. In many cases, including the United States as a source country and blending the product in the United States will place the finished product under a more burdensome country of origin labeling regime.

Similarly, a frozen produce product that entered the United States at some point during the production process is also subject to the Farm Bill scheme, under the current USDA interpretation, and must disclose the fact of the U.S. processing. Broccoli grown in Mexico and the United States that is processed in the United States (for example, by cutting or freezing) would require a label listing both countries of origin in the order of predominance by weight and also identifying that the product was processed in the United States.

In the example above, the relocation of the processing to Mexico would greatly simplify the origin label to “Product of Mexico” or, if the producer so chose, a label identifying both countries of origin, in no particular order. Thus, in various ways, the USDA interpretation of the Farm Bill, if carried over into final regulations, would place a disincentive on processing in the United States and on the use of U.S.-grown ingredients.

The country of origin labeling that would be required under the USDA interpretations for a mixed produce product with multiple countries of origin and processing could be considerably complex. Under the guidelines, for example, a frozen mixed vegetable product that underwent some processing in the United States might be required to bear a label such as:

Produced from covered commodities with the following countries of origin: broccoli grown and packed in Mexico, processed in the United States; cauliflower grown and packed in Chile, processed in the United States; carrots grown and packed in Chile and processed in the United States; and carrots grown, packed and processed in the United States

If the identical product were imported into the United States in finished form, whether or not repacked in the United States, the label could read simply “Product of Mexico and Chile” or, at the option of the producer, “Product of Mexico, Chile, and the United States,” with the countries listed in no particular required order.

#### **4. Potential Differences in Scope under Section 304 and Farm Bill Labeling**

Under Section 304, processing of produce beyond cutting, steam blanching and freezing, as a general matter, results in a change in country of origin such that the finished product is considered a product of the country in which the food processing occurred. Such processing as cooking and combining with significant non-produce ingredients are generally sufficient for this purpose. However, the result in particular cases is determined by a body of case law on the “substantial transformation principle” except where the imported material is from a

NAFTA country, in which a complex set of rules based on change in tariff classification (19 C.F.R. Part 102) must be consulted to determine the country of origin.

The Farm Bill origin labeling contemplated by USDA bears similarity to the principles established under Section 304, but it is not identical with respect to the scope of coverage. USDA officials have indicated that they will apply to issues of scope the definition of “perishable agricultural commodity” contained in PACA (7 U.S.C. § 499a) and the USDA’s regulations implementing PACA (7 C.F.R. § 46.2(u), (v)). PACA generally defines the term “perishable agricultural commodity” as “any of the following, whether or not frozen or packed in ice: fresh fruits and vegetables of every kind and character.” 7 C.F.R. § 46.2(u). The regulatory definition is more detailed, excluding from the scope “those perishable fruits and vegetables which have been manufactured into articles of food of a different kind or character.” 7 U.S.C. § 499a. USDA officials further indicate that they have not resolved all issues of scope and that some such issues will require administrative case-by-case resolution.

### **III. EFFECTS OF THE FUTURE USDA REGULATIONS ON FROZEN SEAFOOD PRODUCTS**

The Farm Bill provisions include detailed country of origin labeling requirements for seafood, which is defined in the statute to include both fish and shellfish. Whole fish and shellfish are covered, as well as “fillets, steaks, nuggets, and any other flesh” from a fish or shellfish. In addition to country of origin, the Farm Bill requires that labeling or signage inform the consumer whether the product is “wild” or “farm-raised.”

The USDA guidelines include within their scope “all fresh and frozen fish and shellfish items” but exclude “cooked and canned fish products” and “restructured fish products, such as fish sticks and surimi.” They further provide that “processed products where the fish or shellfish is an ingredient, such as sushi, crab salad, and clam chowder, are excluded.”

#### **A. Current Country of Origin Marking Requirements for Frozen Seafood Products**

Under current law, certain processing operations are considered to confer origin in the country in which they are performed. For example, processing that converts whole fish to fish fillets is considered to result in a “substantial transformation”; the result is that fish fillets, for purposes of Section 304, currently are considered to have the origin of the country in which they were processed from whole fish into fillets. For Section 304 purposes, whole fish and shellfish generally have the country of origin of the territorial waters in which they were caught. If

caught or substantially transformed on the high seas, these products are considered to have the country of origin of the flag of the vessel on which they were caught or substantially transformed.

Seafood products that are considered to have domestic origin for purposes of Section 304 are not required to bear country of origin labeling. For example, fish that is filleted in the United States is excluded from the Section 304 labeling requirement, regardless of where the fish was caught or, in the case of farm-raised fish, raised. As discussed below, such a product would be subject to country of origin labeling under the Farm Bill provisions as interpreted by USDA.

## **B. Complexity of Origin Labeling of Frozen Seafood under the USDA Guidelines**

The USDA guidelines significantly would complicate the country of origin labeling of seafood products, including frozen seafood products. Products considered to have domestic origin for Section 304 purposes would no longer be exempt from labeling. In another significant change from current law, the Farm Bill provides that a retailer may designate a seafood product as having United States origin only if the product is harvested (or, in the case of farm-raised fish, raised) and processed in the United States. Additionally, the USDA would apply to commingled fungible and mixed seafood products the multiple origin designations prescribed for produce, as described above. As a further complication, the USDA guidelines, and the Farm Bill provision itself, require that the origin label identify whether the seafood product was wild or farm-raised.

The combined effect of the Farm Bill provisions and the USDA interpretations would result in labeling of frozen seafood products that could impose substantial burdens on processors. For example, a U.S. processor might combine in one package shrimp that is farm-raised and shrimp from a different country that is farm-raised or harvested from the wild. The package label would be required to identify the different countries of origin in the order of predominance and also identify, as to each country, whether the shrimp was farm-raised or wild. Changes in sourcing that affect the order of predominance, or the designation of “wild” or “farm-raised,” would necessitate labeling changes.

As is the case with frozen produce, the required labeling for the finished, retail-ready product would vary depending on the location of the processing. Under the USDA approach, seafood of multiple countries of origin that was commingled prior to importation into the United States would retain its origin as determined for tariff purposes; however, the obligation to identify the product as farm-raised or wild nevertheless would apply.

An example illustrates the complicating effect of locating processing of a seafood product in the United States. If, for example, frozen shrimp is imported

into the United States in bulk or in retail packages, with no processing or addition of ingredients in the United States, USDA would consider the product to have retained the country of origin that it had for tariff purposes at the time it crossed the border into the United States. If the shrimp had been raised or harvested in only one country, that country would be listed on the label as the country of origin. If the shrimp had been raised or harvested in multiple countries, these countries would be listed on the label, in no particular order. In both cases, the country of origin label under the USDA interpretation would be unchanged from that now required under Section 304, with one exception: the label would have to identify whether the product had been wild or farm-raised.

In the example of the frozen shrimp, the location in the United States of any blending or processing operation would render the country of origin labeling process considerably more complicated. Source countries, in that event, would be required under the eventual USDA guidelines to be listed in the order of predominance by weight and also list, as to each, whether the covered commodity was farm-raised or wild. As an example, a label for a frozen shrimp product processed and blended in the United States might read as follows:

Produced from covered commodities with the following countries of origin: farm-raised shrimp from Thailand, processed in the United States; wild shrimp from Thailand, processed in the United States; and wild shrimp from Japan, processed in the United States

Had the processing occurred entirely abroad, the product label could bear an origin reference such as “Product of Thailand and Japan,” with the countries listed in no particular order. The designation of “farm-raised” or “wild,” however, still would be required to appear on the label.

#### **IV. NEXT STEPS IN THE PROCESS OF DEVELOPING FINAL COUNTRY OF ORIGIN LABELING REGULATIONS**

USDA officials have indicated that the guidelines will be the basis from which they develop mandatory regulations for promulgation by September 30, 2004. However, the USDA officials also acknowledge that they have not resolved all issues of interpretation and implementation. Affected parties, therefore, should examine closely the effect the guidelines, if adopted as requirements, would have on their operations. It is particularly important for affected parties to estimate compliance costs and to identify examples in which the current USDA interpretations work to the disadvantage of food producers and processors located in the United States.