

FINAL STATEMENT OF REASONS

Title 3, Food and Agriculture Milk Producers Security Trust Fund

PUBLIC HEARING

No hearing was scheduled by the Department, or requested by the public regarding this proposal.

SECTIONS AFFECTED

Amend section 2100 of Title 3, Division 3, Chapter 3, Subchapter 4, Article 1 of the California Code of Regulations.

LOCAL MANDATES DETERMINATION

The proposed regulations do not impose any mandate on local agencies or school districts.

UPDATED INFORMATION

There have been no changes in applicable laws or to the effect of the proposed regulations from those described in the Informative Digest/Policy Statement Overview published in the California Regulatory Notice Register on August 15, 2014 [Notice File No. Z-2014-0804-02, Register 2014, No. 33-Z]. Information is updated as follows:

From May 19, 2015 to June 3, 2015, the Department published a 15-day notice of

- 1) modifications to the originally proposed regulatory text, and,
- 2) documents added to the rulemaking file (updated/amended initial statement of reasons).

Changes to the originally proposed text were organizational and/or typographical in nature. An updated/amended Initial Statement of Reasons was produced to more thoroughly describe and/or indicate the necessity for certain sections of regulatory text being proposed for amendment and/or reorganization, or deletion.

Modifications to the originally proposed text consists of

- 1) addition of the word “interest” to follow the second appearance of the term “beneficial ownership.” This was inadvertently left off of the originally proposed text, and;
- 2) deletion of the code reference (to Food and Agriculture Section 62587) in the end notes/references section. This was deemed redundant and unnecessary given the inclusion of section 62580 in the reference (to the Food and Agricultural Code).

An updated/amended Initial Statement of Reasons was developed to make specific reference to each and every element of the definition. This was done in the interest of full accountability and for greater clarity for the reader.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE NOTICE PERIOD OF AUGUST 15, 2014 TO SEPTEMBER 29, 2014

Summary of Comments Received from the California Department of Finance

The Department of Finance inquired during the comment period regarding two questions:

- 1) In the case of a producer who might lose trust fund coverage as a result of this proposal, is there any other recourse for the producer?
- 2) For the same class of producers who might lose coverage under this proposal, what proportion of the dollar value of the Trust Fund assessment would be attributable to this group?

Response to comments received from the Department of Finance

In response to question #1, producers who fail to receive payment from a handler have recourse as described in the California Food and Agricultural Code, Division 21, Part 3, “Marketing Laws Pertaining to Particular Products,” sections 62181 – 62190, and 62505. Essentially, the producer notifies the Department, a claim is investigated, facts are determined, and finally, proper producer payment is enforced according to statute. Additionally, producers affected by handler payment default have recourse through claims that could be made against statutorily required handler surety bonds, Food and Agricultural code sections 62181-62186. Lastly, affected producers might seek recourse through the civil claims process through the courts.

In response to question #2, it is not possible to determine the “proportion of Trust Fund assessment dollars attributable to this (potentially affected) class of producers. The Department has never routinely collected business-ownership relationship information related to producer/owner-handlers or any other class of handler. To seek to determine this information outside of a Trust Fund claims administration process, the Department would require a governing statute or regulation, additional personnel, and an expanded dairy accounting system.

The Department can, however, state that a high proportion of monthly production volume is generated by “producer/owner-handlers.” Producer/owner-handlers are handlers who have their own its herd along with production facilities. Food and Agricultural Code section 62580 requires handlers to provide acceptable financial securities to the Trust Fund to cover potential liabilities to producers above the current financial asset value currently held by the Fund. A producer/owner-handler may find their obligation to submit acceptable financial securities relieved or lessened to a degree that benefits them more than any potential loss of Trust Fund

coverage through the application of the definition of beneficial ownership set forth in the proposed regulation.

In effect, the proposed amended regulation clarifies that Trust Fund coverage is for individual producers instead of producer/owner-handlers with beneficial ownership interests.

Summary of Comments Received from John Lemmon of Knox, Lemmon, and Anapolsky, LLP in his letter dated September 29, 2014

Mr. Lemmon commented on behalf of the Dairy Institute of California. He reiterated the Dairy Institute's position as summarized in the statements of determination and made a part of the Initial Statement of Reasons.

In regard to proposed section 2100(a)(1), Mr. Lemmon supports the proposed elimination of any minimum percentage threshold as part of a test for determining the existence of a beneficial ownership interest. He maintains that the minimum percentage threshold was never authorized by Food and Agricultural Code section 62580(h) as any ownership interest disqualifies the producer from trust fund coverage.

In regard to proposed section 2100(a)(2), however, Mr. Lemmon asserts that it "is an improper exercise of rulemaking power... and, establishes a two-part test for determining whether a producer holds a disqualifying "beneficial ownership interest" in the handler to which it ships milk." He states that Food and Agricultural Code section 62580(h) does not authorize the Department to implement a new test for the existence of a disqualifying "beneficial ownership interest." He maintains that a beneficial ownership interest is distinct from occupying a position of influence with a company.

Response to Comments Received from Mr. Lemmon in his letter of September 29, 2014

Regarding section 2100(a)(1), the Department acknowledges the statement of support yet maintains that section 2100 was adopted in accordance with rulemaking requirements contained in the Administrative Procedures Act. Section 62580(h) grants the Department discretion in fashioning a definition of beneficial ownership interest that is most suitable to the dairy industry.

Regarding section 2100(a)(2), Mr. Lemmon maintains that it is an improper exercise of rulemaking power. He states that section 2100(a)(2) impermissibly requires that a producer additionally occupy a position with a handler, such as being an officer or director, that confers authority to influence or create policy before the economic interest described in section 2100(a) qualifies as having beneficial ownership interest. Again, the Department has determined that section 62580(h) grants the department discretion to fashion a definition of beneficial ownership

interest that is most suitable to the dairy industry. In this instance, it has concluded that this two-part test will most effectively protect the trust fund from paying claims to producers who can influence the decisions of handlers responsible for paying them.

SUMMARY AND RESPONSE TO COMMENTS RECEIVED DURING THE 15-DAY NOTICE PERIOD OF MAY 19, 2015, TO JUNE 3, 2015

Summary of Comments Received from John Lemmon of Knox, Lemmon, and Anapolsky, LLP in a letter dated June 3, 2015

Mr. Lemmon, on behalf of the Dairy Institute, again reiterates objections previously delivered to the Department on September 29, 2014 (responded to above), and as addressed in the statements of determination published in the initial statement of reasons on August 15, 2014.

Mr. Lemmon presents these objections within the context of the updated, amended initial statement of reasons, published for public comment during the 15-day notice period. Mr. Lemmon acknowledges, however, that the characterization of handler and producer operations in the updated/amended initial statement of reasons may be correct. But he maintains that the Department cannot rely upon this characterization in support of the definition of a beneficial ownership interest set forth in the proposed regulation.

Response to Comments Received from John Lemmon in his letter of June 3, 2015

The Department addresses Mr. Lemmon's objections by incorporating by reference its response to his September 29, 2014 letter and the manner they were addressed in the Initial Statement of Reasons. As for his new claim that the Department cannot rely upon the current status of handler and producer operations to support the proposed regulation, the Department respectfully disagrees. Section 62580(h), as explained in the response to his September 29, 2014 letter, grants the Department discretion to fashion a definition of a beneficial ownership interest that conforms to the practices of the dairy industry.

ALTERNATIVES DETERMINATION

The Department has determined that no alternative would be:

- 1) more effective in carrying out the purpose for which the regulation is proposed, or,
- 2) would be as effective and less burdensome to affected private persons than the proposed regulation, or,
- 3) would be more cost effective to affected private persons and equally effective in implementing the statutory policy.

These determinations are based upon the statement of benefits as articulated in the informative digest/policy statement overview.

ECONOMIC IMPACT ON SMALL BUSINESS

No commenter proposed an alternative to lessen any adverse economic impact on small businesses.

CONCLUSION

The Food and Agricultural Code provides protection for dairymen by requiring 1) handlers provide timely and proper payment for milk delivered, 2) milk purchase contracts, and, 3) surety bonds. The Milk Producers Security Trust Fund provides additional financial protection should a handler default on payment for milk purchased from producers. It was created to protect producer milk payments, but not to allow dairies with a beneficial ownership interest in the handler operation receiving the milk to recover from the Fund in the event of non-payment for their milk. Section 2100 of Title 3 of the California Code of Regulations provides a definition of this interest, and the proposed amendments clarify it so as to make it more readily understandable.

The Department concurs that the 10 percent threshold for determining a beneficial ownership interest is no longer an effective measure and should be eliminated, however, a second test is being required before disqualifying from Trust Fund coverage producer/owner-handlers. That is, only producer/owner-handlers who act in a business decision-making role concerning the handlers' business operation are being affected with this proposal. It is the Department's contention this proposal best meets the spirit and intent of the statute governing the Milk Producers Security Trust Fund as well as the needs and interests of the California dairy industry and dairy consuming public.