UNITED STATES DEPARTMENT OF AGRICULTURE

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      IN THE MATTER OF:       :
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        PUBLIC MEETING        :
    FOOD SERVICE MANAGEMENT   :
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3101 Park Center Drive
Rm 204B
Alexandria, Virginia

Thursday
October 24, 2002

The above-entitled matter came on for meeting before Ron Vogel, at 1:00 p.m., pursuant to notice.

Present:

BARBARA ADAMS
BILL BABB
KATHY MANZO
RACHEL BISHOP
DAVE BROTHERS
CHRISTINE CARPINO
ROSALIND CLEVELAND
RANDALL COLLINS
ROBERT DELORENZO
SANDY FISHER
BONNIE E. GREEN
TOBY HORNER
THOMAS JO
JIMMY J. JOHNSON
LES JOHNSON
TOM LEE
DENISE LONDOS
SARAH CARSON MAUER
CLIFF MEYERS
BRUCE NORMAN
BRIAN O'HARA
PATRICIA PHILLIPS
JOHN R. PURCELL
DEIRDRE PUREFOY
ALAN RAUL
SUZANNE RIGBY
RYAN W. STROSCHEIN, ESQ.
JOSEPH TEMPLIN
SHERRY THACKERAY
STEVEN THOMAS
PAUL VELTRI
RON VOGEL
BARBARA WAGNER
JANET WALLINGTON
CORA YANACEK

PROCEEDINGS

(On the record at 1:00 p.m.)

MR. VOGEL: Would you please just come up? And before I turn this over to Jimmy, it would be helpful to me if we could do, just raise your hand, let everybody know who you are, and who you represent. And I would like to start with Dave, way in the back of the room, by the trophy case.

MR. BROTHERS: I am Dave Brothers --

(Discussion was held off-microphone.)

MR. VOGEL: That might be helpful.

MR. PURCELL: My name is John Purcell --

MR. COLLINS: I am Randy Collins --

MR. TEMPLIN: I am Joe Templin with the FNS Midwest Region in Chicago.

MS. PUREFOY: My name is Deirdre Purefoy, and I am also with the Midwest Regional Office.

MS. CLEVELAND: Rosalind Cleveland, here with the Distribution Division --

MR. O'HARA: Bryan O'Hara with Aramark.

MR. RAUL: Alan Raul, Sidley Austin Brown and Wood, represents Aramark.

VOICE: I am just here to observe.

MR. LEE: Tom Lee, with the Virginia Department of Agriculture -- deal with processing.

MR. BYERS: Joe Byers. I am with --

MS. WAGNER: Barbara Wagner. I am with the Pennsylvania Department of Agriculture.

MR. JOHNSON: Les Johnson. Les Johnson and Associates.

MR. NORMAN: I am Bruce Norman, with Chartwell services.

MS. YANACEK: I am Cora Yanacek, also with Chartwells.

MR. THOMAS: I am Steve Thomas, with the Virginia Department of Agriculture.

MR. HORNER: Toby Horner, Metz and Associates Dining Services.

MS. CARPINO: I am Chris Carpino. I am with the Food and Nutrition Service.

MS. FISHER: Sandy Fisher, with Phillips Resources.

MS. MANZO: Kathy Manzo, with the USDA, in the Mid-Atlantic Region.

MS. PHILLIPS: Patricia Phillips, Phillips Resources.

MR. VOGLE: This is Donna Brown, right here in front, with Food Distribution Division. She is going to make sure everything works smoothly today.

MR. STROSCHEIN: Ryan Stroschein, with the

American Commodity Distribution Association.

MS. ADAMS: Barbara Adams, D.C. Public Schools, School Nutrition Services.

MR. BABB: Bill Babb, with Babb Food Brokers.

MR. DELORENZO: Bob Delorenzo, with Food Distribution, here at headquarters.

MS. BISHOP: I am Rachel Bishop, Office of the General Counsel.

MS. WALLINGTON: Janet Wallington, Food Distribution.

MS. THACKERAY: Sherry Thackeray, Food Distribution headquarters.

MS. RIGBY: I am Suzanne Rigby, and I am with Food Distribution.

MR. JOHNSON: And again, I am Jimmy Johnson. I am going to be facilitating the proceedings here today.

MR. VOGEL: And with that, I am going to turn it over to Jimmy, unless there are any questions before we turn it over to Jimmy. We are all clear why we are here? Good.

MR. JOHNSON: All right. Good afternoon, ladies and gentlemen. My purpose here, really, I want to explain, and that is, I am the facilitator for the proceedings today. I have really no content -- I am coming to this fresh, and hopefully, without opinions, and my job here is to be an impartial controller of the process, to assure that we draw the information that the federal representatives would like to hear, that will assist them in the future, and to make sure that things go smoothly, that we stay on focus, stay on track, that sort of thing. We are going to open today with a brief period of comments from individuals who have indicated that they would like to make some comments. That can be a formal presentation. It could just be some notes that they have, things that they really want to say. That in general, the context of that is not going to be limited, but we will limit the time that you have to five minutes. Donna here, who is, some of you cannot see because she is in front of the column, will actually be serving as a timekeeper. The method that we will use to keep time is a method of displaying cards. If you are unfamiliar with that, when you begin speaking, your five-minute period will begin with a green card. When you have one minute left to speak, she will display a yellow card. And at the end of five minutes, she will display a red card, and we ask you to stop speaking at that time. So, if you have a wide range of topics to comment on, we invite you to refer back to the notice in the *Federal*

Register, as to the subjects that we would be speaking on here today, and try to at least to get that information in, first, before you go elsewhere with your comments. We would appreciate that greatly. After we conclude that portion of the meeting, we will have some remarks from the federal staff, again, regarding the focus in the conversation on the areas that we would like to draw information from you on, and then it will be time for an open discussion.

There are some certain procedural things I would like to let you know about, in doing that, and that is, we would like you to stand, when you are speaking. We do have a recorder here, that is going to be making note of everything that is said, and we want to be able to hear you. So that's the reason that we will be passing around the microphone, and ask you to stand while you are speaking, so you can be easily identified.

The first time that you speak, and make a comment, we would ask that you state your name, your affiliation, and please spell your name, so we can get it accurate in the record. We do have a written list of everyone attending, but it would assist us greatly, in making sure we know who the comments come from. If you should speak another time, simply just state your name, before you speak. It will be unnecessary to, again, spell your name. We ask that only one person speak at a time. Again, if more than one person speaks, it makes it very, very difficult to keep the information straight, and record it. If you have something to say, I will assure you that you will have the opportunity to comment, or rebut, or whatever, on what someone else has to say. Simply, you can raise your hand, or nod at me, or something like that, and I will make sure you get that opportunity.

Again, we want you to focus your comments. We are really here to collect information that will assist greatly, if you stay on topic. If you don’t, it is really my job to call you back to the points of order. So I will be doing that. Please don’t be discouraged by that, but we need to keep things focused here, in order to make best use of our time.

I think that’s pretty much everything. Logistics, if you are not familiar with them, emergency exits are directly at the back of the room, none of them are locked, and in case of any sort of in-flight emergency, you will evacuate over the wings, the doors in the back. If you need to use restroom facilities, you will find those in the elevator lobby, at the far end.

So, with that, I will go ahead, then, and as for the people that have indicated they would like to make comments, if you would like to make a comment, a presentation of some type, for five minutes, please, I will ask you to go back to the desk, and if you did not indicate that, please do so, at this point.

And, of those that have indicated they would like to make a comment, the first person that I have on the list is Les Johnson. So, Les, if you would like to come up, you can use it, and we would appreciate it if you do it at the podium here, for your time.

PRESENTATION OFPRESENTATION OF

LES JOHNSON AND ASSOCIATES

BY MR. JOHNSON:

My name is Les Johnson. I am with Les Johnson Associates, and I am not, my comments are not in terms of representing any particular firm. They are just my personal perspective on this, at this point. And first, I want to applaud USDA for having this meeting, because it is an opportunity for the Government to get input before the regs and policy are actually done. And many of you know that I worked for USDA previously, and once the policy and regs are written, it is far harder to make change, than before they are written. So this is a great opportunity for companies out there to actually have an effect, on what is likely I think to be policy for the next decade in this particular area. From my perspective, there has be a lack of clarity, on fixed priced contracts, in terms of commodities, partly probably because, ten or fifteen years ago, there were very, very little of this going on in the United States, and now this field is growing tremendously and expanded. There is probably a couple of different options, you know, which the Government can take on this, probably more than these two, but in my mind, it comes down to one is the perspective that OIG wrote in their audit, it is kind of an accounting perspective, and that is, every time commodities come in, you find some way to deduct the value of those commodities, or to pay the school back the price. The second perspective, I would call an economic perspective, and I am putting these words to these, as accounting and economic, I am just applying these words to these. And that is that, hey, this is really taking, can be part of the bid price from the beginning. If a company knows they are going to get commodities, aren't they going to bid lower from the beginning? Both of these perspectives have major differences in terms of what transaction cost, how much paperwork you have got to keep, how much risk you have got of getting in trouble afterwards. They have got differences in terms of a level playing field, which is a key in all those kinds of things, so the companies are competing in a level playing field, and they probably have differences in just the clarity of the operation. And so I expect that during this meeting, some of those things, which I am not going to get into, are going to come out, and if they don't come out, then I am sure some of us will throw in our thoughts on them.

I don't know which way the USDA should go right now, but I know there is some really significant stuff here, that this program will be living with for a long time. So thank you for this opportunity to make comments on this, and I am glad you are having this meeting, and I think it is a great idea.

MR. JOHNSON: Thank you. Our next speaker will be Alan Raul.

PRESENTATION OFPRESENTATION OF

SIDLEY, AUSTIN, BROWN AND WOOD

BY MR. RAUL:

MR. RAUL: Thank you. Allen Raul. R-A-U-L. Sidley, Austin, Brown and Wood. Representing Aramark. Thanks for the opportunity to present our thoughts. Ron Vogel, USDA, thank you for doing this. We very much appreciate the open-minded approach to trying to get input to develop the best possible policy going forward.

My approach in the five minutes, which I think will be rigorously enforced, is to throw out really ideas for consideration, since we understand the direction to be really fluid, and the agency to be receptive to the comments and thoughts from industry and elsewhere. So I am going to throw out some basic propositions, some comments on the OIG approach, and then some concerns regarding the complexities of valuation, just again, to throw out the ideas, without asserting a specific policy or regulatory approach that we would advance to FNS, but rather a collection of thoughts, ideas, to be taken into account.

First, I very much agree and understand that the law and regulations provide that commodities must be provided for the use, for the benefit of program meals served in the national school lunch program, rather than for any other purpose. That is the key point that OIG stressed, and we recognize that that is what the law is and what it should be, so the differences then come after that.

Questions of what the commodities will be, that any school and food service management company gets, what the commodities are, how usable they will be, what condition they will be found in, are variables that the companies need to take, will experience, and need to take into account. USDA valuation for commodities may well be higher than what the companies can obtain through their own procurement channels. There is an inevitable complexity in determining realistic and fair valuation for commodities, especially because these commodities are not ordered or managed by the companies, so there are inefficiencies that result from the ad hoc nature of the commodities being supplied.

The menu planning process is complicated by virtue of the appearance of commodities that, again, are not ordered by the company, so some efficiencies are impaired and cost effectiveness, and essentially receiving these ad hoc commodities, as well as some potential impairment in the overall delivery of the nutrition that the companies need to provide for the schools they are working for. Using the commodities may be more labor-intensive to prepare and use, depending on the circumstances of the commodities, and they may not be perfectly useful and needed in every case for the school lunches which these commodities are provided for, depending on what the commodities are, and the quantities, and so on, it may or may not be truly needed, quote unquote, in the school lunches that they are provided for. Requiring crediting and accounting for USDA commodities will necessarily give rise to higher transaction costs, accounting, monitoring, valuation of the products themselves, all will need to be factored in. It is also our understanding that USDA strongly wishes to promote incentives for using commodities rather than to give rise to disincentives.

At the same time, the OIG report makes it clear that that agency recognizes that the current legal requirement, that, under current law and regulation, FNS has only suggested, and not required, the pass through of the commodity value. So any requirements that would change this understanding would need to be adopted, undertaken, through rulemaking, which again I think OIG understands, as does FNS, so we think we are all on the same wavelength there. Valuation guidelines would need to be provided by FNS, if this, if that's the direction the agency goes in.

We note that providing for commodities, which must go for the purposes of the school lunch program, actually goes to the benefit of the school food authorities, in terms of the fixed price bid submitted by food service management companies. Based on their experience, in the past, they are in a position to provide a fixed-price bid, that already takes account of what the likely experience will be with commodities. So the SFA’s get the benefit of relatively low and definitely predictable fixed-price bids, without having to worry about whether there is going to be a contingent and unpredictable, uncertain crediting back for commodities. So there are definite advantages to the SFA’s, to have fixed-price bids, that are not subject to subsequent accounting and crediting back. Thank you.

MR. JOHNSON: Okay. The last person that has indicated they would like to speak is Mr. Randall Collins. No, they, okay, thank you very much. Okay, I will just ask, going with the flow here, is there anyone else who has some comments they would like to share, even if you have not indicated you would like to get. Very good then.

Well, at this moment, I would like to, Suzanne, are you going to? Yes, I would like to have someone come up, who is going to explain a little bit more about the particular subjects that we want to get some input on, here, and to begin our discussion, if we can possibly do that. And Suzanne, would you like to?

MS. RIGBY: Sure, if I don't trip. I am sure most of you caught this, in the *Federal Register* notice, but in case you did not, I would like to just read straight from that, of what the topics are today, and we would like to adhere to this as much as possible. First of all, we are going to be limited to the Office of Inspector General's recommended approach for crediting USDA commodities. Next, we are going to limit to value pass through methods, currently used by food service management companies, and the school food authorities and food service management contracts. And last, we are going to limit our comments to proposals to proposals for the development of new, specific procedures, for crediting USDA donated commodities. Are there questions about that? Okay.

MR. JOHNSON: Well, just to keep you on track here, what we will do is we are going to display the areas of discussion for you, while we are discussing those, and the first area we would like to address is the OIG recommendation number one. So I will open it up to discussion for this point. If you have something you would like to say, just indicate, raise your hand, nod your head and so forth, and we will go forward. So the floor is open.

MR. VOGEL: Can I, I am going to, excuse me, I want to ask Mr. Raul a question, because I am going to have to be leaving shortly, but I want to ask you one particular question. When you mention this factoring in the commodities as part of the fixed-price bid, what would your reaction be to an approach in which companies submitted two different bids, one without factoring in the value of commodities, and one with the value of commodities factored in, so that school districts could see exactly what food service management companies felt their commodities are worth? Can I ask, is anybody else, I would like to have your reaction to that, Alan, and anybody else who wants to weigh in on that, just before I have to leave here.

MR. RAUL: Thanks, Ron. I would say, firstly, that that's a creative suggestion, Mr. Vogel, that you always have creative suggestions, and I think that is a creative one. It would certainly go towards disclosure, and give options. One of the important propositions that is worth the agency's considering is the disadvantages of eliminating flexibility, or, to put it more simply, reducing flexibility is a cost and a constraint that may not produce commensurate advantages. So what you are suggesting is kind of a middle road. Those school food authorities that want the benefits of a fixed price, without the contingency of crediting back for uncertain and unpredictable commodities being supplied, would still be able to select that, if they wish. So that would certainly allow the, essentially the status quo, to continue to exist, and that might be, might be more important. Need to think about the business dynamics a little bit more, but it certainly preserves flexibility.

MR. NORMAN: I am Bruce Norman, with Chartwell's dining services. N-O-R-M-A-N. I would like to echo what Mr. Raul said, and that is, one of the big things that is a negative to this is, one is processing. I know we have some people here from processing, but if we are reimbursing for the value of those commodities, for us to then go and get them processed, is totally uneconomical to do that, because you are then paying for the product one and a half times, in a sense. So that becomes something that would be to the client's benefit, to the school district's benefit, but we are not going to do it, because we figured in 15¢ a meal, that's what we are going to credit, and we can go and buy it for much cheaper than taking a chicken and getting it processing. So that's something that typically is not done. And second is, I would like to echo that we don't know what the future commodities will be, and suddenly we can get fifty cases of salmon, which, if you price it out, would be something that would not fit, pricewise, in a $1.50 school lunch program, but we are forced to use it, and give the client SFA a credit back larger than we ever would for an item that we would purchase on the street, according to that menu mix. And another thing I would like to echo in that is that, in some cases, we are forced to use and credit back commodities that actually are hard to use, because of the nutritional requirements, such as butter, and those types of items. Thank you.

MR. JOHNSON: Let me just add one thing to that, that, if two bids came in, and it were then transparent as to what value the company was giving to the commodities, if they did not play with the numbers, it is almost certainly going to be less, I think, I would guess, less, because of the reasons that these gentlemen presented. Would then USDA be in the situation of proving that there was not a value pass through going to create problems down the line?

MR. VOGEL: I don’t know, Les. I don’t know. Just again, we are here to think about alternatives. You and Mr. Raul both raised this issue of that the bid base, the bid price being the basis of how the company should look at commodities, and my concern is making sure that schools know just exactly how their commodities are being valued in the bids that are being submitted. That’s all. And I don’t know whether it is feasible. I don’t know what other kind of games might be played. I don’t even know whether it is legal. But again, we are talking about solutions here, to what, like, as you said in your opening remarks, there are several ways we could go, and we are trying to figure out the way that works best for both management companies, as well as school food authorities.

MS. PHILLIPS: Hi. I am Patricia Phillips, from Phillips Resources. It is P-H-I-L-L-I-P-S. The one thing I was aware of is the difference in the commodity value that USDA sets on November 15th of the previous school year, and the value of the commodities that the schools are paying, or that the food service management companies are paying when they buy that product commercially. And that, that differential, I question if it is really possible for food service management companies to do a true, with or without two-bid process, because if you know your without commodity value is going to be, is the number from which the commodity values will be subtracted, then you often have to artificially increase that, to accommodate. So I question whether you truly can get competitive bids, of with or without commodities.

MR. BROTHERS: I am Dave Brothers --

MR. JOHNSON: Dave, hold on, just a second. It really is difficult to hear you up here.

MR. BROTHERS: I am Dave Brothers with Food Distribution. Can one of the food service management companies take us through how they go in, and start their negotiations with a school, and what items get talked about? I have heard that you are forced to take commodities that you cannot use, and it seems to me that if you address that with the schools, before you got your commodities, they have a list of 150 commodities they can choose from. They are not required to take one of each 150, so if you all had gone in and talked to them about what is going on, and what commodities you could use in your system, and they ordered more quantity of that commodity, as opposed to taking something you all could not use, then maybe that would be a benefit to you, so can you explain to the USDA people how that process works? I don't understand.

MR. NORMAN: Bruce Norman, Chartwell's. First of all, the comment that you made is only partially correct, because every state is totally different in the commodities you get. In Missouri, for instance, you have a choice possibly to turn some down, but you basically get a letter saying, next month, you are going to get, you know, X number of cases of chicken, and X number of cases of ground beef, and so much of this, and then the next month, you will get none of that, and you will get tons of others. Other states give you a list of what is available, and you are, you can order what you want each month. Others just say, this is what is coming. You can get it, unless you write us back and turn it down. Each state you can pick, if I am correct, different commodities that they want to use. Some states don't choose different commodities. Some process for you, and allow you to use five cases of chicken that's already processed, and they add that on to the delivery freight, and they all do it different. And as far as negotiation goes, typically in the states where you do a lot of the fixed rate, it is not really RFP when it is fixed rate, it tends to be more of an ITB. Illinois, for example, there is not as much negotiation on that. It is like, this is what it is. When you get commodities delivery, you use them, and even states in there that you have to have a minimum value, that you reimburse the SFA for. And so, you can maybe turn down some that you think are really high-priced, but you have to hit that minimum, or you are going to end up owing the client that, anyway. Again, the point is, you are not going to have any sort of consistency in that, across the board, and to reinforce what he said, we don't know what the future will bring, either. Maybe right now, most of the commodities are reasonable, but in the past, we have gotten commodities that would be items you would never purchase for a type A lunch program, either because they are too expensive, or they are not going to be eaten by children, or other factors that are involved, and we would be, in a sense, crediting.

Another question that I would like to raise, to the people here from USDA, is the discussion that, the future is going to be that the commodities will probably become labeled, with, not the USDA labels, but just the manufacturer labels, and we will credit, not based on usage, but based on what we receive, and the question I have is that, does that mean that then we, the FSCC, owns those commodities and we can do whatever we want with them? And I would like to get an answer to that, too, because I think that plays into these recommendations. Does that answer your question?

MR. BROTHERS: Yes. That helps.

MR. JOHNSON: I just wanted to comment, in terms of posing questions to the federal representatives, here. Really, we are here to gather information. That's really what we are trying to do. For guidance, I think, if I may make a suggestion, some proposals regarding those things will certainly be taken into consideration, and receive a great deal of consideration. So I would ask you, if you could possibly, to frame, rather than questions, maybe making some suggestions, or possible ways to handle that. Is there any further discussion of this subject, or anyone want to get their two cents in? Okay.

MS. FISHER: I am Sandy Fisher, F-I-S-H-E-R.

I mentioned I am with Phillips Resources, but I spent 22 years as a state processing specialist, so I want to kind of go between what Dave said, and, I'm sorry, Bruce Norman. He is a little bit in between. The states can accept every commodity that's offered them. They can also accept a limited amount. And it is true, all states operate differently, but what we are talking about here today, in coming up with proposals, it would be possible to come up with some guidance that would help the states operate somewhat similarly, when it comes to the food service management company. And some of the ideas that are coming out here, I think, will probably lead into that. It would be possible maybe to come up with a contract, and limit the number or types of commodities that would be useful. That may not be acceptable to the states, but I am just saying, since we are talking about proposals, I see that as one way of bridging, taking everything, and still taking some commodities to at least alleviate, or reduce the cost to the schools.

MR. JOHNSON: Any additional comments?

MR. BROTHERS: Dave Brothers. I really was not going to talk when I came in this week -- I have got lots of questions. I can understand, from the food service management company perspective, that there is some ambiguity, of what you are getting for a bonus. Your recipients don't have to take any bonus. Bonus is taken if you can use it. So it seems to me like, in your negotiations with these recipients, or the users of your stuff, you set that up out front, that you were not going to take any bonus, that once you bid your contract, that you don't want any bonus commodities to reduce the prices. And it seems to me like then, you would have eliminated that problem that would occur down the road. And you are still going to get your 15¢, or 15-1/4¢, as it is, today. You know that they serve X amount of meals, times 15¢, and that should come, it seems to me like it should come off your bid price, because you know you are going to get meals times rate. So that's money that you all are going to get in commodities. How you choose your commodities, it seems to me, is a discussion with the recipients, and I don't understand why that work out for you. So can a food service management company guy tell me?

MR. NORMAN: Bruce Norman. Maybe the solutions, if you are looking for solutions here, would be that certain commodities get labeled as a garnishment, and are agreed upon that those don't get reimbursed as part of this. An example would be walnuts. If we get walnuts or nuts from the

Government, if you are in a reimbursed cost account, you are going to put those on food bars, on salad bars, on everything, but it is certainly not economical for us to put cans of walnuts out somewhere, and have to reimburse the client. But they, to turn them down, as you suggest, certainly is not in the SFA's benefit -- it would be in the SFA's benefit to then make them be able to garnish the menu with them, without penalizing the food service management company through reimbursement, and that would also pertain to items that are too expensive to normally be on a school lunch menu, would be deemed garnishment, or given a value that would fit in with the program. And that way, when we make our brownies, we can put peanuts and walnuts on the top, and it is going to make it a better product for the children, but not make that dessert go from a nickel to a dime.

MR. BROTHERS: One other comment that I have is that, if you give me back all the food that I gave you, value pass through has occurred. So if you get a bonus product from us, say it is walnuts, and you get a hundred pounds of walnuts, and you put back a hundred pounds of walnuts into the school, value pass through has occurred. I don't believe that you would have to pay us for those walnuts, as long as you kept track of them, and you put them into the school, and you use them, then that value pass through has occurred.

MR. JOHNSON: I don't know if OIG took that approach, Dave. One thing, though, that I did see, in my years of working with food service management companies -- I dealt with a lot of schools and states, is, as you said, every state is different. And the reality is, is that, in many states, the school has very, very, limited choices, and the company has even far more limited choices, and may not be involved in the decision at all, as to what got ordered. In some cases, the states are doing the ordering, with minor consultation from the schools or from a board. The state gets a product in. The state has to move the product, because it is sitting in their warehouse, and there is encouragement to the schools to take it. And so, I think, in the best of all worlds, it would work as you suggested. In the reality of the world, it does not work that way. And so therefore, companies are at a huge restriction situation, if they have to pay back the value of commodities, as they come through. Some things, maybe on ground beef, they know they are going to use it, to within a few cents of what they would have paid, either more or less, anyway. Straightforward. That's it. Other types of things, and they are not always bonus, sometimes they are entitlement, same, or whatever. The state may have ordered that. It is offered to the school. In some cases, it is more than offered to the school, and they have got to credit that back, and it does not fit into the menu at all, into the meal pattern at all, or they have got to work it in. Which means that, it is just throwing off all their estimates on the original bidding that they did on it. And so, I think it is, and wherever, my experience is, wherever there is restriction, the company has to charge more. And then --

MR. JOHNSON: All right. I just wanted to share with you an observation, that, as a completely aside, ignorant person about the entire situation, it sounds as though there are some restriction issues here, and that, perhaps, some method of providing the commodities would be useful. I mean, you can, maybe you can bat that around a little bit. I don't know if you have any suggestions for that, but just as a neutral observer, it sounds like there is not much of that communication that goes on. And I don't know whether that's practical or not, but just, more of an observation than anything else.

Any additional comments at all? If not, I think, although this certainly is still open for discussion, the second issue that we wanted to try to get some input, regards the current methods of value pass through. What is being used now? What works good, some positive experiences, perhaps, to share, or we can continue along the lines of problems that you have experienced, and it would be very, very useful if you have any suggestions for perhaps ways that the problems you have encountered could be dealt with. Now, come on, there has to be somebody that has an opinion on this.

MR. BROTHERS: The idea of the value pass through. How is it currently being handled? The contractual requirements that may be involved in that.

MR. HORNER: Toby Horner, Metz and Associates Dining Services. It is H-O-R-N-E-R. Can I ask you a question? What is your recommended procedure for evaluating pass through in a fixed price per meal contract? How is it supposed to work?

MR. JOHNSON: It is not my role here to have any opinion to try to be as impartial as I possibly can be. It is my role to try and get as much information as possible. If you have no comment, that's great.

MR. HORNER: What is the written rule? What is the written rule, on how management companies are supposed to provide that value back to districts, in a fixed price per meal contract? What is the written rule? Is there any?

MR. JOHNSON: I cannot respond to that, simply because I don't.

MR. HORNER: Does anybody know the answer to that question?

MR. JOHNSON: Yes. Perhaps someone here may, may be able to respond to that.

MR. RAUL: I think there is none. I mean, that's the understanding, I think, of, I believe, everyone here. Even the OIG report makes clear that there is not a current rule about it, and that what we are here talking about is what the prospective rule, if any, should be.

MR. HORNER: My next question would be, then, in a cost-based program, is there a written rule for the pass through value of those commodities, or is that pretty apparent, in a cost-based program?

MS. MANZO: Yes. Kathy Manzo, M-A-N-Z-O. There is a written rule for those food service management companies who operate offsite, and when I say offsite, what I mean is, if a food service management company has a contract with one school district, and they provide foods to that school district, as well as another district, they would be required to have a processing agreement, for the service that they provide to that other school district. But that's only for food service management companies that operate offsite. We do have a regulation.

MR. JOHNSON: Les Johnson. Let me suggest that this places companies in an difficult situation, because this area is so ambiguous, or, and this from a company's perspective, it is ambiguous, as to what the rules are. Not many companies would want to go on the record as exactly how they are doing it right now, particularly when it goes into a printed record, but there are a couple of state agencies in here and that type of thing, there are people who are former state agencies, who might be willing to address how they, if you want to move into this, who might be willing to address how they think it is going to work. You might get some companies who, hypothetically, might be willing to talk about how they see it work. But otherwise, I think discussion in this area is going to be kind of limited.

MS. MANZO: Kathy Manzo. I have spoken, the problem, I think, has come from the fact that we have food service management companies written up in the child nutrition regs, and then we have, for those food service management companies who operate offsite, they are in the food distribution regs. One thing I did, back in my office, was, I talked to the school program people, to find out, like, okay, when you go out and do a management evaluation, do you look at the value of commodities? And their answer was, we just looked at, see if the wording is in the food service management contract. So what they do after that is they do what we call a CRE review, which is a coordinated review effort, and doing this CRE review, there is a host of questions, but not one of them address the value of commodities. So I have made the suggestion that we include that, that verbiage, in those CRE reviews that are going to be done in the future.

MS. FISHER: Sandy Fisher again. We did, in Maryland, have cost-based food service management company, and in food distribution, I actually did the reviews, and I went to the school, and I looked to find out how the credit was given back. And frankly, the credits were not given back, for the very reasons that we are here today, because the cost was not written into the contract, and the food service management company was able to buy food at far less than the cost of the USDA value that we used. Consequently, this school no longer gave commodities to the food service management company.

So, the reason we are here today are for all the problems that are being addressed. But, as Kathy was mentioning, and I think in the findings in the OIG report, that many times, that is not, no one goes out and really checks to find out if the value is ever given back.

MR. HORNER: In a cost-based program, the value is already there, and already accounted for in the bidding process. It is basically the value of what you use. It is the beginning inventory, plus a receipt, minus an ending inventory. In a fixed-price per meal contract, I don't think that same thing is happening, and I think there is a lot of confusion with school districts, on what the difference is between cost-based and fixed price. I will give you my opinion. My opinion is that a fixed price per meal contract, and I am from a management company, a fixed price per meal contract opens up the field, for all kinds of playing around, in all kinds of cost categories. It is easy for a good management company to procure more than the 15-1/2¢ or 15-1/4¢ that you say is the allowance, but in most cases, companies who deal predominantly with fixed price per meal are only going to give a credit back for that 15-1/2¢ or 15-1/4¢. If they get more than that, they are going to reduce the amount of money they spend on commercially bought foods, yet they are going to charge the same price. So, in essence, what is happening is, there is more money coming into the management company, more value coming into their pockets, because they are not purchasing the food, they are using USDA commodities. In most cases, I have not seen a case yet, where a school district has received less per meal than what you have allocated, either in the 15-1/2¢, or the 15-1/4¢, or whatever in may be. In a cost-based program, it is apparent what it is. In a fixed price program, it should be the same. It should be the pass through value, divided by the number of meals you serve, and that’s the amount of credit that a school district gets back. In my mind it is very simple, but that’s not what is happening, in food service, and I will talk from the State of Pennsylvania, because that’s where most of my business is, but that’s not what is happening, and it is apparent in the bid process. All of these management companies are pretty much capable of procuring commercial product, at the same price, at the same deals, based on volume. Yet in the bidding process, we see some companies, and we are all supposed to be bidding on the menus that are supplied, we see some companies with a 65¢-a-meal commercial food cost, and other companies in the same bid with a dollar commercial food cost, and schools don't have a clue how to evaluate any of this. And it is just causing, the bid system right now is crazy, especially when you get into fixed price per meal contracts. When you look at cost-based bidding, you will see food costs in bids from various companies, very close to the same thing, because everybody knows what the basic value of pass through is. In a fixed price per meal, it is all over the board, and I think it is basically because there is no way to determine, for a school district and a business manager, unless he is a scientist in food service, what the actual cost of that pass through is. And I think, in my mind, it is the fixed price per meal process that's creating the problem.

MR. JOHNSON: Let me lay out briefly the other side of that picture. In cost reimbursable or non-fixed price meal process, we are suddenly into perhaps the school wanting to verify what the food costs were that came through, which is, because the company is supposedly passing through food cost, and tacking something on top. That verification process is, can be as complicated as, if you ever go into a car dealership, and say, oh, we are selling below list price. If they really want to verify it, it becomes incredibly difficult. You start getting into discounting that takes place in the company because of volume buys. What if the discounting takes place because they are buying for ten different operations, rather than one? Does that apply to that situation, or doesn’t it, and how do you verify, and how do you handle that? I think the complexities are equally on the other side, as far as where a school goes. And then for the school, the state, and the USDA, to try to get in and verify any of that, if they want to, it becomes a real hornet’s nest. So that, on the fixed price contract, the argument is, is that a company, and it ought to appear in the specs that they have to take commodities, but that a company weighs in the beginning, and makes some assessment of what dollar value commodities is going to come in, and that then is reflected in their bid price, in the very beginning. There is no verification afterwards, because there is no, the rebating took place in the bid price, or the pass through. There is restriction on both sides for the companies, but there is a whole, a totally different verification process that’s involved in that.

Of course, also on the fixed price, the thing that got pointed out some time ago is a lot of people think the fixed price is going to be the same fixed price for a full year, and then we are in the major risk. Fixed price can also be something where every three months it gets revisited for cost of living, cost of food increases, that kind of thing, that's not tied into an index, so a company does not have to be tied into a same year, just to -- fixed price.

MR. PURCELL: My name is John Purcell, P-U-R-C-E-L-L. I am looking at the list that you have up on the screen right now, and one of the management companies made the observation that the product that USDA purchases has a value of, let's say, X. They can buy that up and down the street at a price that is substantially lower, which is oftentimes the case. However, the standard, or the specifications of the that product, is not necessarily the same specification. One of the questions I think you need to consider when you do your rulemaking is that the school food authorities, when they do their contracts, maybe want to consider like products, like raw materials. Then you drop down to bullet number three, you talk about processing of commodities. Processing of commodities for a management company become very pricey, because what they are doing is transferring the cost of taking a raw material, turning it into an end product, versus they get it as a raw material a state warehouse, and they don't have to pay the employees to turn it into a finished good, because it is not part of their contract, then they have to absorb a price that they would not have to absorb if they do processing, and so on down this list. And the last one I would make a comment about is the one where they talk about what is available. I think that the department really seriously needs to consider having a national standard, where people know what they can get, to -- point, 150 products, you know, the utilitarian process of using certain foods, whether it is a management company or if it is a self-op FSD, it is still the implications are the same. And the last point I would like to make is, a lot of costs associated with the commodities, have nothing to do with the management company, or the Department of Agriculture. They are borne by the general fund of the local education agency, which in some cases may exceed the value of the commodity in the first place.

MR. JOHNSON: Any additional comments at all? Okay. Well, the third area, and again, all these areas remain open, if you have another thought, or want to make another comment, you are certainly welcome to do that, but any specific proposals you may have for new procedures, and I think we have a slide that addresses that, that Sherry is going to put up there, the types of things that we would like to speak to, are listed here, so maybe you can give that a little bit of thought, and see if you have any suggestions.

No ideas about how to handle things, huh?

Okay. Well, if we don't have any input, are there any comments regarding any of these three areas, that you would like to make at this point? Everybody said what they have to say.

Are there any specific areas that our federal representatives would like to get additional comment on, or areas they would like to throw out for discussion, while then the opportunity as well

MS. MANZO: Yes. I would be interested to know what the food service management companies think about the single inventory. The way that I view it is, the only way a single inventory, because, in the single inventory, once that food is received, it becomes commercial, and the only way that I could see with commodities that it would work, is if the value was given, when the product was received, not when it was used. So I just wanted to see, like get the feedback of food service management companies on that.

MS. THACKERAY: Is everyone clear on the issue? Is everyone certain of what Kathy is referring to? I am seeing a lot of nods, but no hands. I know you did not come all the way here to sit here and listen to me talk.

Okay. Well, I have another question for you.

MR. HORNER: Toby Horner. I don't know what we are going to talk about, but the bottom line, in my mind, I have not been in this business, nearly as long as a lot of these other folks have been, but I have been in the food business a long time. Food business is evaluated, based on the cost of product used. The way you write your contract language, the way you write your contract language, we, all we ever see is value pass through. That's based on cost of product used. If you give school districts value received, coming in the door, how do you then go back and account for value used, just based on commodities? It would be a nightmare. You would see your commodities with commercial labels being mixed up with your commercial product, so I just don't, I cannot quite see, in my mind, how you can do that with a single inventory, and account for actual pass through value of commodities used. It still seems to me that it is a simple bottom line issue, that, either in a cost-based program, or a fixed-price program, it is about the value of commodities used, and that can easily be equated into a price per meal, if you want to do it that way, and give that credit back to the districts, based on what you actually use. Again, I think the problem arises in the bidding process, because companies, in the backs of their minds, who are good commodity users, know that they can get more than that 15¢ per meal, in commodities, and use that. And if they don't account for exactly what was used, that money is, and again, these guys may hate me for saying this, but that extra money that you are charging for commercial product, on a fixed price, becomes profit in your pocket. And based on your contract language, profit in your pocket is supposed to be your fee, and nothing more, whether it is fixed price, or cost-based. Maybe I am wrong in saying that, but I believe that's the way it is written. You can easily determine that in a cost-based program, and we have guarantees to make sure that we do that. In a fixed price per meal contract, you cannot verify that school districts are getting credits back for exactly what was used, unless you write some language that says that. And again, bottom line is, it should be based on the value of what is actually used.

And I think, there again, I think you set a minimum, when you tell us each year that it is worth 15-1/2¢ or 15-1/4¢, and again, I don't think that there is any management company out there that would say you don't really get that value. I would really say that, it is on the other side of the coin, that you are going to get more than that value, and in the fixed price per meal, I don't think the school districts across the board are getting credit for that extra value.

MS. THACKERAY: Okay. I have a question for you. Since we are all kind of hung up on the concept of using commodities, what would be your response to the comment Chartwell's made earlier, about value of commodity received, at that point, would the management company then essentially own the commodities?

MR. HORNER: In my opinion, I don't think management companies should own the commodities. I think those were intended for the districts, and I think the districts should own the commodities. I think, again, if you allow management companies to own commodities, you open up the marketplace to all kinds of abuses with commodities, or at least you dangle the carrot out there for that to happen, not that I am saying there is any company sitting here there will do that, because I think you have some very fine, reputable companies sitting here, including my own, but the commodities are intended, were intended for use by the districts, and I just don't see where that would be advantageous. I, as a management company, I don't think I would want to own those commodities, and I cannot specifically tell you why at this point, but I would sure think about that.

MS. THACKERAY: I was going to ask, why.

MR. HORNER: Well, I don't know. I would really have to think about that, to give you an educated answer, and take a look at that, and take a look at some numbers, but I just don't see that as a viable option, in my case, anyhow.

MR. NORMAN: Bruce Norman. I think one of the answers that we have been discussing as to why we don't like the single inventory is because, for us to take it, and reimburse the client, the SFA, immediately, and then we own it in a sense, also is a huge burden on us, when it comes to our cash tied up, because in some states, again, they are all different, Illinois gives you a month at a time, and it is approximately one month usage. Missouri will dump six months worth of chicken on you at once, and it will be our obligation to then reimburse the client immediately, and have that money tied up for six months. Our purchasing, and our money flow, which again goes back to the lowest rate to the client, is to have as little tied up in inventory to move our product, and to be, again, to have our money tied up, is going to go back, most likely, in an increase price to the SFA, because we are now carrying much larger inventory, and I don’t think that that’s to the SFA’s advantage.

MR. RAUL: Allen Raul. I just wanted to go back to a couple of comments made in response to what Mr. Horner mentioned, just to reemphasize some points made earlier, to see if everyone agrees. First, it seems like there is a consensus that the food service management companies have greater restrictions, unpredictability, and have their management discretion constrained by the commodity situation. We talked about different states doing it differently. In some states, there is more flexibility, there is more opportunity for choice, but in other states there is much less opportunity for choice. Not all of the commodities applied and received are fully useable, in accordance with the meal planning that the company does when it submits its bid. So the bottom line is that the commodities come in in a non, they are not, the economic consequences are not the same as commercially procured product. And again, so that entails some restrictions, and constraints, all of which, again, affect the economic planning for the bid. And then, going back to the question that Mr. Vogel asked me, about the alternative to prices, a price that would be, that would include any commodities received, and a second price that would contemplate a crediting back, I mean, I don't know that anybody has said it explicitly, but obviously, a price that would include a crediting back would be a higher fixed price. So, in evaluating what the proper regulatory policy ought to be, going back, going forward, everyone ought to recognize that, if crediting back is required, either as an alternative, or as the sole basis for submitting a legitimate bid, that would be a higher price. And so then, the question would be whether the SFA's are really going to get a greater value, as the result of having the higher fixed price in the bid, and then getting some crediting back later. And I submit that it is at least debatable whether that is economically beneficial, and in fact, may not be beneficial in any case. So I just wanted to go back and have people focus on the noneconomic basis for these commodities being delivered to the food service management companies, that constrains discussions, makes planning more difficult, entails risks, and therefore necessarily results in higher prices being bid. So I think it is important to bear that in mind. Thank you.

MS. PHILLIPS: I just, Patricia Phillips, I just wonder, after hearing some of the discussion, if the competitive process is sufficient, and I think as Les is referring to, when companies are bidding for the food service management business for the school district, and their ability to use the donated foods to a greater extent, makes them more competitive, if that addresses the issue kind of at the up front level, by the competitive process, or if food service management companies, by getting involved in four or five-year multiyear contracts, allows them to lock in business at, eliminates the competitive process from functioning in that way.

MR. JOHNSON: Les Johnson. And in fact, and Pat's point I think is really good. The competitive issue only works if in fact you have competition at the management level, on management companies. The second thing though, is it seems like from the USDA's point of view, on the things they are going to look, may have to look closely at, and suggest, is, which of these systems creates an incentive for people to use commodities at the school level? Because the real danger here, for USDA, as part of USDA's job, is to make sure that commodities get placed, is that, most people know that, every year, rules that go under contract, for -- food service management companies, and if food service management companies, there needs to be some incentive for food service management companies to want to use commodities, or we could easily get into a situation someday where schools say, schools, food service management companies say, I don't want to, and then USDA cannot place its commodities. So on the long term policy, that may stretch over a decade, some incentive to use -- support --

MS. THACKERAY: Proposals for incentives, you mean?

MR. JOHNSON: It sounded like an offer, if I ever heard one. I mean, here is your opportunity to make some practical suggestions about ways that these commodities could be used, and incentives for doing it.

Just off the top of my head, let me throw one out, and that would be financial incentives. I heard that businesses usually try to make a profit, and I would think that's probably what they are there to do, and just as a layperson, I would think that some sort of financial incentives, or other things. I mean, you can be creative here. I don't think anyone is going to try to lock you down to specifics. And if that does not work? I guess it does not. I guess, off base on that, I guess.

MS. RIGBY: Suzanne Rigby, FDD. To Les's point, we are concerned about the potential of what we do, to your business. We need each other. We do not need to lose you, as users of commodity. We need to do our job, to support the agriculture market. We consider management companies to be a very viable, growing industry. We want to work with you, to make sure, whatever changes we make, regulatory, will work, and help you to survive as a business. We recognize your role in the school food service world, and if you are maybe hesitant, or unable to help us with this today, we certainly do welcome written comments, and how we can frame our regulatory business that we are going to be doing to help you. Such things as, you heard the term, single inventory record keeping. That tool is out there, now, ready, or, I don't know, most of the schools in the nation have access to being able to use that. We have to take a look and see how that is going to help you, in the way you do business. If a management company chooses to use that, then we have to look at, how are we going to be able to recognize the value pass through. We are interested in hearing, having you help us with solutions to this. If you are not able, or have not thought about it today, it is that kind of thing that we would love to see, through written comments. We really do want to work this out, because we do need you, there is no question about it, and we do recognize that.

MR. NORMAN: A couple of suggestions. One of the frustrations that we have, and this gets a little off, but you have standard contract language, and one of the frustrations that we, as an industry, have, is that, every state tells us they are taking their direction from the same boss, up here, at USDA. Yet we will use a contract from one state as a template in another, and they will send it back, totally red-inked, and marked up that it is totally unacceptable. And when we come to this, it might be nice if the suggested language of how the USDA is going to deal with this, is somewhat standardized among the states. That would be extremely helpful, not just in this area, but maybe keep in the back of your mind for the entire contract, and the rules and regs, because it varies tremendously among the states. I made the suggestion earlier that maybe through the contract language to get maximum use of commodities, there could be some negotiation with the client during the contract process that some of these are labeled garnishments, if you want to use that word, and that they could mark, an example was, in the old days, before they got tighter, we, at some camps that got commodities, we were reimbursed for butter at an oleo rate, because they knew that, if we reimburse them for butter, we were simply going to raise their rate, and that nobody would go out on the market and buy butter, as opposed to oleo, for a boy scout camp menu, and that's similar to a school lunch program, and the walnuts and a lot of those type items could be negotiable, and that would be an incentive for us to get them on the menu, which raises the meal count, which goes to the benefit of the SFA. That's not a measurable benefit, but it is certainly a benefit of -- commodities is raising the participation. So that could be put in there, I think, and then, he was talking about incentives, but we know that DOIG wants to have this as detailed and measurable, I guess is the word, as possible, but maybe an incentive would be that, if 15-1/2¢ is the commodity level, if we can use more than that, that there is some sharing in that value; that after you get over reimbursement of a certain 15¢ or 15-1/2¢, then the SFA and the FSMC split that difference, and that would be an incentive that would help him and help us. I don't think the OIG would go for that, but I think that that would be certainly an incentive that would help us.

MR. HORNER: I would just like to further comment on that same thing. When you look at what management companies are up against, as far as what we call bottom line guarantees, it is sort of a double whammy for us. If we don't make the guarantee, we got to pay the school district back the money, but if we do better than the guarantee, the school district keeps the money. That's sort of tough on us, and it is tough on us to do business that way, and I very, very much like that idea that there should be some incentive for school districts, and it could be based on the usage of USDA commodities. Obviously, the more commodities we use, the more economical it is for the district, and the better that bottom line should be, if in fact it was bid correctly. Why not some sharing of that profit, based on the additional use of commodities in a school district? I think that's an outstanding idea, and if you want to push commodities in the marketplace, that's an outstanding way to do it. I know that, in my particular school districts that I manage, I push general managers to call Judy Malone at the Pennsylvania USDA, every week, and ask her if there is anything extra available in the marketplace. And it is not uncommon for our districts to get more than that 15-1/4¢ value for use in the districts. Most of my districts are cost-based programs. I have inherited a few fixed-price programs, and I think that in those cost-based programs, that's a direct benefits to that food cost, and that bottom line for a district, and I think that would be an excellent incentive for management companies.

MR. JOHNSON: Les, a couple of things. One is that, that in a single-inventory thing, one of the issues that's going to come up on a single-inventory, that I know that, you know, you guys are already struggling with, is the identity of commodities needs to remain a commodity, until the time that almost entered a kid's stomach. I mean, it was tracked all the way back, and somebody was responsible all the way. Under single inventory, that's no longer possible, because it gets mixed in with other inventory at the school level, and it is on the shelf, and you cannot tell it from commercial. So I think it is an interesting idea worth exploring that, once it hits that school, and it is a commodity, that USDA considers it done and gone, and that then it becomes the possession of the school, and therefore the management company, and they don't have to do that expensive tracking that's oftentimes required all the way through, right now. And so, I suggest that you guys would look at that, and see if you can pull that off. A second thing, on my incentive comments, some time ago, I just, in talking to companies over the last eight years, I know that some companies, right now, particularly on a cost reimbursable side, see little or no incentive to commodidize, except that they keep the upper level price down, so that they don't exceed the schools, what a school is willing to pay in general, and they need to do it, and they know they need to do it, but they are doing it, not because they have an incentive in it, they are doing it because the school insist that they take some. But if they could get on the commodities, they would in a heartbeat, and that this worries me, in a long time, long-term basis. And so, and I guess I can say this, in an outside government now, but I know my company is making a little bit of extra money, using commodities, if that moves commodities through the system. And that's what you guys were talking about, I mean, in some kind of split system, or whatever, but, because, right now, USDA is having trouble moving some commodities.

MR. PURCELL: John Purcell, again. The point that Les makes about the department making it attractive, and also these commercial labels, it seems to me you already have instituted some other policies, that make this thing even more complex, and that is, total substitution standard yields, that I think, the kind of reg that came out this week, which means, now the products are really commercial products, going through commercial channels, and the commodity is simply a net off invoice that carries the value that was established by USDA November file. So now it has really become invisible, as a commodity, because now it is just an ingredient. It is the chicken you bought, it is the cheese you bought, it is the potatoes you bought from the farmer, or whatever it is, so the thing that really becomes almost transparent. So some of these things, as you go about designing your rules and regulations for posting in the *Federal Register*, I think you are going to have to think about some of the other policies you already had in place, that are brand-new, and find out what the implications of that action would be on these programs.

MR. JOHNSON: Let me also add that, in that, in that thing about a company making extra money out of commodities or whatever, I really believe the competitive bid process eventually works that down. You know, if you make a killing, a couple of years, you can bid lower the following year, and you are going to bid lower, because you know that money is coming in, and you want to, because you want to bid out your competitor. So I think the competitive marketplace takes care of a lot of that. Pat's question becomes critical, then, is, is there a competitive marketplace out there for most schools.

MS. PHILLIPS: Patricia Phillips. Yes, Les, I agree, as long as the regs then, and that's why it has to be a comprehensive process, that the regs, and the guidance to schools, and how they evaluate contracts, as well as possibly developing a prototype state, a prototype contract, may be similar to how ACDA develops prototype processing contract, which USDA blesses, after the work is, after they have come up with it. Maybe ASSFA or some other organization could facilitate that process. Then if the competition, if it is set up so the competition works, and the worst case is, is the food service management company uses donated foods real well, it is the schools that ultimately benefit from lower prices. So and maybe the fixation on accounting that OIG is focused on, if the rules are changed, and maybe they are more concerned with the rules being followed than every penny being accounted for, and that maybe needs to be the focus, is making sure that the beneficiaries be the school districts, rather than making sure that every penny of donated food is accounted for.

MS. FISHER: Sandy Fisher again. Some of the things that we are talking about today, using hard-to-use commodities, and the cost of using it, they are not just for food management companies. Schools have those very same problems. So I am not sure it is fair to now let the food service management companies off the hook, and only give them the good commodities, but I feel that maybe a two-step, or a two-step process, which we are kind of talking about here today, would be -- I have another question, too, that kind of goes back to Bruce's concern about the states forcing schools to take certain commodities, et cetera.
I understand, with the upcoming ECOS, that someday schools may have more say over what commodities they may or may not receive, that it may come down to a school choice, rather than a state choice, that may also alleviate some of that. And finally, Patricia and I had some discussion today. Years ago, and that goes back to kind of the oleo issue, a processor, if they could show that they were paying a certain price for it, that the item, the ingredient, that they were putting, for example, the cheese into pizza, if they

could prove this is the price that they were paying, and it was far lower than what USDA was paying, that they could produce invoices, states were allowed to, allowed that value pass through, and -- in the meantime, we have an established value. I don't know if it is possible to go back to that type of thing that would help alleviate some of the broad differences between costs that actually paid for a product or an ingredient, and as a commodity.

MR. HORNER: Well, while I understand that the fixed price-per-meal process, and you sir talked about companies sometimes being able to make extra money on commodities, based on the fixed-price-per-meal contract, I think in essence what also happens in the five-year bidding contract, that it creates an uneven playing field for all companies. The example I might use is, let's say, school district X has the same company over the past five years, that company has been lining its pockets based on the fixed price per meal, and not having to purchase all of the commercial products as it said it would purchase, so it is making extra money on the fixed price per meal, on that, on that purchase product category. That company knows, at the end of the five-year process, when it is going to rebid, that it has made a lot of extra money on this particular school district. The other two or three companies, or five companies, or six companies, that are coming in to bid that, and it is supposed to be a level playing field, don't have the advantage of that extra money in their pockets. Company A, who has had the business, can now lower their food cost, their price-per-meal on a lot of categories, knowing that they banked these funds. How is that fair, and how has that playing field been leveled, for the smaller companies coming in, who maybe don't have large pockets, or who have not had made that extra money over the years? Again, we see guarantees on bottom lines that are absolutely absurd, and I am sure you folks have seen some of the bids, and seen some of that same thing. And I think it is the fixed price per meal that is driving a lot of that. Again, the school districts benefit, of course they do, because that bid price gets lowered, but you see that bid price going right back up again in year two, year three, year four, and year five. Companies are going to recoup their funds back again, and there is no competitive bid process in year two, year three, year four, and year five. And I believe me, school districts don't want to get into that competitive bid process. They don't even want to do it every five years, because they get comfortable with the companies that they have. But there is not a level playing field, especially on a rebid, where it is not a self-op program that's being bid for the first time. And I think, again, the commodities, and the pass through value, drive some of that uneven playing field problem.

MR. JOHNSON: Well, again, I will ask if there is again additional comments whatsoever. Issues at hand. Things you would like to address.

MS. THACKERAY: Asking a question on a completely unrelated topic to what we have been discussing, Kathy Manzo mentioned earlier, and since we have some of the larger management companies here, I seem to think this will affect you more so than it will affect some of the smaller guys, doing local business in a school kitchen, is that some management companies may fit the definition of a processor, as defined in the 250 regulations. I am getting some blank looks. Well, my question is that, is, how does that affect the way you do business? How would it affect you, if you had to have a management contract for one aspect of your operations, and a processing contract, to actually plate your meals, to get them out to your schools? Because the 250 regulations have quite a lot of requirements on processors. For instance, you have to keep track of your inventory. You have to keep track of draw down. You have to be subject to a CPA audit, depending on the value of commodities you are receiving. It outlines very specific methods of value pass through for processors.

MR. NORMAN: So you are talking about like a commissary situation, where you have a central commissary --

MS. THACKERAY: Not necessarily a central commissary, but like a central kitchen. For instance, I am a big management company. I have several schools in one region. I take all of my food into one central kitchen, plate it, send it out.

MR. NORMAN: Send out, to more than one district. You are saying, to send out to more than one district.

MS. THACKERAY: In multiple contracts. If you have more than one district in the same geographical area that you can do this, and contain all of your labor costs in one kitchen, does anyone here do that?

MR. NORMAN: Bruce Norman. In our public schools, which is mostly what we do, we have virtually none of that. I think some of our other branches may have a small private or parochial school that's on the national school lunch program, that's too small to have its own kitchen, and maybe fed out of a commissary, but we do, we deal with almost none of that. That's an extremely small, small portion of these. Speaking for our company.

MS. YANACEK: Does your question go to a contract issue, or a duplication of efforts?

MS. THACKERAY: It is a little bit of both. I mean, there are two contracts, and it would be a duplication of efforts, but there are a lot more requirements of those companies that would follow the definition of a processor. So you are telling me that 99.9 percent of the business you do is on-site in a school's kitchen.

So what would be the advantage of having a central production facility to feed one SFA, and not do it in their kitchen?

MR. NORMAN: A large district -- with 20 schools, might have a central production to satellite out, because they have schools, without -- without kitchen facilities, and within one school -- relatively common.

MR. JOHNSON: Sounds like that's a relatively uncommon process.

MS. RIGBY: That's good. Oh, goodness.

MR. JOHNSON: Okay. Well, we are not getting many comments at this point. Things are sort of winding down. Give you one last chance, to get what you want to say in.

MS. THACKERAY: We have got two and a half hours, still.

MS. YANACEK: Cora Yanacek. My question is not geared toward commodities, and perhaps this is the wrong venue to ask the question, but if the guidelines are going to be redrafted, sometime over the next year or eighteen months, will there be a forum such as this, to allow us to come and give our thoughts, and our recommendations, for all the items contained in the guidelines, not limited to commodities, or not limited, frankly, to any one aspect of those guidelines.

MS. THACKERAY: You are referring to the state guidance for management companies.

MS. YANACEK: Correct.

MS. THACKERAY: Child nutrition already opened up that opportunity. I am not sure --

MS. LONDOS: Denise Londos, L-O-N-D-O-S. And we did publish, child nutrition did publish a letter, that went out to school food authorities, by way of the state agencies, asking that it also go to the management companies, soliciting areas, what we would call the reaffirming guidance, which is guidance that just simply restates what we already have, what areas we should focus on. There is also a plan, and it is expressed in the OIG audit response from the department, that says, we will be reissuing the existing state guidance, which I think is what you are referring to, again, in terms of updating, in terms of our changes we have had in the department rights. There is a third piece of that, which is further down in the road, which will be after we do a public rulemaking, it would be a proposed rule with public notice and comment, and then that guidance would finally be updated to reflect whatever that final rule shows. As to how that proposed rulemaking process will go, normally, it is a proposed rule, published in the *Federal Register*. We solicit the comments -- we are bound to consider those comments, under the Administrative Procedures Act. We go through a final rulemaking. Sometimes, an interim in the middle, depending on the situation. I don't know of any other plans, but, as I tell everybody, I am not a cog in this organization, I am not even a slug in this organization. Those are decisions that are not made at what I am, just a regular staff person.

MS. YANACEK: Okay. How does -- to us? Are we responsible for going on the web site, and checking it periodically, to see if -- input -- period us?

MS. LONDOS: I will start through the whole process. Reaffirming guidance, when that goes out, it will be published on our web site. It will go out by way of regional to state agencies, state agencies directed to tell their schools, but it will be available to the web site. When we do a public rulemaking, we normally put a notice on our web site. We published a rule in the *Federal Register*, and it is through the *Federal Register* publication that the public's comments are solicited. So it is, ultimately, since we have our web site, we try to use it as much as possible. The guidance, I would expect the reaffirming guidance, and the updated state agency guidance, and the final state agency guidance, all will be available through the web site. Normally, we have tried to tie publication of those documents, issuance of a letter, to putting it on a web site within 24 to 72 hours, depending on who is available will talk about it.

MS. THACKERAY: -- proposal --

MS. PHILLIPS: Two questions. Is there a time frame or a deadline for comments, Denise, to the child nutrition division on that? You said you asked for comments on the reaffirming guidance.

MS. LONDOS: Those comments were due a while ago. Maybe the end of June. I cannot remember exactly. But it was, it has been a while, on the reaffirming guidance. The state agency update to the guidance, again, what we are talking about is nothing that would not be other than saying the citation is -- thirty fifteen -- thirty sixteen, that kind of update. I am sorry, thirty fifteen and thirty sixteen refer to the department level regulations. We have had a movement of our programs -- one set of rules into another set of rules, so we need to update for those changes. How is.

MS. PHILLIPS: And the other question was, I have heard there is a task force, that's set up for this issue, as well? How do they fit in with this process?

MS. RIGBY: We do have a task force that, oh, I think we started meeting, what, about two months ago, and it consists of regional people, headquarters people, state people, and taking of this, just generally, taking a look at the issue, itself, and trying to develop a few options, which we are doing, today, is going to feed into that process. Comments from today, as well as written comments, will be used to again take a look at the options. Those options, then, will direct us, as to what kind of regulatory changes we will need to make, if any, which we are rather sure we are going to have to do something, guidance, policy, et cetera. So then it will enter, and go through the regular clearance process, rulemaking process. We are not there, yet.

MS. PHILLIPS: -- the task force was comprised solely of governmental people?

MS. RIGBY: That's right. That's right. Your piece is what we are doing today, driving input from you today.

MR. HORNER: Do you have any forum to drive input from school districts, themselves, school district business managers, and people who handle the negotiations with us on these on these contracts, because there seems to be a wide range of understanding of fixed price per meal, cost-based, pass throughs, and the whole standard contract language in this process. I mean, it is there is just a wide range of education, concerning the school food service.

MS. RIGBY: You are right. The piece you are referring to really is the educational component, and, to work backwards on that, I guess that starts for those individuals that will come from the state, that comes from us, and the ultimate materials that we develop, just for that purpose. School districts were not a part of the task force. We went as far down as the states that represent school districts, and states that actually, right now, are taking a look at management contracts, and monitoring them for school districts.

MS. THACKERAY: And since Suzanne did not say it, we are the task force. We are here, and we are listening to what you have to say, and.

MS. RIGBY: You want to introduce them?

MS. THACKERAY: I can introduce myself. I am Sherry Thackeray. I am leading the team. Joe Templin. Denise Londos. Kathy Manzo. And I don't recognize the state people, because I have never met them. I just know their voices.

MS. RIGBY: There are others not here.

MS. THACKERAY: Yes. And there are several others who could not make it in. Many of the states complained, the *Federal Register* gave such short notice, they could not get travel funds to travel. So this is your forum to input. We really would like to hear what you have to say.

MR. JOHNSON: I know you guys did not say it directly, but there is a lot of prohibitions in the Federal Government from companies serving on teams that give input, and this is the only way that they can really do it, legally, congressional laws and stuff. One company is -- that company, the suspicion is, puts through stuff that will only give advantage to them, and not to other companies, and so they have got a lot of restrictions on that, which -- the hardware.

I would guess, though, that on the other stuff, dealing with the -- Denise's stuff, you know, and I think there are a number of issues that we will do what Denise said, or reaffirming, but it might even, might even be beyond reaffirming of some current policies in that area. I expect that if, you know, Stan Garnett, who is the division director, and Ron Vogel and stuff, if people thought it would be useful to do a forum like this in that area, that our e-mails to them would at least let them know that they were, companies would like to have something like this take place, before a reg actually came out. My only experience is, when a reg comes out, there is a lot already set in stone. That's not the official version of the agency, but that's, you know, you are -- you are then just responding to --

I had a certain point. I don't remember what it was, so.

MR. RAUL: Allen Raul. There was a comment or implication earlier that the use of commodities might contribute to pocket-lining, and I just wanted to make a number of observations in that regard. And first, in connection with fixed price contracts, there is no guarantee, there, whatever, on the part of the food service management companies, instead of a guarantee of profits, there is really a commitment to, obviously, to a fixed price, and an undertaking of risk, with regard to the contingencies. There is absolutely guarantee of profits. With regard to years after year one in a contract, at least I am not aware that those can be rebid, at certainly anything close to significantly higher prices in the second through fifth years. There have been a number of comments regarding competition. Obviously, competition is a downward pressure, exerts downward pressure on profits, and at least it is my understanding that in fact the industry is highly competitive in this regard, and finally, that it is a largely a low margin business, rather than a high margin business, so that the opportunities for pocket-lining are entirely limited here, and certainly not available in the fixed price context. Thank you.

MR. HORNER: I have to say that I totally disagree with most of the things you just said, concerning the fixed price contract system. I have seen, in my few years in this business, contracts that have started in the first year with 58¢ a meal in food costs, and ended in the last year at a dollar five. That's a pretty darn wide range of food costs, when you have considered the cost of living index is around two or three percent per year. In my mind, that allows for a lot of pocket-lining. There is a lot of changing and agreements that takes place between year one and year five in most cases, and if you look at a difference of ten or fifteen cent per meal, over five years worth of meals, that's a heck of a lot of money. It is a heck of a lot of money. And again, if your basic parameter is that the management company's profit is the management fee, why is it even allowed to happen? If I think about a fixed price per meal issue, in food service, it is a contradiction of terms. You are fixing price, for something that's extremely variable in nature. Food cost is extremely variable in nature, and the risk is basically either on the management company to control that, or there is some risk in the school district, because, how does the school district determine -- put 90¢ on a, you put 70¢ on a plate, repeatedly, time, and time, and time again. Again, I think that the fixed price per meal concept dangles the carrot in front of management companies, to create efficiencies of cost, on fixed price per meals, because if you can charge 90¢ for a meal, and do it for seventy, there is a lot of extra money available there that's going to be profit, and nothing but profit, to a management company. And I am from a management company. And, you know, I might be costing my company some money in doing this, but my biggest problem in this whole issue, and why I am here is, the bid process is not a fair process, especially in a fixed price per meal issue. If you look at the bids, and look at what is happening, contracts are being bought, with moneys available, on spreads, on fixed price per meals.

MS. THACKERAY: Why would a district choose to use a fixed contract without another cost reimbursement?

MR. HORNER: I think, not education of what it does to them. I have sat down with business managers, to try to show them the difference between fixed price per meal and cost-based. A lot of them don't understand it. I think in the bigger district, I think business managers feel safe with a fixed price per meal, because they know exactly what it is going to cost them, but they don't see what it is going to cost them, if they don't see what can happen to them on the other side. On a cost-based program, it is clean. In my mind, it is clean, because it is based on beginning inventories, purchases, ending inventories, actual cost that can be audited, and verified, and even your notation on your web site says that this whole issue has come up, because school districts cannot verify the pass through value of commodities on fixed price per meals contracts. It is apparent. In cost-based, it can be verified. On fixed price, it cannot. It is almost impossible.

MR. JOHNSON: Les, just to balance that discussion out a little bit, I think there is pros and cons to both sides. I don’t think there is any winner, and it depends on where the department, or where a school wants to lay its risk, in which its disadvantages and advantages it wants to have, but walking back in, and attempt to buy and verify food costs at a company level, almost never happens. It is a task that’s truly awesome, and which takes an immense amount to do. So just as the ability of a food company to play with menus, to save under a fixed, there is also the ability to play with food cost. From the school’s point of view, particularly when you get into discounts for large purposes, and all that kind of thing, rebates within purchasing and that kind of we can, from the school’s point of view, the fixed gives them, they know what they are going to have to spend. And I understand that, if a company is able to buy food very, very cheaply, because they buy in large volume, or because they spend a lot of time on the purchasing end, they are going to make out real well in the competitive situation on the fixed cost. That does not mean there is not a level playing field. That's just the way the world, and that's the way business is supposed to work. And a smaller company that may have to pay more may be at a disadvantage in that situation. Again, that's not an unlevel playing field, that is just saying that one is able to play in that area better than the other one.

MS. THACKERAY: Interesting discussion on fixed versus cost reimbursement contracts. Same topic, or different topic.

MR. HORNER: Same topic.

MS. THACKERAY: Same topic.

MR. HORNER: Toby Horner. I think somebody made the comment that there are no guarantees in a fixed price per meal agreement, and I would say that that's not true. I have not procured a fixed price per meal agreement, yet, that we were not held to that bottom line guarantee, whether there were less meals served or more meals served. The mindset of business managers in school districts is that, once you establish that guarantee, that's it, and there is no opportunity to go to back and revisit that, in most cases, three months from now or six months from now, or there really is no opportunity allowed by school districts to revisit that even based on sometimes strike issues and weather issues and things like that. A guarantee is a guarantee, and the mindset of most districts, and I have not found that to be not true in anyone yet, is that, once you establish that guarantee, that's it and, irregardless of what happens, that's pretty much the way it is going to stand.

MS. THACKERAY: Okay. Well, while this is an absolutely enthralling situation, I think we are kind of getting off track a little. I don't think fixed-rated contracts are going away. I don't think that this discussion is really going to help us solve the problem we are having with commodities. One of the things I heard earlier from you was, problems with states doing things different ways. And this is your opportunity to tell us in what way we can standardize things, that the states are required to do, you know, standardizing what they are required to have in their contracts, areas where we can issue further guidance, not that they will necessarily take it or read it, but we can try it. You know, for instance, the first one, standard contract language. You know, anybody who has read our processing regs, there is some standard contract language. They are in your processing contract. You must have these specific items. Do you think specific regulatory contract requirements for management companies would help you in dealing with states, in eliminating some of the ambiguities between contracts? Somebody has to have a thought on that.

MS. YANACEK: Cora Yanacek. One of the gross problems that, as a management company, we are having, is contracts, period. One of the big discrepancies, or inconsistencies, that we are seeing right now is being told by a number of states, that thirty sixteen is requiring that the schools now draft contracts. Not all the states are telling us that, and that's one of the reasons that we are facing a lot of frustration and confusion. Are we going to be able to continue to draft contracts, which we believe incorporate all the regulatory requirements that USDA sets forth? We are happy to do that, and we are really unsure if this task is being taken away from us now, or if it is not. And if it is being taken away from us, then we need some guidance, in terms of how to proceed.

MS. THACKERAY: For those of you who do not know what she is speaking about, she is speaking to a change in the current -- thirty sixteen, that prohibits contractors that write specification, draft specifications, draft the actual contract, from bidding on that contract. I don't think that's going away. That's a fairly new provision that has been around since, I think, ninety-nine, is that? August 2000? So that's, that, I do not believe is going away. So that, in that provision, it allows potential contractors to, provide information, exactly. You are able to provide information. You are not able to write the actual contract.

MS. YANACEK: In any other course of business, two parties negotiate a contract, and either party may draft the contract. It is my opinion that congressional attempt, I'm sorry?

MS. LONDOS: No. That's fine. I just don't think -- this is not a subject that really --

MS. YANACEK: Well, where is the forum, then? I'm sorry. I understood you to say that this was our forum. If it is not, if we are just talking about commodities. Then I will take back any discussion about thirty sixteen.

MS. THACKERAY: But your discussion is warranted, because, obviously, as a management company, you are much more skilled in providing contracts than a school food authority would be. You have a lot of experience, obviously. And Denise is right, that's really not on the topic of commodity. However, for us to assist school food authorities in preparing their contracts, we can, you know, we can add some additional regulations saying your contracts must contain these items. They can be specific. They can be general.

MS. YANACEK: The guidelines say that.

MS. THACKERAY: You are talking about the pamphlet?

MS. YANACEK: Yes.

MS. THACKERAY: So I guess what Denise was getting at is, along the lines of standardizing things among schools, do you have any contract language that the schools can put in their contracts, that would help you?

MS. YANACEK: With regard to commodities.

MS. THACKERAY: With regard to commodities.

MS. YANACEK: I think we have said all we, I can say, about commodities.

MS. PHILLIPS: Patricia Phillips. I think if everyone in this room were to take the two fifty regs, on what must be in a processing contract, we would come up with as many different contracts. The key is, if you have guidance, that some comprehensive group that includes a number of different representatives come up with standard contract language. I mean, if it is not USDA, feels they cannot with that standard contract language, someone needs to come up with standard contract language that everyone can buy into.

MR. NORMAN: I just would like, Bruce Norman, to comment, though. When you evaluate this, as a committee, and you put out, okay, we are going to do a fixed price, and then reimburse for commodities used, versus having the rate simply be lower, based on commodities available, and you list the pros and cons, I think the OIG tends to have a single focus on measurability. But we want to know, to the penny, if that value went to the client, but, in the discussion that we had with the OIG, that does not necessarily mean that you did what was in the best interest of the client. And I think that, when you list the pros and cons, look at it, the end user is the school district. You made the comment that you really need the input from the business managers, and the people that you are trying to protect here. You are trying to protect school districts, to make sure they get the full credit, and they need to have input, because, sometimes, if you get that every penny, it may affect that they don’t get as good of a comp line, because they drive sales away. They maybe get this bigger credit, but you are using commodities that kids don’t eat, so participation drops, and there is a lot of different things that are involved, besides just the measurable dollar. And I request -- always keep in mind what is in the best interest of the SFA.

MR. PURCELL: I would like to, this is John Purcell, I would like to second Mr. Norman’s comment. I would make one suggestion to the department, whether it is talking about commodities, track language, or anything that you have put up on the screen so far. That is, that you get representatives of the AASA, that’s the superintendents association, here in Arlington, on Broad or Moore Street, and maybe even elected school board members and their representatives here in Washington, to ask them what they think they need, in order to do their jobs better, help you help them be protected. But most of all, maybe learn what goes on in the schools, by virtue of the policies you claim to create, because those people are the people who are the final determinant, of what they do, whether they do self-op, whether they use commodities, whether they don’t use commodities, whether they warehouse them, or don’t warehouse them, or whatever it is, because they are the elected officials who run those 14,500 districts in the United States in the first place. It is just a suggestion.

MR. JOHNSON: I want to second what John and Bruce has said, but Suzanne is being a little bit humble here, because she is a former school food service director for a number of years, and whenever she does anything like this, I know that she always puts together a bunch of key schools throughout the country, and runs stuff through, and I doubt whether -- this would be any example -- she used to be work -- school -- so she is very deeply connected over there, too, but I think moving into the business officials, an excellent idea, other with some of the others -- feedback, yes, it is really -- reduces the risk of doing something --

MS. THACKERAY: Okay. Okay. So you are not giving us any areas where we might be able to provide contract language. Does anyone have any suggested, you know, if we have to go with a method of value pass through -- used overseas -- do you like the IG's recommendation of just reducing the invoice based on use? I mean, the other comments that have been made on my slides, and I have to say, I did not take a lot of time making these slides, but these are more cues to help you in the discussion process, of, key items that we really wanted to get out of you, some procedures other than the IG's recommendation for different methods of value pass through. Does anybody have a problem with writing the district a check when they use commodities? I am seeing a lot of blank stares.

MR. JOHNSON: Yes, I do, and this totally sets aside Toby's thing, because this is not dealing with whether a company argues fixed, or whether it argues, you know, a cost reimbursable. This is where a school has put out something on fixed, which is what the articles do -- into our discussion. But where there is fixed, I think the department ought to look at, closely, about, isn't this taken care of, during the bid process, at the beginning? If in fact you write in into -- into the spec, that commodities are going to be provided, isn't this taken care of in the bid process at the beginning, versus making people go through all the paperwork and coming back afterwards -- write checks? And so, I would ask that that be, be considered.

MS. THACKERAY: Okay. So that's one consideration. Does anybody have any other considerations that do not involve the up-front bidding process? How about the IG's recommendation? And they have all read the report. How does that fit into your business? Can you do business that way?

MR. HORNER: Talk about --

MS. THACKERAY: The IG's recommendation was that, fixed rate per meal contracts be bid as if no commodities would be available. That was number one. And number two was that, the full value of the commodities be shown on the invoice, either through a credit, or a deduction in the invoice price. One or two.

MR. HORNER: Toby Horner, and obviously, I would agree with number two. But I think if you act like there is no commodities available, in the bidding process, you are again going to create just such a wide range of bidding, and in especially the food cost area, because companies are going to know that they are going to get those commodities, and based on their history, they are going to know what their company does, as far as commodity values. I just think you are just going to have a lot of erroneous numbers in the bidding process. I think it is just going to create more issues in the bidding process, and it is going to further complicate things.

MS. THACKERAY: I know I had one suggestion, earlier, that, following IG's recommendation, one, that the contract be bid as if no commodities were available, and then before the contract is awarded, it is reduced by the per meal rate for commodities. The same kind of thing, instead of the management company figuring in the no bid price up front, the school knocks it off, when the contract is awarded, kind of a, you know, this is your bid price. It is so far the best bid price. This is what we have for our client assistance level in commodity. This is what we feel we can actually pay you, to perform the services. You are just nodding.

MR. HORNER: I might know as a management company that, you know, the school district is going to lop off whatever they say, but that's not going to stop me from going out and getting extra commodities, and using them in this program. So, when I bid, I may in the back of my mind know that. I know that that school is going to give me the 15-1/4¢ that you allow. I know that is going to come off the top, but I also know that my company might be procuring fifteen more cents, might be procuring 30¢ a meal. And when I give you that commercial price per meal on that bid, I may take that off of there, and again, another company may not, so how does that create a fair playing field in the bid? I just think, again, it just creates more opportunity for companies to just put in all kind of wild bids, with food cost being the total that's used to link together, or put extra money on the bottom line to, again, buy -- contract.

MS. THACKERAY: What about bonus commodities?

MR. HORNER: You don't know what you are going to -- and they may not take any of those bonus commodities, do you know that, but again, that is the unknown part of it. But, there is a certain factor known, I mean, it is known. I could look at my history of accounts and my history of managers and how they manage accounts and I could tell you exactly across the board the value of what our schools are going to be using commodities, I know that. All the companies know that. So, again, companies could use that when -- legitimate price per year and if that is the kind of competition you want to create, then that is fine. But, if I look, if I look at bids that I have done in Pennsylvania over the last two years, I can think of seven bids right off the top of my head, where one or two companies showed up to bid. Why is that happening when there is 25 companies in the State of Pennsylvania that are qualified to go out and bid these contracts. I thought what we were trying to do was create a partnership between school districts and management companies. I look at the 22 contracts that I procured over the last five years, every single one of them, all but a few that I took from other management companies were school districts that were losing tons of money in school food service. This is suppose to be a break even proposition. Our management company has gotten them out of the hole to break even and I think that is good for school districts, but I think it is also good, I don't mind when only one bidder shows up and it is me, but I don't think that is the atmosphere you are trying to create. You are trying to create a competitive atmosphere. And when there are rich companies and poor companies, sure that is the American way, but if you are going to regulate with contract language, and processes of bidding and all that, then even playing field, big companies, small companies, independent company, private company. And by leaving an open number up there for food costs, and taking that off later after the bid process, I just don't, I just think you will create more uneven, more uneven filed competition. I hope I explained that.

MR. RAUL: Allen Raul. I wanted to address the term value in number two in the OIG recommendation and that is, you know, how do you compute that? In many cases as has been mentioned before, the USDA established price may, in fact, be higher than the price available commercially to the company. How do you account for any damage, spoilage, theft or other loss of commodities? What about commodities that are obtained and used but go into so called extra meals that are prepared but not served and for which are not, for which there is no payment at all to the company, because they have prepare extra to be certain that there were sufficient meals for all the children that might show up? And then what about commodities which have a value, but which are again not instrinct to the meal plan as originally developed by the company, so are in some sense either not really needed or are extraneous.

So, it is all fine and good to talk about, you know, crediting back value, but then that poses the question of what is the right value? And as I have just noted with a couple of observations, and as many others have said, that value is a very complex, not easily ascertained figure. And as Mr. Johnson indicated, aren't there great efficiencies in just letting the companies take care of that in the bid price where they are making their own assumptions based on their experience, past practice and the risk they are going to undertake. And it is pass through in that matter, in the bid price, with the risk then falling on the management company.

Thank you.

MS. THACKERAY: I am actually very happy you brought by the value of commodity, because one of the things obviously everyone agonizes over is how do you value the commodity. Our current regulations have three different ways for the states to value their commodities, it goes back to the November 15 Commodity Price for Processing. What is your opinion of, let me back up.

In looking at this issue in value of commodity, we have looked at many management company contracts from many different areas, some of them address value of commodity, others do not. We have seen some very interesting ways to figure the value of commodity. Not pointing any fingers, but, I remember one specific contract where there were four ways to value commodity, all based on the quality and who was responsible for determining the quality of the product. I am not sure.

One of the things people were tossing around is instead of using one of the state labeled ideas, you know, the actual purchase price, the estimated purchase price, the November 15 Commodity File Price -- market price, you know, this is my can of commodity green beans, the management company says they are also brought commercial green beans, here is their invoice showing that they brought them at this price. They want to pass back the value of the commodity green beans which are in the same commercial label perhaps as the one they just brought at the same price for what they just brought. And it is just minimizing the amount they have to buy. Does that make sense?

And I am seeing some smirks, I am seeing some nods, I am seeing a lot of whispering. Somebody has to have an opinion on how to handle the value of commodity. And I understand you all do it differently, and everyone, I think the general consensus in the room has been that the commodities are often more expensive than what you could purchase it for commercially.

Do you as stakeholders in this process have any thoughts on value commodity?

MR. NORMAN: Bruce Norman. My personal opinion is that value between what the Government asks us to reimburse for ground beef, say an item that you would use easily in a school lunch program versus what we would purchase it for, is not merely as important as the fallacy, the fallacy of the thing is that you would spend 90 cents for a meal and 15 cents of that is commodities, you give that back to the client, the cost is the same to us. We would have purchased it anyway, so we purchase it from them. And that would be true if 100 percent of the commodities were items that he had discussed already were in our menu plan or items that we would have purchased anyway. Items that price wise did a type A or reimbursable lunch or breakfast structure and all those criteria. But, many of the commodities do not fall in that. So, the fallacy is that when we us 18 cents of commodities, it doesn't reduce our price 18 cents, it may only reduce our price 13 or 14 cents, because we would not have purchased that item anyway on the free market because it didn't fit in the program. Therefore, we are going to add three or four cents to our bid price, which actually costs the client more to -- for those extra commodities we made in the reverse. I mean, that is not in the school authority's best interest. And that is the fallacy --

MS. THACKERAY: Which, which kind of commodities do not fit into your menu cycle, beef, chicken, fruits, vegetables?

MR. NORMAN: I don't know, but salmon always comes to mind. They have a plan, so if World War III was fought with canned salmon, we would win easily.

You know, you get tons of that and I don't know about, in the recent year, but in the last few years, if you were to take and price out their product and say this is how much I need to give them, two and a half, three ounces of something to meet the meal requirements, you cost that up, that may be a 50 cent entree. And normally we would not put 50 cent entree in that program. So you simply wouldn't buy that item in the free market. Walnuts in your brownies, you are making a brownie go from a nickel to a dime. You would not do that in a school lunch program, typically.

And so, that raises the total cost of that meal from 90 cents to 95 cents. And so, in our eyes we are simply not going to use them, so they are going to sit in a warehouse or you are going to use them as little as you can. And the other negative effect is you wouldn't normally put salmon in your meal price, in your meal plan because when you put it on the menu, typically that is not your high participation day. So, it costs the client tons of money indirectly, because his labor is the same of fixed cost, and that day instead of doing X amount of meals, he does substantially less because the kids tend to brown bag when they see salmon on the menu. And that is where there is fallacy in that, you know, you buy it from him instead of from somewhere else.

MS. THACKERAY: Okay. I think the salmon you are referring to was a bonus item? It was a bonus item. And I know there is a provision in the Farm Bill that might fix some of those odd bonus items. That allows us to distribute the commodities among the programs, depending on which source it is purchased with. So, that might fix a little bit of that problem.

MR. NORMAN: I don't think, and again, I am not speaking for everybody, but we don't have an issue when it is fruit cocktail and when it is ground beef and when it is green beans and when it is corn. The standard items that can easily be used. But, even butter as an example, the price of butter versus the price of Oleo.

MS. RIGBY: Suzanne Rigby. Just to get the record straight, we don't deal with butter. We haven't for years. In case there is any media here, no butter.

MR. NORMAN: That was just an example of --

MS. RIGBY: I know. I know.

MS. THACKERAY: So, how about having in your negotiations, with the school and the contract procedure, saying, okay, school, you know, we understand you are going to get commodities, these are the only commodities we can accept. We can only take canned corn, green beans, you know, I mean, the schools have the option to reject commodities. They can refuse commodities. Why not say, you know, this is stuff that is good, this is stuff we like, this is stuff we can use, in fits into the menu cycle.

MS. RIGBY: Here again, Suzanne Rigby. We have, many of you have heard about the initiative that we have taken over the last, oh, three or four years to try to fix a lot of what was wrong with the commodity program. We did work with all of our stakeholders, schools, states, industry. Probably the one loudest scream that we were told fix it, was just what you are talking about, receiving commodities that we can't use. Or receiving them in forms we can't use. So you are not alone in this. It is, it is, and yet that presents a dilemma for use because those are the very commodities that need removing from the marketplace. And so, we are all in this together. We truly are. We understand and it would be wonderful if everybody could cherry pick and only take the stuff that could use, but it is going to present a dilemma, our dilemma, but it will present a dilemma for what we do when we are told you will be moving X pounds of salmon. It is. Be glad it wasn't vinson. So, you know, I just want to keep that in the forefront. We do have that.

Now, we, as a result of some of these initiatives were have taken, I do have to say we have become or start measures so that we can become more demand driven. So, rather than pushing product on down to the school, we are providing tools that states can use to help become demand driven. You heard somebody mention ECOS, the ECOS system, Electronic Commodity Ordering System. And it is a system that will, that is designed for schools should states like to let schools use it. We are letting the states have the option for that. But, it is where states, our schools can actually go in and request quantities they want, rather than have states tell them you will have this. Now that is an interesting dynamic. That is going to change things and believe me we will be watched by our congressional friends as well as the Department and how has this changed the dynamics of moving commodities, particularly those hard to use. So, just a little sharing here of some of our dilemma. We appreciate what you are saying, and everybody would like to cherry pick and use all their entitlement money on cheese, beef, chicken and green beans, apple sauce, things we know that we can menu and the kids will take. You are not alone in it, but that is just a little of our, what we are going through.

MR. HORNER: Toby Horner. I have always been of the opinion that most commodities are useable, but that is easy for me to say as I am trained and certified chef and I can come up with lots of ways to use those commodities. It would be very helpful to everyone out in the field, not only management companies, but self operation school districts, if you were going to send us 80,000 tons of dried cherries, help us to learn how to use them, help us with recipes on how to reconstitute them and how to make them into turnover and cherry pies without having to send them to the reprocessors. Kids will only eat so many dried fruits in a little container. But, you can take raisins and make lots of things out of them, and cherries and dried apples and apricots, but we never seem to give much material until long after the fact and long after we make numerous requests for some information and some recipes with guidelines on how to use these products. We would love to use them but with sometimes the skilled or non skilled that we have, we can't. And that is why a lot of it gets refused and you end up with tons of it in your storage.

MS. RIGBY: You are right and we have recognized that and we are working on that as well. Do you have any recipes in your files?

MR. HORNER: I have one for a trailmix cookie, that is just fantastic.

Can I make one more comment?

We were talking about value of commodities, and my base understanding of this, is that it is the value, we charge school districts back, and we evaluate our programs at the end of the year. We are talking about commercial food products, it is based on the value of what is used, not value in the door, but value of what is used. So, value is easy to establish, if you don't think you are going to use it, don't take it, it really doesn't cost you anything and isn't going to be factored in the program as something that is being used. But, again, value is one thing, value of what is used is another. Use is easy to determine, it is what you started with, the value of what you brought in minus the value of what you ended with. In my mind it is simple, it is simple inventory procedures, first in and first out. It is the value of what is used. And I think that is easy to determine either in fixed price or cost --

MS. THACKERAY: So, I guess what we are hearing then is a general resistance to going to a commodity received basis, in such that the management companies aren't real interested in practicing single inventory. I don't even see a nod, I see one nod.

MS. RIGBY: You might think about this, this could be something that you might even want to write up in your comments after you think about it and how, how would it affect your business operation, if you, if you had a method, if you, if you did pay the value upon receipt of the commodity, and I can see this working better as we get more demand driven, where you might be able to help and assist in picking those commodities.

And of course, I don't know, but it is conceivable there could be models where you wouldn't have to pay it all in lump sum, but per rate. So, that if you were unfortunate enough to be in a state that does give it to you six months worth, you can prorate. There are ways to get around that. But, we would be interested in your comments on how would paying the value of received versus used, how would that affect your business model?

MR. HORNER: I think if you require companies to pay cash dollars for products that are free in the marketplace, you will drive companies out of business or they will have to get out of the school lunch business, period. There are just smaller companies out there that do an outstanding job in the school lunch program, and I just don't think they have the cash flow or the funds available over the wide range of the business that they have to be able to pay cash dollars and create cash flow to pay for goods that are free in the marketplace. In my opinion, bottom line, I think that is ridiculous and you would drive companies out of business.

MS. RIGBY: That is interesting, interesting. Essentially passing the value back when it is used, you are doing the same thing. It is just --

MR. HORNER: It is a cash flow issue.

MS. RIGBY: Well, yeah, that is --

MR. HORNER: It takes you 60 to 90 days sometimes to get paid from your client, so.

MS. RIGBY: But, I, I would be, you know, and if that is, we would like comments like that and consider it certainly today and in writing, you know, how this would affect and obviously cash flow would be some, one place, where it would affect. But, what are the advantages that would off set it? That thing we talked about, single inventory record keeping and if more of you want to hear more about that, we can certainly do that by you contacting us.

MR. JOHNSON: Okay. If there are no further comments, I guess we will go ahead and wrap it up.

You have heard numerous suggestions that after you have a chance to go back, mull over what happened, what you have heard, have additional thoughts on things, that we can certainly welcome and encourage, any written comments you may have. Before you, you see a slide here being displayed. That gives you where to direct those comments and how exactly to do that. Let me draw your attention to the due date on that, that, these will need to be in by November 8.

MS. THACKERAY: You don't have to busy yourself writing all this down. We have copies of the slide at the table by the door for you.

MR. JOHNSON: That being said, I thank you for your attendance, for your comments and hope to hear from you again.

(Whereupon, at 3:30 p.m., the meeting was concluded.)