

FOOD AND AGRICULTURE
Title 3, California Code of Regulations

INITIAL STATEMENT OF REASONS
Policy Statement Overview

Division 3, Economics
Chapter 3, Milk Stabilization and Marketing of Milk and Dairy Products
Subchapter 4, Milk Producers Security Trust Fund
Article 1, Eligibility for Coverage
Section 2100, Definition of Beneficial Ownership Interest

Description of the Problem, Administrative Requirement, or Other Condition or Circumstance the Regulation is Intended to Address

The California Department of Food and Agriculture (Department) administers a Milk Producers Security Trust Fund on behalf of producers and handlers of milk. The Department determines liability for payment, eligibility for coverage, and administers a claim process and pays claims. A Milk Producers Security Trust Fund Board assists the Department with oversight responsibilities. Since the establishment of the trust fund in 1987, the financial relationship between producers and handlers has evolved substantially which has in turn impacted the Department's ability to effectively administer the fund for the protection of milk producers as required by the California Food and Agricultural Code. Amending the regulations would serve to improve this situation.

Necessity

California Food and Agricultural Code (FAC), Division 1, Part 1, Chapter 3, Article 1, Section 401, provides that the Department shall promote and protect the agricultural industry of this state.

The FAC, Division 21, Part 3, Chapter 2.5, Article 1, beginning with section 62500, establishes 1) that the production and distribution of milk, and the components thereof, is hereby declared to be a business affected with a public interest; 2) that the marketing of milk requires dairy farmers receive prompt payment; 3) that the policy of this state is to protect producers against loss of payment for bulk milk; 4) that the public interest requires the establishment of a system to provide payment security for producers.

The FAC, Division 1, Part 1, Chapter 3, Article 1, Section 407, grants the Department may adopt such regulations as are reasonably necessary to carry out the provisions of the FAC.

The FAC, Division 21, Part 3, Chapter 2.5, Article 5, describes the Milk Producers Security Trust Fund (MPSTF) and sets forth requirements for qualifying milk for coverage by the MPSTF. Among other requirements, for milk to be considered for coverage pursuant to this chapter, "The producer does not have a beneficial ownership interest in the handler to whom shipments were made."

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The California Code of Regulations, Title 3, Food and Agriculture, Division 3 Economics, Chapter 3, Milk Stabilization and Marketing of Milk and Dairy Products, SubChapter 4, Milk Producers Security Trust Fund, Section 2100, defines “beneficial ownership interest.”

Specific Purpose and Factual Basis

Proposed for amendment is Title 3, Section 2100, *Definition of a Beneficial Ownership Interest*.

Section 2100, establishes a beneficial ownership as beginning with a 10% threshold and articulates myriad other requirements. The Department seeks to eliminate the 10% threshold and further simplify the matter of assessing the presence of an ownership interest. This is necessary to account for how handler and producer operations have evolved over time and to better meet the spirit and intent of the governing statute.

The specific purpose of this proposed action is to redefine the set of circumstances leading to the presence of a milk producer having a beneficial ownership interest in a milk handler. A beneficial ownership, when present, precludes trust fund coverage for milk supplied by a producer to a handler. Producer entities today maintain ownership of handler entities in shares not meeting the 10% threshold, yet they maintain eligibility for trust fund coverage in the case of handler payment default.

This situation places the MPSTF in potential financial jeopardy because the producers selling their milk production to handlers also maintain authority to provide input on the handler’s business decisions. These “producer/owners,” are processing very significant amounts of milk—milk obtained from both producer/owners and individual producers. If a handler so organized should default, both producer/owners and individual producers would be affected and the Trust Fund would be liable for payment of valid claims by these producer/owners. Payment of these claims would significantly impact the Trust Fund and harm the fund’s ability to protect payment for producers not having an ownership interest in the handler.

The definition of a beneficial ownership interest was constructed prior to 2004, when dairies and handlers numbered much greater than today. Additionally, the value of milk, a factor affecting fund administration, is more than twice the amount it was at fund inception. Given today’s operating and market environment, trust fund claims potentially affect a greater number of producers for much higher dollar values.

In November 2013, the Department presented a proposed amended definition of beneficial ownership interest to the MPSTF Board, a decision-making body advisory to the Secretary. Board members and representatives for producers and representatives for handlers discussed the proposal and the two groups later provided written alternative language for proposing an amended definition. One point of agreement for the producers and handler representatives (Industry Groups) is the matter of eliminating the requirement having to do with influencing handler decision-making through participating in the handler business through serving on a

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board of directors, as a manager, or in a decision-making capacity. Other comments received suggested differentiating between privately-held and publicly-held companies in the interest of creating a double standard.

By way of background, in 2000, the Department resolved the first producer claim against the fund and issued payment totaling \$11,633. The question of determining the presence of a beneficial ownership interest, impacted the Department's ability to fairly and expeditiously resolve claims for the protection of producers as intended by the FAC. Regulations promulgated in 2004 improved the Department's ability to effectively administer the trust fund for the protection of producers, and today provide an administrative framework for determining proper payment of claims.

Amending the regulations as proposed would more fairly distribute and afford trust fund obligations and coverage as originally intended by the FAC, resulting in increased financial protection for dairy producers.

Economic Impact Analysis

Today, approximately 150 milk plants process or handle the output of just over 1,500 producers. In 1970, producer entities numbered almost 4,500 and handlers numbered over 500. The value of milk produced today on an annual basis is estimated at over \$9 billion in California.

The first trust fund producer claim was paid in 2000 and amounted to \$11,633. The highest claim was paid in 2002 and amounted to \$2,860,840. The MPSTF has grown in value over time from approximately \$347,000 in 1987 to just over \$50 million today.

The dollar value of the MPSTF liability is determined by the value of 110% of one month's milk purchases by the milk handler with the largest monthly producer payment obligation. In 2006, the FAC was amended to maintain the MPSTF cash at a minimum of \$30 million and allow for a handler with average monthly milk purchases exceeding the higher of either the fund cash or \$30 million, to provide acceptable securities, as defined. Several handlers are currently providing acceptable securities to cover for their producer payment liabilities over the cash held in the Trust Fund.

Determining milk producer eligibility for trust fund coverage involves how the producing entity and the processing entities are organized—California milk is supplied by single owner-operator farmers as well as large cooperatives. Milk handling in California is done by single owner-operators as well as by large publicly held corporations.

Amending the regulations as proposed would prevent producers with a beneficial ownership interest in a handler from obtaining MPSTF coverage. The proposed amendment would also lower the assessment obligation for handlers when the producers supplying the milk have a beneficial ownership interest in that handler.

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Based on the above, it is not anticipated the proposed amended regulations will affect to any significant degree:

- 1) The creation or elimination of jobs in California
- 2) The creation of new businesses or the elimination of existing businesses within California
- 3) The expansion of businesses currently doing business in California
- 4) The health and welfare of California residents, worker safety, and the state's environment.

Benefits of the Regulation

The proposed regulations intend to ensure the financial integrity of the Milk Producers Security Trust Fund (MPSTF) by streamlining certain regulatory functions as performed by the department. Especially as related to the processing of claims made against the MPSTF, the proposed amended regulations will benefit the producers and handlers of milk by ensuring to the greatest extent that potential claims are evaluated for possible payment within the context of the governing statutes. This proposal, if adopted, may serve to restrict to a greater degree than at present, the payment of claims made against the MPSTF. This benefits the California dairy industry which provides for economic benefits to the people of this state including possible job creation opportunities. The continuous marketing of milk as an essential food nutrient promotes good health and wellness to the public. Therefore, the benefits derived from the proposed changes will create a positive impact to the health and general welfare of the people of California.

Statements of Determination

Alternatives Considered: The Department has determined that no reasonable alternative considered by the Department or that has otherwise been identified and brought to the attention of the Department would be more effective in carrying out the purpose for which this action is proposed, or would be as effective and less burdensome to affected private persons than the proposed action.

The foregoing is based on the Department's evaluation of alternatives as provided by industry groups representing Producers (Milk Producers Council) and Handlers (Dairy Institute).

Milk Producers Council is opposed to eliminating the 10% threshold as an essential element of the definition of beneficial ownership interest. Their reasoning is their interpretation of "the Department's task of balancing a goal of equal raw product costs with a need to have provisions addressing individuals or entities who have a 'real' ownership stake in the handler(s) they work with." The Department is rejecting the setting of a 10% ownership stake minimum because it believes that a dairy can possess a beneficial ownership interest in situations where it possesses less than a 10% interest in a handler. Accordingly, it is rejecting this alternative so as to be able

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to more effectively administer a claims process that ensures the financial integrity of the MPSTF.

Dairy Institute commented on aspects of the proposed amended definition of beneficial ownership interest as follows:

- 1) Eliminate any reference to ‘debt’ or ‘lien’ in constructing a definition based on dictionary references and an interpretation of the governing statute.
- 2) Eliminate the two part requirement in the proposed definition and remove any reference to “occupying some role or office or position” based on an interpretation of the governing statutes.
- 3) Possibly introduce a 10% ownership interest threshold for “publicly-traded” handlers but not otherwise based on an interpretation of the governing statutes and based on the “practical safeguards” made present through “brokers, regulators, and stockholders.”

The Department is rejecting these suggestions because it believes that it has crafted an inclusive definition of a beneficial ownership interest, one authorized by statute, which will enable it to more effectively administer a claims process that ensures the financial integrity of the MPSTF.

Local Mandate Determination: The Department has determined that the proposed regulations would not impose a mandate on local agencies or school districts, nor are there any costs for which reimbursement is required by Part 7 (beginning with Section 17500) of Division 4 of the Government Code.

Economic Impact Statement: The Department has made a determination that the proposed regulations would not have a significant statewide adverse economic impact directly affecting businesses, including the ability of California businesses to compete with businesses in other states.

The Department has determined that the proposed regulations would not significantly affect the following:

1. The creation or elimination of jobs within the State of California
2. The creation of new businesses or the elimination of existing businesses within the State of California
3. The expansion of businesses currently doing business within the State of California.
4. Affect the health and welfare of California residents, worker safety and the state’s environment.

Effect on Small Businesses: The Department has determined that the proposed regulations would affect small businesses.

Housing Costs Determination: The Department has made the determination that the proposed regulations would have no impact on housing costs.

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The Department has evaluated and determined that the amendment of this regulation is not inconsistent with existing State regulations. There are no other comparable existing State regulations [Gov. Code sec. 11346.5(a)(3)(D)]

Information Relied Upon

Not applicable.