

DEPARTMENT OF AGRICULTURE**Food and Nutrition Service****7 CFR Part 250**

RIN 0584-AD76

Revisions and Clarifications in Requirements for the Processing of Donated Foods**AGENCY:** Food and Nutrition Service, USDA.**ACTION:** Proposed rule.

SUMMARY: This rule proposes to revise and clarify requirements for the processing of donated foods, in order to incorporate processing options tested in demonstration projects, to more effectively ensure accountability for donated foods provided for processing, and to streamline current reporting and review requirements. Most significantly, it would require multi-State processors to enter into National Processing Agreements to process donated foods into end products, and would permit processors to substitute donated beef and pork with commercially purchased beef and pork of U.S. origin and of equal or better quality than the donated food. The rule would also rewrite regulatory provisions in plain language, to make them easier to read and understand for the general public.

DATES: To be assured of consideration, comments must be received on or before November 22, 2006.

ADDRESSES: The Food and Nutrition Service invites interested persons to submit comments on this proposed rule. You may submit comments, identified by RIN number 0584-AD76, by any of the following methods:

E-mail: Send comments to Robert.Delorenzo@fns.usda.gov. Include RIN number 0584-AD76 in the subject line of the message.

Fax: Submit comments by facsimile transmission to (703) 305-2420. Disk or CD-ROM: Submit comments on disk or CD-ROM to Lillie F. Ragan, Assistant Branch Chief, Policy Branch, Food Distribution Division, Food and Nutrition Service, U.S. Department of Agriculture, Room 500, 3101 Park Center Drive, Alexandria, Virginia 22302-1594.

Mail: Send comments to Lillie F. Ragan at the above address.

Hand Delivery or Courier: Deliver comments to the above address.

Federal eRulemaking Portal: Go to <http://www.regulations.gov>. Follow the online instructions for submitting comments.

Further information on the submission of comments, or the review

of comments submitted, may be found under **SUPPLEMENTARY INFORMATION**, Part III, Procedural Matters.

FOR FURTHER INFORMATION CONTACT:

Lillie F. Ragan at the above address or telephone (703) 305-2662. You may also contact Robert DeLorenzo by e-mail at Robert.Delorenzo@fns.usda.gov.

SUPPLEMENTARY INFORMATION:**I. Background**

The Department of Agriculture (the Department or USDA) provides donated foods to State distributing agencies for distribution to school food authorities participating in the National School Lunch Program (NSLP), and to recipient agencies in other child nutrition or food distribution programs. In accordance with Federal regulations in 7 CFR Part 250, distributing agencies may provide the donated foods to commercial processors for processing into end products that are more suitable for use in school lunch programs or other food programs. The regulations ensure that State and local agencies, and program recipients, receive the full benefit of the donated foods provided to such processors for processing into end products. Distributing agencies must enter into agreements with processors to ensure compliance with the requirements in Federal regulations.

Over the last 30 years or so, the quantity and variety of donated foods provided in the National School Lunch Program has increased substantially. Consequently, the processing of the donated foods into more useful end products has become an integral part of the successful operation of the school lunch program. In the last several years, the Department's Food and Nutrition Service (FNS) has taken a number of steps to facilitate the use of donated foods by commercial processors in the interest of providing more efficient and effective service to school food authorities and other recipient agencies. Most of these changes have been implemented as a result of discussions with State and local program operators, processors, and industry consultants.

In a final rule published in the **Federal Register** on October 23, 2002 at 67 FR 65011, 7 CFR Part 250 was amended to expand the types of donated foods that processors were permitted to substitute with commercially purchased foods without prior FNS approval. The rule permitted processors to substitute donated fruits, vegetables, and eggs with commercially purchased foods of the same generic identity, of U.S. origin, and of equal or better quality than the donated foods. Additionally, limited substitution of donated poultry was

permitted, in accordance with the processor's approved plan. Substitution allows processors to provide finished end products to school food authorities in a more efficient manner, which permits the schools to better utilize the donated foods in the school food service. Only the substitution of donated beef and pork is currently prohibited.

Since June 30, 2001, FNS has conducted a demonstration project to allow selected processors to substitute commercially purchased beef and pork for donated beef and pork, in accordance with an approved plan. The commercial product must be of U.S. origin, and of equal or better quality than the donated food. Since USDA's purchase specifications for ground beef and pork are more stringent than commercially available ground beef and pork, few processors have chosen to participate in the demonstration project. However, FNS has concluded that all processors should have the option to substitute commercial beef and pork, as long as they can meet the same specifications required of donated beef and pork.

In July 2004, FNS initiated a demonstration project to allow multi-State processors to submit end product data schedules to FNS for review and approval at the national level, rather than submitting them to State distributing agencies for their approval. End product data schedules indicate the required yield of donated foods that must be obtained in their processing into end products. Their review and approval, however, is a time and labor-intensive activity for State distributing agencies. Since processors are not required to submit end product data schedules for approval in each State in which they operate, national approval under the demonstration project has reduced the time and labor burden considerably for both distributing agencies and processors.

In conjunction with the demonstration project allowing national approval of end product data schedules, FNS has provided multi-State processors with the option of signing National Processing Agreements. Under the National Processing Agreement, FNS monitors the processor's national inventory of donated foods, and holds and manages the processor's performance bond or letter of credit, which protects the value of the processor's donated food inventories. The monitoring and protection of donated food inventories held by processors at the national level has further reduced the burden on distributing agencies. FNS has entered

into National Processing Agreements with an increasing number of multi-State processors since the initiation of the demonstration project. Under their State processing agreements (called State Participation Agreements), distributing agencies select the processor's nationally approved end products for sale in the State, and may include other State-specific processing requirements.

The regulatory amendments proposed in this rule would incorporate into 7 CFR Part 250 the processing options provided under the demonstration projects described above. They would also more effectively ensure accountability for donated foods provided for processing while streamlining current reporting and review requirements imposed on State distributing agencies and processors. Most significantly, the rule proposes to:

(1) Permit substitution of donated beef and pork with commercial beef and pork of U.S. origin, and of equal or better quality than the donated foods;

(2) Require multi-State processors to sign National Processing Agreements with FNS, and to submit end product data schedules to the Department for approval at the national level;

(3) Require multi-State processors to submit a performance bond or letter of credit to FNS to protect the value of the processors' donated food inventories;

(4) Require in-State processors to obtain independent Certified Public Accountant (CPA) audits every three years, and revise upward the donated food value thresholds that determine the required frequency of such audits for multi-State processors; and

(5) Remove the requirements that the distributing agency conduct an on-site review of in-State processors every two years, and develop a system to verify sales of end products through commercial distributors.

As discussed below, we propose to amend current §§ 250.3, 250.13, 250.16, 250.17, 250.19, and 250.24, and to completely revise § 250.18, and § 250.30 under Subpart C, *Processing and Labeling of Donated Foods*. The revision of Subpart C would break out the single section in that subpart into 10 new sections to more clearly present the specific processing requirements. Lastly, we propose to rewrite all revised sections in plain language, to make them easier to read and understand for the general public. The proposed changes to 7 CFR Part 250 are discussed in detail below.

II. Discussion of the Rule's Provisions

A. Definitions, § 250.3

Due to developments in food distribution programs, and for the purpose of clarification, we propose to remove, revise, and add definitions in current § 250.3 relating to processing of donated foods. We propose to remove the definitions of "Contract value of the donated foods", "Contracting agency", "Discount system", "Fee-for-service", "Refund", "Refund application", "Refund system", and "Substituted food". The proposed definition of "Processing agreement value" would replace the current definition of "Contract value of the donated foods". The term "contracting agency" would be replaced throughout the proposed regulatory provisions with the specific agency (i.e., distributing and/or recipient agency) that may enter into a processing agreement. The meaning of the other terms being removed is clear in the context of the proposed regulatory provisions, and no longer require separate definitions.

We propose to revise the definitions of "Distributor", "Multi-State processor" and "Substitution". The revised definition of "Distributor" would clarify that it is a commercial enterprise that may sell and/or deliver finished end products or store and distribute donated foods to distributing or recipient agencies. We propose to revise the current definition of "Multi-State processor" only to indicate that such a processor may operate in accordance with an agreement with a distributing or recipient agency.

Lastly, we propose to revise the definition of "Substitution" to simply indicate that it is the use of commercially purchased foods in place of donated foods, in accordance with the requirements in 7 CFR Part 250, as we propose to revise them in this rule. The current requirement that substitution of donated foods must be with commercial foods of the same generic identity, of domestic origin, and of equal or better quality than the donated food, would be included in the new § 250.34(a), as proposed in this rule.

The current provision for the substitution of donated nonfat dry milk with concentrated skim milk would be removed. Nonfat dry milk is a food commonly purchased by the Department under price support legislative authority and donated for use in food assistance programs. Hence, substitution of this donated food is rarely made at the current time, and is not encouraged by the Department. Additionally, it is a very complex

substitution to make, as the processor must assure that the milk solids in the skim milk fully replace the quantity of milk solids in the substituted nonfat dry milk. The current stipulation that substitution must meet the 100 percent yield requirement would be removed, as processing yield requirements for donated foods, as well as commercially purchased foods substituted for them, would be included in the new § 250.33.

The provision describing the limited substitution of poultry would be removed. As proposed in the new § 250.34, we would allow substitution of donated poultry under the same conditions as substitution of other donated foods, with the exception of backhauled product. All proposed requirements for the substitution of donated foods are fully discussed later in section II.H.5 of the preamble.

We propose to add definitions of "Backhauling", "Commingling", "End product data schedule", "In-State processor", "National Processing Agreement", "Processing agreement value", "Recipient Processing Agreement", "Replacement value", "7 CFR Part 3052", "Split shipment", "State Participation Agreement", and "State Processing Agreement". A definition of "Backhauling" would describe a means of delivery of donated food to a processor that is sometimes used by recipient agencies. A definition of "Commingling" would describe the common storage of donated foods with commercially purchased foods, as currently permitted for processors and most recipient agencies. A definition of "End product data schedule" would convey the important function of this document in describing the processing of donated foods into finished end products. A definition of "In-State processor" would help the reader distinguish such an enterprise from a multi-State processor. Definitions of "National Processing Agreement", "Recipient Processing Agreement", "State Participation Agreement", and "State Processing Agreement" would help the reader understand the different types of processing agreements permitted. These processing agreements are further described in the new § 250.30. A definition of "Processing agreement value" would clarify the donated food value that must be used by processors in crediting for donated foods in finished end products. A definition of "7 CFR Part 3052" would identify the Departmental regulations relating to audit requirements for State and local governments and nonprofit organizations that receive Federal grants. A definition of "Replacement value" would clarify the donated food

value that must be used by processors to ensure compensation for donated foods lost in processing or other activities, and would distinguish it from the processing agreement value. A definition of "Split shipment" would describe a commonly used means of delivering donated foods to distributing or recipient agencies, or to processors.

B. Distribution and Control of Donated Foods, § 250.13

We propose to amend current § 250.13(c), which describes the timing of transfer of title to donated foods, and the agency to which title is transferred. Currently, title to donated foods transfers to the distributing agency upon its acceptance of donated foods at the time and place of delivery. However, in many cases, recipient agencies receive direct shipments of donated foods from USDA vendors, bypassing the distributing agency. In such cases, title should pass directly to the recipient agency. Hence, we propose to state that title to donated foods passes to the distributing or recipient agency, as appropriate, at the time and place of delivery. However, we also propose to add an exception to the timing of title transfer, in accordance with the requirements under National Processing Agreements proposed in this rule. In the new § 250.32(a), we are proposing to require a multi-State processor to provide a performance bond or letter of credit to FNS to protect the value of the processor's donated food inventory, in accordance with its National Processing Agreement. However, unless the Department retains title to the donated foods held by such a processor, FNS would not have the authority to call in the bond if the processor failed to comply with processing requirements. Hence, we propose to state that title to donated foods provided to a multi-State processor, in accordance with its National Processing Agreement, transfers to the distributing or recipient agency, as appropriate, upon the acceptance of finished end products at the time and place of delivery. We propose to stipulate that, notwithstanding transfer of title, the distributing agency must ensure that donated foods and end products are used in accordance with the requirements of 7 CFR Part 250.

C. Maintenance of Records, § 250.16

In current § 250.16(a)(3), distributing agencies are required to maintain records of refusal of donated foods by school food authorities, if a distributing agency permits those school food authorities to select a limited variety of donated foods from the full list of

donated foods that USDA has made available for distribution. Such an "offer and refusal" system is described in current § 250.48(f). However, in accordance with a proposed rule published in the **Federal Register** on June 8, 2006 at 71 FR 33344, we would remove the "offer and refusal" system of ordering or selecting donated foods and require that the distributing agency permit school food authorities to order from the full list of available foods, and to distribute all such foods to them that can be distributed in a cost-effective manner. Under that proposed revision, refusal of donated foods, and records documenting such refusals, would be obsolete. Hence, we propose to remove current § 250.16(a)(3).

In current § 250.16(a)(4), processors, food service management companies, warehouses, and other entities must maintain records of receipt, distribution, storage, and inventory of donated foods. Processors must also maintain records such as formulas, recipes, production records, and receipt of shipments to document their use of donated foods. As discussed later in the preamble, we are proposing to include specific recordkeeping requirements for processors in the new § 250.37(d), and in the proposed rule published in the **Federal Register** on June 8, 2006 at 71 FR 33344, we proposed to include specific recordkeeping requirements for food service management companies. Hence, we propose to revise this section to state that processors and food service management companies must comply with the applicable recordkeeping requirements in 7 CFR Part 250, and with any other recordkeeping requirements included in their agreements or contracts. We also propose to require that storage facilities and distributors maintain records documenting the receipt, distribution, inventory, and disposal of donated foods or end products sufficient to ensure compliance with requirements in 7 CFR Part 250, and with any other such requirements in their agreements or contracts with distributing or recipient agencies. The specific types of records that such entities would have to maintain would depend on the agency with which they have a contract or agreement, and the specific donated food activities they are conducting under the contract or agreement.

In accordance with the proposed removal of § 250.16(a)(3), we would redesignate current § 250.16(a)(4), (a)(5), and (a)(6), as § 250.16(a)(3), (a)(4), and (a)(5), respectively.

D. Reports, § 250.17

Current § 250.17(b) and (c) contains reporting requirements to ensure processors' compliance with requirements in 7 CFR Part 250. In current § 250.17(b), the distributing agency must submit a report of processors' inventories to the FNS Regional Office on a quarterly basis (this requirement is also contained in current § 250.30(o)). In current § 250.17(c), processors must submit monthly performance reports to the distributing agency. We propose to remove § 250.17(b). FNS Regional Offices do not currently review reports of processors' donated food inventories. The distributing agency is responsible for monitoring such inventories through the review of processors' performance reports, and, in accordance with current § 250.30(n)(1), to ensure that processors do not maintain excessive inventories. As discussed in section II.H.8 of the preamble, we are proposing to include more specific reporting requirements for processors in the new § 250.37. Under the proposals, multi-State processors would be required to submit monthly reports of their national donated food inventories to FNS Headquarters for review. Accordingly, we propose to revise current § 250.17(c) (redesignated as paragraph (b) by this rule) to require processors to submit performance reports and other supporting documentation, as required by the distributing agency or by FNS. In accordance with the removal of § 250.17(b), we would redesignate current § 250.17(c), (d), and (e), as § 250.17(b), (c), and (d), respectively. We propose to remove current § 250.17(f), which stipulates that the date shown on a report submitted by facsimile machine may serve as the submission date.

E. Audits, § 250.18

Currently, § 250.18 describes audit requirements for distributing and recipient agencies and for multi-State processors. We propose to revise this section to clarify audit requirements for distributing and recipient agencies, to include new audit requirements for in-State processors, and to amend audit requirements for multi-State processors.

In current § 250.18(a), fiscal matters must be reviewed in audits conducted under the Single Audit Act, and in accordance with Departmental regulations in 7 CFR Part 3015. However, the current Departmental regulations establishing audit requirements for State and local governments and nonprofit organizations that receive Federal grants

are contained in 7 CFR Part 3052, which incorporates requirements in OMB Circular A-133. In accordance with 7 CFR Part 3052 and OMB Circular A-133, a State or local government or nonprofit organization that expends at least \$500,000 in Federal awards in a school or fiscal year must obtain a single audit for that year. A program-specific audit may be substituted for the single audit if the auditee operates only one Federal program, or one recognized cluster of programs (e.g., National School Lunch, School Breakfast, and Summer Food Service Programs). A State or local government or nonprofit organization that expends less than \$500,000 in Federal awards in a year is not required to obtain an audit for that year. In determining if an audit is required, the value of donated foods must be considered, along with other Federal expenditures.

We propose to include these audit requirements in the new § 250.18(a), as they apply to distributing and recipient agencies, and to reference the Departmental regulations in 7 CFR Part 3052. We also propose to require that the donated food values established by the distributing agency to credit a recipient agency's donated food assistance level, in accordance with current § 250.13(a)(5), must be used. We would indicate that, for a recipient agency utilizing a single inventory management system, the value of donated foods received in a year must be considered, rather than the value of donated foods used or distributed. Under single inventory management, donated foods are commingled with commercially purchased foods, and the amount or value used or distributed may not be discernible.

The requirements contained in 7 CFR Part 3052 and OMB Circular A-133 do not apply to commercial enterprises providing goods and services to distributing or recipient agencies in accordance with agreements or contracts. However, in accordance with current § 250.18(b), multi-State processors must obtain an independent CPA audit at a frequency determined by the value of the donated foods they receive for processing in a year. Currently, a multi-State processor must obtain an independent CPA audit for any year in which it receives more than \$250,000 in donated foods; every two years, if it receives \$75,000 to \$250,000 in donated foods each year; and every three years, if it receives less than \$75,000 in donated foods each year. Such audits must be paid for by the processor.

In-State processors are not currently required to obtain an independent CPA

audit. In order to ensure their compliance with program requirements, the distributing agency must conduct an on-site review of such processors at least once every two years, in accordance with current § 250.19(b)(1)(iii). However, the performance of on-site reviews is a costly and time-consuming exercise for distributing agencies. Hence, we propose instead to require in-State processors to obtain independent CPA audits as well, and, as discussed in section II.F of the preamble, to remove the on-site review requirement currently imposed on the distributing agency for such processors.

In the new § 250.18(b), we propose to require that all in-State processors obtain an independent CPA audit in the first year that they receive donated foods for processing. We propose to require that, after the first year, in-State processors obtain an independent CPA audit every three years. As currently required for multi-State processors, we propose to require that in-State processors pay the cost of the audit. We propose to amend the current audit requirement for multi-State processors by requiring that a multi-State processor obtain an independent CPA audit in each of the first three years that it receives donated foods for processing. After the first three years, a multi-State processor must obtain an audit at a frequency determined by the average value of donated foods received for processing per year, as currently required. However, we propose to revise upward the current thresholds for determining the required frequency of such audits to reflect the much larger volume of donated foods provided to such processors for processing over the last several years. Hence, we propose to require a multi-State processor to obtain an independent CPA audit:

- (1) Annually, if it receives, on average, more than \$5,000,000 in donated foods for processing per year;
- (2) Every two years, if it receives, on average, between \$1,000,000 and \$5,000,000 in donated foods for processing per year; and
- (3) Every three years, if it receives, on average, less than \$1,000,000 in donated foods for processing per year.

As in audits of distributing and recipient agencies, we propose to require that the donated food values established by the distributing agency in accordance with current § 250.13(a)(5) must be used to determine if an audit is required. We also propose to clarify that audits must determine processor compliance with the requirements in this part, and must be conducted in accordance with the FNS Audit Guide

for Processors. However, we propose to remove the current stipulation that, at the discretion of FNS, auditors will be required to attend training sessions conducted by the Department.

In the new § 250.18(c), we propose to indicate that a distributing or recipient agency must submit reports and corrective action plans, and undertake corrective actions in response to the audit, in accordance with the requirements in 7 CFR Part 3052. We propose to clarify that, by December 31st of each year in which an audit is required, a multi-State processor is responsible for ensuring that a copy of the audit is provided to FNS, while an in-State processor must ensure that a copy of the audit is provided to the distributing agency. We also propose to include the requirement in current § 250.18(b)(6) that the processor provide verification to FNS, or the distributing agency, as appropriate, that all deficiencies identified in the audit have been corrected, or provide a corrective action plan with timelines for correcting all deficiencies identified in the audit.

In the new § 250.18(d), we propose to indicate that a distributing or recipient agency is subject to sanctions for failure to obtain the required audit, or for failure to correct deficiencies identified in audits. Such sanctions may include the withholding, suspension, or termination of a Federal award. In current § 250.18(b)(5), noncompliance with audit requirements makes the processor ineligible to continue to receive donated foods for processing. We propose to state that FNS may terminate a processor's National Processing Agreement, or prohibit the further distribution of donated foods to a processor, for its failure to obtain the required audit, or for failure to correct the deficiencies identified in the audit. We propose to state that a distributing or recipient agency may immediately terminate an agreement with a processor, and must not extend or renew such an agreement, for the same reasons, in accordance with the new § 250.38(e).

In current § 250.18(a), the Department, the Comptroller General of the United States, or any of their authorized representatives, may conduct audits or inspections of distributing, subdistributing, or recipient agencies, or with commercial enterprises with which they have agreements or contracts, to assure compliance with the requirements of this part. We propose to maintain that and move it to new § 250.18(e).

F. Reviews, § 250.19

As previously described, we propose to remove current § 250.19(b)(1)(iii), which requires the distributing agency to perform an on-site review of all in-State processors at least once every two years. In accordance with the removal of § 250.19(b)(1)(iii), we would redesignate current § 250.19(b)(1)(iv) and (b)(1)(v), as § 250.19(b)(1)(iii) and (b)(1)(iv), respectively.

Currently, in § 250.19(b)(2), the distributing agency must develop a system to verify sales of end products when a processor has provided end products to a distributor, and the distributor sells such end products to recipient agencies at a discount. The sales verification system must include a statistically valid sample of such sales over a six-month period. If the distributing agency delegates this sales verification requirement to the processor, it must select a subsample of the processor's findings, and reverify them. Current regulations also require the distributing agency to submit sales verification findings to the FNS Regional Office. The purpose of such sales verification is to assure that the distributor has sold the requisite quantity of end products to recipient agencies.

We propose to remove § 250.19(b)(2), and the requirement that the distributing agency develop a sales verification system, as described above. In the new §§ 250.36(d) and 250.37(d), as described later in the preamble, we are proposing to require the processor to ensure that the distributor notify it, on a monthly basis, of its sale of end products to recipient agencies at a discount, or under a fee-for-service, through automated sales reports, or other electronic or written submission, and to require the processor to maintain records of such notification. These records would be available for review by auditors, in conducting the audits required in the proposed § 250.18. We are also proposing, in the new § 250.37(f), to require recipient agencies to maintain records of the receipt of end products from processors or distributors. These records would also be available for review by the distributing agency or other parties, including auditors. Hence, in place of the current burden imposed on the distributing agency to develop a system to verify end product sales, we would ensure, through appropriate documentation, that such sales have been made, and that recipient agencies have received the end products that they are due. The distributing agency may still require, at its option, that the

processor submit documentation to support information included in the processor's performance report, including sales of end products to recipient agencies. The distributing agency may also contact recipient agencies to ensure receipt of end products.

In accordance with the removal of § 250.19(b)(2), we would redesignate current § 250.19(b)(3), (b)(4), (b)(5), and (b)(6), as § 250.19(b)(2), (b)(3), (b)(4), and (b)(5), respectively. However, we propose to remove the last sentence in the redesignated § 250.19(b)(2), which requires the distributing agency to submit a copy of the processor review report to the FNS Regional Office.

G. Distributing Agency Performance Standards, § 250.24

In current § 250.24(g), distributing agencies must provide for the processing of donated foods, in accordance with current § 250.30, and must inform recipient agencies of the processing options available to them. Distributing agencies must also test end products, prior to entering into a processing agreement, or may allow recipient agencies to test end products, and must monitor acceptability of end products. We propose to retain the current requirements in the revised § 250.24(g), but to reference requirements under Subpart C, and to clarify that the distributing agency must ensure that recipient agencies are aware of the processing options available to them. Most of the information on processing is available on the FNS Web site or from other readily available sources, as indicated in the new § 250.39(b).

H. Subpart C—Processing of Donated Foods

As previously mentioned, we propose to completely revise current Subpart C, *Processing and Labeling of Donated Foods*, which currently contains only § 250.30. In revising Subpart C, we would restructure it into 10 new sections, to more clearly present the specific processing requirements, and would rewrite them in plain language. We propose to include the requirements for specific processing activities more or less in the order in which they occur; *i.e.*, entering into processing agreements, processing of donated foods into end products, sale of end products, submission of reports, etc. We also propose to change the heading of Subpart C to *Processing of Donated Foods*. The new sections proposed under the revised Subpart C include the following:

250.30, Types of processing agreements.

250.31, Procurement requirements.

250.32, Protection of donated food value.

250.33, Processing yields of donated foods.

250.34, Substitution of donated foods.

250.35, Storage, inspection, quality control, and inventory management.

250.36, End product sales and crediting for the value of donated foods.

250.37, Reports, records, and reviews of processor performance.

250.38, Provisions of agreements.

250.39, Miscellaneous provisions.

1. Types of Processing Agreements, § 250.30

In the new § 250.30, we propose to state clearly why donated foods are provided to processors for processing, and to describe the different types of processing agreements permitted, including National, State, and Recipient Processing Agreements. However, we propose to include the specific provisions required for each type of agreement in the new § 250.38, as the reason for their inclusion will only be clear with an understanding of the processing requirements contained in the preceding sections.

In the new § 250.30(a), we propose to describe the benefit of providing donated foods to a processor for processing into end products, and to clarify that a processor's use of a commercial facility to repackage donated foods, or to use donated foods in the preparation of meals, is also considered processing in 7 CFR Part 250.

In current § 250.30(b), a distributing agency may contract with a processor to process donated foods, or may permit subdistributing or recipient agencies to contract with processors. In current practice, such contracting is performed under agreements entered into between the parties; hence, in this rule, we use the term agreement, rather than contract, to describe any legal compact entered into with a processor to process donated foods. Currently, most donated foods are processed in accordance with State Processing Agreements. However, some large school food authorities currently have agreements with processors to process donated foods and purchase the finished end products, as permitted by distributing agencies. Additionally, as previously described, FNS has permitted multi-State processors to process donated foods in accordance with National Processing Agreements under a demonstration project initiated in 2004.

In the new § 250.30(b), we propose to clarify that processing of donated foods must be performed in accordance with an agreement between the processor and FNS, between the processor and the distributing agency, or, if permitted by the distributing agency, between the processor and a recipient agency (or subdistributing agency). We propose to include in new § 250.30(b) the stipulation in current § 250.30(c)(4)(ix) that an agreement may not obligate the distributing or recipient agency, or the Department, to provide donated foods to a processor for processing. USDA purchase and donation of foods is dependent on market conditions, and specific foods may not be available for donation in certain years. Additionally, we propose to retain in this new § 250.30(b) the requirement in current § 250.30(p) that, for processing of donated foods in child nutrition programs, the distributing agency must provide the State administering agency (if a different agency) with an opportunity to review its processing agreements to ensure compliance with nutritional and labeling requirements. We propose to remove the stipulation in current § 250.30(c)(1) that a processing agreement must be in standard written form.

In accordance with the National Processing Agreements permitted under the demonstration project, FNS reviews and approves end product data schedules submitted by multi-State processors, and holds and manages the processor's performance bond or letter of credit to protect the value of donated food inventories. FNS also monitors the processor's national donated food inventory through the review of performance reports, which processors must submit to FNS on a monthly basis. As previously mentioned, FNS' performance of these activities has significantly reduced the labor and paperwork burden for both processors and distributing agencies. Hence, in the new § 250.30(c), we propose to require that a multi-State processor enter into a National Processing Agreement with FNS to process donated foods into end products, in accordance with end product data schedules approved by FNS. We would also indicate that, as proposed in the new § 250.32, FNS holds and manages the processor's performance bond or letter of credit to protect the value of donated food inventories under the National Processing Agreement. We would indicate that FNS does not itself procure or purchase end products under such agreements, and that a multi-State processor must enter into a State

Participation Agreement with the distributing agency in order to sell nationally approved end products in the State, as proposed in the new § 250.30(d). However, a distributing agency may still choose to provide donated foods to a multi-State processor for processing in accordance with its State Processing Agreement, as described below, irrespective of that processor's National Processing Agreement.

In the new § 250.30(d), we propose to require the distributing agency to enter into a State Participation Agreement with a multi-State processor to permit the sale of end products produced under the processor's National Processing Agreement in the State, as previously indicated. The State Participation Agreement is currently utilized in conjunction with National Processing Agreements in the demonstration project. Under the State Participation Agreement, we propose to permit the distributing agency to select the processor's nationally approved end products for sale to eligible recipient agencies within the State, or to directly purchase such end products. The processor may provide a list of such nationally approved end products in a summary end product data schedule. We also propose to permit the distributing agency to include other processing requirements in the State Participation Agreement, such as the specific methods of end product sales permitted in the State, in accordance with the new § 250.36, (e.g., a refund, discount, or indirect discount method of sales), or the use of labels attesting to fulfillment of meal pattern requirements in child nutrition programs.

Currently, a distributing agency must enter into a State Processing Agreement with a processor to process donated foods into finished end products for sale in the State. Under such an agreement, the distributing agency may purchase the finished end products for distribution to eligible recipient agencies. However, it may also select a number of processors with which it enters into such agreements, and permit recipient agencies to purchase finished end products from them, in accordance with applicable procurement requirements. These latter types of State Processing Agreements are commonly called "master agreements". The distributing agency must utilize selection criteria in current § 250.30(c)(1) to select processors with which to enter into master agreements. Under all State Processing Agreements, the distributing agency must approve end product data schedules submitted by the processor, hold and manage the

processor's performance bond or letter of credit, and assure compliance with all processing requirements.

In the new § 250.30(e), we propose to clarify the distinction between master agreements and other State Processing Agreements, and to include in this new section the required criteria in current § 250.30(c)(1) for selecting processors under master agreements. However, we propose to remove the statement that selection criteria will be reviewed by the FNS Regional Office during its management evaluation of the distributing agency. We propose to require that the distributing agency enter into a State Processing Agreement with an in-State processor to process donated foods, as currently required. We would also indicate that the distributing agency may choose to provide donated foods for processing under such an agreement with a multi-State processor as well, rather than utilize the State Participation Agreement, as described above.

In current § 250.30(b)(3), the distributing agency may permit recipient agencies (or subdistributing agencies) to enter into agreements with processors to process donated foods and to purchase the finished end products. We propose to permit such agreements in the new § 250.30(f), and to refer to them as Recipient Processing Agreements. We also propose to clarify that, under such agreements, the distributing agency may also permit the recipient agency to approve end product data schedules or select nationally approved end product data schedules, review processor performance reports, and monitor other processing activities. All such activities must be performed in accordance with the requirements of this part. We propose to clarify that a recipient agency may also enter into a Recipient Processing Agreement, and perform the activities described above, on behalf of other recipient agencies, in accordance with an agreement between the parties (such as in a school cooperative, or co-op). We propose to include the requirement in current § 250.30(l) that the distributing agency approve all Recipient Processing Agreements.

In current § 250.30(b)(1), the distributing agency must test end products with recipient agencies prior to entering into processing agreements, to ensure that they will be acceptable to recipient agencies. Such testing is not required if end products have previously been tested, or have otherwise been determined to be acceptable to recipient agencies. We propose to include these requirements in the new § 250.30(g), but to clarify that

the distributing agency may permit recipient agencies to test end products. We also propose to amend the current requirement that the distributing agency develop a system to monitor product acceptability on a periodic basis by requiring instead that the distributing agency, or its recipient agencies, must monitor product acceptability on an ongoing basis.

In current § 250.30(c)(4)(xvi), a processor may not assign the processing agreement, or subcontract with another entity, to perform any aspect of processing without the written consent of the distributing agency and the contracting agency. We propose to clarify, in the new § 250.30(h), that a processor may not assign any processing activities under its processing agreement, or subcontract with another entity to perform any aspect of processing, without the written consent of the other party to the agreement, which may be the distributing, subdistributing, or recipient agency, or FNS. We propose to permit the distributing agency to provide the required consent as part of its State Participation Agreement with the processor.

In current § 250.30(c)(1), processing agreements are limited to one year, but may provide for an option to extend the agreement for two additional one-year periods. In the new § 250.30(i), we propose to revise this requirement by permitting all agreements between a distributing, subdistributing, or recipient agency and a processor to be up to five years in duration. This proposal would permit the appropriate agency to determine the length of agreement that would be to its best advantage, within the five-year limitation, and would reduce the time and labor burden imposed on such agencies. We propose to make National Processing Agreements permanent. We propose to indicate that amendments to any agreements may be made as needed, with the concurrence of the parties to the agreement, and that such amendments will be effective for the duration of the agreement, unless otherwise indicated.

We propose to remove the following requirements or statements in current § 250.30 relating to processing agreements, as they are overly restrictive, or simply unnecessary:

- The requirement in current § 250.30(c)(1) that the FNS Regional Office review processing agreements.
- The requirement in current § 250.30(c)(2) that the agreement be prepared and reviewed by State legal staff to ensure conformance with Federal regulations.

- The statement in current § 250.30(c)(3) indicating which official in the processing enterprise must sign the agreement.

- The requirement in current § 250.30(l) that the distributing agency provide a copy of the 7 CFR Part 250 regulations to processors, and a copy of agreements to the FNS Regional Office.

- The requirement in current § 250.30(q) with respect to FNS reviews of processing agreements or reports, and FNS actions following from such reviews.

- The stipulation in current § 250.30(r) that FNS will provide copies of agreements to persons requesting them.

2. Procurement Requirements, § 250.31

The requirements for the procurement of goods and services under Federal grants are described in 7 CFR Parts 3016 and 3019. 7 CFR Part 3016 contains the Department's regulations establishing uniform administrative requirements for Federal grants and cooperative agreements and subawards to State, local, and Indian tribal governments; 7 CFR Part 3019 contains the Department's regulations establishing uniform administrative requirements for Federal grants and cooperative agreements awarded to institutions of higher education, hospitals, and other nonprofit organizations. In the new § 250.31(a), we propose to indicate the applicability of these requirements to the procurement of processed end products or of other processing services relating to donated foods, and to indicate that distributing or recipient agencies may use procurement procedures that conform to applicable State or local laws, as appropriate, but must ensure compliance with the Federal procurement requirements. We propose to remove the reference in current § 250.30(c)(1) to procurement standards in Attachment O of OMB Circular A-102, as this circular is obsolete.

In accordance with 7 CFR 3016.36 and 3019.44, procurement of goods and services may be performed using small purchase procedures if the cost of such procurement does not exceed the simplified acquisition threshold, as defined in 41 U.S.C. 403(11), which is currently \$100,000. Under these procedures, price quotations must be obtained from several sources. However, if the cost of such procurement exceeds this threshold, sealed bids or competitive proposals must be used. In the new § 250.31(b), we propose to indicate the method of procurement required in accordance with 7 CFR 3016.36 and 3019.44, and the simplified

acquisition threshold. We indicate that these methods of procurement are more fully described in 7 CFR 3016.36 and 3019.44. We also propose to clarify that, if the threshold for determining the required method of procurement is lower under State or local laws, as applicable, then the distributing or recipient agency is obligated to comply with those procedures.

In the new § 250.31(c), we propose to require specific information in procurement documents, to assist recipient agencies in ensuring that they receive credit for the value of donated foods in finished end products. We propose to require that procurement documents include the price to be charged for the finished end product or other processing service, the method of end product sales that will be utilized, the processing agreement value of the donated food in the finished end products, and the location for the delivery of the finished end products. We propose to remove current requirements for the provision of pricing information outside of the procurement process, including:

(1) The requirement in current § 250.30(c)(4)(ii) that pricing information be included with the end product data schedule; and

(2) The requirements in current § 250.30(d)(3) and (e)(2) that the processor provide pricing information summaries to the distributing agency, and the distributing agency provide such information to recipient agencies, as soon as possible after completion of the agreement.

3. Protection of Donated Food Value, § 250.32

In current § 250.30(c)(4)(viii)(B), the processor is required to obtain, and furnish to the distributing agency, financial protection to protect the value of donated foods prior to their delivery for processing, by means of a performance bond, an irrevocable letter of credit, or an escrow account. The distributing agency must determine the dollar value of the financial protection, based on the quantity of donated foods for which the processor is accountable. In the new § 250.32(a), we propose to include the current requirement that the processor obtain such financial protection, but to remove the option to obtain an escrow account, as it is little-used. However, we propose to require that a multi-State processor provide the performance bond or irrevocable letter of credit to FNS, in accordance with its National Processing Agreement. We propose to clarify that the amount of the performance bond or letter of credit must be sufficient to cover the

maximum value of raw or processed donated foods that the processor is expected to maintain in inventory at any give time, which is determined by the distributing agency or by FNS, as appropriate.

In the new § 250.32(b), we propose to indicate the conditions under which the distributing agency must call in the performance bond or letter of credit. We also propose to indicate that FNS will call in the performance bond or letter of credit under the same conditions, and will ensure that any monies recovered are reimbursed to distributing agencies for losses of entitlement foods.

4. Processing Yields of Donated Foods, § 250.33

In current § 250.30(c)(4), the processor must submit, as part of the agreement approval, information regarding the production of an end product to ensure that the distributing or recipient agency, as appropriate, receives the benefit of the donated food processed. This information, which is submitted in a format called the end product data schedule, must include the following:

- A description of the end product.
- The types and quantities of donated foods and other ingredients needed to produce a specific quantity of end product.
- The yield factor for the donated food.
- The contract value of the donated food.
- Any pricing information in addition to the charge for the end product or fee-for-service.

In the new § 250.33, we propose to retain the required submission of the end product data schedule, and to more specifically describe the required processing yields of donated food, which is currently referred to as the yield factor. In the new § 250.33(a), we propose to require submission of the currently required information on the end product data schedule, with the exception of the price charged for the end product or other pricing information, and the contract value of the donated food. As described above, pricing information must be included in the procurement of end products or other processing services relating to donated foods. Inclusion of such information on end product data schedules may be misleading, as it may lead some recipient agencies to conclude that procurement has been performed by the distributing agency under its State Processing Agreement or State Participation Agreement. Prices currently included on end product data schedules generally reflect the highest

price that a processor will charge for the finished end product.

We also propose to require inclusion of the processing yield of donated food, which may be expressed as the quantity of donated food (e.g., lbs. or cases) needed to produce a specific quantity of end product, or as the percentage of donated food returned in the finished end product. We propose to retain the requirement that end product data schedules be approved by the distributing agency under State Processing Agreements. We propose to clarify that, for donated foods processed under guaranteed return or standard yield, the end product data schedules must also be approved by the Department. We propose to require that, under National Processing Agreements, end product data schedules be approved by the Department. Lastly, we propose to clarify that an end product data schedule must be submitted, and approved, for each new end product that a processor wishes to provide, or for a previously approved end product in which the ingredients or other pertinent information have been altered.

In new § 250.33(b) through (e), we propose to describe the several different processing yields of donated foods that may be approved in end product data schedules. In current § 250.30(c)(4)(ii), the processor must meet a 100 percent yield in the processing of all substitutable donated foods (i.e., all donated foods except beef, pork, and poultry). Under 100 percent yield, the processor must ensure that 100 percent of the raw donated food is returned in the finished end product. Production loss of donated food must be accounted for by replacement with commercially purchased food of the same generic identity, of U.S. origin, and of equal or better quality than the donated food. To demonstrate this, the processor must report reductions in donated food inventories on performance reports in the amount of donated food contained in the finished end product rather than the amount that went into production. We propose to include the current 100 percent yield requirement in the new § 250.33(b), and to clarify that this processing yield is required for all donated foods except beef, pork, and poultry. We propose to indicate that FNS may make exceptions to the 100 percent yield requirement, on a case-by-case basis, if a processor experiences a significant manufacturing loss.

Processing of donated foods such as beef, pork, and poultry, invariably results in significant loss of product, such as the bones in chicken. Hence, the processing yield must take such losses into account, in the same manner that

the processing of commercial product accounts for such losses. Currently, the three processing yields approved in end product data schedules to account for such losses include guaranteed yield, guaranteed minimum yield, and standard yield. We propose to describe these processing yields in the following sections.

Under guaranteed yield or return, the processor must ensure that a specific quantity of end product will be produced from the specific quantity of donated food put into production, as determined by the parties to the processing agreement, and, for State Processing Agreements, approved by the Department. The guaranteed yield must be indicated on the end product data schedule. We propose to describe guaranteed yield in the new § 250.33(c).

Under guaranteed minimum yield or return, the processor must ensure that a specific minimum quantity of end product will be produced from the specific quantity of donated food in a production run. If a larger quantity of end product than the guaranteed minimum is produced, the processor must provide the full quantity to the appropriate agency, which must pay the processor for the additional end products produced. We propose to describe guaranteed minimum yield in the new § 250.33(d).

Under standard yield, the processor must ensure that a specific quantity of end product, as determined by the Department, will be produced from a specific quantity of donated food. The established standard yield is higher than the average yield under normal commercial production, and serves to reward those processors that can process donated foods most efficiently. Like guaranteed yield, standard yield ensures that the recipient agency will receive a specific quantity of end product, which helps to ensure that it can meet its food service needs. It also avoids the paperwork and review needed to ensure that guaranteed minimum yield is met. We propose to describe standard yield in the new § 250.33(e).

In the new § 250.33(f), we propose to require that the processor compensate the distributing or recipient agency, as appropriate, for the loss of donated foods, or for commercially purchased foods substituted for donated foods. Loss of donated foods may result for a number of reasons, including the processor's failure to meet the required processing yield, as described above, or from spoilage or damage of donated foods in storage, or improper distribution of end products. In order to compensate for such losses of donated

foods, we propose to require that the processor:

(1) Replace the lost donated food or commercial substitute with commercially purchased food of the same generic identity, of U.S. origin, and of equal or better quality than the donated food; or

(2) Pay the distributing or recipient agency, as appropriate, for the replacement value of the donated food or commercial substitute.

Processing of donated foods may sometimes result in finished end products that are wholesome, but do not meet the specifications required for use in the recipient agency's food service. As this is considered production loss, the processor must provide compensation for the donated foods processed into such end products. In normal business practice, such products are usually returned to production for processing into end products that meet required specifications. These are often called rework products. In the new § 250.33(g), we propose to require that the processor compensate the distributing or recipient agency, as appropriate, for such donated foods, or for commercially purchased foods substituted for donated foods, by returning the end products to production for processing into end products that meet the required specifications. However, we also propose to permit the processor to make such compensation by paying the distributing or recipient agency, as appropriate, for the replacement value of the donated food or commercial substitute in the end products, and retaining such end products for its own use. This option would not, however, be permitted under guaranteed return or standard yield.

In current § 250.30(c)(4)(viii)(D), the processor must credit the distributing or recipient agency, as appropriate, for the sale of any by-products resulting from the processing of donated foods, or of commercially purchased foods substituted for donated foods. Crediting must be achieved through reduction of the processing fee, and must be in the amount received from such sale, or the market value of the by-products. However, such crediting is not required under guaranteed return or standard yield. We propose to include this requirement in the new § 250.33(h), but propose to require crediting through invoice reductions, or another means of crediting. We also propose to clarify that the processor must credit the appropriate agency for the net value received from the sale of by-products, after subtraction of any documented expenses incurred in preparing the by-

product for sale. We propose to remove the requirement in current § 250.30(c)(4)(viii)(D) that the processor credit the distributing or recipient agency for the sale of donated food containers.

In current § 250.30(i), the processor must meet applicable Federal labeling requirements, and must follow the procedures required for approval of labels for end products that claim to meet meal pattern requirements in child nutrition programs. We propose to include these requirements in the new § 250.33(i).

5. Substitution of Donated Foods, § 250.34

We propose to include requirements for the substitution of donated foods in the new § 250.34. Currently, in § 250.30(f)(1), the processing agreement may allow the processor to substitute commercially purchased foods for all donated foods except donated beef, pork, and poultry without prior approval of the Department. Substitution must be with commercially purchased foods of the same generic identity, of U.S. origin, and of equal or better quality than the donated foods. Substitution of donated poultry is permitted with some limitations in accordance with a processor's approved plan. Substitution of donated beef and pork is not permitted under the regulations.

As previously mentioned in the preamble, the Department has waived current regulations, since 2001, to conduct a demonstration project that has permitted selected processors to substitute commercially purchased beef and pork for donated beef and pork, in accordance with an approved plan. Substitution must be with commercial beef and pork of U.S. origin, and of equal or better quality than the donated food. Under the demonstration project, only bulk beef and pork delivered to the processor from a USDA vendor may be substituted. Donated beef and pork delivered to a processor from a recipient agency facility for processing may not be substituted (this process is commonly called backhauling). In a similar manner, substitution of backhauled donated poultry is prohibited in current § 250.30(f)(1)(ii). In its plan, the processor must describe the production and recordkeeping procedures that will be utilized to ensure that substitution requirements will be met.

In the new § 250.34(a), we propose to permit a processor to substitute any donated food that is delivered to it from a USDA vendor with commercially purchased food of the same generic

identity, of U.S. origin, and of equal or better quality than the donated food. Prior approval, or an approved substitution plan, would not be required. Hence, we propose to remove the required elements of a processor's plan for poultry substitution in current § 250.30(f)(1)(ii)(B).

In current § 250.30(f)(1)(ii)(A), substitution of commercial poultry for donated poultry may be made before the processor actually receives a shipment of the donated poultry. In such case, however, the processor assumes all risks—i.e., the Department will not be liable if, due to changing market conditions or other reasons, it is unable to purchase and deliver donated poultry to the processor for processing. In the new § 250.34(a), we propose to allow a processor the option to substitute any donated food in advance of the receipt of the donated food shipment, and to more clearly describe the processor's assumption of risk should the Department be unable to purchase and deliver any donated food so substituted. Lastly, we propose to require that commercially purchased food substituted for donated food meet the same processing yield requirements that would be required for the donated food, as proposed in the new § 250.33.

Donated food may be backhauled to a processor from a recipient agency facility when a recipient agency determines that, despite earlier projections, it is unable to utilize the donated food in its current form. Rather than see it go to waste, the recipient agency provides the food to a processor to process into a more usable form. However, because the food has been sitting in storage for some time, it may be approaching the end of its shelf life. Hence, in the interest of food safety, it is important to assure that the food is processed and used as soon as possible. In the new § 250.34(b), we propose to prohibit substitution or commingling of all backhauled donated foods, and to require that the processor process them into end products for sale and delivery to the recipient agency that provided them, and not to any other recipient agency. Additionally, we propose to prohibit the processor from providing payment for them in lieu of processing.

In current § 250.30(g), the processing of donated beef, pork, and poultry must occur under Federal acceptance service grading, in order to assure that substitution requirements are met. Such grading is conducted by the Agricultural Marketing Service (AMS). The grader verifies the quality and quantity of food that is put into production, and the quantity of end products produced, and includes the pertinent information on a

grading certificate. Federal acceptance service grading is not required for substitution of other donated foods, unless specifically requested by the Department, or by the distributing agency. In accordance with current § 250.30(h), if the distributing agency determines that acceptance service grading is to be performed, it must consult with the applicable Federal agency in establishing specific grading requirements. In all cases, the processor is responsible for paying the cost of the acceptance service grading. In current § 250.30(f)(1), the processor must maintain records (including grading certificates) necessary to document that substitution of all donated foods has been conducted in accordance with the requirements in 7 CFR Part 250. We propose to include all of these requirements in the new § 250.34(c).

In current § 250.30(g), the distributing agency may approve a waiver of the grading requirement for donated beef, pork, or poultry under certain conditions. We propose to include this contingency, and retain the current conditions under which the distributing agency may approve such a waiver, in the new § 250.34(d). However, we propose to indicate that such waivers may only be approved on a case by case basis—*i.e.*, for a specific production run. The distributing agency may not approve a blanket waiver of the requirement. We also include the current stipulation that a waiver may only be approved if the processor's past performance indicates that the quality of the end product will not be adversely affected.

Also, in current § 250.30(f)(1)(ii)(A), the processor may use donated poultry that has been substituted with commercially purchased poultry in any processing activities conducted at its facilities. However, the processor may not sell the donated poultry as an intact unit. Additionally, in current § 250.30(f)(2), substituted donated food must be used by the processor and may not be sold or disposed of in bulk form. In the new § 250.34(e), we propose to include the current provision that the processor may use any substituted donated food in other processing activities conducted at its facilities. We also propose to permit the processor to sell any substituted donated food as an intact unit as long as the processor removes all USDA labels, as applicable. We propose to remove the stipulation, in current § 250.30(f)(4), that title to the substituted donated food passes to the processor upon the initiation of processing of the end product with the commercial substitute. The transfer of title to donated foods, which are part of

the Federal grant, is limited to the distributing agency or recipient agency, as the recipients of the grant. Subsequent donated food activities may be performed, in accordance with Federal regulations and the terms of processing agreements, but would not include a further transfer of title.

We propose to remove the requirements in current § 250.30(f) that the processor maintain documentation that it has not reduced its level of commercial production in exercising the option to substitute commercially purchased foods for donated foods, or that it has made sufficient purchases to meet the 100 percent yield requirement in processing of donated foods. In addition to being virtually impossible to determine, it is unlikely that a processor would choose to process donated foods if it were to adversely affect its commercial activities. The requirement that the processor compensate the distributing or recipient agency for failure to meet required processing yields of donated foods, as proposed in the new § 250.33, is more appropriate, and effective, than a requirement that the processor make specific purchases of foods on the commercial market.

We propose to remove the requirements in current § 250.30(f)(2) and (f)(3) relating to the substitution of concentrated skim milk for donated nonfat dry milk, in accordance with the proposed removal of this substitution option under the revised definition of substitution in § 250.3.

6. Storage, Inspection, Quality Control, and Inventory Management, § 250.35

We propose to include requirements for the storage, inspection, quality control, and inventory management of donated foods provided for processing in the new § 250.35. In current § 250.30(c)(4)(x), the processor must describe its quality control system, and assure that an effective quality control system will be maintained for the duration of its agreement. In the new § 250.35(a), we propose to require the processor to ensure the safe and effective storage of donated foods, including compliance with the general storage requirements in current § 250.14(b), and to maintain an effective quality control system at its processing facilities. We propose to require the processor to maintain documentation to verify the effectiveness of its quality control system, and to provide such documentation upon request.

In current § 250.30(g), the processing of donated beef, pork, and poultry, and of commercial meat products that contain any donated foods, must be performed in plants under continuous

Federal meat or poultry inspection. However, in States certified as having programs at least equal to Federal standards, processing of such foods may be performed in plants under continuous State meat or poultry inspection for processed end products that are utilized in the State, rather than the Federal inspection. The inspection requirements assure that processing of donated foods is performed in a safe and sanitary environment, and that labeling requirements are met. We propose to include these inspection requirements without change in the new § 250.35(b).

In the new § 250.35(c), we propose to clarify that a processor may commingle donated foods and commercially purchased foods, unless the processing agreement specifically requires that donated foods and commercially purchased foods be stored separately, or the donated foods have been backhauled from a recipient agency. However, we propose to clarify that such commingling must be performed in a manner that ensures the safe and efficient use of donated foods, as well as compliance with substitution requirements, and with reporting of donated food inventories on performance reports, as required in 7 CFR Part 250. We also propose to require processors to ensure that commingling of finished end products with other food products by distributors ensures the sale to recipient agencies of end products that meet substitution requirements. This incorporates the provision in current § 250.30(f)(1)(ii)(B) that finished poultry end products that have not been produced under AMS acceptance service grading may not be substituted for end products containing donated foods. However, we propose to remove the requirement in current § 250.30(i) that exterior shipping containers or product labels for end products containing nonsubstitutable donated foods (*i.e.*, beef, pork, and poultry) include such information to ensure their sale to eligible recipient agencies. Such assurance may be made through notification of the appropriate parties or by other means.

In current § 250.30(n)(1), a processor is limited in the amount of donated foods for which it is accountable at any one time. A processor may not have on hand more than a six-month supply of donated foods, based on an average amount utilized for that period. However, the distributing agency may allow the processor, through written approval, to maintain a larger amount of donated foods in inventory if it determines that the processor may efficiently store and process such an amount. The distributing agency may

not order donated foods for delivery to a processor if it would result in excessive inventories, unless it has granted such approval. We propose to include the current limitation on processors' inventories of donated foods, and the distributing agency's authority to approve a larger inventory, in the new § 250.35(d).

In current § 250.30(n)(3), a processor must pay the distributing agency for the value of donated foods held in excess of allowed inventory levels at the end of the year, as indicated on the June performance report. However, in practice, the distributing agency often allows a processor to carry over such donated foods into the next year of the agreement, in accordance with its authority to approve donated food inventories in excess of the six-month limitation. The distributing agency may also direct the processor, in accordance with current § 250.13, to transfer or redonate donated foods held in excess of allowed levels to another distributing or recipient agency, or processor, if the processor is unable to process such foods. In the new § 250.35(e), we propose to clarify that the distributing agency may permit the processor to carry over donated foods in excess of allowed levels into the next year of its agreement, if it determines that the processor may efficiently process such foods. We also propose to include the distributing agency's current option to direct the processor to transfer or redonate such donated foods to another distributing or recipient agency or processor. Lastly, we propose to clarify that, if these options are not practical, the distributing agency must require the processor to pay it for the donated foods held in excess of allowed levels, at the replacement value of the donated foods.

In current § 250.30(j), when an agreement terminates, and is not extended or renewed, the distributing agency must direct the processor to return donated foods remaining in inventory, or pay the distributing or recipient agency for the donated foods at the replacement value. For substitutable donated foods, the distributing agency may also permit the processor to return commercially purchased foods that meet substitution requirements in place of the donated foods, or transfer the donated foods to other agencies with which it has entered into agreements. In the new § 250.35(f), we propose to expand the current options for the disposition of substitutable donated foods at the termination of an agreement to all donated foods, in accordance with our proposal, in the new § 250.34, to permit substitution of all donated foods. We

propose to clarify that the disposition of donated foods may include a redonation, as well as a transfer; i.e., the distributing agency may permit a redonation of donated foods to another State distributing agency, with FNS approval, in accordance with current § 250.13(h). We also propose to permit the transfer or redonation of commercially purchased foods that meet the substitution requirements in the new § 250.34 in place of the donated foods. If the distributing agency requires the processor to pay for donated foods, we propose to require such payment at the processing agreement value or replacement value, whichever is higher, rather than the several options for assigning the donated food value currently included in the regulations. We propose to include the current requirement that the processor pay the cost of transporting any donated foods when the agreement is terminated at the processor's request, or as a result of the processor's failure to comply with the requirements of 7 CFR Part 250.

We propose to remove the stipulation in current § 250.30(j)(3) that funds received by distributing agencies from payments for donated foods upon termination of an agreement be used in accordance with FNS Instruction 410-1. The allowable use of funds accruing from program operations is described in current § 250.15(f).

7. End Product Sales and Crediting for the Value of Donated Foods, § 250.36

In current § 250.30(d)(1), a processor must sell end products to recipient agencies under a system that assures such agencies receive credit or "value pass-through" for the contract value of donated food contained in the end product. And, in current § 250.30(e), a processor must ensure that, when end products are provided to commercial distributors for sale and delivery to recipient agencies, such sales occur under a system that provides such agencies with a credit for the contract value of donated food contained in the end product. In the new § 250.36(a), we propose to require that the sales of end products, either directly by the processor or through a commercial distributor, be performed utilizing one of the methods of end product sales contained in this section, to ensure that the distributing or recipient agency, as appropriate, receives credit for the value of donated foods contained in end products. We also propose to require that all systems of sales utilized must provide clear documentation of crediting for the value of the donated foods contained in the end products.

In current § 250.30(d)(1)(i), a processor may utilize a refund or rebate system, in which the processor sells end products to the distributing or recipient agency, as appropriate, at the commercial, or gross, price, and provides the appropriate agency with a refund for the contract value of donated foods contained in the end products. In current § 250.30(e), a distributor may also sell end products received from the processor under a refund system, with the processor responsible for providing the refund to the appropriate agency. We propose to permit end product sales under this system, by either the processor or distributor, in the new § 250.36(b). We propose to require the processor to remit the refund to the distributing or recipient agency, as appropriate, within 30 days of receiving a request for a refund from the appropriate agency. We propose to clarify that the refund request must be in writing but may be made by e-mail or other electronic means. We propose to remove the requirement in current § 250.30(k) that the recipient agency submit a refund application to receive a refund for the value of donated foods in end products, as the term "refund application" implies the submittal of a written form, which is not necessary. Additionally, we propose to remove the 30-day, or quarterly, period by which the distributing or recipient agency must currently submit such a request. Once end product sales are made, we would expect requests for refunds to be made in an expeditious manner, in the interest of the program. However, it should be up to the appropriate agency to determine how frequently it wishes to receive its refunds. To that end, we also propose to remove the option, in current § 250.30(k)(3), for the processor to submit refunds that total \$25 or less on a quarterly basis. Lastly, we propose to remove the requirement in current § 250.30(k)(3) that the processor submit copies of refund payments to the distributing agency; however, the distributing agency may choose to require the submission of such documentation to support information included in the processor's performance reports.

In current § 250.30(d)(1)(ii), the processor may utilize a discount system, in which the processor sells end products at a net price that provides a discount from the commercial case price for the value of the donated foods contained in the end products. We propose to permit end product sales under this system in the new § 250.36(c). We propose to refer to this system as a direct discount system to

distinguish it from the method of end product sales described in the following paragraph.

In current § 250.30(e)(1)(ii), a distributor may sell end products to the distributing or recipient agency, as appropriate, at a net price that provides a discount from the commercial case price for the value of the donated foods contained in the end products. The processor then compensates the distributor for the value of the discount provided to the distributing or recipient agency. Since the distributor has purchased the end products from the processor at the commercial price, this system is referred to as the “hybrid” system—*i.e.*, it includes a sale of the end product at both the commercial and discounted price. We propose to permit end product sales under this system in the new § 250.36(d), and to refer to it as the indirect discount system. We propose to require the processor to ensure that the distributor notify it of such sales, on a monthly basis, through automated sales reports or other electronic or written submission. We propose to remove the requirement, in current § 250.30(k)(2), that the distributor apply to the processor for a refund under this system.

In current § 250.30(d)(2), and in accordance with the definition in current § 250.3, the processor may sell end products to the distributing or recipient agency at a “fee-for-service”. The fee-for-service includes all costs to produce the end product minus the value of the donated food put into production. The processor must identify any charge for delivery of end products separately from the fee-for-service on its invoice. We propose to permit this method of end product sales in the new § 250.36(e). In current § 250.30(e)(1)(iv), the processor may provide end products sold under a fee-for-service system to a distributor for delivery to the distributing or recipient agency. In such cases, the processor must identify the distributor’s delivery charge separately from the fee-for-service on its invoice, or may permit the distributor to bill the distributing or recipient agency separately for the delivery of end products. As a matter of policy, we have also permitted the processor to provide written approval to the distributor to bill the distributing or recipient agency for the total case price—*i.e.*, for the fee-for-service and the delivery charge. In such cases, the processor must ensure that the distributor identifies the fee-for-service and delivery charge separately on the invoice. The processor must require the distributor to notify it of such sales, on a monthly basis, through automated sales reports or other

submission, which may include e-mail or other electronic means. We propose to include these requirements in the new § 250.36(e).

In current § 250.30(d)(1)(iii), the processor may sell end products to the distributing or recipient agency under an alternate method of end product sales that is approved by FNS and the distributing agency. In current § 250.30(e)(1)(iii), the distributor may also sell end products under such an approved alternate method of sales. Such alternate methods of sale must ensure that the distributing or recipient agency, as appropriate, receives credit for the value of donated foods contained in the end products. We propose to include this option for both processor and distributor in the new § 250.36(f).

In the new § 250.36(g), we propose to clarify that the processing agreement value of the donated foods must be used in crediting for donated foods in end product sales, and to refer to the definition of processing agreement value included in § 250.3. In the new § 250.36(h), we propose to require that the distributing agency provide the processor with a list of recipient agencies eligible to purchase end products, along with the quantity of raw donated food that is to be delivered to the processor for processing on behalf of each recipient agency. This would ensure that only eligible recipient agencies receive end products, and in the amounts for which they are eligible. For end products sold through distributors, we propose to require that the processor provide the distributor with a list of eligible recipient agencies, and the quantities of end products that they are eligible to receive.

8. Reports, Records, and Reviews of Processor Performance, § 250.37

In the new § 250.37, we propose to include the reporting and recordkeeping requirements for the processing of donated foods, and the use of such reports and records to review processor performance. In current § 250.30(m), the processor must submit a monthly performance report to the distributing agency, including the following information for the reporting period, with year-to-date totals:

- (1) A list of all eligible recipient agencies;
- (2) The quantity of donated foods on hand at the beginning of the reporting period;
- (3) The quantity of donated foods received;
- (4) The quantity of donated foods transferred to the processor from another entity, or transferred by the processor to another entity;

(5) The quantity of end products delivered to each eligible recipient agency; and

(6) The quantity of donated foods remaining at the end of the reporting period.

In the new § 250.37(a), we propose to retain the requirement that the processor submit the performance report to the distributing agency on a monthly basis, to describe its processing of donated foods. We propose to retain all of the currently required information in the report with the exception of a list of eligible recipient agencies, as the distributing agency would already have this information. We propose to require that the processor also include grading certificates and other documentation, as requested by the distributing agency, to support the information included in the performance reports. Such documentation may include, for example, bills of lading, invoices, or copies of refund payments to verify sales and delivery of end products to recipient agencies. However, we propose to remove the requirement in current § 250.30(m)(1)(viii) that the processor submit sales verification findings obtained in accordance with current § 250.19(b)(2) along with the December and June performance reports. As discussed in section II.F of the preamble, we are proposing to remove the sales verification requirements in current § 250.19(b)(2). We propose to retain the current deadlines for the submission of performance reports in the new § 250.37(a). However, we propose to remove the requirement in current § 250.30(c)(4)(viii)(I) that the processor submit annual reconciliation reports. The June performance report serves to reconcile data that may have been submitted erroneously earlier in the year.

In the new § 250.37(b), we propose to prohibit the processor from reporting reductions in donated food inventories on performance reports until sales of end products have been made, or until sales of end products through distributors have been verified. We propose to require that, when a distributor sells end products under a refund system, such verification must be through receipt of the distributing or recipient agency’s request for a refund; and, when a distributor sells end products under indirect discount or fee-for-service, such verification must be through the distributor’s automated sales reports or other electronic or written submission.

In the new § 250.37(c), we propose to require that a multi-State processor submit a summary performance report

to FNS, on a monthly basis, containing information from the performance report that would allow FNS to track the processor's total and State-by-State donated food inventories, for the purpose of assessing the amount of the performance bond or letter of credit required of the processor under its National Processing Agreement. However, each distributing agency would still be responsible for monitoring the multi-State processor's inventory of donated foods received for processing in the respective State, in accordance with the new § 250.37(a).

As indicated in section II.C of the preamble, we propose to remove the specific recordkeeping requirements for processors included in current § 250.16(a)(4) (redesignated as paragraph (a)(3) by this rule). However, in the new § 250.37(d), we propose to require processors to maintain specific records to demonstrate compliance with processing requirements in 7 CFR Part 250, including, for example, assurance of receipt of donated food shipments, production, sale, and delivery of end products, and crediting for donated foods contained in end products.

In accordance with current § 250.16(a)(1)(i), accurate and complete records must be maintained with respect to end products processed from donated foods, but specific recordkeeping requirements for distributing agencies are not included. In the new § 250.37(e), we propose to require distributing agencies to maintain specific records to demonstrate compliance with processing requirements in 7 CFR Part 250, including, for example, end product data schedules, performance reports, copies of audits, and documentation of the correction of any deficiencies identified in such audits.

In the new § 250.37(f), we propose to require recipient agencies to maintain specific records to demonstrate compliance with processing requirements in 7 CFR Part 250, including, for example, the receipt of end products purchased from processors or distributors, crediting for donated foods included in end products, and procurement documents.

In accordance with current § 250.19(b)(4), the distributing agency must make a continuing evaluation of processors and recipient agencies, through the review of performance reports and other reports and records, to ensure compliance with the requirements of 7 CFR Part 250. And, in accordance with current § 250.30(m)(3), the distributing agency must review and analyze reports submitted by processors to ensure compliance with such

requirements. We propose to clarify the review requirements for the distributing agency in the new § 250.37(g), including the review of performance reports to ensure that the processor:

- (1) Receives donated food shipments, as applicable;
- (2) Delivers end products to eligible recipient agencies, in the types and quantities for which they are eligible;
- (3) Meets the required processing yields for donated foods under guaranteed minimum yield; and
- (4) Accurately reports donated food inventory activity and maintains inventories within approved levels.

We propose to remove current requirements for the distributing agency to submit the following reports to FNS:

- The final performance report for the year to the FNS Regional Office in accordance with current § 250.30(n)(4); and
- The inventory portion of the performance report to the FNS Regional Office on a quarterly basis, in accordance with current § 250.30(o).

We propose to remove the requirement in current § 250.30(m)(1)(ix) that the processor provide certification that sufficient donated foods are on hand to meet processing obligations under its agreements, and that sufficient foods are in inventory to meet commercial obligations. We expect that, since a processor's failure to meet processing obligations with respect to donated foods would result in either the distributing agency or FNS, as appropriate, calling in the performance bond or letter of credit, in accordance with the new § 250.32(b), a processor would be unlikely to maintain inventories insufficient to conduct its processing activities. We propose to remove the requirements in current § 250.30(m)(2) and (n)(2) relating to the submission of reports and the performance of reviews to ensure that substitution of concentrated skim milk for donated nonfat dry milk is in compliance with requirements. As described in section II.A of the preamble, we are proposing to remove this substitution option under the revised definition of substitution in § 250.3. Lastly, we propose to remove the provision in current § 250.30(n)(5) that prohibits distributing agencies from submitting food orders for processors that report no sales of end products during the prior year. While this would ordinarily be a good practice, it is the distributing agency's decision to determine if a processor may effectively receive and process donated foods in a future period.

9. Provisions of Agreements, § 250.38

In the new § 250.38, we propose to include the required provisions for each type of processing agreement included in the new § 250.30, to ensure compliance with the requirements in 7 CFR Part 250. In the new § 250.38(a), we propose to indicate that the National Processing Agreement includes provisions to ensure that a multi-State processor complies with all applicable requirements relating to the processing of donated foods. FNS has developed a prototype National Processing Agreement that includes all such required provisions.

In the new § 250.38(b), we propose to require that the State Participation Agreement with a multi-State processor contain specific provisions or attachments to assure compliance with requirements in 7 CFR Part 250 that are not included in the multi-State processor's National Processing Agreement. Such provisions include, for example, a list of recipient agencies eligible to receive end products, summary end product data schedules that contain a list of end products that may be sold in the State, and the allowed method(s) of end product sales implemented by the distributing agency.

In the new § 250.38(c), we propose to require that the State Processing Agreement contain specific provisions or attachments to assure compliance with requirements in 7 CFR Part 250. Most of these provisions are included in current § 250.30(c)(4) and include, for example, assurance that the processor will meet processing yields for donated foods and substitution requirements, report donated food inventory activity and maintain inventories within approved levels, credit recipient agencies for donated foods contained in end products, and obtain required audits.

In accordance with the new § 250.38(d), we propose to require that the Recipient Processing Agreement contain the same provisions as a State Processing Agreement, to the extent that the distributing agency permits the recipient agency to monitor compliance with the applicable processing requirements (e.g., approval of end product data schedules or review of performance reports). However, a list of recipient agencies eligible to receive end products need not be included.

In the new § 250.38(e), we propose to prohibit the distributing or recipient agency, as appropriate, from extending or renewing an agreement if the processor has not complied with processing requirements. We propose to indicate that the distributing or

recipient agency may immediately terminate the agreement in the event of such noncompliance.

10. Miscellaneous Provisions, § 250.39

In current § 250.30(t), FNS may waive any of the requirements in 7 CFR Part 250 for the purpose of conducting demonstration projects to determine if processing of donated foods may be performed more efficiently or effectively by other means. We propose to include this provision without change in the new § 250.39(a).

In the new § 250.39(b), we propose to clarify that guidance or information relating to the processing of donated foods is included on the FNS Web site at <http://www.fns.usda.gov/fdd>, or may otherwise be obtained from FNS. Such guidance and information includes program regulations and policies, the processing handbook, the FNS Audit Guide, and National Processing Agreement and summary end product data schedule prototypes.

We propose to remove the requirement in current § 250.30(s) that the distributing agency develop and provide a processing manual or similar materials to processors and other parties. The information described above should provide sufficient guidance for processors and other parties to permit compliance with requirements for the processing of donated foods. The distributing agency may provide additional information relating to State-specific processing procedures upon request.

III. Procedural Matters

A. Public Comment Procedures

Your written comments on this proposed rule should be specific, confined to issues pertinent to the proposed rule, and should explain your reasons for any change recommended. Where possible, you should reference the specific section or paragraph of the proposal you are addressing. Comments received after the close of the comment period (see **DATES**) will not be considered or included in the Administrative Record for the final rule.

The comments, including names, street addresses, and other contact information of commenters, will be available for public review at the Food and Nutrition Service, Room 500, 3101 Park Center Drive, Alexandria, Virginia, during regular business hours (8:30 a.m. to 5 p.m.), Mondays through Fridays, except Federal holidays.

Executive Order 12866 requires each agency to write regulations that are simple and easy to understand. We invite your comments on how to make

these regulations easier to understand, including answers to questions such as the following:

(1) Are the requirements in the rule clearly stated?

(2) Does the rule contain technical language or jargon that interferes with its clarity?

(3) Does the format of the rule (grouping and order of sections, use of headings, paragraphing, etc.) make it more or less clear?

(4) Would the rule be easier to understand if it were divided into more (but shorter) sections?

(5) Is the description of the rule in the preamble sections entitled "Background" and "Discussion of the Rule's Provisions" helpful in understanding the rule? How could this description be more helpful?

B. Executive Order 12866

This proposed rule has been determined to be not significant and was not reviewed by the Office of Management and Budget (OMB) under Executive Order 12866.

C. Regulatory Flexibility Act

This proposed rule has been reviewed with regard to the requirements of the Regulatory Flexibility Act (5 U.S.C. 601–612). Roberto Salazar, Administrator of the Food and Nutrition Service, has certified that this action will not have a significant impact on a substantial number of small entities. Although the rule would require specific procedures for processors and distributing and recipient agencies to follow in the processing of donated foods, USDA does not expect them to have a significant impact on such entities.

D. Public Law 104–4

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Public Law 104–4, establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and the private sector. Under Section 202 of the UMRA, FNS generally must prepare a written statement, including a cost-benefit analysis, for proposed and final rules with Federal mandates that may result in expenditures to State, local, or tribal governments, in the aggregate, or to the private sector, of \$100 million or more in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires FNS to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, more cost-effective or least burdensome alternative that achieves the objectives of the rule.

This rule contains no Federal mandates (under the regulatory provisions of Title II of the UMRA) for State, local, and tribal governments or the private sector of \$100 million or more in any one year. This rule is, therefore, not subject to the requirements of sections 202 and 205 of the UMRA.

E. Executive Order 12372

The donation of foods in USDA food distribution and child nutrition programs is included in the Catalog of Federal Domestic Assistance under 10.550. For the reasons set forth in the final rule in 7 CFR Part 3015, Subpart V and related Notice (48 FR 29115, June 24, 1983), the donation of foods in such programs is included in the scope of Executive Order 12372, which requires intergovernmental consultation with State and local officials.

F. Executive Order 13132

Executive Order 13132 requires Federal agencies to consider the impact of their regulatory actions on State and local governments. Where such actions have federalism implications, agencies are directed to provide a statement for inclusion in the preamble to the regulations describing the agency's considerations in terms of the three categories called for under section (6)(b)(2)(B) of Executive Order 13132.

1. Prior Consultation With State Officials

The programs affected by the regulatory proposals in this rule are all State-administered, Federally-funded programs. Hence, our national headquarters office has formal and informal discussions with State and local officials, as well as processors, on an ongoing basis regarding program issues relating to the processing of donated foods. FNS attends annual conferences of the American Commodity Distribution Association, a national group with State, local, and industry representation, and the School Nutrition Association, as well as other conferences.

2. Nature of Concerns and the Need To Issue This Rule

The rule addresses the concerns of program operators that use donated foods to provide the school lunches and other meals in NSLP and other programs, as well as the processors that process the donated foods into finished end products on their behalf. The rule would reduce the workload for all parties involved in the processing of donated foods, and would facilitate the more efficient processing and delivery of end products.

3. Extent To Which We Meet Those Concerns

FNS has considered the impact of the proposed rule on State and local agencies. The overall effect of this rule is to better ensure that such agencies receive the greatest benefit from donated foods through their processing into end products by commercial processors.

G. Executive Order 12988

This proposed rule has been reviewed under Executive Order 12988, Civil Justice Reform. This proposed rule, when finalized, would have preemptive effect with respect to any State or local laws, regulations, or policies which conflict with its provisions or which would otherwise impede its full implementation. This proposed rule would not have retroactive effect. Prior to any judicial challenge to the provisions of this rule or the application of its provisions, all applicable administrative procedures must be exhausted.

H. Civil Rights Impact Analysis

FNS has reviewed this rule in accordance with the Department Regulation 4300-4, "Civil Rights Impact Analysis", to identify and address any major civil rights impacts the rule might have on minorities, women, and persons with disabilities. After a careful review of the rule's intent and provisions, FNS has determined that this rule will not in any way limit or reduce the ability of participants to receive the benefits of donated foods on the basis of an individual's or group's race, color, national origin, sex, age, or disability. FNS found no factors that would negatively and disproportionately affect any group of individuals.

I. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 (44 U.S.C. chap. 35; see 5 CFR part 1320) requires that OMB approve all collections of information by a Federal agency from the public before they can be implemented. Respondents are not required to respond to any collection of information unless it displays a current valid OMB control number. This proposed rule contains information collections that are subject to review and approval by OMB; therefore, in accordance with the Paperwork Reduction Act of 1995, this notice invites the general public and other agencies to comment on the proposed information collections affected by the proposals in the rule. Written comments on this proposed information collection must be received on or before October 23, 2006.

Comments concerning the information collection aspects of this proposed rule should be sent to the Office of Information and Regulatory Affairs, OMB, Room 10235, New Executive Office Building, Washington, DC 20503, Attention: Desk Officer for the Food and Nutrition Service. A copy of these comments may also be sent to Lillie F. Ragan, at the address listed in the **ADDRESSES** section of this preamble. Commenters are asked to separate their comments on the information collection requirements from their comments on the remainder of the proposed rule.

OMB is required to make a decision concerning the collection of information contained in this proposed regulation between 30 to 60 days after the publication of this document in the **Federal Register**. Therefore, a comment to OMB is best assured of having full consideration if OMB receives it within 30 days of publication. This does not affect the deadline for the public to comment to the Department on the proposed regulation.

Comments are invited on: (a) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (b) the accuracy of the agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on those who are to respond, including use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology.

The title, description, and respondent description of the information collections affected by this rule are shown below, with an estimate of the annual reporting and recordkeeping burdens. These burden hours represent proposed changes to current reporting and recordkeeping requirements, and incorporate some additional proposed requirements.

Title: Food Distribution Regulations and Forms.

OMB Number: 0584-0293.

Expiration Date: March 31, 2009.

Type of Request: Revision of a currently approved collection.

Abstract: This proposed rule would affect only the reporting and recordkeeping requirements under 7 CFR Part 250 described in the following paragraphs and indicated in the tables.

1. Reporting Requirements

Section 250.18, Audits. The reporting burden relating to audit requirements would be reduced from 240 hours to 170 hours. Although distributing agencies would have to review audits required of in-State processors, in addition to those currently required of multi-State processors, the time required for each response would be reduced from the current 4 hours to 2 hours.

Section 250.30, Processing agreements. The reporting burden relating to the execution of processing agreements would be reduced from 324 hours to 245 hours. The reduction is the result of our proposal, in the new § 250.30(c), to permit distributing agencies to sign more abbreviated State Participation Agreements with multi-State processors (which must have National Processing Agreements), rather than the currently required State Processing Agreements. This would reduce the estimated time required for each response from 2 hours to 0.636 hours. Currently, in § 250.30(l), distributing agencies must provide copies of processing agreements to FNS. We are proposing to remove this requirement. Hence, the reporting burden for this activity would be reduced from 456 hours to 0 hours.

Section 250.36, End product sales. The reporting burden relating to the verification of end product sales would be reduced from 4,018.50 hours to 1,410 hours. This is a result of our proposal, in the new § 250.36(b), to permit distributing or recipient agencies, as appropriate, to submit requests for refunds to processors by e-mail or other electronic means, rather than by written submission, which would reduce the time required for each response from 0.57 hours to 0.20 hours.

Section 250.37, Performance reports. The burden relating to the review of performance reports submitted by processors would increase from 4,500 hours to 10,350 hours. This is the result of the increase in the number of processors with which distributing agencies have agreements to process donated foods into end products. In the new § 250.37, we propose to include as respondents the 50 distributing agencies that must review the performance reports submitted by processors. Each distributing agency has a processing agreement with, on average, 23 processors, each of which submits 9 performance reports annually. Hence, each distributing agency must review 207 performance reports annually, resulting in a total of 10,350 annual responses. As each response would take

1 hour, the reporting burden for this activity would be 10,350 hours.

In current § 250.30, the submission of forms FNS-519A and FNS-519B as processor's monthly performance reports and inventory reports is listed erroneously. Hence, we propose to remove the 1,560 burden hours currently listed under this submission. In current §§ 250.17(b) and 250.30(o), distributing agencies must complete and submit a processing inventory report to FNS on a quarterly basis. We are proposing to remove this requirement. Hence, the reporting burden for this activity would be reduced from 912 hours to 0 hours. In current § 250.30(s), distributing agencies are required to develop and provide a processing manual or similar material to processors and recipient agencies. We are also proposing to remove this requirement. Hence, the reporting burden for this activity would be reduced from 18.81 hours to 0 hours.

2. Recordkeeping Requirements

Section 250.18, Audits. The recordkeeping burden relating to audit

requirements would increase from 9.90 hours to 28.1 hours, as distributing agencies would have to maintain records of audit findings for in-State processors, in addition to the current requirement to maintain such records for multi-State processors.

Section 250.30, Processing agreements. The recordkeeping burden relating to the execution of processing agreements would increase from 13.28 hours to 31 hours, as a result of the increase in the number of processors that distributing agencies enter into agreements to process donated foods.

Section 250.37, Records of processing activities. The current recordkeeping burden for the receipt of processed end products, performance reports, and other records related to the processing of donated foods is included under current §§ 250.16 and 250.30, which also include the burden for the maintenance of other records relating to the distribution and management of donated foods. In accordance with the new § 250.37(e), we are proposing to clarify the specific records that the

distributing agency must maintain to ensure compliance with processing requirements, including records of end product data schedules, performance reports, grading certificates, the receipt of end products, etc. In the new § 250.37(f), we are clarifying the recordkeeping requirements for recipient agencies, which would include records of the receipt of end products and of crediting for donated foods included in end products. However, the overall recordkeeping burden would remain unchanged from the current 9,200 hours.

Respondents: State, local, or Tribal Government; Program participants; Business or other for-profit; Nonprofit institutions; Federal Government.

Total Annual Responses: Current: 1,642,762; Proposed: 1,659,358.

Estimated Total Annual Burden on Respondents: Current: 1,085,814; Proposed: 1,104,505.

The proposed changes in the reporting and recordkeeping requirements described above are included in the following tables.

REPORTING

Current/proposed	§§	Respondents	Responses per year	Total responses	Hours/response	Total hours
Current	250.18(c)	30	2	60	4	240
Proposed	250.18	50	1.7	85	2	170
Current	250.12(f) and 250.30(c)	166	1	166	2	324
Proposed	250.30	50	7.7	385	0.636	245
Current	250.30(l)	19	12	228	2	456
Proposed		0	0	0	0	0
Current	250.30(k)	2,350	3	7,050	0.57	4,018.50
Proposed	250.36	2,350	3	7,050	0.20	1,410
Current	250.17(c) and 250.30(m)	500	9	4,500	1	4,500
Proposed	250.37	50	207	10,350	1	10,350
Current	250.17(b) and 250.30(o)	57	4	228	4	912
Proposed		0	0	0	0	0
Current	250.30	57	1	57	0.33	18.81
Proposed		0	0	0	0	0
Current	250.30(m)	40	13	520	3	1,560
Proposed		0	0	0	0	0
Total:						
Current		3,219	3.97	12,809	0.940	12,037.31
Proposed		2,500	7.15	17,870	0.685	12,175

RECORDKEEPING

Current/proposed	§§	Respondents	Responses per year	Total responses	Hours/response	Total hours
Current	250.18(b)	30	1	30	0.33	9.90
Proposed	250.18	50	1.7	85	0.33	28.1
Current	250.12(f)	166	1	166	0.08	13.28
Proposed	250.30	50	7.7	385	0.08	30.8
Current	250.16 and 250.30	115,000	1	115,000	0.08	9,200
Proposed	250.37	115,000	1	115,000	0.08	9,200
Total:						
Current		115,196	1	115,196	0.08	9,223.18
Proposed		115,100	1	115,470	0.08	9,259

J. E-Government Act Compliance

FNS is committed to complying 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. In accordance with current practice, and as clarified in this rule, distributing and recipient agencies, and processors, may, in most cases, submit required information electronically, including through e-mail or other means. For example, the rule clarifies that recipient agencies may submit requests for refunds for the value of donated foods in processed end products by e-mail or other electronic submission.

List of Subjects in 7 CFR Part 250

Administrative practice and procedure, Food assistance programs, Grant programs, Social programs, Indians, Reporting and recordkeeping requirements, Surplus agricultural commodities.

Accordingly, 7 CFR Part 250 is proposed to be amended as follows:

PART 250—DONATION OF FOODS FOR USE IN THE UNITED STATES, ITS TERRITORIES AND POSSESSIONS AND AREAS UNDER ITS JURISDICTION

1. The authority citation for Part 250 continues to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 612c, 612c note, 1431, 1431b, 1431e, 1431 note, 1446a-1, 1859, 2014, 2025; 15 U.S.C. 713c; 22 U.S.C. 1922; 42 U.S.C. 1751, 1755, 1758, 1760, 1761, 1762a, 1766, 3030a, 5179, 5180.

2. In § 250.3:

a. Remove definitions of Contract value of the donated foods, Contracting agency, Discount system, Fee-for-service, Refund, Refund application, Refund system, and Substituted food.

b. Revise definitions of Distributor, Multi-State processor and Substitution.

c. Add definitions, in the appropriate alphabetical order, of Backhauling, Commingling, End product data schedule, In-State processor, National Processing Agreement, Processing agreement value, Recipient Processing Agreement, Replacement value, 7 CFR 3052, Split shipment, State Participation Agreement, and State Processing Agreement.

The revisions and additions read as follows:

§ 250.3 Definitions.

Backhauling means the delivery of donated foods to a processor for

processing from a recipient agency's storage facility.

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Commingling means the storage of donated foods together with commercially purchased foods.

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Distributor means a commercial enterprise that sells and/or delivers finished end products, or stores and distributes donated foods, to distributing or recipient agencies.

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End product data schedule means a processor's description of the processing of donated food into a finished end product, including the processing yield of donated food.

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In-State processor means a processor that has entered into agreements with distributing or recipient agencies that are located only in the State in which the processor's facilities or office is located.

Multi-State processor means a processor that has entered into agreements with distributing or recipient agencies in more than one State, or that has entered into agreements with distributing or recipient agencies that are located in a State other than the State in which the processor's processing facility is located.

National Processing Agreement means an agreement between FNS and a multi-State processor to process donated foods into end products for sale to distributing or recipient agencies.

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Processing agreement value means the specific commodity file value for donated food assigned by the Department that reflects the Department's cost of purchase, delivery, and processing of the donated food, as applicable.

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Recipient Processing Agreement means a recipient agency's agreement with a processor to process donated foods and purchase the finished end products.

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Replacement value means the specific commodity file value assigned by the Department to ensure compensation for donated foods lost in processing or other activities.

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7 CFR Part 3052 means the Department's regulations establishing audit requirements for State and local governments and nonprofit

organizations that receive Federal grants.

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Split shipment means a shipment of donated foods with more than one stop-off or delivery location, or a shipment to one delivery location that is split between two different distributing agencies.

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State Participation Agreement means a distributing agency's agreement with a multi-State processor to permit the sale of finished end products produced under the processor's National Processing Agreement to eligible recipient agencies in the State, or to directly purchase such finished end products.

State Processing Agreement means a distributing agency's agreement with a processor to process donated foods into finished end products for sale to eligible recipient agencies, or to the distributing agency.

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Substitution means the use of commercially purchased foods in place of donated foods in accordance with the requirements of this part.

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3. In § 250.13, revise paragraph (c) to read as follows:

§ 250.13 Distribution and control of donated foods.

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(c) Transfer of title. Title to donated foods transfers to the distributing agency or recipient agency, as appropriate, upon acceptance of the donated foods at the time and place of delivery, with the following exception. Title to donated foods provided to a multi-State processor, in accordance with its National Processing Agreement, transfers to the distributing agency or recipient agency, as appropriate, upon acceptance of the finished end products at the time and place of delivery. Notwithstanding transfer of title, the distributing agency must ensure that donated foods and end products are used in accordance with the requirements of this part.

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4. In § 250.16:

a. Remove paragraph (a)(3).

b. Redesignate paragraphs (a)(4), (a)(5), and (a)(6) as paragraphs (a)(3), (a)(4), and (a)(5), respectively.

c. Revise newly redesignated paragraph (a)(3) to read as follows:

§ 250.16 Maintenance of records.

(a) * * *

(3) Processors and food service management companies must comply

with the applicable recordkeeping requirements in this part, and with any other recordkeeping requirements included in their agreements or contracts. Storage facilities and distributors must maintain records documenting the receipt, distribution, inventory, and disposal of donated foods sufficient to ensure compliance with requirements in this part, and with any other such requirements in their agreements or contracts with distributing or recipient agencies.

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5. In § 250.17:

- a. Remove paragraphs (b) and (f).
- b. Redesignate paragraphs (c), (d), and (e), as paragraphs (b), (c), and (d), respectively.
- c. Revise newly redesignated paragraph (b) to read as follows:

§ 250.17 Reports.

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(b) *Processor performance.* Processors must submit performance reports and other supporting documentation, as required by the distributing agency or by FNS, in accordance with § 250.37, to ensure compliance with requirements in this part.

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6. Revise § 250.18 to read as follows:

§ 250.18 Audits.

(a) *Requirements for distributing and recipient agencies.* In accordance with Departmental regulations in 7 CFR Part 3052 and OMB Circular A-133, a State or local government or nonprofit organization that expends at least \$500,000 in Federal grants or awards (*i.e.*, funds and/or donated foods) in a school or fiscal year must obtain a single audit for that year. A program-specific audit may be substituted for a single audit if the auditee operates only one Federal program (or one recognized cluster of programs). A State or local government or nonprofit organization that expends less than \$500,000 in Federal grants or awards in a school year or fiscal year is not required to have an audit for that year. The value of donated foods used in determining if an audit is required must be the value assigned by the distributing agency, in accordance with § 250.13(a)(5). Recipient agencies utilizing a single inventory management system must consider the value of all donated foods received for the year, rather than the value of donated foods actually used. (For availability of the OMB circular mentioned in this paragraph, please refer to 5 CFR 1310.3).

(b) *Requirements for processors.* In-State processors must obtain an independent certified public accountant

(CPA) audit in the first year that they receive donated foods for processing, while multi-State processors must obtain such an audit in each of the first three years that they receive donated foods for processing. After this initial requirement period, an in-State processor must obtain an independent CPA audit every three years, while a multi-State processor must obtain such an audit at a frequency determined by the average value of donated foods it receives for processing per year, as indicated in this paragraph (b). The value of donated foods used in determining if an audit is required must be the value assigned by the distributing agency, in accordance with § 250.13(a)(5). The audit must determine that the processor's performance is in compliance with the requirements in this part, and must be conducted in accordance with procedures in the FNS Audit Guide for Processors. All processors must pay for audits required in this paragraph (b). A multi-State processor must obtain an audit:

(1) Annually, if it receives, on average, more than \$5,000,000 in donated foods for processing per year;

(2) Every two years, if it receives, on average, between \$1,000,000 and \$5,000,000 in donated foods for processing per year; or

(3) Every three years, if it receives, on average, less than \$1,000,000 in donated foods for processing per year.

(c) *Required actions resulting from audit.* The distributing or recipient agency, as appropriate, must submit reports and corrective action plans, and undertake corrective actions in response to the audit, in accordance with the requirements in 7 CFR Part 3052. A multi-State processor must ensure that a copy of the audit is provided to FNS, and an in-State processor must ensure that a copy of the audit is provided to the distributing agency, by December 31st of each year in which an audit is required. Along with the audit, the processor must provide verification to FNS or the distributing agency, as appropriate, that all deficiencies identified in the audit have been corrected, or must provide a corrective action plan with timelines for correcting all deficiencies identified in the audit.

(d) *Failure to meet audit requirements.* A distributing or recipient agency is subject to sanctions for failure to obtain the required audit, or for failure to correct deficiencies identified in the audit, including the withholding, suspension, or termination of a Federal award. FNS may terminate a processor's National Processing Agreement, or prohibit the further distribution of donated foods to a processor, for its

failure to obtain the required audit, or its failure to correct deficiencies identified in the audit. A distributing or recipient agency may terminate an agreement with a processor, and must not extend or renew such an agreement, for the same reasons, in accordance with § 250.38(e).

(e) *Departmental audits or inspections.* The Department, the Comptroller General of the United States, or any of their authorized representatives, may conduct audits or inspections of distributing, subdistributing, or recipient agencies, or the commercial enterprises with which they have contracts or agreements, to assure compliance with the requirements of this part.

§ 250.19 [Amended]

7. In § 250.19:

a. Remove paragraph (b)(1)(iii), and redesignate paragraphs (b)(1)(iv) and (b)(1)(v) as paragraphs (b)(1)(iii) and (b)(1)(iv), respectively.

b. Remove paragraph (b)(2), and redesignate paragraphs (b)(3), (b)(4), (b)(5), and (b)(6) as paragraphs (b)(2), (b)(3), (b)(4), and (b)(5), respectively.

c. Remove the undesignated text appearing after newly redesignated paragraph (b)(2)(iv).

8. In § 250.24, revise paragraph (g) to read as follows:

§ 250.24 Distributing agency performance standards.

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(g) *Processing.* The distributing agency must provide for the processing of donated foods in accordance with Subpart C of this part, and must ensure that recipient agencies are aware of the processing options available to them. In accordance with § 250.30(g), the distributing agency must provide for testing of end products to ensure their acceptability by recipient agencies before entering into processing agreements. The distributing agency must develop a system to monitor product acceptability on a periodic basis.

9. Revise Subpart C to read as follows:

Subpart C—Processing of Donated Foods

Sec.	
250.30	Types of processing agreements.
250.31	Procurement requirements.
250.32	Protection of donated food value.
250.33	Processing yields of donated foods.
250.34	Substitution of donated foods.
250.35	Storage, inspection, quality control, and inventory management.
250.36	End product sales and crediting for the value of donated foods.
250.37	Reports, records, and reviews of processor performance.
250.38	Provisions of agreements.
250.39	Miscellaneous provisions.

Subpart C—Processing of Donated Foods

§ 250.30 Types of processing agreements.

(a) *Purpose of processing donated foods.* Donated foods are most commonly provided to processors to process into approved end products that are more suitable for use in school lunch programs or other food services provided by recipient agencies. For example, a whole chicken or chicken parts may be processed into chicken nuggets for use in the National School Lunch Program. However, in some cases donated foods are provided to processors to prepare meals, or for repackaging. A processor's use of a commercial facility to repackage donated foods, or to use donated foods in the preparation of meals, is considered processing in this part.

(b) *Agreement requirement.* The processing of donated foods must be performed in accordance with an agreement between the processor and FNS, between the processor and the distributing agency, or, if allowed by the distributing agency, between the processor and a recipient agency or subdistributing agency. However, a processing agreement will not obligate the distributing, subdistributing, or recipient agency, or the Department, to provide donated foods to a processor for processing. For donated foods received in child nutrition programs, the distributing agency must provide the State administering agency (if a different agency) with an opportunity to review its processing agreements to ensure compliance with nutritional and labeling requirements. The different types of processing agreements are described in this section.

(c) *National Processing Agreement.* A multi-State processor must enter into a National Processing Agreement with FNS in order to process donated foods into end products in accordance with end product data schedules approved by FNS. FNS also holds and manages the processor's performance bond or letter of credit under the National Processing Agreement, in accordance with § 250.32. FNS does not itself procure or purchase end products under a National Processing Agreement. A multi-State processor must also enter into a State Participation Agreement with the distributing agency in order to sell nationally approved end products in the State, in accordance with paragraph (d) of this section.

(d) *State Participation Agreement.* The distributing agency must enter into a State Participation Agreement with a multi-State processor to permit the sale of finished end products produced

under the processor's National Processing Agreement to eligible recipient agencies in the State, or to directly purchase such finished end products. The distributing agency may include other State-specific processing requirements in its State Participation Agreement, such as the methods of end product sales permitted, in accordance with § 250.36, or the use of labels attesting to fulfillment of meal pattern requirements in child nutrition programs.

(e) *State Processing Agreement.* A distributing agency must enter into a State Processing Agreement with an in-State processor to process donated foods into finished end products. The distributing agency may also choose to provide donated foods for processing to a multi-State processor under such an agreement, rather than utilize the National Processing Agreement. Under a State Processing Agreement, the distributing agency approves end product data schedules submitted by the processor, holds and manages the processor's performance bond or letter of credit, in accordance with § 250.32, and assures compliance with other processing requirements. The distributing agency may purchase the finished end products for distribution to eligible recipient agencies in the State under a State Processing Agreement, or may choose to select a number of processors with which it enters into such agreements, and permit recipient agencies to purchase finished end products from them, in accordance with applicable procurement requirements. The latter type of State Processing Agreement is called a master agreement. In selecting processors with which it enters into master agreements, the distributing agency must develop selection criteria, which must include the following:

- (1) The nutritional contribution provided by end products;
- (2) The marketability or acceptability of end products;
- (3) The means by which end products will be distributed;
- (4) Prices of end products and processing yields of donated foods;
- (5) Any applicable labeling requirements; and
- (6) The processor's record of ethics and integrity, and capacity to meet regulatory requirements.

(f) *Recipient Processing Agreement.* The distributing agency may permit a recipient agency to enter into an agreement with a processor to process donated foods and to purchase the finished end products in accordance with a Recipient Processing Agreement. A recipient agency may also enter into

a Recipient Processing Agreement on behalf of other recipient agencies, in accordance with an agreement between the parties. The distributing agency may also permit a recipient agency to approve end product data schedules or select nationally approved end product data schedules, review processor performance reports, and monitor other processing activities under a Recipient Processing Agreement. All such activities must be performed in accordance with the requirements of this part. All Recipient Processing Agreements must be reviewed and approved by the distributing agency.

(g) *Ensuring acceptability of end products.* The distributing agency must provide for testing of end products to ensure their acceptability by recipient agencies prior to entering into State Processing Agreements or State Participation Agreements. End products that have previously been tested, or that are otherwise determined to be acceptable, need not be tested. The distributing agency, or its recipient agencies, must monitor product acceptability on an ongoing basis.

(h) *Prohibition against subcontracting.* A processor may not assign any processing activities under its processing agreement, or subcontract with another entity to perform any aspect of processing, without the specific written consent of the other party to the agreement (i.e., distributing, subdistributing, or recipient agency, or FNS, as appropriate). The distributing agency may, for example, provide the required consent as part of its State Participation Agreement with the processor.

(i) *Duration of agreements.* An agreement between a distributing, subdistributing, or recipient agency and a processor may be up to five years in duration. National Processing Agreements are permanent. Amendments to any agreements may be made as needed, with the concurrence of the parties to the agreement. Such amendments will be effective for the duration of the agreement, unless otherwise indicated.

§ 250.31 Procurement requirements.

(a) *Applicability of Federal procurement requirements.* Federal procurement requirements in 7 CFR Parts 3016 and 3019 pertain to the purchase of finished end products from processors or other processing services relating to donated foods. In conducting such procurements, distributing or recipient agencies may use procedures that conform to applicable State or local laws, as appropriate, but must ensure

compliance with Federal regulations in 7 CFR Parts 3016 or 3019, as applicable.

(b) *Methods of procurement.* In accordance with 7 CFR 3016.36 and 3019.44, the distributing or recipient agency may use small purchase procedures in purchasing finished end products or other processing services from processors if the cost of the purchase does not exceed the simplified acquisition threshold fixed at 41 U.S.C. 403(11) (currently set at \$100,000). If the cost of such purchase exceeds that amount, the distributing or recipient agency must use sealed bids or competitive proposals in conducting the procurement. These methods of procurement are more fully explained in 7 CFR 3016.36 and 3019.44. Federal requirements do not absolve the distributing or recipient agency from its obligation to comply with State or local procurement laws or procedures that are more stringent than the Federal requirements.

(c) *Required information in procurement documents.* The procurement documents must include the following information:

- (1) The price to be charged for the finished end product or other processing service;
- (2) The method of end product sales that will be utilized;
- (3) The contract value of the donated food in the finished end products; and
- (4) The location for the delivery of the finished end products.

§ 250.32 Protection of donated food value.

(a) *Performance bond or irrevocable letter of credit.* The processor must obtain a performance bond or an irrevocable letter of credit to protect the value of donated foods that it is to receive for processing, prior to the delivery of the donated foods. The processor must provide the performance bond or letter of credit to the distributing agency, in accordance with its State Processing Agreement. The amount of the performance bond or letter of credit must be sufficient to cover the maximum value of donated foods, both raw and processed, that the processor is expected to maintain in inventory at any given time, as determined by the distributing agency. A multi-State processor must provide the performance bond or letter of credit to FNS, in accordance with its National Processing Agreement. The amount of the performance bond or letter of credit must be sufficient to cover the maximum value of donated foods that the processor is expected to maintain in its national inventory at any given time, as determined by FNS. The surety company from which a bond or letter of

credit is obtained must be listed in the most current Department of Treasury Circular 570.

(b) *Calling in the performance bond or letter of credit.* The distributing agency must call in the performance bond or letter of credit whenever a processor's lack of compliance with Federal requirements, or with the terms of the State Processing Agreement, results in a loss of donated foods to the distributing or recipient agency, and the processor fails to make restitution or respond to a claim action initiated to recover the loss. FNS will call in the performance bond or letter of credit in the same circumstances, in accordance with National Processing Agreements, and will ensure that any monies recovered are reimbursed to distributing agencies for losses of entitlement foods.

§ 250.33 Processing yields of donated foods.

(a) *End product data schedules.* The processor must submit an end product data schedule for approval before it may process donated foods into end products. For State Processing Agreements, the end product data schedule must be approved by the distributing agency and, for donated foods processed under guaranteed return or standard yield, must also be approved by the Department. For National Processing Agreements, the end product data schedule must be approved by the Department. On the end product data schedule, the processor must describe its processing of donated food into an end product, including the information indicated in this paragraph (a). An end product data schedule must be submitted, and approved, for each new end product that a processor wishes to provide, or for a previously approved end product in which the ingredients (or other pertinent information) have been altered. In submitting the end product data schedule, the processor may use its own format, as long as all of the required information is included. The end product data schedule must include the following information:

- (1) A description of the end product;
- (2) The types and quantities of donated foods included;
- (3) The types and quantities of other ingredients included;
- (4) The quantity of end product produced; and
- (5) The processing yield of donated food, which may be expressed as the quantity (lbs. or cases) of donated food needed to produce a specific quantity of end product, or as the percentage of donated food returned in the finished end product.

(b) *100 per cent yield.* Processing of all donated foods except beef, pork, and poultry must be performed under 100 percent yield. Under 100 percent yield, the processor must ensure that 100 percent of the raw donated food is returned in the finished end product. The processor must replace any processing loss of donated food with commercially purchased food of the same generic identity, of U.S. origin, and of equal or better quality than the donated food. The processor must demonstrate such replacement by reporting reductions in donated food inventories on performance reports by the amount of donated food contained in the finished end product, rather than the amount that went into production. The Department may approve an exception if a processor experiences a significant manufacturing loss.

(c) *Guaranteed yield or return.* Under guaranteed yield or return, the processor must ensure that a specific quantity of end product will be produced from a specific quantity of donated food, as determined by the parties to the processing agreement, and, for State Processing Agreements, approved by the Department. The guaranteed yield must be indicated on the end product data schedule.

(d) *Guaranteed minimum yield or return.* Under guaranteed minimum yield or return, the processor must ensure that a specific minimum quantity of end product will be produced from a specific quantity of donated food in a production run, as indicated on the end product data schedule. If a larger quantity of end product than the guaranteed minimum is produced, the processor must provide the full quantity to the distributing or recipient agency, as appropriate, and that agency must pay the processor for the additional end products produced.

(e) *Standard yield.* Under standard yield, the processor must ensure that a specific quantity of end product, as determined by the Department, will be produced from a specific quantity of donated food. The established standard yield is higher than the average yield under normal commercial production, and serves to reward those processors that can process donated foods most efficiently. The standard yield must be indicated on the end product data schedule.

(f) *Compensation for loss of donated foods.* The processor must compensate the distributing or recipient agency, as appropriate, for the loss of donated foods, or for the loss of commercially purchased foods substituted for donated foods. Such loss may occur, for example, if the processor fails to meet

the required processing yield of donated food, if donated foods are spoiled, damaged, or otherwise adulterated at a processing facility, or if end products are improperly distributed. To compensate for such loss, the processor must:

(1) Replace the lost donated food or commercial substitute with commercially purchased food of the same generic identity, of U.S. origin, and of equal or better quality than the donated food; or

(2) Pay the distributing or recipient agency, as appropriate, for the replacement value of the donated food or commercial substitute.

(g) *Compensation for end products that are wholesome but not suitable for use.* The processor must compensate the distributing or recipient agency, as appropriate, for donated foods, or for commercially purchased foods substituted for donated foods, contained in any end products that are wholesome but not suitable for use in the recipient agency's food service. To make such compensation, the processor must return the end products to production for processing into end products that meet the required specifications (which are commonly called rework products). However, except under guaranteed return or standard yield, the processor may also make such compensation by paying the distributing or recipient agency, as appropriate, for the replacement value of the donated foods or commercial substitutes contained in the end products and retain such end products for its own use.

(h) *Credit for sale of by-products.* The processor must credit the distributing or recipient agency, as appropriate, for the sale of any by-products produced in the processing of donated foods, except under guaranteed return or standard yield. The processor must credit for the net value of such sale, or the market value of the by-products, after subtraction of any documented expenses incurred in preparing the by-product for sale. Crediting must be achieved through invoice reduction or by another means of crediting.

(i) *Labeling requirements.* The processor must ensure that all end product labels meet Federal labeling requirements. If a processor claims that an end product contributes to fulfillment of meal pattern requirements in child nutrition programs, it must follow the procedures required for approval of labels for such end products.

§ 250.34 Substitution of donated foods.

(a) *Substitution of commercially purchased foods for donated foods.*

Unless its agreement specifically stipulates that the donated foods must be used in processing, the processor may substitute commercially purchased foods for donated foods that are delivered to it from a USDA vendor. The commercially purchased food must be of the same generic identity, of U.S. origin, and of equal or better quality than the donated food. At the option of the processor, substitution may be made before the actual receipt of the donated food shipment. However, the Department may not be held liable if, due to changing market conditions or other reasons, the purchase of donated foods and their delivery to the processor is not feasible. Commercially purchased food substituted for donated food must meet the same processing yield requirements in § 250.33 that would be required for the donated food.

(b) *Prohibition against substitution and other requirements for backhauled donated foods.* The processor may not substitute or commingle donated foods that are backhauled to it from a recipient agency's storage facility. The processor must process backhauled donated foods into end products for sale and delivery to the recipient agency that provided them, and not to any other recipient agency. The processor may not provide payment for backhauled donated foods in lieu of processing.

(c) *Grading requirements.* To assure that substitution requirements are met, the processing of donated beef, pork, and poultry must occur under Federal acceptance service grading, which is conducted by the Agricultural Marketing Service (AMS). Under Federal acceptance service grading, the grader verifies the quality and quantity of food that is put into production, and the quantity of end products produced. Federal acceptance service grading is not required for substitution of other donated foods, unless specifically requested by the Department or by the distributing agency. If the distributing agency determines that acceptance service grading is to be performed, it must consult with the applicable Federal agency in establishing specific grading requirements. The processor is responsible for paying the cost of acceptance service grading, whether required by regulations, or requested by the Department or the distributing agency. The processor must maintain grading certificates and other records necessary to document that substitution of all donated foods has been conducted in accordance with the requirements of this subpart.

(d) *Waiver of grading requirements.* The distributing agency may waive the grading requirement for donated beef,

pork, or poultry in accordance with one of the conditions listed in this paragraph (d). However, grading may only be waived on a case by case basis (i.e., for a particular production run); the distributing agency may not approve a blanket waiver of the requirement. Additionally, a waiver may only be granted if a processor's past performance indicates that the quality of the end product will not be adversely affected. The conditions for granting a waiver include:

(1) The processor has insufficient time to secure the services of a grader;

(2) The cost of the grader's service in relation to the value of donated beef, pork, or poultry being processed would be excessive; or

(3) The distributing or recipient agency's urgent need for the product leaves insufficient time to secure the services of a grader.

(e) *Use of substituted donated foods.* The processor may use donated foods that have been substituted with commercially purchased foods in other processing activities conducted at its facilities. The processor may also sell substituted donated foods as an intact unit, but must remove all USDA labels (as applicable) before such sale.

§ 250.35 Storage, inspection, quality control, and inventory management.

(a) *Storage and quality control.* The processor must ensure the safe and effective storage of donated foods, including compliance with the general storage requirements in § 250.14(b), and must maintain an effective quality control system at its processing facilities. The processor must maintain documentation to verify the effectiveness of its quality control system, and must provide such documentation upon request.

(b) *Inspection requirements.* The processor must ensure that all processing of donated beef, pork, and poultry, and of commercial meat products that contain any donated foods, is performed in plants under continuous Federal meat or poultry inspection. However, in States certified as having programs at least equal to Federal standards, processing of such foods may be performed in plants under continuous State meat or poultry inspection for processed end products that are utilized in the State, rather than the Federal inspection. Such inspections assure that plants maintain wholesomeness and sanitation requirements, and that labeling requirements are met.

(c) *Commingling of donated foods and commercially purchased foods.* The processor may commingle donated

foods and commercially purchased foods, unless the processing agreement specifically requires separation of donated foods from commercially purchased foods, or the donated foods have been backhauled from a recipient agency. However, such commingling must be performed in a manner that ensures the safe and efficient use of donated foods, as well as compliance with substitution requirements in § 250.34, and with reporting of donated food inventories on performance reports, as required in § 250.37. The processor must also ensure that commingling of processed end products and other food products by the distributor ensures the sale and delivery of end products that meet substitution requirements.

(d) *Limitations on donated food inventories.* The processor may not maintain donated food inventories in excess of a six-month supply, based on an average amount of donated foods utilized for that period. However, the distributing agency may provide written approval to the processor to maintain a larger amount of donated foods in inventory if it determines that the processor may efficiently store and process such an amount. Unless such approval has been granted, the distributing agency may not order donated foods for delivery to a processor if it would result in excessive donated food inventories.

(e) *Excess donated food inventories.* The distributing agency may permit the processor to carry over donated food inventories in excess of allowed levels into the next year of its agreement, if it determines that the processor may efficiently process such foods. The distributing agency may also direct the processor to transfer or donate such donated foods to other distributing or recipient agencies or processors, in accordance with § 250.13. Redonation of donated foods may not be performed without FNS approval, in accordance with § 250.13(h). However, if these actions are not practical, the distributing agency must require the processor to pay it for the donated foods held in excess of allowed levels, at the replacement value of the donated foods.

(f) *Disposition of donated food inventories upon agreement termination.* When an agreement terminates, and is not extended or renewed, the processor must take one of the actions indicated in this paragraph (f) with respect to remaining donated food inventories, as directed by the distributing agency. The processor must pay the cost of transporting any donated foods when the agreement is terminated at the processor's request, or as a result

of the processor's failure to comply with the requirements of this part. The processor must:

(1) Return the donated foods, or commercially purchased foods that meet the substitution requirements in § 250.34, to the distributing or recipient agency, as appropriate;

(2) Transfer or donate the donated foods, or commercially purchased foods that meet the substitution requirements in § 250.34, to another distributing or recipient agency with which it has a processing agreement; or

(3) Pay the distributing or recipient agency, as appropriate, for the donated foods, at the processing agreement value or replacement value of the donated foods, whichever is higher.

§ 250.36 End product sales and crediting for the value of donated foods.

(a) *Methods of end product sales.* To ensure that the distributing or recipient agency, as appropriate, receives credit for the value of donated foods contained in end products, the sale of end products must be performed using one of the systems of end product sales described in this section. All systems of sales utilized must provide clear documentation of crediting for the value of the donated foods contained in the end products.

(b) *Refund or rebate.* Under this system, the processor sells end products to the distributing or recipient agency, as appropriate, at the commercial, or gross, price, and must provide a refund or rebate for the value of the donated food contained in the end products. The processor may also deliver end products to a commercial distributor for sale to distributing or recipient agencies under this system. In both cases, the processor must provide a refund to the appropriate agency within 30 days of receiving a request for a refund from that agency. The refund request must be in writing but may be by e-mail or other electronic submission.

(c) *Direct discount.* Under this system, the processor must sell end products to the distributing or recipient agency, as appropriate, at a net price that provides a discount from the commercial case price for the value of donated food contained in the end products.

(d) *Indirect discount.* Under this system, the processor delivers end products to a commercial distributor, which must sell the end products to an eligible distributing or recipient agency, as appropriate, at a net price that provides a discount from the commercial case price for the value of donated food contained in the end products. The processor must require the distributor to notify it of such sales,

on a monthly basis, through automated sales reports or other electronic or written submission. The processor then compensates the distributor for the value of the discount provided to the distributing or recipient agency.

(e) *Fee-for-service.* Under this system, the processor must sell end products to the distributing or recipient agency, as appropriate, at a fee-for-service, which includes all costs to produce the end products minus the value of the donated food used in production. The processor must identify any charge for delivery of end products separately from the fee-for-service on its invoice. If the processor provides end products sold under fee-for-service to a distributor for delivery to the distributing or recipient agency, the processor must identify the distributor's delivery charge separately from the fee-for-service on its invoice, or may permit the distributor to bill the appropriate agency separately for the delivery of end products. The processor may also provide written approval to the distributor to bill the distributing or recipient agency for the total case price (*i.e.*, including the fee-for-service and the delivery charge), but must ensure that the distributor identifies the fee-for-service and delivery charge separately on the invoice. The processor must require the distributor to notify it of such sales in writing, on a monthly basis, through automated sales reports, e-mail, or other electronic submission.

(f) *Approved alternate method.* The processor or distributor may sell end products under an alternate method approved by FNS and the distributing agency that ensures crediting for the value of donated foods.

(g) *Donated food value used in crediting.* In crediting for donated foods in end product sales, the processing agreement value of the donated foods, as defined in § 250.3, must be used.

(h) *Ensuring sale and delivery of end products to eligible recipient agencies.* In order to ensure the sale of end products to eligible recipient agencies, the distributing agency must provide the processor with a list of recipient agencies eligible to purchase end products, along with the quantity of raw donated food that is to be delivered to the processor for processing on behalf of each recipient agency. In order to ensure that the distributor sells end products only to eligible recipient agencies, the processor must provide the distributor with a list of eligible recipient agencies and the quantities of end products that they are eligible to receive.

§ 250.37 Reports, records, and reviews of processor performance.

(a) *Performance reports.* The processor must submit a performance report to the distributing agency on a monthly basis to describe its processing of donated foods. The report must include the information listed in this paragraph (a). Performance reports must be submitted not later than 30 days after the end of the reporting period; however, the final performance report must be submitted within 60 days of the end of the reporting period. The performance report must include the following information for the reporting period, with year-to-date totals:

- (1) The quantity of donated foods in inventory at the beginning of the reporting period;
- (2) The quantity of donated foods received;
- (3) The quantity of donated foods transferred to the processor from another entity, or transferred by the processor to another entity;
- (4) The quantity of end products delivered to each eligible recipient agency;
- (5) The quantity of donated foods remaining at the end of the reporting period;
- (6) Grading certificates, as applicable; and
- (7) Other supporting documentation, as required by the distributing agency.

(b) *Reporting reductions in donated food inventories.* The processor may not report reductions in donated food inventories on performance reports until sales of end products have been made, or until sales of end products through distributors have been verified. When a distributor sells end products under a refund system, verification consists of the distributing or recipient agency's request for a refund. When a distributor sells end products under indirect discount or fee-for-service, verification consists of the receipt of the distributor's automated sales reports or other electronic or written reports submitted to the processor.

(c) *Summary performance report.* Along with the submission of performance reports to the distributing agency, a multi-State processor must submit a summary performance report to FNS, on a monthly basis, in accordance with its National Processing Agreement. The summary report must include an accounting of the processor's national inventory of donated foods, including the information listed in this paragraph (c). The report must be submitted not later than 30 days after the end of the reporting period; however, the final performance report must be submitted within 60 days of the

end of the reporting period. The summary performance report must include the following information for the reporting period:

- (1) The total donated food inventory by State and the national total at the beginning of the reporting period;
- (2) The total quantity of donated food received by State, with year-to-date totals, and the national total of donated food received;
- (3) The total quantity of donated food reduced from inventory by State, with year-to-date totals, and the national total of donated foods reduced from inventory; and
- (4) The total quantity of donated foods remaining in inventory by State, and the national total, at the end of the reporting period.

(d) *Recordkeeping requirements for processors.* The processor must maintain the following records relating to the processing of donated foods:

- (1) End product data schedules and summary end product data schedules, as applicable;
- (2) Receipt of donated food shipments;
- (3) Production, sale, and delivery of end products, including sales through distributors;
- (4) Remittance of refunds, invoices, or other records that assure crediting for donated foods in end products, and for sale of byproducts;
- (5) Documentation of Federal or State inspection of processing facilities, as appropriate, and of the maintenance of an effective quality control system;
- (6) Documentation of substitution of commercial foods for donated foods, including grading certificates, as applicable;
- (7) Waivers of grading requirements, as applicable; and
- (8) Required reports.

(e) *Recordkeeping requirements for the distributing agency.* The distributing agency must maintain the following records relating to the processing of donated foods:

- (1) Processing agreements;
- (2) End product data schedules or summary end product data schedules, as applicable;
- (3) Performance reports;
- (4) Grading certificates, as applicable;
- (5) Documentation that supports information on the performance report, including sales of end products and crediting for donated foods, as required by the distributing agency;
- (6) Copies of audits of in-State processors and documentation of the correction of any deficiencies identified in such audits;
- (7) The receipt of end products, as applicable; and

(8) Procurement documents, as applicable.

(f) *Recordkeeping requirements for the recipient agency.* The recipient agency must maintain the following records relating to the processing of donated foods:

- (1) The receipt of end products purchased from processors or distributors;
- (2) Crediting for donated foods included in end products;
- (3) Recipient Processing Agreements, as applicable, and, in accordance with such agreements, other records included in paragraph (d) of this section, if not retained by the distributing agency; and
- (4) Procurement documents, as applicable.

(g) *Review requirements for the distributing agency.* The distributing agency must review performance reports and its own records, as required in paragraph (e) of this section, and any other supporting documentation, to ensure that the processor:

- (1) Receives donated food shipments;
- (2) Delivers end products to eligible recipient agencies, in the types and quantities for which they are eligible;
- (3) Meets the required processing yields for donated foods under guaranteed minimum yield; and
- (4) Accurately reports donated food inventory activity, and maintains inventories within approved levels.

§ 250.38 Provisions of agreements.

(a) *National Processing Agreement.* A National Processing Agreement includes provisions to ensure that a multi-State processor complies with all of the applicable requirements in this part relating to the processing of donated foods.

(b) *Required provisions for State Participation Agreement.* A State Participation Agreement with a multi-State processor must include the following provisions:

- (1) Contact information for all appropriate parties to the agreement;
- (2) The effective dates of the agreement;
- (3) A list of recipient agencies eligible to receive end products;
- (4) Summary end product data schedules, with end products that may be sold in the State;
- (5) Assurance that the processor will not substitute or commingle backhauled donated foods, and will provide end products processed from such donated foods only to the recipient agency from which the foods were received;
- (6) Any applicable labeling requirements;
- (7) Other processing requirements implemented by the distributing agency,

in accordance with the requirements in 7 CFR Part 250, such as the specific method(s) of end product sales permitted;

(8) A statement that the agreement may be terminated by either party upon 30 days' written notice; and

(9) A statement that the agreement may be terminated immediately if the processor has not complied with its terms and conditions.

(c) *Required provisions for State Processing Agreement.* A State Processing Agreement must include the following provisions or attachments:

(1) Contact information for all appropriate parties to the agreement;

(2) The effective dates of the agreement;

(3) A list of recipient agencies eligible to receive end products, as applicable;

(4) In the event that subcontracting is allowed, the specific activities that will be performed under subcontracts;

(5) Assurance that the processor will provide a performance bond or irrevocable letter of credit to protect the value of donated foods it is expected to maintain in inventory, in accordance with § 250.32;

(6) End product data schedules for all end products, with all required information, in accordance with § 250.33;

(7) Assurance that the processor will meet processing yields for donated foods, in accordance with § 250.33;

(8) Assurance that the processor will compensate the distributing or recipient agency, as appropriate, for any loss of donated foods, in accordance with § 250.33;

(9) Any applicable labeling requirements;

(10) Assurance that the processor will meet requirements for the substitution of commercially purchased foods for donated foods, including grading requirements, in accordance with § 250.34;

(11) Assurance that the processor will not substitute or commingle backhauled

donated foods, and will provide end products processed from such donated foods only to the recipient agency from which the foods were received, as applicable;

(12) Assurance that the processor will provide for the safe and effective storage of donated foods, meet inspection requirements, and maintain an effective quality control system at its processing facilities;

(13) Assurance that the processor will report donated food inventory activity and maintain inventories within approved levels;

(14) Assurance that the processor will return, transfer, or pay for, donated food inventories remaining upon termination of the agreement, in accordance with § 250.35;

(15) The specific method(s) of end product sales permitted, in accordance with § 250.36;

(16) Assurance that the processor will credit recipient agencies for all donated foods, in accordance with § 250.36;

(17) Assurance that the processor will submit performance reports and meet other reporting and recordkeeping requirements, in accordance with § 250.37;

(18) Assurance that the processor will obtain independent CPA audits, and will correct any deficiencies identified in such audits, in accordance with § 250.18;

(19) A statement that the distributing agency, subdistributing agency, or recipient agency, the Comptroller General, the Department of Agriculture, or their duly authorized representatives, may perform on-site reviews of the processor's operation to ensure that all activities relating to donated foods are performed in accordance with the requirements in 7 CFR Part 250;

(20) A statement that the agreement may be terminated by either party upon 30 days' written notice;

(21) A statement that the agreement may be terminated immediately if the processor has not complied with its terms and conditions; and

(22) A statement that extensions or renewals of the agreement, if applicable, are contingent upon the fulfillment of all agreement provisions.

(d) *Required provisions for Recipient Processing Agreement.* The Recipient Processing Agreement must contain the same provisions as a State Processing Agreement, to the extent that the distributing agency permits the recipient agency to monitor compliance with the applicable processing requirements (e.g., approval of end product data schedules or review of performance reports). However, a list of recipient agencies eligible to receive end products need not be included.

(e) *Noncompliance with processing requirements.* If the processor has not complied with processing requirements, the distributing or recipient agency, as appropriate, must not extend or renew the agreement, and may immediately terminate it.

§ 250.39 Miscellaneous provisions.

(a) *Waiver of processing requirements.* The Department may waive any of the requirements of this part for the purpose of conducting demonstration projects to determine if processing of donated foods may be performed more efficiently or effectively by other means.

(b) *Guidance or information.* Guidance or information relating to the processing of donated foods is included on the FNS Web site at <http://www.fns.usda.gov/fdd>, or may otherwise be obtained from FNS. Such guidance or information includes, for example, program regulations and policies, the processing handbook, the FNS Audit Guide, National Processing Agreement prototypes, and summary end product data schedule prototypes.

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Roberto Salazar,

Administrator, Food and Nutrition Service.

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