

**UNITED STATES DEPARTMENT OF AGRICULTURE
AGRICULTURAL MARKETING SERVICE**

	)	
In Re:	)	
	)	Docket Nos
Milk In The Northeast and	)	AO-14-A73, et al.;
Other Marketing Areas	)	DA-00-10
	)	

**LEPRINO FOODS COMPANY'S
COMMENTS ON THE CLASS I DEFINITION PROPOSED RULE**

These comments are submitted on behalf of Leprino Foods Company ("Leprino") with respect to the Proposed Rule regarding changes in the Class I fluid milk product definition, published at 71 Fed. Reg. 28590 et seq., May 17, 2006. Leprino operates nine plants in the United States, manufacturing mozzarella cheese and whey products domestically, and marketing our products both domestically and internationally. Six of these plants receive milk regulated under the Federal Milk Marketing Order System ("Orders"). The California State Order regulates the other three plants. The markets for the whey products generated by all of our plants, regardless of location, will be impacted by the outcome of this rulemaking proceeding. Therefore, Leprino has a strong interest in the decision by USDA ("Department").

In general, Leprino's position can be summarized as one of support of the specific exclusion for drinkable yogurts and kefirs from the fluid milk definition and opposition to the balance of the Proposed Rule. The balance of the proposed changes are not sufficiently supported by the Hearing record and are characterized by vague language

that will add to the uncertainty surrounding classification decisions and will further contribute to the chilling effect on dairy ingredient demand that Leprino cautioned against in its testimony at the Hearing.

I. The Proposed Rule properly excludes products that contain 20% or more yogurt from the Class I definition.

A. The Department's conclusion that drinkable yogurts and kefirs should be specifically excluded from Class I is sound and the Department should carry the exclusion forward to the Final Decision. The Hearing record is replete with evidence that these products are marketed as meal replacements or snacks and consumers do not perceive them to be replacements for beverage milk. The existing 6.5% SNF composition limit in the fluid milk definition has incentivized producers of drinkable yogurt products to formulate their products with less than 6.5% dairy SNF. The reclassification of those drinkable yogurts and kefirs that are currently classified as Class I will result in less than a 0.47 cent per hundredweight reduction in the blend price. (Taylor (Leprino) Testimony, Tr. 992). Although the increase in dairy ingredient use that should be unleashed once manufacturers are not subject to the 6.5% limitation was not quantified in the hearing, the increase in demand is likely to more than offset the less than half-cent reduction in blend price related to the reclassification.

II. USDA should not adopt the balance of the Proposed Rule as follows:

A. The incorporation of a 2.25% protein threshold into the fluid milk definition, above which a beverage would be captured under the fluid milk definition as a Class I product, should not be adopted. The addition of the 2.25% protein threshold without specific exclusions that clearly eliminate beverages that do not resemble milk and are not marketed directly against milk ("non-traditional beverages") will lead to diminished dairy ingredient demand.

1. The price discrimination that is embodied in the classified pricing system under the Orders has historically been justified in part by an evaluation of demand elasticities. Predominantly, the products addressed by the Orders are produced exclusively from dairy ingredients with de minimis amounts of other ingredients that either add flavoring or are an integral aspect of manufacturing the dairy product.¹ These products are viewed as dairy products by the consuming public and are generally confined to using dairy ingredients either by a standard of identity or by consumer expectations. Consumption decisions for these products are typically made at the ultimate consumer level. Therefore, elasticities have generally been measured at the ultimate consumer level. The ability to extract a comparatively higher price from consumers for a finished product due to its perceived inelasticity has often been used as an argument that dairy ingredients in a particular finished product should be priced as Class I.

In contrast with the mainstream dairy products that are reliant on dairy ingredients for their identity, the evolving non-traditional beverage market is not confined to utilizing dairy ingredients. While some consumers may be cognizant of the specific sources of the nutrients contained in these beverages, they largely are not focused upon whether the nutrient source is dairy or non-dairy. Therefore, product formulators and marketers of those products are making the decisions driving the use of dairy or non-dairy ingredients in these beverages. Therefore, the “consumers” to be considered in relationship to price elasticity as it relates to dairy ingredient use in these products are these formulators and marketers.

¹ Milk used by commercial food processing establishments and milk used to produce custards, puddings, pancake mixes, coatings, batter, buttermilk biscuit mixes, candy, soup, bakery products and other prepared foods processed for general distribution to the public are exceptions to this generalization. Milk in liquid form used in all of these products is classified as Class II. Dry dairy ingredients used in these products retain their original classification (i.e., Class III if a whey product or Class IV if dry whole milk, nonfat dry milk, or dry buttermilk).

The Hearing Record contains no evidence that the demand elasticities for dairy ingredients in the emerging non-traditional beverage category are comparable to the demand elasticities for fluid milk. In fact, all testimony relating to price sensitivity for dairy ingredients used in these alternative beverages pointed to a high degree of sensitivity and competition with non-dairy ingredients.

2. The Hearing Record is replete with evidence that dairy proteins compete with a variety of non-dairy protein sources in the growing non-traditional beverage category. Leprino noted that *“Whey and whey products compete with several non-dairy ingredients in product formulas... 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.”* (Taylor (Leprino) Testimony, Tr. 979 – 981).

B. The exclusion of whey from pricing as a Class I ingredient in the Proposed

Rule does not sufficiently address concerns regarding the dampening effect on demand that the Proposed Rule will have upon whey protein demand. The negative implications of including whey protein in the determination of protein content for the purposes of classification under the fluid milk definition even if the whey is not repriced as Class I was discussed in the Hearing Record.

The inclusion of whey in the calculation of protein and SNF levels in beverages for the purposes of determining whether a product satisfies the Class I compositional criteria is problematic. It would incent beverage manufacturers to limit use of whey in beverages that contain other dairy-derived ingredients in order to stay within the 2.25% cap. (Taylor (Leprino) Testimony, Tr. 989). Additionally, this aspect of the Proposed Rule would require oversight of the nontraditional beverage producers *and “it’s that oversight that I think positions dairy at a disadvantage to other ingredients where they don’t have to be encumbered by reporting.”* (Taylor (Leprino) Testimony, Tr. 1030 – 1031). *“There is almost a visceral reaction to the level of regulation and reporting that’s required under the Federal Order System so even that requirement could keep people from using the whey products.”* (Taylor (Leprino) Testimony, Tr. 1029).

C. The Department should not be granted the additional discretion to assign products to Class I that do not fall within the compositional standards of the fluid milk definition. The application of the compositional standards in the Proposed Rule without an explicit exclusion for beverages that do not resemble milk and are not marketed directly against milk will result in many sports and nutritional beverages potentially being classified as Class I. As noted above, these beverages represent important markets for dairy ingredients and there is no evidence in the Hearing Record that they displace traditional milk sales. Any additional discretion granted to the Department to assign beverages to Class I that otherwise would not be considered Class I will further disincent producers of these products from formulating with dairy proteins and may lead to the virtual

elimination of dairy ingredient use in this beverage category.

D. The proposed establishment of a marketing channel qualifier to meet the meal replacement exclusion is problematic. Although the discussion of the proposed change (71 Fed. Reg. 28602) suggests that the addition of the term “sold to the health care industry” will result in competing products receiving equitable treatment, a literal interpretation of the proposed language would do just the opposite. Specifically, infant formula or meal replacements that are marketed to the health care industry would be excluded from the Class I fluid milk definition while the exact same product marketed through a different distribution channel, such as through the retail market, would not be excluded from the fluid milk definition. This application of the fluid milk definition would certainly not result in equitable treatment of even identical products, would be disruptive to the market and would be administratively burdensome.

Conclusion

The Department must be cautious not to establish a regulatory disadvantage for dairy ingredients that will result in reduced market demand. Given the wide array of alternative ingredients, an increase in cost or regulatory burden would do just that and more than offset any incremental gains realized by producers as a result of Class I classification for such products.

For the reasons cited above, which are based wholly upon and substantiated by evidence in the Hearing Record, the Department should adopt the exclusion of yogurts and kefir from the fluid milk definition but should reject all other changes contemplated in the Proposed Rule.

Respectfully submitted,

Sue M. Taylor
Vice President, Dairy Policy & Procurement
Leprino Foods Company
1830 West 38th Ave
Denver, Colorado 80211-2200