



**International Dairy Foods Association**  
Milk Industry Foundation  
National Cheese Institute  
International Ice Cream Association

USDA  
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**Re: Docket No. AO-14-A73, et al; DA-03-10**

**USDA - Recommended Decision**

**Published May 17, 2006**

**Comments and Written Exceptions Filed On Behalf Of the International Dairy Foods Association**

This post-hearing brief is submitted on behalf of the International Dairy Foods Association (IDFA) and its member companies. IDFA is composed of three constituent organizations: the Milk Industry Foundation (MIF), the National Cheese Institute (NCI) and the International Ice Cream Association (IICA). IDFA's 220 dairy processing members run more than 600 plant operations, and range from large multi-national organizations to single-plant companies. Together they represent more than 85% of the milk, cultured products, cheese and frozen desserts produced and marketed in the United States. Most of the milk bought and handled by IDFA processor and marketing members is purchased under the Federal milk marketing orders promulgated pursuant to the Agricultural Marketing Agreement Act of 1937.

The recommended decision to amend the current fluid milk product definition used in all Federal milk marketing orders was based on the record of a hearing held June 20-23, 2005 in Pittsburgh, PA. This hearing, in turn, was the result of a petition filed by Dairy Farmers of America in June 2003. IDFA, on behalf of its members, repeatedly filed comments with USDA in opposition to holding a hearing due to the complete lack of data and analysis submitted by the proponents seeking to change to the fluid milk product definition. Based upon the hearing record, IDFA continues to find a complete lack of any such data and analysis. In fact, the hearing record clearly indicates that the changes

included in USDA's recommended decision will cause irreparable harm to the dairy industry.

IDFA urges USDA to make no changes in the current fluid milk product definition due to this lack of evidence. IDFA also advances the following specific exceptions to the findings in the recommended decision:

1. Changing the current exclusion from the fluid milk product definition for any products containing less than 6.5 percent nonfat solids by weight, by adding the additional criterion that such products must also contain less than 2.25 percent true milk protein.
2. Changing the current exclusion from the fluid milk product definition for any products containing less than 6.5 percent nonfat solids by weight, by limiting the exclusion if USDA concludes on an ad hoc basis that any such product by its form and intended use is comparable to products meeting the fluid milk product definition.
3. Stating in the decision that USDA will count any and all whey-based products in its calculation of the nonfat solids and protein content of any such product.

**I. No hearing evidence indicated that changes to the fluid milk product definition are needed.**

From the time of the first petition to USDA requesting a hearing to consider changes to the fluid milk product definition, IDFA and its constituent members have taken the position that such a hearing was unnecessary. When the possibility of a hearing was first advanced, MIF on September 19, 2003, submitted comments to USDA indicating its opposition to holding a hearing, based on the lack of data and analysis necessary to justify any change in the regulation. USDA then extended the deadline for interested parties to submit comments on whether to hold a hearing to January 30, 2004. This time, the National Milk Producers Federation joined with MIF to file joint comments to USDA requesting that no hearing be held, citing the lack of information about the market for beverage products containing milk and other dairy-derived ingredients. Again USDA

extended the deadline for submitting comments, this time to September 30, 2004, and again National Milk Producers Federation joined with MIF to request that USDA not hold a hearing, noting that "initiating the formal rule-making process required to amend Federal Orders without further data and analysis may compromise the effectiveness of the resulting decision." (Yonkers, Transcript pages 879-80).

None of the evidence presented at the hearing changes the correctness of MIF's longstanding position. No factual empirical evidence was presented demonstrating that products in today's marketplace that do not meet the current fluid milk product definition are in any way causing disorderly marketing conditions at this time. This observation is consistent with its own testimony at the hearing: "MIF's philosophy toward proposed amendments to the federal order system can be simply stated. MIF believes that the proponents of such amendments carry the burden of coming forth with solid data and analysis demonstrating both the need for a change and that the proposed amendment will address that need. Anecdotal evidence or broad suppositions do not suffice." Yonkers, Transcript pages 880-81.

MIF's position was actually supported by the testimony of the proponents of proposal 7, who noted that adoption of this proposal would not change the classification of any existing products in today's marketplace. They testified that "Proposal 7 would accomplish this without reclassifying any existing products and following established principles of form and use." Cryan, Transcript page 151. This admission illustrates the absence of any need for a change.

In the recommended decision, USDA dismisses this assertion, stating that "Classification determinations made by the department are not available to the public because of the proprietary nature of the information; therefore the proponents have no basis to accurately conclude that adoption of a true protein standard would not alter any current products classification." (Fed Reg Vol. 71, No. 95, p. 28600) However, the foundation for this statement appears nowhere in the hearing record. Two USDA witnesses testified at the hearing, and neither testified as to the public availability of USDA

decisions regarding classification of product. Milk order amendments are required to be based on the hearing record.

In testimony on behalf of MIF, Yonkers noted past instances where USDA rejected proposed changes to Federal order regulations due to the absence of demonstrable proof that actual marketplace conditions existed to justify the requested changes. As Yonkers explained, "USDA has itself adopted this approach to federal order amendments. A good example is the proposed rule issued in Milk in the Texas and Southwest Plains Marketing Areas, Docket Nos: AO-231-A56 and AO-210-A48 and DA-88-110, published June 16, 1988 (53 FR 22499), addressing (and rejecting) a proposal to amend a federal order with respect to the "producer handler" exemption. Although the proponents asserted that the exemption created a significant unfair advantage, USDA noted that 'The existence of large producer-handler operations merely *implies* that the conditions for disorderly and disruptive marketing conditions *may* exist.' MIF similarly notes that the mere existence of beverages that contain milk and other dairy-derived ingredients does not prove that those products either compete with beverages that meet the existing fluid milk product definition, nor that such competition has a negative impact on the market for fluid milk products or producer revenue under existing Federal Order regulations.

"In the producer-handler decision, USDA went on to note that mere 'concern over the *potential* of a large handler who may have the ability to become a producer-handler does not provide sufficient basis for a regulatory change.' Applying that lesson here, it seems clear that the proponents of any change to the fluid milk product definition must provide actual data and analysis to demonstrate that products not meeting the current fluid milk product definition are having an impact on the market, not merely that they have the potential to do so. Without such data and analysis, there cannot be a sufficient basis to justify a regulatory change.

"USDA in the producer-handler decision made another apt observation, pointing out that 'not sufficient time has elapsed between the time that Pure Milk acquired producer-handler status and when the hearing was held' to evaluate the economic impact. MIF has similarly and consistently maintained that the market for beverages containing

milk and dairy-derived ingredients is in its infancy, noting in a January 30, 2004 letter to USDA that 'At such time that study and experience provide a more conclusive basis for redefinition of Class I products, the dairy industry can ask the Department to address the issue.'

"USDA's decision in the producer-handler decision to which I have referred is only one example of the approach to decision-making that should also be applied here. For example, in its 1998 decision rejecting proposals to establish a floor price, USDA concluded that 'The data contained in the record of the public hearing in this proceeding provide no basis to expect that an adequate supply of milk for fluid use will not be available nationwide. Therefore, the record does not support adopting the proposal, which would encourage more milk.' Again, USDA placed the burden on the proponents to come forward with hard data and analysis justifying the change, and in its absence, declined to adopt the proposed order amendment. Milk in the New England and Other Marketing Areas, Docket Nos. AO-14-A68, DA-98-01, published June 12, 1998 (63 FR 32147)." Yonkers Transcript pages 881-84.

The absence of record evidence demonstrating a need for change demonstrates why no change should be made.

**II . USDA should not require that products containing less than 6.5 percent nonfat solids also contain less than 2.25 percent true milk protein to be exempt from the fluid milk product definition.**

There was no evidence presented during the hearing that products with less than 6.5 percent nonfat solids by weight, but containing 2.25 percent or more true milk protein, are causing disorderly marketing and therefore must be classified as fluid milk products. Such products would have to be shown to compete with other products that do meet the current fluid milk product definition.

In fact, the proponents in this proceeding themselves noted past classification decisions in which USDA concluded that actual problems in the market were necessary to justify changes in classification. As Dr. Cryan admitted, "In those hearings, USDA

specifically cited the growth of skim or reduced-fat milk sales, and the resulting price-based inequities, as a basis for reclassification.” Cryan, Transcript page 160 lines 15-18. Yet the proponents in this hearing cited no market growth data for products that are not currently included in Class I but which would become Class I if proposal 7 were adopted.

Even assuming that some products would be reclassified as a result of adopting proposal 7, the evidence supporting the need for such an amendment to current Federal order regulation is simply lacking. The type of information necessary to establish an economic justification for adopting such a change was outlined during the hearing by Dr. Yonkers. "Let me be more specific as to the data and analysis that I or any other dairy economist would need to see before determining whether an economic change in the fluid milk product definition were needed.

1. A quantification of the market share held by beverages which do not fall under the current fluid milk product definition but would be included under any proposed change. Speculative conjecture of the hypothetical potential for such products to gain significant market share in the future is not sufficient. There has been no quantitative market data demonstrating that beverage products not meeting the current fluid milk product definition have a significant market share. Without such information, there can be no analysis of the competitive impact such products are having on the market for beverages which meet the existing fluid milk product definition.
2. An analysis of the cross price elasticity of demand between beverages which meet the existing fluid milk product definition and beverages which would meet any of the proposed changes to the fluid milk product definition. This is the necessary economic test to determine whether two such product types are truly in competition with each other as substitutes in the marketplace. Such competition is a prerequisite to reaching any conclusion regarding whether other products are being placed at an unfair competitive disadvantage, or whether disorderly marketing conditions exist. Merely looking at how the two products are packaged or where in the retail store they are sold is not sufficient to demonstrate the products compete in the marketplace. I believe that data necessary to perform this analysis could have been obtained and analyzed by the proponents, at least with respect to some of the products that would be re-classified

as fluid milk products under the proposed amendments. And even if the fact that no empirical evidence of such cross price elasticities has been presented at this hearing were due to the lack of the data necessary to conduct such an analysis, this would simply demonstrate that the market share of those beverages is just too small today to warrant regulatory attention.

3. An analysis of the own-price elasticity of demand for those beverages. The most obvious economic test to determine the impact of a regulatory change, which would change the cost of ingredients used in beverages with milk and dairy-derived ingredients, is to study how economic agents react to such a change. The first inquiry would address empirical evidence of the impact of consumer response to the increased cost of the product--in economist's terms, own price elasticity of retail demand. That inquiry would be necessary to assess the impact of the regulatory change on the pool--specifically, would the positive impact on pool revenues resulting from a higher minimum price for raw milk be more than offset by the decline in sales of the product resulting from the higher price for the product." Yonkers transcript pages 884-87.

The hearing record contains no evidence that any products would be reclassified as a result of Proposal 7 compete with products that meet the current fluid milk product definition. Furthermore, numerous witnesses testified that adopting such a protein criteria would reduce the attractiveness and use of dairy ingredients in new, innovative beverage products. This in turn would decrease the demand for farm milk, certainly not an outcome one would expect USDA to be advocating. As economist Tipton testified, the adopting of a protein criteria would likely result in "products that now contain some dairy derived ingredients will be reformulated to minimize, if not eliminate, milk-derived ingredients by substituting non-milk ingredients such as soy." Transcript page 1052. Tipton went on to note: "Not only are class price issues driving food companies to use non-dairy ingredients, but also the record keeping and reporting requirements and presenting records for audits by market administrators are added burdens that many food processors would prefer to avoid. This is another incentive to use non-dairy ingredients." Transcript page 1052. This was echoed by the testimony of other witnesses. (Box, Transcript pages 656-657; Davis, Transcript pages 498-99; Olsen/Ledman, Transcript pages 515, 517-18, 522-23; Suever,

Transcript pages 915-23; Taylor, Transcript pages 972-76; Tucker, Transcript pages 456-58; and Waldron, Transcript pages 749-50 and 752-53). In fact, no witness representing a food processing company indicated that the adoption of a protein criterion in the fluid milk product definition would have anything but a negative effect on the use of milk-based ingredients in beverage products.

**III. USDA should not change the current exclusion from the fluid milk product definition for any products containing less than 6.5 percent nonfat solids by weight, by limiting the exception if USDA concludes any such product by its form and intended use is comparable to products meeting the fluid milk product definition.**

Federal order regulations have, and should continue, to incorporate clear, objective criteria, so that all industry participants know the regulatory impact of their current and contemplated actions. Nowhere is this more important than in the criteria for product classification, where companies considering new products and new product formulations must know the financial implications of their choices.

In the recommended decision, USDA departs from its long-standing practice of establishing clearly defined requirements for regulatory action. The decision instead vests USDA officials with the authority to make ad hoc classification decisions, based on their personal conclusions whether a product in its form and intended use is comparable to products meeting the fluid milk product definition. No criteria are provided to guide such decisions.

The recommended decision attempts to justify this change by pointing to the legislation authorizing the Federal milk marketing orders, which allows regulation of milk based on the "form in which or the purpose for which it is used." But USDA historically has carried out this responsibility through adopting regulatory language that itself establishes clear, objective criteria for product classification. Substitution of purely subjective criteria will have several serious negative consequences for the dairy industry.



The food industry invests significant time and money in the development of new and innovative products to meet the constantly changing demands of the marketplace. Food industry product formulators must have advance knowledge, even in the earliest stages researching the potential for a new product, of the costs associated with potential ingredients. Formulators of food products, including beverage products, make their ingredient decisions based on a clear understanding of the costs associated with all ingredients, and do so from the very first step in the market research process, long before actual product prototypes are available for testing. The inclusion in the recommended decision of unclear, immeasurable, subjective criteria such as "form and intended use" fails to provide ingredient cost certainty for any dairy-based ingredient. This uncertainty applies not only to the price of the ingredient, but to the regulatory burden of potentially becoming a regulated handler under the Federal milk marketing order system.

In addition, IDFA is more than a little concerned about expanding the role of agency discretion in the classification of beverage products containing dairy ingredients. The purpose of the fluid milk product definition is to clearly state the objective criteria for classification, thus avoiding the potential disorderly marketing that can arise from decisions reached at different times or by different agency personnel.

**IV . USDA should not include whey-based ingredients when calculating the percent nonfat solids or protein contained in any beverage product.**

The proponents of proposal 7 attempted to craft reasons to price all dairy-derived proteins in such products as Class I *except* for those made from whey ("Similarly, in proposing that whey and whey products not be counted toward pricing Class I milk, we do not propose to exclude any other milk-derived ingredient." Cryan Transcript page 168), but nonetheless to include all whey and whey-derived proteins in determining whether a beverage contained at least 2.25% milk protein ("In proposing a protein standard for fluid milk products, NMPF intends that the protein content of any and all dairy -derived ingredients be counted, including, but not limited to, milk , skim milk, milk protein concentrate, casein and caseinate, whey, whey protein concentrates, and any other milk-derived ingredients, including those not currently defined as nonfat milk solids for the

purpose of defining fluid milk product. I would include calcium caseinate, sodium caseinate, and any other dairy-derived protein.” Cryan, Transcript pages 167-68).

Proponents first attempted to justify this inconsistency by arguing that whey protein used in fluid milk products should not be priced at Class I because “whey has already been priced within the Class III formula, and establishing an up-charge procedure for whey is problematic.” (Cryan, Transcript page 177). However, this contention ignores the fact that *all* dry milk products, include those listed in Cryan's testimony on pages 167-68 cited above, have already been priced at the time of manufacture. Second, this testimony never explains why establishing an up-charge for whey would present a unique problem. If this is a problem for any whey protein product, how can it not also be a problem for any milk protein product?

This proponent also stated that “NMPPF does not believe that, at the current time, the innovative use of whey in beverages results in beverages that compete with existing fluid milk products.” Cryan, Transcript page 177. If the use of whey in beverages results in products that do not compete with existing fluid milk products, there is no reason to include whey and whey-derived proteins in determining whether or not a product is excluded from the fluid milk product definition.

The inconsistency and lack of explanation for the proposed disparate treatment of whey demonstrates the absence of any basis for changing the existing fluid milk product exclusion from one with a nonfat solids threshold to one that also includes a protein threshold.

**V. The combined effect of the proposed addition of the 2.25 percent true milk protein test, and the requirement that any whey-based ingredients be included in determining both the nonfat solids and true protein content of a product, will lower producer returns.**

The proponents presented no evidence that allayed the concern that adopting proposal 7 would have a negative impact on producer pool revenue in Federal milk

marketing orders. Several witnesses noted that adopting this proposal could reduce the incentive for beverage manufacturers to use dairy proteins in new formulated products in the future. Yonkers noted the importance of such an analysis before a decision to adopt proposal 7 could be made: "One would also need to assess the higher regulated price on the ingredient formulation of the product. This requires empirical analysis of the input substitution between dairy and non-dairy ingredients in those beverages. Once again, the issue is whether the positive impact on pool revenues resulting from a higher minimum price for raw milk would be more than offset by the decline in use of dairy ingredients in the product because of the higher price for the dairy ingredients. Without such an analysis, there can be no credible testimony regarding the impact on producer revenue at federal order minimum class price from the proposed regulatory change." Yonkers transcript pages 887-88.

Dr. Mark Stephenson from Cornell University, who did not testify in favor of or opposition to any proposal, noted that his research led him to conclude that the inclusion of a 2.25% protein test for fluid milk products could have a significant negative impact on producer revenue: "When new product manufacturers substitute nondairy ingredients for milk rather aggressively in response to reclassification, there are significant negative impacts of the reclassification on dairy producer revenues. This negative effect is about \$3.2 billion over the nine years that we simulated. This represents about minus 1.8 percent of producer revenues or about a negative 22 cents per hundredweight of milk sold. This negative effect arises because the demand for milk components increases much less as demand for the new product grows over time." Stephenson transcript page 578 lines 2-14).

In addition, numerous witnesses testified to the fiercely competitive market for protein ingredients that can and are used in beverages. One proponent admitted that non-dairy proteins compete with dairy proteins in product formulation (Hollon, Transcript page 112). A witness from General Mills noted that product formulators in that company focus on delivering the characteristics desired by consumers in a product with the least cost ingredients: "We have experts at product formulation that rely on their creativity and wisdom and experience with dairy products to make us the products that consumers are

expecting to taste once they have told us that a concept of the mind that we have presented to them is something they want to buy. They will then use milk and whatever ratio of ingredients to try to deliver upon that expected or anticipated expectation of what the product will taste like.” Waldron, Transcript page 830.

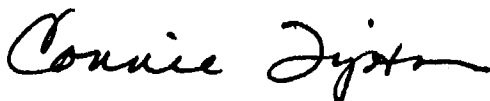
This analysis was echoed by the witness from Leprino: “Product developers consider many factors when selecting ingredients to be incorporated in product formulations. These factors include the functionality, the contribution of each ingredient to the end product characteristics, and cost, among other things. In many cases, several alternative ingredients can be used to provide the desired nutritional or functional profile. Whey and whey products compete with several non-dairy ingredients in product formulas. Under the proposals that would adopt a protein compositional standard, the competitive position of high protein whey fractions, such as whey protein concentrates and isolates, would be most highly impacted. Proteins are generally added to foods or beverages for their contribution to the nutritional profile of the finished product or to enhance the structure and mouth feel. The most commonly referenced competitive ingredients tend to be soy-based, whether they are soy protein concentrates or soy protein isolates. These are the most likely substitutes for whey proteins in applications where they are being used for their protein contribution. However, many other ingredients such as wheat protein isolates and vital wheat gluten/isolates can also be substituted to achieve the desired protein contribution. Several different ingredients can be substituted for whey proteins that are being used to provide structure and mouth feel. An expanding family of hydrocolloids can substitute for whey protein to achieve desired structure and mouth feel. These products can be used individually or in combination with starches and gums. Product developers are very skillful in combining these proteins in developing products. The competitive issues facing the whey complex are becoming more acute over time as improvements are made in alternative ingredients. Soy historically has been criticized for its beanie flavor and its use in beverages has been limited to highly flavored products that were capable of masking the flavor. However, with the more recent development of low flavor soybeans and improved refining techniques, flavor is becoming less of a constraint on soy use. Most every marketer of soy proteins now market low flavor protein with reduced beanie flavor. Archer

Daniels Midland, Dupont, Solae, and Central Soya are just a few of these companies.”  
Taylor, Transcript pages 979-81.

Economist Ledman, appearing on behalf of the Yogurt Manufacturers’ Association, also noted the realities of ingredient substitution: “In terms of new product development, I have witnessed a venture capitalist walk away from a new dairy beverage start-up company due to the complexity and lack of long-term forward pricing for milk. In the competitive, ever changing world of beverages, product developers do not need to use dairy ingredients to manufacture a nutritious beverage. In particular, the soy industry is very aggressive in finding new market opportunities for soy protein. In some cases, soy and milk proteins are being used together in applications that were once considered dairy only.” (Ledman, Transcript pages 517-18.).

In the recommended decision, USDA noted that "no data was presented at the hearing to indicate at what price level or degree such substitution would take place." But, IDFA observes that the proponents of changes to the current fluid milk product definition never presented any data showing that disorderly marketing was occurring in the marketplace. By contrast, the hearing record contained testimony from numerous food processing companies stating that they expected such substitution would occur with the adoption of a protein criteria and the inclusion of all whey-based products in the determination of the nonfat solids and protein content of beverage products. The hearing record supports leaving the fluid milk definition as is.

Sincerely,

A handwritten signature in black ink, appearing to read "Connie Tipton". The signature is fluid and cursive, with a long horizontal stroke at the end.

Connie Tipton  
President & CEO  
International Dairy Foods Association