

## **Distributor/Processor Agreement Value Pass through Method Definitions**

### **PURPOSE:**

Federal Regulations for the processing of foods donated by the USDA into end products requires an agreement between the processor and the distributor of the end products. See 7 CFR 250.30(i). Pursuant to regulation, the agreement must specify the financial liability for the replacement value of donated foods, not less than monthly end product sales reporting frequency, delivery and receipt of donated food shipments, and the applicable value pass through system to ensure that the value of donated foods and finished end products are properly credited to recipient agencies.

This document will outline the definition of the value pas through methods per FD-40: Processing Memo dated 7/16/2021, title FD-40 Inventory Draw Down in USDA Foods processing.

### ***Rebate***

Under this system, a processor sells end products to the SDA or RA at the commercial, or gross, price and must provide a refund or rebate for the value of the USDA Foods contained in or needed to produce the end products. Alternatively, a processor may deliver end products to a commercial distributor for sale to SDAs or RAs. In both cases, the processor must provide a refund to the appropriate agency within 30 days of receiving a request for a refund from that agency.

Products sold under this value pass through system begin as commercial sales and are not recognized as sales of end products containing USDA Foods until USDA Foods inventory is confirmed and the rebate is issued. Accordingly, a processor should not reduce inventory at the time of delivery to a commercial distributor. Inventory is drawn down from the appropriate agencies' USDA Foods inventory (also referred to as the agency's bank) when the processor issues the rebate to the SDA or RA. This inventory draw down constitutes the transfer of title for the USDA Foods from USDA to the eligible recipient. The rebate should be paid according to the value of the USDA Foods contained in or needed to produce the product, which is in effect at the time of payment.

### ***Direct Discount***

Under this system, a processor must sell end products directly to the SDA or RA (i.e., distributors are not involved) at a net price that incorporates a discount from the commercial case price for the value of USDA Foods contained in or needed to produce the end products. Inventory is drawn down from the appropriate agency's bank (i.e. title transfers) upon acceptance of the end product by the SDA or RA. Direct discount differs from direct fee-for-service, discussed below. Direct discount is used for commercial product and the price paid by the eligible recipient is calculated by subtracting the value of the USDA Foods contained in or needed to produce the product from the commercial price.

### ***Indirect Discount (a.k.a. Net off Invoice)***

Under this system, also known as net off invoice (NOI), a processor delivers end products to a commercial distributor, which must sell the end products to an eligible SDA or RA at a net price that incorporates a discount from the commercial case price for the value of USDA Foods contained in or needed to produce the end products. A commercial distributor is always involved under this system.

Product sales under this system begin as commercial sales and the products being sold are commercial products. An SDA or RA procures commercial products from a distributor and the distributor procures those products from a processor. The distributor pays the processor at the commercial price. If the eligible SDA or RA to which the product is being sold has the necessary USDA Foods inventory with the processor, the sale is converted from a commercial sale to an NOI sale. The SDA or RA then pays the distributor the NOI price which is calculated by subtracting the value of USDA Foods contained in or needed to produce the product from the commercial price and adding a fixed fee for storage and distribution by the distributor.

The processor must require the distributor to notify it of such sales, at least on a monthly basis, through automated sales reports or other electronic or written submission<sup>1</sup>. After the NOI sale is confirmed, the processor compensates the distributor for the discount provided for the value of the USDA Foods in its sale of end products to an eligible recipient. FNS cannot assume that the end product delivered by the processor will be sold by the distributor to an eligible recipient. Therefore, the processor may not draw down inventory (i.e. transfer title to RA) until documentation is provided by the distributor that shows a sale to an eligible recipient with adequate USDA Foods inventory. This documentation may be a sales velocity report or other documentation acceptable to the processor that identifies the end product that was sold and the eligible recipient that bought the product<sup>3</sup>.

The practice, sometimes referred to as closed stock-keeping unit (SKU) NOI, under which a processor sets up a separate SKU for a specific NOI product and restricts the sale of that product to only agencies with the necessary USDA Foods inventory, is allowable under the regulatory definition of NOI. This practice is essentially an internal accounting mechanism and is an allowable practice provided that it follows the procedures outlined above. The most common use of this practice is for sales of beef and pork end products.

### ***Fee-for-Service***

Under this system, a processor must sell end products to the SDA or RA at a fee-for-service (FFS) price, which includes all costs to produce the end products except for the value of the USDA Foods used in production. Unlike some of the other systems, this is not used for commercial products. Three basic types of fee-for-service are used, including direct FFS, FFS through a distributor, and what is commonly known as modified FFS.

#### *Direct Fee-for-Service:*

Under this system, the SDA or RA procures end products directly from the processor, pays the FFS price, and the processor either delivers the product to the agency or the agency picks the product up from the processor. The processor's invoice to the SDA or RA must identify any charge for delivery of end products separately from the FFS price<sup>3</sup>. Inventory is drawn down from the appropriate agency's bank (i.e. title transfers) upon delivery or pickup. Direct fee-for-service differs from direct discount, discussed above. Direct fee-for-service is used for non-commercial product and the price paid by the eligible recipient is calculated by summing all the costs to produce the end product, not including the value of the USDA Foods contained in or needed to produce the product.

#### *Fee-for-service through a distributor:*

The SDA or RA procures end products directly from the processor and also separately procures storage and/or distribution services from a distributor. The processor ships multiple pallets of product to a distributor (or the distributor picks the product up from the processor) with a breakout of which RA owns which products. The agency pays the processor the FFS price and separately pays the distributor a fee for storage and/or distribution. Inventory is drawn down from the RA's bank (i.e. title transfers to RA) upon delivery to/pickup by the agency's contracted distributor.

#### *Modified Fee-for-Service (MFFS):*

The RA procures end products from a distributor, pays the distributor the FFS price plus a fixed fee for storage and distribution, and the distributor delivers the end product to the RA. The distributor, acting as the RA's authorized agent, procures and purchases end products produced with USDA Foods from the processor on behalf of the RA and pays the processor the FFS price. Inventory is drawn down from the RA's bank (i.e. title transfers) upon delivery to/pickup by the RA's contracted distributor.