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Brief Filed by

THE TIPTON GROUP, INC.

on behalf of

**Bravo! Foods International Corporation
Lifeway Foods, Inc.
PepsiCo
Starbucks Corporation
Unilever United States, Inc.**

**Docket No. AO-14-A73, et al; DA-03-10
USDA – Federal Milk Marketing
Order Hearing Held
June 20, through June 23, 2005**

To consider amending the class I fluid milk product definition

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Pittsburgh, PA 15219**

GENERAL COMMENTS

The companies on whose behalf this brief is being submitted urge that this proceeding be terminated as it relates to all matters except the classification in Class II of yogurt and kefir in all forms, i.e. whether spoonable, drinkable or combined with water, juices or other foods.

We believe the entire record of this proceeding (except as noted above with respect to yogurt and kefir) falls far short of justifying any additional expenditure of resources by the Government or by affected parties to continue the proceeding relative to the 6.5 percent nonfat milk solids threshold for the exclusion of products from Class I, as well as all other matters except the classification of yogurt and kefir.

The primary bases for this request are:

1. The hearing was called prematurely without adequate study and evaluation of facts and issues that bear directly on any decision by USDA. Industry associations and other interested parties repeatedly informed USDA that there was insufficient market performance information and data on a number of new products to which the hearing was being directed to warrant a hearing. On June 1, 2005, The Tipton Group, Inc., on behalf of its clients requested the opportunity to inspect and make copies of all proposals and the supporting documentation under the provisions of the Freedom of Information Act. Although it has been long past the allotted time to reply, USDA has yet to provide any further information or the documents it relied upon to call the hearing. (Copies of correspondence attached as Addendum I.)
2. A significant number of witnesses testified that more study and analysis was necessary before changes were made to the present Class I definition. USDA has a long history and numerous precedents in past decisions of not changing Federal order provisions based on alleged, speculative, prospective predictions or unproven anticipated assertions of:
 - Disruptive market conditions,
 - Potential inadequacies of the milk supply, and
 - Adverse effects on producer revenues.

USDA, consumers and the regulated industry would be well-served if the Department would terminate this proceeding as we have requested, thereby, eliminating the ex-parte restrictions on open discussion and debate of future policies relating to the proper price classification of milk.

Upon termination of this proceeding, USDA should invite interested parties to participate in in-depth probative studies and analysis of the issues involved in its future classification policies. The market for beverages and drinkable foods is changing dramatically. New variations of drinkable foods and beverages, some containing milk-derived ingredients and others that are formulated without dairy-derived ingredients, are being introduced with

regularity. The technology used to produce proteins from not only milk, but also peas, wheat, soy, rice and other basic food products is rapidly developing. The statutory basis for price classification, form and use, needs to be understood in the broader context of the beverage and drinkable foods market. More data and information on these strategic issues should be developed and analyzed before any changes are made.

RECOMMENDED ACTIONS BASED ON EVIDENCE CONTAINED IN THE HEARING RECORD

If USDA does not partially terminate this proceeding as requested in the "General Comments" of this brief, the following actions are recommended:

1. The present exclusion from the fluid milk product definition of products containing less than 6.5 percent by weight of nonfat milk solids should continue. It should be made clear that the determination of whether the subject product contains 6.5 percent nonfat milk solids and therefore, whether the exclusion does or does not apply, is based on the ratio of the weight of the nonfat solids it contains and the weight of the finished product. For the purpose of applying the 6.5 percent standard, milk equivalencies should not be used. Also, in determining the 6.5 percent standard, all milk-derived ingredients should be included except for whey and whey products. All whey and whey products should be excluded.
2. The proposal to replace the current 6.5 percent nonfat milk solids with a 2.25 percent protein standard should be rejected.
3. All yogurt and kefir should be classified in Class II, irrespective of whether it is spoonable, drinkable or combined with water, juices or other foods.
4. The current order exclusions for "formulas especially prepared for infant feeding or dietary use (meal replacement) that are packaged in hermetically sealed containers" should be continued without modification.

HEARING CALLED PREMATURELY WITHOUT ADEQUATE STUDY AND EVALUATION OF FACTS AND ISSUES BY USDA

USDA announced on June 28, 2003, that Dairy Farmers of America (DFA) had proposed that the Department hold an emergency public hearing to consider amending the fluid milk product definition in all Federal milk marketing orders. USDA invited the submission of additional proposals by September 19, 2003.

The date for the submission of proposals was subsequently extended three times after receiving joint requests from the National Milk Producers Federation (NMPF) and the International Dairy Foods Association (IDFA) to do so. The last extension provided for submission of additional proposals by January 31, 2005. (Yonkers R 879-880)

Both the producer and processor organizations jointly argued that USDA should not call a hearing to amend the fluid milk definition at that time. They argued that more time was needed

to determine whether the new milk-based products were substitutes for fluid milk products or whether they were most likely more competitive with non-dairy beverages. They stated that the market for these beverages had not matured sufficiently to ascertain how consumers were going to use them or to what extent they would be consumed. The text of one of those letters follows:

Together, the National Milk Producers Federation and the Milk Industry Foundation request that USDA not hold a hearing to consider changes in the fluid milk product definition at this time. Given the importance of this issue, and despite the additional time already granted for parties to comment or make additional proposals on this issue, more time is needed to study the nascent market for new milk-based drinks and other beverages containing milk before considering changes to Federal Milk Marketing regulations. The impacts of such changes on both milk producers and processors depend on a number of factors. Preliminary analysis suggests that the dairy industry needs better data about these products and their markets.

We respectfully request that USDA not hold a hearing at this time. We will continue to evaluate this developing market. At such time that study and experience provide a more conclusive basis for redefinition of Class I products, the dairy industry can ask the Department to address the issue. Doing so at the present is inappropriate, as it may compromise the effectiveness of the resulting decision. (Letter to Richard McKee, dated January 30, 2004) (Copy of full letter attached as Addendum 2.)

Despite the multiple pleas of the two major trade associations representing the dairy industry, USDA issued the hearing notice for this proceeding on April 12, 2005.

Nineteen months elapsed from USDA's first request for proposals and the actual beginning of the hearing. Prior to the issuance of the hearing notice, other industry representatives contended there was a need for more and better data and analysis of new milk-based drinks and their markets before a hearing was convened.

In response to the initial Dairy Farmers of America request that the Agricultural Marketing Service initiate a hearing to modify the fluid milk product definition, the American Beverage Association submitted a comment urging that AMS not proceed to a hearing. We did not believe that there was any basis to suggest that the current definition is failing to properly classify products. Rather than forcing parties to proceed to the time and cost of a hearing, we argued that AMS should conduct an economic analysis to examine if these new products were, in fact, competing with fluid milk for consumers. Unfortunately AMS has ignored our request and proceeded to this public hearing without conducting any economic analysis and despite the fact that there is no demonstrable evidence that the current system is not working. (Davis R 492-493)

USDA has a long history of responsibly addressing issues under Federal Milk Orders that reflect major changes in markets or operations and has avoided making significant changes to the program in response to short-term market phenomena. Making a sea change decision on this issue at this time is unwarranted and premature. (Tipton R 1056)

USDA did not undertake any such studies nor engage the industry in jointly gathering pertinent information on which a decision could be based. Clearly, more analysis is needed as to whether, how, and to what extent these new products compete with or are substitutes for fluid milk products or what the impact of reclassification might be on the market for these products, on the market for dairy-derived ingredients or on dairy farmer revenues. However, the record evidence is clear that no action to change the 6.5 percent threshold is warranted at this time. There are numerous instances in the record that provide evidence of the need for greater examination of these market developments. As an example, during the cross-examination of Robert Waldron, president of Yoplait, by Ben Yale, Mr. Yale asked, "The question that comes to

mind is: Is a change from Class I to Class II going to change the consumer price enough to generate additional demand to offset the value of Class I? Can you answer that question?" Mr. Waldron replied:

I would answer the question in this form is that for at least a year, year and a half now General Mills has promoted that an economic study be done of these products and inclusive with that study could be the full economic analysis that you're talking about and within this could have been the next logical step versus the hearing today. So I support your line of thinking and would recommend a full economic analysis be done. (Waldron R 763-764)

The wisdom of the industry's advice to not hold a hearing at that time was well founded based on the lack of evidence that changes were or are warranted or appropriate.

WITNESSES TESTIFIED THAT MORE STUDY AND ANALYSIS WAS NECESSARY BEFORE CHANGES ARE MADE TO THE CLASS I DEFINITION

Dr. Robert Yonkers, stating the position of the Milk Industry Foundation (MIF), the organization representing the nation's fluid milk processors said, "MIF believes that the proponents of such amendments carry the burden of coming forth with solid data and analysis demonstrating both the need for change and that the proposed amendment will address that need. Anecdotal evidence or broad suppositions do not suffice." (Yonkers R 881)

Dr. Yonkers went on to cite several instances in which USDA had adopted this same approach. Among the examples cited was the rejection of a proposal to amend the Texas and Southwest Plains Orders in 1988. In that proceeding, the proponents for change asserted that the exemption for Producer/Handlers created a significant unfair advantage. However, USDA noted that "The existence of large producer-handler operations merely implies that the conditions for disorderly and disruptive marketing conditions may exist" (Yonkers R 881) USDA went on to note that the "concern over the potential of a large handler who may have the ability to become a producer-handler does not provide sufficient basis for a regulatory change." (Yonkers R 882)

The second example of previous approaches to decision-making that is directly applicable to this proceeding is found in a 1998 decision rejecting proposals to establish a floor price. USDA concluded that, "The data contained in the record of the public hearing in this proceeding provide no basis to expect that an adequate supply of milk for fluid use will not be available nationwide. Therefore, the record does not support adopting the proposal, which would encourage more milk." (Yonkers R 883-884)

Both of these decisions are strong precedents for this proceeding and should be noted. Proponents' witnesses wrongly stated that changing the 6.5 percent nonfat milk solids requirement to a 2.25 percent protein standard would cause no product classifications to be changed. A subsequent witness revealed several products that would likely be reclassified in Class I if the 2.25 percent protein standard were adopted.

"... Protein drinks using dairy ingredients will likely be moved from Class II to Class I under the NMFP proposal. . . A more thorough understanding of the products that would be impacted under the proposal is necessary to understand the demand implications for dairy ingredients in those products." (Taylor R 978)

Ms. Taylor described several sports and high protein drinks with milk-derived protein content in excess of the 2.25 percent protein standard proposed in proposal #7. (Taylor R 983-988)

Proponents of the 2.25 percent protein standard argued that such a change would not offset the classification of existing products. This line of argument has fatal flaws for their position in three regards. First, as identified by Ms. Taylor's testimony, is that Dr. Cryan's claim is simply not accurate. Second, when Dr. Cryan was asked "Do you know whether you or anybody else, including the government, has a list of the products that might be affected by these proposals?" (Tipton R 254) He responded that no such list existed.

A. We don't have a list. No one has brought to our attention any products that might be affected. There may be products. Nobody has told us definitely that there are products. One product has been suggested, but only as a possibility. We do not have a comprehensive list. However, it is clear that it is not a very large number of products, even if there are some. To the best of our knowledge, we are not certainly aware of any product that would change regulation.

Q. So you don't think there are very many products that are even on the market that are competing, as you would say – whether they are or are not is another question – but those products that you would put in Class I because they are being sold as beverages that are not Class I now? You don't think there are many of those?

A. I don't believe there are any, but there may be one or two we missed. I'm interested to know if you have any.

Q. No, my question goes to the – I do know of a lot, but my question goes to the issue of if you know – you need to know who you are going to regulate before proceeding to propose the regulation, and I haven't been able to find anybody so far that's got a list of who's going to get regulated or who even potentially is to be regulated . . . (Cryan R 254-256)

Clearly, USDA should not change the definition when the primary proponents have not even analyzed what products would be affected by their own proposal.

Third, if the change does not affect the classification of products, it is clear such a change is unnecessary and would be premature. It is also proof of the fact that disruptive market conditions do not exist.

Dr. Cryan confirmed that many new drinkable products containing a small amount of dairy ingredients had not sold well on the market and had been withdrawn from the market; again, reaffirming the lack of disruptive market conditions resulting from the marketing of these type products. (Tipton R 1054)

Q. I have one other question, and I want to go back to the list of products that you have in the appendix. Do you know how well or how poorly those products are doing? For example, Raging Cow, do you regard that as a threat?

A. I believe it is off the market. I'm sure it is off the market.

Q. What about Jakada?

A. I believe that is off the market as well.

Q. Swerve's off the market?

A. But I don't maintain that these are threats. I maintain that these are Class II products, and we don't propose to change the regulation, the status of these products.

Q. But I understood you to say that you wanted this action taken because you were fearful there were other products that were going to be developed that might come along the pike, and these products have been on the market but they haven't done well; correct?

A. But these products would not be affected by our proposal." (Cryan R 258-259)

Proponents failed to make the case that there was any market disruption occurring by virtue of the current classification of certain milk-containing beverages, nor could they point to any potential disruptions that might occur if the current Class I exclusion for products containing less than 6.5 percent nonfat milk solids is not changed.

In short, the existing market conditions do not warrant a change in current rules. This was the position taken by the two major trade associations before the hearing notice was issued and it was borne out to be the correct position based on this record.

Exhibit #12, introduced by John Rourke of USDA, documents the premature nature of this hearing and the entire proceeding. Based on the data presented for calendar year 2004 there was less than one quarter of one percent of "total package disposition" in all Federal milk orders that was "carb reduced or free beverages." Additionally, it was only sold in four Federal milk marketing order areas and there was no testimony alleging market disruption from the marketing of this product. In fact, sales of reduced and carb free drinkable products is seriously declining from this already small market share. This may have been the only product identified in Exhibit 12 that contained less than 6.5 percent nonfat milk solids but more than 2.25 percent milk protein and whose classification would have changed. Furthermore, the proper classification of this product is currently under judicial review at USDA, again emphasizing the premature nature of this proceeding. The judicial remedy that is underway should be permitted to run its course. Other witnesses documented the minute market penetrations of these new beverages and the premature consideration of changing the fluid milk products definition.

Researchers at Cornell have concluded that reclassification of new dairy beverage products from Class II to Class I disregarding other market responses is likely to affect producer prices by less than one cent per hundredweight. The volume of milk in Class I beverages that are not traditional fluid milk products is also small, representing only 0.8 percent of total Class I product disposition in 2003 as reported in the annual Federal Milk Order Statistics publication. Data from 2004 assembled by Mr. Rourke in Exhibit No. 12 similarly reveal only 0.53 percent of Class I sales in products consisting on non-milk dairy beverages. (Suever R 931-932)

PART OF THIS PROCEEDING SHOULD BE TERMINATED

We urge that this proceeding be terminated, except for the issues of classification of yogurt and kefir. USDA should undertake a thorough study and analysis of products that are considered non-dairy products by any Federal or state definition but contain more than 6.5 percent nonfat milk solids, as well as those that are below 6.5 percent. Such an analysis should

identify how many and which products are involved, how they are positioned in the market, their consumption patterns, the effect of changing classes on the substitution of non-dairy ingredients for dairy ingredients, the impacts (positive or negative) on producer revenues and any other issues that may impact upon a potential decision to reclassify products.

There were many witnesses who testified in favor of USDA, in conjunction with the industry, undertaking a thorough review of issues raised but not answered in this proceeding.

In general, agencies bear a heavy burden to justify changes to long-standing regulatory provisions. Given such a recent reconsideration of this provision, any effort to modify the current standard must be supported by compelling evidence which we submit has not been generated by petitioners or AMS. AMS should therefore refrain from making any changes to the current classification system. . . If AMS believes that some action is necessary, then instead of making changes to the current regime, AMS should first conduct a thorough economic analysis to determine which products, if any, are competing with or substituting for fluid milk.” (Davis R 495-496, 498-499)

And I think that really underscores one of the problems that we are grappling with. There is really not very much information around about the use of different protein sources in different applications in the U.S. food industry. We would like to see a lot more work done in this area before we start changing the rules too hurriedly, because I am not convinced that anybody has really an accurate picture of just how much soy, for example, is being used vis-à-vis dairy in the marketplace. (Tucker R 471)

[T]he proponents of any change to the fluid milk product definition must demonstrate using actual data and analysis that products not meeting the current fluid milk product definition are having an impact on the market, not merely that they may have the potential to do so. Without such data and analysis, there cannot be a sufficient basis to justify a regulatory change. (Yonkers R 882)

Dr. Yonkers went on to describe the specific data and information that would be necessary to properly evaluate whether a change to the Class I definition would be justified. (Yonkers R 884 – 888) Dr. Yonkers concluded his statement by saying:

Analyzing the economic impact of changing the fluid milk product definition requires actual market data and empirical analyses, not simply conjecture and speculation. Those data and analyses have not been presented at this hearing. There is, therefore, no justification for changing the fluid milk product definition at this time. (Yonkers R 888)

Other witnesses also addressed the availability of data that would bear directly upon this proceeding:

We have provided extensive elasticity data related to fluid milks to make the point that USDA should not adopt new rules to extend classified pricing to new products that contain limited amounts of milk-derived ingredients because they are perceived to be competitive with Class I milk. The attempt to extract Class I prices from the small amount of milk-derived ingredients contained in coffee drinks, or juice and milk or yogurt blends is a substantial overreach and can only be viewed as a protectionist action. The protectionist advocates believe that classifying these type products in Class I will deter their development and make them less competitive with milk, thereby increasing producer revenues from beverage milk. It is not based on sound economic analysis. We believe dairy farmer revenues will likely be reduced by such protectionist action. (Tipton R 1051-1052)

The hearing record of this proceeding does not justify changing the current exclusion of products from Class I that contain less than 6.5 percent nonfat dairy ingredients. Therefore, this portion of the proceeding should be terminated.

THE CURRENT EXCLUSION FROM CLASS I FOR BEVERAGES CONTAINING LESS THAN 6.5 PERCENT NONFAT MILK SOLIDS IS PROPER AND SHOULD NOT BE CHANGED

Ten parties represented at the hearing favored retention of the 6.5 percent nonfat milk solids standard. They included:

American Beverage Association (Davis R 490, 494)
Bravo Food International (Tipton R 1061-1062 and Tipton R 1065)
Dannon (Box R 654-656)
H.P. Hood LLC (Suever R 915)
International Dairy Foods Association (Yonkers R 884, 888, 890)
Leprino Foods Company (Taylor R 971)
Lifeway Foods, Inc. (Tipton R 1061-1062 and Tipton R 1065)
PepsiCo (Tipton R 1061-1062 and Tipton R 1065)
Starbucks Corporation (Tipton R 1061-1062 and Tipton R 1065)
Unilever United States, Inc. (Tipton R 1061-1062 and Tipton R 1065)
Yoplait (Waldron R 747-748)

The only parties who favored substituting a milk protein standard for the current provisions were the National Milk Producers Federation, Dairy Farmers of America, and O-AT-KA Milk Products Cooperative.

Dr. Mark Stevenson, Professor, Cornell University presented a model (Exhibit #23) that he and his colleagues developed to measure “the extent to which new product introduction and the classification of milk used to make them influence producer revenues.” The model was developed in direct response to USDA’s original solicitation of proposals for this hearing. The conclusions from that research are:

Over a broad range of market and product characteristics, the impact of reclassification of new products from class II to class I is likely to be small – less than $\pm 0.1\%$ of the discounted revenues ($\pm \$0.01/\text{cwt}$). However, if there is substitution of non-dairy ingredients for dairy ingredients (product re-formation) in response to reclassification, the negative impacts on dairy producer revenues are much larger, about -1.8% of discounted revenues ($\$0.23/\text{xwt}$). One way to interpret these results is that there is little upside potential from reclassification, but significant downside potential. A more general implication is that a broad range of product characteristics can and should be taken into account in the classification of new dairy products. Parameter values such as demand elasticities or physical characteristics such as “form and use” are useful, but they are incomplete as guidelines for classification *if the goal is maximization of producer revenues*. Accounting for dynamic (potentially offsetting) effects will provide better insights about the outcomes of classification. (Stevenson R 562-563)

Replacing the 6.5 percent nonfat dairy solids standard with a protein standard of 2.25 percent will almost surely reduce dairy farmers’ revenue because, as witness after witness testified, it will effectively place an economic limit on the amount of dairy-derived protein that

will be used. Formulations will likely be made with less than 2.25 percent milk protein to avoid triggering the higher Class I price. Non-dairy sources of protein will likely be less costly but will perform the functions sought equally well, if not better than milk protein. It is even probable that increasingly, over time, other sources of protein will be used in the first 2.25 percent base. Once a company begins formulating products with non-dairy protein sources, the likelihood of the company using the non-dairy source more extensively is increased significantly. (Box R 656-657) (Davis R 498-499) (Olsen/Ledman R 515, 517-518, 522-523) (Suever R 915-928) (Taylor R 972-976) (Tipton R 1052-1065) (Tucker R 456-458) (Waldron R 749-750, 752-753)

Multiple witnesses discussed the quite credible hypothesis that the movement to a milk protein standard, which would be intended to boost producer revenue by capturing more milk in the Class I pool, may have the effect in the marketplace of reducing revenue at the farm level.

On closer examination it is likely that farm milk prices will be reduced by these proposals. Current marketing order rules stifle product innovation and development by capturing in the fluid milk definition products that are not fluid milk. Proposals at the hearing would further discourage new products innovation and encourage use of non-dairy ingredients in beverages. These consequences are damaging to the industry, damaging to producers and damaging to the interests of the consuming public. (Suever R 917)

It is my opinion that proposals to broaden the Class I fluid milk definition to include a wide variety of beverages containing dairy ingredients appear to be an attempt to throw out a regulatory net to see what additional volume could be captured into the ever shrinking Class I pool of milk. Unfortunately, this attempt to enhance the pool is more likely to reduce the pool long term. (Olsen/Ledman R 517)

Forcing higher ingredient costs as a result of Class I classification will reduce dairy ingredient use when there are viable alternative sources of ingredients. Among the many remarks addressing this point were the following:

If such actions are taken by USDA, it is highly likely that the products that now contain some dairy-derived ingredients will be reformulated to minimize, if not eliminate, milk-derived ingredients by substituting non-milk ingredients such as soy. The technologies are now readily available to make non-dairy ingredients fulfill functions similar to those of dairy-derived ingredients. (Tipton R 1052)

Specifically, I am concerned about the dampening effect the existing definition has on the demand for dairy ingredients in what I will term non-traditional beverages and smoothie type products. These products do not resemble milk and are not marketed directly against milk but represent significant markets for dairy ingredients. Increasingly, products are being engineered from ingredients that did not even exist ten years ago. In the case of dairy, whey products have benefited from the technological advances with the development of more highly specialized fractions that can be effectively marketed into a broader set of food applications than ever before. Whey protein manufacturers have made substantial progress in addressing the heat stability concerns that had historically been a limiting factor in whey protein applications. Cornell and other universities have also made progress fractionating milk prior to manufacturing products. They have shown, for example, that it is possible to extract the milk serum proteins prior to cheese making. The milk serum proteins are what we think of as whey proteins once the milk has undergone the cheese-making process. Concurrent with the advances in technology in dairy, advanced fractionation technology has been applied across a broad spectrum of ingredients resulting in an almost exponential growth in ingredient options. In many cases, the fractionation has contributed to the reduction or elimination of unfavorable attributes of specific ingredients, resulting in many new ingredients that compete more effectively across a broader spectrum of applications. Determining the classification of dairy products by specific component levels has become increasingly difficult in light of these advances in fractionating technology. It is also much riskier. I believe that the current definition has a chilling effect

on dairy ingredient demand that extends far beyond what is known by the Department or the industry. (Taylor R 972-974)

The burden of regulation is a reason many food processors avoid marketing products that would be classified as Class I.

Not only are class price issues driving food formulators to use non-dairy ingredient sources, but also the record keeping and reporting requirements and presenting records for audits by market administrators are added burdens that many food processors would prefer to avoid. This is another incentive to use non-dairy ingredients. Additionally, the Food and Drug Administration, through its Federal/State Cooperative Milk Program, is considering changes to its dairy-specific health and sanitary inspection programs so beverages that contain some dairy-derived ingredients and are similar to milk in their use, would be subject to FDA's "Grade A" milk requirements. This would limit dairy ingredients used in such products to those meeting the "Grade A" inspection requirements, which from a practical standpoint, would eliminate use of many imported ingredients that are now very widely used, as they do not meet FDA's "Grade A" requirements. This could include casein and caseinates, concentrated proteins and other fractionated components, and nutrients contained in milk including some that are not available in significant quantities from domestic producers. This is yet another incentive for food formulators to use non-dairy ingredients in these new products. Higher costs, more recordkeeping and administrative burdens, and special regulatory inspection requirements are likely to reduce the use of dairy ingredients in these type products again leaving less net revenues for dairy farmers. (Tipton R 1052-1054)

In the face of rapidly advancing technologies and the chilling effect that Class I regulation has on the use of dairy ingredients in many existing and new product formulations such as non-traditional dairy beverages, Leprino believes that it is time to refocus the Class I fluid milk product definition on beverage milk and those products that directly compete with beverage milk. . . Based upon discussions that I had with beverage marketers as part of my consulting business prior to joining Leprino, I believe that product formulators are constraining their use of dairy ingredients in products that would otherwise be classified as Class I in order to avoid both the regulatory burden and the increased costs associated with the production and marketing of Class I products. While this concerned me ten years ago, it is of much greater concern today because of the significantly larger market opportunity that is being constrained. Additionally, proposals before the Department to replace the SNF standard with a protein standard are likely to establish even further constraints, particularly as it relates to smoothies, products containing yogurt and the nontraditional beverage category." (Taylor R 970, 974-975)

The advances in non-dairy proteins are erasing the historical advantage that dairy ingredients have had over soy and other alternatives in the areas of taste, quality, and function; and along with increasing awareness of similar health benefits; the use of such alternatives is on the rise. As stated by Simon Tucker of Fonterra USA:

We see products made of soy, rice, nuts, grains and oils, all marketed with the names consumers have associated with dairy . . . The claim by the soy industry linking soy to reducing the risk of heart disease has FDA approval. Scandinavian authorities have approved a health claim for cheese where all the milk fat has been replaced by canola oil . . . The table included in my testimony shows that in nutritional applications alone, between 1999 and 2003 the use of soy protein in nutritional applications has enjoyed an average annual growth rate of 16.5 percent, while milk protein has increased by only 10.1 percent. Soy is clearly eroding the dominant market position of these products once enjoyed by milk protein. (Tucker R 456-458)

The only reason given for switching to the proposed 2.25 percent milk protein standard was that companies could, under the current rule of 6.5% nonfat milk solids use just less than 6.5 percent milk-derived protein and still be below the Class I triggering point. These products could be formulated using larger amounts of milk protein but not necessarily causing the product

to be classified as Class I. Proponents of the 2.25 percent protein standard argued that formulators who used most or all of the permitted 6.5 percent nonfat milk solids but avoided triggering the Class I classification were somehow “milking the system” because they were substituting higher value milk proteins for other lower cost non-protein milk solids. This argument is nonsensical.

It is not that the milk protein is without cost or that dairy farmers have not been compensated for the commercial value of the protein. The user would have paid the market price for the protein and the dairy farmers who produced the milk from which the protein was derived would have been paid for the milk including the protein contained therein. The only element at issue here is whether an additional charge equal to the differentially higher Class I price should be imposed on the equivalent amount of milk that would have been used to make the protein. Extracting this differential value is likely to be comparable to “killing the goose that laid the golden egg.” Replacing the 6.5 percent nonfat milk solids standard with a 2.25 percent protein standard will likely reduce dairy farmer revenues.

Product formulators have to purchase milk proteins or other nonfat milk solids based on prevailing market prices. Because milk protein often has a higher market price than other milk components such as lactose, formulators would have already decided that the higher-cost milk protein brings greater value to the finished product than other lower-cost milk components and therefore, are willing to incur the higher cost. In either case, if the finished product contains more than 6.5 percent nonfat milk solids from milk protein or other non-protein milk solids, it would be classified as Class I and the Class I differential would be charged for the equivalent amount of milk that would have been used to produce the milk protein or other milk components. This is the added cost of triggering Class I classification. The decision matrix for the formulator would most likely be as follows:

Assuming there are alternative protein sources that perform the desired functions equally well, the formulator would choose the lower cost alternative based on prevailing market prices for each alternative type of protein. If there are any differences in how well either source performs the desired functions, the relative adequacies would be factored into the evaluation of their relative costs and a judgment made on a case-by-case basis as to the price and functionality tradeoffs. However, a number of witnesses described the technological improvements in functionalizing milk components and the resulting expansion in components that can be used to formulate new beverages.

WHEY AND WHEY PRODUCTS SHOULD BE EXCLUDED FROM BOTH THE DETERMINATION ON WHETHER A PRODUCT IS CLASS I AS WELL AS THE ADDED PAYMENT OF THE CLASS I COST

Again, speaking to the premature nature of this proceeding is the lack of technological information available on the record. Proponents of the 2.25 percent protein standard substitution failed to provide facts and evidence on several crucial issues that bear directly on the feasibility of using a protein standard.

The first consideration is the availability of laboratory tests to measure the quantity of protein to administer the 2.25 percent threshold. The second consideration relates to

distinguishing and identifying the source of protein (i.e. dairy vs. non-dairy). The third issue is the available tests to distinguish between whey protein and other dairy-derived proteins, as well as the ability to measure the quantity of whey protein as compared to other dairy-derived protein because the proponents proposed different pricing for whey protein compared to other protein. And finally, the availability of tests to determine whether the whey protein has been altered or modified or whether certain whey proteins have been removed. The record contains no authoritative evidence on these issues.

Proponents of the protein standard claimed little or no knowledge about the ability to test and distinguish among the sources of protein or the cost of doing so. The record is virtually devoid of evidence on this crucial issue.

Ingredients and technology are improving at a phenomenal rate. Ultra-filtration has ushered in the ability to separate milk components in ways that were unthinkable a few years ago. Filtration and fractionation technologies formerly used only in other countries are now commonplace in the U.S. Equipment manufacturers are offering equipment and technologies that are drastically changing the way products are made. Much of the technology and know-how of filtration and fractionation of milk protein has now been perfected for many other protein sources. Among the popular new sources of modified protein are those derived from peas, wheat, rice, soy and various other products. These, along with milk proteins can be easily substituted for each other. As technology continues to improve, flavor and functionality will become less limiting. Already, price is the driving force in the selection of which protein source to use because their functionality, taste and impact on the finished product characteristics are indistinguishable among the various protein sources.

Proponents proposed that whey protein derived from the cheese-making process be excluded from Class I pricing. Again, this displays a lack of knowledge as to the feasibility of such a proposal. New technologies permit the ultra-filtration of milk to remove whey protein, some water content, and lactose before the ingredient enters the cheese plant. The new process is very popular because it greatly improves the efficiency of the cheese-making operation. Because whey proteins are filtered out before raw material enters the cheese plant, the cheese plant handles less raw product that reduces environmental issues and significantly increases the yield of the cheese-making equipment (i.e. pounds of raw product processed per unit of cheese). Whey produced by such a process, and ultimately the whey protein, is the same as that produced at the cheese plant from the regular cheese-making process or the same as if the raw milk was filtered in the cheese plant as a direct part of the cheese-making process.

Likewise, whey is a byproduct of casein production. Casein can be produced by micro-filtration with direct acid or with cultures. There was uncertainty on the record as to whether whey from casein production was identical to whey from cheese-making.

We have cited these issues because the hearing record is deficient in providing the facts and the basis for limiting the whey exemption to only that whey resulting from the cheese-making process. If this proceeding as it relates to maintaining the current nonfat milk solids standard is not terminated, whey should be exempted from calculating the percentage of nonfat milk solids that a product contains; the amount of whey protein it contains and/or any higher

Class I pricing charges. All forms of whey and whey products should be excluded. Witnesses who addressed this issue overwhelmingly testified in support of the exclusion of whey and or whey protein. (Box R 652) (Tipton R 1075-1076) (Waldron R 748-749, 847-848)

To further demonstrate the inadequacy of this hearing record and to further alert the Department of the need to gain a better understanding of the effect of the new and burgeoning technologies that are now in the market, we offer one more example of an issue that was not even addressed in the hearing. Micro-filtration now permits the separation and isolation of specific proteins. Lactoferrin is a milk whey protein associated with bone regeneration treatment and the treatment of osteoporosis and cancerous tumors. Lactoferrin is now being produced in New Zealand and in the U.S. In New Zealand, the product that remains after the micro-filtration of lactoferrin is used to make a basic milk powder. How should products that use this lactoferrin-free powder be classified and how does one calculate the milk equivalency of such a powder?

There can be no doubt that USDA and the industry need to better understand the current and developing market conditions with regard to new products as well as the effects of new technologies before changes are made to base the classification rules on protein.

ALL YOGURT AND KEFIR SHOULD BE CLASSIFIED IN CLASS II IRRESPECTIVE OF WHETHER IT IS SPOONABLE, DRINKABLE, OR COMBINED WITH WATER, JUICES OR OTHER FOODS

Yogurt and kefir should be classified in Class II irrespective of whether it is spoonable, drinkable, or combined with water, juices or other foods. Consumer attitudinal and use data supplied by Yoplait and Dannon establish that drinkable yogurt and combinations of yogurt and juices are not substitutes or replacements for fluid milk. (Box R 683-686) (Waldron R 739-745) Kefir, which is very similar to yogurt in composition and its place in the market, is also not a replacement or a substitute for fluid milk.

Upon review of price elasticity data for yogurt and yogurt-containing drinks (multiple times greater than fluid milk, see Box R 671-672) and the ability to use alternative sources of dairy and non-dairy components, it is highly likely that dairy producer revenues are being reduced as a result of Class I classification of drinkable kefir and yogurt.

Kefir is a cultured dairy product similar to yogurt. Both products have characterizing bacterial cultures, which consumers buy based on the probiotic cultures' various health benefits that are otherwise absent in milk. The viscosity of kefir is very similar to yogurt. Kefir, like yogurt, is not consumed with a meal, but often as a meal replacement. Both kefir and yogurt's snack usage is substantial. Most kefirs, like yogurt, are sweetened and their acidity levels are quite similar as well. Kefir and yogurt are competitive products that can be substituted for each other at various eating occasions. For these reasons and others, kefir should be in the same class as yogurt.

Both yogurt and kefir are often combined with other liquids such as fruit juices, purees, water and other food ingredients to provide a specific taste and texture. These mixes are sometimes marketed using the name "smoothie", and in such cases yogurt or kefir are identified

as ingredients, or as a product containing two foods, e.g. fruit juices and kefir or yogurt. Kefir and yogurts that are combined with juices, other foods and water provide an excellent opportunity for dairy farmers to expand the use of dairy ingredients and should not be burdened with the additional costs of Class I classification.

Based on a number of factors, it is clear that drinkable kefir and yogurt are not milk and do not compete with fluid milk. They are not consumed in lieu of milk or as a substitute for milk. These products are frequently not sold in the same section of the store as milk, they have a substantially different texture and taste profile; and are typically packed in containers that are intended to be consumed "on the go" in a single serving. Consumers choose kefir and yogurt cultured beverages for different occasions and taste reasons than when consumers elect to purchase fluid milk. In light of these distinct differences, kefir and yogurt should be classified in Class II for all uses. Due to the similarities that exist, if one is placed in Class II, and the other in Class I, there would be a clear competitive advantage for the Class II product, and a disadvantage to the Class I product. This is not merited by the facts given their similar composition and positioning in the market place.

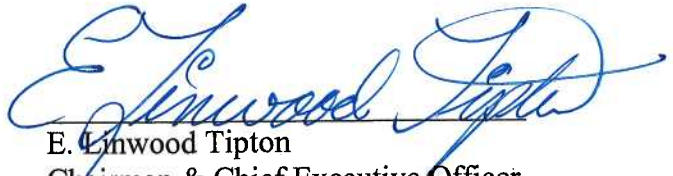
Cultured dairy products are one such category where great opportunities exist and most especially for kefir. USDA should look at the issues relating to yogurt and kefir and see that the interests of producers and processors are truly aligned when these products are placed in a more competitive position, and not shackled by regulations which, however well-intended, have the effect of dampening the prospects for this category.

THE CURRENT ORDER EXCLUSIONS FOR "FORMULAS ESPECIALLY PREPARED FOR INFANT FEEDING OR DIETARY USE (MEAL REPLACEMENT) THAT ARE PACKAGED IN HERMETICALLY SEALED CONTAINERS" SHOULD BE CONTINUED

There is no basis for changing the exclusion from Class I for "formulas especially prepared for infant feeding or dietary use (meal replacement) that are packaged in hermetically-sealed containers." This proceeding should be terminated with respect to this issue. The proponents of proposal #3, O-AT-KA Milk Products Cooperative, Inc., withdrew support of their own proposal. Proposal #3 names several types of formulas for specific categories that should be exempted. However, in view of O-AT-KA's withdrawal and of the fact that Hormel Foods failed to testify in support of its proposal, we believe this matter should be terminated in this proceeding and no changes made at this time.

Respectfully submitted on behalf of the following companies:

Bravo! Foods International Corporation
Lifeway Foods, Inc.
PepsiCo
Starbucks Corporation
Unilever United States, Inc.



E. Linwood Tipton
Chairman & Chief Executive Officer
The Tipton Group, Inc.
703 D Street, Southeast
Washington, D.C. 20003

and



Brandon N. Partridge
Vice President
The Tipton Group, Inc.
703 D Street, Southeast
Washington, D.C. 20003



703 D Street, SE Washington, DC 20003 • Telephone: 202 675-8470 • Fax: 202 675-8472

June 1, 2005

By facsimile (202-720-1362) and e-mail: zipora.bullard@usda.gov

Ms. Zipora Bullard
 FOIA/PA Officer
 Agricultural Marketing Service
 Room 3517-South Building.
 United States Department of Agriculture
 Ag Stop 0202
 1400 Independence Avenue, S.W.
 Washington, DC 20250-0273

Dear Ms. Bullard:

I hereby request, under the provisions of the Freedom of Information Act, 5 U.S.C. § 552, and the provisions of 7 C.F.R. Part 1, the opportunity to inspect and make copies of the following records:

All proposals and supporting documentation submitted in response to the August 28, 2003 "Invitation to Submit Proposals for a Public Hearing to Amend Provisions of the Northeast and Other Milk Marketing Orders" (a copy of which is attached), including the initial proposal, dated June 30, 2003, which prompted the Invitation, and any proposal that was submitted, but was for whatever reason rejected by the Department.

For purposes of assessing charges for the production of these records, this requester is a "commercial use requester." We are willing to pay reasonable fees for this request, including duplication fees, of up to \$250.00 without further notice. If you anticipate that fees for this request will exceed \$250.00, please let me know in advance so that I may provide you with further authorization.

Please reply as soon as possible, but as provided in the Freedom of Information Act, no later than within twenty working days.

Sincerely,

E. Linwood Tipton
 Chairman & CEO



United States
Department of
Agriculture

Agricultural
Marketing
Service

1400 Independence Ave., S.W.
South Building
Washington, DC 20250

JUN 16 2005

In reply, please refer to
AMS FOIA No. 88-05

Mr. E. Linwood Tipton
Chairman & CEO
The Tipton Group, Inc.
703 D Street, SE
Washington, DC 20003

Dear Mr. Tipton:

This is an interim response to your June 1, 2005, request under the Freedom of Information Act (FOIA), 5 U.S.C. § 552, which I received on June 2, 2005. You are seeking copies of documents submitted in response to the August 28, 2003 "Invitation to Submit Proposals for a Public Hearing to Amend Provisions of the Northeast and Other Milk Marketing Orders."

Section 552(a)(6)(B) of Title 5, United States Code, provides that in unusual circumstances the time limits prescribed for responding to FOIA requests may be extended 10 additional business days by written notice. This is to notify you that we are taking the additional time provided. Your request involves the examination of materials related to similar requests that are currently being reviewed by our Office of General Counsel (OGC). We are awaiting the results of our OGC review. We expect to release the requested records or provide reasons why any records are to be withheld soon.

Sincerely,

A handwritten signature in cursive script that reads "Zipora D. Bullard".

Zipora D. Bullard
AMS Freedom of Information Act Officer



703 D Street, SE Washington, DC 20003 • Telephone: 202 675-8470 • Fax: 202 675-8472

August 3, 2005

By facsimile (202-720-1362) and e-mail: zipora.bullard@usda.gov

Ms. Zipora Bullard
FOIA/PA Officer
Agricultural Marketing Service
Room 3517-South Building
United States Department of Agriculture
Ag Stop 0202
1400 Independence Avenue, S.W.
Washington, DC 20250-0273

Dear Ms. Bullard:

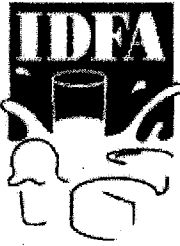
I am writing regarding a pending Freedom of Information Act (FOIA) request, AMS FOIA No. 88-05. This was a request for copies of documents submitted in response to the August 28, 2003 "Invitation to Submit Proposals for a Public Hearing to Amend Provisions of the Northeast and Other Milk Marketing Orders." Following my initial letter dated June 1, 2005, I received your interim response dated June 16, 2005, in which you stated you would be taking the additional ten business days provided for in law to prepare your response.

At that time you indicated the Office of General Counsel (OGC) was reviewing this request along with others you had received that requested similar documents. As today is the 44th business day since my initial letter, I hope you can inform me when you intend to release the requested records or provide reasons why any records are being withheld.

Thank you for your efforts to provide for the release of these documents as soon as possible.

Sincerely,

E. Linwood Tipton
Chairman & CEO



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



January 30, 2004

Mr. Richard M. McKee
Deputy Administrator
USDA/AMS/Dairy Programs
Mail Stop-0225, Room 2968
1400 Independence Avenue, S.W.
Washington, DC 20250-0225

RE: Request for additional comments in connection with the hearing requested to amend the fluid milk product definition in all Federal Milk Orders.

Dear Rich,

Together, the National Milk Producers Federation and the Milk Industry Foundation request that USDA not hold a hearing to consider changes in the fluid milk product definition at this time. Given the importance of this issue, and despite the additional time already granted for parties to comment or make additional proposals on this issue, more time is needed to study the nascent market for new milk-based drinks and other beverages containing milk before considering changes to Federal Milk Marketing regulations. The impacts of such changes on both milk producers and processors depend on a number of factors. Preliminary analysis suggests that the dairy industry needs better data about these products and their markets.

We respectfully request that USDA not hold a hearing at this time. We will continue to evaluate this developing market. At such time that study and experience provide a more conclusive basis for redefinition of Class I products, the dairy industry can ask the Department to address the issue. Doing so at present is inappropriate, as it may compromise the effectiveness of the resulting decision.

Sincerely,

Roger Cryan
Director of Economic Research
National Milk Producers Federation

Robert D. Yonkers
Chief Economist and Director of Policy Analysis
Milk Industry Foundation

cc: Secretary Ann Veneman
Under Secretary Bill Hawks
Chief Economist Keith Collins
Administrator AMS, A.J. Yates

Brandon Partridge

From: Bullard, Zipora [Zipora.Bullard@usda.gov]
Sent: Friday, August 05, 2005 7:59 AM
To: tip@tiptongroupdc.com
Cc: brandon@tiptongroupdc.com
Subject: STATUS FOIA 88-05

Dear Mr. Tipton,

You should be receiving a response soon (possibly weeks). We are still waiting for the Office of General Counsel (OGC) to make a decision. Please feel free to contact me again in two weeks if you do not receive a response.

Thanks,

Zipora Bullard
AMS FOIA OFFICER
202-720-2498

8/12/2005