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DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

7 CFR Part 250

RIN 0584-AE38

Revisions and Clarifications in Requirements for the Processing of Donated Foods

AGENCY: Food and Nutrition Service (FNS), USDA

ACTION: Proposed rule.

SUMMARY: This rule proposes to revise and clarify requirements for the processing of donated foods in order to: incorporate successful processing options tested in demonstration projects, ensure accountability for donated foods provided for processing, and increase program efficiency. The rule would require multi-State processors to enter into National Processing Agreements to process donated foods into end products, permit processors to substitute commercially purchased beef and pork of U.S. origin and of equal or better quality for donated beef and pork, and would increase oversight of inventories of donated foods at processors. The rule also revises regulatory provisions in plain language, to make them easier to read and understand.

DATES: To be assured of consideration, comments must be received on or before [insert date 60 days after date of publication in the FEDERAL REGISTER].

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-AE38, by any of the following methods:

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

E-mail: Send comments to ProcessingRuleComments@fns.usda.gov. Include RIN number 0584-AE38 in the subject line of the message.

Mail: Send comments to Kiley Larson, Program Analyst, Policy Branch, Food Distribution Division, Food and Nutrition Service, U.S. Department of Agriculture, Room 500, 3101 Park Center Drive, Alexandria, Virginia 22302-1594.

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

FOR FURTHER INFORMATION CONTACT: Kiley Larson or Erica Antonson at the above address or telephone (703) 305 - 2680.

SUPPLEMENTARY INFORMATION:

I. Background

The Department of Agriculture (the Department or USDA) provides donated foods to State distributing agencies for distribution to recipient agencies (e.g., school food authorities) participating in the National School Lunch Program (NSLP) and 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 for use in NSLP or other food programs. For example, a whole chicken or chicken parts may be processed into precooked grilled chicken strips for use in NSLP. The ability to divert donated foods for processing provides recipient agencies with more options for using donated foods in their programs. The regulations ensure that State and recipient 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, the quantity and variety of donated foods provided in the NSLP and other child nutrition programs has increased substantially. Donated foods meet the highest quality and safety standards and are selected by the Department to assist recipient agencies in offering nutritious and well-balanced meals that meet meal pattern and nutrition standards for meals served in child nutrition programs. Concurrently, the variety of end products offered by processors has increased and adapted to reflect the types of foods recipient agencies need. 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.

FNS has used its regulatory waiver authority in current 7 CFR 250.30(q) to initiate demonstration projects designed to better serve recipient agencies and foster a more efficient program. These demonstration projects have proven very informative as the industry and the needs of recipient agencies have evolved. Many of these methods tested, such as the expansion of permitted substitutions and the implementation of National Processing Agreements, have proven successful and are proposed for codification in this rule.

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 USDA-approved substitution plan. Substitution allows processors more flexibility and efficiency in producing finished end products for school food authorities which helps minimize cost while ensuring quality.

In May 2013, FNS initiated a demonstration project which permitted processors with a USDA-approved substitution plan to substitute commercially purchased beef and pork for donated beef and pork, in accordance with the processor's USDA-approved substitution plan. In accordance with the terms of the demonstration project, as established in FNS policy memorandum *FD-130: Processing - Substitution of USDA Beef and Pork*, the commercial product must be of U.S. origin and of equal or better quality in all Departmental purchase specifications than the donated food. Among other requirements of the demonstration project, the substitution plan has required assurances that: 1) processing is performed in plants under continuous Federal or State meat inspection; 2) the Department's Agricultural Marketing Service (AMS) graders monitor the process to ensure compliance with substitution requirements; 3) commercial product is purchased from an AMS-approved vendor in good standing and is tested to ensure that it is of equal or better quality in all Departmental purchase specifications, including specifications relating to acceptable tolerance levels for specific microorganisms, chemical residues,

and fat; and 4) commercial product is subject to audited processes for humane handling, food defense, and threat agent testing.

In October 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. Review and approval of end product data schedules, however, is a time and labor-intensive activity for State distributing agencies. National approval of end product data schedules under the demonstration project has reduced the time and labor burden considerably for both distributing agencies and all multi-State processors since processors are not required to submit end product data schedules for approval in each State in which they operate.

In conjunction with the demonstration project allowing national approval of end product data schedules, FNS requires multi-State processors to sign a National Processing Agreement. 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. Under the demonstration project, the monitoring and protection of donated food inventories held by processors at the national level has further reduced the burden on distributing agencies. Distributing agencies may include other State-specific processing requirements and select the processor's nationally approved end products for sale in the State under their State Participation Agreements with multi-State processors. On August 24, 2006, FNS published a proposed a rule to revise and clarify requirements

for the processing of donated foods (71 FR 50249). As part of this proposed rule, FNS proposed to retain title to donated foods delivered to multi-State processors until acceptance of finished end products by the State distributing or recipient agency. It was subsequently determined that FNS needed additional statutory authority to retain title to donated foods at the processor and the rule was not finalized pending legislative change. Section 4104 of the Agricultural Act of 2014 (P.L. 113-79, the Farm Bill) amended Section 17 of the Commodity Distribution Reform Act and WIC Amendments of 1987, 7 U.S.C. 612c note to provide that authority and the necessary statutory authority for FNS to promulgate regulations ensuring accountability of USDA Donated Foods.

The regulatory amendments proposed in this rule would implement provisions of the Farm Bill related to processing of donated foods and incorporate into 7 CFR Part 250 the processing options provided under the demonstration project described above. They would also more effectively ensure accountability for donated foods provided for processing while streamlining requirements to increase program efficiency for recipient agencies. Most significantly, the rule proposes to:

- 1) Require that FNS retain title of USDA Donated Foods while at multi-State processors;
- 2) Require each multi-State processor to sign a National Processing Agreement 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) Permit substitution of donated beef and pork with commercial beef and pork of U.S. origin and of equal or better quality in all Departmental purchase specifications than the donated food, provided applicable requirements are met, including a USDA-approved substitution plan;
- 5) Establish a title transfer exception dictating that when a recipient agency has contracted with a distributor to act as an authorized agent, title to finished end products containing donated foods transfers to the recipient agency upon delivery and acceptance by the contracted distributor;
- 6) Require processors providing end products containing donated foods to a distributor to enter into a written agreement with the distributor specifying the a) distributor's financial liability for the replacement value of donated foods once delivered to the distributor; b) frequency of reporting; and c) applicable value pass through system; and
- 7) Require distributing agencies to more closely monitor donated food inventories at processors to ensure that processors do not maintain inventories in excess of what can be effectively utilized by recipient agencies in a timely manner.

As discussed below, we propose to amend current §§ 250.2, 250.11, 250.18 and 250.19, and to completely revise § 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 but not to change or alter the interpretation and application of the revised sections. The proposed changes to 7 CFR Part 250 are discussed in detail below.

II. Discussion of the Rule's Provisions

A. Definitions, § 250.2

Due to developments in food distribution programs, and for the purpose of clarification, we propose to remove, revise, and add definitions in current § 250.2 relating to processing of donated foods. We propose to remove the definitions of “Contracting agency” and “Fee-for-service.” 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 term “Fee-for-service” is clear in the context of the proposed regulatory provisions and no longer requires a separate definition.

We propose to add definitions of “Backhauling,” “Commingling,” “End product data schedule,” “In-State Processing Agreement,” “National Processing Agreement,” “Recipient Agency Processing Agreement,” “Replacement value,” and “State Participation Agreement.” The definition of “Backhauling” would describe a means of delivery of donated food to a processor from a recipient agency’s storage facility. The definition of “Commingling” would describe the common storage of donated foods with commercially purchased foods. The 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. Definitions of “National Processing Agreement,” “Recipient Agency Processing Agreement,” “State Participation Agreement,” and “In-State Processing Agreement” would help the reader understand the different types of

processing agreements permitted. These processing agreements are further described in the proposed § 250.30. The 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. The definition of “Replacement value” reflects the price in the market at the time that the Department assigns the value whereas the definition of “Contract value” in current regulations reflects the Department’s current acquisition price, which is set annually.

B. Delivery and receipt of donated food shipments, § 250.11

We propose to amend current § 250.11(e), 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 or recipient agency upon its acceptance of the donated foods 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 amendments made by Section 4104 of the Farm Bill and the requirements under National Processing Agreements proposed in this rule. In the proposed § 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 in the inventory of 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 in § 250.11(e) 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.

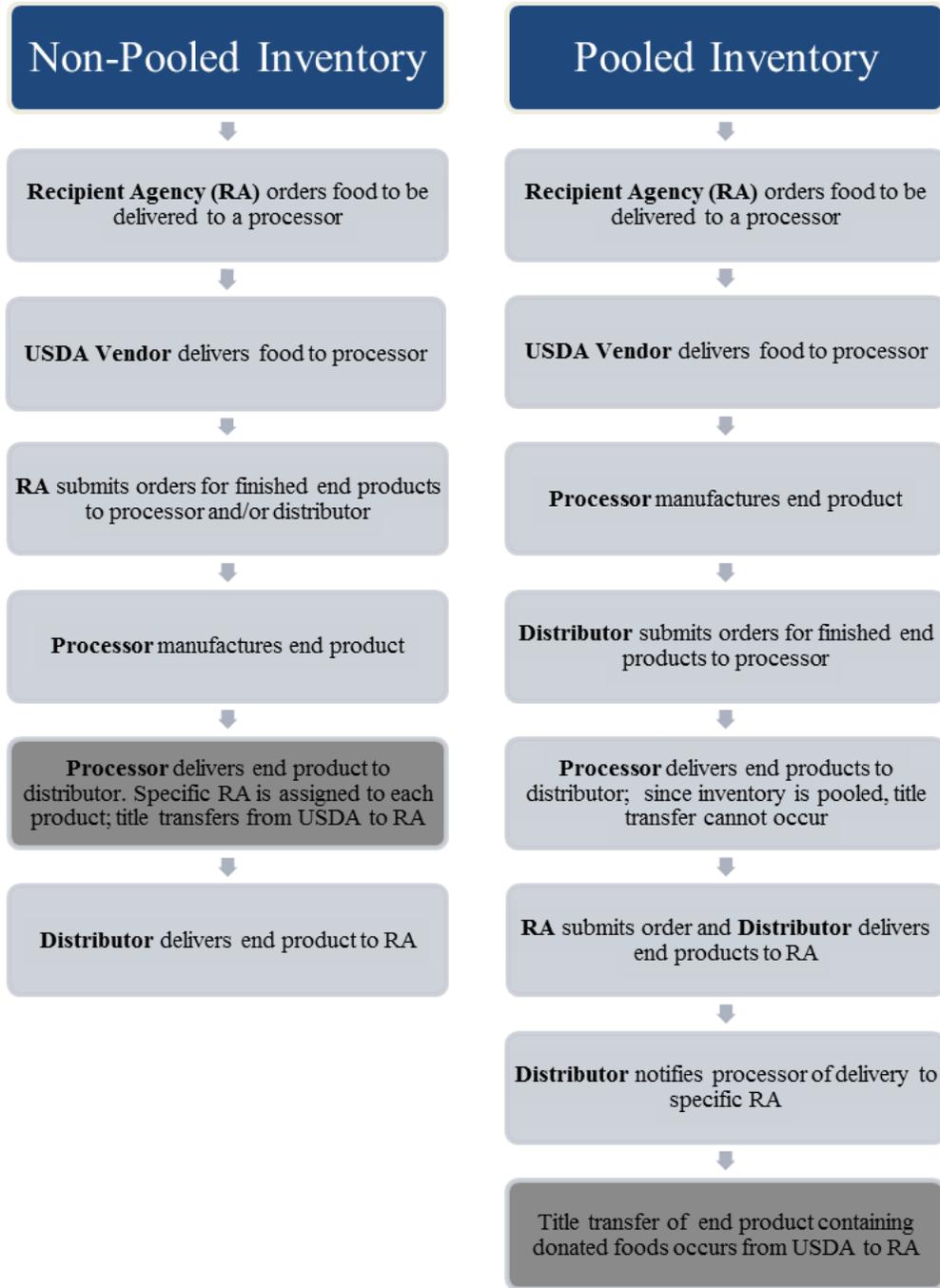
Many recipient agencies receiving finished end products from multi-State processors contract with a distributor to store end products and/or transport the finished end products to their facilities. The inclusion of distributors in the supply chain for finished end products creates challenges related to tracking and reporting the value of donated foods. Because processors are not a party to the contractual relationship between recipient agencies and distributors, processors lose control of finished end products once they are delivered to the distributors designated by each recipient agency. Therefore, we propose in this rulemaking that when a distributor is contracted by the recipient agency for the transportation and/or storage of finished end products and is acting as the recipient agency's authorized agent (i.e., purchasing processed end products containing donated foods on behalf of the recipient agency), title of donated foods would transfer to the recipient agency upon the acceptance of finished end products at the time and place of delivery at the recipient agency or the distributor acting as the authorized agent of the recipient agency, whichever happens first.

Currently, in situations where recipient agencies contract with a distributor to store and/or transport processed end products containing donated foods and act as their authorized agent, complications can arise that may impede the transfer of title described above. Some processors and distributors, working in this manner, manufacture and/or order some processed end products prior to receiving donated food orders from recipient

agencies. This results in processors and distributors “pooling” their inventories of processed end products, particularly for products containing nonsubstitutable items. In other words, processors will manufacture finished end products and distributors will order and receive processed end products from the processor without either entity knowing specifically which recipient agency will order or receive those items. This is most commonly due to processors and/or distributors manufacturing/ordering end products in advance of receiving orders from recipient agencies based on forecasted estimates. The diagram below illustrates the differences between “pooled” and “non-pooled” inventory in these specific cases (i.e., nonsubstitutable donated food traveling through a supply chain that includes a distributor acting as the recipient agency’s authorized agent).

In the case of “pooled” inventories (as illustrated below), under current regulations title cannot transfer to the recipient agency at the time of delivery at their contracted distributor because neither the processor nor the distributor know which recipient agency will receive which products. The intent of the proposed § 250.11(e) is to discourage the pooling of processed end products containing nonsubstitutable donated foods (i.e., end products must be assigned to a specific recipient agency by the time they are accepted at a distributor so that the title may be transferred to the correct recipient agency).

Current Practice:



This shift in the timing of title transfer would impact the calculation of performance bonds currently being required of multi-State processors through National Processing Agreements. All other factors held equal, some multi-State processors would encounter a reduction in the required annual bond amount, as determined by FNS, due to the transfer

of title of donated foods to the recipient agency taking place at an earlier stage in the supply chain. Although this shift would reduce inventories and bonding amounts for some multi-State processors, it would also place more responsibility on recipient agencies to track and protect the value of donated food inventories being managed by their designated distributors, acting as their agents.

C. Reporting requirements, § 250.18

In current § 250.18(b), processors are required to submit monthly performance reports to the distributing agency, in accordance with current § 250.30(m). We propose to retain this requirement but to clarify that processors must submit performance reports and other supporting documentation, as required by the distributing agency or by FNS, in accordance with proposed § 250.37.

D. Recordkeeping requirements, § 250.19

In current § 250.19(a), processors must maintain records documenting the sale of end products to recipient agencies, including the sale of such end products by distributors. As discussed later in the preamble, we are proposing to include specific recordkeeping requirements for processors in the proposed § 250.37(d). Hence, we propose to amend this section to require that processors must comply with the applicable recordkeeping requirements in Subpart C of this part and with any other recordkeeping requirements included in their agreements.

E. 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 rewrite these sections in plain language. We propose to include the requirements for specific processing activities in the order in which they most commonly 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 Processing of donated foods into end products.

250.31 Procurement requirements.

250.32 Protection of donated food value.

250.33 Ensuring processing yields of donated foods.

250.34 Substitution of donated foods.

250.35 Storage, food safety, 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. Processing of donated foods into end products, § 250.30

In the proposed § 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, In-State, and Recipient Agency Processing Agreements. However, we propose to include the specific provisions required for each type of agreement in the proposed § 250.38, as the reason for their inclusion would only be clear with an understanding of the processing requirements contained in the preceding sections.

In the proposed § 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. Currently, most donated foods are processed in accordance with National Processing Agreements or In-State Processing Agreements. However, some large school food authorities currently have agreements with processors to process donated foods and contracts to 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 proposed § 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 proposed § 250.30(b) the stipulation in current § 250.30(c)(5)(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. We propose to clarify that the agreements described in this section are required in addition to, not in lieu of, competitively procured contracts required in accordance with § 250.31. We propose to revise the requirement in current § 250.30(c)(4) that indicates which official of the processor must sign the processing agreement and more simply state in proposed § 250.30(b) that the processing agreement must be signed by an authorized individual acting for the processor. 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 Agreement 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. Hence, in the proposed § 250.30(c), we would 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, in the proposed §

250.32, FNS holds and manages the multi-State 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 in the proposed § 250.30(d).

In the proposed § 250.30(d), we would 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 proposed § 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. We propose to require the distributing agency to utilize selection criteria in current § 250.30(c)(1) to select processors with which to enter into State Participation Agreements.

Currently, a distributing agency must enter into an In-State Processing Agreement with an in-State processor (i.e., a processor which only services recipient agencies in a single State via a production facility located in the same State) to process donated foods into finished end products for sale in the State. Under such an agreement, the distributing agency may procure the services and 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 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 In-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 proposed § 250.30(e), we propose to clarify the distinction between master agreements and other In-State Processing Agreements and to include in this proposed section the required criteria in current § 250.30(c)(2) for selecting processors under master agreements. We propose to require that the distributing agency enter into an In-State Processing Agreement with an in-State processor to process donated foods, as currently required under the demonstration project.

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 proposed § 250.30(f), and to refer to them as Recipient Agency Processing Agreements. We also propose to clarify that, under such agreements, the distributing agency may also delegate oversight and monitoring to the recipient agency to approve end product data schedules or select nationally approved end product data schedules, review processor performance reports, manage the performance bond or letter of credit of an in-State processor, 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 Agency 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). We propose to require the recipient agency to utilize selection criteria in current § 250.30(c)(1) to select processors with which to enter into Recipient Agency Processing Agreements. We propose to include the requirement in current § 250.30(l) that the distributing agency approve all Recipient Agency Processing Agreements. In general, FNS recommends that distributing agencies consult with the State administering agency for the review and approval of these agreements, if necessary. State administering agencies have experience reviewing and establishing processes to review contracts which are similar to Recipient Agency 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 proposed § 250.30(g), but to clarify that the requirements only apply to distributing agencies that procure end products on behalf of recipient agencies or otherwise limit recipient agencies' access to the procurement of specific end products. We also propose 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)(5)(xv), 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. We propose to clarify, in the proposed § 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 written consent as part of its State Participation Agreement or In-State Processing Agreement with the processor.

In the proposed § 250.30(i), we would require agreements between processors and distributors. This proposal would provide distributing and recipient agencies with another tool to ensure that the value of donated foods and finished end products are properly credited and provided to recipient agencies when third party distributors exist in the supply chain between processors and recipient agencies. The agreement, initiated by the processor before releasing finished end products to a distributor, must reference, at a minimum, the financial liability (i.e., who must pay) for the replacement value of donated foods, not less than monthly end product sales reporting frequency, requirements under § 250.11, and the applicable value pass through system to ensure that the value of donated foods and finished end products are properly credited to recipient agencies. Distributing agencies could set additional requirements such as requiring that copies or templates of these agreements be included with the submission of signed State Participation Agreements.

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 proposed § 250.30(j), 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 (e.g. when new

subcontractors are added), with the concurrence of the parties to the agreement, and that such amendments would be effective for the duration of the agreement, unless otherwise indicated.

We propose to remove the following requirements or statements in current § 250.30 related to processing agreements, as they are overly restrictive or unnecessary given current practice and administrative structure:

- The requirement in current § 250.30(c)(1) that the FNS Regional Office review processing agreements.
- The requirement in current § 250.30(c)(3) that the agreement be prepared and reviewed by State legal staff to ensure conformance with Federal regulations.
- 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 processors and the FNS Regional Office.

2. Procurement requirements, § 250.31

The requirements for the procurement of goods and services under Federal grants are established in 2 CFR Part 200 and USDA implementing regulations at 2 CFR Part 400 and Part 416, as applicable. In the proposed § 250.31(a), we propose to indicate the applicability of these requirements to the procurement of processed end products, distribution, or of other processing services related to donated foods. We also propose to indicate that distributing or recipient agencies may use procurement procedures that

conform to applicable State and local laws, as appropriate, but must ensure compliance with the Federal procurement requirements.

In the proposed § 250.31(b), we would 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 would be utilized, an assurance that crediting for donated foods would be performed in accordance with the applicable requirements for such method of sales in proposed § 250.36, the contract 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)(5)(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)(5)(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 proposed § 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 and unnecessarily complicates this section. 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 at least 75 percent of the value of donated foods in the processor's physical or book inventory, as determined annually, and at the discretion of FNS, for processors under National Processing Agreements. For multi-state processors in their first year of participation in the processing program, the amount of the performance bond or letter of credit must be sufficient to cover 100 percent of the value of donated foods, as determined annually, and at the discretion of FNS. This proposed clarification would codify existing Program policy.

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

4. Ensuring processing yields of donated foods, § 250.33

In current § 250.30(c)(5), 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, 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 for the donated food;
- The contract value of the donated food; and
- Any pricing information in addition to the charge for the end product or fee-for-service.

In the proposed § 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. In the proposed § 250.33(a), we would 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, in the proposed § 250.31, 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 a competitive procurement has been performed by the

distributing agency under its In-State Processing Agreement or State Participation Agreement. Prices currently included on end product data schedules generally reflect the highest price that a processor would charge for the finished end product and not necessarily the actual price of the 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., pounds 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 In-State Processing Agreements. We propose to clarify that the end product data schedules for products containing donated red meat or poultry must also be approved by the Department, as is currently required under the demonstration project. 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 in a standard electronic format dictated by FNS, 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 proposed § 250.33(b), we propose to describe the different processing yields of donated foods that may be approved in end product data schedules. In current § 250.30(c)(5)(ii), the processor must meet a 100 percent yield in the processing of all substitutable donated foods (i.e., generally all donated foods except beef, pork and

poultry). Under 100 percent yield, the processor must ensure that 100 percent of the raw donated food diverted for processing 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. These reductions must be reported 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 proposed § 250.33(b)(1). We propose to indicate that FNS may make exceptions to the 100 percent yield requirement, on a case-by-case basis. Exceptions to the 100 percent yield requirement can result in one of the alternate processing yields described below.

Processing of donated foods such as beef, pork, and poultry invariably results in significant loss of product, such as the bones in chicken or fat in beef and pork. 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. In an effort to simplify the yield requirements and streamline monitoring for distributing and recipient agencies we propose to limit the processing yields to 100 percent yield, guaranteed yield, and standard yield.

Under guaranteed yield, the processor must ensure that a specific quantity of end product would be produced from a specific quantity of donated food put into production. The guaranteed yield for a specific product is determined and agreed upon by the parties to the processing agreement, and, for In-State and Recipient Agency Processing Agreements, approved by the Department. Guaranteed yield is generally used when significant variance is present across processors in manufacturing and yield for a particular end product. The guaranteed yield must be indicated on the end product data schedule. We propose to describe guaranteed yield in the proposed § 250.33(b)(2).

Under standard yield, the processor must ensure that a specific quantity of end product, as determined by the Department, would be produced from a specific quantity of donated food. The standard yield is determined and applied uniformly by the Department to all processors for specific donated foods. 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. If necessary, the processor must use commercially purchased food of the same generic identity, of U.S. origin, and equal or better in all USDA procurement specifications than the donated food to provide the number of cases required to meet the standard yield to the distributing or recipient agency, as appropriate. Like guaranteed yield, standard yield ensures that the recipient agency would receive a specific quantity of end product, which helps to ensure that it can meet its food service needs. We propose to describe standard yield in the proposed § 250.33(b)(3).

In the proposed § 250.33(c), we would 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. 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. 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. Loss of donated foods may result for a number of reasons, including the processor's failure to meet the required processing yield or failure to produce end products that meet required specifications, as described above, 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 equal or better in all USDA procurement specifications than the donated food; or
- 2) Return end products that are wholesome but do not meet required specifications to production for processing into the requisite quantity of end products that meet the required specifications; or
- 3) Pay the distributing or recipient agency, as appropriate, for the replacement value of the donated food or commercial substitute only if the purchase of replacement foods is not feasible and the processor has received approval. In-State processors would be required to obtain distributing agency approval for such payment and multi-State processors would be required to obtain FNS approval.

In current § 250.30(c)(5)(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. We propose to include this requirement in the proposed § 250.33(d), 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)(5)(viii)(D) that the processor credit the distributing or recipient agency for the sale of donated food containers because the burden required to monitor the credit outweighed the value returned.

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 proposed § 250.33(e).

5. Substitution of donated foods, § 250.34

We propose to include requirements for the substitution of donated foods in the proposed

§ 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. Under current regulations, substitution of donated poultry is permitted with some limitations in accordance with a processor's USDA-approved substitution plan. Substitution of donated beef and pork is not permitted under the current regulations.

As previously discussed in the preamble, beginning in 2013, the Department used its regulatory waiver authority, to permit processors with a Department-approved Processor Control Certification Program plan to substitute commercially purchased beef and pork for donated beef and pork. The commercial product must be of U.S. origin, and of equal or better quality in all Departmental purchase specifications than the donated food. In addition, only donated 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 the proposed § 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 in all Departmental

purchase specifications than the donated food. We propose to clarify that commercially purchased beef, pork or poultry must meet the same specifications as donated product, including inspection, grading, testing, and humane handling standards, and must be approved by the Department in advance of substitution. 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 if, due to changing market conditions or other reasons, the Department is unable to purchase and deliver donated poultry to the processor for processing. In the proposed § 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 in the proposed § 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. In the proposed §

250.34(b), we propose to prohibit substitution or commingling of all backhauled donated foods and to require that the processor, if amenable to reformulation, process such end products into end products for sale and delivery to the same recipient agency that provided them and not to any other recipient agency. In other words, the recipient agency which backhauls a previously processed end product to a processor for reformulation must in turn use the reformulated end products, containing their backhauled product, in their food service. Additionally, we propose to prohibit the processor from providing payment to the recipient agency in lieu of processing and prohibit the distributing or recipient agency from transferring the backhauled food to another processor.

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 and yield requirements are met and that end products conform with the applicable end product data schedule. Such grading is conducted by the Department's Agricultural Marketing Service. 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. 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 proposed § 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 proposed § 250.34(d). However, we propose to indicate that such waivers may only be approved on a case by case basis—e.g., 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 would 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. 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 proposed § 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 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)(1)(iii) 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 in the proposed § 250.33(f), is more appropriate, and effective, than a requirement that the processor make specific purchases of foods in the commercial market.

6. Storage, food safety, quality control, and inventory management, § 250.35

We propose to include requirements for the storage, food safety oversight, quality control, and inventory management of donated foods provided for processing in the proposed § 250.35. In current § 250.30(c)(5)(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 proposed § 250.35(a), we would require the processor to ensure the safe and effective storage of donated foods, including compliance with the general storage requirements in current § 250.12, 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. We propose to simplify these regulations in the proposed § 250.35(b) by requiring that all processing of donated foods is conducted in compliance with all Federal, State, and local requirements relative to food safety.

In the proposed § 250.35(c), we propose to clarify that a processor may commingle donated foods and commercially purchased foods, unless the processing agreement specifically stipulates that the donated foods must be used in processing, and not substituted, 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 that processors ensure that commingling of finished end products with other food products by distributors results in the sale to recipient agencies of end products that meet substitution requirements. One way that this may be achieved is by affixing the applicable USDA certification stamp to the exterior shipping containers of such end products. 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 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, at the processor's request, provide written approval to allow 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. 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 inventories of donated foods at a processor in the proposed § 250.35(d) and to clarify that distributing agencies are not permitted to submit food orders for processors reporting no sales activity during the prior year's contract

period unless documentation is submitted by the processor which outlines specific plans for donated food drawdown, product promotion, or sales expansion. Many distributing agencies have adopted “sweep” policies in which they transfer excess processor inventories for one recipient agency to another recipient agency or processor which is willing to accept it, to ensure that inventory is used effectively. For example, a distributing agency may transfer a recipient agency’s remaining inventory at a processor to another recipient agency that is willing to accept such foods and use the foods efficiently. Such policies provide an additional tool for distributing agencies to ensure that donated foods are used efficiently and that processors and recipient agencies effectively manage their donated food inventories. We propose to include an allowance for FNS to require an inventory transfer to another State distributing agency or processor when inventories are determined to be excessive for a State distributing agency or processor, i.e., more than six months on-hand or exceeding the established inventory protection, to ensure full utilization prior to the end of the school year.

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 § 250.12(e), to transfer 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 proposed § 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 the distributing agency 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 re-donate 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 for the donated foods held in excess of allowed levels in an amount equal to 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 as applicable 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 proposed § 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 proposed § 250.34 to permit substitution of all donated foods. We propose to clarify that the disposition of donated foods may include a transfer; i.e., the distributing agency may permit a transfer of donated foods to another State distributing agency, with FNS approval, in accordance with current § 250.12(e). We also propose to permit the transfer of commercially purchased foods that meet the substitution requirements in the proposed

§ 250.34 in place of the donated foods. We propose to permit the processor to pay the distributing or recipient agency, as appropriate, for the donated foods only if returning or transferring the donated foods or commercially purchasing food that meets the substitution requirements is not feasible and if FNS approval has been granted. If the distributing agency requires the processor to pay for donated foods, we propose to require such payment at the contract 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 § 250.17(c). The allowable use of funds accruing from program operations, including funds received by distributing agencies from payments for donated foods upon termination of an agreement, is described in current § 250.17 and thus the stipulation is no longer necessary.

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 proposed § 250.36(a), we would 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 proposed § 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 transmitted via 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. The agency may determine how frequently it wishes to receive its refunds, but refunds must be issued more frequently than annually. 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.

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 proposed § 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 discount provided for the value of the donated food in its sale of end products. We propose to permit end product sales

under this system in the proposed § 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, at least on a monthly basis, through automated sales reports or other 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 § 250.2, 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 proposed § 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 distributing or recipient agency-contracted distributor to bill the distributing or recipient agency, as appropriate, 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 appropriate agency has advance notification of the fee-for-service and delivery charge. The processor must require that

the distributor notify it of such sales, at least 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 proposed § 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 proposed § 250.36(f).

In the proposed § 250.36(g), we propose to clarify that the contract value of the donated foods must be used in crediting for donated foods in end product sales and to refer to the definition of contract value included in current § 250.2. In the proposed § 250.36(h), we would 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 either the quantities of approved end products that each recipient agency is eligible to receive, or the quantity of donated food allocated to each recipient

agency along with the raw donated food (pounds or cases) needed per case of each approved end product.

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

In the proposed § 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 receiving end products;
- 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 proposed § 250.37(a), we propose to retain the requirement that the processor submit the performance report to the distributing agency (or to the recipient agency, in accordance with a Recipient Agency Processing Agreement) on a monthly basis. We propose to retain all of the currently required information in the report. We propose to require the processor to include quantities of donated food losses. 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. We propose to retain the current deadlines for the submission of performance reports in the proposed § 250.37(a).

In the proposed § 250.37(b), we would require that the processor must include reductions in donated food inventories on monthly performance reports only after sales of end products have been made, or after sales of end products through distributors have been documented. We propose to require that, when a distributor sells end products under a refund system, such documentation must be through the distributing or recipient agency's request for a refund (under a refund system) or through the distributor's automated sales reports or other electronic or written submission (under an indirect discount system or under fee-for-service).

In the proposed § 250.37(c), we would require that a multi-State processor submit a summary performance report to FNS, on a monthly basis and in a standard format established by FNS, containing information from the performance report that would allow FNS to track the processor's total and State-by-State donated food inventories. The purpose of this report is to assess 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 proposed § 250.37(a).

In the proposed § 250.37(d), we would 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 § 250.19(a), accurate and complete records must be maintained with respect to end products processed from donated foods. In the proposed § 250.37(e), we would 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 proposed § 250.37(f), we would require that recipient agencies 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 the value of donated foods included in end products, and procurement documents.

In accordance with current § 250.18(b), 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 proposed § 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; and
- 4) Accurately reports donated food inventory activity and maintains inventories within approved levels.

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. Donated nonfat dry milk is no longer available for donation to schools.

9. Provisions of agreements, § 250.38

In the proposed § 250.38, we include the required provisions for each type of processing agreement included in the proposed § 250.30, to ensure compliance with the requirements in 7 CFR Part 250. In the proposed § 250.38(a), we propose to establish that the National Processing Agreement is inclusive of all provisions necessary 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 proposed § 250.38(b), we would 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, a requirement that processors enter into a written agreement with distributors handling end products containing donated foods, and the allowed method(s) of end product sales implemented by the distributing agency.

In the proposed § 250.38(c), we would require that the In-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)(5) 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, enter into a written agreement with distributors handling end products containing donated foods, credit recipient agencies for the value of all donated foods contained in end products, and obtain required audits.

In accordance with the proposed § 250.38(d), we propose to require that the Recipient Agency Processing Agreement contain the same provisions as an In-State Processing Agreement, to the extent that the distributing agency permits the recipient to perform activities normally performed by the distributing agency under an In-State Processing Agreement (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 proposed § 250.38(e), we propose to prohibit a distributing or recipient agency, as appropriate, from extending or renewing an agreement when a processor has not complied with processing requirements. We propose to allow a distributing or recipient agency to immediately terminate an agreement in the event of such noncompliance.

10. Miscellaneous provisions, § 250.39

In current § 250.30(q), FNS may waive any of the requirements in 7 CFR Part 250 for the purpose of conducting demonstration projects to test program changes which might improve processing of donated foods. We propose to include this provision with minimal change in the proposed § 250.39(a).

In the proposed § 250.39(b), we propose to retain the requirement in current § 250.30(p) that the distributing agency develop and provide a processing manual or similar materials to processors and other parties to ensure sufficient guidance is given to processors and other parties to permit compliance with requirements for the processing of donated foods.

Consistent with the current demonstration project, the distributing agency would be permitted to provide additional information relating to State-specific processing procedures upon request.

In the proposed § 250.39(c), we propose to clarify that guidance or information relating to the processing of donated foods is included on the FNS website or may otherwise be obtained from FNS. Such guidance and information includes program regulations and policies, the FNS Audit Guide, and the USDA National Processing Agreement.

III. Procedural Matters

A. Executive Order 12866 and 13563

Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

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

B. Regulatory Impact Analysis

This rule has been designated as not significant by the Office of Management and Budget, therefore, no Regulatory Impact Analysis is required.

C. Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601-612) requires Agencies to analyze the impact of rulemaking on small entities and consider alternatives that would minimize any significant impacts on a substantial number of small entities. Pursuant to that review, the Administrator of FNS has certified that this rule would not have a significant impact on a substantial number of small entities.

D. Unfunded Mandates Reform Act

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, the Department generally must prepare a written statement, including a cost benefit analysis, for proposed and final rules with “Federal mandates” that may result in expenditures by State, local or Tribal governments, in the aggregate, or the private sector, of \$146 million or more (when adjusted for inflation; GDP deflator source: Table 1.1.9 at <http://www.bea.gov/iTable>) in any one year. When such a statement is needed for a rule, Section 205 of the UMRA generally requires the Department to identify and consider a reasonable number of regulatory alternatives and adopt the most cost effective or least burdensome alternative that achieves the objectives of the rule.

This proposed rule does not contain Federal mandates (under the regulatory provisions of Title II of the UMRA) for State, local, and Tribal governments or the private sector of \$146 million or more in any one year. Thus, the rule is 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 10.555, 10.558, 10.559, 10.565, 10.567, and 10.569 is subject to Executive Order 12372, which requires intergovernmental consultation with State and local officials. (See 2 CFR chapter IV)

F. Federalism Summary Impact Statement

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 13121.

The Department has considered the impact of this rule on State and local governments and has determined that this rule does not have federalism implications. Therefore, under section 6(b) of the Executive Order, a federalism summary is not required.

G. Civil Rights Impact Analysis

FNS has reviewed this proposed rule in accordance with USDA Regulation 4300-4, “Civil Rights Impact Analysis,” to identify any major civil rights impacts the rule might have on program participants on the basis of age, race, color, national origin, sex or disability. After a careful review of the rule’s intent and provisions, FNS has determined that this rule would not in any way limit or reduce the ability of participants to receive the benefits of donated foods in food distribution or child nutrition programs 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.

H. Executive Order 13175

Executive Order 13175 requires Federal agencies to consult and coordinate with Tribes on a government-to-government basis on policies that have Tribal implications, including regulations, legislative comments or proposed legislation, and other policy statements or actions that have substantial direct effects on one or more Indian Tribes, on the relationship between the Federal Government and Indian Tribes, or on the distribution of power and responsibilities between the Federal Government and Indian Tribes. FNS consulted with Tribes on this proposed rule on November 19, 2014, however no concerns or comments were received. We are unaware of any current Tribal laws that could be in conflict with the final rule.

I. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995, this notice invites the general public and other public agencies to comment on this proposed information collection.

This collection is a revision of a currently approved collection, OMB#0584-0293.

Written comments must be received on or before [insert date 60 days after date of publication in the Federal Register]. 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 shall 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 that were used; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (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.

Comments will be accepted through the Federal eRulemaking Portal. Go to <http://www.regulations.gov>, and follow the online instructions for submitting comments electronically. Comments may also be sent to Kiley Larson, 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 proposed rule.

Title: Food Distribution Forms.

OMB Number: 0584-0293

Expiration Date: 11/30/2016

Type of Request: Revision of a currently approved collection.

Abstract: This is a revision of an existing information collection based on this proposed rule, *Revisions and Clarifications in Requirements for the Processing of Donated Foods*.

The rule proposes to add reporting requirements to the existing information collection associated with 7 CFR part 250, OMB Number 0584-0293 as follows:

New Reporting Requirements associated with this rulemaking

- § 250.37(c), Summary Performance Report. Multi-State processors submit a summary performance report to FNS. The summary performance report lists the complete donated food inventory at the beginning and end of the reporting month and the total donated food inventory by State and the national total.

Approximately 110 respondents are expected to submit 12 summary performance reports per year. Each performance report is expected to take 1 hour to complete, for a total annual burden of 1320.00 hours.
- § 250.30(i), Agreements between Processors and Distributors. A processor providing end products containing donated foods to a distributor must enter into a written agreement with the distributor. The agreement must include the financial liability for the replacement value of donated foods, monthly end product sales reporting frequency, requirements under 250.11, and the applicable value pass through system. These agreements can be considered permanent, with amendments made as necessary. We estimate that 225 respondents will enter into an agreement in the first year and 5 will amend their agreements each year for the

next 2 years, with 2.0 hours per response. The estimated annual reporting burden for this activity is 156.66 hours.

- § 250.33(a), End Product Data Schedules. Processors must submit end product data schedules, in a standard electronic form dictated by FNS for approval by FNS (for National Processing Agreements) or by the State distributing agency (for In-State Processing Agreements) for each new product that a processor wishes to provide or for a previously approved end product in which the ingredients have been altered. All products containing donated red meat and poultry must have their end product data schedules approved by USDA. The end product data schedule must include a description of the end product, the donated foods and other ingredients included in the end product, the quantity of the end product produced, and the processing yield of the donated food. We expect 131 processors to provide end product data schedules to FNS or the State distributing agency 12 times a year. The estimated time for each response is 0.5 hours, for a total of 786 burden hours.

In addition to the above reporting requirements, FNS has reviewed the information collection associated with 7 CFR part 250 and determined that several reporting and recordkeeping requirements require update due to changes in historical averages and/or duplicate counting. Those adjustments result in a net burden reduction of 5,177 hours. The table below summarizes the changes to the burden for OMB Number 0584-0293. For additional details, see the information collection material included in the docket to this rule.

Affected Public	Est. No. of Respondents	No. of Responses per Respondent	Total Annual Responses	Est. total Hours per Response	Est. total Burden
Reporting					
State, Local, and Tribal Governments	20,866	11.13	232,319.24	0.25	58,679.50
Private For Profit	2,812	306.43	861,681.33	0.03	26,093.88
Private Not for Profit	1,600	2.03	3,240.00	0.19	614.50
Individual	611,200.00	1.96	1,199,200.00	0.25	304,400.00
Total Estimated Reporting Burden	636,478.00	3.61	2,296,440.57	0.17	389,787.88
Recordkeeping					
State, Local, and Tribal Governments	20,866.00	22.58	471,130.46	0.08	35,413.02
Private For Profit	2,812	367.86	1,034,429.00	0.06	62,671.72
Private Not for Profit	1,600	7.99	12,782.00	52.63	672,662.29
Individual	0	0.00	0.00	0.00	0.00
Total Estimated Recordkeeping Burden	25,278.00	60.07	1,518,341.46	0.51	770,747.03
Total of Reporting and Recordkeeping					
	Est. No. of Respondents	No. of Responses per Respondent	Total Annual Responses	Est. total Hours per Response	Est. total Burden
Reporting	636,478.00	3.61	2,296,440.57	0.17	389,787.88
Recordkeeping	25,278.00	60.07	1,518,341.46	0.51	770,747.03
Total	636,478.00	5.99	3,814,782.03	0.30	1,160,534.91

J. E-Government Act Compliance

The Department 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.

List of Subjects in 7 CFR Part 250

Administrative practice and procedure, Food assistance programs, Grant programs, Social programs, 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 § 250.2:

- a. Remove definitions of Contracting agency and Fee-for-service.
- b. Add definitions in alphabetical order for Backhauling, Commingling, End product data schedule, In-State Processing Agreement, National Processing Agreement, Recipient Agency Processing Agreement, Replacement value, and State Participation Agreement.

The revisions and additions read as follows:

§ 250.2 Definitions.

* * * * *

Backhauling means the delivery of donated foods to a processor for processing from a distributing or recipient agency’s storage facility.

* * * * *

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

* * * * *

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

* * * * *

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

* * * * *

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.

* * * * *

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

* * * * *

Replacement value means the price assigned by the Department to a donated food which must reflect the current price in the market to ensure compensation for donated foods lost in processing or other activities. The replacement value may be changed by the Department at any time.

* * * * *

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.

* * * * *

3. In § 250.11, revise paragraph (e) to read as follows:

§ 250.11 Delivery and receipt of donated food shipments.

* * * * *

(e) Transfer of title. In general, 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. 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. However, when a recipient agency has contracted with a distributor to act as an authorized agent, title to finished end products containing donated foods transfers to the recipient agency upon delivery and acceptance by the contracted distributor. Notwithstanding transfer of title, distributing and recipient agencies must ensure compliance with the requirements of this part in the distribution, control, and use of donated foods.

* * * * *

4. In § 250.18, revise paragraph (b) to read as follows:

§ 250.18 Reporting requirements.

* * * * *

(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(a), to ensure compliance with requirements in this part.

* * * * *

5. In § 250.19, revise paragraph (a) to read as follows:

§ 250.19 Recordkeeping requirements.

(a) Required records. Distributing agencies, recipient agencies, processors, and other entities must maintain records of agreements and contracts, reports, audits, and claim actions, funds obtained as an incident of donated food distribution, and other records specifically required in this part or in other Departmental regulations, as applicable. In addition, distributing agencies must keep a record of the value of donated foods each of its school food authorities receives, in accordance with § 250.58(e), and records to demonstrate compliance with the professional standards for distributing agency directors established in § 235.11(g) of this chapter. Processors must also maintain records documenting the sale of end products to recipient agencies, including the sale of such end products by distributors, and must submit monthly performance reports, in accordance with Subpart C of this part and with any other recordkeeping requirements included in their agreements. Specific recordkeeping requirements relating to the use of donated foods in contracts with food service management companies are included in § 250.54. Failure of the distributing agency, recipient agency, processor, or other entity to comply with recordkeeping requirements must be considered prima facie evidence of improper distribution or loss of donated foods and may result in a claim against such party for the loss or misuse of donated foods, in accordance with § 250.16, or in other sanctions or corrective actions.

* * * * *

6. Revise Subpart C to read as follows:

Subpart C—Processing of Donated Foods

Sec.

250.30 Processing of donated foods into end products.

250.31 Procurement requirements.

250.32 Protection of donated food value.

250.33 Ensuring processing yields of donated foods.

250.34 Substitution of donated foods.

250.35 Storage, food safety, 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 Processing of donated foods into end products.

(a) Purpose of processing donated foods. Donated foods are most commonly provided to processors to process into approved end products for use in school lunch programs or other food services provided by recipient agencies. The ability to divert donated foods for processing provides recipient agencies with more options for using donated foods in their programs. For example, donated foods such as whole chickens or chicken parts may be processed into precooked grilled chicken strips for use in the National School Lunch Program. 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 any party to provide donated foods to a processor for processing. The agreements described below are required in addition to, not in lieu of, competitively procured contracts required in accordance with § 250.31. The processing agreement must be signed by an authorized individual for the processor. 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 such processor's performance bond or letter of credit under its 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 end products produced under the processor's National Processing Agreement to eligible recipient

agencies in the State or to directly purchase such 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. The distributing agency must utilize the following criteria in its selection of processors with which it enters into agreements. These criteria will be reviewed by the appropriate FNS Regional Office during the management evaluation review of the distributing agency.

- (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) Price competitiveness 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.

(e) In-State Processing Agreement. A distributing agency must enter into an In-State Processing Agreement with an in-State processor to process donated foods into finished end products, unless it permits recipient agencies to enter into Recipient Agency Processing Agreements for such purpose, in accordance with paragraph (f) of this section. Under an In-State Processing Agreement, the distributing agency approves end product data schedules (except red meat and poultry) 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 also purchase the finished end products for distribution to eligible recipient agencies in the State under an In-State Processing Agreement, or may permit recipient agencies to purchase such end products, in accordance with applicable procurement requirements. In the latter case, the In-State Processing Agreement is often called a “master agreement.” A distributing agency that procures end products on behalf of recipient agencies, or that limits recipient agencies’ access to the procurement of specific end products through its master agreements, must utilize the following criteria in its selection of processors with which it enters into agreements. These criteria will be reviewed by the appropriate FNS Regional Office during the management evaluation review of the distributing agency:

- (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) Price competitiveness 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 Agency Processing Agreement. The distributing agency may permit a recipient agency to enter into an agreement with an in-State processor to process donated foods and to purchase the finished end products in accordance with a Recipient Agency Processing Agreement. A recipient agency may also enter into a Recipient Agency Processing Agreement on behalf of other recipient agencies, in accordance with an agreement between the parties. The distributing agency may also delegate a recipient

agency to approve end product data schedules or select nationally approved end product data schedules, review in-State processor performance reports, manage the performance bond or letter of credit of an in-State processor, and monitor other processing activities under a Recipient Agency Processing Agreement. All such activities must be performed in accordance with the requirements of this part. All Recipient Agency Processing Agreements must be reviewed and approved by the distributing agency. All recipient agencies must utilize the following criteria in its selection of processors with which it enters into agreements:

- (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) Price competitiveness 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.
- (g) Ensuring acceptability of end products. A distributing agency that procures end products on behalf of recipient agencies, or that otherwise limits recipient agencies' access to the procurement of specific end products, must provide for testing of end products to ensure their acceptability by recipient agencies, prior to entering into processing agreements. End products that have previously been tested, or that are otherwise determined to be acceptable, need not be tested. However, such a distributing agency 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 to another entity to perform any aspect of processing, without the specific written consent of the other party to the agreement (i.e., distributing or recipient agency, or FNS, as appropriate). The distributing agency may, for example, provide the required consent as part of its State Participation Agreement or In-State Processing Agreement with the processor.

(i) Agreements between Processors and Distributors. A processor providing end products containing donated foods to a distributor must enter into a written agreement with the distributor. The agreement must reference, at a minimum, the financial liability (i.e., who must pay) for the replacement value of donated foods, not less than monthly end product sales reporting frequency, requirements under § 250.11, and the applicable value pass through system to ensure that the value of donated foods and finished end products are properly credited to recipient agencies. Distributing agencies can set additional requirements.

(j) Duration of agreements. An agreement between a distributing, 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 both 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. Distributing and recipient agencies must comply with the requirements in 2 CFR Part 200 and Part 400, as

applicable, in purchasing end products, distribution, or other processing services from processors. Distributing and recipient agencies may use procurement procedures that conform to applicable State or local laws and regulations, but must ensure compliance with the procurement requirements in 2 CFR parts 200 and 400, as applicable.

(b) Required information in procurement documents. In all procurements of processed end products containing USDA donated foods, procurement documents must include the following information:

- (1) The price to be charged for the end product or other processing service;
- (2) The method of end product sales that will be utilized and assurance that crediting for donated foods will be performed in accordance with the applicable requirements for such method of sales in § 250.36;
- (3) The value of the donated food in the end products; and
- (4) The location for the delivery of the 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 to be received for processing prior to the delivery of the donated foods to the processor. The processor must provide the performance bond or letter of credit to the distributing or recipient agency, in accordance with its In-State or Recipient Agency Processing Agreement. However, a multi-State processor must provide the performance bond or letter of credit to FNS, in accordance with its National Processing Agreement. For multi-State processors, the minimum amount of the performance bond or letter of credit must

be sufficient to cover at least 75 percent of the value of donated foods in the processor's physical or book inventory, as determined annually and at the discretion of FNS for processors under National Processing Agreements. For multi-state processors in their first year of participation in the processing program, the amount of the performance bond or letter of credit must be sufficient to cover 100 percent of the value of donated foods, as determined annually, and at the discretion of FNS. The surety company from which a bond is obtained must be listed in the most current Department of Treasury's Listing of Approved Sureties (Department Circular 570).

(b) Calling in the performance bond or letter of credit. The distributing or recipient agency must call in the performance bond or letter of credit whenever a processor's lack of compliance with this part, or with the terms of the In-State or Recipient Agency Processing Agreement, results in a loss of donated foods to a distributing or recipient agency and the processor fails to make restitution or respond to a claim action initiated to recover the loss. Similarly, 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 Ensuring processing yields of donated foods.

(a) End product data schedules. The processor must submit an end product data schedule, in a standard electronic format dictated by FNS, for approval before it may process donated foods into end products. For In-State Processing Agreements, the end product data schedule must be approved by the distributing agency and, for products containing

donated red meat and poultry, the end product data schedule must also be approved by the Department. For National Processing Agreements, the end product data schedule must be approved by the Department. 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. On the end product data schedule, the processor must describe its processing of donated food into an end product, including 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 (pounds or cases) of donated food needed to produce a specific quantity of end product or as the percentage of raw donated food versus the quantity returned in the finished end product.

(b) Processing yields of donated foods. All end products must have a processing yield of donated foods associated with its production and this processing yield must be indicated on its end product data schedule. The processing yield options are limited to 100 percent yield, guaranteed yield, and standard yield.

- (1) 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 equal or better in all USDA procurement specifications 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.

(2) Under guaranteed yield, the processor must ensure that a specific quantity of end product (i.e., number of cases) will be produced from a specific quantity of donated food, as determined by the parties to the processing agreement, and, for In-State Processing Agreements, approved by the Department. If necessary, the processor must use commercially purchased food of the same generic identity, of U.S. origin, and equal or better in all USDA procurement specifications than the donated food to provide the guaranteed number of cases of end product to the distributing or recipient agency, as appropriate. The guaranteed yield must be indicated on the end product data schedule.

(3) Under standard yield, the processor must ensure that a specific quantity of end product (i.e., number of cases), as determined by the Department, will be produced from a specific quantity of donated food. The established standard yield is higher than the yield the processor could achieve under normal commercial production and serves to reward those processors that can process donated foods most efficiently. If necessary, the processor must use commercially purchased food of the same generic identity, of U.S. origin, and equal or better in all USDA procurement specifications than the donated food to provide the number of cases required to meet the standard yield to the distributing or recipient agency, as appropriate. The standard yield must be indicated on the end product data schedule.

(c) 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 or fails to produce end products that meet required specifications, 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 equal or better in all USDA procurement specifications than the donated food; or
- (2) Return end products that are wholesome but do not meet required specifications to production for processing into the requisite quantity of end products that meet the required specifications (commonly called rework products); or
- (3) If the purchase of replacement foods or the reprocessing of products that do not meet the required specifications is not feasible, the processor may, with FNS, distributing agency, or recipient agency approval, dependent on which entity maintains the agreement with the processor, pay the distributing or recipient agency, as appropriate, for the replacement value of the donated food or commercial substitute.

(d) 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. 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.

(e) Labeling requirements. The processor must ensure that all end product labels meet Federal labeling requirements. A processor that claims end products fulfill meal pattern requirements in child nutrition programs must comply with the procedures required for approval of labels of 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 equal or better in all USDA procurement specifications than the donated food. Commercially purchased beef, pork, or poultry must meet the same specifications as donated product, including inspection, grading, testing, and humane handling standards and must be approved by the Department in advance of substitution. The processor may choose to make the substitution before the actual receipt of the donated food. However, the processor assumes all risk and liability if, due to changing market conditions or other reasons, the Department's 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 distributing or recipient agency's storage facility. The processor must process backhauled donated foods into end products for sale and delivery to the distributing or recipient agency that provided them and not to any other agency. Distributing or recipient agencies must purchase end products utilizing donated foods backhauled to their contracted processor. The processor may not provide payment for backhauled donated foods in lieu of processing.

(c) Grading requirements. The processing of donated beef, pork, and poultry must occur under Federal acceptance service grading, which is conducted by the Department's Agricultural Marketing Service. Federal acceptance service grading ensures that processing is conducted in compliance with substitution and yield requirements and in conformance with the end product data schedule. The processor is responsible for paying the cost of acceptance service grading. The processor must maintain grading certificates and other records necessary to document compliance with requirements for substitution of donated foods and with other 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 (e.g., 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) That even with ample notification time, the processor cannot 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.

§ 250.35 Storage, food safety, 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 § 250.12, 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) Food safety requirements. The processor must ensure that all processing of donated foods is conducted in compliance with all Federal, State, and local requirements relative to food safety.

(c) Commingling of donated foods and commercially purchased foods. The processor may commingle donated foods and commercially purchased foods, unless the processing agreement specifically stipulates that the donated foods must be used in processing, and not substituted, 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, either at its facility or at the facility of a commercial distributor, ensures the sale and delivery of end products that meet the processing requirements in this subpart—e.g., by affixing the applicable USDA certification stamp to the exterior shipping containers of such end products.

(d) Limitation on donated food inventories. Inventories of donated food at processors may not be in excess of a six-month supply, based on an average amount of donated foods utilized for that period, unless a higher level has been specifically approved by the distributing agency on the basis of a written justification submitted by the processor. Distributing agencies are not permitted to submit food orders for processors reporting no sales activity during the prior year's contract period unless documentation is submitted by the processor which outlines specific plans for donated food drawdown, product promotion, or sales expansion. When inventories are determined to be excessive for a State or processor, e.g., more than six months or exceeding the established protection, FNS may require the transfer of inventory and/or entitlement to another State or processor to ensure utilization prior to the end of the school year.

(e) Reconciliation of excess donated food inventories. If, at the end of the school year, the processor has donated food inventories in excess of a six-month supply, the distributing agency may, in accordance with paragraph (d) of this section, permit the processor to carry over such excess inventory into the next year of its agreement, if it

determines that the processor may efficiently store and process such quantity of donated foods. The distributing agency may also direct the processor to transfer such donated foods to other recipient agencies, or to transfer them to other distributing agencies, in accordance with § 250.12(e). 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 or recipient agency, as appropriate. 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; or
- (2) Transfer 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) If returning or transferring the donated foods, or commercially purchased foods that meet the substitution requirements in § 250.34, is not feasible, the processor may, with FNS approval, pay the distributing or recipient agency, as appropriate, for the donated foods, at the contract 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, which may be transmitted via 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, at least on a monthly basis, through automated sales reports or other electronic or written submission. The processor then compensates the distributor for the discount provided for the value of the donated food in its sale of end products.

(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 not including 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 to the appropriate agency or may permit the distributor to bill the agency separately for the delivery of end products. When the recipient agency procures storage and distribution of processed end products separately from the processing of donated foods, the recipient agency may provide the distributor written approval to act as the recipient agency's authorized agent for the total case price (i.e., including the fee-for-service and the delivery charge). The processor must require that the distributor notify it of such sales, at least on a monthly basis, through automated sales reports, e-mail, or other electronic or written submission.

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

(g) Donated food value used in crediting. In crediting for the value of donated foods in end product sales, the contract value of the donated foods, as defined in § 250.2, 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 either:

(1) The quantities of approved end products that each recipient agency is eligible to receive; or

(2) The quantity of donated food allocated to each recipient agency and the raw donated food (pounds or cases) needed per case of each approved end product.

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

(a) Performance reports. The processor must submit a performance report to the distributing agency (or to the recipient agency, in accordance with a Recipient Agency Processing Agreement) on a monthly basis, which 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 (June) 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) A list of all recipient agencies purchasing end products;
- (2) The quantity of donated foods in inventory 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 donated foods losses;
- (6) The quantity of end products delivered to each eligible recipient agency;
- (7) The quantity of donated foods remaining at the end of the reporting period;
- (8) A certification statement that sufficient donated foods are in inventory or on order to account for the quantities needed for production of end products;
- (9) Grading certificates, as applicable; and
- (10) Other supporting documentation, as required by the distributing agency or recipient agency.

(b) Reporting reductions in donated food inventories. The processor must report reductions in donated food inventories on performance reports only after sales of end products have been made, or after sales of end products through distributors have been documented. Documentation of distributor sales must be through the distributing or recipient agency's request for a refund (under a refund or rebate system) or through receipt of the distributor's automated sales reports or other electronic or written reports submitted to the processor (under an indirect discount system or under a fee-for-service system).

(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 and in a format established by FNS, 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 foods shipments;
- (3) Production, sale, and delivery of end products, including sales through distributors;
- (4) All agreements with distributors;
- (5) Remittance of refunds, invoices, or other records that assure crediting for donated foods in end products and for sale of byproducts;

(6) Documentation of Federal or State inspection of processing facilities, as appropriate, and of the maintenance of an effective quality control system;

(7) Documentation of substitution of commercial foods for donated foods, including grading certificates, as applicable;

(8) Waivers of grading requirements, as applicable; and

(9) 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) In-State Processing Agreements and State Participation 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, as required by the distributing agency (e.g., sales invoices or copies of refund payments);

(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 the value of donated foods contained in end products;

(3) Recipient Agency Processing Agreements, as applicable, and, in accordance with such agreements, other records included in paragraph (e) 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 other records that it must maintain, in accordance with the requirements in paragraph (e) of this section, 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; 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 distributing or recipient agency from which the foods were received;
- (6) Any applicable labeling requirements;
- (7) Other processing requirements implemented by the distributing agency, 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;
- (9) A statement that the agreement may be terminated immediately if the processor has not complied with its terms and conditions; and
- (10) A statement requiring the processor to enter into an agreement with any and all distributors delivering processed end products to recipient agencies that ensures adequate data sharing, reporting, and crediting of donated foods, in accordance with § 250.30(i).

(c) Required provisions of the In-State Processing Agreement. An In-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(a);
- (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(c);
- (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(f);

- (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 the value of 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 § 250.20;
- (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;
- (22) A statement that extensions or renewals of the agreement, if applicable, are contingent upon the fulfillment of all agreement provisions; and
- (23) A statement requiring the processor to enter into an agreement with any and all distributors delivering processed end products to recipient agencies that ensures adequate data sharing, reporting, and crediting of donated foods, in accordance with § 250.30(i).

(d) Required provisions for Recipient Agency Processing Agreement. The Recipient Agency Processing Agreement must contain the same provisions as an In-State Processing Agreement, to the extent that the distributing agency permits the recipient agency to perform activities normally performed by the distributing agency under an In-State Processing Agreement (e.g., approval of end product data schedules, review of performance reports, or management of the performance bond). 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 Food and Nutrition Service may waive any of the requirements contained in this part for the purpose of conducting demonstration projects to test program changes designed to improve the processing of donated foods.

(b) Processing activity guidance. Distributing agencies must develop and provide a processing manual or similar procedural material for guidance to contracting agencies, recipient agencies, and processors. Distributing agencies must revise these materials as necessary to reflect policy and regulatory changes. This guidance material must be provided to contracting agencies, recipient agencies, and processors at the time of the approval of the initial agreement by the distributing agency, when there have been regulatory or policy changes which necessitate changes in the guidance materials, and

upon request. The manual must include, at a minimum, statements of the distributing agency's policies and procedures regarding:

- (1) Contract approval;
- (2) Monitoring and review of processing activities;
- (3) Recordkeeping and reporting requirements;
- (4) Inventory controls; and
- (5) Refund applications.

(c) Guidance or information. Guidance or information relating to the processing of donated foods is included on the FNS website or may otherwise be obtained from FNS.

Dated: December 23, 2016.

Richard Lucas
Acting Administrator
Food and Nutrition Service
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