



**House
Legislative
Analysis
Section**

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**MILK, DAIRY PLANTS: REQUIRE
FINANCIAL SECURITY**

**House Bill 5879 (Substitute H-2)
Sponsor: Rep. Mike Green**

**House Bill 5880 (Substitute H-2)
Sponsor: Rep. Allen Lowe**

First Analysis (5-21-96)

Committee: Agriculture and Forestry

THE APPARENT PROBLEM:

Michigan currently regulates persons who operate dairy plants, which manufacture various dairy products using milk, and milk plants under two separate acts -- the Manufacturing Milk Act (MMA) and the Fluid Milk Act (FMA), respectively. Both of these acts specify minimum financial security requirements that must be met for a person to be licensed as either a dairy or milk plant. However, these provisions failed to prevent the Pinconning Cheese Plant, which was licensed as a dairy plant under the MMA, from operating in a financially unsound manner that led to numerous local milk farmers not getting paid for milk which they supplied to it. The plant eventually closed and a suit was filed by the Department of Agriculture on behalf of affected farmers. The department also formed a committee to study what might be done to improve the financial security requirements of the MMA and FMA, and legislation has been proposed that would adopt the changes recommended by the committee.

THE CONTENT OF THE BILLS:

House Bill 5879 would amend the Manufacturing Milk Act (MCL 288.101 et al.) and House Bill 5880 would amend the Fluid Milk Act (MCL 288.22 et al.) to add nearly identical language to each act specifying minimum financial security requirements that dairy plants and milk plants, respectively, would have to meet in order to be licensed by the Department of Agriculture.

Application for licensing, renewal. Both bills would require an applicant for an initial license to apply to the department for licensing and provide a statement that contained various identifying information about the dairy or milk plant, including its business name, and--if the business was not an individual--the names of officers, directors, partners, members, or owners owning more than 35 percent of equity or stock in it;

the plant's location and the name of the "responsible person" who could be contacted there; the anticipated value of greatest milk receipts the plant expected to receive during a consecutive 30-day period within the licensing period; a complete list of producers with whom the plant was doing business and identifying information about them; and the name of the financial institution through which milk checks were issued to producers.

The bills would require a plant to annually renew a license by applying to the department at least 30 days before an existing license expired. The anniversary date of the license for a milk/dairy plant that was providing a financial statement as a security device would be 130 days after the close of the licensee's fiscal year, and all other licenses would expire on June 30 following the date of issuance. A plant would have to apply for license renewal from the department and provide a statement containing the same identifying information required for an initial license application.

In addition, House Bill 5879 would authorize the department to issue a temporary license to operate as a dairy plant if it determined that doing so would not threaten the public's health, safety, or welfare, or would not cause an imminent threat of financial loss to "producers" (which both bills would define as persons who owned or operated dairy farms and sold or distributed milk produced from them, including those who marketed milk on behalf of such persons).

Financial security requirements. The acts currently condition the ability to operate as a licensed dairy or milk plant on whether a person files with the department director certain security devices, including an audited financial statement prepared by a certified public accountant verifying the person's ability to meet the minimum liquidity requirement ratio of 1.2:1 current assets to current liabilities, and certain financial

House Bills 5879 and 5880 (5-21-96)

instruments (i.e., bonds, cash, stocks, and other securities acceptable to the department) to protect producers in case a default in payment occurs. The bills would expand on these provisions to require the following:

* The audited financial statement would have to be done according to generally accepted accounting principles, and would have to contain a balance sheet, income statement, equity statement, statement of cash flow, notes to the statements, and other information required by the department. As is the case at present, this audit would have to be done within 120 days after the licensee's fiscal year ended, except the department could extend the date for filing it by up to 30 days if a written request for extension was made--including the reason for the delay--by a licensee no less than ten days before the original deadline.

* A quarterly verified financial statement verifying the licensee's ability to meet the 1.2:1 asset-to-liability requirement would have to be filed within 60 days after a fiscal quarter ended, and would have to at least include a balance sheet, income statement, and other information required by the department.

* The department could require a licensee to file a supplementary or interim financial statement or provide additional information at any time pertaining to financial statements that were filed or to specific information requests made by the department. In determining whether a licensee had met the minimum liquidity requirement ratio in a financial statement, the department would have to exclude all intangible assets and assets it determined were "of doubtful value," and the bills list numerous other financial instruments that the department could exclude. The bills also include provisions regarding security requirements that would apply to a license applicant that had not been in the business of receiving milk during the previous 12 months.

The bills also would require as a condition of licensure that a person provide certain forms of security, in a form and subject to terms and conditions deemed necessary by the department, for the benefit of producers damaged by a default. The value of such securities would have to be in an amount determined by the department to be the greater of either of the following: the value of the greatest milk receipts received by a plant within a consecutive 30-day period during the plant's most recent fiscal year, or the value of the greatest milk receipts a plant anticipated receiving during a consecutive 30-day period within the licensing period. The bills would permit the following kinds of securities to be provided:

* A commercial surety bond made payable to the department and subject to cancellation only after written notice to it at least 90 days prior to cancellation;

* A certificate of deposit or money market certificate that was issued or endorsed to the department and could not be cancelled or redeemed (or have funds transferred or withdrawn from them) without the department's written authorization;

* Stocks, bonds, or securities acceptable to the department that were issued or endorsed to the department, readily convertible to cash by it, and subject to redemption or sale only upon written permission of the department;

* An irrevocable letter of credit filed as security with the department and made payable to it, that was issued by a financial institution acceptable to the department and licensed to operate in Michigan. A letter of credit would have to provide for automatic renewal unless, at least 90 days before the scheduled renewal date, the issuing financial institution gave written notice that it would not be renewed. The department could request information from the Financial Institutions Bureau regarding the financial institution's financial viability.

* Life insurance policies acceptable to the department that were issued or endorsed to it so that the insurer could not make any payment to the policy beneficiaries unless it first paid the equivalent of cash surrender value to the department and so that this amount was paid to the department upon cancellation or surrender of the policy; and

* Other securities acceptable to the department.

However, the bills would delete current language in both acts that permit as an acceptable form of financial security cash in an amount tied to the value of highest milk receipts received or anticipated to be received by a licensee.

The department could require a dairy or milk plant to provide a change or increase in a security device if it had reason to believe after reviewing relevant financial information that the respective plant no longer met the minimum liquidity requirement or could no longer make payments to its milk producers as required by the bills. Also, House Bill 5879 would permit the department to require such a change if the value of a dairy plant's security device fell below the value required of it in the bill due to depreciation in the security's value, an increase in the maximum liability to producers, or the cancellation or change of the security device.

In addition, the department would have to send written notice by certified mail to a dairy or milk plant stating why it was requiring a change or increase in a security device and setting the date when the change or increase would have to occur. Also, the department would have to notify all producers shipping, respectively, dairy products to a dairy plant or milk to a milk plant of the decision to require the respective plant to modify or change its security device, and the notice would have to be provided within five days after the department issued an order requiring another security device.

Notice to producers. The bills would require the department to notify producers delivering either dairy products or milk to, respectively, a licensed dairy plant or milk plant of the type of security device used for the benefit of producers, and about when a license was issued, renewed, or modified. This notice would have to include certain information detailing the financial security requirements that apply to licensees under the acts, as well as other information related to a licensee. (Both bills indicate the exact wording the notice would have to contain.)

License revocation, denial, suspension. The department would have to revoke or deny the license of a dairy plant that produced manufactured dairy products or of a milk plant if the licensee or applicant failed to provide one of the acceptable types of security devices. Also, the department could revoke or suspend a license issued to a dairy or milk plant upon determining a licensee had done any of the following:

- * Failed to provide certain information required by the department or requested by it pertaining to the licensee's financial security;
- * Failed to provide a security device in an amount and manner required by the bills;
- * Knowingly made a material misrepresentation or provided false or fraudulent information on an application, or provided either of these in response to a request for information from the department;
- * Failed to pay a producer or producer agent as required by the bills; or
- * Violated either of the respective acts or rules promulgated under them.

A person whose license was suspended, revoked, or denied would have to immediately discontinue operation of the business for which the license had been issued or requested, and someone whose license was suspended or revoked would not be eligible for reinstatement of

the license until the department determined that the violation had been remedied.

Notice of intent. House Bill 5880 would require the department, before suspending, revoking, or denying a license, to provide the affected licensee with a written notice that identified the department's intent to suspend, revoke, or deny the person's license, the grounds upon which such intended action was based, and the time and place of hearing on the intended action. The department would have to personally serve or send by certified mail to the licensee the notice of the hearing at least ten days prior to its date, and the hearing would have to be conducted in a manner required by the Administrative Procedures Act. (Similar provisions already are contained in the Manufacturing Milk Act.)

Also, both bills would require the department to notify in writing each producer with whom a dairy or milk plant did business at least five days prior to the date the hearing was set.

Summary suspension. Both bills would permit the department to summarily suspend the license of a licensee if it determined this was necessary to protect the public's health, safety, or welfare. Similarly, if the department had provided notice to a licensee about its intended action and subsequently determined that summary suspension of his or her license was necessary to prevent an imminent threat of financial loss to one or more producers with whom the licensee did business, it could summarily suspend that licensee's license. The department would have to incorporate a determination in its order of summary suspension, and could order this to take effect as specified in an order or upon the licensee being served the certified order, whichever was later. Summary suspension would be in effect during proceedings, and these would have to be commenced and determined promptly.

Payments for milk. Currently, both acts require persons who buy milk to resell or manufacture into other products to pay the producer at least once every month--by the fifteenth day for milk received in the previous month--although buyers may pay producers more frequently than this. The bills would delete these provisions and, instead, would require buyers of milk to pay the producer an advance payment on or before the last day of each month for milk received during the first 15 days of the month and a final payment on or before the fifteenth day after the month ended for milk received during the preceding month. Violators would be subject to license revocation. Also, both bills would prohibit either a dairy plant that produced manufactured milk products or someone who purchased milk for this purpose or for resale from issuing a check to a milk

producer unless the purchaser's name was noted on the check.

Penalties. Currently, both acts specify that someone who violates the acts or certain rules promulgated under them is guilty of misdemeanor and could be fined up to \$500 (but not less than \$50), jailed up to 90 days, or both. Under the bills, someone who provided materially false or fraudulent information on an application or in response to a request from the department would also be subject to these penalties.

FISCAL IMPLICATIONS:

The Department of Agriculture says the bills would not affect state or local budget expenditures. (5-16-96)

ARGUMENTS:

For:

The bills would add nearly identical provisions to the Manufacturing Milk Act and Fluid Milk Act that have been recommended by a special committee formed by the Department of Agriculture to strengthen the financial security requirements that must be met by licensed dairy plants and milk plants. The bills were prompted by the Pinconning Cheese Plant's failure to pay milk producers (i.e., farmers) for milk they had supplied to it because checks it issued to them had bounced. A suit was recently filed against the plant on the farmers' behalf by the state. The provisions contained in the bills are similar to provisions contained in a Wisconsin statute adopted in 1992 in response to a similar plant failure that occurred in 1989. (Wisconsin, of course, is the largest producer of dairy products in the nation.) By detailing the kinds of security devices that licensees would have to provide to the department and specifying other requirements they would have to meet, the bills should prevent the kind of situation that led to the Pinconning Cheese Plant failure and the hardship it caused to milk farmers who supplied it.

POSITIONS:

The Department of Agriculture supports the bills. (5-16-96)

The Michigan Farm Bureau supports the bills. (5-20-96)

The following testified in support of the bills before the House Agriculture and Forestry Committee on 5-16-96:

- * The Michigan Milk Producers Association
- * The Michigan Dairy Foods Association

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.