DEPARTMENT OF AGRICULTURE

Food and Nutrition Service

7 CFR Part 246

RIN 0584–AA80

Special Supplemental Nutrition Program for Women, Infants and Children (WIC): Food Delivery Systems

AGENCY: Food and Nutrition Service, USDA

ACTION: Final rule.

SUMMARY: This final rule amends the regulations governing the Special Supplemental Nutrition Program for Women, Infants and Children. It strengthens vendor management in retail food delivery systems by establishing mandatory selection criteria, training requirements, criteria to be used to identify high-risk vendors, and monitoring requirements, including compliance investigations. In addition, the rule strengthens food instrument accountability and sanctions for participants who violate program requirements. It also streamlines the vendor appeals process. The rule will increase program accountability and efficiency in food delivery and related areas and decrease vendor violations of program requirements and loss of program funds.

DATES: This rule is effective February 27, 2001. State agencies must implement the provisions of this rule no later than February 27, 2002.

FOR FURTHER INFORMATION CONTACT: Debra Whitford, Branch Chief, Supplemental Food Programs Division, Food and Nutrition Service, USDA, 3101 Park Center Drive, Room 542, Alexandria, Virginia 22302, (703) 305–2730.

SUPPLEMENTARY INFORMATION:

Executive Order 12866

This final rule has been determined to be ''significant'' and was reviewed by the Office of Management and Budget (OMB) under Executive Order 12866.

Regulatory Flexibility Act

This rule has been reviewed with regard to the requirements of the Regulatory Flexibility Act (5 U.S.C. 601–612). Pursuant to that review, Shirley R. Watkins, Under Secretary, Food, Nutrition, and Consumer Services, has certified that this rule would not have a significant impact on a substantial number of small entities. This rule amends vendor selection, training, monitoring, and appeal procedures and/or systems. The effect of these changes falls primarily on State agencies. Local agencies and vendors will also be affected, some of which are small entities. However, the impact on small entities is not expected to be significant.

Whereas extensive data is collected regarding program participants, the WIC Program does not collect data on the size of businesses that are authorized as vendors. Of the 45,000 authorized vendors, it is estimated that approximately 20,000 of them may be small businesses. Stores choose whether to apply for program authorization. All authorized vendors, regardless of their size, agree to comply with the program requirements. Although this rule strengthens some of the program requirements regarding vendors, many State agencies have already implemented similar provisions using their current authority. For example, although specific selection criteria are now mandated, most State agencies already use the noted criteria. As such, we do not foresee dramatic future decreases in the number of smaller vendors. Likewise, training is routinely provided to vendors. This final rule allows such training to be provided on-site at the vendor, off-site classroom style, or via a training video or newsletter. In addition, although the State agency is responsible for designating the date, time, and location of the training, the State agency must offer the vendor at least one alternative date on which to attend the training.

Executive Order 12372

The Special Supplemental Nutrition Program for Women, Infants and Children (WIC) is listed in the Catalog of Federal Domestic Assistance Programs under 10.557. For the reasons set forth in the final rule in 7 CFR 3015, Subpart V, and related Notice (48 FR 29115), this program is included in the scope of Executive Order 12372 which requires intergovernmental consultation with State and local officials.

Executive Order 12988

This final rule has been reviewed under Executive Order 12988, Civil Justice Reform. This proposed rule is intended to have preemptive effect with respect to any State or local laws, regulations or policies which conflict with its provisions or which would otherwise impede its full implementation. This rule is not intended to have retroactive effect unless so specified in the **DATES** paragraph of this preamble. Prior to any judicial challenge to the application of the provisions of this rule, all applicable administrative procedures must be exhausted.

Executive Order 13132

Executive Order 13132 requires Federal agencies to consider the impact of their regulatory actions on State and local governments. Although the proposed rule was published before the Executive Order was issued, we considered the impact on State agencies when we developed both the proposed and final rules.

Before drafting both the proposed and final rules, we received input from State agencies at various times. Because the Program is a State-administered, federally funded program, our regional offices have formal and informal discussions with State and local officials on an ongoing basis. These discussions involve implementation and policy issues. This arrangement allows State agencies to provide feedback that forms the basis for many discretionary decisions in this and other Program rules. In addition, FNS officials attend regional, national, and professional conferences to discuss issues and receive feedback from State officials at all levels.

Lastly, the comments on the proposed rule from State officials were carefully considered in drafting this final rule. For example, in response to comments from State agencies we revised the proposed rule to leave the following areas to State agency discretion: (1) Use of limiting criteria, (2) use of training receipts, (3) development of alternative criteria for identifying high-risk vendors, and (4) use of abbreviated rather than full administrative review procedures. The preamble below contains a more detailed discussion of our response to all the comments received on the rule.

Unfunded Mandates Reform Act of 1995

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1531–38) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local and tribal governments and the private sector. Under section 202 of the UMRA, the Food and Nutrition Service (FNS) generally must prepare a written statement, including a cost benefit analysis, for proposed and final rules with ''Federal mandates'' that may result in expenditures to State, local or tribal governments, in the aggregate, or the private sector, of $100 million or more in any one year. When such a statement is needed for a rule, section 205 of the UMRA generally requires FNS to identify and consider a

reasonable number of regulatory alternatives and adopt the most cost-effective or least burdensome alternative that achieves the objectives of the rule.

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

Paperwork Reduction Act of 1995

The reporting and recordkeeping requirements associated with this final rule have been submitted for approval to the Office of Management and Budget (OMB) under OMB No. 0584–0043. This submission includes a revised reporting requirement for State Plan submissions (Section 246.4) and new reporting requirements for vendor training (Section 246.12(i)(1)), vendor monitoring (Section 246.12(j)(4)), food instrument disposition (Section 246.12(q)), and targeted local agency reviews (Section 246.19(b)(5)). In addition, the submission includes new recordkeeping requirements for vendor training (Section 246.12(i)(4)), vendor monitoring (Section 246.12(j)(6)), and participant claims disposition (Section 246.23(c)(1)). These new requirements will be effective upon OMB approval.

1. Background

Major final amendments to the WIC Program regulations regarding food delivery systems were last published on May 28, 1982 at 47 FR 23626 in response to audits and management evaluations disclosing problems in the food delivery area that could result in the loss of WIC Program funds. Both the National Vendor Audit issued by our Office of Inspector General in 1988 and the WIC Vendor Issues Study in 1993 indicated that significant levels of vendor violations persisted. (See section 21 of this preamble for the full citations to the reference materials mentioned in the preamble.)

In response to the National Vendor Audit, we published a proposed rule on December 28, 1990 at 55 FR 53446 to strengthen State agency operations in vendor management and related food delivery areas. We provided a 120-day comment period that closed on April 29, 1991. During the comment period, we received 1,066 comments from State and local agencies, vendors and associated groups, public interest groups, members of Congress, members of the public, and WIC participants. They indicated that significant modifications to the December 1990 proposed rulemaking were still required, and that the extent of such modifications would warrant another opportunity for public input. In addition, several members of Congress requested that the rule be proposed again in light of its potential impact on certain State agency food delivery systems.

In response, we proposed a new food delivery rule on June 16, 1999 at 64 FR 32308. We subsequently extended the comment period from 90 days to 120 days after receiving requests to do so from several potential commenters. We proposed to amend the WIC regulations to address the original OIG audit recommendations by strengthening vendor management systems. We also proposed to implement three provisions of the William F. Goodling Child Nutrition Reauthorization Act of 1998, P.L. 105–336 (Goodling Act), which amended the Child Nutrition Act of 1966, 42 U.S.C. 1771–1791 (Child Nutrition Act). These provisions require the State agency to: (1) Identify high-risk vendors, (2) conduct compliance buys on high-risk vendors, and (3) consider prices in the selection of vendors.

We received 4,601 comment letters, including three form letters from 4,481 participants in California, 22 WIC-only stores in California, and 7 food store owners in California. This resulted in 94 distinct comment letters, which fell into the following categories: State agencies (28), local agencies (13), State agency staff (2), Federal agencies (2), industry groups (23), vendors (7), public interest groups (7), general public (2), and participants (1). After the end of the comment period, several members of Congress wrote us to express their concern about certain aspects of the proposal. We thoroughly analyzed the comments and made revisions to the proposal consistent with the mission of the WIC Program.

a. Summary of This Preamble

This preamble addresses our response to the comments. In general, we only discuss the comments that opposed proposed provisions and the areas of the proposal that are changed by this final rule. We organized the preamble by topic rather than the order in which provisions appear in the final rule. The headings in the preamble identify the sections of the final rule that are discussed in that part of the preamble. To help in using the preamble, we included an outline of the areas covered in the preamble below.

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2. Definitions of ''Vendor'' and ''Vendor Authorization'' and General Provisions for Vendor Authorization and Agreements
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6. Vendor Violations, Vendor Overcharges, and Vendor Claims
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12. Preventing and Identifying Dual Participation
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15. General Requirements for Food Delivery Systems
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19. Conflict of Interest
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21. References

b. Plain Language

In addition to the changes we made in response to the comments, we made changes throughout the proposed regulatory language to make the rule easier to read. We added paragraph headings and made other changes to use plain language. Eventually, the entire WIC regulations at 7 CFR Part 246 will be revised similarly.

c. Implementation of This Rule

One commenter requested that we provide State agencies with at least one year to implement this final rule. Another commenter suggested that the implementation period for the final rule provide for the gradual implementation of the provisions to avoid disruption in State agency vendor services. In their comment letters, many commenters indicated that their State agencies had already implemented a number of the provisions in response to our December 28, 1990 proposal, because they had anticipated that we would finalize that rule. Consequently, State agencies will vary in the amount of effort necessary to implement this final rule. We made this rule effective 60 days after publication and require State agencies to fully implement its provisions no later than one year after the effective date.

The one-year implementation period recognizes the variations among State agency operations and provides adequate time for State agencies to incorporate these changes into their

food delivery systems. Not all provisions from this final rule must be implemented at the same time. For example, a State agency that enters into vendor agreements on a rolling basis may decide to amend the agreements as new ones are entered into, provided that agreements reflecting the new requirements are in place for all vendors prior to the end of the implementation period. Many State agencies have established vendor councils to facilitate communication between the State agency and its vendor community. We have found that such councils can be helpful as State agencies implement changes to their food delivery systems. We recommend that State agencies either establish vendor councils or use existing ones to ensure the timely implementation of this rule.

2. Definitions of ''Vendor'' and ''Vendor Authorization'' and General Provisions for Vendor Authorization and Vendor Agreements

a. Definition of ''Vendor'' (Section 246.2)

Commenters generally supported the proposed definition of ''vendor.'' However, thirteen commenters suggested that we modify the definition to use the term ''retailer'' instead of ''vendor,'' because the term retailer is used by vendors, State governments, and the Food Stamp Program. Although we acknowledge the two terms are often used interchangeably, the fact remains that the requirements for WIC vendors and Food Stamp Program retailers differ in several basic ways. The term vendor uniquely identifies stores authorized for the WIC Program. Therefore, we did not make this modification.

Seven commenters noted that the definition of vendor did not include several types of business entities that may operate stores, such as limited liability companies, limited partnerships, and franchisers/franchisees. Rather than attempt to list all types of business entities in the definition, we decided to specify the more common types of business entities and include a reference to ''or other business entity'' to cover all other business entities. This approach also will accommodate any new types of business entities that may be created in the future.

Several commenters requested that we distinguish between the concept of vendor as a business entity and the concept of vendor as the location of the business (i.e., the store itself). One commenter asserted that this change is necessary to make the definition of vendor consistent with the definition of ''vendor violation,'' because a vendor violation requires an intentional or unintentional action by the vendor, which cannot be committed by a store. Another commenter noted that requiring the State agency to enter into separate agreements with each store, instead of entering into one agreement to cover multiple stores operated by the same business entity, would triple the State agency's administrative burden of contracting with its vendors.

Once again, we believe the commenters' suggestions and concerns have merit, but we believe for a number of reasons that the concept of ''vendor'' must refer to a single store operated by a business entity. For instance, if the concept of vendor only referred to the business entity, including a corporation operating multiple stores, what would happen if one manager at one store of the largest chain in the State is convicted of trafficking? Similarly, what would happen if one store of the largest chain is disqualified for three years from the Food Stamp Program (FSP)? Would such sanctions require the State agency to disqualify the business entity, including all of its stores, from the WIC Program? If so, would business entities operating multiple stores always receive civil money penalties in lieu of disqualification because their disqualification would always result in inadequate participant access?

We believe that the State agency should be able to disqualify a single store of a large chain, provided that participants have adequate access to other vendors operating in the same area. Consequently, we revised the definition of vendor to clarify that each store operated by a single business entity must be authorized separately. However, Section 246.12(h)(1) of this final rule continues to permit the State agency to use a single agreement to cover multiple vendors (i.e., multiple authorized stores) operated by the same business entity. Under this approach, the State agency will still be able to sanction multiple vendors for a vendor violation committed by owners, officers, or managers of a single business entity, if the State agency determines that the vendor violation involves multiple vendors.

One commenter suggested that the term vendor refer to the business entity only so that the State agency must authorize all of a business entity's stores and not arbitrarily authorize some of the business entity's stores while denying authorization to some of its other stores. As discussed below in section 4 of this preamble, vendor authorization is not an arbitrary process. To be authorized, each vendor applicant must meet or exceed the State agency's selection criteria, unless the State agency allows for exceptions, such as for mobile stores or for pharmacies that provide only exempt infant formula and/or WIC-eligible medical foods. The State agency's authorization decisions must balance its need to provide adequate participant access with its need to ensure effective vendor management, oversight, and review. Chain stores must apply for vendor authorization in the same manner as any other store, and the State agency is not obligated to authorize all stores operated by a business entity.

One commenter suggested that we delete the reference to mobile stores from the definition of vendor, because such stores create opportunities for fraud and abuse and can be difficult to monitor. The State agency may only authorize mobile stores when they are necessary to ensure adequate participant access. Although we understand the commenter's concerns, these stores, when authorized, must fall under the definition of a vendor to be held accountable for compliance with the Program's vendor requirements. For this reason, we did not accept the commenter's suggestion.

b. Definition of ''Vendor Authorization'' (Section 246.2)

In response to the proposed definition of the term ''vendor authorization,'' one commenter noted that the definition improperly uses the term ''vendor'' when referring to a store that has not yet been authorized as a vendor. We revised the definition to use ''store'' rather than ''vendor.'' We made conforming changes throughout the rule to use ''store'' or ''vendor applicant'' when referring to a store that is not yet authorized.

c. Entering into Vendor Agreements (Sections 246.12(h)(1) and 246.4(a)(14)(iii))

To become a vendor, a store must apply for program authorization, meet or exceed the State agency's selection criteria, and enter into an agreement with the State agency. In Section 246.12(h)(1), we proposed to require vendor agreements to be signed by ''a representative who has legal authority to obligate the vendor and a representative of the State agency.'' We proposed this change to ensure that vendors are authorized consistently statewide. Fifteen commenters opposed this proposed change for a variety of reasons, including: local agencies need to sign vendor agreements to establish authority over and communication with vendors as well as to be accountable to the State agency for vendor oversight;

local agencies can use a standard agreement and carry out this activity using the State agency's procedures and guidance; and requiring the State agency to enter into all vendor agreements would increase costs, may cause such agreements to fall under the State's procurement procedures, and may expose the State agency to additional financial liability. To address the commenters' concerns, the final rule adds Section 246.12(h)(1)(ii) to allow the State agency to delegate the signing of vendor agreements to local agencies as long as such delegation authority is indicated in its State Plan (Section 246.4(a)(14)(iii)) and the State agency provides supervision and instruction to ensure the uniformity and quality of local agency activities. Although the State agency may delegate certain vendor authorization and management activities to its local agencies, it is the State agency that is ultimately responsible for such activities and the language in this final rule reflects that responsibility.

d. Length of Vendor Agreements (§ 246.12(h)(1)) and Limiting Periods for Vendor Applications (§ 246.12(g)(7))

In Section 246.12(h)(1), we also proposed to limit the length of vendor agreements to a period not to exceed three years. Under this proposed requirement, to continue as an authorized vendor, a store periodically would need to reapply for program authorization. Whereas eleven commenters supported this proposed provision, sixteen opposed the three-year limit on vendor agreements for a variety of reasons, including: the provision would be counter-productive to State agencies that use more resource-efficient, automatic renewal or annual renewal systems; the provision would discourage stores from applying for authorization; and the provision would result in stores exiting and re-entering the Program, causing confusion for participants.

One commenter suggested that, rather than requiring stores to reapply every three years, the State agency be permitted to automatically renew vendor agreements if there are no vendor violations. Although we understand the commenter's viewpoint, we believe only stores that can demonstrate they continue to meet or exceed the State agency's current selection criteria should continue to be authorized. Requiring vendors to reapply for authorization at least every three years does not preclude the State agency from developing a streamlined system for accepting reapplication information from current vendors. However, such systems must ensure that the store provides updated information regarding all of the selection criteria, including information regarding its current prices, quantities and varieties of the supplemental foods it stocks, and business integrity, as well as updated information regarding the store's ownership and management. Regardless of whether a store is applying for reauthorization or initial authorization, the State agency must select vendors based on its current selection criteria. For these reasons, we retained the three-year limit on vendor agreements.

A majority of commenters opposed the portion of the provision in proposed Section 246.12(g)(6) that provides that the State agency may limit the periods during which it will accept and process applications for vendor authorization, except that applications must be accepted and processed at least once every three years. Many commenters misunderstood this provision as requiring all State agencies to only accept applications once every three years. The commenters noted a wide variety of arguments against such limited application periods. However, the State agency has always had the discretion to restrict its timeframes for accepting and processing vendor applications. Some State agencies have found such restrictions very useful in establishing annual workplans for their limited staffs. The proposal would only have specifically incorporated this discretion in the program regulations and clarified that if the State agency chose this approach, applications must be accepted ''at least once every three years.'' The proposal also would have required the State agency to develop procedures for processing vendor applications outside of its timeframes when it determines there will be inadequate participant access unless additional vendors are authorized. This provision is consistent with the three-year limit on vendor agreements and is adopted in Section 246.12(g)(7) of the final rule.

e. Vendor Reassessment (§§ 246.12(g)(3) and (h)(3)(xxiv))

One commenter suggested that, rather than requiring vendors to reapply every three years, the State agency should be permitted to conduct annual reviews of vendor qualifications. The requirement for three-year agreements is not inconsistent with a State agency's periodic review of vendor qualifications. In Section 246.12(g)(3), we proposed to authorize the State agency to reassess any authorized vendor at any time during the vendor's agreement period using the vendor selection criteria in effect at that time. One commenter suggested that we modify the provision so that a vendor that fails to meet a selection criterion during a reassessment be given the opportunity to correct the deficiency. The State agency may include as part of both its vendor selection process and its reassessment process an opportunity to correct any deficiency that would otherwise lead to nonselection or termination of the vendor agreement. However, this is at the discretion of the State agency, and the State agency must make this clear in its procedures for implementing its vendor selection criteria.

Another commenter pointed out that the vendor agreement section of the proposal did not clearly reflect the requirement in this section that specifies that the State agency must terminate the agreements with vendors that no longer meet its selection criteria. In addition, we noticed that the vendor agreement section did not make clear that vendors must comply with the vendor selection criteria throughout the agreement period. We agree with the commenter and added Section 246.12(h)(3)(xxiv) in the final rule to make these clarifications.

f. Vendor Agreement Not a License or Property Interest (§ 246.12(h)(3)(xxi))

We proposed in Section 246.12(h)(3)(xxi) to clarify that the vendor agreement does not constitute a license or a property interest and if the vendor wishes to continue to be authorized beyond the period of its current agreement, the vendor must reapply for authorization. Although commenters overwhelmingly supported this provision, fourteen commenters questioned whether a vendor that has been disqualified for a period of time that is less than the remaining term of its agreement should be allowed to resume its authorization without reapplying. Commenters indicated that when a vendor is disqualified, its slot may need to be filled immediately to ensure adequate participant access. In addition, they also noted that this is inconsistent with the State agency's authority to reassess a vendor at any time during the agreement period and terminate the vendor's agreement if it no longer meets the selection criteria. In response to the commenters' concern, we revised Section 246.12(h)(3)(xxi) to notify vendors that the State agency will terminate the agreements of vendors that are disqualified. A store may reapply for vendor authorization after the expiration of its disqualification period.

g. Compliance with Applicable Statutes, Regulations, Policies, and Procedures (§ 246.12(h)(3)(xxii)) and Notifying Vendors of Changes (§ 246.12(h)(7))

All five commenters supported our proposal to require vendor agreements to make clear that vendors must comply with any changes to the Program statute and regulations and State policies and procedures. One commenter pointed out that we needed to reference State laws and regulations as well as State policies and procedures. We revised this provision to clarify that vendors must comply with the vendor agreement and Federal and State statutes, regulations, policies, and procedures governing the Program, including any changes made during the agreement period. To ensure that vendors are notified of such changes, we also added Section 246.12(h)(7) in the final rule to require the State agency to provide vendors with notice of changes to Federal or State statutes, regulations, policies, and procedures governing the Program at the time they are implemented by the State agency. We encourage the State agency to provide as much advance notice of such changes as possible. In addition, the State agency is required by Section 246.12(i)(2) to include changes to program requirements in their annual vendor training.

h. Notification of Changes in Vendor Ownership, Store Location, or Cessation of Operations (§ 246.12(h)(3)(xvii))

In Section 246.12(h)(3)(xvii), we proposed to require vendors to provide the State agency with at least 45 days advance notification in writing of a change in vendor ownership, store location, or cessation of operations. A majority of commenters opposed the 45-day advance notification and recommended a variety of alternative timeframes, including 30 days, 21 days, 15 days, promptly, as soon as practicable, and a number of days specified by the State agency in the vendor agreement. Two commenters noted that the proposed 45-day notice is unenforceable because in most situations the vendor allows its agreement to expire. Several commenters noted that a 45-day notice is impractical because businesses cease operations, buy and sell stores, and change ownership on short notice. In addition, many business transactions, such as a change in ownership, contain confidentiality requirements that prohibit the disclosure of information until the deal is consummated in order to maintain employees and customers.

Several commenters requested that we delete the last sentence of the provision regarding changes in business structure. One commenter noted that vendor agreements are nontransferable; therefore, a transfer of a majority interest in a store renders the agreement null and void. Another commenter warned that phrases like ''changes in business structure'' and ''corporate reorganization'' open the door for hidden ownership changes. Another commenter indicated that the State agency must verify changes in business structure through its Secretary of State's business division, because past experience has shown that some corporations will call a change in ownership a restructuring in order to maintain their WIC authorization.

Several commenters asked that we either delete or clarify the exception for the State agency to ''permit vendors to move short distances without voiding the agreement.'' One commenter suggested that we delete the exception to send a clear message to vendors that if a store changes location, then the vendor must reapply to be a vendor at the new location. Another commenter indicated that in an urban area a move across the street may result in a change in zip code, and allowing a vendor to move into another zip code without voiding its agreement may result in denial of another vendor in that same zip code without providing equal review of both potential locations.

In response to commenters' concerns, we modified Section 246.12(h)(3)(xvii) in the final rule to remove the specific length of advance notice required and to clarify that it is within the State agency's discretion to determine: the length of advance notice required for vendors reporting changes under this provision, whether a change in location qualifies as a short distance, and whether a change in business structure constitutes a change in ownership. In addition, we clarified that the notice must be in writing and revised this provision to use the term ''terminated,'' instead of the term ''voided,'' when referring to vendor agreements.

i. Sale of Store to Circumvent a WIC Sanction (§ 246.12(g)(5))

In Section 246.12(g)(4), we proposed to prohibit the State agency from authorizing a vendor applicant when it determines that the store has been sold (i.e., a change in ownership) to circumvent a WIC sanction. Seventeen commenters supported this provision. One commenter suggested we modify the provision to prohibit authorization of a store that has been sold until the disqualification period is over, because this would be easier for the State agency to implement. We did not accept this comment because it could impair the owner from selling the store to a legitimate buyer for its fair market value. One commenter indicated that a denial of authorization based on this provision would be difficult to uphold on appeal. Another commenter suggested that a new owner could be required to sign an affidavit during the application process stating that the previous owner has no interest and is not involved in the business. We believe that through its application and selection process the State agency will be able to prevent and detect situations in which owners sell stores to circumvent WIC sanctions. Consequently, we retained this provision in Section 246.12(g)(5) of the final rule.

j. Data Collection at Authorization (§ 246.12(g)(8))

The proposal included a provision that would require the State agency to collect a vendor applicant's shelf prices and its FSP authorization number if it participates in that program. One commenter asked that we clarify whether a vendor applicant had to be authorized by the FSP to be selected for WIC authorization and whether a WIC application should be delayed until the vendor applicant provides its FSP authorization number. Another commenter suggested that we require vendor applicants to be authorized by the FSP in order to be WIC authorized. We proposed this requirement in part to improve the State agency's coordination with the FSP in the reciprocity of sanctions, as required by the WIC/Food Stamp Program Vendor Disqualification final rule published on March 18, 1999 at 64 FR 13311 (Vendor Disqualification final rule). If a vendor applicant that is authorized in the FSP fails to provide its FSP authorization number, the State agency must delay or deny authorization, because this provision requires the State agency to collect this information at the time of application. Although some State agencies may require FSP authorization as a condition of WIC authorization, Federal regulations do not include such a requirement.

In this provision, we also proposed that the State agency collect the vendor applicant's shelf prices, ''unless the State agency uses competitive bidding to set vendor prices for such foods.'' In retrospect, we believe that the exception is inappropriate because a State agency that uses a competitive bidding system needs the vendor applicant's shelf prices to ensure that the vendor applicant's bid prices do not exceed its shelf prices. For this reason, we deleted

the exception. We added a heading to this provision, ''Data collection at authorization,'' and retained it in Section 246.12(g)(8) of the final rule.

3. Vendor Limiting Criteria (§§ 246.12(g)(2) and 246.4(a)(14)(ii))

We proposed to require the State agency to limit the number of vendors it authorizes to a level that ensures adequate participant access as well as effective State agency management, oversight, and review of authorized vendors. Although current regulations permit the State agency to limit its number of authorized vendors, commenters overwhelmingly opposed the proposed provision to require vendor limitation. Commenters stated that mandatory limitation would be impossible to implement consistently throughout the State agency's jurisdiction, add another layer to the authorization process, be an unnecessary administrative burden, be costly to implement, create access problems for participants, impede the State agency's ability to adapt to growth during agreement cycles, result in more appeals and litigation, and create ill will among cooperating vendors.

A majority of those who opposed mandatory limitation suggested that Federal rules focus on selection rather than limitation and that limitation should remain at the State agency's discretion. The rationale for this compromise is that strong selection criteria limit the number of authorized vendors without the problems associated with limiting criteria. The General Accounting Office (GAO) study (''Efforts to Control Fraud and Abuse in the WIC Program Can Be Strengthened'') released in August 1999 states that ''42 of the 51 State agencies [surveyed] reported making some effort to limit the number of authorized vendors.'' However, more State agencies reported using strong selection criteria to limit their number of authorized vendors than reported using limiting criteria. The GAO recommended that we ''[a]mend the regulations on vendor management to ensure that the States limit their authorized vendors to a number they can effectively manage and issue guidance to States on the specific criteria we will use to assess their compliance with the regulations and the actions they would need to take if we determine that they have authorized more vendors than they can effectively manage.''

We believe the compromise noted above, to require strong selection criteria and retain limitation at the State agency's discretion, will achieve our goal of reducing vendor fraud and abuse and still address the GAO's recommendation. Through the management evaluation process, we assess whether the State agency effectively manages its vendors and requires the corrective actions when necessary. For these reasons, we adopted strong selection criteria, as discussed below, and retained the State agency's authority to establish criteria to limit the number of vendors it authorizes. We also made a conforming change to Section 246.4(a)(14)(ii) to clarify that the State agency is only required to include limiting criteria in its State Plan if the State agency opts to use such criteria.

4. Vendor Selection Criteria

A substantial majority of the comments we received on the use of mandatory vendor selection criteria supported the provision as proposed. Commenters pointed out that making vendors meet or exceed strong selection criteria in order to be authorized is more effective than conducting compliance investigations on vendors after they have been authorized. One commenter noted that selection criteria will keep vendors honest and may improve vendors' attitudes toward participants, because vendors will not take for granted that they automatically qualify for WIC authorization. Those few commenters opposing mandatory selection criteria asserted that the State agency should have the discretion to establish the selection criteria and that the proposed mandatory selection criteria were too stringent and would impair the viability of some vendors.

As noted in the preamble to the proposed rule and by those who commented on the proposal, State agency experience has shown that strong selection criteria can provide a cost-effective means of both cost containment and prevention of vendor violations. Therefore, this final rule retains the requirement for mandatory vendor selection criteria. We discuss the comments and changes to the individual selection criteria below.

a. Competitive Price and Price Limitations (§§ Sections 246.12(g)(3)(i) and 246.14(b)(2))

A majority of the commenters supported the competitive price selection criterion, although a number of those commenters suggested modifications. Some commenters recommended that we either delete the competitive price criterion or make it a State agency option. Others indicated that we should allow the marketplace to establish the prices of supplemental foods.

As noted in the preamble to the proposed rule, section 17(h)(11) of the Child Nutrition Act (42 U.S.C. 1786(h)(11)) requires the State agency to take into consideration the prices a store charges for supplemental foods compared to other stores when selecting stores for program authorization. This section also requires the State agency to establish procedures to ensure that authorized stores do not subsequently raise their prices for supplemental foods to levels that would otherwise make them ineligible for authorization. Therefore, we retained the competitive price selection criterion in the final rule. However, we revised this provision to address commenters' concerns and to clarify the requirements for this criterion.

First, we clarified the distinction between the ''competitive price selection criterion'' and ''price limitations.'' The competitive price selection criterion is the process of considering, at the time of vendor authorization, the prices a vendor applicant charges for supplemental foods as compared to the prices charged by other vendor applicants and authorized vendors. The State agency may evaluate a vendor applicant based on its shelf prices or on the prices it bids for supplemental foods, which may not exceed its shelf prices.

The State agency also must establish price limitations that the authorized vendor may not exceed during its agreement period. The price limitations must be designed to ensure that the State agency does not pay a vendor at a level that would otherwise make the vendor ineligible for authorization. This term is also used in the vendor agreement section in connection with the provision in Section 246.12(h)(4) that requires the State agency's redemption procedures ensure that the vendor is not paid more than the price limitations applicable to that vendor and in Section 246.12(k)(1) in the context of the requirements for State agency review of food instruments (and discussed further in section 6.d of the preamble). We also made a conforming change to Section 246.14(b)(2) to make clear that for food costs to be allowable, they may not exceed the price limitations applicable to the vendor.

Several commenters noted the importance of giving the State agency the flexibility to determine the best method to implement the competitive price criterion. In response, we included a description of this requirement in the final rule to clarify the range of flexibility the State agency has in implementing the competitive price criterion. In response to a number of

questions from commenters, the final rule also clarifies that the State agency may establish competitive price criteria and price limitations for different vendor peer groups.

Another commenter suggested that we permit the State agency to except pharmacies that only provide exempt infant formula and/or WIC-eligible medical foods from the competitive price criterion and price limitations because pharmacies often do not know the price of exempt infant formula and/or WIC-eligible medical foods until they order it. This final rule authorizes such an exception.

Several commenters indicated that the competitive price criterion would have a negative effect on smaller stores that may have higher operating costs or that may be unable to offer supplemental foods at prices below their costs. As noted in the preamble to the proposed rule, in many areas smaller vendors are essential to ensuring participant access. As with all aspects of its food delivery system, the State agency must ensure adequate participant access when it establishes its competitive price criterion and price limitations. Developing appropriate vendor peer groups is one way the State agency can both ensure adequate participant access and consider prices during the vendor selection process. Contrary to one commenter's suggestion, the State agency continues to retain the discretion to decide whether and how to establish its vendor peer groups.

Both supporting and opposing commenters questioned how to handle price fluctuations that may occur during the agreement period due to government and market forces beyond a vendor's control. We clarified in the final rule that the State agency may include a factor in its price limitations to account for fluctuations in wholesale prices. For example, the State agency could include an inflation factor in its price limitations.

Commenters also asked us whether certain scenarios would satisfy the requirement to ensure compliance with the price limitations throughout the agreement period. The following scenarios would satisfy the requirement:

Scenario 1: The State agency assigns vendors to peer groups upon authorization and then makes price adjustments to its payments to vendors based on the price limitations applicable to the vendor's peer group.

Scenario 2: The State agency compares the prices a vendor applicant charges for supplemental foods with those charged by other vendor applicants and authorized vendors to determine which vendors to authorize and then periodically conducts a reassessment of the vendor's prices to ensure they meet the applicable price limitations.

Scenario 3: The State agency establishes a maximum price it will pay for each type of food instrument and then includes a provision in the vendor agreement that the State agency will not pay vendors in excess of the maximum price established for each food instrument.

b. Minimum Variety and Quantity of Supplemental Foods (§ 246.12(g)(3)(ii))

Almost all of the commenters supported the requirement to consider as part of the selection process whether vendor applicants stock a minimum variety and quantity of supplemental foods. Commenters noted that the minimum variety/quantity requirement is one of the best selection criteria and is more effective at limiting the number of vendors the State agency authorizes than using limiting criteria. One commenter noted that the proposed rule did not make clear that authorized vendors must maintain the minimum variety and quantity of supplemental foods at all times, not just at the time of authorization. As discussed in section 2.e of this preamble, Section 246.12(h)(3)(xxiv) of this final rule puts vendors on notice that they must comply with all the vendor selection criteria, including this one, throughout the vendor agreement period.

Four commenters suggested that we adopt the same criterion for minimum variety and quantity as the FSP has proposed to establish for its authorized retailers. The FSP proposal would require retailers to offer for sale at least three varieties of staple food intended for home preparation and consumption in each of four categories of staple foods (meat, poultry, or fish; bread or cereals; vegetables or fruit; and dairy products). The inherent differences in the types of food that program participants may obtain with food stamps versus WIC food instruments makes this definition inappropriate for the WIC Program. Furthermore, the variations in the supplemental foods approved by each State agency make it difficult to establish a standard definition for the WIC Program. Therefore, this final rule does not adopt a standard definition of the minimum variety and quantity of supplemental foods that vendor applicants must stock. Rather, such decisions are left to State agency discretion.

Several commenters suggested that we establish some flexibility or tolerance in this requirement or consider supplemental foods that a vendor can document it has ordered. Two commenters suggested that the State agency be permitted to authorize stores that do not stock infant formula or to authorize pharmacies that only provide exempt infant formula and/or WIC-eligible medical foods to participants. The State agency may accommodate such stores when it determines that they are necessary to ensure adequate participant access. As with the competitive price criterion, it is critical that the State agency clearly incorporate any necessary flexibility in its selection criteria at the time the criteria are established so that all vendor applicants are held to the same standards. In recognition of the wide range of stores that serve as vendors, this rule clarifies that the State agency may establish different minimum variety and quantity standards for different vendor peer groups. However, we must emphasize the importance of establishing appropriate minimums so that participants are able to obtain all of the authorized supplemental foods on their food instruments. Vendors may not provide substitutions, cash, or credit (including rainchecks) if the authorized supplemental foods are not available. Authorizing vendors that do not maintain the required minimum stocks of supplemental foods undermines the nutritional goals of the Program.

c. Business Integrity (§ 246.12(g)(3)(iii))

Although a majority of commenters supported the proposal to require the State agency to consider the business integrity of vendors in the selection process, many commenters suggested modifications to the business integrity criteria. We proposed three criteria in this category: (1) Lack of a record of criminal conviction or civil judgment for certain offenses that indicate a lack of business integrity; (2) lack of a history of serious vendor violations; and (3) lack of a history of serious FSP violations.

Even those commenters who agreed with the substance of these criteria found them confusing. We completely rewrote this section to clarify the requirements. In addition, we strengthened the regulatory language to emphasize that the State agency may rely solely on facts already known to it and representations made by vendor applicants on their vendor applications. This change responds to the many commenters who asked whether costly background checks were required and whether the State agency would be held accountable for authorizing vendors whose criminal records were not known to the State agency.

Several commenters indicated that the proposal did not make clear what would happen if the State agency discovered that a vendor had lied on its application. This final rule adds a sentence to the termination provision in Section 246.12(h)(3)(xvi) notifying the vendor that the State agency will terminate its agreement if the State agency determines that it has provided false information in connection with its application. Two commenters questioned the value of vendor self-declarations on applications. We believe that adding a requirement to terminate the vendor agreement when a vendor is found to have provided false information will deter such behavior among vendor applicants.

Several commenters questioned the people covered by the business integrity criteria. One commenter suggested that the criteria include immediate family members of the owners, officers or partners, managers, and any stockholders who have a substantial role in the operation of a store. Two other commenters questioned who would be covered in a publicly traded company. The proposed rule would have applied the business integrity criteria to the business entity itself and its current owners, officers, directors, or partners. We revised this provision in the final rule to cover only the vendor's current owners, officers, and managers. This change conforms the coverage to parallel the FSP rule and recognizes the important role managers play with respect to a vendor applicant's business integrity.

i. No Criminal Conviction or Civil Judgment

We also had a number of questions and suggestions about the specific business integrity criteria. With respect to the criteria requiring a lack of a record of a criminal conviction or civil judgment for certain offenses that indicate a lack of business integrity, commenters wanted to know whether the State agency would be limited to the listed activities, whether to consider felonies or misdemeanors or both, and what is meant by ''business integrity'' and ''business honesty.'' Four commenters opposed this provision on the grounds that once a person has served a criminal sentence, that person should not be further penalized through denial of authorization. Two other commenters suggested that rather than denying authorization for such offenses, stores that cannot meet this selection criterion should be authorized and then identified as high-risk vendors subject to compliance investigations. Another commenter opposed this selection criterion because it would be difficult for the State agency to apply in a fair and consistent manner. Two commenters requested that we clarify the number of years that constitutes a vendor applicant's ''history.''

Vendors play a valuable role in most State agencies' food delivery systems. We believe it is critical that the State agency consider business integrity in the selection of its vendors, because the integrity of vendors reflects on the integrity of the WIC Program. Congress made clear its concern about the integrity of vendors when it required: high-risk identification and compliance investigations of vendors; permanent disqualification for vendors convicted of trafficking; and disqualification of vendors that have been disqualified as retailers in the FSP. We substantially revised the business integrity criterion in the final rule to clarify that only criminal convictions and civil judgments imposed in the six years prior to the application must be considered and to clarify the areas of this criterion in which the State agency has discretion. We have not distinguished between felonies and misdemeanors because of the wide variation among States in designating these criminal offenses as felonies vs. misdemeanors.

ii. No Serious WIC Program Vendor Violations and No Serious Food Stamp Program Violations

Commenters were divided on the merits of the proposed selection criteria for a lack of a history of serious WIC violations and a lack of a history of serious FSP violations. Many commenters believed that both criteria went too far because serious WIC and FSP violations are those that give rise to a disqualification, criminal conviction, or civil judgment. Furthermore, if violations do not rise to such a level, then they should not be used as a basis to deny authorization. Two commenters noted that this criterion could effectively extend a one-year disqualification for up to six more years. Other opposing commenters reiterated their views that the business integrity criteria are confusing and bureaucratic and that vendor integrity is better handled through vendor monitoring. On the other hand, one commenter suggested that we permit the State agency to set a timeframe of longer than the proposed six years for cases of particularly egregious violations.

We did not include these two criteria in the final rule, even though we believe serious WIC and FSP violations do reflect on the business integrity of vendor applicants. Rather than make such violations mandatory vendor selection criteria, we decided to give the State agency the discretion to establish selection criteria for serious WIC and FSP violations or use such vendor information to identify high-risk vendors.

We want to point out that we proposed to make failure to participate in the annual vendor training a basis for nonselection. Although this is not required by the selection criteria in the final rule, many State agencies have found this to be an effective means of vendor management. The State agency continues to have the authority to establish failure to attend vendor training as a selection criterion.

iii. Sanctions Imposed by Another WIC State Agency (§ 246.12(l)(2)(iii))

A number of commenters responded to our request for comments on whether to make mandatory vendor sanctions imposed by another WIC State agency a mandatory selection criterion. Almost all commenters supported this idea, although most suggested various modifications. Three commenters requested that, if established, the selection criterion should permit the State agency to rely on the representations made by vendor applicants on their vendor applications. Other commenters suggested that we maintain a database for State agencies to use for this purpose. Under the final rule, the State agency has the discretion to establish a selection criterion to consider WIC sanctions imposed by another State agency.

Two commenters asked how the State agency would be able to uphold a denial of authorization on appeal if it denied authorization to a vendor based on a WIC sanction imposed by another State agency or based on a FSP sanction. These commenters suggested that information about WIC sanctions imposed by other State agencies be used to identify high-risk vendors rather than as a selection criterion. Three commenters believed that only the mandatory sanctions, not State agency-established sanctions, imposed by another State agency should result in nonselection. Whereas one commenter raised concerns about the time and costs of denying authorization based on WIC sanctions imposed by another State agency, another commenter asserted that if a vendor commits vendor violations in one State agency's WIC Program, the vendor is likely to commit such violations in another State agency's WIC Program.

For a State agency that opts to deny authorization based a prior WIC sanction, a WIC sanction by another

State agency, or a FSP withdrawal of authorization or prior FSP disqualification, we made a corresponding change to the administrative review procedures. This change specifies that if the State agency denies authorization to a vendor applicant based on a WIC sanction (regardless of which State agency imposed the sanction) or a FSP withdrawal of authorization or disqualification, the State agency is only required to provide the vendor applicant with an abbreviated administrative review. We made this change because the vendor applicant already had an opportunity to appeal the facts underlying the WIC sanction or FSP withdrawal/disqualification; therefore, it is not necessary to provide a second review of these facts. An abbreviated administrative review provides the vendor applicant with the opportunity to appeal such narrow factual issues as whether its store is the same one that received the sanction and whether the sanction occurred during the applicable period.

One commenter questioned the appropriateness of denying authorization of a vendor applicant for a vendor violation that did not result in a sanction. The commenter indicated that the vendor applicant would be denied authorization based on information that it did not have an opportunity to examine or refute. If a State agency denies authorization on this basis, the State agency must include a description of the vendor violation in the notice of adverse action and must give the vendor an opportunity to appeal the adverse action.

d. No Current Food Stamp Program Disqualification or Civil Money Penalty for Hardship (§ 246.12(g)(3)(iv))

Twenty-four of the twenty-six commenters supported the proposed requirement to deny authorization to vendor applicants that are currently disqualified from the FSP or that have received a FSP civil money penalty for hardship and the period for the FSP disqualification that would otherwise have been imposed has not expired. Three supporting commenters suggested that we require FSP authorization as a prerequisite for WIC authorization. We did not make this change because of the differences in the populations served and the benefits provided under the two programs.

e. Considering Participant Access in Authorization Determinations

In drafting the final rule, we noticed that it was not clear whether the State agency would be required to deny authorization to a vendor applicant that did not meet one or more of the selection criteria. We clarified in the final rule that a vendor applicant that does not meet the competitive price and minimum variety/quantity criteria may not be authorized, even if such denial of authorization would result in inadequate participant access. For the competitive price criterion, the State agency must compare the prices of the vendor applicant against those of other vendor applicants and authorized vendors. Consequently, the State agency is able to adjust its competitive price criterion to select enough vendors to ensure adequate participant access. As for the minimum quantity/variety criterion, we believe that a vendor applicant that does not meet or exceed this criterion must be denied authorization because such a store cannot provide participants all the authorized supplemental foods on their food instruments.

We clarified that the remaining two vendor selection criteria, business integrity and a current disqualification/civil money penalty for hardship in the FSP, that the State agency may authorize a vendor applicant that fails to meet these criteria if necessary to ensure adequate participant access. We believe this requirement strikes the necessary balance between program integrity and participant access, similar to that balance struck when a State agency decides to impose a civil money penalty in lieu of a disqualification in order to ensure adequate participant access.

5. Food Instrument Requirements

No commenters opposed the food instrument requirements in proposed Sections 246.12(f)(1), (f)(2)(i), (f)(2)(iv), (f)(2)(v), (f)(2)(vi), and (f)(3). Consequently, we adopted these provisions as proposed with minor revisions to conform to language used throughout the final rule. Below are separate discussions of the food instrument proposals that received opposing comments.

a. Printed Food Instrument Requirements (§§ 246.12(f)(2)(ii), (f)(2)(iii), (f)(2)(vii), and (r)(5))

One commenter opposed the proposed provisions in Sections 246.12(f)(2)(ii) and (f)(2)(iii), requiring the ''first date of use'' and the ''last date of use'' to be printed on food instruments, because vendors are often penalized when they accept food instruments either before or after the specified dates. The commenter indicated that the State agency issues food instruments too far ahead of the ''first date of use'' and suggested that food instruments be more specific and to the point. A major responsibility of vendors is to make sure that they accept food instruments only during their valid dates. This requirement is similar to accepting manufacturers' coupons, which are for specific food items and contain expiration dates. Cashiers must be familiar enough with the food instruments used by the State agency to identify whether or not a food instrument is valid for transaction. We believe the requirements as adopted in Sections 246.12(f)(2)(i) through (f)(2)(vii) of the final rule address the commenter's concerns in that they require ''[e]ach printed food instrument must clearly bear on its face'' the authorized supplemental foods, the first date of use, the last date of use, the redemption period, the serial number, and spaces for the purchase price and the signature.

In response to the commenter's concern about issuing food instruments too far in advance, program regulations that require the State agency to issue no more than a three-month supply of food instruments at any one time have been in place since 1982 and were included in the proposal. No other opposing comments were received on these regulations. Cashiers need to examine the dates on a food instrument to ensure it is valid, regardless of when the food instrument was issued. Requiring shorter issuance cycles would neither eliminate the need for such an examination nor be a cost-effective solution to the commenter's concern. However, in our review of this provision, we did note that although a three-month supply of food instruments is acceptable, a three-month supply of supplemental foods is not. Consequently, we modified this provision in Section 246.12(r)(5) so that ''no more than a * * * one-month supply of authorized supplemental foods is issued at any one time. * * *''

b. Electronic Benefits Transfer (EBT) (§§ 246.12(a) and (h)(3)(iv))

In the Vendor Disqualification final rule, we amended the definition of ''food instrument'' to include an electronic benefits transfer card (EBT). We made this change to recognize that some State agencies are using EBT cards in place of printed food instruments. For the same reason, we proposed to include a statement in Section 246.12(a) to acknowledge that the current regulations do not specify separate requirements or exceptions for EBT systems and that the operation of EBT systems may require modifications of some regulatory provisions.

One commenter suggested that we delete the reference to EBT systems in Section 246.12(a). Another commenter opposed our ''piecemeal and potentially premature approach toward WIC EBT.'' This commenter suggested that we implement a new series of EBT pilot programs and evaluate them in public forums before we make modifications to the regulations regarding EBT systems. In addition, three commenters requested that we clarify the purpose of this proposed change and suggested that we wait until EBT is fully implemented and then issue a more practical final rule.

The EBT provision in Section 246.12(a) is intended to recognize the emergence of EBT systems in the WIC Program and acknowledge that these systems will not always conform with current regulatory provisions that apply to printed food instruments. We believe that this authority is a necessary first step toward the further development of EBT systems in the WIC Program.

The suggestion that we wait until EBT is fully implemented before issuing a final rule is unworkable. We do not have separate authority to modify regulatory requirements for pilot projects. Further, some of the provisions in this rulemaking are in response to statutory deadlines, most of the new requirements in this rulemaking will be unaffected by EBT implementation, and EBT may not be implemented for decades in areas where it is not a cost-effective alternative to printed food instruments. Nevertheless, we revised this provision to clarify the situations in which we will modify a regulatory provision to accommodate a particular EBT system.

c. Food Instrument Issuance and Security (§§ 246.12(r)(1) through (r)(5) and (p) and 246.4(a)(14)(xii))

We received only one comment regarding the proposed provisions in Sections 246.12(r)(1) through (r)(4), which concern food instrument issuance. The commenter supported the proposed amendments except for the use of the term ''proxy.'' The commenter's concern is addressed below in our discussion of the definition of proxy in section 13.a of this preamble. We made minor changes to the provisions in Sections 246.12(r)(1) through (r)(5) to incorporate ''parents or caretakers of infant and child participants'' and to make these provisions conform to language used throughout the final rule.

Ten commenters expressed various concerns about the food instrument security requirements in Section 246.12(p) of the proposal. Three commenters asked that we clarify how this provision applies to State agencies with print-on-demand technology. Another commenter asked that we clarify what the term ''perpetual inventory'' means and whether a system that maintains inventory and receipt of food instruments would be sufficient to meet this regulatory requirement.

A perpetual inventory refers to an ongoing record maintained by local agencies and, if applicable, clinics of the food instruments received from the State agency and the food instruments issued to participants. The perpetual inventory is a running inventory of a local agency or clinic's supply of food instruments, and the monthly physical inventory is used to reconcile the perpetual inventory with the supply of food instruments on hand. For local agencies and clinics that use a print-on-demand technology to produce their food instruments, this requirement would apply only to their supplies of special check stock, if used, and, if applicable, to their supply of emergency, back-up, pre-printed food instruments. For local agencies and clinics that issue EBT cards, this requirement would only apply to the supplies of EBT cards maintained on premises.

One commenter indicated that monthly physical inventories would be administratively burdensome for integrated local agencies and were unnecessary due to the State agency's use of electronic acknowledgment of receipts of food instruments by local agencies. Three commenters suggested that the physical inventory be conducted on a quarterly rather than on a monthly basis; however, one commenter suggested that monthly inventories are preferable to quarterly inventories because they become part of the local agency's monthly routine. Another commenter indicated that monthly inventories are unnecessary because the State agency uses a one-to-one reconciliation of food instruments, which is a better and more cost-effective control.

As noted in the preamble to the proposed rule, the purpose of perpetual and physical inventories is to prevent and detect employee fraud. Neither an electronic acknowledgment of receipt of food instruments nor a one-to-one reconciliation of food instruments after redemption provides for the accountability and security of a local agency or clinic's food instruments on hand. We believe the most effective means to prevent employee fraud is to have controls in place to account for and limit the access to food instruments from the time they are created or received until the time they are issued to participants. A monthly reconciliation of perpetual and physical inventories provides local agencies and clinics with a method to detect when food instruments are missing from their inventories.

One commenter requested that we modify this provision so that local agencies are only required to maintain perpetual inventory records for seven years, because record retention is both expensive and time-consuming. We did not specify a time limit for the retention of such records and do not expect that the records be retained beyond the State agency's current record retention schedule for other WIC records.

Two commenters opposed the proposed provision in Section 246.4(a)(14)(xii), which would require the State agency to include a description of its system for ensuring food instrument security in its State Plan. As noted above, we believe that such a system provides a necessary protection against employee fraud. In addition, we believe that inclusion of a description of the State agency's system in its State Plan is essential to ensuring that the system is put into place in the local agencies and clinics under the State agency's jurisdiction. One commenter recommended that State agencies currently designing data systems include a food instrument inventory component in their data systems that is automated at the local agency as well as at the State agency level. We agree that automation of the local agency or clinic's perpetual inventory of food instruments on hand would be a worthwhile component of any data system.

d. Definition of ''Authorized Supplemental Foods'' (§ 246.2)

In Section 246.2, we proposed to define the term ''authorized supplemental foods.'' One commenter suggested that we delete the phrase ''for a particular participant'' from the definition, so that this term will not be confused with the existing term ''supplemental foods.'' The commenter did not understand our need to narrow the definition to ''a particular participant.'' Current regulations at 7 CFR 246.2 state: ''*Supplemental foods* means those foods containing nutrients determined to be beneficial for pregnant, breastfeeding, and postpartum women, infants and children, as prescribed by the Secretary in § 246.10.'' The proposed definition of authorized supplemental foods was intended to distinguish between the general categories of supplemental foods contained in Section 246.10 from the specific supplemental foods authorized

for a particular participant, which are listed on the participant's food instruments.

The commenter further indicated that her State agency uses to term ''authorized supplemental foods'' to refer to the supplemental foods approved by the State agency for use in the WIC Program. We are aware that State agencies use various terms for the supplemental foods approved by the State agency for program use, including the term ''WIC-approved foods.'' We did not propose to define a term for those foods approved by the State agency for program use, so we do not believe it would be appropriate to include such a definition in this final rule. However, we adopted the definition for authorized supplemental foods as proposed because the definition provides us with a concise term to refer to the specific supplemental food items authorized by the State agency for a particular participant and listed on that participant's food instruments. The term authorized supplemental foods captures both the type and quantities of the supplemental foods, which we believe is essential to understanding other regulatory provisions. For example, in this final rule, Section 246.12(l)(1)(iv) states: ''The State agency must disqualify a vendor for one year for a pattern of providing unauthorized food items in exchange for food instruments, including charging for supplemental foods provided in excess of those listed on the food instrument.'' In this provision, ''unauthorized food items'' not only refers to any type of food item not listed on the food instrument, such as an unauthorized brand of cereal, but also refers a quantity of supplemental food item in excess of those listed on the food instrument, such as an extra box of an authorized brand of cereal.

e. No Substitutions, Cash, Credit, Refunds, or Exchanges (§ 246.12(h)(3)(ii))

In Section 246.12(h)(3)(ii), we proposed to expand the regulatory language that ''vendors shall only provide the supplemental foods specified on the food instrument'' to specify that vendors must not provide unauthorized or non-food items, cash, credit, rainchecks, or refunds in exchange for food instruments. We proposed only one exception to this provision, to permit exchanges of ''identical supplemental foods.'' The only opposition to this proposed provision concerned the exception. Two commenters asked that we clarify the circumstances under which an exchange may be permitted. One commenter requested that we delete the exception because it would be the same thing as offering a raincheck or credit. We clarified in the final rule that exchanges are only permitted for ''an identical authorized supplemental food item when the original authorized supplemental food item is defective, spoiled, or has exceeded its 'sell by' or 'best if used by' date.''

Another commenter requested that we delete the exception because the State agency has found that during administrative reviews an exchange for a ''similar'' food item is considered to be an exchange for an ''identical'' supplemental food item. The commenter warned that State agencies would lose administrative reviews regarding the substitution of non-rebate infant formulas for the authorized infant formula because preamble language is not considered part of the regulation. We believe there is a clear distinction between the words ''similar'' and ''identical.'' Nonetheless, we added a sentence to this provision in the final rule to clarify that an ''identical authorized supplemental food item means the exact brand and size as the original authorized supplemental food item obtained and returned by the participant.''

f. Food Instrument Transaction and Redemption (§§ 246.12(h)(3)(iv) through (h)(3)(vi), (h)(3)(viii), and (h)(4))

In the final rule, we added headings to all the paragraphs in Section 246.12(h) and reordered some of the paragraphs in Section 246.12(h)(3). In addition to making the information in this section more accessible to readers, we made these changes to help readers understand the distinction between the concepts of ''transaction'' and ''redemption'' as they apply to food instruments. Food instrument transaction refers to the process in which a participant, parent/caretaker, or proxy tenders a food instrument to a vendor in exchange for authorized supplemental foods. Food instrument redemption refers to the process in which a vendor submits food instruments for redemption and the State agency (or its financial agent) makes payment to the vendor for the food instruments.

The proposed rule contained a single paragraph that addressed the procedures for entering both the purchase price and the signature on food instruments. Three commenters requested that we delete the provision because vendors will be penalized for not following the requirements. Vendors should not be paid for food instruments that lack purchase prices or signatures. This provision is necessary so vendors understand these requirements.

Another commenter requested that we delete the preamble language that discusses allowing the participant to enter the purchase price on food instruments, because errors made by the participant when entering the purchase price, which may result in vendor overcharges or undercharges, would be attributed to the vendor. Another commenter suggested that we clarify that the participant or proxy must sign the food instrument ''in the presence of the cashier'' and that the purchase price must be entered before the ''food instrument is tendered.'' In Sections 246.12(h)(3)(v) and (h)(3)(vi) of the final rule, we clarify that: (1) It is the vendor's responsibility to ensure that a purchase price is entered on the food instrument in accordance with the State agency's procedures; (2) the State agency has the discretion to determine whether the vendor or the participant enters the purchase price; (3) the purchase price must be entered before the food instrument is signed; and (4) the participant, parent/caretaker, or proxy must sign the food instrument in the presence of the cashier.

As discussed below in section 6.b of this preamble, the variety of redemption systems employed by State agencies combined with the proliferation of various cost containment measures has made a concise definition of a ''vendor overcharge'' that is applicable to all State agencies impossible. In recognition of this, we revised the definition of vendor overcharge to mean intentionally or unintentionally charging the State agency more for supplemental foods than is permitted under the vendor agreement. This approach provides the needed flexibility to accommodate the wide variety of systems that State agencies have developed for entering purchase prices and redeeming food instruments. We made a corresponding change to the vendor agreement provisions to require in Section 246.12(h)(4) that the State agency describe in the vendor agreement its purchase price and redemption procedures.

These changes also necessitated a change to the proposed requirement in § 246.12(h)(3)(viii) that vendors may not charge the State agency more than the price charged other customers or the current shelf price, whichever is less, or, when the State agency uses competitive bidding, the contract price. Whereas the proposed provision focused on the amount a vendor may ''charge'' the State agency, in the final rule the provision focuses on the State agency's procedures for submitting food instruments for

redemption. The provision also puts the vendor on notice that the State agency may make price adjustments to the purchase price on food instruments to ensure compliance with the price limitations applicable to the vendor.

g. Food Instrument Disposition (§ 246.12(q)) and Adjustments to Expenditures (§ 246.13(h))

We proposed to replace the heading of Section 246.12(n), ''Reconciliation of food instruments,'' with the heading, ''Food instrument disposition,'' and to move this provision to Section 246.12(q). We also proposed to amend the language in this paragraph to clarify the food instrument disposition process and to include language regarding the food disposition process in EBT systems. One commenter requested that we clarify the meaning of the terms used in this provision, including the terms ''redeemed,'' ''expired,'' ''duplicate,'' and ''enrollment record.'' Although we made a few changes to the terminology used in the proposed provision, most of the terms are unchanged. Nevertheless, we believe a review of the meanings of the terminology used in this provision may be helpful for many readers.

The term ''issued'' refers to food instruments that have been issued to a participant. The term ''voided'' refers to food instruments that have been invalidated by the State or local agency or clinic, including food instruments that were voided after they were issued. All food instruments that are no longer on hand (i.e., those food instruments that were received/created that are no longer in inventory) must be identified as either issued or voided, and as either ''redeemed'' (i.e., submitted for redemption by a vendor and payment has been made by the State agency) or ''unredeemed'' (i.e., no payment was has been made by the State agency).

All redeemed food instruments must be identified as falling into one of the following categories: (1) ''validly issued'' (i.e., the food instrument matches a participant's enrollment and issuance record); (2) ''lost'' (i.e., the food instrument was reported lost by a participant or by the State or local agency or clinic); (3) ''stolen'' (i.e., the food instrument was reported stolen by a participant or by the State or local agency or clinic); (4) ''expired'' (i.e., the food instrument was submitted by the vendor after the specified period for redemption and the State agency provided payment to the vendor in accordance with Section 246.12(k)(5)); (5) ''duplicate'' (i.e., the food instrument was issued to a participant to replace a lost, stolen, or voided food instrument); or (6) ''not matching valid enrollment and issuance records'' (i.e., the food instrument does not match a participant's enrollment and issuance record).

One commenter characterized accounting for voided, lost, and stolen food instruments as not beneficial, unnecessary, and overly burdensome. We disagree. It is necessary to account for voided food instruments because otherwise such food instruments would seem to be missing when the State or local agency or clinic reconciles its perpetual inventory with its monthly physical inventory. When the State agency makes payment on a voided, lost, or stolen food instrument, there is evidence of fraud or abuse. It is the State agency's responsibility to investigate such incidences to determine if the fraud or abuse was committed by a participant, an employee, a vendor, or an unauthorized person. If the State agency detects criminal activity, it must report it to the proper authorities for investigation.

The commenter also characterized accounting for unredeemed food instruments as solving a problem that does not exist, because such food instruments do not represent an expenditure of grant funds. We disagree. In § 246.13(h), we proposed to require the State agency to ''adjust projected expenditures to account for redeemed food instruments and other changes as appropriate.'' This provision, which received no negative comments and has been adopted as proposed, requires the State agency to adjust its obligations to account for food instruments that have been paid (i.e., issued and redeemed) as well as those that have been deobligated (i.e., voided or unredeemed). Consequently, the State agency needs to account for both voided and unredeemed food instruments in order to remove them from its obligations. In addition, we would like to point out that anytime a food instrument is issued there is an associated nutrition services and administration cost, regardless of whether the food instrument is redeemed. An examination of unredeemed food instruments may reveal irregularities or waste, such as instances of dual enrollment.

One commenter suggested that we modify § 246.12(q) to differentiate between accounting for automated food instruments and accounting for manual food instruments that contain no participant data. The commenter noted that: manual food instruments represent 11.2% of the State agency's total redemptions, only 0.57% of these manual food instruments are recorded without participant data, and the State agency has never uncovered an instance of fraud in its investigations of such food instruments. The commenter recommended that we permit the reconciliation of a sample of manual food instruments that contain no participant data to ensure ''with reasonable statistical certainty'' that they were issued as a result of human error rather than as a result of fraud.

Although we understand the commenter's concern about the effort involved in the reconciliation of manual food instruments without participant data, we believe the fact that a manual food instrument lacks participant data represents a lapse in program integrity that should be addressed by the State agency. Such instances should be investigated, and procedures should be put in place to ensure that all manual food instruments contain participant data, which allows them to be reconciled without excessive effort. In addition, we believe that as State agencies employ new technologies, such as print-on-demand food instruments and EBT, to issue food instruments, the use of manual food instruments should decline steadily until there is no longer a need for them. For these reasons, we did not accept the commenter's recommendation.

Whereas two commenters supported the proposed amendments to § 246.12(q) because their systems currently meet these requirements, three commenters asked that we acknowledge the additional costs for some State agencies to the implement this provision. We realize that some State agencies will incur significant costs to reprogram their systems in order to link participant enrollment records with food instrument issuance and redemption data. However, we believe this step is necessary to provide a level of accountability that ensures the integrity of the Program.

One commenter noted that in § 246.12(q) of the proposal we use the term ''PIN'' (Personal Identification Number) when we mean ''PAN'' (Primary Account Number). The proposed provision reads: ''In an EBT system, evidence of matching redeemed food instruments to a valid issuance and enrollment record may be satisfied through the linking of the PIN associated with the electronic transaction to a valid issuance and enrollment record.'' In this instance, the correct term is PAN, which is a standard term used in the banking industry for the account number embossed on credit and bank cards. In an EBT system, the PAN is used to link redemption data to enrollment and issuance records; the PIN refers to the number entered by the participant at the point-of-sale device to

access and transact program benefits. Consequently, we amended the proposal to reflect this correction.

h. Claims Against the State Agency (§ 246.23(a)(4))

One commenter asked that we clarify whether all three conditions listed in §§ 246.23(a)(4)(i) through (a)(4)(iii) must be satisfied to avoid a claim against the State agency for failing to account for the disposition of all redeemed food instruments. To avoid a claim, the State agency must satisfy all three conditions, which make up a three-step process in which the State agency has: (1) ''Made every reasonable effort to comply with the requirement;'' (2) ''Identified the reasons for its inability to account for the disposition of each redeemed food instrument; and'' (3) ''Provided assurances that, to the extent considered necessary by FNS, it will take appropriate actions to improve its procedures'' (emphasis added).

One commenter was concerned that the term ''reasonable effort'' is subjective and open to various interpretations by Federal and State auditors. Another commenter requested that we clarify what is meant by ''made every reasonable effort.'' We believe that what constitutes ''every reasonable effort'' will vary based on the specific situation and cannot be defined in such a manner that could be applied to all situations. Because all three conditions of this provision must be met, what constitutes every reasonable effort will be driven by whether the State agency's efforts result in both the identification of the source of the problem and the State agency's assurance that improvements will be made to its procedures to correct the problem. For example, in the situation described above regarding the inability of the State agency to reconcile its manual food instruments that lack participant data, if the State agency were to investigate a sample of such food instruments, identify that the problem is due to local agency staff inadvertently omitting the participant data, and implement a procedure that requires local agency staff to use a checklist, which includes entering participant data, when issuing manual food instruments, then the State agency would satisfy the conditions of § 246.23(a)(4) and avoid a claim. If the State agency is unable to satisfy the conditions in § 246.23(a)(4) and we recommend additional efforts that the State agency could undertake to identify and correct its accounting problem and the State agency refuses to make such efforts, then the State agency has failed to make every reasonable effort and will be subject to a claim.

One State agency recommended that we establish an unbiased mediation process to review cases in which our determination of what constitutes ''every reasonable effort'' is in question. We did not propose an unbiased mediation process be established for vendor or State agency claims and do not believe that such a process is necessary in either case. Similar to the provision in § 246.18(a)(1)(iii)(F) that prohibits the administrative review of vendor claims, current regulations at 7 CFR 246.22(a) make clear that we will not provide a hearing or review for claims against the State agency arising under § 246.23(a). In addition, similar to the requirements in Section 246.12(k)(3), which provide vendors with ''an opportunity to justify or correct'' a food instrument error that results in a claim, we provide the State agency with an opportunity to justify or correct the situation that results in its inability to reconcile all of its food instruments and believe this is sufficient.

One commenter suggested that we allow for the withholding of a portion of the State agency's next year's grant, until the issue is resolved, rather than withholding up to 100% of the State agency's current funding, which could result in participants not being served. Section 246.23(a)(4) sets forth the requirements for establishing a claim against the State agency for failing to account for the disposition of all of its redeemed food instruments and for failing to take appropriate actions to correct its accounting problems. This provision does not address withholding nutrition services and administration funds but rather establishing a claim for an amount that corresponds to the State agency's unreconciled food instruments. Such claims are not allowable nutrition services and administration costs for the State agency and must be paid with State funds.

6. Vendor Violations, Vendor Overcharges, and Vendor Claims

a. Definition of ''Vendor Violation'' (§ 246.2) and Vendor Responsibility for Employee Actions (§ 246.12(h)(3)(xiii))

Seventeen of the nineteen commenters on the proposed definition of ''vendor violation'' supported the definition. Commenters did suggest a number of modifications. Seven commenters indicated that focusing on the acts of the vendor did not make sense, in light of the definition of vendor as a business entity that operates a store. We revised the definition to state that a vendor violation is an action of a vendor's current owners, officers, manager, or employees. Another commenter recommended that we add ''agents'' to the definition to cover situations in which friends or relatives are asked by owners to act as substitute cashiers. We accepted the commenter's recommendation and revised the definition accordingly.

Another commenter focused on the part of the definition that refers to actions that violate the Program statute or regulations or State agency policies or procedures. The commenter recommended that the definition include actions that violate State law, rules, and regulations as well. We accepted this recommendation and revised the definition to include actions that violate ''the vendor agreement or Federal or State statutes, regulations, policies, or procedures governing the Program.''

The two commenters who opposed the definition unless we modified it focused on the inclusion of unintentional actions in the definition. As noted in the discussion of the definition of vendor violation in the proposed rule, we believe vendors should be held accountable for all violations, whether they are deliberate attempts to violate program requirements or inadvertent errors, because both ultimately result in increased food costs and fewer participants being served. We acknowledged the complexity of WIC transactions and noted that even with training and supervision, cashiers may occasionally make unintentional errors. We also stated that the State agency has a wide range of actions that it may take as a result of a vendor violation, including assessing a claim, requiring increased training, identifying the vendor as a high-risk vendor subject to compliance investigation, and imposing a sanction. One supporting commenter questioned whether this statement is contrary to the mandatory vendor sanctions required by the Vendor Disqualification final rule. We want to emphasize that not all vendor violations will give rise to a vendor sanction. For example, even though an inadvertent mistake in entering the purchase price on a food instrument may constitute both a vendor violation and a vendor overcharge, it would not necessarily trigger a sanction. Only a pattern of vendor overcharges triggers the mandatory sanction. Consequently, we retained the ''unintentional action'' language in the vendor violation definition, as well as the State agency's discretion to take a variety of actions against a vendor when vendor violations do not rise to a level that triggers a sanction.

One commenter suggested that the provision in proposed § 246.12(h)(3)(xiii) provide an exception similar to the one in § 246.12(l)(1)(i)(B), which provides the State agency with an option to impose a civil money penalty in lieu of permanent disqualification when the vendor had, at the time of the violation, an effective program and policy in effect to prevent trafficking and the ownership of the vendor was not aware of, did not approve of, and was not involved in the conduct of the violation. Another commenter asserted that if a vendor is doing everything it can to comply with program requirements and fires the employee who committed the vendor violations, the vendor should be able to retain its authorization. Otherwise, when a vendor is disqualified, participants are forced to go to a less convenient store or even drop off the Program completely.

For the same reasons we did not remove unintentional actions from the definition of vendor violation, we retained in § 246.12(h)(3)(xiii) of the final rule the requirement that vendor agreements include a statement concerning the responsibility of the vendor for the actions of its employees. To be consistent with the definition of vendor violation, we included a reference in this provision to the vendor's accountability for the actions of its owners, officers, and managers. Also, rather than limiting this provision to actions relating to the ''handling of food instruments,'' we revised the provision to require accountability for ''vendor violations.'' As we noted above, not every vendor violation results in a sanction. Furthermore, for most mandatory sanctions, if the State agency determines that disqualification of the vendor would result in inadequate participant access, the State agency must impose a civil money penalty, except in the case of third or subsequent mandatory sanctions.

b. Definitions of ''Vendor Overcharge'' and ''Price Adjustment'' (§ 246.2)

Nineteen of the twenty-one commenters supported the proposed definition of ''vendor overcharge.'' Two commenters suggested removing the word ''pattern,'' noting that although a pattern of overcharging is required to trigger the mandatory sanction for vendor overcharges, it is unnecessarily limiting to include the pattern requirement in the definition itself. We agree and made this change in the final rule.

Two commenters objected to the word ''unintentional.'' As noted in the discussion of the definition of vendor violation above and the discussion of vendor overcharges in the preamble to the Vendor Disqualification final rule, we believe that limiting the scope of vendor overcharges only to those that are intentional or fraudulent would undermine the integrity of the WIC Program. It also puts an additional burden on the State agency to prove the intent of the person who commits the vendor overcharge. Funds lost due to vendor overcharges, whether intentional or inadvertent, are not available to serve program participants. Therefore, we did not remove the word ''unintentional.''

Five of the supporting commenters and one opposing commenter pointed out that the proposed definition of vendor overcharge did not adequately distinguish between a vendor overcharge and what they termed an ''overpriced food instrument'' or ''overage.'' The commenters described an overpriced food instrument as a food instrument on which the vendor properly entered purchase price but due to a pre- or post-payment edit is paid by the State agency an amount lower than the purchase price.

We agree with the commenters and, in the final rule, added a new definition of ''price adjustment,'' which is defined as ''an adjustment made by the State agency, in accordance with the vendor agreement, to the purchase price on a food instrument after it has been submitted by a vendor for redemption to ensure that the payment to the vendor for the food instrument complies with the State agency's price limitations.'' We made a conforming change to the definition of vendor overcharge to clarify that a vendor overcharge does not occur when the State agency makes a price adjustment to the purchase price of a food instrument in accordance with the procedures outlined in the vendor agreement.

The definition of price adjustment recognizes the increasing number of State agency systems under which adjustments routinely are made to the purchase price on food instruments after they have been submitted for redemption. For example, in one State agency, prices are established for supplemental foods through competitive bids. The purchase price entered by the vendor on the food instrument corresponds to the current shelf prices for the authorized supplemental food items provided to the participant. The State agency bills the vendor at the end of each month for the difference between the purchase prices on its food instruments and the vendor's contract prices for the supplemental foods. These adjustments are not made to account for errors but as a regular part of the State agency's system for redeeming food instruments. Another State agency may have a system under which the State agency has established maximum prices for each type of food instrument and does not pay vendors in excess of that amount, regardless of their shelf prices for the supplemental foods. These situations are not properly categorized as overcharges, because the price adjustments are a regular part of the State agency's redemption system.

We also recognize that sometimes the price adjustments are not made directly by State agencies, but rather by the banks they contract with to redeem food instruments. In these cases, the banks, acting as financial agents of the State agency, redeem the food instruments and make price adjustments pursuant to their contracts with the State agency. Thus, the price adjustments made by contractors of the State agency would be considered to be price adjustments made by the State agency and would not be considered vendor overcharges.

A vendor still could commit a vendor overcharge in a system that uses price adjustments. For example, a vendor agreement may establish a maximum price by food instrument type but still requires the vendor to enter a purchase price that corresponds to its shelf prices. Under this arrangement, anytime the vendor enters a purchase price that exceeds its shelf prices, the vendor has committed an overcharge. A pattern of such vendor overcharges would trigger a mandatory sanction under § 246.12(k)(1)(iii)(C).

We also revised the definition of vendor overcharge to replace the reference to charging participants more than non-WIC customers or the shelf or contract price with ''charging the State agency more for authorized supplemental foods than is permitted under the vendor agreement.'' We made this modification to recognize the wide variety of State agency redemption systems. In most cases, the vendor will be required to enter the purchase price corresponding to the shelf prices or prices charged non-WIC customers, whichever is less. However, in some cases the vendor may be required to enter a purchase price that does not exceed the food instrument's maximum price before submitting it to the State agency for redemption.

Two commenters suggested incorporating a dollar threshold in the definition of vendor overcharge. As we have discussed in our guidance on the mandatory sanction for vendor overcharges, the severity of an overcharge should be taken into account in establishing a pattern of vendor overcharges. However, we believe it is

important to have a firm definition of what constitutes a vendor overcharge and then for the State agency to establish a threshold for imposing a sanction or other action according to the number and severity of the vendor overcharges.

Another commenter recommended that we limit vendor overcharges to actions that are proven through compliance buys. Most vendor overcharges will be established through compliance buys. However, State agencies may be able to develop edits or other means to detect vendor overcharges that provide sufficient evidence to support their sanction actions.

We made a conforming change to the mandatory sanction in § 246.12(k)(1)(iii)(C) to use the defined term ''vendor overcharge'' rather than repeating the substance of the definition within the sanction provision. Finally, one opposing commenter noted that the definition should not reference ''charging participants'' because the State agency, not the participant, is charged for authorized supplemental foods obtained from a vendor. We agree with commenter and made this change.

c. Review of Food Instruments (§ 246.12(k)(1))

Thirteen of the fifteen commenters on § 246.12(k)(1) supported the proposal to require the State agency to have systems to identify vendor overcharges and other errors on redeemed food instruments not less frequently than quarterly, although a number of the supporting commenters recommended that we modify the provision. Several commenters questioned how a State agency could have a system to detect vendor overcharges because they thought that compliance buys are the only way to establish vendor overcharges. We agree that compliance buys are the best way to support sanctioning a vendor for vendor overcharge violations. These comments pointed out that our reference to a system to ''identify'' vendor overcharges and other errors needed modification to apply to all State agencies.

We revised this provision to clarify that the State agency must have a system to detect ''questionable food instruments, suspected vendor overcharges, and other errors. * * *'' This language both responds to the concern that in most instances a review of food instruments will not be able to identify an actual vendor overcharge, just a suspected vendor overcharge, and parallels the current language in 7 CFR 246.12(r)(5)(i) on this point. This revision also takes into account the need to detect other food instruments that may contain something questionable, but not clearly an error, that requires follow up.

We also revised this provision to require that the system ensure compliance with the applicable price limitations. As discussed in section 4.a of this preamble, section 17(h)(11) of the Child Nutrition Act (42 U.S.C. 1786(h)(11)) now requires that the State agency establish procedures to ensure that authorized stores do not raise their prices after authorized, to levels that would otherwise make them ineligible for authorization. As a result, we required in § 246.12(g)(3)(i) that the State agency establish price limitations and in § 246.12(h)(4) that the State agency's redemption procedures must ensure that it does not pay a vendor more than the applicable price limitations. To further implement this statutory mandate, we revised the requirement for the review of food instruments to ensure compliance with the applicable price limitation. The final rule also makes clear that the review must include a price comparison or other edit designed to ensure compliance with the applicable price limitations and to detect suspected vendor overcharges.

Two commenters asked that we clarify whether this requirement could be satisfied by inspecting a representative sample of food instruments. It was always our intention to permit the State agency to review only a representative sample of the food instruments submitted for redemption. We revised this provision to clarify that the State agency may review either all or a representative sample of food instruments and that the review may be done either before or after the State agency makes payment to the vendor on the food instruments. However, as State agencies continue to automate their food instrument redemption systems, they should design their systems to include a review of all food instruments before they make payment on them.

One commenter suggested that we modify the requirement to detect ''redemption of expired food instruments'' to read ''food instruments redeemed outside of valid dates.'' We revised this provision to read ''transacted or redeemed after the specified date'' to capture both food instruments that vendors accept after the date for transacting them and food instruments submitted for redemption after the specified date.

Finally, we clarified what we meant when we proposed that the system must detect vendor overcharges and other errors at least quarterly. We did not mean that the review was to be conducted quarterly. Instead, we were trying to establish a timeframe for follow-up action on any suspected vendor overcharges and other errors. In the final rule, we specify that the State agency must take follow-up action within 120 days of detecting any questionable food instruments, suspected vendor overcharges, or other errors. The review itself must be done on a continuing basis.

d. Delaying Payment and Establishing Claims (§§ 246.12(k)(2) and 246.12(h)(3)(ix))

The majority of the commenters supported the proposed requirement that the State agency assess claims resulting from vendor violations identified during inventory audits or other reviews. However, in reviewing the proposed rule, we noted that we did not clearly establish a general requirement to establish claims against vendors that have committed vendor violations that affect the payment to the vendor. The final rule makes this clear in §§ 246.12(k)(2) and 246.12(h)(3)(ix) and also clarifies that the State agency may delay payment in cases in which the vendor violation is discovered before payment has been made.

In response to proposed § 246.12(h)(3)(ix), a number of commenters asserted that an ''overpriced food instrument'' should give rise to a claim and a ''vendor overcharge'' should give rise to a sanction. As noted above, a price adjustment is not a vendor overcharge and does not trigger a claim. Price adjustments, which must be described in the vendor agreement, are part of the method used by the State agency to determine the amount a vendor is paid for a food instrument.

We want to make clear that claims and sanctions are not mutually exclusive. Claims arise in situations in which the vendor has not complied with the requirements for food instrument redemption, such as recording the wrong price or accepting food instruments without signatures. In these cases, the State agency must either deny payment of the food instrument or assert a claim. Sanctions arise as a result of vendor violations, such as a pattern of vendor overcharges.

One commenter requested that we clarify that in addition to assessing claims, the State agency may sanction vendors for a pattern of vendor overcharges. The commenter indicated this clarification is necessary to avoid dealing with vendor assertions that as long as they paid claims resulting from vendor overcharges, they cannot be

sanctioned for vendor overcharge violations. We revised § 246.12(h)(3)(ix) to clarify that: ''In addition to denying payment or assessing a claim, the State agency may sanction the vendor for vendor overcharges or other errors in accordance with the State agency's sanction schedule.''

Three commenters suggested that a pattern of overcharges be used to identify high-risk vendors. Another commenter indicated that having a variable maximum price that is not printed on the food instrument eliminates the opportunity for systemic and excessive overcharging, lessening the need for pursuing claims, regardless of the cause or the size of vendor overcharges. Although we believe both of these approaches would improve program integrity, they should be used in addition to, and not in lieu of, strong requirements to pursue claims.

e. Collecting the Full Purchase Price of Food Instruments Containing Vendor Overcharges or Other Errors (§§ 246.12(k)(2) and 246.12(h)(3)(ix))

Both Sections 246.12(k)(2) and 246.12(h)(3)(ix) in the proposed rule would have permitted, but not required, the State agency to withhold payment or collect from the vendor the full redeemed value of a food instrument containing a vendor overcharge or other error. Just under half of the commenters on each of these provisions opposed this authority for two reasons. First, they pointed out that it treated inadvertent cashier errors the same as intentional fraud. They asserted that there is no deterrent effect when human error is the cause. Second, they noted that establishing a claim for the full purchase price of the food instrument failed to compensate vendors for the amount of the supplemental foods that were properly provided to participants. One commenter suggested that we permit claim assessment for a percentage of the food instrument value rather than for the full amount. Another commenter was particularly concerned about this provision in light of the proposal to limit vendors' ability to appeal claims.

The ability to establish a claim for the full purchase price of a food instrument can provide a powerful incentive for vendors to ensure that their cashiers are properly trained in order to reduce inadvertent errors during WIC transactions. As such, we retained this option for the State agency.

f. Opportunity to Justify or Correct Errors (§ 246.12(k)(3))

Two commenters supported retaining the current provision requiring the State agency to give vendors the opportunity to justify or correct errors before denying payment or assessing a claim. One commenter indicated that our example was inadequate because some State agencies do not pay for food instruments with missing purchase prices or signatures and do not permit, under their vendor agreements, vendors to make these types of corrections after a food instrument has been submitted for redemption. We agree with the commenter and deleted this example.

One commenter on the claims provision of the vendor agreement noted that we had removed the current provision requiring the State agency to give vendors an opportunity to justify or correct food instrument errors. To emphasize that vendors must still be provided this opportunity, we added a reference to this opportunity in the claims provision of the vendor agreement.

g. Timeframe for Initiating Claims (§ 246.12(k)(4))

Two commenters pointed out that requiring the State agency to begin collection efforts before an investigation is complete could jeopardize the investigation. We agree and revised the requirement for initiating collection action to read ''the date of detection of the vendor violation or the completion of the review or investigation giving rise to the claim, whichever is later.'' We also reordered paragraph (k) to clarify that the opportunity to justify or correct must occur within the 90 days the State agency has to make a final decision to deny a payment or initiate claims collection action.

h. Food Instruments Redeemed after the Specified Period (§ 246.12(k)(5))

Two commenters suggested that we raise the dollar limit for permitting the State agency to pay vendors for food instruments submitted for redemption after the specified date without our approval. They indicated that this dollar limit was outdated. We agree and raised the limit for prior FNS Regional Office approval from $200 to $500.

7. Miscellaneous Vendor Agreement Specifications

a. Recordkeeping (§ 246.12(h)(3)(xv))

We proposed to require the vendor agreement to provide that vendors must maintain inventory records used for Federal tax reporting purposes and other records the State agency may require for a period of time specified by the State agency. One commenter recommended that we set the length of time in the final rule, rather than defer to the State agency. Other commenters requested that we specify what records must be retained and that we require that shelf price records be maintained to facilitate follow-up on suspected vendor overcharges. Finally, one commenter questioned whether the records may be kept off-site.

This rule adopts the provision largely as proposed. We left it to the State agency to specify the record retention period. We clarified that the time period must be specified by the State agency in the vendor agreement. The State agency has the discretion to require as part of the vendor agreement that the vendor maintain shelf price records. Finally, this rule retains the requirement that the records be available at any reasonable time and place. This means that records may be kept off-site as long as they are readily accessible.

b. Sanction Schedule (§ 246.12(h)(5))

All commenters supported our proposal to require the State agency to include its sanction schedule as part of the vendor agreement. This provision would replace the current approach of separately listing in the program regulations the mandatory sanctions that the State agency must include in its vendor agreement. Several commenters suggested that we clarify that the sanction schedule may be included as an attachment to the vendor agreement. Another commenter requested that we permit cross-reference to State laws or regulations in areas in which the State agency's sanction schedule has been incorporated in State law or regulations. We made these changes and also revised the provision to clarify that the sanction schedule must include both the mandatory and State agency vendor sanctions.

One commenter suggested that the required sanction schedule only include the mandatory sanctions, because the State agency needs some flexibility in assessing the State agency sanctions in order to take into account the nuances of each case. We disagree. A State agency may build some flexibility into its sanction schedule, such as factors that will be taken into account in determining the length of a disqualification. However, vendors need advance notice of the consequences of committing vendor violations. We believe that allowing the State agency to either attach the sanction schedule to or cross-reference it in the vendor agreement provides the State agency with an efficient and effective means to provide vendors with such advance notice.

Two commenters asked whether the State agency would be permitted to

continue to include its sanction schedules in the vendor handbook that is provided to vendors along with the vendor agreement. This practice is permissible only if the sanction schedule section of the vendor handbook is referenced in the vendor agreement. Providing vendors with advance notice of the sanction schedule through the vendor agreement prevents vendors from arguing during administrative reviews that they were unaware of the sanctions for various vendor violations.

c. Adverse Actions Subject to Administrative Review and Administrative Review Procedures (§ 246.12(h)(6))

We proposed to require the State agency to include with the vendor agreement a list of the actions a vendor may appeal and a copy of the State agency's administrative review procedures. Commenters generally supported this provision, but suggested some modifications to provide the State agency with some flexibility in the implementation of this provision. One commenter asked that we clarify that such procedures may be included in a vendor handbook or as an attachment to the agreement. Another commenter suggested that when the procedures are included in State law or regulations, that the vendor agreement just cross-reference those documents. Finally, one commenter asked whether this provision is necessary in light of the requirement that the State agency must provide such procedures to the vendor along with its notice of an adverse action that is subject to review.

The final rule incorporates many of these suggestions. It permits the State agency to include the list of adverse actions and the administrative review procedures either in the agreement or as an attachment to it. If these items are included in State law or regulations or in another document, such as a vendor handbook, provided at the time the vendor is authorized, the State agency may simply include an appropriate cross-reference in the vendor agreement. As an alternative to these approaches for the administrative review procedures, the State agency may include a statement in the vendor agreement that the administrative review procedures are available upon request and applicable procedures will be provided along with a notice of adverse action that is subject to review.

One commenter indicated that the vendor agreement should include a list of the adverse actions that are not subject to administrative review, rather than a list of the adverse actions that are subject to administrative review. The commenter asserted that an all-inclusive list of all actions that may be subject to administrative review is impossible. We did not intend the State agency to include a laundry list of all possible adverse actions. However, we also do not believe that simply providing a list of adverse actions not subject to administrative review is appropriate in light of the two categories of administrative reviews established under this rule (full and abbreviated administrative reviews). We expect the State agency to list the adverse actions in the same level of detail as they are described in Section 246.18. We revised this provision to require the State agency to list the adverse actions that are not subject to review as well. As with the sanction schedule, we believe it is critical that vendors receive advance notice of the consequences of their actions and whether they will be able to obtain administrative review in the event of an adverse action by the State agency.

8. Vendor Training

The proposal included several provisions that would strengthen the vendor training requirements. The goal of these changes is to improve vendors' understanding of program rules and requirements in order to prevent program noncompliance and errors. The proposal specified where vendor training would take place, who would be required to attend training, how often training would take place, and what type of training would be provided. Commenters were primarily concerned about the costs associated with the proposed changes.

a. Location of Training (§ 246.12(i)(1)), Preauthorization Visits (§ 246.12(g)(4)), and Personnel Required to Attend Training (§§ 246.12(h)(3)(xi) and (i)(1))

The most common concern among commenters was the location of vendor training. The proposal would have required the State agency to provide training to new vendors ''on the site of the vendor.'' This provision was intended to combine the initial vendor training with the documented on-site visit that currently is required by § 246.12(e)(1) prior to or at the time of initial authorization of a new vendor. Most of those who commented on this aspect of the provision indicated that on-site training was ineffective for a variety of reasons, including constant interruptions, inadequate space in stores for training, and inefficiency due to training vendors individually rather than training a large group of vendors at the same time. Three commenters preferred on-site training because off-site training creates a burden for small businesses with few employees. To address commenters' concerns, we decided to revise this provision to give the State agency discretion to determine the appropriate location for vendor training. When possible, we believe that the State agency should attempt to accommodate requests from small businesses to provide on-site vendor training. To accommodate this revision, we retained the current requirement that the State agency conduct an on-site visit prior to or at the time of a vendor's initial authorization. This requirement appears in § 246.12(g)(4) of the final rule.

Proposed § 246.12(h)(3)(xi) would have required ''the manager of the vendor or other member of management'' to participate in vendor training. Commenters were divided on the issue of who should be required to attend training. One commenter suggested that we require store owners and/or general managers as well as key store personnel to participate in annual training. Another commenter indicated that requiring ''management'' to attend training was inappropriate. A third commenter asserted that, because the vendor is responsible for its employees' actions regardless of who commits violations or attends training, the vendor should have the discretion to determine who is in the best position to participate in the training and to provide training information and materials to other store employees. Based on the comments we received, it appears that there are a variety of successful formats for vendor training, ranging from large, off-site, train-the-trainer programs to on-site, cashier training programs. To allow for a variety in formats, we believe it is necessary to provide both the State agency and vendors with discretion regarding the appropriate audience for vendor training. Consequently, we revised both the vendor agreement and vendor training provisions to clarify that at least one representative from each vendor is required to participate in the training and that the State agency will designate the audience (e.g., managers, cashiers, etc.) to which the training is directed.

b. Frequency and Format of Training (§§ 246.12(i)(1) and (h)(3)(xi))

Of the seven commenters who requested that we delete the annual training requirement: two misunderstood the proposed provision and opposed it because attending off-site training on an annual basis would be a burden, three opposed it because they do not think it would be the best

use of limited resources, one opposed it because it would prohibit the State agency from directing its resources to vendors that need more training than others, and one commenter just opposed annual training. Due to the high turnover in vendor personnel, which was noted by a few commenters, and the complexities of and periodic changes in program requirements, we believe that an annual training requirement is both reasonable and necessary. Providing vendors with training materials on current program requirements on an annual basis is not overly burdensome for the State agency. Similarly, examining training materials provided by the State agency on an annual basis is not overly burdensome for the vendor. Consequently, we decided to adopt the annual training requirement as proposed.

Several commenters opposed attaching the frequency of the required face-to-face training to the agreement period, especially for State agencies that use probationary or one-year agreement periods. One commenter indicated that State agencies would adopt longer agreement periods to avoid the costs of providing more frequent face-to-face training. Three commenters suggested that we modify the provision to require face-to-face training once every three years. We accepted this suggestion and made a corresponding change in the final rule because it creates a standard requirement for all State agencies irrespective of the length of their vendor agreements.

Another area of commenter concern was the proposed requirement for ''face-to-face'' training. Three commenters suggested that we use the term ''interactive'' instead of ''face-to-face'' because it would give the State agency the flexibility to use new technologies, such as video teleconferencing. Several commenters made a related point that group training is often more successful than on-site training because some group members ask questions that are informative to other trainees. Our rationale for requiring face-to-face training was to provide vendor representatives with the opportunity to ask questions in order to fully understand how the program requirements apply to their store operations. We agree with the commenters' suggestion that this goal can be achieved through other interactive formats. For this reason, we accepted the commenters' suggestion and revised the provision so that ''interactive'' training is required prior to or at the time of a vendor's initial authorization and once every three years thereafter. We also added language to clarify that interactive training ''includes a contemporaneous opportunity for questions and answers.''

c. Training Content (§ 246.12(i)(2)) and Training Documentation (§ 246.12(i)(4))

In § 246.12(i)(2), we proposed to require that specific topics be covered by the annual training. One commenter indicated that the required subjects could not, as suggested in the preamble, be effectively communicated by simply revising the handbook or using audio tapes. The proposed provision states that the ''annual training shall include instruction'' on the required subjects. Whereas the vendor agreement must contain very specific information about the program requirements, annual training is intended to provide more general information about how these requirements apply to vendor operations. For instance, instruction on the vendor sanction system may reference where the sanction schedule is located in the vendor agreement and generally cover the process the State agency uses to impose sanctions and the procedures that vendors must follow to appeal sanctions. To clarify our intent, we revised this provision to delete the requirement that the training cover the vendor agreement in order to avoid the implication that the entire vendor agreement must be reviewed each year. Instead, § 246.12(i)(2) requires the annual training to cover any changes to program requirements since the last training.

Five commenters suggested that we delete the ''training receipt'' requirement in proposed §§ 246.12(i)(4) and (h)(3)(xi) because they believe it is clear that the State agency will hold vendors responsible for violations regardless of whether they are intentional or inadvertent and regardless of who commits the violations or who attends vendor training. We proposed this requirement because some State agencies have indicated in the past that violative vendors have argued during administrative reviews that they were not appropriately trained on their program responsibilities. A signed receipt, acknowledging the vendor's receipt and understanding of training, would provide the State agency with evidence that vendors received training and understand program requirements. Nevertheless, we believe that by signing their agreements vendors have accepted the terms of the agreement and are legally responsible for understanding program requirements. Vendors should thoroughly read and understand their vendor agreements prior to signing them. Vendor training is not intended to educate vendors on every aspect of the vendor agreement; vendor training is provided by the State agency to assist vendors in understanding program requirements in order to reduce program errors, prevent program noncompliance, and improve program service. We accepted the commenters' suggestion and amended § 246.12(i)(4) to require the State agency to document the content of its annual training but not to require vendor receipts. This change holds the State agency accountable for covering the training subjects required by Section 246.12(i)(2) and provides the State agency with the discretion of whether to require signed receipts for vendor training. Consequently, if the State agency finds such receipts helpful during administrative reviews, it has the option to require signed receipts for vendor training. We also made a conforming change to § 246.12(h)(3)(xi).

d. Training of Staff by Vendor (§ 246.12(h)(3)(xii)) and Vendor Accountability (§ 246.12(h)(3)(xiii))

We received no comments opposing proposed Section 246.12(h)(3)(xii), which requires the vendor to inform and train cashiers and other staff on program requirements. This provision is related to Section 246.12(h)(3)(xiii), which establishes the vendor's accountability for the actions of its employees in the handling of food instruments. We adopted both of these provisions in the final rule with technical and conforming changes to make them consistent with language used throughout the final rule.

9. Vendor Monitoring and Identifying High-Risk Vendors

a. Definitions of ''High-Risk Vendor,'' ''Compliance Buy,'' ''Inventory Audit,'' and ''Routine Monitoring'' (§ 246.2)

Ten commenters supported the proposed definition of ''high-risk vendor.'' One commenter opposed the proposed definition, unless it is modified to distinguish between intentional and unintentional conduct. As discussed in the preamble to the Vendor Disqualification final rule, the violations that trigger mandatory sanctions do not require the State agency to distinguish between fraudulent (intentional) and abusive (unintentional) vendor violations, because both types of vendor violations result in loss of program funds. The State agency is not required to demonstrate that a vendor intended to commit a vendor violation(s) to support its sanction. Instead, the State agency is required to provide evidence that the vendor committed the vendor violation(s) and that the evidence is

sufficient to support the sanction being imposed. For this reason, we did not accept the commenter's recommendation and adopted the definition with one revision to incorporate the defined term ''vendor violation.''

Ten commenters also supported the proposed definition of ''compliance buy.'' One commenter suggested that we modify the definition to cover situations in which an investigator poses as a proxy. We accepted this recommendation and also added language to the definition to cover situations in which an investigator poses as a ''parent or caretaker of an infant or child participant.''

Whereas ten commenters supported our proposed definition of ''inventory audit,'' one commenter requested that we delete the definition because inventory audits rely on internal store records, which should not form the basis of a compliance investigation. We did not accept the commenter's request because inventory audits are useful in investigating vendors who may be, for example, redeeming food instruments for unauthorized stores, exchanging unauthorized food or non-food items for food instruments, or trafficking. Another commenter suggested that we modify the definition to include the ''examination of beginning and ending inventory levels and food invoices.'' We did not accept this commenter's suggestion because the meaning of the phrase ''during a given period of time'' implies an examination that covers a specific period, which naturally must have a beginning and an ending point. We adopted the definition in the final rule with one modification to conform to language used throughout the final rule.

Of the ten commenters who supported the definition of ''routine monitoring,'' one commenter noted that it was odd that in the proposal we replaced ''representative monitoring'' with routine monitoring and then dropped the requirement for routine monitoring. The routine monitoring requirement is discussed below in section 9.d of this preamble. We adopted the definition of routine monitoring as proposed.

b. Vendor Monitoring (§ 246.12(j)(1))

Two commenters suggested that we add language to proposed § 246.12(j)(1) to permit the State agency to delegate all of its vendor monitoring to another State agency by written agreement. We did not accept this comment for two reasons. First, if one State agency pays another State agency for compliance investigation services, then the State agency that conducts the investigations would be considered a contractor under this provision. No additional regulatory language is necessary to address this type of agreement. Second, even if one State agency chooses to meet its entire requirement for compliance investigations by counting the compliance investigations conducted by another State agency, the first State agency still will need to establish its own vendor monitoring system to address the monitoring activities that may not be delegated. Each State agency must conduct its own routine monitoring visits, identify its high-risk vendors, and track its progress toward meeting the thresholds for routine monitoring visits and compliance investigations. The circumstances under which a State agency may count the compliance investigations conducted by another State agency are discussed in Section 9.d of this preamble.

c. Identifying High-Risk Vendors (§ 246.12(j)(3))

Of the forty-one commenters who addressed proposed § 246.12(j)(2), which covers the requirements for the identification of high-risk vendors, thirty opposed it for a variety of reasons. Many opposed it because we did not include our high-risk criteria in the regulatory language or discuss the specifics of these criteria in the preamble. We believe that these criteria should not be included in the regulatory language because doing so would compromise State agency investigative techniques. Unscrupulous vendors may use this information to avoid being identified as high-risk vendors subject to compliance investigations. Although some stores post signs warning their customers that shoplifters will be subject to criminal prosecution, no stores post signs that specifically disclose the techniques they use to identify potential shoplifters. Most vendors, like most shoppers, are honest and have no reason to be concerned about investigative techniques.

Several commenters criticized the provision as a ''one-size-fits-all'' approach that would require all State agencies to use the same high-risk identification criteria and asserted that State agencies are in the best position to determine which criteria are most effective. Our experience with State agency-established criteria is mixed. According to The Integrity Profile (TIP) report for fiscal year 1998, the two most common indicators that State agencies use in their high-risk systems were complaints from participants, local agencies, and other vendors and WIC business volume. Complaints do not take into account vendor redemption patterns, and WIC business volume simply identifies larger vendors. Of the seven most commonly used high-risk indicators reported by State agencies for the fiscal year 1989 through fiscal year 1994 Vendor Activity Monitoring Profile (VAMP) reports, complaints and WIC business volume ranked fifth and sixth at identifying vendors that subsequently committed overcharge violations during compliance buys.

We believe there is sufficient data to support the effectiveness of particular high-risk identification criteria and that State agencies are not making the best use of these criteria. However, to address commenters' concerns about the potential ineffectiveness of our criteria, we revised the regulatory language to permit the State agency to use other statistically-based criteria we approve in lieu of the our criteria. This revision gives the State agency the flexibility to employ other criteria when it believes that our criteria are ineffective in its jurisdiction.

Several commenters were concerned about the length of the advance notice we would provide to the State agency prior to changing our high-risk identification criteria. One commenter suggested that we provide the State agency with a minimum of eighteen months advance notice, while another commenter suggested that we agree to use our criteria for five years prior to making changes. Commenters were concerned about the length of time it takes to make changes to their automated systems and the costs associated with frequent changes. Strengthening high-risk identification systems certainly will require a commitment of resources by State agencies. However, the result of this effort will be a more efficient compliance investigation system, which identifies and removes violative vendors from the Program. We will not change our high-risk identification criteria more frequently than once every two years and will change the criteria only when more effective criteria have been identified. To address commenter's concerns about the time required for implementing changes, we revised this provision to provide State agencies with ''adequate advance notice,'' which will allow for various implementation timeframes depending on the change.

One commenter suggested that we modify the provision to specify the period for identifying high-risk vendors. We accepted this suggestion and revised the provision to require high-risk identification ''at least once a year.'' Establishing this as an annual requirement is consistent with the period during which the State agency

must conduct the specified number of compliance investigations. In addition, the commenter suggested that we specify that vendors appearing on multiple lists be given a higher priority for compliance investigations. This is a valid comment, but we believe that such direction should be provided to State agencies as part of the guidance that contains our high-risk criteria rather than be included in regulatory language.

d. Routine Monitoring (§ 246.12(j)(2)) and Compliance Investigations (§§ 246.12(j)(4), 246.12(l)(2)(iii), and 246.18(a)(1)(ii)(H))

Many of those who commented on the requirement in proposed Section 246.12(j)(3)(i), which would require the State agency to conduct compliance investigations on ten percent of its vendors, were concerned that the ten percent level was too high, too expensive, a ''one-size-fits-all'' approach, and would make routine monitoring prohibitive due to the cost of the required compliance investigations, and shift resources away from nutrition education and breastfeeding promotion. As noted in the Fiscal Year 1998 TIP report, State agencies vary widely in the areas of high-risk identification and compliance investigations. Whereas some State agencies reported identifying no high-risk vendors, others reported identifying over one third of their vendors as high-risk. Similarly, some State agencies reported conducting no compliance investigations; others reported conducting compliance investigations on nearly all of their vendors. Currently, the State agency must design and implement a high-risk identification system and have the capability to conduct compliance buys. Some State agencies would need to do very little to implement this proposed provision; others would need to modify their systems to identify high-risk vendors to incorporate our criteria and begin conducting compliance buys on their vendors.

Section 203(f) of the Goodling Act amended section 17(f)(24) of the Child Nutrition Act (42 U.S.C. 1786(f)(24)) to require each State agency to identify high-risk vendors and conduct compliance investigations of the vendors. A number of commenters indicated that their number of high-risk vendors is well below ten percent and suggested that we modify the provision to a lower percentage, such as three or five percent, or that the State agency be granted discretion to determine the percentage of vendors that should be monitored. Under the current regulations, which allow for State agency discretion, a number of State agencies neither identify high-risk vendors, nor conduct compliance investigations. To implement a provision consistent with the Goodling Act, we must require the State agency both to identify high-risk vendors and to conduct compliance investigations. Setting a minimum percentage for compliance investigations is the most effective means of ensuring that the legislative mandate is implemented consistently by State agencies.

One suggested modification that was supported by ten commenters was to modify the provision so that the State agency must monitor ten percent of its vendors and conduct compliance investigations on half of those vendors subject to monitoring. This compromise would set a standard for compliance investigations, as we proposed, as well as retain a standard for routine monitoring, as recommended by thirteen commenters. The compromise would address the majority of commenters' concerns regarding this provision. Consequently, we adopted the compromise but clarified that the standards for routine monitoring and compliance investigations are separate standards—five percent routine monitoring and five percent compliance investigations. This compromise retains half of the current requirement for ten percent routine (representative) monitoring and reduces the proposed ten percent compliance investigations requirement by half, thereby reducing the amount of resources necessary to carry out this provision. To accommodate these changes, this rule reorganizes and renumbers the requirements for compliance investigations in proposed § 246.12(j)(3) into two paragraphs, § 246.12(j)(2), *Routine monitoring,* and § 246.12(j)(4), *Compliance investigations.* Throughout this final rule, we used the term ''compliance investigations'' to refer to both inventory audits and compliance buys.

Several commenters expressed concern that requiring compliance buys would set up an adversarial relationship with vendors. Others commented that the most effective vendor monitoring system is a preventive approach. Although we agree that vendor training and routine monitoring, including ''educational buys,'' are effective methods to curb vendor abuse by reducing cashier errors that result in the loss of program funds, preventive methods are ineffective at addressing vendor fraud, because vendors do not inadvertently commit fraud. By mandating that we require State agencies to conduct compliance investigations of high-risk vendors, Congress has directed that program resources be used to combat vendor fraud. In the final rule, we balanced our desire to continue to commit resources toward preventive methods, such as strengthening the vendor training requirements and retaining a routine monitoring requirement, with our responsibility to remove fraudulent vendors from the Program.

Two commenters suggested that we modify this provision to require compliance investigators to notify vendors of violations detected during compliance buys in a timely manner. One of these commenters suggested that the required timely notification should be either when violations occur or within seven days of their occurrence. One commenter indicated that it is unfair to notify vendors of violations 45–60 days after they were discovered, because such late notification may limit the vendor's ability to discipline cashiers under their labor agreements. Another commenter suggested that compliance investigators assist checkers with honest mistakes.

Although we understand the concerns expressed by these commenters, we do not believe that corresponding modifications to the regulatory language are justified. As defined by this final rule, a compliance buy is ''a covert, on-site investigation in which a representative of the Program poses as a participant, parent or caretaker of an infant or child participant, or proxy, transacts one or more food instruments, and does not reveal his or her identity during the visit.'' Unlike personnel conducting a routine monitoring visit, compliance investigators must adhere to strict procedures in order for their compliance buys to be admissible as evidence in administrative reviews and, if necessary, judicial proceedings. These procedures prohibit investigators from revealing their identity and the fact that the vendor is under investigation, because revealing this type of information could compromise both current and on-going investigations. For the same reasons, we included a provision in the proposed rule and this final rule to protect the identity of compliance investigators when they testify in administrative reviews. Whereas timely feedback is essential to the effectiveness of monitoring visits, often it is contrary to the effectiveness of compliance investigations.

Three commenters suggested that we modify this provision to permit the State agency to count toward the proposed ten percent standard compliance investigations conducted by another WIC State agency on vendors authorized by both State agencies,

especially in situations in which one of the State agencies is an Indian Tribal Organization. The proposed rule would have allowed the State agency to ''waive'' conducting a compliance investigation on a high-risk vendor if the State agency documented that the vendor was under investigation by a Federal, State, or local law enforcement agency or for some other such compelling reason. To clarify this provision, we revised it to allow the State agency to ''count'' toward this requirement investigations conducted by a Federal, State, or local law enforcement agency, provided that such investigations include the investigation of either WIC or FSP fraud or abuse. In addition, we accepted the commenter's suggestion and revised this provision so that the State agency may count compliance investigations conducted by another State agency on shared vendors, provided that certain conditions are met.

In order for a State agency to count compliance investigations conducted by another WIC State agency on vendors shared by the two State agencies, the final rule requires the State agency to implement a system for reciprocal sanctions with the other WIC State agency. This means that the State agency counting the compliance investigations of another WIC State agency must take reciprocal action based on mandatory sanctions imposed by the other State agency. To take such reciprocal action, the State agency must include in its sanction schedule, which is a required part of the vendor agreement, a sanction that requires disqualification for any mandatory sanction imposed by the other State agency. This serves to put vendors on notice of the reciprocal effect of the mandatory sanctions imposed by the other WIC State agency. Prior to imposing a disqualification, the State agency must consider whether disqualification of the vendor would result in inadequate participant access. If disqualification of the vendor would result in inadequate participant access, then the State agency must impose a civil money penalty in lieu of disqualification. This provision does not permit the State agency to impose a civil money penalty in response to a civil money penalty for a mandatory sanction imposed by the other WIC State agency. Vendors that appeal a sanction based on another State agency's mandatory sanction must be provided an abbreviated administrative review in accordance with the procedures in § 246.18(c). The areas subject to administrative review are limited to: (1) Whether the vendor received a disqualification for a mandatory sanction from the other WIC State agency and (2) whether the State agency's sanction schedule included a sanction based on a mandatory sanction imposed by the other WIC State agency.

To incorporate this change, we made conforming changes to the sanction and administrative review sections of the regulations. We added § 246.12(l)(2)(iii) to the final rule to clarify that the State agency has the option to establish a sanction based on a mandatory sanction imposed by another WIC State agency. We also added § 246.18(a)(1)(ii)(H) to clarify that the State agency may provide abbreviated administrative reviews, rather than full administrative reviews, to vendors that appeal a ''disqualification or a civil money penalty imposed in lieu of disqualification based on a mandatory sanction imposed by another WIC State agency.'' In addition, we want to clarify that although compliance investigations conducted by other State agencies may be counted toward a State agency's five percent compliance investigations requirement, these activities should not be reported on the TIP report as compliance buys or inventory audits conducted by the State agency, because such double counting would lead to inflated numbers.

Another area of concern was the number of compliance buys necessary to close a compliance investigation in which no vendor violations are found. The proposal would have established two separate standards: three negative compliance buys within a twelve-month period to close compliance investigations of high-risk vendors and State agency discretion to close compliance investigations of non-high-risk vendors. Several commenters recommended that we establish a single standard for all compliance investigations. As part of the compromise discussed above, ten commenters suggested that the State agency be provided with the discretion to determine when to close all compliance investigations. However, as noted in the WIC Vendor Issues Study, compliance investigations that consist of more than one compliance buy are more effective at uncovering vendor violations than compliance investigations consisting of a single compliance buy. In addition, conducting compliance investigations on non-high-risk vendors helps to verify the effectiveness of the high-risk identification criteria used by the State agency. If the same standard is not used to close compliance investigations of both high-risk and non-high-risk vendors, then the results of the two types of compliance investigations cannot be compared to verify the effectiveness of the high-risk criteria. For these reasons, we revised this provision to require at least two compliance buys be conducted before the State agency may close a compliance investigation in which no vendor violations are detected. The reduction in the number of negative compliance buys to close an investigation of a high-risk vendor should offset the corresponding increase in the number of negative buys necessary to close compliance investigations of non-high-risk vendors.

One commenter recommended that we specify the time period during which compliance buys must be conducted. Another commenter suggested that we delete the twelve-month limit on compliance buys for compliance investigations and allow the State agency to conduct compliance investigations without a strict time limitation. Once again, rather than specifying such detail in regulations, we believe that the period of time a compliance investigation remains open depends on the type of investigation and should be based on the State agency's investigative techniques. We established above that high-risk identification must be done on an annual basis. Due to the time it takes to identify high-risk vendors, plan and conduct compliance buys, and examine redeemed food instruments used during compliance buys, we believe some investigations, especially those in which violations are detected, may take longer than twelve months. For this reason, we deleted the twelve-month timeframe contained in the proposal. We still believe that a twelve-month timeframe is reasonable, but we want to ensure that the State agency has sufficient time to obtain the evidence necessary to support its sanctions and uphold them upon appeal.

In situations in which the State agency is unable to establish the level of evidence necessary to support a sanction, we recommend that the State agency issue a warning to the vendor identifying the vendor violations found and recommending corrective actions, such as additional training. Providing the vendor with a warning that violations are occurring puts the vendor on notice and also provides support for sanctions in the event that additional violations are uncovered during future compliance investigations. One commenter suggested that the regulations include timeframes for follow-up compliance buys after warning letters are issued. Once again, we believe that such investigative

techniques should be discussed in guidance rather than being included in the regulations.

As in the proposed rule, the final rule specifies that, when the number of vendors identified as high-risk is below five percent of the State agency's total number of vendors, the State agency must conduct compliance investigations of randomly selected non-high-risk vendors to reach the five-percent requirement. When the number of vendors identified as high-risk exceeds five percent, the State agency must conduct compliance investigations on the high-risk vendors it determines to have the greatest risk for program noncompliance and/or loss of program funds. Vendors identified as high-risk by multiple criteria should receive higher priority for compliance investigations. In the event they are subsequently identified as high-risk vendors, high-risk vendors not subject to compliance investigations due to the priority system should be subject to compliance investigations the following year. Over time, we anticipate that State agencies will be able to conduct thorough compliance investigations on all vendors identified as high-risk and that the percentage of high-risk vendors will decrease as noncompliant vendors are removed from the Program.

e. Report on Vendor Monitoring Results (§ 246.12(j)(5))

One commenter requested that we clarify that the required report in proposed § 246.12(j)(4) refers to the TIP report or replaces the TIP report, because the commenter opposes any additional reporting requirements. This provision does refer to submission of TIP report data to us. We did not specifically identify the TIP report in the regulatory language because the names of reports occasionally change when the reports are updated. For example, the TIP report was previously known as the VAMP report. For this reason, we adopted the regulatory language as proposed.

f. Documentation of Monitoring Visits (§ 246.12(j)(6))

One commenter suggested that, instead of documenting the price charged for each item purchased during a compliance buy, investigators only document the price shown on the item, shelf, or sign. In order to determine whether a vendor has committed an overcharge violation, the investigator must document both the current shelf price, or price charged other customers, and the price the vendor actually charged for each item. Consequently, we did not accept the commenter's suggestion.

Two commenters requested that we delete the requirement that reviewers or investigators document for all monitoring visits their ''observation that the vendor appears to be in compliance with program requirements.'' One commenter noted that an investigator would not know if a food instrument being transacted contains an overcharge until after it is redeemed. The other commenter noted that a reviewer conducting a routine monitoring visit who makes this kind of judgment in writing can destroy the effectiveness of months of covert monitoring, because attorneys for vendors appealing sanctions have used this type of documentation to cast doubt on the findings of compliance investigations. To address the commenters' concerns, we deleted this requirement from the provision in the final rule.

10. Vendor Administrative Review Procedures

We proposed to amend the procedures for administrative review of vendor appeals by limiting the types of actions subject to administrative review, establishing abbreviated administrative review procedures for certain adverse actions, and extending the timeframe for rendering a review decision. As part of limiting the types of actions subject to administrative review, we proposed to create three categories: (1) Adverse actions subject to full administrative reviews; (2) adverse actions subject to abbreviated administrative reviews; and (3) actions not subject to administrative review. Commenters were divided on the issue of limiting the types of actions subject to administrative reviews. Commenters were especially concerned about the proposal to eliminate administrative reviews of vendor claims. Regardless of whether they supported or opposed our efforts to streamline the administrative review process, commenters were concerned that limiting the administrative review of some actions may violate a vendor's due process protections.

We have always held that authorization as a WIC vendor is not a license and does not convey property rights to a store or business entity. To clarify our position, we included a provision to this effect in the proposed rule, which we adopted in the final rule at § 246.12(h)(3)(xxi). In any case, due process does not always include full trial-type hearings, and sometimes does not require hearings at all. We re-evaluated the three categories of adverse actions in the proposed rule and continue to believe that the proposed procedures do not present due process implications. With respect to claims, we want to point out that anytime the State agency delays payment to a vendor or establishes a claim the State agency must provide the vendor an opportunity to justify or correct a vendor overcharge or other error.

However, in recognition of possible State procedures that require all administrative reviews to meet certain procedural requirements, the final rule provides the State agency with the option to provide full administrative reviews of the adverse actions listed in § 246.18(a)(1)(ii) of the final rule, which covers the adverse actions subject to abbreviated administrative reviews. In addition, we want to emphasize that the procedural requirements set forth in the regulations for both full and abbreviated administrative reviews are minimum requirements. The State agency may include additional procedural requirements in its administrative review procedures.

a. Adverse Actions Subject to Abbreviated Administrative Reviews (§ 246.18(a)(1)(ii))

Several commenters suggested that the termination of a vendor agreement based on changes in ownership or location or cessation of operations be moved to the category of actions receiving no administrative review. Another commenter made a similar suggestion with regard to the denial of authorization because the vendor submitted its application outside the timeframe for accepting applications. Although we agree that in most cases these determinations will be clear-cut, we believe that an abbreviated review provides an appropriate level of review in cases in which the vendor disputes the State agency's determination.

Two commenters suggested we add permanent disqualifications based on trafficking convictions to the list of actions that are not subject to administrative review. We believe that a permanent disqualification based on a trafficking conviction presents a narrow factual question: Was the sanctioned vendor convicted of trafficking? Consequently, we added permanent disqualifications based on trafficking convictions to the list of adverse actions subject to abbreviated administrative reviews.

We also want to point out that we retained the requirement that a denial of authorization based on vendor limiting criteria is subject to an abbreviated administrative review. This requirement only applies to those State agencies that choose to use vendor limiting criteria.

b. Actions Not Subject to Administrative Reviews (§ 246.18(a)(1)(iii))

Several commenters asserted that eliminating or restricting the administrative review of certain actions would force vendors to seek judicial review of these actions, which in the long run would create an administrative burden on the State agency. Although we understand the commenters' concerns, we believe that, by carefully limiting the actions that are not subject to review, we can streamline the administrative review procedures without shifting these matters to the courts. Therefore, the final rule retains the proposed categories of actions that are not subject to administrative review. We did clarify in this final rule that, like the participant access determinations themselves, the validity and appropriateness of the participant access criteria are not subject to administrative review.

In response to commenters, the final rule includes a cross-reference to the requirement in § 246.12(k)(3) that the State agency must provide vendors the opportunity to justify or correct vendor overcharges or other errors. In addition, we added to the list of actions not subject to administrative reviews the State agency's determinations of whether the vendor has an effective policy and program in effect to prevent trafficking. Both the statute (section 17(o)(4)(A) of the Child Nutrition Act (42 U.S.C. 1786(o)(4)(A))) and the regulations (§ 246.12(l)(1)(i)) commit this determination to the sole discretion of the State agency.

c. Effective Date of Adverse Actions (§ 246.18(a)(2))

Although they generally supported the effective date provision in proposed § 246.18(a)(3), commenters raised a number of issues. One suggested that we set an effective date for all adverse actions against vendors, another asked that we clarify the standard for determining when to postpone the effective date. A third commenter noted the potential hardship on vendors when adverse actions are made effective after 15 days and review decisions are not rendered for 90 days. We believe that the State agency is in the best position to balance these competing concerns. In the final rule, § 246.18(a)(2) provides the State agency with the discretion to make its adverse actions effective no earlier than 15 days after the date of the notice and no later than 90 days after the date of the notice or, in the case of an adverse action that is subject to administrative review, the date the vendor receives the review decision. As always, the State agency should make adequate participant access the chief concern in determining the effective date of such actions.

d. Full Administrative Review Procedures (§ 246.18(b))

We proposed in § 246.18(b)(1) to require the State agency to notify a vendor receiving a mandatory disqualification that: ''This disqualification from WIC may result in a disqualification as a retailer from the Food Stamp Program.'' One commenter recommended that we modify the required statement to provide that the WIC disqualification ''will'' result in a FSP disqualification, rather than ''may'' result in a FSP disqualification. Most, but not all, disqualifications that are mandatory vendor sanctions require reciprocal FSP disqualifications. Consequently, it is inappropriate to use ''will'' instead of ''may.'' The complete list of WIC disqualifications that give rise to reciprocal FSP disqualifications appears in the FSP regulations at 7 CFR 278.6(e)(8). Accordingly, we did not accept the commenter's recommendation.

A number of comments concerned the proposed changes to the procedures for full administrative reviews. Five commenters indicated that the proposed provision permitting cross-examination of WIC program investigators ''in camera'' was confusing. We clarified this concept in § 246.18(b)(5) of the final rule.

Another commenter questioned whether the provision in § 246.18(b)(7), which would give appellant vendors the opportunity to examine the evidence upon which an adverse action is based, would require the State agency to divulge its high-risk identification criteria. This provision does not require the State agency to turn over its complete vendor file. Only the documents, both pro and con, the State agency relied upon to take the adverse action under review must be provided. The State agency's high-risk identification criteria are only used to determine which vendors will be subject to compliance investigations. It is the information found as a result of a compliance investigation or periodic review of the vendor's qualifications that will normally form the basis for the adverse action.

One commenter suggested that we retain the current provision in 7 CFR 246.18(b)(8), which requires the decision-maker to make his or her decision based solely on the statutory and regulatory provisions governing the Program. We agree with the commenter that the proposed revision to this section did not fully convey our intent that the decision-maker for an administrative review must base his or her decision solely on applicable statutes, regulations, policies and procedures, including the policies and procedures established by the State agency. The decision-maker must then apply these standards to the factual evidence in the case at hand. The decision-maker should not, however, be in the position of determining the validity of Federal or State requirements. These are legal issues that should be reserved for the courts. We clarified this point in the final rule.

Most commenters supported the proposal to increase from 60 to 90 days the time for rendering a decision on a full administrative review. Five commenters suggested that we extend the timeframe to 120 days. Opposing commenters asserted that this provision violated due process requirements, citing the possibility that a State agency could make an adverse action effective 15 days after providing notice, leaving the vendor in an unauthorized status until the review decision is rendered. We acknowledge the competing needs of the State agency and needs of the vendor, and encourage the State agency to ensure that review decisions are made as quickly as possible. We believe that this final rule streamlines the administrative review process and assists the State agency in reducing the time it takes to render review decisions. However, as noted by several commenters, even with these changes some State agencies may not be able to consistently meet the current 60-day timeframe. Therefore, this final rule retains the proposed 90-day timeframe. We clarified in § 246.18(b)(9) of the final rule that this timeframe is only an administrative requirement for the State agency and is not jurisdictional. This means that the failure of a decision-maker to render a decision within 90 days may not be cited as a basis for overturning a State agency adverse action.

e. Effective Date of Review Decisions (§ 246.18(e)) and Judicial Review (§ 246.18(f))

One commenter suggested that the effective date of review decisions be left up to the decision-maker. We still believe that once a decision is rendered it must take effect immediately; therefore, we retained the proposed provision in § 246.18(e) that requires decisions to take effect on the date of receipt of the review decision, if the adverse action has not previously taken effect.

Three commenters objected to the proposed modification to the current provision requiring the State agency to explain the right to judicial review. As we noted in the preamble to the proposed rule, the availability and type of judicial review of State agency adverse actions is a matter of State law and may vary depending on the action taken. This change was not intended to preclude or discourage vendors from seeking judicial review, but to avoid putting the State agency in the position of determining the appropriate avenue of judicial review. Accordingly, this final rule adopts § 246.18(f) as proposed. State agencies that have the ability to determine the details of available judicial review are free to provide this information to their vendors.

11. Vendor Authorization and Local Agency Selection Subject to Procurement Procedures (§ 246.18(a)(1)(iii)(D) and (a)(3)(ii)(B))

We proposed in § 246.18(a)(1)(iii)(D) to include in the category of actions not subject to administrative review those vendor authorization determinations that are subject to the procurement procedures of the State agency. We proposed this change in recognition of the procedural safeguards built into procurement requirements that would be duplicated if included in the administrative review requirements of the WIC regulations. The one commenter on this provision indicated that some State agencies select their local agencies using State procurement procedures as well. The commenter suggested that we modify the proposal so that local agency selection determinations that are subject to procurement procedures are not subject to administrative review. We accepted this comment and added a provision to this effect to § 246.18(a)(3)(ii)(B). We clarified in both the vendor and local agency provisions that the exception from administrative review applies only to administrative reviews pursuant to section 246.18 and also made other revisions to clarify the coverage of these exceptions.

12. Preventing and Identifying Dual Participation (§§ 246.4(a)(15), 246.7(l), and 246.23(c)(2))

Nine of the fifteen commenters supported the proposal to require the periodic identification of dual participation. However, two commenters recommended that the rule require semiannual, rather than quarterly detection. Those commenters noted that the six-month certification periods for most participants make quarterly detection unnecessary. They also cited their experience that the cost of detecting the dual participants far outweighed the improperly issued benefits. Commenters also noted that the new requirements for verifying identity and residency will assist in preventing dual participation. We agree that a balance must be struck between the goal of detecting and preventing program fraud and the cost of doing so. Accordingly, this rule requires dual participation detection semiannually, rather than quarterly, and that follow-up action must be taken within 120 days of detecting instances of suspected dual participation.

Two of the opposing commenters objected to reporting on dual participation. The proposed changes to the requirements for detecting dual participation do not establish reporting requirements. However, as with all program operations the State agency must keep records of its efforts to identify and follow up on instances of dual participation. The State agency's compliance with these requirements will then be assessed during our management evaluations of the State agency.

One commenter questioned whether a system designed to detect dual *enrollment* would meet the proposed requirement to detect dual *participation.* Dual enrollment occurs when a participant enrolls in more than one clinic or program, but actually receives benefits from only one of them. Dual participation is when benefits are actually obtained from more than one clinic or program. In order to receive benefits from more than one clinic or program, a participant would have to be enrolled in more than one. Therefore, a system to detect dual enrollment would satisfy the requirement to detect dual participation, provided the State agency takes appropriate follow-up action for persons identified as dual enrolled. Such action would include terminating the individuals from all clinics and programs, except the one in which they are currently participating.

The majority of the commenters approved of the proposal to require interstate detection of dual participation where geographical or other factors make it likely that participants travel regularly between contiguous local service agencies located across State agency borders. However, both supporting and opposing commenters thought that this requirement could be costly, especially when the level of automation varies significantly between the adjoining State and for States that have a large number of bordering States. One commenter asked whether additional funds would be available and another thought we would need to provide significant assistance to State agencies as they implemented this requirement.

The State agency is already required to coordinate dual participation detection efforts with Commodity Supplemental Food Program State agencies and WIC Indian State agencies. The State agency should be able to draw on this experience in expanding such efforts to adjoining States. In addition, we recognize that the methods for coordination may be limited by the systems used by the various State agencies. Finally, the State agency should remember that it needs to develop interstate systems only in areas where participants travel regularly across State lines.

Commenters generally supported the proposed provisions requiring disqualification, and in some instances claims, for participants who are found to be participating in more than one program. Similarly, commenters also supported the proposal that FNS will assert a claim against the State agency if the State agency fails to take adequate steps to pursue participant disqualification and claims as a result of dual participation. The comments raised on these provisions mostly concerned larger issues relating to participant claims and sanctions and are discussed in section 13 of this preamble. We did notice that we inappropriately used the term ''disqualification'' in § 246.7(l)(1)(iii) when referring to cases of dual participation that did not result from intentional misrepresentation. Disqualification means terminating the participation of a participant and prohibiting further participation for a specified period and is only used in cases of intentional misrepresentations. In all other situations, the appropriate action is to ''terminate'' the participation of the participant in one of the programs or clinics. We revised this provision accordingly.

13. Participant Provisions

a. Definition of ''Proxy'' (§ 246.2)

Fifteen of twenty-three commenters supported the proposed definition of ''proxy.'' The most prevalent comment, made by both supporting and opposing commenters, concerned the inclusion in the proxy definition of parents or caretakers who apply for program benefits on behalf of infants or children. These commenters noted that this approach did not reflect the common usage of this term by their State agencies. One commenter asserted that the parent or caretaker applying on behalf of an infant or child participant

is actually the person authorized to designate a proxy. Another commenter noted that the proxy definition did not clearly permit a woman participant to designate a proxy. Finally, one commenter recommended that the proxy definition require proxies to be approved by the State or local agency.

In response to commenters' concerns and recommendations, we revised the definition of proxy to clarify that a parent or caretaker applying on behalf of an infant or child participant is not a proxy and that such a parent/caretaker may designate another person, such as a spouse, other family member, or friend, as a proxy for an infant or child participant. We made conforming changes throughout this rule to incorporate this change and to clarify which persons are authorized to take certain actions. We also clarified in the definition of proxy that proxies must be designated consistent with the State agency's procedures established pursuant to § 246.12(r)(1).

b. Definition of ''Participant Violation'' (§ 246.2)

All ten commenters supported the inclusion of dual participation as a type of participant violation. In order to emphasize that participant violations include all intentional acts that violate Federal or State statutes, regulations, policies, or procedures governing the Program, we included a new definition of ''participant violation'' in § 246.2, which includes the examples that were in § 246.12(u)(1) of the proposed rule. The participant violation definition clarifies that a participant violation may be committed by a participant, a parent or caretaker of an infant or child participant, or a proxy.

c. Participant Sanctions (§ 246.12(u)(1) through (u)(4))

Sixteen of the twenty commenters supported increasing the maximum disqualification period for a participant sanction to one year. Commenters generally supported requiring a disqualification for participant violations that give rise to a claim. However, a number of commenters suggested that State and local agencies be given the discretion to adjust the length of the mandatory disqualification to correspond to the period of the dual participation or the amount of the claim. Another commenter noted that claim amounts are normally small and that participants often make restitution quickly. The four opposing commenters objected to any action that affects benefits for infant and child participants.

Participant claims are only imposed when a participant commits a participant violation. Participant violations must involve intentional actions by a participant, parent/caretaker, or proxy. Although we believe that these situations are generally serious enough to warrant a mandatory one-year disqualification, we agree with commenters that the State agency should have the flexibility to determine whether to disqualify a participant in cases of small claims. Therefore, this rule requires a one-year disqualification only in cases of claims of $100 or more, claims resulting from dual participation, or second or subsequent claims of any amount.

One commenter thought that the determination of whether a participant (or parent/caretaker or proxy) intended to commit the action giving rise to disqualification or a claim should not be left to the judgment of a WIC eligibility worker or supervisor. We acknowledge that the decision to assert a claim or to disqualify a participant requires the exercise of discretion. However, this is but one of many decisions that WIC staff must make about program participation. In all cases, the State agency is responsible for ensuring that the decisions made by State and local agency staff are made in accordance with the regulatory requirements. In this instance, it means ensuring that the WIC staff knows the standards for determining when to assert a claim or disqualify a participant, and how to correctly apply those standards. If the State agency fails to do so, it will find that it is unable to sustain these determinations when participants appeal the decisions. This rule does not change the requirement in § 246.9 that the State agency must have a hearing procedure under which participants may appeal claims of any amount and disqualifications of any length. Further, §§ 246.12(u)(4) and 246.23(c)(1)(i) of this rule require the State agency to advise participants of the procedures to follow to obtain a fair hearing at the time they are notified of a claim or disqualification.

Other commenters suggested that we permit a pregnant or breastfeeding woman to continue program participation if an acceptable proxy can be found, which would be consistent with the proposal to permit infant and children participants to avoid disqualification if a proxy is approved. If adopted, this change would extend the proxy exception to all program participants, except for postpartum women. We did not accept the commenters' suggestion. However, this rule does permit the State agency to approve proxies in lieu of disqualification for participants under age 18 in addition to infant and child participants.

The final rule retains the proposed provision permitting the State agency to allow a disqualified participant to reapply to the Program if restitution is made. In response to a suggestion made by two commenters, we clarified in the final rule that if restitution is made or a repayment plan is agreed to within 30 days of the receipt of the letter demanding repayment of the claim, the State agency may permit the participant to continue participation without disqualification.

d. Participant Claims (§ 246.23(c)(1))

Although only seven of the twenty-five commenters supported the proposed participant claims provisions, a majority of the objections reflected a misunderstanding of the provisions. First, many commenters objected to the provision concerning in-kind restitution. Those commenters indicated that this practice would not be cost-effective. One commenter was concerned about allowing participants who are being punished for program violations to work in a clinic setting. We want to emphasize that, like the proposal, the final rule makes in-kind restitution the option of the State agency, and not the participant.

Second, commenters asserted that collection efforts should be pursued only to the extent that they are cost-effective. Again, we wish to emphasize that, like the proposal, the final rule requires the State agency to pursue claims collection after the initial letter demanding repayment only to the extent that it is cost-effective. To clarify this point, we added a sentence to require the State agency to establish standards, based on a cost benefit analysis, for determining when collection actions are not longer cost-effective. This provision is the same as in current 7 CFR 246.23(c). One commenter suggested that we establish a $500 threshold for pursuing claims. Although the final rule requires demand letters to be sent out for *all* claims, the State agency could include dollar thresholds for the subsequent steps in the collection process as part of its standards for claims collection.

Six commenters indicated that establishing mandatory restitution for all claims would preclude the State agency from considering the family's ability to pay a claim. Two commenters opposed both requiring participant restitution in all cases and permitting the State agency to force participants to ''work off'' claims resulting from State

agency mistakes. This rule requires claims collection actions only in the case of intentional acts of the participant, parent/caretaker, or proxy. The State agency is not required to assess claims in cases of unintentional participant error or State agency error. Although we believe we need to protect the Program's integrity by pursuing claims resulting from participant violations, we also recognize the financial circumstances of program participants. In the final rule, we balance these considerations by requiring claims collection only in cases of intentional actions that qualify as participant violations and by providing the State agency with the discretion to enter into repayment schedules with participants and to allow in-kind restitution. The final rule also clarifies that the State agency must assess claims for both benefits that have been obtained improperly and disposed of improperly. Benefits that have been disposed of improperly include exchanging food instruments for cash or credit or selling supplemental foods that were obtained with food instruments.

One of the supporting commenters suggested permitting collection through offset of future program benefits, provided that the participant agrees to this arrangement. Section 17(f)(14) of the CNA requires overissuances of food benefits resulting from intentional actions to be collected in cash. Therefore, this rule does not permit collection through offset.

14. Home Food Delivery Systems and Direct Distribution Food Delivery Systems (§§ 246.2, 246.12(m), 246.12(n), 246.12(o), and 246.12(s))

Only one commenter opposed our proposed amendments to the provisions concerning home food delivery and direct distribution food delivery systems. The commenter suggested that home food delivery systems be categorically banned and that we grandfather in State agencies that currently operate such systems. Although most State agencies currently operate retail food delivery systems and we encourage their use, we did not propose to eliminate home food delivery systems and do not want to limit the options available to the State agency at this time. For this reason, we adopted the proposed amendments to the home food delivery and direct distribution food delivery systems with minor revisions to make them consistent with changes made by this rule.

15. General Requirements for Food Delivery Systems

a. Food Delivery System Contracts Must Conform with 7 CFR Part 3016 (§ 246.12(a)(4))

We proposed to retain the requirement that all contracts or agreements entered into by the State or local agency for the management or operation of food delivery systems must be in conformance with the requirements of 7 CFR Part 3016. Part 3016 sets forth the general requirements applicable to grants to State and local governments. One of the three supporting commenters suggested that we delete the reference to contracts or agreements entered into by the local agency, in light of the requirement in § 246.12(h)(1) that all vendor agreements must be entered into by the State agency. We retained the reference to local agencies because this provision covers home food delivery and direct distribution contracts as well as vendor agreements.

b. No Charge for Authorized Supplemental Foods (§ 246.12(c) and (h)(3)(x))

Currently, 7 CFR 246.12(c) reads: ''Participants shall receive the Program's supplemental foods free of charge.'' We proposed to amend this provision to read: ''State and local agencies shall provide participants the Program's supplemental foods free of charge.'' Our intent with this change was to make clear that the burden was on State and local agencies to ensure that supplemental foods are provided to participants free of charge, regardless of whether they are provided through a home food delivery system, direct distribution food delivery system, or retail food delivery system.

One commenter supported this proposed change, whereas another commenter indicated that the proposed language was confusing. Nine commenters opposed the proposed language and recommended that we either retain the language from the current rule or modify the proposed language, because the proposal makes it sound as if State and local agencies provide supplemental foods directly to participants. To address the commenters' concerns and to clarify our intent, we amended this provision to read: ''The State agency must ensure that participants receive their authorized supplemental foods free of charge.'' We also added a sentence to § 246.12(h)(3)(x) to require the vendor agreement to include a provision that the vendor may not charge participants, parents or caretakers of infant and child participants, or proxies for authorized supplemental foods obtained with food instruments.

16. Vendor Management Staffing (§ 246.3(e)(5))

Commenters were split about evenly on the merits of the proposed provision that would require State agencies with more than fifty vendors to employ one full-time or equivalent vendor management specialist. Supporters noted that the provision would ensure that resources are allocated to vendor management and that they would be surprised if there was any resistance to the provision. Those who opposed the proposed provision indicated that: there is no evidence that relates vendor staffing equivalents to desired outcomes; centralization of vendor management functions to one position is not cost-effective; the provision would create an inequitable burden on small State agencies; and the requirement would result in a diversion of resources from client services and local agencies. Two commenters noted that some State agencies might circumvent this staffing requirement either by limiting the number of vendors they authorize to fewer than fifty or by modifying their position descriptions to meet the requirement without making any meaningful change in responsibilities.

As a compromise, two commenters suggested that we modify the provision to require the State agency to designate a staff person responsible for vendor management and place all vendor management functions under the direct supervision of this person. Another commenter noted that State agencies are responsive to our use of State Technical Assistance Review (STAR) findings to cite staffing needs, which allows for more flexibility in small State agencies. We believe it is essential that each State agency have at least one staff member who is knowledgeable about its entire food delivery system, who thoroughly understands the regulations and policies regarding vendor management, and who can be held accountable for resolving issues and problems involving the food delivery side of program operations. We accepted the suggested compromise and revised this provision to read: ''A staff person designated for food delivery system management. The person to whom the State agency assigns this responsibility may perform other duties as well.''

17. Participant Access Criteria in State Plan (§ 246.4(a)(14)(xiv))

The proposal contained a provision to require the State agency to include in its State Plan ''[a] description of the State

agency's participant access determination criteria consistent with § 246.12(l)(8).'' Six commenters supported adopting this provision as proposed. One commenter suggested that we modify the provision to allow for some flexibility, because there is no single objective standard that could be applied and defended statewide. Another commenter opposed the provision, unless it is modified to read: ''A statement that the State agency uses or does not use a 'participant access policy' to assist in the determination of vendor participation in the WIC Program.'' A third commenter opposed including the participant access determination criteria in the State Plan, because participant access must be determined on a case-by-case basis and each community requires different criteria. We believe it is necessary for the State agency to include its participant access determination criteria in its State Plan because the State agency's participant access determinations are not subject to administrative review. The State Plan approval process provides the public with an opportunity to comment on the criteria the State agency proposes to use to make these determinations. We also made a conforming change to § 246.12(l)(8) to clarify the State agency's responsibility to establish participant access determination criteria.

Section 246.12(l)(8) specifies that, when making participant access determinations, the State agency must consider ''the availability of other authorized vendors in the same area as the violative vendor and any geographic barriers to using such vendors.'' We understand that the various urban, suburban, and rural areas under a State agency's jurisdiction may require the use of different participant access criteria. We do not expect the State agency to be able to include every variation of its criteria in its State Plan. However, we do expect the State agency to include in its State Plan the general criteria that it uses to make its participant access determinations. For instance, a State agency may use such general criteria as: (1) A minimum vendor-to-participant ratio in the local agency or clinic service area; (2) the number of other vendors within a specified distance of the violative vendor, where the distance used depends on whether the area is classified as urban, suburban, or rural; and (3) the existence of any geographical barriers to the other vendors, such as rivers or mountains that increase driving distances to other vendors. None of these criteria specify the actual ratios, numbers, or mileage used by the State agency to make its participant access determinations. However, the criteria do provide the public with some assurance that the State agency's participant access determinations rely on objective measures.

18. Management Evaluations and Monitoring Reviews

a. State Agency Corrective Action Plans (§ 246.19(a)(2))

The majority of commenters supported the proposal to require the State agency to develop a corrective action plan if we make negative findings about its administration of the WIC Program. The specific objections to this provision were that ''negative findings'' is not a precise enough standard, 60 days are not long enough to develop a corrective action plan, and some negative findings may be too minor to warrant a corrective action plan.

Although ''negative findings'' is a frequently used term in audits and evaluations, we revised this provision to say ''findings that the State agency did not comply with agency program requirements.'' With respect to the concern about the timeframe, we want to point out that the 60-day period is not the period during which corrective action must be taken, but just the period during which a corrective action plan, outlining the corrective action to be taken, must be developed and submitted. In addition, even findings that are easily corrected must be documented in the corrective action plan. In many cases, the State agency will be able to describe corrective action that it already took in response to such findings.

Several commenters addressed the portion of this provision that is in current regulations concerning the withholding of nutrition services and administration funds for various types of program noncompliance. Those commenters indicated that there needs to be a better definition of the situations in which such withholding may occur and also specific remedial actions that must be taken before such withholding may occur. We do not think it is possible to list more specifically the situations that would trigger withholding. The specific remedial actions will generally be those agreed to in the State agency's corrective action plan.

b. Standard Areas of Review of Local Agencies (§ 246.19(b)(2))

Five of the six commenters supported the minor revisions to the requirements for the areas of local agency activities that the State agency must review. One commenter questioned the meaning of the added area of ''participant services.'' We added this provision to make sure that the State agency evaluates not only certification and nutrition education, but also the many other contacts that local agencies have with participants, such as setting up appointments, issuing food instruments and explaining their use, and referring participants to other health and social services.

Another commenter suggested that the State agency's review of vendor training conducted by its local agencies be limited to verifying whether the training was conducted, and not the effectiveness of the training. Although we agree that it can sometimes be difficult to determine the effectiveness of training, we believe it is critical that any State agency that delegates training activities look closely at the content of the training and any vendor feedback on the training. In recognition of the new provision in § 246.12(h)(1)(ii) that permits the State agency to delegate signing of vendor agreements to its local agencies, we also added a provision to this section requiring the State agency to review the local agencies' effectiveness in conducting this activity.

c. Areas of In-Depth Review of Local Agencies (§ 246.19(b)(5))

The majority of commenters opposed the proposal to require the State agency to conduct in-depth reviews of specified areas of local agency operations during monitoring reviews when requested to do so by us. Commenters both pro and con were confused about whether these focused reviews would be a part of, or in addition to, the currently required monitoring reviews. Three local agency commenters indicated that in-depth reviews are not necessary, because local agencies are already subject to State and Federal monitoring, almost to the point of over-evaluation.

First, we want to clarify that the in-depth review of these areas would be a part of the regular monitoring reviews of local agencies and would be an area of focus within the standard areas required to be reviewed. Second, we do not expect that we would routinely specify focused areas for review. Instead, we would use this when necessary to get a better understanding of a particular aspect of local agency operations or to monitor compliance with a particular

program requirement that has been identified as a problem area nationally.

Several commenters expressed concern that adding these areas of in-depth review would further strain the limited State agency resources available for local agency reviews. To address this concern, one commenter suggested that we drop one area that would normally be required to be covered in the review in years in which an in-depth review is required. Another commenter suggested that we limit areas of in-depth review to no more than two areas every other year in order to limit the burden and to conform to the two-year cycle for local agency reviews. We recognize the additional work that may be required to conduct in-depth review of a particular area. As a result, we proposed to limit the number of areas to two in any fiscal year and to give at least six months' advance notice. We further revised this provision in the final rule to require that the areas not be added or changed more often than once every two fiscal years. We did not adopt the suggestion that we drop one of the standard areas of review in years in which we require an in-depth review of an area. The areas of in-depth review will be areas of focus within the standard review areas. Further, we believe that requiring review of the standard review areas is critical to ensuring the uniformity of local agency reviews and the effectiveness of program operations.

d. Local Agency Corrective Action Plans (§ 246.19(b)(4))

The majority of the commenters supported the proposal to require local agencies to prepare corrective action plans to address deficiencies identified by the State agency during monitoring reviews. However, many of the commenters recommended that we increase the time for submitting the corrective action plan from 45 days to 60 days. We made this change. We also moved this provision to § 246.19(b)(4) in order to integrate it better with the existing regulatory language requiring the State agency to establish a corrective action process for local agencies. Finally, we revised the wording to parallel the new requirements for State agency corrective action plans.

19. Conflict of Interest (§ 246.12(t) and 246.12(h)(3)(xix))

All the comments on the conflict of interest provision supported the amendment, although some commenters suggested modifications. Most of these comments concerned the need to clarify what is meant by ''conflict of interest.'' One commenter asked whether a conflict of interest exists when a person with a financial interest in a vendor is employed by the WIC Program, but has no involvement in vendor selection or vendor management.

In the preamble to the proposed rule, we stated our view that this is an area which is based more appropriately on State laws or regulations governing conflict of interest. For that reason, we decided not to include a definition of ''conflict of interest'' in the WIC regulations. We continue to believe that the State agency is in the best position to make these determinations, based on its knowledge of the structure of the State agency and the responsibilities of its staff. We did not intend our discussion in the preamble to indicate that no one employed by the State agency could have any financial interest in a vendor. This determination must be made on a case-by-case basis taking into account State laws, regulations, and policies and the particular facts of the situation, such as the size of the financial interest and whether the employee has any responsibilities for vendor selection or management.

One commenter suggested that the provision be amended to prohibit ''known'' conflicts of interest. We did not make this change. This provision is designed to require the State agency to establish standards for avoiding conflicts of interest. These may be actual or apparent conflicts. Just because a State agency does not know of a conflict does not relieve the State agency from the burden of taking the necessary steps to ensure that it avoids such conflicts and to take action when a conflict is discovered.

20. Confidentiality

a. Vendor Information (§ 246.26(e))

We proposed to restrict the use and disclosure of vendor information. The vast majority of the commenters supported the proposal, although several of those who supported the provision recommended modifications. Two commenters questioned how this provision would apply to information requested under State freedom of information acts or other open record laws. These commenters indicated that because the WIC regulations currently are silent on this point some State agencies have had to disclose vendor information under these laws. It is up to the State agency to make sure it complies with all WIC Program requirements and if there is a conflict with State law, to ensure that it takes the necessary steps to remove the conflict. Therefore, we urge the State agency to consult with its legal counsel on the effect of this provision on any State laws concerning public access to State records.

One of the commenters who opposed this provision asserted that, unlike participants, vendors do not have comparable expectations of privacy that justify the creation of new privacy rights. The reason for limiting the use and disclosure of vendor information is two-fold—to encourage vendors to provide the information necessary to authorize and monitor vendors and to avoid compromising State agency investigative techniques. We believe that these benefits outweigh the commenter's concern.

The other commenter who opposed this provision suggested that applicant vendors be allowed full access to information concerning an adverse action against them. In the proposal, we specified that the State agency could disclose confidential vendor information to appellant vendors to the extent that the information provided the basis of an action under review. However, this comment pointed out to us that we needed to broaden and clarify this category of disclosure in order to take into account those adverse actions that are not subject to administrative review, such as claims. The final rule permits disclosure of confidential vendor information to a vendor that is subject to an adverse action, including claims, to the extent that the information concerns the vendor subject to the adverse action and the information to be disclosed is related to the adverse action.

Some commenters suggested we clarify that vendor information may be disclosed to other WIC State agencies. As noted in the preamble to the proposed rule, other WIC State agencies would be authorized to receive vendor information. They fall in the category of persons directly connected with the administration or enforcement of a Federal law (i.e., the Child Nutrition Act, which authorizes the WIC Program). In order to avoid confusion, we revised this provision to list separately the use and disclosure of confidential vendor information to personnel directly connected with the administration and the enforcement of the WIC Program and Food Stamp Program who the State determines have a need to know for the purposes of these programs. In addition, we listed personnel from WIC local agencies and other WIC Sate agencies and persons investigating or prosecuting WIC Program or FSP violations as examples of the persons who fall in this category.

One commenter objected to the requirement for a written agreement as administratively unworkable,

particularly within the short timeframes for vendor administrative reviews. We assume the commenter was referring to situations in which the administrative reviews are conducted for the WIC State agency by another agency of the State and the commenter's perception that a written agreement would be required before disclosing vendor information to the agency providing the administrative review. We revised this provision to clarify that written agreements are not required prior to disclosing confidential vendor information for purposes of WIC Program and Food Stamp Program administration, which includes administrative reviews.

Further, in any situations in which the State agency needs to disclose confidential vendor information on a regular basis for other permitted purposes, the State agency may enter into a single written agreement that generically covers the disclosure and use of confidential vendor information for such activities. Individual agreements for each disclosure of information are not necessary.

One commenter suggested that we give the State agency the discretion to release non-proprietary vendor information to the extent that the State agency determines the disclosure to be for the benefit of the Program. We think that this approach is overly complicated and did not accept this suggestion.

We did revise this provision in the final rule to clarify that only information that individually identifies a vendor (other than its name, address, and authorization status) is considered confidential. Aggregate data about vendors and other data that does not individually identify a vendor are not subject to these limitations on use and disclosure. This change addresses a commenter who requested that we permit redemption data to be used in community meetings as part of program outreach and expansion. Putting this data in aggregate or other forms that does not identify the vendor should serve this purpose.

b. Food Stamp Program Retailer Information (§ 246.26(f))

Commenters generally supported the proposal to restrict the use and disclosure of FSP retailer information to persons directly connected with the administration or enforcement of the WIC Program. The one opposing comment questioned whether vendor information should be afforded any confidentiality. As noted in the preamble to the proposed rule, section 9(c) of the Food Stamp Act of 1977, as amended, 7 U.S.C. 2011–2036 (Food Stamp Act) (7 U.S.C. 2018(c)) specifically restricts the use and disclosure of information obtained from FSP retailers to two areas: (1) Federal and State law enforcement and investigative agencies for the purposes of administering or enforcing any Federal or State law or implementing regulations; and (2) WIC State agencies for the purposes of administering the Child Nutrition Act and implementing regulations. Therefore, we must retain the proposed restriction on the use of information obtained from FSP retailers. The preamble to the proposed rule also discussed the need to restrict the use of information obtained from the FSP even when it is not protected under section 9(c) of the Food Stamp Act. Subsequently, we realized that the regulatory language in the proposed rule was not clear on this point. This final rule revises proposed § 246.26(f) to clarify that all information obtained from the FSP may be used only in the administration or enforcement of the WIC Program.

c. Access by USDA and Comptroller General of the United States (§ 246.26(g))

This final rule also clarifies that the confidentiality provisions do not relieve the State agency of its responsibility to provide USDA and the Comptroller General of the United States access to all program records pursuant to § 246.25(a)(4). We added a new paragraph (g) to § 246.26 to this effect.

21. References

(1) WIC State Agency Guide to Vendor Monitoring and Fraud and Abuse Control: Grant No. FNS–59–3198–0–96 (April 1982). Prepared by Arthur W. Burger and Steven Stollmack, ANALOGS, Incorporated. This study identifies methods for reducing vendor fraud and abuse in the WIC Program.

(2) Applied Research on Vendor Abuse: Grant No. FNS–59–3198–1–117 (June 1985). Produced by David Kornetsky, Nancy Wogman, and the Massachusetts WIC Program. This study worked with a consortium of ten States to design a high-risk vendor identification system.

(3) WIC Compliance Buy Handbook: produced by the USDA, June 1985. This handbook provides guidance for State agencies in conducting WIC compliance investigations.

(4) National Vendor Audit: Audit Report 27661–2–Ch, Special Supplemental Food Program for Women, Infants and Children—Vendor Monitoring and Food Instrument Delivery Systems, June 15, 1988. Conducted by the Office of Inspector General (OIG), U.S. Department of Agriculture.

(5) Vendor Management Study (1990): Contract No. 53–3198–5–33 (December 1990). Conducted for FNS by Professional Management Associates. This study surveyed the 50 geographic WIC State agencies and the District of Columbia, excluding Vermont and Mississippi, which provide benefits exclusively through home food delivery and direct distribution, respectively.

(6) WIC Vendor Issues Study: Contract No. 53–3198–9–53 (May 1991). Conducted for FNS by Aspen Systems Corporation. This study investigated the extent of program losses due to fraud and regulatory noncompliance from vendor overcharging in the WIC Program.

(7) The WIC Files: Case Studies of Vendor Audits and Investigations in the WIC Program, June 1991. Produced by the vendor managers of Southeast Region in cooperation with the Florida WIC Program.

(8) National Association of WIC Directors (NAWD) National Vendor Management Roundup Survey (1995). This survey, designed by FNS and the NAWD Vendor Committee representatives, provided profile date on State vendor management information systems.

(9) Vendor Activity Monitoring Profile (VAMP) and The Integrity Profile (TIP): VAMP reports produced annually by USDA through 1997 and TIP reports annually thereafter. These reports analyze WIC State agency vendor monitoring activities.

(10) Efforts to Control Fraud and Abuse Can Be Strengthened: GAO/RCED–99–224 (August 1999). Report to Congressional Committees by the United States General Accounting Office (GAO). For its review, GAO collected information, through surveys and interviews, from FNS and State and local WIC agencies on the extent of fraud and abuse in the Program.

List of Subjects in 7 CFR Part 246

Food assistance programs, Food donations, Grant programs—Social programs, Infants and children, Maternal and child health, Nutrition education, Public assistance programs, WIC, Women.

For reasons set forth in the preamble, 7 CFR Part 246 is amended as follows:

PART 246—SPECIAL SUPPLEMENTAL NUTRITION PROGRAM FOR WOMEN, INFANTS AND CHILDREN

1. The authority citation for Part 246 continues to read as follows:

Authority: 42 U.S.C. 1786.

2. In Section 246.2, add in alphabetical order the definitions of *Authorized supplemental foods, Compliance buy, High-risk vendor, Home food delivery contractor, Inventory audit, Participant violation, Price adjustment, Proxy, Routine monitoring, Vendor, Vendor authorization, Vendor limiting criteria, Vendor overcharge, Vendor selection criteria, Vendor violation,* and *WIC* to read as follows:

§ 246.2 Definitions.

* * * * *

Authorized supplemental foods means those supplemental foods authorized by the State or local agency for issuance to a particular participant.

* * * * *

Compliance buy means a covert, on-site investigation in which a representative of the Program poses as a participant, parent or caretaker of an infant or child participant, or proxy, transacts one or more food instruments, and does not reveal during the visit that he or she is a program representative.

* * * * *

High-risk vendor means a vendor identified as having a high probability of committing a vendor violation through application of the criteria established in § 246.12(j)(3) and any additional criteria established by the State agency.

Home food delivery contractor means a sole proprietorship, partnership, cooperative association, corporation, or other business entity that contracts with a State agency to deliver authorized supplemental foods to the residences of participants under a home food delivery system.

* * * * *

Inventory audit means the examination of food invoices or other proofs of purchase to determine whether a vendor has purchased sufficient quantities of supplemental foods to provide participants the quantities specified on food instruments redeemed by the vendor during a given period of time.

* * * * *

Participant violation means any intentional action of a participant, parent or caretaker of an infant or child participant, or proxy that violates Federal or State statutes, regulations, policies, or procedures governing the Program. Participant violations include intentionally making false or misleading statements or intentionally misrepresenting, concealing, or withholding facts to obtain benefits; exchanging food instruments or supplemental foods for cash, credit, non-food items, or unauthorized food items, including supplemental foods in excess of those listed on the participant's food instrument; threatening to harm or physically harming clinic or vendor staff; and dual participation.

* * * * *

Price adjustment means an adjustment made by the State agency, in accordance with the vendor agreement, to the purchase price on a food instrument after it has been submitted by a vendor for redemption to ensure that the payment to the vendor for the food instrument complies with the State agency's price limitations.

* * * * *

Proxy means any person designated by a woman participant, or by a parent or caretaker of an infant or child participant, to obtain and transact food instruments or to obtain supplemental foods on behalf of a participant. The proxy must be designated consistent with the State agency's procedures established pursuant to § 246.12(r)(1). Parents or caretakers applying on behalf of child and infant participants are not proxies.

* * * * *

Routine monitoring means overt, on-site monitoring during which program representatives identify themselves to vendor personnel.

* * * * *

Vendor means a sole proprietorship, partnership, cooperative association, corporation, or other business entity operating one or more stores authorized by the State agency to provide authorized supplemental foods to participants under a retail food delivery system. Each store operated by a business entity constitutes a separate vendor and must be authorized separately from other stores operated by the business entity. Each store must have a single, fixed location, except when the authorization of mobile stores is necessary to meet the special needs described in the State agency's State Plan in accordance with § 246.4(a)(14)(xiv).

Vendor authorization means the process by which the State agency assesses, selects, and enters into agreements with stores that apply or subsequently reapply to be authorized as vendors.

Vendor limiting criteria means criteria established by the State agency to determine the maximum number and distribution of vendors it authorizes pursuant to § 246.12(g)(2).

Vendor overcharge means intentionally or unintentionally charging the State agency more for authorized supplemental foods than is permitted under the vendor agreement. It is not a vendor overcharge when a vendor submits a food instrument for redemption and the State agency makes a price adjustment to the food instrument.

Vendor selection criteria means the criteria established by the State agency to select individual vendors for authorization consistent with the requirements in § 246.12(g)(3).

Vendor violation means any intentional or unintentional action of a vendor's current owners, officers, managers, agents, or employees (with or without the knowledge of management) that violates the vendor agreement or Federal or State statutes, regulations, policies, or procedures governing the Program.

WIC means the Special Supplemental Nutrition Program for Women, Infants and Children authorized by section 17 of the Child Nutrition Act of 1966, 42 U.S.C. 1786.

* * * * *

3. In Section 246.3:

a. Redesignate paragraph (e)(5) as paragraph (e)(6); and

b. Add a new paragraph (e)(5).

The addition reads as follows:

§ 246.3 Administration.

* * * * *

(e) * * *

(5) A staff person designated for food delivery system management. The person to whom the State agency assigns this responsibility may perform other duties as well.

* * * * *

4. In § 246.4:

a. Add a heading to paragraph (a)(14)(i);

b. In paragraph (a)(14)(v), add a heading and remove the reference to ''§ 246.12(k)(1)(i)'' and add a reference to ''§ 246.12(l)(1)(i)'' in its place;

c. Revise paragraphs (a)(14)(ii), (a)(14)(iii), (a)(14)(iv), and (a)(14)(vi);

d. Remove paragraph (a)(14)(vii) and redesignate paragraphs (a)(14)(viii) through (a)(14)(xi) as paragraphs (a)(14)(vii) through (a)(14)(x), respectively;

e. In newly redesignated paragraph (a)(14)(vii), add a heading and remove the words ''food vendors'' and add ''vendors'' in its place;

f. In newly redesignated paragraph (a)(14)(viii), add a heading;

g. In newly redesignated paragraphs (a)(14)(ix) and (a)(14)(x), add headings and remove the periods at the end and add semicolons in their place;

h. Add new paragraphs (a)(14)(xi) through (a)(14)(xiv);

i. Revise the first sentence of paragraph (a)(15); and

j. In paragraph (a)(21), remove the reference to ''§ 246.12(r)(8)'' and add a reference to ''§ 246.12(r)(4)'' in its place.

The revisions and additions read as follows:

§ 246.4 State plan.

(a) * * *

(14) * * *

(i) *Type of system.* * * *

(ii) *Vendor limiting and selection criteria.* Vendor limiting criteria, if used by the State agency, and the vendor selection criteria established by the State agency consistent with the requirements in § 246.12(g)(3);

(iii) *Vendor agreement.* A sample vendor agreement, including the sanction schedule, which may be incorporated as an attachment or, if the sanction schedule is in the State agency's regulations, through citation to the regulations. State agencies that intend to delegate signing of vendor agreements to local agencies must describe the State agency supervision and instruction that will be provided to ensure the uniformity and quality of local agency activities;

(iv) *Vendor monitoring.* The system for monitoring vendors to ensure compliance and prevent fraud, waste, and program noncompliance, and the State agency's plans for improvement in the coming year in accordance with § 246.12(j). The State agency must also include the criteria it will use to determine which vendors will receive routine monitoring visits. State agencies that intend to delegate any aspect of vendor monitoring responsibilities to a local agency or contractor must describe the State agency supervision and instruction that will be provided to ensure the uniformity and quality of vendor monitoring;

(v) *Options regarding trafficking convictions.* * * *

(vi) *Food instruments.* A facsimile of the food instrument, if used, and a description of the system the State agency will use to account for the disposition of food instruments in accordance with § 246.12(q);

(vii) *Names of contractors.* * * *

(viii)*Nutrition services and administration funds conversion.* * * *

(ix) *Homeless participants.* * * *

(x) *Cost containment systems.* * * *

(xi) *Vendor training.* The procedures the State agency will use to train vendors in accordance with § 246.12(i). State agencies that intend to delegate any aspect of training to a local agency, contractor, or vendor representative must describe the State agency supervision and instruction that will be provided to ensure the uniformity and quality of vendor training;

(xii) *Food instrument security.* A description of the State agency's system for ensuring food instrument security in accordance with § 246.12(p);

(xiii) *Participant access determination criteria.* A description of the State agency's participant access determination criteria consistent with § 246.12(l); and

(xiv) *Mobile stores.* The special needs necessitating the authorization of mobile stores, if the State agency chooses to authorize such stores.

(15) The State agency's plans to prevent and identify dual participation in accordance with § 246.7(l)(1)(i) and (l)(1)(ii). * * *

* * * * *

5. In § 246.7:

a. In paragraph (f)(2)(iv), remove the reference to ''§ 246.12(r)(8)'' and add a reference to ''§ 246.12(r)(4)'' in its place;

b. In paragraph (h)(1)(i), remove the reference to ''§ 246.12(k)(2)'' and add the words ''the definition of *Participant violation* in § 246.2'' in its place; and

c. Revise paragraph (l)(1).

The revision reads as follows:

§ 246.7 Certification of participants.

* * * * *

(l) * * *

(1) The State agency is responsible for the following:

(i) In conjunction with WIC local agencies, the prevention and identification of dual participation within each local agency and between local agencies under the State agency's jurisdiction, including actions to identify suspected instances of dual participation at least semiannually. The State or local agency must take follow-up action within 120 days of detecting instances of suspected dual participation;

(ii) In areas where a local agency serves the same population as an Indian State agency or a CSFP agency, and in areas where geographical or other factors make it likely that participants travel regularly between contiguous local service areas located across State agency borders, entering into an agreement with the other agency for the detection and prevention of dual participation. The agreement must be made in writing and included in the State Plan;

(iii) Immediate termination from participation in one of the programs or clinics for participants found in violation due to dual participation; and

(iv) In cases of dual participation resulting from intentional misrepresentation, the collection of improperly issued benefits in accordance with § 246.23(c)(1) and disqualification from both programs in accordance with § 246.12(u)(2).

* * * * *

6. Revise § 246.12 to read as follows:

§ 246.12 Food delivery systems.

(a) *General.* This section sets forth design and operational requirements for food delivery systems. In recognition of emergent electronic benefits transfer (EBT) technology, FNS may, on a case-by-case basis, modify regulatory provisions to the extent FNS determines the particular EBT system provides adequate safeguards that serve the purpose of the provisions being modified.

(1) *Management.* The State agency is responsible for the fiscal management of, and accountability for, food delivery systems under its jurisdiction. The State agency may permit only authorized vendors, home food delivery contractors, and direct distribution sites to accept food instruments.

(2) *Design.* The State agency must design all food delivery systems to be used by its local agencies.

(3) *FNS oversight.* FNS may, for a stated cause and by written notice, require revision of a proposed or operating food delivery system and will allow a reasonable time for the State agency to effect such a revision.

(4) *Part 3016.* All contracts or agreements entered into by the State or local agency for the management or operation of food delivery systems must conform to the requirements of Part 3016 of this title.

(b) *Uniform food delivery systems.* The State agency may operate up to three types of food delivery systems under its jurisdiction—retail, home delivery, or direct distribution. Each system must be procedurally uniform throughout the jurisdiction of the State agency and must ensure adequate participant access to supplemental foods. When used, food instruments must be uniform within each type of system.

(c) *No charge for authorized supplemental foods.* The State agency must ensure that participants receive their authorized supplemental foods free of charge.

(d) *Compatibility of food delivery system.* The State agency must ensure that the food delivery system(s) selected is compatible with the delivery of health and nutrition education services to participants.

(e) *Retail food delivery systems: General.* Retail food delivery systems are systems in which participants, parents or caretakers of infant and child

participants, and proxies obtain authorized supplemental foods by submitting a food instrument to an authorized vendor.

(f) *Retail food delivery systems: Food instrument requirements.* (1) *General.* State agencies using retail food delivery systems must use food instruments that comply with the requirements of paragraph (f)(2) of this section.

(2) *Printed food instruments.* Each printed food instrument must clearly bear on its face the following information:

(i) *Authorized supplemental foods.* The supplemental foods authorized to be obtained with the food instrument;

(ii) *First date of use.* The first date on which the food instrument may be used to obtain supplemental foods;

(iii) *Last date of use.* The last date on which the food instrument may be used to obtain authorized supplemental foods. This date must be a minimum of 30 days from the first date on which it may be used, except for the participant's first month of issuance, when it may be the end of the month or cycle for which the food instrument is valid. Rather than entering a specific last date of use on each instrument, all instruments may be printed with a notice that the participant must transact them within a specified number of days after the first date on which the food instrument may be used;

(iv) *Redemption period.* The date by which the vendor must submit the food instrument for redemption. This date must be no more than 90 days from the first date on which the food instrument may be used. If the date is fewer than 90 days, then the State agency must ensure that the allotted time provides the vendor sufficient time to submit the food instrument for redemption without undue burden;

(v) *Serial number.* A unique and sequential serial number;

(vi) *Purchase price.* A space for the purchase price to be entered. At the discretion of the State agency, a maximum price may be printed on the food instrument that is higher than the expected purchase price of the authorized supplemental foods for which it will be used, but that is low enough to protect against potential loss of funds. When a maximum price is printed on the food instrument, the space for the purchase price must be clearly distinguishable from the maximum price. For example, the words ''purchase price'' or ''actual amount of sale'' could be printed larger and in a different area of the food instrument than the maximum price; and

(vii) *Signature space.* A space where participants, parents or caretakers of infant or child participants, or proxies must sign.

(3) *Vendor identification.* The State agency must implement procedures to ensure each food instrument submitted for redemption can be identified by the vendor that submitted the food instrument. Each vendor operated by a single business entity must be identified separately. The State agency may identify vendors by requiring that all authorized vendors stamp their names and/or enter a vendor identification number on all food instruments prior to submitting them for redemption.

(g) *Retail food delivery systems: Vendor authorization.* (1) *General.* The State agency must authorize an appropriate number and distribution of vendors in order to ensure adequate participant access to supplemental foods and to ensure effective State agency management, oversight, and review of its authorized vendors.

(2) *Vendor limiting criteria.* The State agency may establish criteria to limit the number of stores it authorizes. The State agency must apply its limiting criteria consistently throughout its jurisdiction. Any vendor limiting criteria used by the State agency must be included in the State Plan in accordance with § 246.4(a)(14)(ii).

(3) *Vendor selection criteria.* The State agency must develop and implement criteria to select stores for authorization. The State agency must apply its selection criteria consistently throughout its jurisdiction. The State agency may reassess any authorized vendor at any time during the vendor's agreement period using the vendor selection criteria in effect at the time of the reassessment and must terminate the agreements with those vendors that fail to meet them. The vendor selection criteria must include the following categories and requirements and must be included in the State Plan in accordance with § 246.4(a)(14)(ii).

(i) *Competitive price and price limitations.* The State agency must consider the prices a vendor applicant charges for supplemental foods as compared to the prices charged by other vendor applicants and authorized vendors. The State agency may evaluate a vendor applicant based on its shelf prices or on the prices it bids for supplemental foods, which may not exceed its shelf prices. The State agency must also establish price limitations on the amount that it will pay vendors. The price limitations must be designed to ensure that the State agency does not pay a vendor at a level that would otherwise make the vendor ineligible for authorization. The State agency may establish different competitive price requirements and price limitations for different vendor peer groups, may include a factor to reflect fluctuations in wholesale prices in its price limitations, and may except pharmacy vendors that supply only exempt infant formula and/or WIC-eligible medical foods from both the competitive price selection criterion and the price limitations.

(ii) *Minimum variety and quantity of supplemental foods.* The State agency must establish minimum requirements for the variety and quantity of supplemental foods that a vendor applicant must stock to be authorized. The State agency may not authorize a vendor applicant unless it determines that the vendor applicant meets these minimums. The State agency may establish different minimums for different vendor peer groups.

(iii) *Business integrity.* The State agency must consider the business integrity of a vendor applicant. In determining the business integrity of a vendor applicant, the State agency may rely solely on facts already known to it and representations made by the vendor applicant on its vendor application. The State agency is not required to establish a formal system of background checks for vendor applicants. Unless denying authorization of a vendor applicant would result in inadequate participant access, the State agency may not authorize a vendor applicant if during the last six years the vendor applicant or any of the vendor applicant's current owners, officers, or managers have been convicted of or had a civil judgment entered against them for any activity indicating a lack of business integrity. Activities indicating a lack of business integrity include fraud, antitrust violations, embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, receiving stolen property, making false claims, and obstruction of justice. The State agency may add other types of convictions or civil judgments to this list.

(iv) *Current Food Stamp Program disqualification or civil money penalty for hardship.* Unless denying authorization of a vendor applicant would result in inadequate participant access, the State agency may not authorize a vendor applicant that is currently disqualified from the Food Stamp Program or that has been assessed a Food Stamp Program civil money penalty for hardship and the disqualification period that would otherwise have been imposed has not expired.

(4) *On-site preauthorization visit.* The State agency must conduct an on-site

visit prior to or at the time of a vendor's initial authorization.

(5) *Sale of store to circumvent WIC sanction.* The State agency may not authorize a vendor applicant if the State agency determines the store has been sold by its previous owner in an attempt to circumvent a WIC sanction. The State agency may consider such factors as whether the store was sold to a relative by blood or marriage of the previous owner(s) or sold to any individual or organization for less than its fair market value.

(6) *Impact on small businesses.* The State agency is encouraged to consider the impact of authorization decisions on small businesses.

(7) *Application periods.* The State agency may limit the periods during which applications for vendor authorization will be accepted and processed, except that applications must be accepted and processed at least once every three years. The State agency must develop procedures for processing vendor applications outside of its timeframes when it determines there will be inadequate participant access unless additional vendors are authorized.

(8) *Data collection at authorization.* At the time of application, the State agency must collect the vendor applicant's Food Stamp Program authorization number if the vendor applicant is authorized in that program. In addition, the State agency must collect the vendor applicant's current shelf prices for supplemental foods.

(h) *Retail food delivery systems: Vendor agreements.* (1) *General.* (i) *Entering into agreements.* The State agency must enter into written agreements with all authorized vendors. The agreements must be for a period not to exceed three years. The agreement must be signed by a representative who has legal authority to obligate the vendor and a representative of the State agency. When the vendor representative is obligating more than one vendor, the agreement must specify all vendors covered by the agreement. When more than one vendor is specified in the agreement, the State agency may add or delete an individual vendor without affecting the remaining vendors. The State agency must require vendors to reapply at the expiration of their agreements and must provide vendors with not less than 15 days advance written notice of the expiration of their agreements.

(ii) *Delegation to local agencies.* The State agency may delegate to its local agencies the authority to sign vendor agreements if the State agency indicates its intention to do so in its State Plan in accordance with § 246.4(a)(14)(iii). In such cases, the State agency must provide supervision and instruction to ensure the uniformity and quality of local agency activities.

(2) *Standard vendor agreement.* The State agency must use a standard vendor agreement throughout its jurisdiction, although the State agency may make exceptions to meet unique circumstances provided that it documents the reasons for such exceptions.

(3) *Vendor agreement provisions.* The vendor agreement must contain the following specifications, although the State agency may determine the exact wording to be used:

(i) *Acceptance of food instruments.* The vendor may accept food instruments only from participants, parents or caretakers of infant and child participants, or proxies.

(ii) *No substitutions, cash, credit, refunds, or exchanges.* The vendor may provide only the authorized supplemental foods listed on the food instrument. The vendor may not provide unauthorized food items, non-food items, cash, or credit (including rainchecks) in exchange for food instruments. The vendor may not provide refunds or permit exchanges for authorized supplemental foods obtained with food instruments, except for exchanges of an identical authorized supplemental food item when the original authorized supplemental food item is defective, spoiled, or has exceeded its ''sell by,'' ''best if used by,'' or other date limiting the sale or use of the food item. An identical authorized supplemental food item means the exact brand and size as the original authorized supplemental food item obtained and returned by the participant.

(iii) *Treatment of participants, parents/caretakers, and proxies.* The vendor must offer program participants, parents or caretakers of infant of child participants, and proxies the same courtesies offered to other customers.

(iv) *Time periods for transacting food instruments.* The vendor may accept a food instrument only within the specified time period.

(v) *Purchase price on food instruments.* The vendor must ensure that the purchase price is entered on food instruments in accordance with the procedures described in the vendor agreement. The State agency has the discretion to determine whether the vendor or the participant enters the purchase price. The purchase price must include only the authorized supplemental food items actually provided and must be entered on the food instrument before it is signed.

(vi) *Signature on food instruments.* For printed food instruments, the vendor must ensure the participant, parent or caretaker of an infant or child participant, or proxy signs the food instrument in the presence of the cashier. In EBT systems, a Personal Identification Number (PIN) may be used in lieu of a signature.

(vii) *Sales tax prohibition.* The vendor may not collect sales tax on authorized supplemental foods obtained with food instruments.

(viii) *Food instrument redemption.* The vendor must submit food instruments for redemption in accordance with the redemption procedures described in the vendor agreement. The vendor may redeem a food instrument only within the specified time period. As part of the redemption procedures, the State agency may make price adjustments to the purchase price on food instruments submitted by the vendor for redemption to ensure compliance with the price limitations applicable to the vendor.

(ix) *Vendor claims.* When the State agency determines the vendor has committed a vendor violation that affects the payment to the vendor, the State agency will delay payment or establish a claim. The State agency may delay payment or establish a claim in the amount of the full purchase price of each food instrument that contained the vendor overcharge or other error. The State agency will provide the vendor with an opportunity to justify or correct a vendor overcharge or other error. The vendor must pay any claim assessed by the State agency. In collecting a claim, the State agency may offset the claim against current and subsequent amounts to be paid to the vendor. In addition to denying payment or assessing a claim, the State agency may sanction the vendor for vendor overcharges or other errors in accordance with the State agency's sanction schedule.

(x) *No charge for authorized supplemental foods or restitution from participants.* The vendor may not charge participants, parents or caretakers of infant and child participants, or proxies for authorized supplemental foods obtained with food instruments. In addition, the vendor may not seek restitution from these individuals for food instruments not paid or partially paid by the State agency.

(xi) *Training.* At least one representative of the vendor must participate in training annually. Annual vendor training may be provided by the State agency in a variety of formats, including newsletters, videos, and

interactive training. The State agency will have sole discretion to designate the date, time, and location of all interactive training, except that the State agency will provide the vendor with at least one alternative date on which to attend such training.

(xii) *Vendor training of staff.* The vendor must inform and train cashiers and other staff on program requirements.

(xiii) *Accountability for owners, officers, managers, and employees.* The vendor is accountable for its owners, officers, managers, agents, and employees who commit vendor violations.

(xiv) *Monitoring.* The vendor may be monitored for compliance with program requirements.

(xv) *Recordkeeping.* The vendor must maintain inventory records used for Federal tax reporting purposes and other records the State agency may require for the period of time specified by the State agency in the vendor agreement. Upon request, the vendor must make available to representatives of the State agency, the Department, and the Comptroller General of the United States, at any reasonable time and place for inspection and audit, all food instruments in the vendor's possession and all program-related records.

(xvi) *Termination.* The State agency will immediately terminate the agreement if it determines that the vendor has provided false information in connection with its application for authorization. Either the State agency or the vendor may terminate the agreement for cause after providing advance written notice of a period of not less than 15 days to be specified by the State agency.

(xvii) *Change in ownership or location or cessation of operations.* The vendor must provide the State agency advance written notification of any change in vendor ownership, store location, or cessation of operations. In such instances, the State agency will terminate the vendor agreement, except that the State agency may permit vendors to move short distances without terminating the agreement. The State agency has the discretion to determine the length of advance notice required for vendors reporting changes under this provision, whether a change in location qualifies as a short distance, and whether a change in business structure constitutes a change in ownership.

(xviii) *Sanctions.* In addition to claims collection, the vendor may be sanctioned for vendor violations in accordance with the State agency's sanction schedule. Sanctions may include administrative fines, disqualification, and civil money penalties in lieu of disqualification. The State agency does not have to provide the vendor with prior warning that violations were occurring before imposing such sanctions.

(xix) *Conflict of interest.* The State agency will terminate the agreement if the State agency identifies a conflict of interest, as defined by applicable State laws, regulations, and policies, between the vendor and the State agency or its local agencies.

(xx) *Criminal penalties.* A vendor who commits fraud or abuse in the Program is liable to prosecution under applicable Federal, State or local laws. Those who have willfully misapplied, stolen or fraudulently obtained program funds will be subject to a fine of not more than $10,000 or imprisonment for not more than five years or both, if the value of the funds is $100 or more. If the value is less than $100, the penalties are a fine of not more than $1,000 or imprisonment for not more than one year or both.

(xxi) *Not a license/property interest.* The vendor agreement does not constitute a license or a property interest. If the vendor wishes to continue to be authorized beyond the period of its current agreement, the vendor must reapply for authorization. If a vendor is disqualified, the State agency will terminate the vendor's agreement, and the vendor will have to reapply in order to be authorized after the disqualification period is over. In all cases, the vendor's new application will be subject to the State agency's vendor selection criteria and any vendor limiting criteria in effect at the time of the reapplication.

(xxii) *Compliance with vendor agreement, statutes, regulations, policies, and procedures.* The vendor must comply with the vendor agreement and Federal and State statutes, regulations, policies, and procedures governing the Program, including any changes made during the agreement period.

(xxiii) *Nondiscrimination regulations.* The vendor must comply with the nondiscrimination provisions of Departmental regulations (Parts 15, 15a and 15b of this title).

(xxiv) *Compliance with vendor selection criteria.* The vendor must comply with the vendor selection criteria throughout the agreement period, including any changes to the criteria. Using the current vendor selection criteria, the State agency may reassess the vendor at any time during the agreement period. The State agency will terminate the vendor agreement if the vendor fails to meet the current vendor selection criteria.

(xxv) *Reciprocal Food Stamp Program disqualification for WIC Program disqualifications.* Disqualification from the WIC Program may result in disqualification as a retailer in the Food Stamp Program. Such disqualification may not be subject to administrative or judicial review under the Food Stamp Program.

(4) *Purchase price and redemption procedures.* The State agency must describe in the vendor agreement its purchase price and redemption procedures. The redemption procedures must ensure that the State agency does not pay a vendor more than the price limitations applicable to the vendor.

(5) *Sanction schedule.* The State agency must include its sanction schedule in the vendor agreement or as an attachment to it. The sanction schedule must include all mandatory and State agency vendor sanctions and must be consistent with paragraph (l) of this section. If the sanction schedule is in State law or regulations or in a document provided to the vendor at the time of authorization, the State agency instead may include an appropriate cross-reference in the vendor agreement.

(6) *Actions subject to administrative review and review procedures.* The State agency must include the adverse actions a vendor may appeal and those adverse actions that are not subject to administrative review. The State agency also must include a copy of the State agency's administrative review procedures in the vendor agreement or as an attachment to it or must include a statement that the review procedures are available upon request and the applicable review procedures will be provided along with an adverse action subject to administrative review. These items must be consistent with § 246.18. If these items are in State law or regulations or in a document provided to the vendor at the time of authorization, the State agency instead may include an appropriate cross-reference in the vendor agreement.

(7) *Notification of program changes.* The State agency must notify vendors of changes to Federal or State statutes, regulations, policies, or procedures governing the Program before the changes are implemented. The State agency should give as much advance notice as possible.

(i) *Retail food delivery systems: Vendor training.* (1) *General requirements.* The State agency must provide training annually to at least one representative of each vendor. Prior to or at the time of a vendor's initial authorization, and at least once every

three years thereafter, the training must be in an interactive format that includes a contemporaneous opportunity for questions and answers. The State agency must designate the date, time, and location of the interactive training and the audience (e.g., managers, cashiers, etc.) to which the training is directed. The State agency must provide vendors with at least one alternative date on which to attend interactive training. Examples of acceptable vendor training include on-site cashier training, off-site classroom-style train-the-trainer or manager training, a training video, and a training newsletter. All vendor training must be designed to prevent program errors and noncompliance and improve program service.

(2) *Content.* The annual training must include instruction on the purpose of the Program, the supplemental foods authorized by the State agency, the minimum varieties and quantities of authorized supplemental foods that must be stocked by vendors, the procedures for transacting and redeeming food instruments, the vendor sanction system, the vendor complaint process, the claims procedures, and any changes to program requirements since the last training.

(3) *Delegation.* The State agency may delegate vendor training to a local agency, a contractor, or a vendor representative if the State agency indicates its intention to do so in its State Plan in accordance with § 246.4(a)(14)(xi). In such cases, the State agency must provide supervision and instruction to ensure the uniformity and quality of vendor training.

(4) *Documentation.* The State agency must document the content of and vendor participation in vendor training.

(j) *Retail food delivery systems: Monitoring vendors and identifying high-risk vendors.* (1) *General requirements.* The State agency must design and implement a system for monitoring its vendors for compliance with program requirements. The State agency may delegate vendor monitoring to a local agency or contractor if the State agency indicates its intention to do so in its State Plan in accordance with § 246.4(a)(14)(iv). In such cases, the State agency must provide supervision and instruction to ensure the uniformity and quality of vendor monitoring.

(2) *Routine monitoring.* The State agency must conduct routine monitoring visits on a minimum of five percent of the number of vendors authorized by the State agency as of October 1 of each fiscal year in order to survey the types and levels of abuse and errors among authorized vendors and to take corrective actions, as appropriate. The State agency must develop criteria to determine which vendors will receive routine monitoring visits and must include such criteria in its State Plan in accordance with § 246.4(a)(14)(iv).

(3) *Identifying high-risk vendors.* The State agency must identify high-risk vendors at least once a year using criteria developed by FNS and/or other statistically-based criteria developed by the State agency. FNS will not change its criteria more frequently than once every two years and will provide adequate advance notification of changes prior to implementation. The State agency may develop and implement additional criteria. All State agency-developed criteria must be approved by FNS.

(4) *Compliance investigations.* (i) *High-risk vendors.* The State agency must conduct compliance investigations of a minimum of five percent of the number of vendors authorized by the State agency as of October 1 of each fiscal year. The State agency must conduct compliance investigations on all high-risk vendors up to the five percent minimum. The State agency may count toward this requirement a compliance investigation of a high-risk vendor conducted by a Federal, State, or local law enforcement agency. The State agency also may count toward this requirement a compliance investigation conducted by another WIC State agency provided that the State agency implements the option to establish State agency sanctions based on mandatory sanctions imposed by the other WIC State agency, as specified in paragraph (l)(2)(iii) of this section. A compliance investigation of a high-risk vendor may be considered complete when the State agency determines that a sufficient number of compliance buys have been conducted to provide evidence of program noncompliance, when two compliance buys have been conducted in which no program violations are found, or when an inventory audit has been completed.

(ii) *Randomly selected vendors.* If fewer than five percent of the State agency's authorized vendors are identified as high-risk, the State agency must randomly select additional vendors on which to conduct compliance investigations sufficient to meet the five-percent requirement. A compliance investigation of a randomly selected vendor may be considered complete when the State agency determines that a sufficient number of compliance buys have been conducted to provide evidence of program noncompliance, when two compliance buys are conducted in which no program violations are found, or when an inventory audit has been completed.

(iii) *Prioritization.* If more than five percent of the State agency's vendors are identified as high-risk, the State agency must prioritize such vendors so as to perform compliance investigations of those determined to have the greatest potential for program noncompliance and/or loss of funds.

(5) *Monitoring report.* For each fiscal year, the State agency must send FNS a summary of the results of its vendor monitoring containing information stipulated by FNS. The report must be sent by February 1 of the following fiscal year. Plans for improvement in the coming year must be included in the State Plan in accordance with § 246.4(a)(14)(iv).

(6) *Documentation.*

(i) *Monitoring visits.* The State agency must document the following information for all monitoring visits, including routine monitoring visits, inventory audits, and compliance buys:

(A) the date of the monitoring visit, inventory audit, or compliance buy;

(B) the name(s) and signature(s) of the reviewer(s); and

(C) the nature of any problem(s) detected.

(ii) *Compliance buys.* For compliance buys, the State agency must also document:

(A) the date of the buy;

(B) a description of the cashier involved in each transaction;

(C) the types and quantities of items purchased, current shelf prices or prices charged other customers, and price charged for each item purchased, if available. Price information may be obtained prior to, during, or subsequent to the compliance buy; and

(D) the final disposition of all items as destroyed, donated, provided to other authorities, or kept as evidence.

(k) *Retail food delivery systems: Vendor claims.* (1) *System to review food instruments.* The State agency must design and implement a system to review food instruments submitted by vendors for redemption to ensure compliance with the applicable price limitations and to detect questionable food instruments, suspected vendor overcharges, and other errors. This review must examine either all or a representative sample of the food instruments and may be done either before or after the State agency makes payments on the food instruments. The review must include a price comparison or other edit designed to ensure compliance with the applicable price limitations and to assist in detecting vendor overcharges. For printed food instruments, the system also must detect

the following errors: purchase price missing; participant, parent/caretaker, or proxy signature missing; vendor identification missing; food instruments transacted or redeemed after the specified time periods; and, as appropriate, altered purchase price. The State agency must take follow-up action within 120 days of detecting any questionable food instruments, suspected vendor overcharges, and other errors and must implement procedures to reduce the number of errors when possible.

(2) *Delaying payment and establishing a claim.* When the State agency determines the vendor has committed a vendor violation that affects the payment to the vendor, the State agency must delay payment or establish a claim. Such vendor violations may be detected through compliance investigations, food instrument reviews, or other reviews or investigations of a vendor's operations. The State agency may delay payment or establish a claim in the amount of the full purchase price of each food instrument that contained the vendor overcharge or other error.

(3) *Opportunity to justify or correct.* When payment for a food instrument is delayed or a claim is established, the State agency must provide the vendor with an opportunity to justify or correct the vendor overcharge or other error. If satisfied with the justification or correction, the State agency must provide payment or adjust the proposed claim accordingly.

(4) *Timeframe and offset.* The State agency must deny payment or initiate claims collection action within 90 days of either the date of detection of the vendor violation or the completion of the review or investigation giving rise to the claim, whichever is later. Claims collection action may include offset against current and subsequent amounts owed to the vendor.

(5) *Food instruments redeemed after the specified period.* With justification and documentation, the State agency may pay vendors for food instruments submitted for redemption after the specified period for redemption. If the total value of such food instruments submitted at one time exceeds $500.00, the State agency must obtain the approval of the FNS Regional Office before payment.

(l) *Retail food delivery systems: Vendor sanctions*—(1) *Mandatory vendor sanctions*—(i) *Permanent disqualification.* The State agency must permanently disqualify a vendor convicted of trafficking in food instruments or selling firearms, ammunition, explosives, or controlled substances (as defined in section 102 of the Controlled Substances Act (21 U.S.C. 802)) in exchange for food instruments. A vendor is not entitled to receive any compensation for revenues lost as a result of such violation. If reflected in its State Plan, the State agency may impose a civil money penalty in lieu of a disqualification for this violation when it determines, in its sole discretion, and documents that:

(A) Disqualification of the vendor would result in inadequate participant access; or

(B) The vendor had, at the time of the violation, an effective policy and program in effect to prevent trafficking; and the ownership of the vendor was not aware of, did not approve of, and was not involved in the conduct of the violation.

(ii) *Six-year disqualification.* The State agency must disqualify a vendor for six years for:

(A) One incidence of buying or selling food instruments for cash (trafficking); or

(B) One incidence of selling firearms, ammunition, explosives, or controlled substances as defined in 21 U.S.C. 802, in exchange for food instruments.

(iii) *Three-year disqualification.* The State agency must disqualify a vendor for three years for:

(A) One incidence of the sale of alcohol or alcoholic beverages or tobacco products in exchange for food instruments;

(B) A pattern of claiming reimbursement for the sale of an amount of a specific supplemental food item which exceeds the store's documented inventory of that supplemental food item for a specific period of time;

(C) A pattern of vendor overcharges;

(D) A pattern of receiving, transacting and/or redeeming food instruments outside of authorized channels, including the use of an unauthorized vendor and/or an unauthorized person;

(E) A pattern of charging for supplemental food not received by the participant; or

(F) A pattern of providing credit or non-food items, other than alcohol, alcoholic beverages, tobacco products, cash, firearms, ammunition, explosives, or controlled substances as defined in 21 U.S.C. 802, in exchange for food instruments.

(iv) *One-year disqualification.* The State agency must disqualify a vendor for one year for a pattern of providing unauthorized food items in exchange for food instruments, including charging for supplemental foods provided in excess of those listed on the food instrument.

(v) *Second mandatory sanction.* When a vendor, who previously has been assessed a sanction for any of the violations in paragraphs (l)(1)(ii) through (l)(1)(iv) of this section, receives another sanction for any of these violations, the State agency must double the second sanction. Civil money penalties may only be doubled up to the limits allowed under paragraph (l)(1)(x)(C) of this section.

(vi) *Third or subsequent mandatory sanction.* When a vendor, who previously has been assessed two or more sanctions for any of the violations listed in paragraphs (l)(1)(ii) through (l)(1)(iv) of this section, receives another sanction for any of these violations, the State agency must double the third sanction and all subsequent sanctions. The State agency may not impose civil money penalties in lieu of disqualification for third or subsequent sanctions for violations listed in paragraphs (l)(1)(ii) through (l)(1)(iv) of this section.

(vii) *Disqualification based on a Food Stamp Program disqualification.* The State agency must disqualify a vendor who has been disqualified from the Food Stamp Program. The disqualification must be for the same length of time as the Food Stamp Program disqualification, may begin at a later date than the Food Stamp Program disqualification, and is not subject to administrative or judicial review under the WIC Program.

(viii) *Voluntary withdrawal or nonrenewal of agreement.* The State agency may not accept voluntary withdrawal of the vendor from the Program as an alternative to disqualification for the violations listed in paragraphs (l)(1)(i) through (l)(1)(iv) of this section, but must enter the disqualification on the record. In addition, the State agency may not use nonrenewal of the vendor agreement as an alternative to disqualification.

(ix) *Participant access determinations.* Prior to disqualifying a vendor for a Food Stamp Program disqualification pursuant to paragraph (l)(1)(vii) of this section or for any of the violations listed in paragraphs (l)(1)(ii) through (l)(1)(iv) of this section, the State agency must determine if disqualification of the vendor would result in inadequate participant access. The State agency must make the participant access determination in accordance with paragraph (l)(8) of this section. If the State agency determines that disqualification of the vendor would result in inadequate participant access, the State agency must impose a civil money penalty in lieu of disqualification. However, as provided in paragraph (l)(1)(vi) of this section, the State agency may not impose a civil money penalty in lieu of

disqualification for third or subsequent sanctions for violations in paragraphs (l)(1)(ii) through (l)(1)(iv) of this section. The State agency must include documentation of its participant access determination and any supporting documentation in the file of each vendor who is disqualified or receives a civil money penalty in lieu of disqualification.

(x) *Civil money penalty formula.* For each violation subject to a mandatory sanction, the State agency must use the following formula to calculate a civil money penalty imposed in lieu of disqualification:

(A) Determine the vendor's average monthly redemptions for at least the 6-month period ending with the month immediately preceding the month during which the notice of adverse action is dated;

(B) Multiply the average monthly redemptions figure by 10 percent (.10);

(C) Multiply the product from paragraph (l)(1)(x)(B) of this section by the number of months for which the store would have been disqualified. This is the amount of the civil money penalty, provided that the civil money penalty shall not exceed $10,000 for each violation. For a violation that warrants permanent disqualification, the amount of the civil money penalty shall be $10,000. When during the course of a single investigation the State agency determines a vendor has committed multiple violations, the State agency must impose a CMP for each violation. The total amount of civil money penalties imposed for violations investigated as part of a single investigation may not exceed $40,000.

(xi) *Notification to FNS.* The State agency must provide the appropriate FNS office with a copy of the notice of adverse action and information on vendors it has either disqualified or imposed a civil money penalty in lieu of disqualification for any of the violations listed in paragraphs (l)(1)(i) through (l)(1)(iv) of this section. This information must include the name of the vendor, address, identification number, the type of violation(s), and the length of disqualification or the length of the disqualification corresponding to the violation for which the civil money penalty was assessed, and must be provided within 15 days after the vendor's opportunity to file for a WIC administrative review has expired or all of the vendor's WIC administrative reviews have been completed.

(xii) *Multiple violations during a single investigation.* When during the course of a single investigation the State agency determines a vendor has committed multiple violations (which may include violations subject to State agency sanctions), the State agency must disqualify the vendor for the period corresponding to the most serious mandatory violation. However, the State agency must include all violations in the notice of administration action. If a mandatory sanction is not upheld on appeal, then the State agency may impose a State agency-established sanction.

(2) *State agency vendor sanctions.* (i) *General requirements.* The State agency may impose sanctions for vendor violations that are not specified in paragraphs (l)(1)(i) through (l)(1)(iv) of this section as long as such vendor violations and sanctions are included in the State agency's sanction schedule. State agency sanctions may include disqualifications, civil money penalties assessed in lieu of disqualification, and administrative fines. The total period of disqualification imposed for State agency violations investigated as part of a single investigation may not exceed one year. A civil money penalty or fine may not exceed $10,000 for each violation. The total amount of civil money penalties and administrative fines imposed for violations investigated as part of a single investigation may not exceed $40,000.

(ii) *Food Stamp Program civil money penalty for hardship.* The State agency may disqualify a vendor that has been assessed a civil money penalty for hardship in the Food Stamp Program, as provided under § 278.6 of this chapter. The length of such disqualification must correspond to the period for which the vendor would otherwise have been disqualified in the Food Stamp Program. If a State agency decides to exercise this option, the State agency must:

(A) Include notification that it will take such disqualification action in its sanction schedule; and

(B) Determine if disqualification of the vendor would result in inadequate participant access in accordance with paragraph (l)(8) of this section. If the State agency determines that disqualification of the vendor would result in inadequate participant access, the State agency may not disqualify the vendor or impose a civil money penalty in lieu of disqualification. The State agency must include documentation of its participant access determination and any supporting documentation in each vendor's file.

(iii) *A mandatory sanction by another WIC State agency.* The State agency may disqualify a vendor that has been disqualified or assessed a civil money penalty in lieu of disqualification by another WIC State agency for a mandatory vendor sanction. The length of the disqualification must be for the same length of time as the disqualification by the other WIC State agency or, in the case of a civil money penalty in lieu of disqualification assessed by the other WIC State agency, for the same length of time for which the vendor would otherwise have been disqualified. The disqualification may begin at a later date than the sanction imposed by the other WIC State agency. If a State agency decides to exercise this option, the State agency must:

(A) Include notification that it will take such action in its sanction schedule; and

(B) Determine if disqualification of the vendor would result in inadequate participant access in accordance with paragraph (l)(8) of this section. If the State agency determines that disqualification of the vendor would result in inadequate participant access, the State agency must impose a civil money penalty in lieu of disqualification, except that the State agency may not impose a civil money penalty in situations in which the vendor has been assessed a civil money penalty in lieu of disqualification by the other WIC State agency. Any civil money penalty in lieu of disqualification must be calculated in accordance with paragraph (l)(2)(x) of this section. The State agency must include documentation of its participant access determination and any supporting documentation in each vendor's file.

(3) *Prior warning.* The State agency does not have to provide the vendor with prior warning that violations were occurring before imposing any of the sanctions in paragraph (l) of this section.

(4) *Administrative reviews.* The State agency must provide administrative reviews of sanctions to the extent required by § 246.18.

(5) *Installment plans.* The State agency may use installment plans for the collection of civil money penalties and administrative fines.

(6) *Failure to pay a civil money penalty.* If a vendor does not pay, only partially pays, or fails to timely pay a civil money penalty assessed in lieu of disqualification, the State agency must disqualify the vendor for the length of the disqualification corresponding to the violation for which the civil money penalty was assessed (for a period corresponding to the most serious violation in cases where a mandatory sanction included the imposition of multiple civil money penalties as a result of a single investigation).

(7) *Actions in addition to sanctions.* Vendors may be subject to actions in

addition to the sanctions in this section, such as claims pursuant to paragraph (k) of this section and the penalties set forth in § 246.23(c) in the case of deliberate fraud.

(8) *Participant access determination criteria.* The State agency must develop participant access criteria. When making participant access determinations, the State agency must consider the availability of other authorized vendors in the same area as the violative vendor and any geographic barriers to using such vendors.

(9) *Termination of agreement.* When the State agency disqualifies a vendor, the State agency must also terminate the vendor agreement.

(m) *Home food delivery systems.* Home food delivery systems are systems in which authorized supplemental foods are delivered to the participant's home. Home food delivery systems must provide for:

(1) *Procurement.* Procurement of supplemental foods in accordance with § 246.24, which may entail measures such as the purchase of food in bulk lots by the State agency and the use of discounts that are available to States.

(2) *Accountability.* The accountable delivery of authorized supplemental foods to participants. The State agency must ensure that:

(i) Home food delivery contractors are paid only after the delivery of authorized supplemental foods to participants;

(ii) A routine procedure exists to verify the correct delivery of authorized supplemental foods to participants, and, at a minimum, such verification occurs at least once a month after delivery; and

(iii) Records of delivery of supplemental foods and bills sent or payments received for such supplemental foods are retained for at least three years. Federal, State, and local authorities must have access to such records.

(n) *Direct distribution food delivery systems.* Direct distribution food delivery systems are systems in which participants, parents or caretakers of infant or child participants, or proxies pick up authorized supplemental foods from storage facilities operated by the State agency or its local agencies. Direct distribution food delivery systems must provide for:

(1) *Storage and insurance.* Adequate storage and insurance coverage that minimizes the danger of loss due to theft, infestation, fire, spoilage, or other causes;

(2) *Inventory.* Adequate inventory control of supplemental foods received, in stock, and issued;

(3) *Procurement.* Procurement of supplemental foods in accordance with § 246.24, which may entail measures such as purchase of food in bulk lots by the State agency and the use of discounts that are available to States;

(4) *Availability.* The availability of program benefits to participants and potential participants who live at great distance from storage facilities; and

(5) *Accountability.* The accountable delivery of authorized supplemental foods to participants.

(o) *Participant, parent/caretaker, proxy, vendor, and home food delivery contractor complaints.* The State agency must have procedures to document the handling of complaints by participants, parents or caretakers of infant or child participants, proxies, vendors, home food delivery contractors, and direct distribution contractors. Complaints of civil rights discrimination must be handled in accordance with § 246.8(b).

(p) *Food instrument security.* The State agency must develop standards for ensuring the security of food instruments from the time the food instruments are created to the time they are issued to participants, parents/caretakers, or proxies. For pre-printed food instruments, these standards must include maintenance of perpetual inventory records of food instruments throughout the State agency's jurisdiction; monthly physical inventory of food instruments on hand throughout the State agency's jurisdiction; reconciliation of perpetual and physical inventories of food instruments; and maintenance of all food instruments under lock and key, except for supplies needed for immediate use. For EBT and print-on-demand food instruments, the standards must provide for the accountability and security of the means to manufacture and issue such food instruments.

(q) *Food instrument disposition.* The State agency must account for the disposition of all food instruments as either issued or voided, and as either redeemed or unredeemed. Redeemed food instruments must be identified as validly issued, lost, stolen, expired, duplicate, or not matching valid enrollment and issuance records. In an EBT system, evidence of matching redeemed food instruments to valid enrollment and issuance records may be satisfied through the linking of the Primary Account Number (PAN) associated with the electronic transaction to valid enrollment and issuance records. This process must be performed within 150 days of the first valid date for participant use of the food instruments and must be conducted in accordance with the financial management requirements of § 246.13. The State agency will be subject to claims as outlined in § 246.23(a)(4) for redeemed food instruments that do not meet the conditions established in paragraph (q) of this section.

(r) *Issuance of food instruments and authorized supplemental foods.* The State agency must:

(1) *Parents/caretakers and proxies.* Establish uniform procedures that allow parents and caretakers of infant and child participants and proxies to obtain and transact food instruments or obtain authorized supplemental foods on behalf of a participant. In determining whether a particular participant or parent/caretaker should be allowed to designate a proxy or proxies, the State agency must require the local agency or clinic to consider whether adequate measures can be implemented to provide nutrition education and health care referrals to that participant or, in the case of an infant or child participant, to the participant's parent or caretaker;

(2) *Signature requirement.* Ensure that the participant, parent or caretaker of an infant or child participant, or proxy signs for receipt of food instruments or authorized supplemental foods, except as provided in paragraph (r)(4) of this section;

(3) *Instructions.* Ensure that participants, parents or caretakers of infant and child participants, and proxies receive instructions on the proper use of food instruments, or on the procedures for obtaining authorized supplemental foods when food instruments are not used. The State agency must also ensure that participants, parents or caretakers of infant and child participants, and proxies are notified that they have the right to complain about improper vendor and home food delivery contractor practices with regard to program responsibilities;

(4) *Food instrument pick up.* Require participants, parents and caretakers of infant and child participants, and proxies to pick up food instruments in person when scheduled for nutrition education or for an appointment to determine whether participants are eligible for a second or subsequent certification period. However, in all other circumstances the State agency may provide for issuance through an alternative means such as EBT or mailing, unless FNS determines that such actions would jeopardize the integrity of program services or program accountability. If a State agency opts to mail food instruments, it must provide justification, as part of its alternative issuance system in its State Plan, as

required in § 246.4(a)(21), for mailing food instruments to areas where food stamps are not mailed. State agencies that opt to mail food instruments must establish and implement a system that ensures the return of food instruments to the State or local agency if a participant no longer resides or receives mail at the address to which the food instruments were mailed; and

(5) *Maximum issuance of food instruments.* Ensure that no more than a three-month supply of food instruments or a one-month supply of authorized supplemental foods is issued at any one time to any participant, parent or caretaker of an infant or child participant, or proxy.

(s) *Payment to vendors and home food delivery contractors.* The State agency must ensure that vendors and home food delivery contractors are paid promptly. Payment must be made within 60 days after valid food instruments are submitted for redemption. Actual payment to vendors and home food delivery contractors may be made by local agencies.

(t) *Conflict of interest.* The State agency must ensure that no conflict of interest exists, as defined by applicable State laws, regulations, and policies, between the State agency and any vendor or home food delivery contractor, or between any local agency and any vendor or home food delivery contractor under its jurisdiction.

(u) *Participant violations and sanctions.* (1) *General requirements.* The State agency must establish procedures designed to control participant violations. The State agency also must establish sanctions for participant violations. Participant sanctions may include disqualification from the Program for a period of up to one year.

(2) *Mandatory disqualification.* (i) *General.* Except as provided in paragraphs (u)(2)(ii) and (u)(2)(iii) of this section, whenever the State agency assesses a claim of $100 or more, assesses a claim for dual participation, or assess a second or subsequent claim of any amount, the State agency must disqualify the participant for one year.

(ii) *Exceptions to mandatory disqualification.* The State agency may decide not to impose a mandatory disqualification if, within 30 days of receipt of the letter demanding repayment, full restitution is made or a repayment schedule is agreed on, or, in the case of a participant who is an infant, child, or under age 18, the State or local agency approves the designation of a proxy.

(iii) *Terminating a mandatory disqualification.* The State agency may permit a participant to reapply for the Program before the end of a mandatory disqualification period if full restitution is made or a repayment schedule is agreed upon or, in the case of a participant who is an infant, child, or under age 18, the State or local agency approves the designation of a proxy.

(3) *Warnings before sanctions.* The State agency may provide warnings before imposing participant sanctions.

(4) *Fair hearings.* At the time the State agency notifies a participant of a disqualification, the State agency must advise the participant of the procedures to follow to obtain a fair hearing pursuant to § 246.9.

(5) *Referral to law enforcement authorities.* When appropriate, the State agency must refer vendors, home food delivery contractors, and participants who violate program requirements to Federal, State, or local authorities for prosecution under applicable statutes.

7. Revise § 246.13(h) to read as follows:

§ 246.13 Financial management system.

* * * * *

(h) *Adjustment of expenditures.* The State agency must adjust projected expenditures to account for redeemed food instruments and for other changes as appropriate.

* * * * *

8. In § 246.14:

a. Revise paragraph (b)(2); and

b. In paragraph (e)(3)(i), remove the reference to ''§ 246.12(r)(5)(iii)'' and add a reference to ''§ 246.12(k)(3)'' in its place.

The revision reads as follows:

§ 246.14 Program costs.

* * * * *

(b) * * *

(2) For costs to be allowable, the State agency must ensure that food costs do not exceed the customary sales price charged by the vendor, home food delivery contractor, or supplier in a direct distribution food delivery system. In addition, food costs may not exceed the price limitations applicable to the vendor.

* * * * *

9. Revise § 246.18 to read as follows:

§ 246.18 Administrative review of State agency actions.

(a) *Adverse actions subject to administrative reviews.* (1) *Vendor appeals.* (i) *Adverse actions subject to full administrative reviews.* Except as provided elsewhere in paragraph (a)(1) of this section, the State agency must provide full administrative reviews to vendors that appeal the following adverse actions:

(A) denial of authorization based on the vendor selection criteria for competitive price or for minimum variety and quantity of authorized supplemental foods (§ 246.12(g)(3)(i) and (g)(3)(ii)) or on a determination that the vendor is attempting to circumvent a sanction (§ 246.12(g)(4));

(B) termination of an agreement for cause;

(C) disqualification; and

(D) imposition of a fine or a civil money penalty in lieu of disqualification.

(ii) *Adverse actions subject to abbreviated administrative reviews.* The State agency must provide abbreviated administrative reviews to vendors that appeal the following adverse actions, unless the State agency decides to provide full administrative reviews for any of these types of adverse actions:

(A) denial of authorization based on the vendor selection criteria for business integrity or for a current Food Stamp Program disqualification or civil money penalty for hardship (§ 246.12(g)(3)(iii) and (g)(3)(iv));

(B) denial of authorization based on a State agency-established vendor selection criterion if the basis of the denial is a WIC vendor sanction or a Food Stamp Program withdrawal of authorization or disqualification;

(C) denial of authorization based on the State agency's vendor limiting criteria (§ 246.12(g)(2));

(D) denial of authorization because a vendor submitted its application outside the timeframes during which applications are being accepted and processed as established by the State agency under § 246.12(g)(7);

(E) termination of an agreement because of a change in ownership or location or cessation of operations (§ 246.12(h)(3)(xvii));

(F) disqualification based on a trafficking conviction (§ 246.12(l)(1)(i));

(G) disqualification based on the imposition of a Food Stamp Program civil money penalty for hardship (§ 246.12(l)(2)(ii)); and

(H) disqualification or a civil money penalty imposed in lieu of disqualification based on a mandatory sanction imposed by another WIC State agency (§ 246.12(l)(2)(iii)).

(iii) *Actions not subject to administrative reviews.* The State agency may not provide administrative reviews pursuant to this section to vendors that appeal the following actions:

(A) the validity or appropriateness of the State agency's vendor limiting or selection criteria (§ 246.12(g)(2) and (g)(3));

(B) the validity or appropriateness of the State agency's participant access criteria and the State agency's participant access determinations;

(C) the State agency's determination whether a vendor had an effective policy and program in effect to prevent trafficking and that the ownership of the vendor was not aware of, did not approve of, and was not involved in the conduct of the violation (§ 246.12(l)(1)(i)(B));

(D) denial of authorization if the State agency's vendor authorization is subject to the procurement procedures applicable to the State agency;

(E) the expiration of a vendor's agreement;

(F) disputes regarding food instrument payments and vendor claims (other than the opportunity to justify or correct a vendor overcharge or other error, as permitted by § 246.12(k)(3); and

(G) disqualification of a vendor as a result of disqualification from the Food Stamp Program (§ 246.12(l)(1)(vii)).

(2) *Effective date of adverse actions against vendors.* The State agency must make denials of authorization and disqualifications imposed under § 246.12(l)(1)(i) effective on the date of receipt of the notice of adverse action. The State agency must make all other adverse actions effective no earlier than 15 days after the date of the notice of the adverse action and no later than 90 days after the date of the notice of adverse action or, in the case of an adverse action that is subject to administrative review, no later than the date the vendor receives the review decision.

(3) *Local agency appeals.* (i) *Adverse actions subject to full administrative reviews.* Except as provided in paragraph (a)(3)(ii) of this section, the State agency must provide full administrative reviews to local agencies that appeal the following adverse actions:

(A) denial of a local agency's application;

(B) disqualification of a local agency; and

(C) any other adverse action that affects a local agency's participation.

(ii) *Actions not subject to administrative reviews.* The State agency may not provide administrative reviews pursuant to this section to local agencies that appeal the following actions:

(A) expiration of the local agency's agreement; and

(B) denial of a local agency's application if the State agency's local agency selection is subject to the procurement procedures applicable to the State agency;

(iii) *Effective date of adverse actions against local agencies.* The State agency must make denials of local agency applications effective immediately. The State agency must make all other adverse actions effective no earlier than 60 days after the date of the notice of the adverse action and no later than 90 days after the date of the notice of adverse action or, in the case of an adverse action that is subject to administrative review, no later than the date the local agency receives the review decision.

(b) *Full administrative review procedures.* The State agency must develop procedures for a full administrative review of the adverse actions listed in paragraphs (a)(1)(i) and (a)(3) of this section. At a minimum, these procedures must provide the vendor or local agency with the following:

(1) Written notification of the adverse action, the procedures to follow to obtain a full administrative review and the cause(s) for and the effective date of the action. When a vendor is disqualified due in whole or in part to violations in § 246.12(l)(1), such notification must include the following statement: ''This disqualification from WIC may result in disqualification as a retailer in the Food Stamp Program. Such disqualification is not subject to administrative or judicial review under the Food Stamp Program.''

(2) The opportunity to appeal the adverse action within a time period specified by the State agency in its notification of adverse action.

(3) Adequate advance notice of the time and place of the administrative review to provide all parties involved sufficient time to prepare for the review.

(4) The opportunity to present its case and at least one opportunity to reschedule the administrative review date upon specific request. The State agency may set standards on how many review dates can be scheduled, provided that a minimum of two review dates is allowed.

(5) The opportunity to cross-examine adverse witnesses. When necessary to protect the identity of WIC Program investigators, such examination may be conducted behind a protective screen or other device (also referred to as an ''in camera'' examination).

(6) The opportunity to be represented by counsel.

(7) The opportunity to examine prior to the review the evidence upon which the State agency's action is based.

(8) An impartial decision-maker, whose determination is based solely on whether the State agency has correctly applied Federal and State statutes, regulations, policies, and procedures governing the Program, according to the evidence presented at the review. The State agency may appoint a reviewing official, such as a chief hearing officer or judicial officer, to review appeal decisions to ensure that they conform to approved policies and procedures.

(9) Written notification of the review decision, including the basis for the decision, within 90 days from the date of receipt of a vendor's request for an administrative review, and within 60 days from the date of receipt of a local agency's request for an administrative review. These timeframes are only administrative requirements for the State agency and do not provide a basis for overturning the State agency's adverse action if a decision is not made within the specified timeframe.

(c) *Abbreviated administrative review procedures.* Except when the State agency decides to provide full administrative reviews for the adverse actions listed in paragraph (a)(1)(ii) of this section, the State agency must develop procedures for an abbreviated administrative review of the adverse actions listed in paragraph (a)(1)(ii) of this section. At a minimum, these procedures must provide the vendor with the following:

(1) Written notification of the adverse action, the procedures to follow to obtain an abbreviated administrative review, the cause(s) for and the effective date of the action, and an opportunity to provide a written response; and

(2) A decision-maker who is someone other than the person who rendered the initial decision on the action and whose determination is based solely on whether the State agency has correctly applied Federal and State statutes, regulations, policies, and procedures governing the Program, according to the information provided to the vendor concerning the cause(s) for the adverse action and the vendor's response; and

(3) Written notification of the review decision, including the basis for the decision, within 90 days of the date of receipt of the request for an administrative review. This timeframe is only an administrative requirement for the State agency and does not provide a basis for overturning the State agency's adverse action if a decision is not made within the specified timeframe.

(d) *Continuing responsibilities.* Appealing an action does not relieve a local agency or a vendor that is permitted to continue program operations while its appeal is in process from the responsibility of continued compliance with the terms of any written agreement with the State agency.

(e) *Finality and effective date of decisions.* The State agency procedures must provide that review decisions rendered under both the full and abbreviated review procedures are the final State agency action. If the adverse action under review has not already taken effect, the State agency must make the action effective on the date of receipt of the review decision by the vendor or the local agency.

(f) *Judicial review.* If the review decision upholds the adverse action against the vendor or local agency, the State agency must inform the vendor or local agency that it may be able to pursue judicial review of the decision.

10. In § 246.19, revise the section heading and revise paragraphs (a)(2), (b)(2), (b)(4), and (b)(5) to read as follows:

§ 246.19 Management evaluation and monitoring reviews.

(a) * * *

(2) The State agency must submit a corrective action plan, including implementation timeframes, within 60 days of receipt of an FNS management evaluation report containing a finding that the State agency did not comply with program requirements. If FNS determines through a management evaluation or other means that during a fiscal year the State agency has failed, without good cause, to demonstrate efficient and effective administration of its program, or has failed to comply with its corrective action plan, or any other requirements contained in this part or the State Plan, FNS may withhold an amount up to 100 percent of the State agency's nutrition services and administration funds for that year.

* * * * *

(b) * * *

(2) Monitoring of local agencies must encompass evaluation of management, certification, nutrition education, participant services, civil rights compliance, accountability, financial management systems, and food delivery systems. If the State agency delegates the signing of vendor agreements, vendor training, or vendor monitoring to a local agency, it must evaluate the local agency's effectiveness in carrying out these responsibilities.

* * * * *

(4) The State agency must promptly notify a local agency of any finding in a monitoring review that the local agency did not comply with program requirements. The State agency must require the local agency to submit a corrective action plan, including implementation timeframes, within 60 days of receipt of a State agency report of a monitoring review containing a finding of program noncompliance. The State agency must monitor local agency implementation of corrective action plans.

(5) As part of the regular monitoring reviews, FNS may require the State agency to conduct in-depth reviews of specified areas of local agency operations, to implement a standard form or protocol for such reviews, and to report the results to FNS. No more than two such areas will be stipulated by FNS for any fiscal year and the areas will not be added or changed more often than once every two fiscal years. These areas will be announced by FNS at least six months before the beginning of the fiscal year.

* * * * *

11. In § 246.23, revise paragraphs (a)(4) and (c) to read as follows:

§ 246.23 Claims and penalties.

(a) * * *

(4) FNS will establish a claim against any State agency that has not accounted for the disposition of all redeemed food instruments and taken appropriate follow-up action on all redeemed food instruments that cannot be matched against valid enrollment and issuance records, including cases that may involve fraud, unless the State agency has demonstrated to the satisfaction of FNS that it has:

(i) Made every reasonable effort to comply with this requirement;

(ii) Identified the reasons for its inability to account for the disposition of each redeemed food instrument; and

(iii) Provided assurances that, to the extent considered necessary by FNS, it will take appropriate actions to improve its procedures.

* * * * *

(c) *Claims.* (1) *Claims against participants.* (i) *Procedures.* If the State agency determines that program benefits have been obtained or disposed of improperly as the result of a participant violation, the State agency must establish a claim against the participant for the full value of such benefits. For all claims, the State agency must issue a letter demanding repayment. If full restitution is not made or a repayment schedule is not agreed on within 30 days of receipt of the letter, the State agency must take additional collection actions until restitution is made or a repayment schedule is agreed on, unless the State agency determines that further collection actions would not be cost-effective. The State agency must establish standards, based on a cost benefit analysis, for determining when collection actions are no longer cost-effective. At the time the State agency issues the demand letter, the State agency must advise the participant of the procedures to follow to obtain a fair hearing pursuant to § 246.9 and that failure to pay the claim may result in disqualification. In addition to establishing a claim, the State agency must determine whether disqualification is required by § 246.12(u)(2).

(ii) *Types of restitution.* In lieu of financial restitution, the State agency may allow participants or parents or caretakers of infant or child participants for whom financial restitution would cause undue hardship to provide restitution by performing in-kind services determined by the State agency. Restitution may not include offsetting the claim against future program benefits, even if agreed to by the participant or the parent or caretaker of an infant or child participant.

(iii) *Disposition of claims.* The State agency must document the disposition of all participant claims.

(2) *Claims against the State agency.* FNS will assert a claim against the State agency for losses resulting from program funds improperly spent as a result of dual participation, if FNS determines that the State agency has not complied with the requirements in § 246.7(l)(1).

(3) *Delegation of claims responsibility.* The State agency may delegate to its local agencies the responsibility for collecting participant claims.

* * * * *

12. In § 246.26, revise the heading of paragraph (d), and add new paragraphs (e), (f), and (g) to read as follows.

§ 246.26 Other provisions.

* * * * *

(d) *Confidentiality of applicant and participant information.* * * *

(e) *Confidentiality of vendor information.* Confidential vendor information is any information about a vendor (whether it is obtained from the vendor or another source) that individually identifies the vendor, except for vendor's name, address and authorization status. Except as otherwise permitted by this section, the State agency must restrict the use or disclosure of confidential vendor information to:

(1) Persons directly connected with the administration or enforcement of the WIC Program or the Food Stamp Program who the State agency determines have a need to know the information for purposes of these programs. These persons may include personnel from its local agencies and other WIC State and local agencies and

persons investigating or prosecuting WIC or Food Stamp Program violations under Federal, State, or local law;

(2) Persons directly connected with the administration or enforcement of any Federal or State law. Prior to releasing the information to one of these parties (other than a Federal agency), the State agency must enter into a written agreement with the requesting party specifying that such information may not be used or redisclosed except for purposes directly connected to the administration or enforcement of a Federal, or State law; and

(3) A vendor that is subject to an adverse action, including a claim, to the extent that the confidential information concerns the vendor subject to the adverse action and is related to the adverse action.

(f) *Confidentiality of Food Stamp Program retailer information.* Except as otherwise provided in this section, the State agency must restrict the use or disclosure of information about Food Stamp Program retailers obtained from the Food Stamp Program, including information provided pursuant to Section 9(c) of the Food Stamp Act of 1977 (7 U.S.C. 2018(c)) and § 278.1(q) of this chapter, to persons directly connected with the administration or enforcement of the WIC Program.

(g) *USDA and the Comptroller General.* The State agency must provide the Department and the Comptroller General of the United States access to all WIC Program records, including confidential vendor information, pursuant to § 246.25(a)(4).

Dated: December 21, 2000.

Shirley R. Watkins,

Under Secretary, Food, Nutrition, and Consumer Services.

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