

# Proposed Rules

Federal Register

Vol. 71, No. 95

Wednesday, May 17, 2006

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

## DEPARTMENT OF AGRICULTURE

### Agricultural Marketing Service

#### 7 CFR Part 1000

[Docket no. AO-14-A73, et al.; DA-03-10]

#### Milk in the Northeast and Other Marketing Areas; Recommended Decision and Opportunity to File Written Exceptions on Proposed Amendments to Marketing Agreements and Orders

**AGENCY:** Agricultural Marketing Service, USDA.

**ACTION:** Proposed rule; recommended decision.

7 CFR part	Marketing area	AO Nos.
1001 ...	Northeast .....	AO-14-A73.
1005 ...	Appalachian .....	AO-388-A14.
1006 ...	Florida .....	AO-356-A37.
1007 ...	Southeast .....	AO-366-A43.
1030 ...	Upper Midwest .....	AO-361-A38.
1032 ...	Central .....	AO-313-A47.
1033 ...	Mideast .....	AO-166-A71.
1124 ...	Pacific Northwest	AO-368-A34.
1126 ...	Southwest .....	AO-231-A67.
1131 ...	Arizona Las-Vegas.	AO-271-A39.

**SUMMARY:** This document recommends changes to the fluid milk product definition for all Federal milk marketing orders and is based on the record of a hearing held June 20-23, 2005, in Pittsburgh, Pennsylvania. Specifically, this document recommends maintaining the current 6.5 percent nonfat milk solids criteria and incorporating an equivalent 2.25 percent true protein criteria in determining if a product meets the fluid milk product definition. This decision also proposes to clarify how milk and milk-derived ingredients should be priced under all orders. In addition, "drinkable" yogurt products containing at least 20 percent yogurt, kefir and products designed to be meal replacements, regardless of packaging, are proposed to be exempted from the fluid milk product definition.

**DATES:** Comments should be submitted on or before July 17, 2006.

**ADDRESSES:** Comments (six copies) should be filed with the Hearing Clerk, Stop 9200-Room 1031, United States Department of Agriculture, 1400 Independence Avenue, SW., Washington, DC 20250-9200.

Comments may also be submitted at the Federal eRulemaking portal: <http://www.regulations.gov> or by submitting comments by e-mail to: [amsdairycomments@usda.gov](mailto:amsdairycomments@usda.gov).

Reference should be made to the title of action and docket number.

**FOR FURTHER INFORMATION CONTACT:** Henry H. Schaefer, Economist, USDA/AMS/Dairy Programs, Upper Midwest Milk Market Administrators Office, Suite 210, 4570 West 77th Street, Minneapolis, Minnesota 55435-5037, (952) 831-5292. E-mail address: [hschaefer@fmma30.com](mailto:hschaefer@fmma30.com); or Gino M. Tosi, Associate Deputy Administrator, USDA/AMS/Dairy Programs, Order Formulation and Enforcement, Stop 0231-Room 2971-S 1400 Independence Avenue, SW., Washington, DC 20250-0231, (202) 690-1366, e-mail address: [gino.tosi@usda.gov](mailto:gino.tosi@usda.gov).

**SUPPLEMENTARY INFORMATION:** This administrative action is governed by the provisions of Sections 556 and 557 of Title 5 of the United States Code and, therefore, is excluded from the requirements of Executive Order 12866.

The amendments to the rules proposed herein have been reviewed under Executive Order 12988, Civil Justice Reform. They are not intended to have a retroactive effect. If adopted, the proposed amendments would not preempt any state or local laws, regulations, or policies, unless they present an irreconcilable conflict with this rule.

The Agricultural Marketing Agreement Act of 1937 (Act), as amended (7 U.S.C. 604-674), provides that administrative proceedings must be exhausted before parties may file suit in court. Under section 608c(15)(A) of the Act, any handler subject to an order may request modification or exemption from such order by filing with the Department a petition stating that the order, any provision of the order, or any obligation imposed in connection with the order is not in accordance with the law. A handler is afforded the opportunity for a hearing on the petition. After a hearing, the Department

would rule on the petition. The Act provides that the district court of the United States in any district in which the handler is an inhabitant, or has its principal place of business, has jurisdiction in equity to review the USDA's ruling on the petition, provided a bill in equity is filed not later than 20 days after the date of the entry of the ruling.

#### Regulatory Flexibility Act and Paperwork Reduction Act

In accordance with the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*), the Agricultural Marketing Service has considered the economic impact of this action on small entities and has certified that this proposed rule will not have a significant economic impact on a substantial number of small entities. For the purpose of the Regulatory Flexibility Act, a dairy farm is considered a "small business" if it has an annual gross revenue of less than \$750,000, and a dairy products manufacture is a "small business" if it has fewer than 500 employees.

For the purposes of determining which dairy farms are "small businesses," the \$750,000 per year criterion was used to establish a production guideline of 500,000 pounds per month. Although this guideline does not factor in additional monies that may be received by dairy producers, it should be an inclusive standard for most "small" dairy farmers. For purposes of determining a handler's size, if the plant is part of a larger company operating multiple plants that collectively exceed the 500-employee limit, the plant will be considered a large business even if the local plant has fewer than 500 employees.

For the month of June 2005, the month the hearing was held, 52,425 dairy farmers were pooled on the Federal order system. Of the total, 49,160, or 94 percent were considered small businesses. During the same month, 1,530 plants were regulated by or reported their milk receipts to their respective Market Administrator. Of the total, 847, or 55 percent were considered small businesses.

This decision recommends maintaining the current 6.5 percent nonfat milk solids criteria and adding a minimum true protein standard of 2.25 percent to the fluid milk product definition. These criteria are not intended to be absolute determinates of

whether a product meets the fluid milk product definition. The form and intended use of the product will be the primary criteria used by the Department for determining whether a product meets the fluid milk product. The proposed amendments also would not consider beverages containing 20 percent or more yogurt as an ingredient in the finished product or Kefir as meeting the fluid milk product definition. In addition, this decision recommends removing the requirement that meal replacements be packaged in hermetically-sealed containers to be exempt from the fluid milk product definition.

The proposed amendments to the fluid milk product definition set out the criteria for determining if the use of producer milk and milk-derived ingredients in such products should be priced at the Class I price. The established criteria for the classification of producer milk established are applied in an identical fashion to both large and small businesses and will not have any different impact on those businesses producing fluid milk products. Therefore, the proposed amendments will not have a significant economic impact on a substantial number of small entities.

A review of reporting requirements was completed under the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). It was determined that these proposed amendments would have no impact on reporting, record keeping, or other compliance requirements because they would remain identical to the current requirements. No new forms are proposed and no additional reporting requirements are necessary.

This notice does not require additional information collection that needs clearance by the Office of Management and Budget (OMB) beyond currently approved information collection. The primary sources of data used to complete the forms are routinely used in most business transactions. The forms require only a minimal amount of information which can be supplied without data processing equipment or a trained statistical staff. Thus, the information collection and reporting burden is relatively small. Requiring the same reports for all handlers does not significantly disadvantage any handler that is smaller than the industry average.

Interested parties are invited to submit comments on the probable regulatory and informational impact of this proposed rule on small entities. Also, parties may suggest modifications of this proposal for the purpose of

tailoring its applicability to small businesses.

*Prior documents in this proceeding: Notice of Hearing: Issued April 6, 2005; published April 12, 2005 (70 FR 19012).*

#### **Preliminary Statement**

Notice is hereby given of the filing with the Hearing Clerk of this recommended decision with respect to the proposed amendments to the tentative marketing agreements and the orders regulating the handling of milk in the Northeast and other marketing areas. This notice is issued pursuant to the provisions of the Agricultural Marketing Agreement Act and applicable rules of practice and procedure governing the formulation of marketing agreements and marketing orders (7 CFR part 900).

Interested parties may file written exceptions to this decision with the Hearing Clerk, United States Department of Agriculture, Room 1031-Stop 9200, 1400 Independence Avenue, SW., Washington, DC 20250-9200, by the July 17, 2006. Six (6) copies of the exceptions should be filed. All written submissions made pursuant to this notice will be made available for public inspection at the office of the Hearing Clerk during regular business hours (7 CFR 1.27(b)).

The hearing notice specifically invited interested persons to present evidence concerning the probable regulatory and informational impact of the proposals on small businesses. Some evidence was received that specifically addressed these issues, and some of the evidence encompassed entities of various sizes.

The proposed amendments set forth below are based on the record of a public hearing held in Pittsburgh, Pennsylvania, on June 20-23, 2005, pursuant to a notice of hearing issued April 6, 2005; published April 12, 2005 (70 FR 19012).

The material issues on the record of the hearing relate to:

1. Amending the fluid milk product definition.

#### **Findings and Conclusions**

This decision recommends maintaining the current 6.5 percent nonfat milk solids criteria and incorporating an equivalent 2.25 percent minimum true protein criteria in determining if a product meets the fluid milk product definition. This decision proposes that for purposes of computing the true protein or nonfat milk solids content of a product, all milk-derived ingredients be included.

This decision also proposes to exempt from the fluid milk product definition "drinkable" yogurt products (often

referred to as smoothie products) that contain at least 20% yogurt, Kefir, and dietary products designed to be meal replacements that are marketed to the health care industry regardless of packaging. As proposed, such products would be considered Class II products and the dairy ingredients included in these products would be priced at the Federal order Class II price.

Federal milk orders currently specify that a fluid milk product shall include any milk product in fluid or frozen form that contains less than 9 percent butterfat that is intended to be used as beverages. The fluid milk product definition contains a non-definitive list of dairy products that are fluid milk products. It also sets a maximum upper limit on the butterfat contained in a product of 9 percent and a lower limit of 6.5 percent nonfat milk solids by weight for a product to be considered a fluid milk product. Dairy products that do not fall within these limits are not considered fluid milk products and the milk used to produce these products are classified in Class II, Class III or Class IV depending on the form or purpose for which the products are to be used.

Eleven proposals were published in the hearing notice for this proceeding. Proposals 1, 3, 4, and 6 were abandoned at the hearing by their proponents in support of other noticed proposals. No further reference to these proposals will be made.

A proposal published in the hearing notice as Proposal 2, offered by Dairy Farmers of America, Inc. (DFA), seeks to amend the fluid milk product definition to include any dairy ingredient, including whey, when calculating the milk contained in a product on a protein-equivalent or nonfat solids equivalent basis. DFA is a dairy farmer-member owned cooperative whose members milk is pooled throughout the Federal order system.

H.P. Hood LLC (H.P. Hood), which owns and operates milk processing and manufacturing plants in the Eastern and Midwest United States, is the proponent of a proposal published in the hearing notice as Proposal 5 that was modified at the hearing. As modified, Proposal 5 seeks to amend the fluid milk product definition to include any product that, based upon substantial evidence as determined by the Department, directly competes with other fluid milk products and that the Department must make a written determination before any product can be reclassified as a fluid milk product.

A proposal published in the hearing notice as Proposal 7 was offered by the National Milk Producers Federation (NMPF). NMPF consists of 33 dairy-

farmer member cooperatives that represent more than 75 percent of U.S. dairy farmers. Proposal 7 seeks to amend the fluid milk product definition by removing the reference "6.5 percent nonfat solids standard and whey," and adopting a 2.25 percent true milk protein criteria. During the hearing, DFA offered a modification to Proposal 7 by seeking to authorize the Department to make an interim classification determination for new products that result from new technology. The Department would then convene a hearing to address the use of the new technology in classification decisions and make a final classification determination for the new product within one year.

A proposal published in the hearing notice as Proposal 8 seeks to amend the fluid milk product definition by excluding yogurt-containing beverages. This proposal was offered by The Dannon Company, Inc. (Dannon), a wholly owned subsidiary of The Danone Group, which produces yogurt and fresh dairy products in 40 countries including the United States.

A proposal published in the hearing notice as Proposal 9 also seeks to amend the fluid milk product definition by excluding drinkable food products that contain at least 20 percent yogurt by weight from the fluid milk product definition. Proposal 9 was offered by General Mills, Inc. (General Mills), a food manufacturer that markets such products as Yoplait yogurt and yogurt-containing products in over 100 countries, including the United States.

A proposal published in the hearing notice as Proposal 10 was offered by the Novartis Nutrition Corporation (Novartis). Novartis is a company that develops and manufactures products, including milk based products, designed to meet specific nutritional needs. Proposal 10 seeks to amend the fluid milk product definition by removing the 6.5 percent nonfat milk solids standard and excluding formulas prepared for dietary use.

A proposal published in the hearing notice as Proposal 11 seeks to amend the fluid milk product definition by excluding healthcare beverages distributed to the healthcare industry. Proposal 11 was offered by Hormel Foods, LLC (Hormel), a wholly-owned subsidiary of Hormel Foods Corporation and manufacturer of a variety of food products primarily for the health care industry.

A witness appearing on behalf of National Milk Producers Federation (NMPF) testified in support of Proposal 7. The witness testified that Proposal 7 would close loopholes in the current

fluid milk product definition that have allowed products developed as a result of new technology to avoid classification as a fluid milk product. The witness said that the 6.5 percent nonfat solids standard should be eliminated and replaced with a 2.25 percent protein standard that would also include whey proteins in determining if the product meets the protein standard. The witness stressed that whey proteins should be defined as whey proteins that are a by-product of the cheese making process. The witness was of the opinion that adoption of Proposal 7 would not alter the classification of any product currently being marketed.

The NMPF witness stressed that Federal order regulations have always adapted to marketing conditions and that the current fluid milk product definition should be amended to reflect changes in market conditions brought about by changes in technology. The witness testified that technology has evolved such that milk can now be separated into numerous components that can be recombined to create a vast number of new milk products. The witness argued that new technology has enabled manufacturers to manipulate milk components, such as removing lactose or substituting whey for other milk solids, to create new products that contain less than 6.5 percent nonfat milk solids. This enables manufacturers of the new products to avoid classification of the new product as a fluid milk product even though the form and use does not differ from what is currently considered as fluid milk products.

The NMPF witness testified that Carb Countdown<sup>®</sup>, a product manufactured by the H.P. Hood Company, contains whey and has a reduced lactose content that results in its composition below 6.5 percent nonfat milk solids standard. According to the witness, two market research studies suggest that the product is similar in form and use to traditional fluid milk. Relying upon a market study conducted by IRI, a market research firm, the witness related that 98.4 percent of Carb Countdown<sup>®</sup> sales are purchased as a substitute for fluid milk while only 1-percent of its sales are represented as an expansion of the fluid milk market.

The NMPF witness was of the opinion that classifying a product on the basis of protein is appropriate because protein is the highest valued skim component in the marketplace. The witness testified that a 2.25 percent protein standard is the appropriate equivalent of the current 6.5 percent nonfat milk solids standard. The witness asserted that protein has

the most value to producers, processors and consumers because it contributes to milk nutrition, flavor and texture. While the witness was of the opinion that all dairy-derived ingredients should be used in computing the true protein standard of a product, the witness did not believe whey and whey product ingredients should be priced at the Class I price. The witness maintained that the use of whey and whey products should not exclude a product from the fluid milk product definition because manufacturers are using whey in their new products to avoid a fluid milk product classification. The witness also noted that instead of relying upon the Food and Drug Administration (FDA) standard, the Department should provide its own definition of whey.

A post-hearing brief submitted on behalf of NMPF reiterated the positions they testified to at the hearing. The brief asserted that adoption of a protein standard would close regulatory loopholes that prevent products developed as a result of new technology from avoiding classification as a fluid milk product. According to the brief, adoption of a true protein standard merely changes the way milk proteins are accounted for and would not change the classification of any product. However, these changes would capture those products currently formulated to avoid being classified as a fluid milk product.

A witness from Dairy Farmers of America (DFA), appearing on behalf of DFA and Dairylea Cooperative, Inc., (DLC), testified in support of NMPF's Proposal 7 and Proposal 2. DFA is a dairy-member owned cooperative with 12,800 member farms located in 49 states. DLC is a dairy-member owned cooperative with 2,400 member farms located in seven states.

The DFA/DLC witness was of the opinion that the purpose of the hearing was to refine the fluid milk product definition to reflect current market conditions brought about by technological innovations to ensure that dairy farmers are equitably paid for their milk. The witness testified that dairy processing technology, such as ultra filtration and milk component fractionalization, has enabled new products to be developed that were not foreseen when the current classification definition was last considered.

The DFA/DLC witness testified that the current fluid milk product definition does not recognize the value of dairy proteins in the development of new products and therefore does not classify and subsequently price these new products appropriately. The witness claimed that manufacturers formulate

their products so as to contain less than 6.5 percent total nonfat milk solids to avoid a Class I use of milk even though these products compete directly with and are substitutes for fluid milk and fluid milk uses.

The DFA/DLC witness was of the opinion that the form and use of a product should be the primary factor in determining product classification. The witness said that secondary criteria used to make classification determinations should include such factors as: Product composition, a specific but not exclusive list of included and excluded dairy products, product substitutability and enhancement of producer revenue. The witness argued that eliminating the current total nonfat milk solids standard and replacing it with an equivalent milk protein standard would better reflect the demand for dairy proteins in the marketplace.

The DFA/DLC witness offered a modification to Proposal 7 that the witness said would provide the Department with latitude for classifying future products which are a result of new technology. The witness explained that the modification would allow the Department to make an interim classification decision for a new product and then have up to one year to hold a public hearing to determine the appropriate permanent classification.

The DFA/DLC witness also testified in support of Proposal 2. The witness said that its adoption would recognize the importance of dairy proteins in the marketplace by including all dairy protein sources, including whey and whey products, in computing the products protein content. However, said the witness, while whey and whey products would be used in classification determinations, those ingredients should not be priced as Class I.

A post-hearing brief submitted on behalf of DFA/DLC reiterated their support for adopting a protein standard. The brief reiterated their claim that new technology has enabled some products that contain less than 6.5 percent nonfat milk solids to be classified at a lower use-value than competitors in the market. The brief maintained that adoption of a protein standard would more adequately identify products that should be classified as fluid milk product's in light of new fractionation technology.

A witness appearing on behalf of O-AT-KA Milk Products Cooperative, Inc. (O-AT-KA) testified in support of Proposals 2 and 7. O-AT-KA is a cooperative owned by the dairy farmer members of Upstate Farms Cooperative, Inc.; Niagara Milk Cooperative, Inc. and Dairylea Cooperative, Inc. The witness

was of the opinion that the development of new technology necessitates a change to the fluid milk product definition. However, the witness cautioned that changes should not capture all beverages which contain milk solids as fluid milk products because not all milk-containing beverages compete with fluid milk.

The O-AT-KA witness asserted that Proposal 7 should not be thought of as a fundamental change to the current standard; rather that the proposed true protein standard of 2.25 percent is an equivalent to the current 6.5 percent nonfat milk solids standard and should be considered as a needed clarification brought about by new technological advances in milk processing. According to the witness, the proposed 2.25 percent standard recognizes protein as a highly-valued ingredient in milk products and that products with less than 2.25 percent protein would remain exempt from fluid milk product classification. The witness also advocated the adoption of Proposal 2 which would include whey and whey products in the computation of the protein percentage of the product but would not price the whey ingredients at Class I prices.

A post-hearing brief, submitted on behalf of O-AT-KA, reiterated their support for Proposal 7. The brief claimed that the adoption of the protein standard would increase the use of dairy ingredients in beverages that are not "in the competitive sphere of the traditional milk beverages," thus increasing producer revenue. The brief also supported DFA/DLC's modification to Proposal 7 giving the Department authority to make an interim classification decision if a new product is a result of new technology.

A post-hearing brief submitted on behalf of Select Milk Producers, Inc. (Select) and Continental Dairy Products (Continental) expressed support for adoption of a protein standard as a component of the fluid milk product definition. According to the brief, Select and Continental are dairy-farmer owned cooperatives that market milk on various Federal orders. The brief argued that adoption of a protein standard is a needed change to reflect current manufacturing technology and does not fundamentally alter current regulations. The brief stressed that milk proteins are valuable ingredients in the market and that classification and pricing determinations should be reflective of this.

A witness appearing on behalf of H.P. Hood testified in opposition to any changes to the fluid milk product definition. The witness was of the

opinion that the fluid milk product definition should not be amended in a manner that would classify more dairy products as fluid milk products unless data is provided which would conclude such products compete directly with fluid milk and such amendments would enhance producer revenue.

The H.P. Hood witness asserted that if Proposal 7 was adopted and resulted in the reclassification of some products as fluid milk products, the change would only affect a small number of products and the enhancement of producer revenue would be minimal. If ingredient substitution for milk occurred as a result of adopting other proposals, the witness said, producer revenue could actually decrease. The witness was of the opinion that adoption of proposals which broaden the fluid milk product definition would stifle product innovation and discourage the use of dairy-derived ingredients because of the resulting increased costs to the manufacturer. These results, the witness said, should not be encouraged by the Federal milk order program.

A post-hearing brief submitted on behalf of H.P. Hood reiterated their opposition to Proposal 7. The brief maintained that no disorderly marketing conditions exist to warrant a change to the fluid milk product definition and that proponents of the protein standard failed to meet the burden of proof required by the AMAA to make a regulatory change. The H.P. Hood brief reviewed many factors used by the Department in previous classification decisions to determine the proper classification of Class I products. Their list included, but was not limited to, demand elasticities, enhancement of producer revenue and product competition. The brief stated that proponents failed to provide adequate data addressing these factors or prove that disorderly marketing conditions exist to warrant a change, and urged the Department to terminate the proceeding.

A witness appearing on behalf of Leprino Foods Company (Leprino) testified in opposition to the adoption of the 2.25 percent protein standard contained in Proposal 7. According to the witness, Leprino operates nine plants in the United States that manufacture mozzarella cheese and whey products. The witness was of the opinion that a protein standard would reclassify products such as sport and protein drinks and yogurt smoothie products that are formulated with ingredients such as whey and whey products as fluid milk products. The witness stressed that broadening the fluid milk product definition to account for all dairy derived ingredients could

lessen the demand for such ingredients. The witness speculated that manufacturers may seek out other less costly non-dairy ingredient substitutes which would result in decreased producer revenue.

A witness appearing on behalf of Dannon testified in opposition to Proposals 2 and 7. The witness was opposed to the adoption of a protein standard and to the inclusion of whey when calculating the nonfat milk solids content of a product because, the witness said, it was not the original intent of the fluid milk product definition to include these milk-derived ingredients. The witness believed that adoption of a protein standard would cause more products to be classified as fluid milk products even though they do not compete with fluid milk. The witness argued that protein is not a major component of fluid milk products and therefore using a protein standard would not be appropriate for making classification determinations. The witness speculated that if a protein standard was adopted, it could stifle product innovation or cause food processors to use non-dairy ingredients in their food products. The witness also opposed Proposal 2 seeking to include whey proteins in determining the protein content of a product. The witness said that if whey proteins are included, manufacturers may look for less expensive non-dairy ingredients to be used as a viable substitute.

A post-hearing brief submitted on behalf of Dannon reiterated their opposition to the adoption of a protein standard claiming that adequate justification for such a change was not given by proponents at the hearing and that the mere ability to test for milk proteins does not justify its adoption.

A post-hearing brief submitted on behalf of the National Yogurt Association (NYA) expressed opposition to Proposal 7. According to the brief, NYA is a trade association representing manufacturers of live and active culture yogurt products and suppliers of the yogurt industry. The brief claimed that proponent testimony was inconsistent regarding the impact on product classification of their proposals and stated that if the 2.25 percent protein standard were adopted, at least one yogurt-containing product would be reclassified as a fluid milk product. The brief also asserted that proponents did not provide a clear picture of how Proposal 7 would be implemented. Specifically, the brief noted that the following were not addressed: (1) How wet and dry whey would be handled, (2) how whey from cheese production would be differentiated from whey from

casein production, and (3) how products that meet the proposed 2.25 percent true protein standard and contain whey and other proteins would be classified and priced was not addressed.

The NYA brief speculated that including whey in the protein calculation would lead to more products being classified as fluid milk products and cause manufacturers to seek out less costly non-dairy ingredients. The potential loss to producer revenue by substitution with non-dairy ingredients, concluded the brief, is not supported by the record.

A post-hearing brief submitted on behalf of National Cheese Institute (NCI) expressed opposition to Proposal 7 and claimed that its adoption would stifle the use of dairy-derived ingredients, particularly whey proteins. According to the brief, NCI is a trade association representing processors, manufacturers, marketers and distributors of cheese and related products. NCI claimed that proponents of Proposal 7 did not identify any specific marketplace disorder that would be corrected by the adoption of a protein standard or list any product that would be reclassified if the fluid milk product definition were amended. The brief reviewed previous rulemaking decisions where proposals were denied because proponents failed to demonstrate that disorderly marketing conditions were present.

The NCI brief stressed that use of dairy-derived ingredients in a product should not automatically qualify a product as a competitor of fluid milk or that their classification in a lower-valued use negatively affects producer revenue. The brief further maintained that proponents did not adequately address why whey proteins should be included in determining if the product met the proposed protein standard for a fluid milk product and why whey should be priced at the Class I price. The brief concluded that whey should be excluded from the fluid milk product definition because its inclusion would lead to products being classified as fluid milk products even when they do not compete with fluid milk.

A post-hearing brief submitted on behalf of Sorrento Lactalis, Inc. (Sorrento) objected to the adoption of a protein standard. According to the brief, Sorrento is a manufacturer that operates five cheese plants throughout the United States. The brief stated that adoption of a protein standard as part of the fluid milk product definition would reduce the demand for dairy ingredients, especially whey proteins, which in turn will result in increased costs to manufacturers and reduced producer revenue.

A witness testifying on behalf of H.P. Hood was of the opinion that if the Department found changing the fluid milk product definition was warranted, adoption of a modified Proposal 5 would be appropriate. The witness said that adoption of Proposal 5 would provide the Department with standards to determine if a dairy product with less than 6.5 percent nonfat milk solids competes with and displaces fluid milk sales which would justify classification of the product as a fluid milk product. The witness also noted that if Proposal 5 was adopted, a new product with less than 6.5 percent nonfat milk solids and route distribution in a Federal milk marketing area of less than 3 million pounds would be exempted from classification as a fluid milk product. This distribution criteria, the witness explained, would allow manufacturers to test market a new product with the assurance that it would not be classified as a fluid milk product until the distribution threshold was exceeded.

A witness appearing on behalf of Leprino testified in support of Proposal 5. The witness was of the opinion that fluid milk products should only be those products that meet the FDA standard of identity for milk and cultured buttermilk and products that compete with milk and cultured buttermilk. The witness testified that the fluid milk product definition is currently too broad and as a result, has lessened the demand for dairy ingredients in new non-traditional dairy products because of the possibility of being classified as a fluid milk product. The witness argued that many of these new products do not compete for sales with fluid milk and their use of dairy-derived ingredients should not qualify them to be defined as a fluid milk product.

The Leprino witness explained that advances in technology have allowed the creation of dairy-derived ingredients through milk fractionation. The witness stated that the use of dairy-derived ingredients has made it difficult to classify products by their components. According to the witness, dairy manufacturers are avoiding investing in some product innovation because of the regulatory burden and increased costs that are associated with manufacturing a fluid milk product.

A witness testifying on behalf of DFA/DLC was opposed to the adoption of Proposal 5. The witness said that Proposal 5 would place an undue burden on the Department in making classification determinations and would also extend Class II classification to more products, neither of which the witness supported. The post-hearing

brief submitted by DFA/DLC reiterated their opposition.

A witness appearing on behalf of Bravo! Foods International Corporation, Lifeway Foods, Inc., PepsiCo, Starbucks Corporation and Unilever United States, Inc., testified in opposition to all proposals that would reduce or eliminate the 6.5 percent minimum nonfat milk solids standard, adopt a protein standard, or include whey in determining the nonfat milk solids content of a product. Hereinafter, these companies are referred to collectively as Bravo!, *et al.*

A post-hearing brief submitted on behalf of Bravo!, *et al.*, urged the termination of the proceeding except for the portion addressing the exemption of yogurt and kefir products from the fluid milk product definition. Bravo!, *et al.*, asserted that the hearing record does not support adoption of a protein standard. The brief stated that decisions to amend Federal order provisions are not made without clear evidence of disorderly market conditions, the potential shortage of milk for fluid use, or lowering of producer revenue. The brief also discussed letters sent to the Department by producers and manufacturers which urged that a hearing be postponed because more analysis and market data was needed to justify amending the current fluid milk product definition. Bravo!, *et al.*, argued that conducting the hearing was premature and without adequate study and market data on the proposals that are under consideration. According to the brief, more time was needed to accurately determine the impact of new milk products on the marketplace.

The Bravo!, *et al.*, brief summarized hearing testimony from previous Department rulemaking decisions where no changes were recommended due to a lack of evidence to support a regulatory change. The brief asserted that this proceeding also lacked evidence of disorderly marketing conditions which would warrant a change to the fluid milk product definition. According to Bravo!, *et al.*, proponents did not provide evidence of disorder in the marketplace nor did they substantiate their claims that products currently in the market would not be reclassified if a protein standard was adopted. On the basis of such conditions, the brief concluded that the current fluid milk product definition is adequate.

If the Department did not terminate the proceeding, the Bravo!, *et al.*, brief recommended that the 6.5 percent nonfat milk solids standards remain, that the computation of nonfat milk solids not be made on a milk

equivalency basis, and that whey and whey ingredients be excluded from the computation.

A witness appearing on behalf of Fonterra USA, Inc. (Fonterra) testified in opposition to proposals that would include milk protein concentrates (MPCs) in determining if the product met the protein standard of the fluid milk product definition. Fonterra is a wholly owned subsidiary of Fonterra Co-operative Group Limited, a New Zealand based dairy cooperative owned by 12,000 New Zealand dairy farmers. Fonterra operates plants within the United States that produce, among other things, MPCs. The witness stressed that changes to the fluid milk product definition would increase ingredient costs, discourage manufacturing companies from using dairy ingredients in their products, and force those companies to seek other less costly substitutes such as soy and soy products.

A post-hearing brief submitted on behalf of Fonterra reiterated their objection to changing the nonfat milk solids standard and predicted that adoption of a protein standard would make classification decisions unnecessarily complicated without providing additional benefits to producers. The brief asserted that the hearing record did not contain a sufficient economic analysis on the possible benefits that adopting a protein standard would have on producer revenue or its impact on the dairy industry.

The Fonterra brief speculated that adoption of a protein standard would increase the market price for milk proteins, discourage new product development and encourage the substitution of producer milk with non-dairy ingredients. The brief noted that the annual growth rate of soy and soy products in nutritional products from 1999 to 2003 was 16.5 percent, while the growth of milk proteins in nutritional products only increased 10.1 percent over the same time period. The brief predicted that if protein prices rise as a result of the adoption of a protein standard, the growth of soy proteins will likely increase because they could be substituted for more costly milk proteins.

The Fonterra brief also stated that the hearing record does not reveal disorder in the market by the application of the current fluid milk product definition and therefore concluded that amending the fluid milk product definition is not justified. The Fonterra brief also argued that proponents did not provide adequate reasoning for including whey proteins in determining if a product met

the protein standard but not pricing whey proteins the same as other milk proteins. Furthermore, the brief stated that proponents did not propose a method for differentiating between whey proteins resulting from cheese production and whey proteins from other sources.

A witness appearing on behalf of the American Beverage Association (ABA) testified in opposition to all proposals seeking to amend the fluid milk product definition. ABA is a trade association that represents beverage producers, distributors, franchise companies and their supporting industries. The witness was of the opinion that the current fluid milk product definition already properly classifies dairy products and that there is insufficient evidence to warrant any changes. The witness claimed that any change would broaden the fluid milk product definition to include products that contain only small amounts of milk. The witness argued that many new beverage products which contain small amounts of milk or milk ingredients do not compete with fluid milk but do compete with soft drinks, juices and bottled water. The witness asserted that amending the fluid milk product definition to include some dairy ingredients not currently considered would increase manufacturers cost of production, result in stifled innovation of new products and encourage the use of non-dairy ingredients as substitutes for milk-derived ingredients.

A witness appearing on behalf of Ohio Farmers Union (OFU) testified in opposition to any change to the fluid milk product definition. The witness testified that the primary purpose of the Federal milk marketing order program was to provide consumers with a reliable supply of safe and wholesome milk. The witness asserted that MPC's, caseinates, whey proteins and other similar milk-derived ingredients have functional and nutritional characteristics different than fluid milk. Accounting for those ingredients in the fluid milk product definition, the witness said, would undermine the goal of the Federal milk order program. The witness stressed that if the fluid milk product definition was amended, consumer confidence in the long established perception of milk as a fresh, pure and wholesome beverage would be diminished and would thus threaten the economic viability of domestic producers.

A witness appearing on behalf of the Milk Industry Foundation (MIF) testified in opposition to amending the fluid milk product definition. According to the witness, MIF is an organization

with over 100 member companies that process and market approximately 85 percent of the fluid milk and fluid milk products consumed nationwide. The witness stated that simply because a beverage contains milk or other dairy-derived ingredients does not prove the proponents claim that those products compete with fluid milk or that such competition lowers producer revenue.

The MIF witness asserted that previous Federal milk order rulemaking decisions have required data and analysis to prove that an amendment is warranted. According to the witness, the proponents of proposals for changing the fluid milk product definition did not provide such data and analysis. Along this theme, the witness said that proponents should have provided data such as the market share held by products that do not fall under the current fluid milk product definition but would be included under any proposed change, cross price elasticity of demand analysis of products which meet the existing fluid milk product definition and of products that would be classified as a fluid milk product if any of their proposals were adopted, and an own-price elasticity of demand analysis for products that would be reclassified.

A post-hearing brief submitted on behalf of MIF reiterated their opposition to any changes to the current fluid milk product definition. The brief urged that if the Department does amend the fluid milk product definition, it should exclude all whey-derived protein products in determining if a product meets the fluid milk product definition. The brief stated that MIF has continuously opposed a hearing to consider amending the fluid milk product definition because they are of the opinion that not enough evidence is available to warrant a change. The brief maintained that proponents did not offer adequate data at the hearing to demonstrate that there is disorder in the marketplace that can be remedied by adoption of a protein standard.

The MIF brief expanded their testimony by citing numerous rulemaking decisions which denied proposals on the basis that adequate evidence was not presented to warrant amendments to order provisions. MIF stressed that the mere existence of beverages which contain dairy-derived ingredients is not evidence of marketwide disorder.

A witness appearing on behalf of the National Family Farm Coalition (NFFC) testified in opposition to all proposals that would amend the fluid milk product definition. The witness testified that MPCs do not meet FDA's Generally Recognized as Safe (GRAS) standards as

legal food ingredients. Furthermore, the witness said, MPCs have not been subjected to scientific testing to determine if they are safe for human consumption and should not be allowed in milk products.

A witness appearing on behalf of Public Citizen testified in opposition to proposals that seek to amend the fluid milk product definition. According to the witness, Public Citizen is a non-profit consumer advocacy organization with approximately 150,000 members. The witness was opposed to any change in the fluid milk product definition that would, in the witnesses' opinion, encourage the use of MPCs.

Two Pennsylvania dairy farmers testified in opposition to any change to the fluid milk product definition. The producers opposed all proposals that would allow the use of caseinates and MPCs in fluid milk products. They asserted that MPCs are not allowed in the production of standardized cheese and should also not be allowed in the production of fluid milk products.

A post-hearing brief submitted on behalf of the American Dairy Products Institute (ADPI), an association representing manufacturers of dairy products, offered support for amending the fluid milk product definition to include milk beverages that compete directly with fluid milk. However, the brief cautioned against developing a fluid milk product definition that would include non-traditional beverages and smoothie type (yogurt-containing beverages) products. The brief recommended that an economic study be conducted to determine the possible impacts of the proposed changes before action is taken to amend the fluid milk product definition.

A post-hearing brief submitted on behalf of General Mills contended that the fluid milk product definition should not be amended because proponents did not provide sufficient evidence or data that would justify the change. The brief maintained that the hearing record is not clear on how proposals would be implemented or on the impact to producers, manufacturers, and consumers if the protein standard was adopted. General Mills contended that before a change is made, the Department should conduct an economic analysis to evaluate how protein and products are competing in the marketplace and how the adoption of a protein standard would impact the marketplace. If a protein standard was recommended for adoption, General Mills recommended that whey not be included in the protein calculation, or if whey is included, that a 2.8 percent protein standard be

adopted in order to maintain the status quo.

A post-hearing brief submitted on behalf of New York State Dairy Foods, Inc. (NYSDF) opposed amending the fluid milk product definition. According to their brief, NYSDF is a trade association representing dairy product processors, manufacturers, distributors, retailers and producers in the Northeast United States. The brief argued that products produced with the use of new fractionation technology are a small portion of the milk beverage market. They were of the opinion that such products are still too new to determine their impact on Class I sales and producer revenue. The brief also asserted that adoption of a protein standard as part of the fluid milk product definition would discourage new product development and would increase costs that would result in reduced sales of dairy-derived ingredients. The brief urged that the proceeding be terminated.

A Professor from Cornell University testified regarding a research study, conducted by the Cornell Program on Dairy Markets and Policy, focusing on the demand elasticity's of various dairy products. The witness did not appear in support of or in opposition to any proposal presented at the hearing. The witness explained that the goal of the study was to ascertain the extent to which product innovation and classification decisions influence producer revenue. The study was designed to evaluate four hypothetical dairy products and test the effect that a range of classification determinations would have on producer revenue. The witness explained the study concluded that the impact on producer revenue of a new product being reclassified from Class II to Class I was likely to be small, plus-or-minus \$0.01 per hundredweight (cwt.) However, the witness added, if non-dairy ingredients were substituted as a result of the reclassification, the study predicted that the effect on producer revenue would be lowered by \$0.22 per cwt. The witness concluded that while the financial returns from product reclassification could be positive, the resulting ingredient substitution which could take place would result in a significant negative impact on producer revenue.

The NMPF brief also addressed concerns articulated at the hearing regarding the need for a demand elasticity study to address the issue of product substitution before amending the fluid milk product definition. The brief asserted that a demand elasticity study would not take into account newly emerging products, changing

consumer preferences, and product innovations that could change the competitive relationships between products and therefore would not provide any relevant data. The brief also argued that the economic model created by Cornell University and discussed at the hearing contained many incorrect assumptions and thus concluded that the study results were flawed.

The DFA/DLC brief also rebutted opposition to Proposal 7 that called for studies of product usage or demand elasticity's before considering amendments to the fluid milk product definition. The brief asserted the previous amendments to the classification system have been made without such economic studies and that this proceeding should be handled in the same manner.

A witness appearing on behalf of Dannon testified in support of Proposal 8—the proposal that seeks to exclude yogurt containing beverages which contain at least 20 percent yogurt by weight from the fluid milk product definition. The witness argued that yogurt containing beverages are not similar in form and use to fluid milk products and should be excluded from the fluid milk product definition. The witness revealed that Dannon currently manufactures yogurt containing products which are classified as both fluid milk products and Class II products. Dannon maintained that regardless of the classification, none of their products compete with fluid milk. According to the witness these products should all be classified as Class II. The witness emphasized that unlike fluid milk, yogurt and yogurt-containing products use unique cultures, ingredients, and production technology that differentiate them from fluid milk products. Furthermore, the witness said, the products' packaging, taste, mouth feel, shelf-life and how they are marketed by their placement in the grocery store differentiates them from fluid milk.

The witness presented market research conducted by Dannon which concluded that yogurt-containing beverages are consumed as a food product and not as an alternative to fluid milk. The witness claimed that less than one percent of potential consumers of a Dannon yogurt-containing product consume the product as a substitute for fluid milk. Additionally, the witness noted that Dannon advertises its yogurt-containing products as a substitute for snacks, not fluid milk. The witness concluded from this that yogurt-containing products are different than fluid milk, do not compete with fluid milk in the

marketplace and therefore should not be classified as a fluid milk product. The Dannon witness urged the adoption of Proposal 8 to exclude yogurt containing beverages with at least 20 percent yogurt by weight from the fluid milk product definition.

The Dannon witness also testified in opposition to Proposal 9 because it proposes adoption of a protein standard that Dannon does not consider justified. The witness noted that Dannon does support the proposed 20 percent minimum yogurt content standard that a product should contain as a condition for being exempted from fluid milk product classification.

A post-hearing brief submitted on behalf of Dannon reiterated their hearing testimony. The brief claimed that fluid milk products should only be those products that are closely related to, or compete with, fluid milk for sales. The brief stressed that yogurt-containing beverages are dissimilar to fluid milk beverages and are used as a food replacement, not as a beverage substitute. The brief noted that in 2004, more than 37 percent of Dannon's sales were from products developed within the last 5 years and stressed that classifying all milk drinks with milk-derived ingredients as fluid milk products would result in decreased innovation for developing additional uses for milk.

A witness appearing on behalf of General Mills testified in support of Proposal 9. The witness argued that the Department should classify products primarily on the basis of form and use and asserted that drinkable yogurt products, while containing milk ingredients, are food products and do not compete with fluid milk. The witness explained that drinkable yogurt products were created to meet a change in consumer preferences for convenience and portability. The witness presented market research conducted by Yoplait demonstrating that consumers view drinkable yogurt products as alternatives to traditionally packaged yogurt and other nutritional snacks, not fluid milk. The witness asserted that 80 percent of Yoplait drinkable yogurt smoothie consumers would substitute another yogurt product for the smoothie.

The General Mills witness advocated that the current classification system be maintained. However, if the Department determined that a change to the fluid milk product definition is appropriate, the witness urged adoption of Proposal 9 to exclude drinkable yogurt products that contain at least 20 percent yogurt by weight and 2.2 percent skim milk protein from the fluid milk product

definition. According to the witness, including drinkable yogurt products in the fluid milk product definition would increase costs to manufacturers resulting in stifled innovation and a shift towards using non-dairy ingredients. The witness said this would be financially detrimental to both dairy farmers and dairy product manufacturers.

A post-hearing brief submitted on behalf of General Mills maintained that ample evidence regarding the fundamental differences of fluid milk and yogurt containing beverages was presented at the hearing to justify exempting yogurt containing products with more than 20 percent yogurt from classification as a fluid milk product.

Two witnesses appearing on behalf of the National Yogurt Association (NYA) testified in support of proposals that would exempt yogurt containing products from the fluid milk product definition. The witnesses testified that previous regulatory decisions made by the Department emphasized that products classified as fluid milk products should be intended to be consumed as beverages and compete with fluid milk. The witnesses expressed disagreement with a classification decision published in the 1990's that classified drinkable yogurt products as fluid milk products. The witnesses were of the opinion that in both form and use, yogurt and drinkable yogurt products compete with other food products, not fluid milk, and should accordingly be classified as Class II products. They explained that yogurt products are produced and shipped nationally by a few manufacturers, have a shelf-life averaging 30–60 days, have a texture and taste distinctly different than fluid milk and are positioned in retail stores separate from fluid milk. The witnesses noted that yogurt-containing beverages were developed as a substitute for spoonable yogurt products not fluid milk.

The NYA witnesses asserted that if a protein standard was adopted that resulted in yogurt containing products being classified as fluid milk products, manufacturers would look for less expensive non-dairy proteins as substitute ingredients. Furthermore, the witnesses believed that the increase in producer revenue resulting from classifying drinkable yogurt products as fluid milk products would not overcome the decrease in revenue due to the loss of sales from an increase in the price of drinkable yogurt products.

A post-hearing brief submitted on behalf of the NYA reiterated their support for excluding all products containing at least 20 percent yogurt

provided that the yogurt meets the standard of identity for yogurt. According to the brief, the 20 percent content requirement would ensure that only products whose characterizing ingredient is yogurt would be excluded from the fluid milk product definition. The brief also indicated that if the Department determines not to exclude yogurt containing products, then NYA strongly opposes any change to the current fluid milk product definition.

The NYA brief argued that consumer surveys and marketplace data provided by Dannon and General Mills, explaining how yogurt-containing products are fundamentally different than fluid milk, was not contradicted at the hearing. The brief also noted that while DFA and NMPF testified that consumers are buying low-carbohydrate milk instead of fluid milk, they did not offer similar evidence for yogurt-containing products.

A witness appearing on behalf of Bravo!, *et al.*, testified in support of amendments that would exempt yogurt containing products and drinkable kefir from the fluid milk product definition. The witness argued that both products are compositionally different than fluid milk and do not compete for sales with fluid milk. Furthermore, the witness noted that yogurt and kefir products are one of the fastest growing segments in the dairy industry, providing a large opportunity for the expanded use of dairy-derived ingredients which should not be hampered by the additional costs of such ingredients being priced at the Class I price.

The witness appearing on behalf of Leprino testified that if the Department recommended amending the fluid milk product definition, then Leprino supported the adoption of Proposal 9 to exclude products containing at least 20 percent or more yogurt by weight from the fluid milk product definition. The witness also was of the opinion that yogurt containing products do not compete with fluid milk and should be classified as Class II products. The witness stressed that if these products are not excluded from the fluid milk product definition, then Leprino strongly opposed the adoption of a protein standard to be part of the fluid milk product definition.

The witness appearing on behalf of NMPF testified in opposition to exempting yogurt-containing beverages from the fluid milk product definition. The witness believed that these products are similar in form and use to other flavored fluid milk products and should be considered a substitute for fluid milk. In its post-hearing brief, NMPF maintained its opposition to

proposals that would exclude drinkable yogurt products from the fluid milk product definition.

The witness appearing on behalf of DFA/DLC also testified in opposition to the adoption of Proposals 8 and 9. The witness claimed that adoption of these proposals would allow more products to be classified as Class II products, even though they compete with fluid milk for sales.

The DFA/DLC brief further claimed that the growth of drinkable yogurt products in the market place has not been impeded by previous classification decisions and that such products should not be excluded from the fluid milk product definition because some hearing participants claimed it would harm the innovation of new dairy products.

The witness appearing on behalf of Leprino testified in support of Proposal 10. The witness testified that only products that compete with fluid milk should be classified as fluid milk products; therefore meal replacements and nutritional drinks should remain exempted from the fluid milk product definition.

A post-hearing brief submitted on behalf of Novartis stated that the Department should exempt special dietary need and nutritional beverages from the fluid milk product definition. The brief explained that Novartis' products are not currently classified as fluid milk products due to their nutritional nature, the level of nonfat milk solids contained in their product, and because their products are only available through foodservice and healthcare channels. The brief stressed that Novartis' health care products were never intended to compete with traditional fluid milk.

The brief predicted that Novartis' products could possibly become reclassified as fluid milk products if a 2.25 percent protein standard were adopted as a part of the definition. The brief insisted that if these products are reclassified, it would result in higher costs for patients with special dietary and nutrition needs. If a protein standard was adopted as part of the fluid milk product definition, Novartis urged the Department to exempt nutritional products consumed for special dietary use from the fluid milk product definition.

A witness appearing on behalf of Hormel testified in support of Proposal 11 seeking to exclude healthcare beverages from the fluid milk product definition. The witness testified that fluid milk products designed for the health care industry should be exempted because they do not compete

with fluid milk for sales, their distribution is primarily to health care facilities, and they are targeted to a small segment of the population. The witness argued if products designed for the health care industry were classified as fluid milk products, it would have no effect on producer revenue because these products have extremely limited distribution. The witness explained that many products they manufacture are designed to help counter the effects of malnutrition in adults with a variety of medical conditions. These specially designed products are not marketed nor labeled as fluid milk, instead they are considered to be foods for special dietary use, the witness noted, and should be exempt from the fluid milk product definition.

The Bravo!, *et al.*, witness also testified in support of the continued exemption from the fluid milk product definition for products such as infant formula, meal replacements, products packaged in hermetically sealed containers, snack replacements, high protein drinks, and products that contain alcohol or are formulated for animal use. The witness explained that meal replacements and similar products have historically been exempted from the fluid milk product definition and that their regulatory status should not be changed.

The NMPF witness testified in opposition to Proposal 10 arguing that its adoption would eliminate important factors in determining if a product was specially formulated for a specific dietary purpose that would warrant exemption from the fluid milk product definition. The witness was also opposed to Proposal 11 because the proposed language—"nutrient enhanced fortified formulas"—was too broad and would not clearly distinguish such products from traditional fluid milk products.

The DFA/DLC witness testified in opposition to Proposals 10 and 11. The witness was of the opinion that amending the fluid milk product definition to broaden the exemption of products such as infant formulas and meal replacements was not justified because doing so would significantly lower Class I use. This position was reiterated in their brief.

The witness appearing on behalf of O-AT-KA testified that products packaged in hermetically-sealed containers or that are specialized for longer shelf life should remain exempt from fluid milk product classification because those products are used as meal replacements and meal supplements, not as alternatives to milk. The witness said that since the term "meal replacement"

is not defined in the current definition, no change in the exemption of hermetically sealed containers should be made. The position was reiterated in their brief.

The Dannon witness testified in opposition to the adoption of Proposal 10 because it would remove the 6.5 percent nonfat milk solids standard of the fluid milk product definition.

*Findings:* This decision recommends that the fluid milk product definition for all Federal orders maintain the current 6.5 percent nonfat milk solids product content criteria and incorporate an equivalent true protein standard of 2.25 percent product content criteria for determining whether a product meets the fluid milk product definition. The 6.5 percent nonfat milk solids and the 2.25 percent true protein criteria are not intended to be absolute determinates of whether a product meets the fluid milk product definition. In determining if a product meets the fluid milk product definition, the Department's primary criteria will be the form and intended use of the product as required by the Agriculture Marketing Agreement Act. The calculation of the percent true protein and the percent nonfat milk solids contained in a product will be performed by measuring the true protein and nonfat milk solids of all milk-derived ingredients contained in the finished product.

The primary goal of Federal milk marketing orders is to establish and maintain orderly marketing conditions. This is achieved primarily through the use of classified pricing (pricing milk based on its use) and the marketwide pooling of the proceeds of milk used in a marketing area among all classes of use. These two tools enable Federal orders to establish minimum prices that handlers must pay for milk based on use and return a weighted average or uniform price that dairy farmers receive for their milk. The AMAA specifies that Federal orders classify milk " \* \* in accordance with the form in which or the purpose for which it is used." With respect to milk products, there can be many forms. In most cases, the form of the milk product provides a reasonable basis upon which to differentiate the milk into different classes of use.

Through classified pricing and marketwide pooling, Federal orders promote and maintain orderly marketing by equitably pricing milk used in the same class among competing handlers within a marketing area. This does not mean that handlers will necessarily have equal costs since differences in milk tests, procurement costs, and transportation will impact the final raw milk costs. However, it does

allow handlers to have the same minimum regulated price for milk used in a particular category of products or class of products for which they compete for sales. The regulated minimum price is the class price for the respective class of use. Thus, it is reasonable and appropriate that milk used in identical or nearly identical products should therefore be placed in the same class of use. This tends to reduce the incidence of disorderly marketing that may arise because of price differences between competing handlers.

Federal milk orders classify producer milk (skim milk and butterfat) disposed of or used to produce a product. Producer milk classified as Class I consists of those products that are intended to be used as beverages including, but not limited to, whole milk, skim milk, low fat milk, and flavored milk products like chocolate milk. Producer milk classified as Class II includes milk used in the production of soft or spoonable manufactured products such as sour cream, ice cream, cottage cheese, yogurt, and milk that is used to manufacture other food products. Producer milk classified as Class III includes, among other things, skim milk and butterfat used in the production of hard cheese products. The Class IV use of producer milk generally consists of milk used in the production of any dried milk product such as nonfat dry milk and butter.

Federal orders provide a definition of a "fluid milk product" to identify the types of products that are intended to be consumed as beverages and to specify that the skim milk and butterfat in these types of milk products should be classified as Class I and priced accordingly. The current fluid milk product definition contained in all Federal milk orders provides a non-exhaustive list of products that are specifically identified as fluid milk products. The definition also specifies certain compositional criteria for fluid milk products—any product containing less than 9 percent butterfat and 6.5 percent or more milk solids nonfat. The definition also specifically exempts from the fluid milk product definition formulas especially prepared for infant feeding or dietary use (meal replacement) packaged in a hermetically-sealed container, any product that contains by weight less than 6.5 percent milk solids nonfat, and whey.

Numerous witnesses urged that the definition of milk (standard of identity) not be changed. This decision does not change the definition of milk as defined by the Food and Drug Administration

(FDA) in 21 CFR 131.110. Some witnesses were of the opinion that the addition of various ingredients to milk would cause the resulting product to not meet the Grade A standard. Federal orders do not determine if milk is Grade A or what ingredients are allowed in milk. Federal orders do not establish standards of identity for milk. Such standards are established by other agencies such as a state board of health or the FDA. This decision does amend the definition of a fluid milk product in all marketing orders on the basis of form and intended use.

Testimony given at the hearing and positions taken in post-hearing briefs discussed extensively the importance of form and intended use in determining whether a product should be defined as a fluid milk product. In this regard, the legislation providing for milk marketing orders, as already discussed, provides for milk to be classified in accordance with the form in which or purpose for which it is used. This requirement should be the primary basis for classifying milk. In identifying the form and intended use of milk, all Federal orders currently define a fluid milk product as a product intended to be used as a beverage.

As in the 1974 uniform classification decision and subsequent classification decisions, this decision recommends that the primary criteria to be relied upon for determining whether or not a product should be considered a fluid milk product be its form and intended use. Fluid milk products are drinkable and are intended to be used as beverages. The fluid milk product definition also should continue to list the various products that are identified as fluid milk products and provide criteria to exclude those that are not. The identification of these various fluid milk products in the fluid milk product definition has not been, and is not now, intended to be an all inclusive list of products that are defined to be fluid milk products.

Comparability to the products listed in the fluid milk product definition should also assist in determining if other products should be defined as a fluid milk product. If a product is not one of the listed products but is similar to a listed product, this decision recommends that the form in which and the intended purpose for which the product is used be considered together with the product's composition.

Composition criteria, as currently provided, provides criteria to exclude products from the fluid milk product definition. The criteria that a fluid milk product must contain by weight more than 6.5 percent nonfat milk solids has

been a long-held criteria in defining and excluding products from the definition. However, Federal orders do not define nonfat milk solids. The record reveals that this has been administratively addressed in directives specifying which milk solids should be considered in determining the nonfat milk solids content of a product. Currently, not all nonfat milk solids are considered in this determination even though all of such solids are derived from milk.

This decision recommends continuing to rely, in part, on compositional criteria in determining if a product meets the fluid milk product definition. The fluid milk product definition would continue to state that a product should contain less than 9 percent butterfat and contain more than 2.25 percent true protein or 6.5 percent nonfat solids, by weight. The 9 percent butterfat criteria is currently used as the maximum butterfat content to differentiate between fluid milk products and products that are fluid cream products (a Class II use of milk) and should remain unchanged.

The 2.25 percent true protein criteria should, in most cases, be sufficient to distinguish if a product is a Class I or Class II use of milk. Nevertheless, products that may more closely resemble the listed fluid milk products in form and intended use but contain less than 2.25 percent true protein, may be determined by the Department to meet the fluid milk product definition because the products are competing with fluid milk.

The proposed composition criteria of the fluid milk product definition are not intended to be definitive in determining if a product meets the fluid milk product definition any more than the list of defined fluid milk products is definitive. Rather, the criteria are intended to assist in determining whether or not the product in question has the form and intended use as the listed fluid milk products. This gives first-priority consideration that the primary classification criteria be a product's form and intended use.

Record evidence reveals criticism that the current fluid milk product definition has not changed to reflect the technological advances including the fractionation of milk. While the dairy industry has changed significantly, the principles of product classification on the form and intended use have remained relatively unchanged since 1974. Technological advances that provide the ability to fractionate milk into its more basic components has given rise to the inadequacy of the current fluid milk product definition and the need for its revision. For

example, the ability to separate proteins from the lactose and ash and to separate proteins between casein and "whey proteins" creates the opportunity to make new dairy-based beverages that may be similar to milk but are different in composition. A dairy-based beverage could be made from microfiltered "whey proteins", butteroil, lactose and water that would have equivalent butterfat, true protein, and nonfat solids as milk. Fractionation technology creates the ability to produce dairy-based beverages of almost any composition.

Several witnesses at the hearing addressed specific composition criteria that should be used for determining if a product meets the fluid milk product definition. Proponents of the 2.25 percent true protein criteria explained that with the technology to separate the lactose from the protein in milk, protein also should be used in determining if a product should be a fluid milk product because protein is the highest valued nonfat milk solid and because lactose is the component most often not used in the formulation of many manufactured dairy-based beverages. Under the current 6.5 percent nonfat milk solids criteria, a dairy-based beverage with lactose removed is generally determined to not be a fluid milk product. Milk, in either wet or dry form, that has lactose removed is generalized as "milk protein concentrate (MPC)." MPC has administratively been excluded from being considered a nonfat milk solid even though it is derived from milk. Thus with lactose removed, a product closely resembling milk in form and intended use may contain less than the current 6.5 percent nonfat milk solids even though the protein content could exceed the protein content of milk.

Other testimony contended that protein is not a significant component in fluid milk products and incorporating a protein criteria is therefore not appropriate. Contrary to the view that protein is not a significant component in fluid milk products, in whole milk protein is the third most abundant component following lactose and butterfat. In lowfat milk, protein is the second most abundant component.

Even though the record and post hearing briefs contain considerable discussion concerning the possible substitution of nondairy ingredients in fluid milk products, no data was presented at the hearing to indicate at what price level or degree such substitution would take place. Testimony at the hearing speculated that handlers may use nondairy ingredients in the event that the fluid milk product definition were

broadened, for example, by adoption of the 2.25 percent true protein criteria as an option to the current 6.5 percent nonfat milk solids criteria. Additionally, most handlers who are making new dairy-based beverages were of the opinion that broadening the fluid milk product definition would hinder innovation and new product development.

The addition of a true protein criteria should assist in determining those products that should be considered fluid milk products. The inclusion of a true protein minimum criteria also would assure that products which are comparable to the products listed in the fluid milk product definition will be properly classified as Class I. The 2.25 percent true protein criteria is comparable to 6.5 percent nonfat milk solids.

Proponent witnesses speculated that adoption of a 2.25 percent true protein criteria would not change the classification of products currently not determined to meet the fluid milk product definition. 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. To the extent that existing products meet the proposed fluid milk product definition, such products will be reclassified as fluid milk products.

The Class I use of milk will continue to be priced on skim milk and butterfat. Skim milk and butterfat pricing does not distinguish what components or the level of components that are in the skim fraction. Therefore, even if there is a greater level of protein in the skim fraction, there is no greater value that will be assigned to the skim fraction. Producers may benefit from products being determined as meeting the fluid milk product definition if the dairy ingredients in these products are priced as Class I and not because of the adoption of a 2.25 percent true protein criteria.

The true protein or nonfat milk solids contained in the finished product should be used to determine if the 2.25 percent true protein or the 6.5 percent nonfat solids criteria has been met. The composition of the finished product, including all milk-derived ingredients, will provide a clear comparison of the product in question to the products listed and defined in the fluid milk product definition. These ingredients include, but are not limited to, the specific products listed in the fluid milk definition, nonfat dry milk, milk protein

concentrate, casein, calcium and sodium caseinate, and whey. The compositional content will be computed by using the pounds of true protein or nonfat milk solids in the finished products. For all other purposes, such as pricing and pooling, the fluid equivalent of all dairy ingredients will be used except casein, sodium and calcium caseinate and whey. These dairy ingredients may be used in some form to produce products that are substitutes for other fluid milk products.

Nonfat dry milk is a storable product that is subsequently used in many other products. Nonfat dry milk can be mixed with water and the resulting product can be marketed as skim milk in competition with fresh skim milk or, with the addition of cream or butter, and water, a product could compete with fresh whole milk. Federal milk orders have long held, and this decision reaffirms, that nonfat dry milk reconstituted to make a fluid milk product or to fortify a fluid milk product should be assessed the Class I value because the reconstituted or fortified product competes against Class I fluid milk products. The Class I charge, commonly referred to as an "up-charge" or compensatory payment, is based on the difference between the current months Class I price and Class IV price. The compensatory payment is assessed on the volume of reconstituted milk in the modified product, up to the level of an unmodified product. The compensatory payment accounts for the difference from how the dry product was first priced (Class IV) and how the dry product was actually used (Class I.)" The "up-charge" assures equity between competing handlers on raw product cost. The "up-charge" also assures producers that they will receive the Class I value's contribution to a marketing order's blend price for milk marketed as a fluid milk product. Most importantly, it maintains the integrity of classified pricing.

Milk protein concentrate (MPC) in both wet and dry (powdered) forms have similarities to nonfat dry milk even though MPC does not have the same component composition as skim milk or nonfat dry milk. Dry MPC, like nonfat dry milk, is the end result of a manufacturing process (the removal of water and lactose) to convert milk solids into a storable, easily transportable, and versatile product for use in the dairy and food industry. MPCs can be used as a substitute in drinkable/beverage products for the protein and some of the butterfat traditionally supplied by fresh milk, ultra-filtered skim milk, nonfat dry milk, or whole milk powder. These similarities in uses to nonfat dry milk

support concluding that MPCs should be included in determining the nonfat milk solids or true protein content of a drinkable product and, on a fluid equivalent basis, be included in the allocation and pricing of producer milk contained in the fluid milk product.

Because casein, calcium and sodium caseinates and whey are milk-derived, they are recommended to be included in determining if a product is a fluid milk product. However, their use in fluid milk products will not be priced at the Class I price or be subject to an "up-charge" as will nonfat dry milk and MPC. These products can not readily be substituted for a listed fluid milk product as can nonfat dry milk and MPC. For example, whey contains little or no casein and only some of the lactose and ash of milk. Similarly, calcium and sodium caseinates do not contain the whey proteins (whether derived from cheese making or some other process) as well as the lactose and ash found in milk. Therefore, these and similar milk-derived ingredients will not be priced in products that are determined to be fluid milk products.

Milk-derived ingredients, except ingredients such as casein, calcium and sodium caseinate and whey, contained in a fluid milk product will be included in the allocation process of producer milk and the resulting classification and pricing on a fluid milk equivalent basis. Whey is intended to include whey, dry whey and whey protein concentrates. The fluid equivalent for those products in which the relationship between the protein and nonfat milk solids has not been altered will be computed using nonfat solids while the fluid equivalent for those products in which the relationship between the protein and nonfat milk solids has been altered will be determined on a true protein basis.

The computation of a handler's cost under Federal milk orders is unchanged as a result of this decision. These included products, such as nonfat dry milk and MPC will be used to determine the quantity of the fluid milk equivalent in the modified fluid milk product that is greater than the volume of an unmodified fluid milk product of the same type and butterfat content. The equivalent volume will be Class I and charged the Class I price while the greater volume will be an "other source receipt" and be included in Class IV. Any of the excess that may be allocated to Class I will be subject to an upcharge—at the difference between the Class I and Class IV prices.

Although the record lacks specific data concerning the possible changes in classification of current products as a result of adoption of this decision, the

need for the continued use of the form and intended use criteria specified in the AMAA is clear. The record of this proceeding contains sufficient evidence to determine the criteria that can be relied upon for determining if a new product meets or does not meet the proposed fluid milk product definition. This is particularly evident since this decision does not recommend changing the primary criteria of classifying milk on the basis of its form and intended use.

Even though whey should be included in determining if a product meets the fluid milk product definition, whey should not be included in the pricing and pooling of fluid milk product that contains whey. In this regard, opposition to the inclusion of whey as a determinate of whether or not a product meets the fluid milk product definition because it may cause processors to use alternative protein sources in manufactured beverages and reduce producer revenue is rendered moot.

Since casein, sodium and calcium caseinates and whey used in making a fluid milk product could have been previously priced under a Federal milk order, previous pricing should not be a criterion for determining if a dairy ingredient should continue to be included in pricing of the fluid milk product in which casein, sodium and calcium caseinates and whey are contained. Other criteria, such as substitutability for fluid milk products, are better determinates for including a dairy ingredient in the computation of the criteria and the pricing of such products.

Some witnesses testified that even though a product met the fluid milk product definition, the intended use of that product should be considered for assigning the milk in that product to the most appropriate class use. In this regard, if the intended use of the product is a food item that does not compete with traditional fluid milk in the market place, the product should be exempted from the fluid milk product definition. The most notable products of this characteristic are drinkable yogurts which contain yogurt and other dairy products that are drinkable but are not intended to be used as a beverage. The record reveals that drinkable yogurts are marketed as a food item to supplement or even replace a meal such as breakfast or lunch, and are a quick and easy to carry snack. This differentiates their intended use from fluid milk products consumed as beverages or as accompaniments to other mealtime foods.

The record supports concluding that the intended use of drinkable yogurts are not for use as a beverage because they are marketed and positioned in the marketplace differently than fluid milk products. These products are not marketed alongside milk in retail outlets. Instead, they are positioned alongside spoonable yogurts in cups. It is reasonable to conclude that drinkable yogurts do not compete with fluid milk products.

Nevertheless, it is also reasonable to establish a minimum level of yogurt that needs to be contained in the finished product to separate them from other drinkable yogurt-containing beverages. The proposed minimum content of yogurt of 20 percent offered by proponents is reasonable and is recommended for adoption for excluding drinkable yogurt products from the fluid milk product definition. The yogurt contained in exempted drinkable yogurt products must meet the yogurt standard of identity as defined by the FDA.

Opponents of excluding drinkable yogurts from the fluid milk products definition stress that these should not be excluded because they are beverages and are packaged similarly to other fluid milk products. Opponents are of the opinion that drinkable yogurts are fluid milk products because they are comparable to flavored or cultured fluid milk products. Drinkable yogurts do have several characteristics similar to listed fluid milk products—they can be used as a beverage and are similarly packaged. There are, however, other characteristics which differentiate drinkable yogurts from fluid milk products. These characteristics include, in most cases, a different consistency than the fluid milk products, a significant volume of added yogurt, the addition of fruit and not just flavorings, and live and active cultures supplied by the yogurt. These differences between listed fluid milk products and drinkable yogurts warrant the exclusion of drinkable yogurts containing at least 20 percent yogurt from being a fluid milk product. Drinkable products with less than 20 percent yogurt will be considered fluid milk products. The yogurt contained in those products with less than 20 percent yogurt will be priced at the Class II price and not be subject to an “up charge” as a result of their use in a fluid milk product.

One proponent for excluding drinkable yogurts from the fluid milk product definition sought to also include kefir. The only evidence provided to support excluding kefir from the fluid milk product definition was identifying kefir as a cultured

product similar to drinkable yogurt. Kefir is a cultured product that, like drinkable yogurts, contains active cultures. While cultured beverages are one of the listed products in the fluid milk product definition, kefir’s similarities to drinkable yogurts provide a reasonable basis to conclude that the milk used in kefir products should be classified in the same way as milk used in drinkable yogurt products. As with drinkable yogurts containing at least 20 percent yogurt, kefir should be exempt from the fluid milk product definition.

The exclusion of drinkable yogurts from the fluid milk product definition will have a minimal impact on the resulting uniform prices to producers. Less than one-half of one percent of the packaged fluid milk products distributed in 2004 were drinkable yogurt or kefir type beverages that are currently classified as fluid milk products. For 2004, it is estimated that if all of the current yogurt and kefir beverages had been Class II, the impact on producers, either through the uniform price or producer price differential, would have been a \$0.0026 per hundredweight reduction on the more than 103 billion pounds of producer milk pooled on Federal orders.

Manufacturers of milk-based products that are intended to be used for dietary uses (meal replacements) testified that products sold for such dietary use in hermetically-sealed containers and the same product sold in other types of containers receive different regulatory classifications. Some products, such as those intended to be used for infant feeding and dietary needs (meal replacements), are currently considered Class II products if they are hermetically-sealed. However, the same product in a brick-pack or other types of packaging are considered fluid milk products. These products have a limited distribution and in the case of many of the dietary products, sales are only to health care facilities (such as hospitals and nursing homes) and they have a very long shelf life. The limited distribution and packaging these products indicates that they do not directly compete with Class I products. Most importantly, their intended use can be generalized as substitutes for meals by infants, the infirm and the elderly and not for use as a beverage.

This decision, in the narrow context of a highly specialized and marketed drinkable product sold to the healthcare industry, finds that packaging is not a legitimate criterion for considering some meal replacement products as Class II products and others in Class I. Whether the dietary products (meal replacements) are in hermetically-sealed

containers or not, the dietary products (meal replacements) are intended to be used to replace the nutrition of normal meals in the health care industry and not intended to be used in the same manner as fluid milk. The dietary products packaged in other than hermetically-sealed containers still have the same basic form and intended use as those in hermetically-sealed containers and it is therefore reasonable that they should be similarly classified. Dietary products (meal replacements) should be excluded from the fluid milk product definition and should be considered Class II products.

To further clarify which products should be excluded from the fluid milk product definition, the term “meal replacement” is incorporated into the description detailing the intended meaning of dietary use. The term “meal replacement” will not include a fortified fluid milk product or fortified dairy beverage. The term “meal replacement” encompasses those dairy products that are truly intended to be a replacement for a meal. Meal replacements are categorized as those products sold to the health care industry and may include other products that are similar in form and intended use. This decision recommends adding the qualifier “sold to the health care industry” to the description of “dietary use (meal replacement)” and eliminating the need for dietary (meal replacement) products to be packaged in hermetically-sealed containers. By replacing “hermetically-sealed” with “sold to the health care industry,” competing products will receive equitable regulatory treatment. This change should have a de minimus impact on producer milk revenue because most products considered to be meal replacements are currently Class II products and because the quantity of milk in these products relative to all milk pooled under Federal orders is very small.

In response to concerns that expanding exemptions of products from the fluid milk product definition would result in lower producer revenue, the record of this proceeding lacks the data to conclude that exempting certain milk-based products, or reclassifying current products from one class to another, will harm producer revenue. Any negative impact may be offset by other products that may be determined to meet the fluid milk product definition as a result of adoption of its recommended changes.

Proposal 5 calls for, in part, retaining the 6.5 percent nonfat solids criteria and giving the Department the flexibility to include as fluid milk products other products that fell below 6.5 percent

nonfat solids. At the hearing, the proposal was modified to require the Department to make other determinations and to conduct studies before a product is determined to meet the fluid milk product definition. The modified proposals would require the Department to determine if a product competes directly and substantially with FDA defined milk products. The modified proposal included five criteria for making the required determination and would require the Department to provide written determination of classification prior to the product being included as a fluid milk product. The modified proposal would also require that the handler market more than three million pounds in a Federal order per month before the product could be considered a fluid milk product even if the product met the proposed five criteria.

The criteria of Proposal 5, as modified, for determining if a product should be a fluid milk product are not reasonable and do not make the classification of milk on the basis of form and intended use. The additional criteria, including a comparison of retail prices, advertising, and substitutability between the new product and fluid milk products do not conform to the requirement of classification on the basis of form and intended use.

In addition, the data collection and analysis called for in Proposal 5's modification would be unduly burdensome to both the dairy industry and to the Department. The burden is also without significant improvement to product classification determinations and the potential loss of revenue to producers who would never recover lost revenue in the event a new product is determined to meet the fluid milk product definition.

A modification to Proposal 7 made at the hearing should not be adopted. This modification to require the Department to hold a hearing do determine the classification of a new product made by new technology is not necessary for the same reasons as in recommending that Proposal 5 not be adopted. Furthermore, there is no need to incorporate a specific requirement in to the order to hold a hearing when such an option is already available.

A number of opponents of proposals seeking to change the fluid milk product definition argued that there must necessarily exist a current problem in order to make amendments to the provisions of Federal milk marketing orders. This decision disagrees with such arguments. Anticipating problems and amending regulations to address anticipated changes in marketing

conditions may be a valid action on the part of the Department to assure continued orderly marketing conditions and equity among producers and handlers. In this proceeding it is especially appropriate to have provisions that can address the future needs of a rapidly changing industry brought about by new technology.

#### **Rulings on Proposed Findings and Conclusions**

Briefs and proposed findings and conclusions were filed on behalf of certain interested parties. These briefs, proposed findings and conclusions, and the evidence in the record were considered in making the findings and conclusions set forth above. To the extent that the suggested findings and conclusions filed by interested parties are inconsistent with the findings and conclusions set forth herein, the requests to make such findings or reach such conclusions are denied for the reasons previously stated in this decision.

#### **General Findings**

The findings and determinations hereinafter set forth supplement those that were made when the Northeast and other marketing orders were first issued and when they were amended. The previous findings and determinations are hereby ratified and confirmed, except where they may conflict with those set forth herein.

(a) The tentative marketing agreements and the orders, as hereby proposed to be amended, and all of the terms and conditions thereof, will tend to effectuate the declared policy of the Act;

(b) The parity prices of milk as determined pursuant to section 2 of the Act are not reasonable in view of the price of feeds, available supplies of feeds, and other economic conditions which affect market supply and demand for milk in the marketing areas, and the minimum prices specified in the tentative marketing agreements and the orders, as hereby proposed to be amended, are such prices as will reflect the aforesaid factors, ensure a sufficient quantity of pure and wholesome milk, and be in the public interest; and

(c) The tentative marketing agreements and the orders, as hereby proposed to be amended, will regulate the handling of milk in the same manner as, and will be applicable only to persons in the respective classes of industrial and commercial activity specified in, marketing agreements upon which a hearing has been held.

#### **Recommended Marketing Agreements and Order Amending the Orders**

The recommended marketing agreements are not included in this decision because the regulatory provisions thereof would be the same as those contained in the orders, as hereby proposed to be amended. The following order amending the orders, as amended, regulating the handling of milk in the Northeast and other marketing areas is recommended as the detailed and appropriate means by which the foregoing conclusions may be carried out.

#### **List of Subjects in 7 CFR Part 1000**

Milk marketing orders.

For the reasons set forth in the preamble 7 CFR Part 1000 is proposed to be amended as follows:

#### **PART 1000—GENERAL PROVISIONS OF FEDERAL MILK MARKETING ORDERS**

1. The authority citation for 7 CFR Part 1000 continues to read as follows:

**Authority:** 7 U.S.C. 601–674.

2. Amend § 1000.15 by revising paragraphs (a), (b) introductory text, and (b)(1), redesignating paragraph (b)(2) as (b)(4) and adding new paragraphs (b)(2) and (b)(3), to read as follows:

#### **§ 1000.15 Fluid milk product.**

(a) Fluid milk products shall include any milk products in fluid or frozen form intended to be used as beverages. Such products include, but are not limited to: Milk, fat-free milk, lowfat milk, light milk, reduced fat milk, milk drinks, eggnog and cultured buttermilk, including any such beverage products that are flavored; cultured; modified with added or reduced nonfat solids, milk proteins, or lactose; sterilized; concentrated; or, reconstituted. As used in this part, the term concentrated milk means milk that contains not less than 25.5 percent, and not more than 50 percent, total milk solids:

(b) Fluid milk products shall not include:

(1) Plain or sweetened evaporated milk/skim milk, sweetened condensed milk/skim milk, yogurt containing beverages containing 20 percent or more yogurt by weight, Kefir, formulas especially prepared for infant feeding or dietary use (meal replacement) sold to the health care industry, and whey;

(2) Milk products containing more than 9 percent butterfat;

(3) Milk products containing less than 2.25 percent true milk protein and less than 6.5 percent nonfat milk solids, by weight, unless their form and intended

use is comparable to the products contained in paragraph (a)(1) of this section; and

\* \* \* \* \*

**§ 1000.40 [Amended]**

3. Section 1000.40 is amended by revising paragraphs (b)(2)(iii) and (b)(2)(vi) to read as follows:

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(iii) Aerated cream, frozen cream, sour cream, sour half-and-half, sour cream mixtures containing nonmilk items, yogurt, including yogurt containing beverages with more than 20 percent yogurt by weight, Kefir, and any other semi-solid product resembling a Class II product;

\* \* \* \* \*

(vi) Formulas especially prepared for infant feeding or dietary use (meal replacement) that are sold to the health care industry;

\* \* \* \* \*

Dated: May 12, 2006.

**Lloyd C. Day,**

*Administrator, Agricultural Marketing Service.*

[FR Doc. 06-4591 Filed 5-16-06; 8:45 am]

**BILLING CODE 3410-02-P**

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**SMALL BUSINESS ADMINISTRATION**

**13 CFR Part 121**

**RIN 3245-AF29**

**Small Business Size Standards; Air Traffic Control, Other Airport Operations, and Other Support Activities for Air Transportation**

**AGENCY:** U.S. Small Business Administration.

**ACTION:** Proposed rule.

**SUMMARY:** The U.S. Small Business Administration (SBA) proposes to increase the size standard for the Air Traffic Control (North American Classification Systems (NAICS) 488111), Other Airport Operations (NAICS 488119), and Other Support Activities for Air Transportation (NAICS 488190) industries from \$6.5 million in average annual receipts to \$21 million. The proposed revisions are being made to better define the size of a small business in these industries based on a review of industry characteristics.

**DATES:** Comments must be received by SBA on or before June 16, 2006.

**ADDRESSES:** You may submit comments, identified by RIN 3245-AF29, by one of the following methods: (1) Federal

eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments; (2) Fax: (202) 205-6390; or (3) Mail/Hand Delivery/Courier: Gary M. Jackson, Assistant Administrator for Size Standards, 409 Third Street, SW., Mail Code 6530, Washington, DC 20416. **FOR FURTHER INFORMATION CONTACT:** Diane Heal, Office of Size Standards, (202) 205-6618 or [sizestandards@sba.gov](mailto:sizestandards@sba.gov).

**SUPPLEMENTARY INFORMATION:** SBA has received a request from a Federal agency that contracts for services in the Other Airport Operations Industry to review this industry's existing \$6.5 million size standard. This size standard was last revised in 2005 to incorporate an inflation adjustment to receipt-based size standards (70 FR 72577, December 19, 2005). SBA has not conducted a review of this industry's characteristics since the early 1980's. This agency believes that SBA should create a special size standard under NAICS 488119 for Federal contracts consisting of processing passengers and servicing aircraft for long range or international flights. Many of these contracts involve coordinating all aspects of passenger service (including customs clearances, security requirements) as well as aviation services (such as food service, janitorial services, and aircraft fueling services). The agency also pointed some of these activities individually have higher size standards (*i.e.*, the Food Service Contractors Industry and the Janitorial Services Industry have size standards of \$19 million and \$15 million, respectively, while the Aircraft Fueling Industry carries a 500-employee size standard). Although the Federal agency requested a review of the Air Airport Operations Industry, SBA decided to review also the Air Traffic Control Industry and Other Support Activities for Air Transportation Industries because many firms that perform Other Airport Operation Services also are active in these two industries.

Below is a discussion of the methodology used by SBA to review its size standards, and the analysis leading to the proposal to increase the size standard for the three industries comprising air transportation support activities from \$6.5 million to \$21 million in average annual receipts.

**Size Standards Methodology:** Congress granted SBA discretion to establish detailed size standards (15 U.S.C. 632(a)(2)). SBA's Standard Operating Procedure (SOP) 90 01 3, "Size Determination Program" (available on SBA's Web site at [http://](http://www.sba.gov/library/soprooom.html)

[www.sba.gov/library/soprooom.html](http://www.sba.gov/library/soprooom.html)) describes four factors SBA considers for establishing and evaluating size standards: (1) The structure of the industry and its various economic characteristics; (2) SBA program objectives and the impact of different size standards on these programs; (3) whether a size standard successfully excludes those businesses which are dominant in the industry; and (4) other factors if applicable. Other factors, including the impact on other Federal agencies' programs, may come to the attention of SBA during the public comment period or from SBA's own research on the industry. No formula or weighting has been adopted so that the factors may be evaluated in the context of a specific industry. Below is a discussion of SBA's analysis of the economic characteristics of an industry, the impact of a proposed size standard on SBA programs, and the evaluation of whether a firm at or below a size standard could be considered dominant in the industry.

**Industry Analysis:** Section 3(a)(3) of the Small Business Act (15 U.S.C. 632 (a)(3)) requires that size standards vary by industry to the extent necessary to reflect differing industry characteristics. SBA has two "base" or "anchor" size standards that apply to most industries—500 employees for manufacturing industries and \$6.5 million in average annual receipts for nonmanufacturing industries. SBA established 500 employees as the anchor size standard for the manufacturing industries at SBA's inception in 1953 and shortly thereafter established a \$1 million average annual receipts size standard for the nonmanufacturing industries. The receipts-based anchor size standard for the nonmanufacturing industries has been adjusted periodically for inflation so that, currently, the anchor size standard is \$6.5 million. Anchor size standards are presumed to be appropriate for an industry unless its characteristics indicate that larger firms have a much greater significance within that industry than the "typical industry."

When evaluating a size standard, the characteristics of the specific industry under review are compared to the characteristics of a group of industries, referred to as a "comparison group." A comparison group is a large number of industries grouped together to represent the typical industry. It can be comprised of all industries, all manufacturing industries, all industries with receipt-based size standards, or some other logical grouping. For purposes of this proposed rule, one comparison group comprises industries with the