

# Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## DEPARTMENT OF AGRICULTURE

### Food and Nutrition Service

#### 7 CFR Parts 210, 215 and 220

RIN 0584-AD38

#### Procurement Requirements for the National School Lunch, School Breakfast and Special Milk Programs

**AGENCY:** Food and Nutrition Service, USDA.

**ACTION:** Proposed rule.

**SUMMARY:** This rule proposes to amend the regulations governing procedures related to the procurement of goods and services in the National School Lunch Program, School Breakfast Program and Special Milk Program to remedy deficiencies identified in audits and program reviews. This proposal makes changes in three areas: the school food authority's responsibility for proper procurement procedures and contracts; prohibitions on the school food authority's use of nonprofit school food service account funds for costs resulting from improper procurements and contracts; and the State agency's review and approval of school food authority procurement procedures and contracts. The proposed rule also makes technical amendments to the Special Milk Program and School Breakfast Program regulations to make the procurement and contract requirements and consequences for failing to take corrective action in these regulations consistent with the National School Lunch Program regulations and adds the definitions of contractor and nonprofit school food service account to the National School Lunch Program, Special Milk Program and School Breakfast Program regulations. These changes are intended to promote free and open competition in school food authority procurements, clarify State agency rights and ensure that only allowable contract costs are paid with nonprofit school food service account funds.

**DATES:** To be assured of consideration, comments must be received on or before February 28, 2005.

**ADDRESSES:** The Food and Nutrition Service invites interested persons to submit comments on this proposed rule. Comments may be submitted by any of the following methods:

- E-Mail: Send comments to [CNDPROPOSAL@FNS.USDA.GOV](mailto:CNDPROPOSAL@FNS.USDA.GOV), (In the subject line of the message, identify that the comments are for the CND proposed procurement rule.
- Fax: Submit comments by facsimile transmission to: (703) 305-2879, attention Terry Hallberg.
- Mail: Comments should be addressed to Mr. Terry Hallberg, Chief, Program Analysis and Monitoring Branch, Food and Nutrition Service, Department of Agriculture, 3101 Park Center Drive, Room 640, Alexandria, Virginia 22302-1594. All written submissions will be available for public inspection at this location Monday through Friday, 8:30 a.m. to 5 p.m.

- Hand Delivery or Courier: Deliver comments to 3101 Park Center Drive, Room 640, Alexandria, Virginia 22302-1594, during normal business hours of 8:30 a.m. to 5 p.m.
- Federal eRulemaking Portal: Go to <http://www.regulations.gov>. Follow the online instructions for submitting comments.

**FOR FURTHER INFORMATION CONTACT:** Denise Londos or Todd J. Barrett at the above address or by telephone at 703-305-2590.

**SUPPLEMENTARY INFORMATION:**

**I. Background**

#### I. Background

Generally, schools manage the school meals programs under the Department's Child Nutrition Programs—the National School Lunch Program, School Breakfast Program and Special Milk Program, on their own. School food service activities are self-managed by local school food authority officials. In conducting these activities, school food authorities manage the school meals programs but contract with vendors for goods and services related to the school food service operation, using either fixed price or cost reimbursable contracts. Under a fixed price award, the resulting contract has a firm fixed price, with or without adjustments. In a cost-reimbursable contract or contract with cost-reimbursable provisions, the school food authority pays the

contractor for certain costs incurred by the contractor, with or without a fixed fee for services. The vast majority of these contractors are commercial enterprises.

In other situations, school food authorities operating the National School Lunch Program and/or the School Breakfast Program contract with a commercial enterprise or nonprofit organization to manage the school meal programs. These companies are collectively known as food service management companies. These contracts may be either fixed price or cost-reimbursable. The vast majority of these contractors are commercial enterprises.

School food authorities use funds from the nonprofit school food service account to pay for costs incurred under both self-managed and food service management company contracted programs. The funds in the nonprofit school food service account come from federal and nonfederal sources. The federal funds are provided as reimbursements through the Department's Child Nutrition Programs for meals and milk meeting the requirements in 7 CFR 210.10, 215.7 and 220.8 that are served to eligible children. The primary sources of nonfederal revenue are student payments, adult payments and a la carte sales revenue. Additional funding sources include State and local funds and sales revenue from vending and catering activities. Regardless of the source, the school food authority must retain all of these revenues in the restricted nonprofit school food service account and may only expend these revenues for the allowable costs of the school food authority's nonprofit school food service program. The allowability of the expenditures is determined using the applicable program and departmental regulations (7 CFR Parts 210, 215, 220, 3016 and 3019, as applicable) and Office of Management and Budget Cost Circulars (A-87 Cost Principles for State, Local Governments and Indian Tribal Governments or A-122 Cost Principles for Non-profit Organizations, as applicable).

A school food authority is permitted to engage in other activities that are outside of the scope of the nonprofit school food service; however the school food authority must ensure none of the resources of its nonprofit school food

service subsidize the costs of such activities. Some examples of these nonprogram activities include food service catering to the community and individuals, providing food and nonfood supplies for school functions such as graduation ceremonies, sports banquets and school club meetings, etc., sales of meals to school non-student visitors, and allowing school food service facilities and equipment to be used by other school or community groups. The direct and indirect costs of these activities are not Child Nutrition Program charges to the nonprofit school food service account. As a result, these costs must be fully funded by the revenues received from such activities or from sources outside the nonprofit school food service account.

## II. Discussion of the Rule's Provisions

### A. Procurement Procedures

Regardless of the requested goods or services or the procurement method used, all procurements must be conducted in a manner that provides full and open competition. When conducting a procurement, a public school food authority must follow its own procurement procedures that reflect applicable State and local laws, provided that the procurement complies with the standards set forth in Department regulation 7 CFR 3016.36(b) through (i) and 3016.60(b) through (c). Similarly, a State agency conducting a procurement on behalf of one or more school food authority or other Child Nutrition Program participant would follow those same Department regulations. A not for profit school food authority may opt to follow its own organizational procedures for procurements made with nonprofit school food service account funds provided the procedures comply with the standards set forth in 7 CFR 3019.40 through 3019.48.

The procurement procedures used by school food authorities are either formal or informal. Formal procurement procedures use either sealed bids or competitive proposals and must be used when the proposed purchase will exceed the small purchase threshold. Formal procurement procedures require public advertising and direct solicitation of potential suppliers with written responses from the potential suppliers. Formal procurements also require the use of specific forms and processes that must be followed depending upon the formal procurement procedure chosen. The informal or small purchase procurement procedure is used for purchases that are

not expected to exceed the small purchase threshold.

In a small purchase procurement, an adequate number of suppliers are contacted to obtain price quotations. While obtaining written price quotations and contacting at least three suppliers is recommended, the number of suppliers that should be contacted depends on the marketplace. This means in some areas with a large number of suppliers, more than three suppliers should be contacted, while in other areas, less than three suppliers may exist.

Full and open competition provides a "level playing field" so that all potential contractors have the opportunity to win the contract award. The outcome of a properly conducted procurement results in the school food authority obtaining the best product at the best price. When competition is impaired, the school food authority loses the fundamental benefit of an open marketplace. The loss of this benefit can needlessly diminish the resources of the nonprofit school food service account and inhibit the school food authority from providing high quality, nutritious meals to children and implementing needed improvements to its food service operations.

### B. Goals of This Proposed Rule

We are proposing to amend the National School Lunch Program regulations, 7 CFR Part 210, Special Milk Program regulations, 7 CFR Part 215, and School Breakfast Program regulations, 7 CFR Part 220 to remedy deficiencies in school food authority procurement practices that have been identified in audits conducted by the U.S. Department of Agriculture's Office of Inspector General, Report Numbers 27010-3-AT, February 2002 and 27601-0027-CH, April 2002. These identified deficiencies are undermining free and open competition and resulting in unallowable uses of nonprofit school food service account funds.

### C. Audit Results—Cooperative Buying Groups

In February 2002, the Department's Office of Inspector General (OIG) released Audit Report 27010-3-AT. The audit outlined problems in school food authority cooperative buying arrangements. Under these arrangements, school food authorities in a single jurisdiction or multiple, often geographically related, jurisdictions, pool purchasing needs and solicit a single service provider to provide goods and services. School food authorities, as a cooperative buying group, expect the service provider to perform a number of different functions. These functions

generally include selling food and nonfood supplies to the school food authorities from the service provider's inventory, conducting procurements with manufacturers and food processors on behalf of the member school food authorities, and storing, distributing and managing the school food authorities' inventories of USDA donated foods and purchased foods and nonfood supplies. The OIG's audit identified a number of instances where the cooperative buying group, using nonprofit school food service account funds, failed to conduct procurement transactions in a manner that provided for full and open competition. For example, one cooperative buying group failed to include all items to be purchased in its bid solicitation and instead, purchased items directly from the service provider outside of the terms of the contract. In another instance, the service provider was permitted to make a material change to the contract resulting in an unallowable cost-plus-percentage-of-cost pricing structure. As a result, unallowable costs were paid by school food authorities with funds from the nonprofit school food service account.

### D. Audit Results—Procurement Procedures and Allowable Costs

In April 2002, OIG released Audit Report 207601-0027-CH which revealed problems in several cost-reimbursable contracts between school food authorities and food service management companies. Some contracts between school food authorities and food service management companies lacked controls as to exactly how the company would determine the allowability of costs charged to the school food authority, including how the company would provide the school food authority with the benefits of purchase discounts and rebates in the determination of net costs. In some cases, this resulted from the school food authority's failure to inform potential contractors of how costs should be charged to the school food authority under the resulting contract award. In other cases, even though the school food authority's procurement documents required return of such discounts and rebates, some school food authorities permitted a material change to the food service management company contract that specifically allowed the food service management company to keep discounts and rebates earned through purchases billed to the school food authority.

The failure of a school food authority to fully describe its cost reporting requirements in its solicitation document undermines full and open

competition by placing unreasonable burdens on potential contractors. Without adequate details on how it must report costs to the school food authority, a potential contractor lacks the information needed to properly establish the fixed price component (management fee) of its offer. For example, one potential contractor, assuming that no discounts, rebates and credits will be returned to the school food authority, could provide an offer with a low management fee, knowing that its fixed costs and profit margin would actually be funded, in part, through the retained discounts, rebates and credits. A second potential contractor, recognizing the discounts, rebates and credits as being due to the school food authority might provide an offer with a higher management fee that included all its fixed costs and profit margin. Since school food authorities only evaluate the fixed fee component when determining the most cost effective offer under a cost reimbursable contract, the failure of a school food authority to address its cost reporting requirements in its solicitation documents creates unacceptable risks to full and open competition. Further, failure to adequately address issues regarding allowable costs in solicitation documents and contracts can result in unallowable cost charges to the school food authority that are paid with nonprofit school food service account funds.

As the OIG found, the absence of a specific contract requirement limiting food service management company charges to allowable costs has resulted in food service management companies charging school food authorities for administrative costs that were already included as part of the fixed fee, billing for the same expense twice, and charging the school food authority for the food service management company's administrative cost overruns. Without adequate guidance from the school food authority on how costs must be billed, a contractor lacks the information needed to properly identify allowable and unallowable costs submitted for payment to the school food authority. In turn, the school food authority cannot determine whether nonprofit school food service account funds can be used to pay all or only part of the costs billed by the contractor. Either result is untenable.

This proposed rule would clarify that only costs resulting from cost reimbursable contracts or cost reimbursable contract provisions that meet applicable cost allowability requirements are allowable nonprofit school food service account

expenditures. The proposed rule does not interfere in the right of a school food authority to enter into a contract, including a contract with terms that result in unallowable costs. The proposed rule, does, however, prohibit the school food authority from using nonprofit school food service account funds to pay for those unallowable costs.

In addition this proposed rule would prohibit contract terms that allow payments from the nonprofit school food service account in excess of the contractor's actual net allowable costs. Such net allowable costs must be computed by deducting certain discounts, rebates and other applicable credits. Contractors, using applicable department and program regulations and OMB cost circulars, would be required to provide sufficient information to permit the school food authority to identify allowable and unallowable costs and the amount of all such discounts and rebates on invoices and bills presented for payment to school food authorities. The school food authority would use this contractor supplied information to calculate the amount of net allowable costs that can be paid from the nonprofit school food service account. In making this calculation, the school food authority would apply the applicable program and department regulations and OMB cost circulars to identify the allowable costs, net of applicable credits, that may be paid from the nonprofit school food service account and unallowable contract costs that must be paid from other funding sources.

Further, the proposed rule would require that upon request, contractors would be required to provide documentation of discounts, rebates and other applicable credits as well as costs billed to the school food authorities. As defined by the applicable OMB cost circulars, discounts, rebates and other applicable credits include, but are not limited to, price reductions due to: product promotion, volume purchasing, on-line ordering or other electronic ordering systems, prompt payments or advance payments and use of certain suppliers. This proposed rule would apply to all discounts, rebates and credits accruing to or received by the contractor, including any assignee under the contract to the extent those amounts are allocable to the allowable costs for which the contractor will be reimbursed by the school food authority. For reference purposes, this proposed rule clarifies the applicability of the definition of applicable credits is the respective OMB cost circulars.

School food authorities that fail to comply with proper procurement procedures or permit a contractor to make a material change to a contract after contract award compromise the integrity of the entire procurement process. A material change to a contract after it has been awarded alters the terms and conditions of that contract to the extent that had other bidders known of these changes in advance, they could have bid differently and more competitively. This means that when a school food authority agrees to or allows a winning bidder to make changes to contract terms that are materially inconsistent with the underlying solicitation document, the school food authority has subverted full and open competition by denying all bidders the opportunity to compete under the same terms and conditions. While all school food authorities must have procedures to respond to bid protests, when a material change occurs to the contract after the bid has been awarded, the only way a disadvantaged bidder will learn of the change is through obtaining and reviewing the executed contract. This is inherently unfair given that the school food authority has undermined open and free competition by providing an unwarranted advantage to the successful bidder to the detriment of the other bidders.

This proposed rule would prohibit school food authorities from using nonprofit school food service account funds for any cost resulting from a procurement that failed to meet program requirements.

#### *E. State Agency Review of Contracts*

Under current regulations, State agencies generally do not review school food authority contracts until after the contracts have been executed (signed by the school food authority and contractor). Except for school food authority/food service management company contracts, State agencies do not receive copies of other school food authority contracts and generally only review these contracts during the normal on-site review process. In some States, a pre-approved prototype contract or contract terms are provided to the school food authority by the State agency. In the case of a pre-approved prototype contract, State agency officials generally do not review the executed contract since the State agency expects all school food authorities to use the approved prototype as it was drafted. In other cases, a State agency may limit its review only to discretionary contract terms and conditions because the State agency expects the school food authority has incorporated, verbatim,

the pre-approved contract terms the State agency provided.

The OIG found that some food service management companies required material changes to contracts that operated to the disadvantage of the school food authorities. These included changes that were made after the State agency's review and approval of executed contracts, changes to pre-approved prototype contracts and changes to required contract terms. Many of the changes circumvented regulatory requirements. State agencies and school food authorities have indicated that food service management companies were able to accomplish these changes by requiring the school food authority sign a food service management company prepared contract or refusing to sign the school food authority's approved contract until the changes were made. While the school food authorities should have conducted a new procurement in response to these demands, the delay incident to such actions would have prevented some school food authorities from providing meals to students. Some State agencies have expressed concerns with their ability to obtain copies of contracts prior to their execution and have further expressed concerns that they do not have the ability or authority to mandate changes to contract terms and obtain required corrective actions.

When the State agency finds problems with the terms of an already executed contract, it may be too late to remedy the problems for the current contract, except when State or local laws and procedures permit contract nullification. Since the school food authority is bound to fulfill its contract terms, in the most serious cases, the State agency's only recourse is to disallow all costs resulting from the contract. In the majority of cases, the State agency's required corrective action results in the school food authority initiating a new procurement process at the end of the current contract year, eliminating the option for contract renewals. None of these approaches provide timely corrective action. To reduce the number of contract disallowances and re-bid situations, this rule proposes that when a school food authority contracts with a food service management company, the contract must be reviewed and approved by the State agency prior to the contract being executed. The proposed rule also clarifies that for all other contracts, State agencies have authority to obtain copies of the contracts prior to execution and are encouraged to do so for all contracts. Further, this rule proposes that the school food authority obtain written

State agency approval of any change to a prototype solicitation document or prototype contract before the revised solicitation is issued or the revised contract is executed. This provision does not interfere with the school food authority or potential contractor's right to negotiate, pursuant to Department regulations, 7 CFR parts 3016 and 3019, contract terms and conditions under a competitive proposal procurement. In this type of procurement, the pre-approved prototype contract or contract terms only address the nonnegotiable aspects of the contract. Contract terms for areas subject to negotiation are not prepared until after the negotiations have been completed.

To ensure that school food authorities understand the scope of the authority granted to State agencies to properly administer the school meals programs, the proposed rule would clarify the right of the State agency to obtain procurement documents prior to issuance of the school food authority's solicitation as well as prior to the execution of the resulting contract. State agencies are encouraged to obtain these procurement documents prior to the school food authority's issuance (publication, direct mailing, internet posting, etc.) of the solicitation. Through this review, the State agency can provide technical assistance to the school food authority by identifying deficiencies in the procurement documents and processes before the solicitation is released. State agencies are also encouraged to obtain the school food authority's procurement documents when reviewing contracts to determine the adequacy of the contract terms and identify instances where the integrity of the procurement process may have been compromised.

Further, this proposed regulation would prohibit school food authorities from using nonprofit school food service account funds to pay for unallowable contract costs, including costs that result from improperly procured contracts and from a school food authority's failure to initiate corrective actions to procurement and contract documents as required by the State agency. Currently, 7 CFR 210.24 requires State agencies withhold program payments when a school food authority fails to comply with program requirements. This withholding would stay in effect until the school food authority took corrective action satisfactory to the State agency. At that point, the withheld funds are released to the school food authority. However, the school food authority would still be prohibited from using its nonprofit school food service account funds to

pay for unallowable costs. Therefore, whether or not the State agency withheld program payments, costs incurred under an improperly procured contract as well as costs incurred during the period the school food authority fails to take State agency required corrective action would be unallowable costs.

This proposed regulation does not absolve a school food authority from fulfilling its contractual obligations, even in those cases where the school food authority has failed to comply with required procurement practices. Additionally, this proposed regulation does not impair a school food authority's right to contract, including the right to contract for goods or services that represent unallowable nonprofit school food service account costs as long as the procurement and contract terms require adequate reporting and disclosure of such costs. Such costs could include catering school board luncheons or operating concession stands at school sporting events. While this proposed regulation would not impair a school food authority's right to contract for goods and services that represent unallowable costs, such unallowable costs cannot be paid with nonprofit school food service account funds.

#### *F. Ethics and Integrity in the Procurement Process*

While not specifically identified as a deficiency in the OIG audits, the Department is aware of instances in which full and open competition has been undermined by a lack of ethical conduct on the part of potential contractors and school food authorities. When State agencies or others determine such conduct is intentional, the matter should be referred to the appropriate legal authorities. However, in some cases, the unethical conduct results from school food authorities failing to fulfill their responsibilities under applicable code of conduct rules. All public and nonprofit school food authorities must have a written code of conduct governing the performance of its employees engaged in the award and administration of contracts. The code of conduct must prohibit any employee, officer or agent of the school food authority from participating in the selection, award or administration of the contract if a conflict of interest, whether real or apparent, exists. The Department regulations at 7 CFR 3016.36(b)(3) and 3019.42 define the minimum standards for determining when a conflict of interest exists and the actions that must be taken if a conflict occurs. The information indicates that school food

authorities appear to know that an individual is prohibited from personally soliciting or accepting cash as an inducement to award a contract. However, we have been concerned that these same school food authorities seem unaware that soliciting or personally accepting noncash gratuities (gifts) or accepting cash or noncash gifts in the name of the school is also prohibited. This lack of awareness may stem from the various forms such inducements can take. Inducements to contract in any form are not acceptable under Departmental regulations.

The Department is aware of situations in which school officials, in exchange for requiring the school food authority to purchase products from a specified contractor, have requested or accepted tickets to professional sporting events, contractor paid vacations, funds for student scholarships, and school building and athletic venue improvements. These situations have occurred primarily in two settings: First, in long term beverage contracting and second, in food service management company procurements.

#### *G. Long Term Beverage Contracting*

A number of schools have entered into long term beverage contracts, particularly for the acquisition of carbonated soft drinks and bottled water. Generally, these contracts provide financial incentives to the school, either in the form of cash payments or improvements to school facilities, in exchange for the contractor's right to sell its beverages to the school on an exclusive, long-term basis. These contracts are usually obtained outside of the nonprofit school food service operation and school officials may or may not have followed competitive procurement requirements.

While these incentives may represent improper inducements under applicable Department regulations, as long as nonprofit school food service resources *i.e.*, cash, labor or other assets are not used to support, directly or indirectly, any purchase made under the contract, and the school observes the regulatory prohibitions on competitive food sales and the sale of foods of minimal nutritional value, the Department has no authority over the procurement or operation of these contracts.

However, in some cases, the incentives offered by a potential contractor are contingent on the nonprofit school food service purchasing beverages under the contract. In these cases, a conflict of interest has arisen, applicable procurement requirements have been violated and the Department does have

an interest in the contract. While the nonprofit school food service may be bound by the terms of the contract, all direct and indirect costs resulting from the contract would be unallowable nonprofit school food service account expenses. On the other hand, if the nonprofit school food service is included in a properly procured long term beverage contract that includes incentives, cost allowability is generally not an issue; however, these incentives represent program income. The full value of all incentives (cash and noncash) would be used to determine the amount of program income resulting from the contract. This full value of these incentives is used to compute the amount of the program income that is allocated and deposited into the nonprofit school food service account. Failure to provide the nonprofit school food service with its allocated share of noncash incentives (*i.e.*, athletic equipment, classroom improvements, score boards, etc.) would circumvent the proper allocation of program income to the nonprofit school food service and would be a violation of existing Department regulations, 7 CFR 3016.25 and 3019.24.

#### *H. Food Service Management Companies and Procurement*

In the area of food service management company procurements, we are aware of situations in which potential bidders have offered gifts to school officials or cash payments to the school upon execution of the contract. In some cases these payments were never requested, while in other cases, some school officials have required payment at the start of the contract in exchange for contract award; and in still others, the payment is offered as an advance on a guaranteed return provision of the contract. In all of these cases, whether or not the receipt of funds is a factor in awarding the contract, the payment creates the appearance of a prohibited conflict of interest.

The Department is not proposing to add regulatory requirements to address these issues since existing regulations already require compliance with ethics and integrity requirements. However, the Department is seeking public comments to determine if there is a need for us to publish a rule on ethics and integrity for these situations.

#### *I. Regulatory Consistency*

The procurement and contract requirements and consequences for failure to comply with program regulations are not consistently addressed in the National School

Lunch, School Breakfast and Special Milk Program regulations. This proposed rule makes changes to School Breakfast Program and the Special Milk Program regulations to make the procurement and contracting requirements and the consequences for failure to comply with program regulations consistent with the National School Lunch program regulations.

#### *J. Definition of Nonprofit School Food Service Account*

The phrase "nonprofit school food service account" is used by school food authorities, State agencies and the Department to describe the books and records maintained for the nonprofit school food service pursuant to §§ 210.19(a)(2) and 220.13(i). We are proposing to add a definition of nonprofit school food service account to codify this commonly used term. This new definition does not create any new requirements and does not require creation of a separate bank account. In the Special Milk Program, the phrase "nonprofit milk program" is used instead of nonprofit school food service. For the Special Milk Program, the proposed definition of nonprofit school food service account is modified accordingly.

### **III. Procedural Matters**

#### *A. Executive Order 12866*

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

#### *B. Regulatory Flexibility Act*

This proposed rule has been reviewed with regard to the requirements of the Regulatory Flexibility Act (5 U.S.C. 601–612). Roberto Salazar, Administrator for the Food and Nutrition Service, has certified that this proposed rule would not have a significant economic impact on a substantial number of small entities. This proposed rule would simplify school food authority administrative procedures by clarifying procurement requirements so that all cost reimbursable contracts or cost reimbursable provisions of contracts are bid in a consistent manner. The U.S. Department of Agriculture does not anticipate any significant fiscal impact that would result from implementation of this proposed rulemaking.

#### *C. Public Law 104–4*

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Public Law 104–4, establishes requirements for Federal agencies to assess the effects of

their regulatory actions on State, local, and tribal governments and the private sector. Under section 202 of the UMRA, the Food and Nutrition Service generally prepares a written statement, including a cost-benefit analysis, for proposed and final rules with "Federal mandates" that may result in expenditures to State, local, or tribal governments, in the aggregate, or to the private sector, of \$100 million or more in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires the Food and Nutrition Service to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, more cost-effective or least burdensome alternative that achieves the objectives of the rule.

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

#### *D. Executive Order 12372*

The National School Lunch Program, Special Milk Program and the School Breakfast Program, which are listed in the Catalog of Federal Domestic Assistance under Nos. 10.555, 10.556, and 10.553, respectively, are subject to the provisions of Executive Order 12372, which requires intergovernmental consultation with State and local officials. (See 7 CFR part 3015, subpart V, and final rule related notice published at 48 FR 29114, June 24, 1983.)

#### *E. Executive Order 13132*

Executive Order 13132 requires Federal agencies to consider the impact of their regulatory actions on State and local governments. Where such actions have federalism implications, agencies are directed to provide a statement for inclusion in the preamble to the regulations describing the agency's considerations in terms of the three categories called for under section 6(b)(2)(B) of Executive Order 13132. The Food and Nutrition Service (FNS) has considered the impact of this rule on State and local governments and has determined that this rule would not have federalism implications. This proposed rule would not impose substantial or direct compliance costs on State and local governments. Therefore, under section 6(b) of the Executive Order, a federalism summary impact statement is not required.

#### *F. Executive Order 12988*

This proposed rule has been reviewed under Executive Order 12988, Civil Justice Reform. This proposed rule, when finalized, would have preemptive effect with respect to any State or local laws, regulations or policies which conflict with its provisions or which would otherwise impede its full implementation. This proposed rule would not have retroactive effect unless so specified in the **DATES** section of the final rule preamble. Prior to any judicial challenge to the provisions of this rule or the application of the provisions, all applicable administrative procedures must be exhausted. In the National School Lunch Program and the School Breakfast Program, the administrative procedures are set forth under the following regulations: (1) School food authority appeals of State agency findings as a result of an administrative review must follow State agency hearing procedures as established pursuant to 7 CFR 210.18(q), 215.13(g) and 220.14(e); (2) school food authority appeals of FNS findings as a result of an administrative review must follow FNS hearing procedures as established pursuant to 7 CFR 210.30(d)(3) and 220.14(g); and (3) State agency appeals of State Administrative Expense fund sanctions (7 CFR 235.11(b)) must follow the FNS administrative review process as established pursuant to 7 CFR 235.11(f).

#### *G. Civil Rights Impact Analysis*

Under Department Regulation 4300-4, Civil Rights Impact Analysis, FNS has reviewed this proposed rule to identify and address any major civil rights impacts the proposed rule might have on minorities, women, and persons with disabilities. After a careful review of the rule's intent and provisions, FNS has determined that this rule would not in any way limit or reduce participants' ability to participate in the 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. Paperwork Reduction Act*

The Paperwork Reduction Act of 1995 (44 U.S.C. Chap. 35; see 5 CFR part 1320) requires that the Office of Management and Budget (OMB) approve all collections of information by a Federal agency from the public before they can be implemented. Respondents are not required to respond to any collection of information unless it displays a current valid OMB control number. This proposed rule contains

information collections that are subject to review and approval by OMB; therefore, in accordance with the Paperwork Reduction Act of 1995, this notice invites the general public and other agencies to comment on the proposed information collection. Written comments on this proposed information collection must be received on or before February 28, 2005.

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

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

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

The title, description, and respondent description of the information collections are shown below with an estimate of the annual reporting and recordkeeping burdens. Included in the estimate is the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. The chart below identifies only the burden hours associated with those

sections of 7 CFR Part 210, National School Lunch Program, 7 CFR Part 215, Special Milk Program and 7 CFR Part 220, School Breakfast Program. These burden hours represent proposed changes to the current reporting and recordkeeping requirements and incorporate additional proposed requirements.

*Title:* 7 CFR Part 210 National School Lunch Program.

*OMB Number:* 0584-0006.

*Expiration Date:* 07/31/2006.

*Type of Request:* Revision of existing collection.

*Abstract:* This proposed rule would update the National School Lunch Program regulations, 7 CFR Part 210 (OMB Number: 0584-0006) regarding the use of federal funds for the provision of meals and milk for school children under these programs.

This proposed rule would prohibit a school food authority from using funds in the nonprofit school food service account for expenditures made under an improperly procured contract, including any cost reimbursable provision of a contract that permits the contractor to receive payments in excess of the

contractor's actual net allowable costs. State agencies would also be responsible for reviewing and approving contracts between school food authorities and food service management companies prior to their execution.

The expected result is that regulatory language will ensure optimum utilization of funds in the nonprofit school food service account. The burden associated with the proposed rules will only affect schools participating in the National School Lunch or School Breakfast Programs that contract with food service management companies.

ESTIMATED ANNUAL RECORDKEEPING AND REPORTING BURDEN

	Section	Annual number of respondents	Annual frequency	Average burden per response	Annual burden hours
National School Lunch Program State agency review and approve procurements between school food authority and contractor:					
Total existing State agencies .....	7 CFR 210.19(a) .....	57	22	.167	207
Total proposed State agencies .....	7 CFR 210.19(a) .....	57	30	4	6,840
School food authority provide procurement materials to State agency for approval:					
Total existing school food authorities .....	7 CFR 210.16(c) .....	1,648	1	.25	412
Total proposed school food authorities .....	7 CFR 210.16(a) .....	1,648	1	1.5	2,487
School Breakfast Program*					

\*The vast majority of schools participating in the SBP also participate in the NSLP. Therefore, the burden associated with state agencies and school food authorities contracting for goods and services to operate the School Breakfast Program is carried in the NSLP information collection budget:

Total Existing: 619  
 Total Proposed: 9,327  
 Change: +8,708

*Title:* 7 CFR Part 215 Special Milk Program.

*OMB Number:* 0584-0005.

*Expiration Date:* 01/31/06.

*Type of Request:* Revision of existing collection.

*Abstract:* This proposed rule would update the Special Milk Program regulations, 7 CFR Part 215 (OMB Number: 0584-0005) regarding the use of federal funds for the provision of meals and milk for school children under these programs. This proposed rule would prohibit a school food authority from using funds in the nonprofit school food service account for expenditures made under an improperly procured contract, including any cost reimbursable provision of a contract that permits the contractor to receive payments in excess of the contractor's actual net allowable costs. State agencies would also be responsible for reviewing and approving contracts between school food authorities and food service management companies prior to their execution. The expected result is that regulatory language will ensure optimum utilization of funds in the nonprofit school food service account. The burden associated with

contract review in the proposed rule will only affect schools participating in the National School Lunch or School Breakfast Programs that contract with food service management companies. The burden associated with schools participating in the Special Milk Program would be minimal because milk is often the sole procured item and the procurement is generally handled at the school food authority level. Therefore this burden is also carried in the NSLP information collection budget.

*Title:* 7 CFR 220 School Breakfast Program.

*OMB Number:* 0584-0012.

*Expiration Date:* 08/31/07.

*Type of Request:* Revision of existing collection.

*Abstract:* This proposed rule would update the School Breakfast Program Regulations, 7 CFR Part 220, (OMB Number: 0584-0012) regarding the use of federal funds for the provision of meals and milk for school children under these programs. This proposed rule would prohibit a school food authority from using funds in the nonprofit school food service account for expenditures made under an improperly procured contract, including

any cost reimbursable provision of a contract that permits the contractor to receive payments in excess of the contractor's actual net allowable costs. State agencies would also be responsible for reviewing and approving contracts between school food authorities and food service management companies prior to their execution. The expected result is that regulatory language will ensure optimum utilization of funds in the nonprofit school food service account. The burden associated with the proposed rules will only affect schools participating in the National School Lunch or School Breakfast Programs that contract with food service management companies. The vast majority of schools participating in the SBP also participate in the NSLP. Therefore, the burden associated with state agencies and school food authorities contracting for goods and services to operate the School Breakfast Program is carried in the NSLP information collection budget.

*I. Government Paperwork Elimination Act Compliance*

FNS is committed to compliance with the Government Paperwork Elimination

Act, which requires Government agencies to provide the public with the option of submitting information or transacting business electronically to the maximum extent possible.

#### List of Subjects

##### 7 CFR Part 210

Children, Commodity School Program, Food assistance programs, Grants programs-social programs, National School Lunch Program, Nutrition, Reporting and recordkeeping requirements, Surplus agricultural commodities.

##### 7 CFR Part 215

Food assistance programs, Grant programs-education, Grant programs-health, Infants and children, Milk, Reporting and recordkeeping requirements.

##### 7 CFR Part 220

Children, Food assistance programs, Grant programs-social programs, Nutrition, Reporting and recordkeeping requirements, School Breakfast Program.

Accordingly, 7 CFR Parts 210, 215 and 220 are proposed to be amended as follows:

### PART 210—NATIONAL SCHOOL LUNCH PROGRAM

1. The authority citation for Part 210 continues to read as follows:

**Authority:** 42 U.S.C. 1751–1760, 1779.

2. In § 210.2, add, in alphabetical order, the definitions of “*Applicable credits*”, “*Contractor*”, and “*Nonprofit school food service account*” to read as follows:

#### § 210.2 Definitions.

\* \* \* \* \*

*Applicable credits* shall have the meaning established in Office of Management and Budget Circulars, A–87, C(4) and A–122, Attachment A, A(5), respectively. For availability of OMB circulars referenced in this definition see 5 CFR 1310.3.

\* \* \* \* \*

*Contractor* means a commercial enterprise, public or nonprofit private organization or individual that enters into a contract with a school food authority.

\* \* \* \* \*

*Nonprofit school food service account* means the restricted account in which all of the revenue from all food service operations conducted by the school food authority principally for the benefit of school children is retained and used

only for the operation or improvement of the nonprofit school food service.

\* \* \* \* \*

#### 3. In § 210.16:

a. Amend paragraph (a)(7) by removing the word “and” at the end of the paragraph;

b. Amend paragraph (a)(8) by removing the period at the end of the paragraph and adding a semicolon in its place;

c. Add paragraphs (a)(9) and (a)(10) at the end; and

d. Amend paragraph (b)(1) by removing the second sentence and adding a new sentence in its place.

The additions read as follows:

#### § 210.16 Food service management companies.

(a) \* \* \*

(9) Obtain written approval of invitations for bids and requests for proposals prior to their issuance when required by the State agency. The school food authority must incorporate all State agency required changes to its solicitation documents prior to issuance of those documents; and

(10) Ensure that, prior to the execution of any contract or amendment to an existing food service management company contract, the State agency has reviewed and approved the contract terms and the school food authority has incorporated all State agency required changes into the contract or amendment. Any changes made by the school food authority or a food service management company to a State agency pre-approved prototype contract or State agency approved contract term must be approved in writing by the State agency prior to execution of the contract. To obtain approval of any proposed contract or contract modification, the school food authority must submit all procurement documents, including responses submitted by potential contractors, if requested by the State agency.

(b) \* \* \*

(1) \* \* \* A school food authority with no capability to prepare a cycle menu may, with State agency approval, require that each food service management company include a 21-day cycle menu, developed in accordance with the provisions of § 210.10, with its bid or proposal. \* \* \*

\* \* \* \* \*

#### 4. In § 210.19:

a. Amend paragraph (a)(2) by adding two new sentences between sentences two and three; and

b. Amend paragraph (a)(6) by removing the first sentence and adding two sentences in its place.

The additions read as follows:

#### § 210.19 Additional responsibilities.

(a) \* \* \*

(2) \* \* \* All costs resulting from contracts that do not meet the requirements of this part are unallowable nonprofit school food service account expenses. When the school food authority fails to incorporate State agency required changes to solicitation or contract documents, all costs resulting from the subsequent contract award are unallowable charges to the nonprofit school food service account. \* \* \*

\* \* \* \* \*

(6) \* \* \* Each State agency shall annually review each contract between any school food authority and food service management company to ensure compliance with all the provisions and standards set forth in this part prior to the execution of the contract by either party. Each State agency shall review each contract amendment between a school food authority and food service management company to ensure compliance with all the provisions and standards set forth in this part prior to the execution of the amended contract by either party. \* \* \*

\* \* \* \* \*

#### 5. In § 210.21:

a. Revise paragraph (a);

b. Amend paragraph (b) by removing the words “7 CFR part 3015” and adding, in their place, the words “this part and parts 3015, 3016 and 3019 of this title, as applicable,”;

c. Revise paragraph (c); and

d. Add a new paragraph (e).

The revisions and addition read as follows:

#### § 210.21 Procurement.

(a) *General.* State agencies and school food authorities shall comply with the requirements of this part and parts 3015, 3016 and 3019 of this title, as applicable, and applicable Office of Management and Budget Circulars, concerning the procurement of all goods and services with nonprofit school food service account funds.

\* \* \* \* \*

(c) *Procedures.* The State agency or school food authority may use its own procurement procedures which reflect applicable State and local laws and regulations, provided that procurements made with nonprofit school food service account funds adhere to the standards set forth in this part and §§ 3016.36(b) through 3016.36(i), 3016.60 and 3019.40 through 3019.48 of this title, as applicable, and in the applicable Office of Management and Budget Circulars. These requirements are adopted by FNS to ensure that all supplies, food,

equipment and services are obtained for the program in compliance with applicable laws and executive orders.

(1) *Pre-issuance review requirement.* The State agency may impose a pre-issuance review requirement on a school food authority's proposed procurement. The school food authority must make available, upon request of the State agency, its procurement documents, including but not limited to solicitation documents, specifications, evaluation criteria, procurement procedures, proposed contracts and contract terms. School food authorities shall comply with State agency requests for changes to procurement procedures and solicitation and contract documents to ensure that to the State agency's satisfaction, such procedures and documents reflect applicable procurement and contract requirements and the requirements of this part.

(2) *Prototype solicitation documents and contacts.* The school food authority must obtain the State agency's prior written approval for any change made to prototype solicitation or contract documents prior to issuance of the revised solicitation documents or execution of the revised contract.

(3) *Prohibited expenditures.* No expenditure may be made from the nonprofit school food service account for any cost resulting from a procurement failing to meet the requirements of this part.

(e) *Cost reimbursable contracts.* (1) *Required provisions.* The school food authority must include the following provisions in all cost reimbursable contracts, including contracts with cost reimbursable provisions, and in solicitation documents prepared to obtain offers for such contracts:

(i) Allowable costs will be paid to the contractor net of all discounts, rebates and other applicable credits accruing to or received by the contractor or any assignee under the contract, to the extent those credits are allocable to the allowable portion of the costs billed to the school food authority;

(ii) The contractor must separately identify for each cost submitted for payment to the school food authority the amount of that cost that is allowable (can be paid from the nonprofit school food service account) and the amount that is unallowable (cannot be paid from the nonprofit school food service account);

(iii) The contractor's determination of its allowable costs must be made in compliance with the applicable Departmental and Program regulations and Office of Management and Budget cost circulars;

(iv) The contractor must individually identify discounts, rebates and other applicable credits on all bills and invoices presented to the school food authority for payment; and

(v) The contractor must maintain documentation of costs and discounts, rebates and other applicable credits, and must furnish such documentation upon request to the school food authority, the State agency, or the Department.

(2) *Prohibited expenditures.* No expenditure may be made from the nonprofit school food service account for any cost resulting from a cost reimbursable contract that fails to include the requirements of this section, nor may any expenditure be made from the nonprofit school food service account that permits or results in the contractor receiving payments in excess of the contractor's actual, net allowable costs.

6. In § 210.24, amend the first sentence by removing the word “§ 3015.103” and adding in its place the words “Departmental regulations at §§ 3016.43 and 3019.62 of this title”.

\* \* \* \* \*

**PART 215—SPECIAL MILK PROGRAM**

1. The authority citation for Part 215 continues to read as follows:

**Authority:** 42 U.S.C. 1772 and 1779.

2. In § 215.2, add paragraph (c), previously reserved, and paragraphs (e-3) and (r-1) to read as follows:

**§ 215.2 Definitions.**

\* \* \* \* \*

(c) *Applicable credits* shall have the meaning established in Office of Management and Budget Circulars, A-87, C(4) and A-122, Attachment A A(5), respectively. For availability of OMB circulars referenced in this definition, see 5 CFR 1310.3.

\* \* \* \* \*

(e-3) *Contractor* means a commercial enterprise, public or nonprofit private organization or individual that enters into a contract with a school food authority.

\* \* \* \* \*

(r-1) *Nonprofit school food service account* means the restricted account in which all of the revenue from the nonprofit milk service maintained for the benefit of children is retained and used only for the operation or improvement of the nonprofit milk service.

\* \* \* \* \*

3. In § 215.14a;

a. Revise paragraph (a);

b. Amend paragraph (b) by removing the words “OMB Circular A-102 and 7

CFR part 3015,” and adding, in their place, the words “this part and parts 3015, 3016 and 3019 of this title, as applicable,”;

c. Revise paragraph (c); and

d. Add a new paragraph (d).

The revisions and addition read as follows:

**§ 215.14a Procurement standards.**

(a) *General.* State agencies and school food authorities shall comply with the requirements of this part and parts 3015, 3016 and 3019 of this title, as applicable, and applicable Office of Management and Budget Circulars, concerning the procurement of all goods and services with nonprofit school food service account funds.

\* \* \* \* \*

(c) *Procedures.* The State agency or school food authority may use its own procurement procedures which reflect applicable State or local laws and regulations, provided that procurements made with nonprofit school food service account funds adhere to the standards set forth in this part and §§ 3016.36(b) through 3016.36(i), 3016.60 and 3019.40 through 3019.48 of this title, as applicable, and in the applicable Office of Management and Budget Circulars.

These requirements are adopted by FNS to ensure that all supplies, food, equipment and services are obtained for the program in compliance with applicable laws and executive orders.

(1) *Pre-issuance review requirement.* The State agency may impose a pre-issuance review requirement on a school food authority's proposed procurement. The school food authority must make available, upon request of the State agency, its procurement documents, including but not limited to solicitation documents, specifications, evaluation criteria, procurement procedures, proposed contracts and contract terms. School food authorities shall comply with State agency requests for changes to procurement procedures and solicitation and contract documents to ensure to the State agency's satisfaction, such procedures and documents reflect applicable procurement and contract requirements and the requirements of this part.

(2) *Prototype solicitation documents and contacts.* The school food authority must obtain the State agency's prior written approval for any change made to prototype solicitation or contract documents prior to issuance of the revised solicitation documents or execution of the revised contract.

(3) *Prohibited expenditures.* No expenditure may be made from the nonprofit school food service account for any cost resulting from a

procurement failing to meet the requirements of this part.

(d) *Cost reimbursable contracts.* (1) *Required provisions.* The school food authority must include the following provisions in all cost reimbursable contracts, including contracts with cost reimbursable provisions, and in solicitation documents prepared to obtain offers for such contracts:

(i) Allowable costs will be paid to the contractor net of all discounts, rebates and other applicable credits accruing to or received by the contractor or any assignee under the contract, to the extent those credits are allocable to the allowable portion of the costs billed to the school food authority;

(ii) The contractor must separately identify for each cost submitted for payment to the school food authority the amount of that cost that is allowable (can be paid from the nonprofit school food service account) and the amount that is unallowable (cannot be paid from the nonprofit school food service account);

(iii) The contractor's determination of its allowable costs must be made in compliance with the applicable Departmental and Program regulations and Office of Management and Budget cost circulars;

(iv) The contractor must individually identify all discounts, rebates and other applicable credits on all bills and invoices presented to the school food authority for payment; and

(v) The contractor must maintain documentation of costs and discounts, rebates and other applicable credits, and must furnish such documentation upon request to the school food authority, the State agency, or the Department.

(2) *Prohibited expenditures.* No expenditure may be made from the nonprofit school food service account for any cost resulting from a cost reimbursable contract that fails to include the requirements of this section, nor may any expenditure be made from the nonprofit school food service account that permits or results in the contractor receiving payments in excess of the contractor's actual, net allowable costs.

4. Redesignate §§ 215.15 through 215.17 as §§ 215.16 through § 215.18, respectively; and add a new § 215.15 to read as follows:

**§ 215.15 Withholding payments.**

In accordance with Departmental regulations at §§ 3016.43 and 3019.62 of this title, the State agency shall withhold Program payments in whole or in part, to any school food authority which has failed to comply with the provisions of this part. Programs

payments shall be withheld until the school food authority takes corrective action satisfactory to the State agency, or gives evidence that such corrective actions will be taken, or until the State agency terminates the grant in accordance with §§ 215.16. Subsequent to the State agency's acceptance of the corrective actions, payments will be released for any milk served in accordance with the provisions of this part during the period the payments were withheld.

**PART 220—SCHOOL BREAKFAST PROGRAM**

1. The authority citation for Part 220 continues to read as follows:

**Authority:** 42 U.S.C. 1773, 1779, unless otherwise noted.

2. In § 220.2, add paragraphs (a–1), (d–1) and (o–3) to read as follows:

**§ 220.2 Definitions.**

\* \* \* \* \*

(a–1) *Applicable credits* shall have the meaning established in Office of Management and Budget Circulars, A–87, C(4) and A–122, Attachment A, A(5), respectively. For availability of OMB circulars referenced in this definition see 5 CFR 1310.3.

\* \* \* \* \*

(d–1) *Contractor* means a commercial enterprise, public or nonprofit private organization or individual that enters into a contract with a school food authority.

\* \* \* \* \*

(o–3) *Nonprofit school food service account* means the restricted account in which all of the revenue from all food service operations conducted by the school food authority principally for the benefit of school children is retained and used only for the operation or improvement of the nonprofit school food service.

\* \* \* \* \*

3. In § 220.7, revise paragraph (d) to read as follows:

**§ 220.7 Requirements for participation.**

\* \* \* \* \*

(d)(1) Any school food authority (including a State agency acting in the capacity of a school food authority) may contract with a food service management company to manage its food service operation in one or more of its schools. However, no school or school food authority may contract with a food service management company to operate an a la carte food service unless the company agrees to offer free, reduced price and paid reimbursable breakfasts to all eligible children. Any

school food authority that employs a food service management company in the operation of its nonprofit school food service shall:

(i) Adhere to the procurement standards specified in § 220.16 when contracting with the food service management company;

(ii) Ensure that the food service operation is in conformance with the school food authority's agreement under the Program;

(iii) Monitor the food service operation through periodic on-site visits;

(iv) Retain control of the quality, extent, and general nature of its food service, and the prices to be charged the children for meals;

(v) Retain signature authority on the State agency-school food authority agreement, free and reduced price policy statement and claims;

(vi) Ensure that all federally donated foods received by the school food authority and made available to the food service management company accrue only to the benefit of the school food authority's nonprofit school food service and are fully utilized therein;

(vii) Maintain applicable health certification and assure that all State and local regulations are being met by a food service management company preparing or serving meals at a school food authority facility;

(viii) Obtain written approval of invitations for bids and requests for proposals prior to their issuance when required by the State agency. The school food authority must incorporate all State agency required changes to its solicitation documents prior to issuance of those documents; and

(ix) Ensure that, prior to the execution of any contract or amendment to an existing food service management company contract, the State agency has reviewed and approved the contract terms and the school food authority has incorporated all State agency required changes into the contract or amendment. Any changes made by the school food authority or a food service management company to a State agency pre-approved prototype contract or State agency approved contract term must be approved in writing by the State agency prior to execution of the contract. To obtain approval of any proposed contract or contract modification, the school food authority must submit all procurement documents, including responses submitted by potential contractors, if requested by the State agency.

(2) In addition to adhering to the procurement standards under this part, school food authorities contracting with

food service management companies shall ensure that:

(i) The invitation to bid or request for proposal contains a 21-day cycle menu developed in accordance with the provisions of § 220.8, to be used as a standard for the purpose of basing bids or estimating average cost per meal. A school food authority with no capability to prepare a cycle menu may, with State agency approval, require that each food service management company include a 21-day cycle menu, developed in accordance with the provisions of § 220.8, with its bid or proposal. The food service management company must adhere to the cycle for the first 21 days of meal service. Changes thereafter may be made with the approval of the school food authority; and

(ii) Any invitation to bid or request for proposal indicate that nonperformance subjects the food service management company to specified sanctions in instances where the food service management company violates or breaches contract terms. The school food authority shall indicate these sanctions in accordance with the procurement provisions stated in § 220.16.

(3) Contracts that permit all income and expenses to accrue to the food service management company and “cost-plus-a-percentage-of-cost” and “cost-plus-a-percentage-of-income” contracts are prohibited. Contracts that provide for fixed fees such as those that provide for management fees established on a per meal basis are allowed. Contractual agreements with food service management companies shall include provisions which ensure that the requirements of this section are met. Such agreements shall also include the following requirements:

(i) The food service management company shall maintain such records as the school food authority will need to support its Claim for Reimbursement under this part, and shall, at minimum, report claim information to the school food authority promptly at the end of each month. Such records shall be made available to the school food authority, upon request, and shall be available for a period of 3 years from the date of the submission of the final Financial Status Report, for inspection and audit by representatives of the State agency, of the Department, and of the Government Accountability Office at any reasonable time and place. If audit findings have not been resolved, the records shall be retained beyond the three-year period (as long as required for the resolution of the issues raised by the audit);

(ii) The food service management company shall have State or local health

certification for any facility outside the school in which it proposes to prepare meals and the food service management company shall maintain this health certification for the duration of the contract; and

(iii) No payment is to be made for meals that are spoiled or unwholesome at time of delivery, do not meet detailed specifications as developed by the school food authority for each food component specified in § 220.8, or do not otherwise meet the requirements of the contract. Specifications shall cover items such as grade, purchase units, style, condition, weight, ingredients, formulations, and delivery time.

(4) The contract between a school food authority and food service management company shall be of a duration of no longer than 1 year and options for the yearly renewal of the contract shall not exceed 4 additional years. All contracts shall include a termination clause whereby either party may cancel for cause with 60-day notification.

\* \* \* \* \*

4. In § 220.16,

a. Revise paragraph (a);

b. Amend paragraph (b) by removing the words “OMB Circular A-102 and 7 CFR 3015” and adding in their place the words “this part and parts 3015, 3016 and 3019 of this title, as applicable”;

c. Revise paragraph (c); and

d. Add paragraph (e).

The revisions and addition read as follows:

#### § 220.16 Procurement standards.

(a) *General.* State agencies and school food authorities shall comply with the requirements of this part and parts 3015, 3016 and 3019 of this title, as applicable, and applicable Office of Management and Budget Circulars, concerning the procurement of all goods and services with nonprofit school food service account funds.

\* \* \* \* \*

(c) *Procedures.* The State agency or school food authority may use its own procurement procedures which reflect applicable State and local laws and regulations, provided that procurements made with nonprofit school food service account funds adhere to the standards set forth in this part and §§ 3016.36(b) through 3016.36(i), 3016.60 and 3019.40 through 3019.48 of this title, as applicable, and the applicable Office of Management and Budget Circulars. These requirements are adopted by FNS to ensure that all supplies, food, equipment and services are obtained for the program in compliance with applicable laws and executive orders.

(1) *Pre-issuance review requirement.* The State agency may impose a pre-issuance review requirement on a school food authority’s proposed procurement. The school food authority must make available, upon request of the State agency, its procurement documents, including but not limited to solicitation documents, specifications, evaluation criteria, procurement procedures, proposed contracts and contract terms. School food authorities shall comply with State agency requests for changes to procurement procedures and solicitation and contract documents to ensure that to the State agency’s satisfaction, such procedures and documents reflect applicable procurement and contract requirements and the requirements of this part.

(2) *Prototype solicitation documents and contracts.* The school food authority must obtain the State agency’s prior written approval for any change made to prototype solicitation or contract documents prior to issuance of the revised solicitation documents or execution of the revised contract.

(3) *Prohibited expenditures.* No expenditure may be made from the nonprofit school food service account for any cost resulting from a procurement failing to meet the requirements of this part.

\* \* \* \* \*

(e) *Cost reimbursable contracts. (1) Required provisions.* The school food authority must include the following provisions in all cost reimbursable contracts, including contracts with cost reimbursable provisions, and in solicitation documents prepared to obtain offers for such contracts:

(i) Allowable costs will be paid to the contractor net of all discounts, rebates and other applicable credits accruing to or received by the contractor or any assignee under the contract, to the extent those credits are allocable to the allowable portion of the costs billed to the school food authority;

(ii) The contractor must separately identify for each cost submitted for payment to the school food authority the amount of that cost that is allowable (can be paid from the nonprofit school food service account) and the amount that is unallowable (cannot be paid from the nonprofit school food service account);

(iii) The contractor’s determination of its allowable costs must be made in compliance with the applicable Departmental and Program regulations and Office of Management and Budget cost circulars;

(iv) The contractor must individually identify all discounts, rebates and other

applicable credits on all bills and invoices presented to the school food authority for payment; and

(v) The contractor must maintain documentation of costs and discounts, rebates, and other applicable credits, and must furnish such documentation upon request to the school food authority, the State agency, or the Department.

(2) *Prohibited expenditures.* No expenditure may be made from the nonprofit school food service account for any cost resulting from a cost reimbursable contract that fails to include the requirements of this section, nor may any expenditure be made from the nonprofit school food service account that permits or results in the contractor receiving payments in excess of the contractor's actual, net allowable costs.

4. Redesignate §§ 220.18 through 220.21 as §§ 220.19 through 220.22, respectively; and add a new § 220.18 to read as follows:

**§ 220.18 Withholding payments.**

In accordance with Departmental regulations at §§ 3016.43 and 3019.62 of this title, the State agency shall withhold Program payments, in whole or in part, to any school food authority which has failed to comply with the provisions of this part. Programs payments shall be withheld until the school food authority takes corrective action satisfactory to the State agency, or gives evidence that such corrective actions will be taken, or until the State agency terminates the grant in accordance with § 220.19. Subsequent to the State agency's acceptance of the corrective actions, payments will be released for any breakfasts served in accordance with the provisions of this part during the period the payments were withheld.

Dated: December 21, 2004.

**Roberto Salazar,**

*Administrator, Food and Nutrition Service.*

[FR Doc. 04-28532 Filed 12-29-04; 8:45 am]

BILLING CODE 3410-30-P

**DEPARTMENT OF AGRICULTURE**

**Agricultural Marketing Service**

**7 CFR Part 1124**

[Docket No. AO-368-A30; DA-01-08-PNW]

**Milk in the Pacific Northwest Marketing Area; Decision on Proposed Amendments to Marketing Agreement and to Order**

**AGENCY:** Agricultural Marketing Service, USDA.

**ACTION:** Proposed rule.

**SUMMARY:** This document proposes to adopt as a final rule, order language contained in the interim final rule published in the **Federal Register** on January 12, 2004, concerning pooling provisions of the Pacific Northwest Federal milk order. This document also sets forth the final decision of the Department and is subject to approval by producers. Specifically, the final decision adopts an amendment that would continue to amend the *Producer milk* provision which will eliminate the ability to simultaneously pool the same milk on the order and on a State-operated order that provides for marketwide pooling.

**FOR FURTHER INFORMATION CONTACT:**

Gino M. Tosi, Marketing Specialist, USDA/AMS/Dairy Programs, Order Formulation and Enforcement Branch, Room 2968, 1400 Independence Avenue, SW., STOP 0231, Washington, DC 20250-0231, (202) 690-1366, e-mail address [gino.tosi@usda.gov](mailto:gino.tosi@usda.gov).

**SUPPLEMENTARY INFORMATION:** This administrative action is governed by the provisions of sections 556 and 557 of Title 5 of the United States Code and therefore is excluded from the requirements of Executive Order 12866.

These proposed amendments have been reviewed under Executive Order 12988, Civil Justice Reform. This proposed rule is not intended to have a retroactive effect. If adopted, this proposed rule will not preempt any state or local laws, regulations, or policies, unless they present an irreconcilable conflict with this rule.

The Agricultural Marketing Agreement Act of 1937, as amended (7 U.S.C. 601-674), provides that administrative proceedings must be exhausted before parties may file suit in court. Under Section 608c(15)(A) of the Act, any handler subject to an order may request modification or exemption from such order by filing with the Secretary a petition stating that the order, any provision of the order, or any obligation imposed in connection with the order is not in accordance with the law. A handler is afforded the opportunity for a hearing on the petition. After a hearing, the Secretary would rule on the petition. The Act provides that the district court of the United States in any district in which the handler is an inhabitant, or has its principal place of business, has jurisdiction in equity to review the Secretary's ruling on the petition, provided a bill in equity is filed not later than 20 days after the date of the entry of the ruling.

**Regulatory Flexibility Act and Paperwork Reduction Act**

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the Agricultural Marketing Service has considered the economic impact of this action on small entities and has certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. For the purpose of the Regulatory Flexibility Act, a dairy farm is considered a "small business" if it has an annual gross revenue of less than \$750,000, and a dairy products manufacturer is a "small business" if it has fewer than 500 employees. For the purposes of determining which dairy farms are "small businesses," the \$750,000 per year criterion was used to establish a production guideline of 500,000 pounds per month. Although this guideline does not factor in additional monies that may be received by dairy producers, it should be an inclusive standard for most "small" dairy farmers. For purposes of determining a handler's size, if the plant is part of a larger company operating multiple plants that collectively exceed the 500-employee limit, the plant will be considered a large business even if the local plant has fewer than 500 employees.

In the Pacific Northwest Federal milk order, 805 of the 1,164 dairy producers (farmers), or about 69 percent, whose milk was pooled under the Pacific Northwest Federal milk order at the time of the hearing (April 2002), would meet the definition of small businesses. On the processing side, 9 of the 20 milk plants associated with the Pacific Northwest milk order during April 2002 would qualify as "small businesses," constituting about 45 percent of the total.

The adoption of the proposed pooling standard serves to revise established criteria that determine the producer milk that has a reasonable association with—and consistently serves the fluid needs of—the Pacific Northwest milk marketing area and is not associated with other marketwide pools concerning the same milk. Criteria for pooling are established on the basis of performance levels that are considered adequate to meet the Class I fluid needs and by doing so determine those that are eligible to share in the revenue that arises from the classified pricing of milk. Criteria for pooling are established without regard to the size of any dairy industry organization or entity. The established criteria are applied in an identical fashion to both large and small businesses and do not have any different economic impact on small