



Legislative Fiscal Bureau

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March 16, 2010

TO: Members
Joint Committee on Finance

FROM: Bob Lang, Director

SUBJECT: Assembly Bill 748: Suspension of Milk Contractor Assessments to the Agricultural Producer Security Fund

Assembly Bill 748 would suspend, for the license year beginning May 1, 2010, the assessments required to be paid by milk contractors to the agricultural producer security fund. On February 25, 2010, the Assembly Committee on Agriculture recommended passage of the bill by a vote of 11 to 0.

CURRENT LAW

The Department of Agriculture, Trade and Consumer Protection (DATCP) administers the agricultural producer security (APS) program under Chapter 126 of the statutes and several administrative rules. The program requires the following entities to be licensed by DATCP and pay license fees and assessments into the segregated APS fund: (a) grain dealers; (b) grain warehouse keepers; (c) milk contractors; and (d) vegetable contractors. The fund supports payments to agricultural producers in the event of a default on payments by a contractor to whom they sell products. Milk producer payments generally may be for up to 80 percent of the first \$60,000 allowed and 75 percent of any amount in excess of \$60,000. Also, the maximum exposure of the fund is limited to 60 percent of its cash balance on the last day of the month preceding the default. The February 28, 2010, APS fund balance was \$10,480,600, meaning the maximum exposure in March, 2010, is approximately \$6.3 million. The fund also supports 13.42 positions in DATCP for program administration. Administrative costs are intended to be covered by license fees, while annual assessments are intended to provide the means for making future default payments.

The statutes define milk contractors as persons who buy milk from producers or who market producer-owned milk as agents of producers. License years for milk contractors run May 1 through April 30, and contractors are required by statute to pay certain license fees into the APS fund.

License fees would not be affected by the bill. License fees consist of: (a) an annual application processing fee of \$25; (b) applicable surcharges and penalties, if any, for unlicensed operation (\$500), late license renewal (\$100), or failure to file a required annual financial statement (\$100); and (c) a monthly fee of 15 hundredths of a cent for each hundredweight (100 pounds) of milk the contractor procured in Wisconsin in the preceding month. However, the statutes require the Department to issue credits of monthly license fees to milk contractors who pay assessments to the APS fund and who file timely license renewals if, on February 28 of each year, the balance in the APS fund attributable to milk contractors exceeds \$4 million. The total credit available for contractors is 50 percent of the excess. DATCP reports that milk contractors began receiving these credits with the license year beginning May 1, 2007. Since that time, DATCP has credited: (a) \$34,700 in fiscal year 2006-07; (b) \$209,700 in 2007-08; and (c) \$215,000 in 2008-09. Total credits for 2009-10 are estimated to be \$240,000.

Although all milk contractors are required to be licensed, not all pay assessments into the APS fund. Those who do are classified as contributing contractors. DATCP reports there are currently 110 licensed milk contractors, consisting of: (a) 73 contractors required to pay assessments based on their financial condition; (b) 22 contractors who voluntarily pay assessments, but whose financial condition does not require it; (c) 13 contractors who have opted out based on their financial condition; and (d) two contractors who are currently disqualified from participation due to having negative equity. Contractors who are disqualified are not required to pay assessments after their disqualification. However, DATCP may hold other security outside the APS program to help disqualified contractors ensure payments to producers. The APS fund does not pay claims against noncontributing contractors.

Annual assessments are calculated by DATCP at the beginning of each license year in part on the basis of a contractor's obligations for milk purchased in its preceding fiscal year. For instance, assessments payable during the license year beginning May 1, 2010, would generally be calculated on 2009 milk sales. Assessments are payable in equal quarterly installments and are due on June 1, September 1, December 1 and March 1.

The statutes specify that a contractor's total annual assessments are the sum of two individual components: the current ratio assessment and the debt-to-equity ratio assessment. The current ratio assessment considers the contractor's ratio of assets to liabilities, while the debt-to-equity ratio assessment considers the contractor's total debt against its total equity. Each assessment gives consideration to contractors that have been in the program for uninterrupted periods, with five or more full license years of consecutive participation receiving the highest consideration. Further, each assessment uses the dollar value of milk purchased in the preceding year as a multiplier. Therefore, a contractor's assessment can vary widely from year to year based on the entity's financial condition, its continuous participation in the APS program, and the market prices of milk in the preceding year. Current law allows for reductions if a contractor has filed with the Department any security that may be statutorily required, such as cash, a surety bond or a bank letter of credit, or if the APS fund and the amounts attributable to collections from individual license categories achieve certain balances. These balance-related reductions are discussed later in greater

detail. Administrative rule ATCP 100 (milk contractors) specifies minimum annual assessments from \$100 to \$500 based on the total obligations from milk purchases as reported as of the end of the contractor's most recently completed fiscal year. However, certain contractors may pay several thousands of dollars in annual assessments. The Department reports 14 contractors were assessed \$10,000 or more for the current license year.

Under the statutes, DATCP may adjust assessments by rule. The statutes also require assessments be adjusted to maintain certain minimum and maximum balances in both the overall APS fund and the balances attributable to each license category. The statutes do not require a suspension of or exemption from assessments. However, ATCP 100 currently provides that a contractor is not obligated to pay an assessment under the following conditions: (a) the contractor was classified as a contributor to the APS fund in each of the five preceding license years; (b) the APS fund balance is at least \$11 million on the February 28 of the preceding license year; and (c) the APS fund balance attributable to collections from milk contractors is at least \$6 million on the February 28 of the preceding license year. DATCP reports as of February 28, 2010, \$7,413,300 of the \$10.5 million APS fund balance was attributable to milk contractor license fees, assessments and interest earned on fund balances.

BILL SUMMARY

The bill would specify that no milk contractor would be required to pay an assessment to the APS fund during the license year beginning May 1, 2010, nor would DATCP be required for that license year to provide contractors with otherwise required notices of their obligations under the annual assessment.

FISCAL EFFECT

The statutes do not require APS program assessments or license fees to be charged by licensees to milk producers, nor would the bill require that the savings from the suspended assessments to be passed to milk producers. However, it could be argued that the incidence of the assessments is split between contractors and producers and the bill is intended to save milk producers some costs, particularly in light of lower milk prices that producers received throughout 2009. Average milk prices as reported by the Wisconsin Agricultural Statistics Service fell from a record high of \$22.20 per hundredweight in December, 2007, to a June, 2009, low of \$11.40 per hundredweight. The most recent reported price is \$16.10 per hundredweight for February, 2010.

DATCP estimates that the one-time revenue loss to the APS fund would be \$500,000 SEG. As the first quarterly payment in the next license year would be due June 1, 2010, approximately \$125,000 would occur in fiscal year 2009-10 and \$375,000 would occur in 2010-11. (The DATCP fiscal estimate inadvertently places the fiscal effect in 2010-11 and 2011-12, respectively.) Although DATCP would not know total billable assessments until contractors submit required financial statements, the Department bases this estimate primarily on lower milk prices received by producers throughout 2009. The estimates assume the overall financial ratios of participating

contractors would remain stable.

DATCP estimates AB 748 could save dairy farmers an average of up to \$50 over the upcoming license year, which assumes: (a) the Department would bill approximately \$500,000 for the upcoming license year; (b) there are approximately 10,200 dairy producers in the state that sell their milk to contractors who pay assessments into the APS fund; and (c) all milk contractor assessment savings would be passed entirely to producers. However, because savings would be realized on the basis of assessments payable, and because assessments increase as a contractor's risk increases, savings under AB 748 would tend to accrue to those contractors whose financial reports suggest less favorable asset-to-liability and debt-to-equity ratios.

Assuming a \$500,000 SEG revenue loss, the APS fund would be expected to have a June 30, 2011, balance of approximately \$10.6 million. This assumes total revenues over the biennium generally remain stable from 2008-09 levels, although revenues attributable to each license category would be likely to vary with changes in market prices. Table 1 shows the current estimated condition of the APS fund on June 30, 2011, while Table 2 shows the estimated condition under AB 748.

TABLE 1
Agricultural Producer Security (APS) Fund Condition -- Current Law

	<u>Actual 2008-09</u>	<u>Estimated 2009-10</u>	<u>Estimated 2010-11</u>
Opening Balance	\$9,078,600	\$9,611,900	\$10,448,500
Revenue	<u>1,981,700</u>	<u>1,985,000</u>	<u>1,900,000</u>
Total Available	\$11,060,300	\$11,596,900	\$12,348,500
Administration	\$1,448,400	\$1,148,400	\$1,148,400
Defaults	<u>0</u>	<u>0</u>	<u>130,000</u>
Closing Balance	\$9,611,900	\$10,448,500	\$11,070,100

TABLE 2
Agricultural Producer Security (APS) Fund Condition -- AB 748

	<u>Actual 2008-09</u>	<u>Estimated 2009-10</u>	<u>Estimated 2010-11</u>
Opening Balance	\$9,078,600	\$9,611,900	\$10,323,500
Revenue	<u>1,981,700</u>	<u>1,860,000</u>	<u>1,525,000</u>
Total Available	\$11,060,300	\$11,471,900	\$11,848,500
Expenditures	\$1,448,400	\$1,148,400	\$1,148,400
Defaults	<u>0</u>	<u>0</u>	<u>130,000</u>
Closing Balance	\$9,611,900	\$10,323,500	\$10,570,100

Although defaults by contractors have been uncommon recently in the APS program, it is difficult in a given year to determine whether the APS fund will be obligated to cover any contractor defaults, and how much the fund would be obligated to pay. The APS fund has made one payment since its inception in 2002 to cover a default, an event which occurred in fiscal year 2005-06 and resulted in payment of \$130,400. DATCP also reports contractor defaults dating back to 1980 have averaged approximately \$520,000 annually in current dollars, which consists of: (a) \$367,000 for milk contractors; (b) \$137,000 for grain dealers; and (c) \$16,000 for grain warehouse keepers. Assuming a general 80 percent liability for the APS fund, this could suggest average annual fund obligations would be \$416,000, though they would be expected to vary substantially from year to year. However, under the current APS program, DATCP has assumed a more proactive role in limiting contractors from taking on greater liabilities if a contractor's reporting shows it to be in distress or at risk of default. Therefore, estimates in the tables above assume: (a) there will be no defaults in the current fiscal year, given the limited time remaining in the year and current financial conditions of APS participants; and (b) payments in 2010-11, if any, will be limited to a level similar to the 2005-06 payments, given DATCP's practice of engaging troubled contractors to limit the exposure of the fund. The fund balance would be affected to the extent actual claims vary from this estimate.

The statutes require DATCP to adjust assessments to maintain minimum and maximum balances both for the entire APS fund and within each license category. Further, as noted earlier, ATCP 100 allows certain long-term participating milk contractors to be exempt from assessments if the APS fund and the balance attributable to milk contractors achieve certain balances. The Department expects the assessment exemption could begin with the license years beginning in 2011 or 2012, assuming that revenues in the intervening time are sufficient and assuming that the fund is not liable for major default payments. Table 3 shows the amounts that trigger assessment exemptions under administrative rules and the balances for each license category as of February 28, 2010. Table 4 shows revenue totals for each category in 2008-09; not shown is \$121,300 for interest earned on the fund's balance. It should be noted that although the balance attributable to

milk contractors has met the amount required for assessment exemptions, there have been no exemptions due to the \$11 million overall fund balance not being met.

TABLE 3
Agricultural Producer Security (APS) Fund by License Category

	<u>Exemption Threshold</u>	<u>February, 2010 Ending Balance</u>
Milk Contractors	\$6,000,000	\$7,413,300
Grain Dealers	3,000,000	2,327,000
Grain Warehouse Keepers	500,000	- 365,100
Vegetable Contractors	<u>1,500,000</u>	<u>1,105,400</u>
Total APS Fund	\$11,000,000	\$10,480,600

TABLE 4
APS Revenues by Type and License Category, 2008-09

	<u>License Fees</u>	<u>Assessments</u>	<u>Other</u>	<u>Total</u>
Milk Contractors	\$161,500	\$891,800	\$5,900	\$1,059,200
Grain Dealers	141,600	406,500	30,700	578,800
Grain Warehouse Keepers	10,900	37,700	141,700	190,300
Vegetable Contractors	<u>1,100</u>	<u>20,000</u>	<u>11,000</u>	<u>32,100</u>
Total APS Fund	\$315,100	\$1,355,900	\$189,400	\$1,860,400

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