USDA - Federal Milk Order Hearing

Sheraton Hotel Station Square
West Station Square Drive
Pittsburgh, PA 15219

Monday, June 20, 2005
8:00 a.m.

BEFORE: PETER M. DAVENPORT
U.S. ADMINISTRATIVE JUDGE

TRANSCRIPT OF PROCEEDINGS

VOLUME I

Reported by:
Michelle L. Hall
Registered Merit Reporter

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APPEARANCES:

U. S. Department of Agriculture: Office of the General Counsel by Garrett Stevens, Deputy Assistant General Counsel


Texas Market Administrators: Todd Wilson

Dairy Farmers of America: Elvin Hollon, Director Fluid Marketing, and Marvin Beshore, Esq.


General Mills: Deb Grocholski, Associate General Counsel

O-AT-KA Milk Products Corp.: Upstate Farmers Cooperative, Inc. by Timothy R. Harner, General Counsel


National Yogurt Association: Cooley Godward, LLP by Aaron F. Olsen, Esq.
APPEARANCES (CONT.):

Bravo! Foods International Corp., Linwood Tipton
Lifeway Foods, Inc.,
PepsiCo, Starbucks
Corporation, and
Unilever:

Fonterra, USA: Blank Rome, LLP
by Edward Farrell, Esq.

Dannon Company, Inc.: James Box

Milk Industry
Foundation: Robert Yonkers

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CROSS BY MR. WILSON

WITNESS: ROGER CRYAN, Ph.D.

EXAMINATION:

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JUDGE DAVENPORT: This is a hearing, Docket No. AO-361-A38; DA-03-10. I'm Peter Davenport. I'm the Administrative Law Judge, and this hearing has been set pursuant to notice and is called pursuant to the provisions of the Agricultural Marketing Agreement Act of 1937 as amended and the applicable rules of practice and procedure governing the formulation of market agreements and marketing orders.

The purpose of this hearing is to receive evidence with respect to the economic and marketing conditions which relate to the proposed amendments which have been set forth in the proposed rules, and any appropriate modifications thereof to attempted marketing agreements and orders.

We are prepared to take testimony from all witnesses, and I ask that any interested parties who wish to introduce exhibits should provide me at the hearing with at least six copies of the exhibits for the
official record. It would also be helpful if additional copies are available for use of the other participants at the hearing.

Now, just a couple of introductory remarks. For the convenience of all people here, I would ask you at this time to either turn your cell phones to either silent or vibrate mode, or some other mode which would tend to eliminate the disruptions to the hearing.

In other words, we will be taking testimony from witnesses. I would ask that as you come forward to testify, that you either testify from the microphone or we can make other microphones available, that you introduce yourself each time that you, in other words, come to the microphone. The first time I would ask that you spell your name for the hearing reporter and also indicate the entity that you are representing.

Now, this week has been -- or this hearing has been scheduled to last the entire week. I have been approached by a number of people who indicate that they have special
scheduling needs. It is my intention, if possible, to accommodate those scheduling needs, so we will take those people when they are available to the maximum extent possible.

At this time, I would call upon Garrett Stevens from the Office of General Counsel to add any additional remarks and to introduce the members of the United States Department of Agriculture who are present here today.

MR. STEVENS: Thank you, Your Honor.

My name is Garrett Stevens. I'm with the Office of General Counsel, U.S. Department of Agriculture, Washington, D.C., and there are other people here for the Department who will make their appearances.

MR. TOSI: My name is Gino Tosi, T as in Tom, O-S-I. I'm with the U.S. Department of Agriculture, Agricultural Marketing Service, Dairy Programs, Washington, D.C.

MS. CARTER: Good morning. My name is Antoinette Carter,
MR. CHERRY: Good morning. My name is Richard Cherry, United States Department of Agriculture, Dairy Programs, Washington, D.C.

MS. TAYLOR: Good morning. I'm Erin Taylor, also with the Department of Agriculture, Agricultural Marketing Service and Dairy Programs in Washington.

JUDGE DAVENPORT: Mr. Stevens, do you want to --

MR. STEVENS: Just a minute, Your Honor.

JUDGE DAVENPORT: -- introduce Mr. Walker and some of the others who might testify later.

MR. TOSI: We have another colleague that's yet to arrive. His name is Todd, T-O-D-D, Wilson, W-I-L-S-O-N. He's employed by the Texas Market Administrator's
Office in Dallas, Texas. We also have other Market Administrators who are here, and USDA will also be putting on one witness who has prepared statistics on requests in the industry.

JUDGE DAVENPORT: Very well. Could I have other general appearances.

Mr. Beshore?

MR. BESHORE: Marvin Beshore, B-E-S-H-O-R-E. I'm here on behalf of Dairy Farmers of America.

JUDGE DAVENPORT: Mr. Yale?

MR. YALE: Benjamin F. Yale, Yale Law Office, Waynesville, Ohio. I'm here on behalf of Select Milk Producers, Inc., and Continental Dairy Products, Inc.


MR. VETNE: My name is John Vetne, V-E-T-N-E. My appearance is for HP Hood and Chelsea Mass.

MS. GORCHOLSKI: Deb Gorcholski, G-O-R-C-H-O-L-S-K-I. I'm counsel
for General Mills, Inc.

MR. FARRELL: Edward Farrell, F-A-R-R-E-L-L, with Blank Rome, LLP, on behalf of Fonterra, USA.

MR. OLSEN: Aaron Olsen, O-L-S-E-N, on behalf of National Yogurt Association.

MR. BOX: Jim Box on behalf of the Dannon Company, Inc.


MR. Tipton: Tip Tipton; Linwood, L-I-N-W-O-O-D, T-I-P-T-O-N. I'm appearing on behalf of Bravo!, B-R-A-V-O, exclamation mark, Foods International Corporation; Lifeway Foods, Incorporated; Pepsico; Starbucks Corporation; and Unilever Corporation.

JUDGE DAVENPORT: Other participants?

JUDGE DAVENPORT: Other appearances? Mr. Stevens?

MR. STEVENS: Your Honor, we have some preliminary exhibits, I guess we would like to go through them if that's proper at this time. You Honor, I have given copies to the reporter, and I have a copy for you, Your Honor.

I think we will just go through them one by one. I believe there are copies in the back of the room. As we identify these, you will know what they are, and then we will have them and ask for their admission.

Let's start with the Notice of Hearing.

JUDGE DAVENPORT: This is the proposed rules, which is Federal Register Volume 70 No. 69, Tuesday, April 12, 2005?

MR. STEVENS: Yes, Your Honor.

JUDGE DAVENPORT: Very well. I have marked that as Exhibit No. 1.

(Exhibit No. 1 was marked for identification.)
MR. STEVENS: Thank you, Your Honor. The next document is a document entitled, Program Announcement, with the heading "Program Announcement." I believe it is a press release entitled, "USDA Sets Hearing on Proposed Amendments to All Federals Milk Orders."

I would like that marked for identification as Exhibit 2, if I could, please.

JUDGE DAVENPORT: So marked.

(Exhibit No. 2 was marked for identification.)

MR. STEVENS: The next document is a one-page document, Certificate of Officials Notified, signed by Joyce M. McPherson, the docket clerk at the U.S. Department of Agriculture.

It has the docket number and the notation of the hearing on it, and it speaks to the notification of the governors of the states listed in that document.

I would like that marked for identification as Exhibit 3.
JUDGE DAVENPORT: So marked.

(Exhibit No. 3 was marked for identification.)

MR. STEVENS: The next document is a Determination Re Mailing of Notice of Hearing with the docket number, signed by Richard Fleming, one of the Market Administrators for the southwest marketing area.

I would like that marked for identification as Exhibit 4.

JUDGE DAVENPORT: So marked.

(Exhibit No. 4 was marked for identification.)

MR. STEVENS: The next document is a Determination Re Mailing of Notice of Hearing signed by Sue L. Mosley, Market Administrator for the Florida and southeast markets.

I would like that marked for identification as Exhibit 5.

JUDGE DAVENPORT: So marked.

(Exhibit No. 5 was marked for identification.)
MR. STEVENS: The next document is a Determination Re Mailing of Notice of Hearing signed by Robert E. Vander Linden, who is the Market Administrator for the central order, with the docket number -- I should say that these are determinations of mailing as noted in the document described. I would like this marked for identification as Exhibit 6.

JUDGE DAVENPORT: So marked.

(Exhibit No. 6 was marked for identification.)

MR. STEVENS: The next document is, again, a Determination Re Mailing of Notice of Hearing signed by H. Paul Kyburz, Market Administrator for the midwest order. I would like that marked as Exhibit 7.

JUDGE DAVENPORT: So marked.

(Exhibit No. 7 was marked for identification.)

MR. STEVENS: The next document, another Determination of Mailing signed by Erik F. Rasmussen, Market
Administrator for the northeast order.

I would like that marked for identification as Exhibit 8.

JUDGE DAVENPORT: So marked.

(Exhibit No. 8 was marked for identification.)

MR. STEVENS: The next one, again, is a Determination of Mailing for the docket number, and this is signed by James R. Daugherty, who is the Market Administrator for the pacific northwest and Arizona-Las Vegas market orders.

I would like this marked for identification as Exhibit 9.

JUDGE DAVENPORT: So marked.

(Exhibit No. 9 was marked for identification.)

MR. STEVENS: Your Honor, I would like marked as Exhibit 10 a similar document, Determination of Mailing of Notice of Hearing, signed by Harold H. Friedly, Jr., who is the Market Administrator for the Appalachian marketing area.

I would like this marked as
Exhibit 10.

JUDGE DAVENPORT: So marked.

(Exhibit No. 10 was marked for identification.)

MR. STEVENS: And the last one is a two-page document that has a memo on the top concerning Certificate of Mailing, and the Certificate of Mailing is signed by David Z. Walker, Market Administrator for the mideast marketing area.

I would like that marked for identification as Exhibit 11.

JUDGE DAVENPORT: So marked.

(Exhibit No. 11 was marked for identification.)

JUDGE DAVENPORT: Are there any objections to any of these preliminary documents? They will be admitted at this time, then, and added to the record.

(Exhibits 1 through 11 were admitted.)

MR. STEVENS: Your Honor, I would like to call John Rourke to the stand.

JUDGE DAVENPORT: Mr. Rourke,
would you please come forward. Would you raise your right hand, please, sir.

JOHN P. ROURKE

a witness herein, having been first duly sworn, was examined and testified as follows:

JUDGE DAVENPORT: Please be seated. Spell your last name for the hearing reporter.

THE WITNESS: Last name is R-O-U-R-K-E.

DIRECT EXAMINATION

BY MR. STEVENS:

Q. Good morning, John.

A. Good morning.

MR. STEVENS: Your Honor, I would like marked for identification, mine is three pages, I believe they are all three pages, two pages of which are John's statement and a third of which is a table and exhibit, if you will, but I would like it all marked as Exhibit -- I guess we are at Exhibit --

JUDGE DAVENPORT: 12.

MR. STEVENS: 12. Thank you,
J. Rourke - Direct

Your Honor.

(Exhibit No. 12 was marked for identification.)

JUDGE DAVENPORT: So marked.

BY MR. STEVENS:

Q. John, where do you work?

A. I work for the Market Information Branch, Dairy Programs, Agricultural Marketing Service.

Q. Do you have a background in dairy? Could you describe that briefly for the record.

A. Yes. I started working in Dairy Division, predecessor to Dairy Programs, in May of 1970. I have worked in various different positions in Dairy Division. Then I became the chief in the Market Information Branch in about 1991.

Q. And, John, what is your educational background?

A. I have an undergraduate degree from the University of Maryland in economics, and I did postgraduate work at Penn State in agricultural economics.

Q. Have you testified in Federal Order
J. Rourke - Direct

Hearings before?

A. Yes. I've testified at several Federal Milk Order Hearings before.

Q. Were you asked to prepare information for this hearing?

A. Yes, I was.

Q. Certain parties asked you to provide information at the hearing today?

A. Yes. It was recommended that I put some information together that would be useful. We agreed that that would be basic information and probably would be of use for the hearing.

Q. And you brought that with you today?

A. Yes, I did.

Q. And it's represented in what we have marked for identification as Exhibit 12?

A. That is correct.

Q. And you have prepared a statement that you would like to enter into the record?

A. Yes, I have.

Q. Are you prepared to enter that statement at this time, read it into the record?

A. Yes, I am
J. Rourke - Direct

Q. Please do so.

A. My name is John Rourke. I'm the chief of the Market Information Branch, Dairy Programs, Agricultural Marketing Service. One of my areas of responsibility is the National Federal Milk Order Statistics Program.

The information that I am presenting today has not been prepared in favor of or opposition to any proposal being considered at this hearing. The information was collected by Market Administrator staffs at my direction and assembled by me.

The information on the last page of this document shows annual data for 2004 for selected milk product beverages that are not listed separately in regular published reports. These products have been grouped by class of utilization. If the classification of a product changed during the year, the monthly volumes were included in the applicable class.

For each product, the following information shown: Product pound, butterfat test, proportion of total Class I products disposition, and Federal milk order reporting.
J. Rourke - Direct

the product. The data are totals for all orders combined.

For nearly all products, individual order data pertained to the operations of fewer than three firms and thus cannot be released without disclosing confidential information.

Market Administrators were directed to collect information only from those fluid milk processing plants that actually produce the product. If a regulated distributing plant's only route disposition of one of these products was a resale of a product received from another plant, then the plant was excluded from the data collection.

Market Administrators obtained this information from handler reports of receipts and utilization or from audits or handler records. The information collected differs by type of fluid milk processing plant as follows:

One, fully regulated distributing plants. For Class I products, the statistic used is "total packaged disposition." This includes route disposition, regardless of destination, packaged transfers to other order
J. Rourke - Direct

plants, both in the same order or in another order, and packaged transfers to unregulated plants. The term route disposition is used as defined under the order.

For Class II products, the milk, skim milk, and cream used to produce the product were recorded. Two, partially regulated distributing plants, (PRDP)-route dispositions in all Federal milk order marketing areas were collected. Some milk, skim milk, and cream used to produce the selected Class II products was reported for this type of plant.

Three, regulated or unregulated manufacturing plants - the information is milk, skim milk, and cream used to produce the selected Class II products. Information was not collected from producer-handlers or exempt plants.

I have two additional comments. First, the term "total Class I products disposition" means total packaged disposition of products classified as Class I by fully regulated distributing plants. This figure
J. Rourke - Direct

does not include the selected Class II products shown on the table.

Second, under "orders reporting the product," PRDP stands for partially regulated distributing plants.

Following is an explanation of the data in the table, using the first line, the data for carb reduced or free beverages.

First looking at the last column, there were four orders that reported this product being made by fully regulated plants; the Order numbers are shown. Also, this product was distributed on routes in FMO marketing areas by partially regulated distributing plants; this fact is indicated by PRDP.

Going back to the second column, there were 101,490,181 pounds of this product reported; the butterfat test of these products was 1.91 percent.

Going now to the fourth column, the 101 plus million pounds accounted for 0.23 percent of the total pounds of Class I packaged products disposed by fully regulated
J. Rourke - Cross - by Mr. Beshore
distributing plants.

This concludes my prepared comments, and I'm ready for any questions.

JUDGE DAVENPORT: Objections to the statement? It will be entered into the record at this time as Exhibit 12.

(Exhibit No. 12 was admitted.)

JUDGE DAVENPORT: Mr. Beshore?

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CROSS-EXAMINATION

BY MR. BESHORE:

Q. Good morning, John.

A. Good morning.

Q. First of all, I would like to thank you for your effort and work with you and your staff and all the Market Administrators in putting together this data, which is your statement, indicates has not previously been published or available, and it's extremely, extremely helpful.

You have been working at Dairy Programs for a number of years, I take it?

A. Yes.

Q. The classification definitions that
J. Rourke - Cross - by Mr. Beshore

are presently in the order were, a number of
them Class I and Class II, were made uniform
for the first time in the system in the early
1970s; is that about right?

A. I believe that's about correct.

Q. Were you working in the Department
then or --

A. Yes, I was.

Q. Okay. Now, would you agree with me
that the technology for dairy products, fluid
milk product production, was quite different at
that time than it is today?

A. Yes, I would agree that that's true.

Q. And one of the differences, maybe
one of the primary differences, is the degree
to which it's possible with technology today to
fractionate the -- to divide out in various
ways the components of fluid milk?

A. That's correct.

Q. Now, you haven't presented any price
data. I'm sure we will take notice of some of
the official publications which are produced
under your supervision and price data, but I
wonder if you work with these numbers every day
J. Rourke - Cross - by Mr. Beshore

and you know them, I think, generally.

Would you agree with me that the components of milk have widely -- the solids components have widely differing values in the marketplace?

A. By that you mean protein and nonfat solids?

Q. Yes.

A. That would be a correct statement.

Q. And protein today under the Federal Orders, approximately what's the price of protein per pound?

A. It's probably somewhere in the neighborhood of $2.15 per pound.

Q. Now, the other nonfat solids in milk -- whey, for instance -- what approximately is the value of dry whey?

A. Under solids value is in the neighborhood of 10 to 15 cents.

Q. Versus the $2.15 for protein?

A. That's correct.

Q. Now, is there published weekly under your direction and marketing information a price for the market price of lactose?
J. Rourke - Cross - by Mr. Beshore

A. The under the Dairy Market Use Service, the weekly price for lactose I believe is somewhere around 20 cents a pound. A little less than that right now.

Q. So then protein, whey, lactose, are they the primary -- of course whey being a species of protein, a portion of protein -- are those the primary nonfat solids in milk?

A. Yes. Yes.

Q. Let me turn to Page 3 of Exhibit 12 for a couple of questions.

There is somewhat of a difference, I take it, in the volume figures for the Class I versus Class II in the sense that Class I is volumes of product distributed, Class II is volumes of product that was used to produce the listed products; is that correct?

A. That's basically correct.

Q. Okay. So that, for instance, where you have yogurt-based beverages in both categories, in Class II, yogurt-based beverages, the actual shelf volumes may be somewhat greater than the volumes shown in the table?
J. Rourke - Cross - by Mr. Beshore

A. Shelf volume, you mean the weight of the product on the shelf?

Q. Yes.

A. That is correct.

Q. Because there may be ingredients other than the milk ingredients used to produce the product?

A. Correct.

Q. Now, the percentages in the fourth column of Page 3 of Exhibit 12, for Class II, those are percentages, if I understood you correctly, not of Class II product -- Class II usage in the system, but of Class I usage in the system; is that correct?

A. Correct. The volume number that those are percentages of shown in the footnote three, 44 billion plus pounds, and that is total Class I packaged disposition.

Q. Why are there yogurt-based beverages in both class categories?

A. Why are there?

Q. Yes.

A. There are composition of the products. Some of the composition of the products.
J. Rourke - Cross - by Mr. Beshore

products falls into the Class I category and
some falls in the Class II category.

Q. Is that basically the 6.5 percent nonfat solids?

A. It's my understanding that that's correct, that the Class II beverages would fall in the less than 6.5 percent nonfat solids, less than the compositional standard.

Q. And currently, that 6.5 percent nonfat solids are considered equal, so to speak, for that percentage test? Would that be correct? Pound of protein -- percent of protein and a percent of lactose are the same -- or quantity?

A. I'm not sure I understood your question.

Q. Okay. For the 6.5 percent under the present definitions is of nonfat solids irrespective of the type of nonfat solids?

A. Correct.

Q. So that a product with, you know, 6.5 units of protein is considered on the same basis as a product that would have 6.5 percent units of nonprotein to nonfat solids?
J. Rourke - Cross - by Mr. Yale

A. I'm not sure about how that -- how the particular product is accounted for.

Q. Okay. In any event, as you indicated, the 6.5 does not differentiate between nonfat solids or among nonfat solids?

A. That's correct.

MR. BESHORE: Thank you.

JUDGE DAVENPORT: Other cross?

Mr. Yale?

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CROSS-EXAMINATION

BY MR. YALE:

Q. Good morning.

A. Good morning.

Q. To follow up with a few other questions.

JUDGE DAVENPORT: Mr. Yale, for the hearing reporter, would you state your name again.

MR. YALE: Benjamin F. Yale on behalf of Select Milk Producers and Continental Dairy Products. Sorry.

BY MR. YALE:

Q. Mr. Rourke, the lactose-free
J. Rourke - Cross - by Mr. Yale

beverages, when you use the term "lactose free," are you referring to those where they hydrolyzed the lactose and made it for like LactAid and some of the other type drinks or is this one in which the lactose has been removed?

A. These are the products where the lactose has been processed and it's LactAid type products.

Q. Are you familiar with how that process works or that --

A. A little bit.

Q. It takes -- lactose is a double sugar; is that right? And this process breaks it down into two simple sugars?

A. That's my understanding, yes.

Q. So this isn't necessarily reflecting something that is removed, the lactose?

A. It's my understanding that lactose is basically still in that product.

Q. Just to make it clear, all we have is for 2004, there is -- we have no data available that one can try to estimate to see whether there's a growth in any of these products over the last five years?
J. Rourke - Cross - by Mr. Yale

A. I do not -- I do not have any.

Q. And the information you used to put this together is not readily available to the public, it was only available to the Department?

A. That's correct.

Q. Now, are you aware of a product being marketed in the southwest and Texas in particular called Utopia, a designer milk that puts -- the lactose has been reduced and the protein has been enhanced?

A. I'm not familiar with that product, no.

MR. YALE: You indicated that Todd -- is he going to testify?

MR. TOSI: No.

BY MR. YALE:

Q. Are you familiar with the computation that's used under the present system to determine the skim equivalent of some of these products?

A. I'm aware of it. I don't know how familiar I am with it.

MR. YALE: I would make a
J. Rourke - Cross - by Mr. Yale

request whether the Department would have
anybody that can testify as to how they compute
the skim equivalency and can get that into the
record.

A. I would be willing to take a shot at
it, if you want.

Q. You are willing to take a shot?
I'll give you a try. The problem is I'm not
all that great at it, either, so we will walk
through this together.

Generally, what is the skim
equivalent? What does that mean?

A. Skim equivalent is basically an
arithmetic computation to come up with the
volume of skim milk that would be -- that the
different components would convert to.

Q. In other words, you take the product
at hand and you determine how much that is
equivalent to what skim milk would be in the
same volume or another volume?

A. You would take that -- whatever the
component is that you are trying to convert
back to skim milk, and you would convert it to
its equivalent volume of skim milk that would
J. Rourke - Cross - by Mr. Yale

be basically used to produce that product.

Q. And today, what particular component are they using to come up with the skim equivalent? Do you know, what is the practice?

A. They use nonfat dry milk or condensed skim, depending on what might be used in the fortification process, or it depends on what the product is, I guess, as to what component might be used to convert to the skim --

Q. You could use just protein; right?

A. Yes.

Q. Are you familiar with the process of how that skim equivalency is determined? The math that goes through -- let me ask you --

A. I've not been through the math, no.

Q. Are you aware of the fact that use of specific gravity of each of the components to come up with a per gallon weight of the product that's compared to the producer milk?

A. I might be aware of that, but I don't know how to do it.

MR. YALE: We may have to put on some other evidence on that, but I would
J. Rourke - Cross - by Mr. Yale

like to have official notice taken of two books. One is -- or articles. One is

Q. And just going back to you, Mr. Rourke, you would not be able to then testify how he used specific gravity and arrived at the final skim in the fortification?

A. No, I would not.

Q. Finally, on this table, this lists only those products in which the Market Administrators have determined to either be Class I or Class II under the market; is that correct?

A. The products listed are those that were in the original requests for the data.

Q. Okay. Now, looking at the Class II, you are aware, are you not, that it is possible
J. Rourke - Cross - by Mr. Yale

to produce a Class II product and not be -- and that plant not be subject to the Order regulation have to report, is that right, if it's only a Class II plant?

A. That's correct.

Q. Do we know whether there are any plants -- based on your requests that you made to the Market Administrator, are there any plants that are producing any of the products under that second part of the table that are being marketed but would not have been on this report?

A. I would assume that to be the case, yes.

Q. And, similarly, other products -- well, let me ask you this question: Are you familiar with the product called Swerve?

A. I have heard of that, yes.

Q. Do you know how that would fit under either one of these two or if at all?

A. I'm not familiar with the classification of that product.

Q. Have you drank it?

A. I don't believe I've had Swerve, no.
J. Rourke - Cross - by Mr. Vetne

MR. YALE: So then we won't ask your opinion. Okay. I have no other questions. Thank you.

JUDGE DAVENPORT: Other cross?

Mr. Vetne?

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CROSS-EXAMINATION

BY MR. VETNE:


Mr. Rourke, your responsibilities in Dairy Programs are related to market information and statistics; is that correct?

A. That's correct.

Q. Your responsibilities do not include a role in determination of what products are Class I or Class II?

A. That's correct.

Q. And you do not apply in your work for the Dairy Programs the skim equivalent or component equivalent formulas that are used by others in the program; is that correct?

A. Could you repeat that question?
Q. You were asked some questions about skim equivalent formulas and you had some general idea. Am I correct that you do not apply those in your work, those formulas?

A. That's correct.

Q. And you are not involved in development of those formulas?

A. No, I'm not.

Q. The data on the table, on the last page of your testimony, for 2004 -- let me look at the Class I products first.

You are, however, involved in producing statistical compilation, including Federal milk Order Market Statistics have been published annually and monthly or bi-monthly for a long time?

A. That's correct.

Q. And towards the end of the annual Federal Milk Order Market Statistics publication, there is and has been for a long time a table showing distribution of Class I products by handlers and broken down to various types of products?

A. That's correct.
J. Rourke - Cross - by Mr. Vetne

Q. And in that table, which I don't have in front of me, the products broken down are whole milk, two percent milk, one percent milk, skim milk, and at the bottom there is a category for other?

A. Correct.

Q. Okay. Would the Class I products that are listed here for 2004 be those products that are included in the "other" category in the Federal Milk Order Market Statistics?

A. Some of these products may be included in the -- like butterfat content regular-type products. It depends on the Market Administrator has some latitude in how that product is reported. The miscellaneous or other category may include these. It may include some other products as well.

Q. The miscellaneous or other category of Class I products distributed, would it be correct to say that those include all products that are not eligible to be labeled as milk?

A. I would say that's not true.

Q. That is not true?

A. That's not true.
Q. Is it your belief that some products shown as whole milk, one percent milk, two percent milk, or fat-free or skim milk include products that are not eligible to be labeled as milk?

A. I would say that is a possibility that some volume shown under those products may be some of these products that are shown here.

Q. Is there a standard or guideline for the development of those statistics that would place it in one category or another in that table in the annual statistics?

A. There is not a guideline for where the products are placed on that table.

Q. The products in your table, lactose-free beverages, those are products that, I think you described, are simply lactose -- the lactose in the milk is neutralized and converted to other sugars?

A. Correct.

Q. And they would be labeled milk?

A. It would be my understanding.

Q. Do you know whether any of the carb-reduced or carb-free beverages in the
J. Rourke - Cross - by Mr. Vetne

first line of this are labeled or eligible to be labeled milk?

A. I do not know that.

Q. Do you know whether any of the yogurt-based beverages are labeled or eligible to be labeled as milk?

A. I do not know that, either.

Q. In the category of Class I products, under the -- to the far right there is the PRDP, partially regulated distributing plants, those could include and probably do include plants located in California that market packaged products into Federal Orders; correct?

A. That's correct.

Q. As far as the classification of those products is concerned, you don't know whether California classifies those products as Class I or Class II?

A. All of these products?

Q. Yes.

A. No, I don't.

Q. Do you know whether the carb-reduced or carb-free beverages are Class I or Class II in California?
J. Rourke - Cross - by Mr. Vetne

A. It seems to me my understanding that they are not Class I in California.

Q. They are not Class I. Do you know whether any of the yogurt-based beverages are Class I or Class II in California?

A. I do not know that.

Q. Do you know whether any of the products that are listed in your table as Class II products are instead Class I in California?

A. I do not know that, either.

Q. With respect to the products in Class I in your table, do you know whether any of the carb-reduced or carb-free beverage volumes shown there include products that have more than 8.25 solids nonfat as required by the FDA for milk?

A. I do not know the specific solids nonfat content of those products.

Q. And also with respect to those products, the carb-reduced or carb-free beverages, are you aware that -- strike that. Is it your understanding that those are all products to which Dairy Programs
J. Rourke - Cross - by Mr. Vetne

attributes more than 6.5 percent solids nonfat?

A. I do not know if that's completely true across the board.

Q. Again, that's somebody's responsibility other than your own?

A. Correct.

Q. You talked again about the skim equivalent process. Are you aware that Dairy Programs also uses a component equivalent process attributing to these products components that are removed?

A. Yes. I believe I know -- I believe I understand what you are talking about, yes.

Q. I think it was Mr. Beshore asked you a question to the effect that you tally up the solids nonfat, it doesn't matter what the nature of the solids is, whether it's protein or lactose or something else?

A. That's my understanding.

Q. Are you aware that Dairy Programs includes, among other things, milk protein concentrate, milk protein isolate, whey protein, casein, calcium caseinate as milk solids to be tallied in the 6.5 percent?
J. Rourke - Cross - by Mr. Vetne

A. Yes, I am

Q. And are you aware that at some point prior to 2004, those products were not included in the tally of milk solids nonfat for the determination of 6.5 percent?

A. I don't know what the time period is when they were not, but at one point in the past they were not.

Q. And are you aware that for some of these milk ingredient derivatives, USDA applies a formula to be discussed to determine a milk component equivalent?

A. That's my understanding, yes.

Q. With respect to the Class II beverages or Class II products -- first of all, these are all beverages; is that correct?

A. Yes.

Q. And these are the type of products that are at issue in the various proposals in this Notice of Hearing; is that your understanding?

A. I'm not enough familiar with what -- with what the proposals do to make that determination.
J. Rourke - Cross - by Mr. Vetne

Q. Do you know whether there are any Class II beverages on the market that are not included in one of the four categories of Class II products in your table?

A. Infant formula I don't believe is on this -- is in a Class II product that's on -- is not on this table.

Q. So infant formula is not included in the meal replacement category?

A. I don't believe so.

Q. Are you aware of any other beverages in Class II that are not included in the volume?

A. No, I'm not.

Q. And going back to our discussion on the Federal Milk Order Market Statistic Publication, there is for Class II similar to Class I a table at the end of those publications annually that list the volume of milk and cream, skim milk, used to produce various specified products such as cottage cheese, frozen desserts, cream, frozen yogurt, and then there's a column for other Class II use?
J. Rourke - Cross - by Mr. Vetne

A. Correct.

Q. And then other Class II use column, that the total there that is not represented by identified products includes miscellaneous cream, it includes bakery products, candy, milk, soup, milk to commercial food processing establishments as well as these miscellaneous beverages; is that correct?

A. Probably not entirely. I would think it's -- I'm not sure if the yogurt-based beverages are necessarily reported separately from the Order or not.

Q. So the yogurt portion may or may not be under the yogurt column?

A. Correct.

Q. But the other non-yogurt beverages would be part of the other products that are not identified in the FMOMS?

A. Correct.

Q. The Federal Milk Order Market Statistics table that reports Class I in various products is posted on the Internet; correct?

A. Correct.
J. Rourke - Cross - by Mr. Vetne

Q. And for calendar year 2004, the data for Class I no longer includes an "other" category. Do you know why that is?
A. I don't believe we posted the particular table that you were talking about earlier, I don't believe that's on the Internet yet for 2004.

Q. For Class I products?
A. For that particular table that you referenced earlier that shows the annual data by product.

Q. Okay.
A. We do have other types of information on other statistics such as sales data that have broader cap orders.

Q. So it's your intention to use past comparable data for 2004 comparable to 2003 and prior years?
A. Correct.

MR. VETNE: Thank you.

JUDGE DAVENPORT: Other cross of this witness? Yes, sir.

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J. Rourke - Cross - by Mr. Vetne

CROSS-EXAMINATION

BY MR. LEINSOL:

Q. Good morning.

JUDGE DAVENPORT: Once again, would you please identify yourself --

MR. LEINSOL: Zalmel Leinsol. I'm the President of Noga Dairy in Long Island, New York.

For the record, you can blame me for sitting here today because I'm the first one to come up with this concept in the United States 14 years ago of yogurt shakes. I'm the first one. We share the same distribution. The Frusion came first. Smoothie tried to duplicate my product later on. Later on, Yoplait came and Stanfield products and so on.

This is Class II (indicating), it's a yogurt everyone's familiar with. It's a Class II yogurt cup. It's the same product with a new definition that you are trying to establish. The only difference, you take this cup, you stir it, you pour it, you get in this product (indicating) exactly the same product, the same content, the same solids.
Right now, according to the old definition, this one has less than 6.5 percent solids. That's why it's still considered a Class II product. Originally, 14 years ago when I came first with the product, it was 8.25 percent, but Market Administration came to me and asked me for more money to classify it as Class I, so I changed the formula.

I added a little bit more stabilizers and I reduced the amount of solids inside and it became Class II. But according to the new definitions that you are trying to establish, the only difference would be just the package. You need to define what you call beverage. It's my point. It's the same product. It doesn't make sense to me. Thank you.

JUDGE DAVENPORT: Other cross?

Very well. Mr. Cryan?

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CROSS-EXAMINATION

BY DR. CRYAN:

Q. Excuse me. Good morning. My name is Roger Cryan, C-R-Y-A-N. I'm with the
J. Rourke - Cross - by Dr. Cryan

National Milk Producers Federation, and with that representation I will ask questions to clarify this. Thanks again. Thanks for the data, John. I appreciate that. It's very good data.

Let me ask you, the Class II products, I think a lot of this has gone on before, but the Class II products are per pound on a used to produce basis; is that correct?

A. That's correct.

Q. So that means the products would have to be under 6.5 percent -- well, for the -- the ones that are under 6.5 percent nonfat milk solids, necessarily the pounds on the shelf would be more than the pounds that are listed in the table; is that correct?

A. That would be correct.

Q. Okay. Thank you. And there was a little bit of talk about the Class I conversion factors, and I was -- I don't know if the record is very clear on that.

It's my understanding that in a sense the product will be converted into an equivalent of milk volume according to its...
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J. Rourke - Cross - by Dr. Cryan

content, solids content, and that that can never be more than a one for one.

It will always be either, for example, a gallon of product can produce -- can contain up to a gallon of Class I milk but no more than that, is that correct, in terms of the Federal Order accounting?

A. There are standard conversion factors for converting units into pounds of milk for standard type products, which is whole milk, low fat milk, chocolate milk, and it is a -- those factors are based on the butterfat content and the nonfat solids content.

Q. Okay. But 100 pounds of -- 100 pounds of Class I sales as measured by the Market Administrator for statistics can't involve -- okay. What share of the U.S. fluid market is represented by Federal Order sales?

A. Federal milk orders, this particular data series is probably somewhere in the neighborhood of 75 percent.

Q. Okay.

A. In the total U.S.

MR. CRYAN: Thank you.
J. Rourke - Cross - by Mr. Tipton

JUDGE DAVENPORT: Mr. Tipton?

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CROSS-EXAMINATION

BY MR. TIPTON:

Q. Tip Tipton, with the Tipton Group.

Good morning, John.

A. Good morning.

Q. You I think noted that infant formulas were not included with the meal replacement data?

A. That's my understanding, yes.

Q. And why were they not?

A. I believe we have the data request specifically asks for meal replacements. We interpreted that to mean the specific type of exclusion that's in the Class II definition, and that infant formula was listed separately from meal replacement.

So we took that to mean that they were just interested in the meal replacement type product, not the infant formula.

Q. So there's no distinction in the Order, is there, between a meal replacement and an infant formula?
J. Rourke - Cross - by Mr. Farrell

A. I don't know if the meal replacement has to be in a specific type of container or not. I am not familiar enough with that. But as far as classification is concerned, they are in the same class.

Q. I was just wondering what basis you made the distinction between what is an infant formula and what is a meal replacement.

A. I didn't have a basis for that, for the distinction, besides the fact of what was specifically asked for in the request.

MR. TIPTON: Thank you.

JUDGE DAVENPORT: Yes, sir.


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CROSS-EXAMINATION

BY MR. FARRELL:

Q. Just a clarifying question, if you will.

On the Class II product list, what is included in the category less than 6.5 percent?
J. Rourke - Cross - by Mr. Farrell

A. I don't know if I know the specific products that are included in that category. The names of the products, I think there are some beverages that are -- I don't know -- I don't know the names of the specific products.

Q. Would infant formula be included in that category?

A. I do not believe so.

Q. The problem I'm having is that that category would seem to encompass all the Class II products; right? I mean, if you just take a category and call it less than 6.5 percent, doesn't that capture all of your Class II products?

A. In this particular data collection, it was to capture those products that are not specifically otherwise listed.

Q. Did you submit for the record the request from the Market Administrators for this information?

A. I --

MR. STEVENS: No.

A. No.

Q. Would that be available? It would
J. Rourke - Cross - by Mr. Farrell
certainly I think help to clarify this issue.
The concern of course is that there is not
double accounting.

A. That -- I don't think there's
anything confidential in the specific request
from the Market Administrators.

MR. STEVENS: I'm informed
that we don't have it here with us. So you can
ask and they will take your request.

MR. FARRELL: Well, we would
ask that it be submitted for the record.

JUDGE DAVENPORT: So noted.

MR. FARRELL: Thank you. I
have no further questions.

JUDGE DAVENPORT: Other
questions of Mr. Rourke?

Well, Mr. Rourke, apparently you
can step down.

(Mr. Rourke was excused.)

JUDGE DAVENPORT: Ms. Carter,
do we have any other government witnesses at
this time?

MS. CARTER: No, Your Honor,
we do not.
J. Rourke - Cross - by Mr. Farrell

JUDGE DAVENPORT: Very well. I guess at this point I would sort of like a feel as to how you wish to proceed, whether there are people that have particular scheduling problems today, and I'll repeat this on the basis each and every day: If there are people that do need to be heard that would need a specific time, we would try to accommodate those.

MR. BESHORE: Might we go off the record for a minute and talk about how many witnesses we have and the possible order? It might be more efficient to do it that way.

JUDGE DAVENPORT: Let's do that. Why don't we take our break early at this time. Maybe you all can caucus and see if there is some consensus as to how you want to proceed, and then we will go on from there.

How long do you think you might need, Mr. Beshore?

MR. BESHORE: Ten minutes.

JUDGE DAVENPORT: Okay.

(Recess was taken.)

JUDGE DAVENPORT: We're back
J. Rourke - Cross - by Mr. Farrell

in session.

Mr. Beshore, would you summarize
some of the discussion that took place during
the break among you and your other
representatives.

MR. BESHORE: Yes. We did
have an informal discussion at the break among
most of the interested parties participating.
The consensus was that we proceed at this time
with Mr. Hollon's testimony, Dr. Cryan,
Mr. Alexander, Mr. Leinsol.

JUDGE DAVENPORT: Mr. Leinsol.

MR. BESHORE: From there,
there are a number of other persons who may be
available prepared to testify later on this
afternoon.

JUDGE DAVENPORT: Very well.

It is also possible that some people are going
to modify their proposals, which I guess in the
interest of fairness that if anyone is going to
do that, that they make sure that they be
prepared to distribute those and at least give
some advanced notice so that we don't go down
one path and then have to reverse ourselves.
E. Hollon - Direct

Very well. Mr. Hollon, would you raise your right hand.

ELVIN HOLLON

a witness herein, having been first duly sworn, was examined and testified as follows:

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JUDGE DAVENPORT: State your full name, please.

THE WITNESS: My name is Elvin Hollon.

JUDGE DAVENPORT: Mr. Beshore?

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DIRECT EXAMINATION

BY MR. BESHORE:

Q. Mr. Hollon, would you please state your business address and business position for the record.

A. I'm employed by Dairy Farmers of America. Our offices are on Executive Hills Boulevard in Kansas City, Missouri.

My title is Director of Fluid Marketing and Economic Analysis. I've been with Dairy Farmers of America, or a predecessor, since 1979, and my day-to-day
E. Hollon - Direct

Duties, at this point, one of them specifically deals with regulatory affairs, Federal Marketing Orders, both at the Washington level, if you will, and individual Market Administrator level.

I do not do day-to-day milk marketing activities, but I work closely with the folks in our organization who do that. I do economic studies, price analyses, some price forecasting. In the past, I have had from 10 to 12 years in the upper midwest a day-to-day responsibility and day-to-day job in buying and selling milk in the fluid sector as well as the manufacturing sector.

And I've also worked in the southwest area in a role there dealing with buying and selling of milk and regulatory issues and also spent part of my time dealing with national agricultural policy with DFA.

Q. What is your educational background, Mr. Hollon?

A. I have a Bachelor of Science Degree in how to make cheese and ice cream, a dairy manufacturing degree, and Master’s degree in
E. Hollon - Direct

agricultural economics and both from Louisiana State University.

Q. Have you previously testified in Federal Order proceedings?

A. I have testified in numerous Federal Order proceedings dating back to the '80s.

Q. Do you have a statement that you have prepared and made available?

A. I do. It's eight pages.

MR. BESHORE: I would like Mr. Hollon's statement to be marked the next consecutive exhibit.

JUDGE DAVENPORT: Exhibit 13, Mr. Beshore.

(Exhibit No. 13 was marked for identification.)

MR. BESHORE: I have distributed copies of it on most of the tables of the room at the break, and there are additional copies on the table in the rear. If anyone does not have one, there should be plenty available.

At this time, I would ask that Mr. Hollon be recognized as an expert in his
E. Hollon - Direct

field of agricultural economics and marketing
and present his statement which has been marked
as Exhibit 13.

JUDGE DAVENPORT: Does anyone
require voir dire of this witness? He is
accepted as an expert.

BY MR. BESHORE:

Q Would you precede please,
Mr. Hollon.

A Yes. I will have one addition to my
statement in the second paragraph. This is
also being presented or endorsed by Dairy
League Cooperative, Inc.

Statement of Dairy Farmers of
America, Inc. Dairy Farmers of America, DFA,
is the proponent of Proposals 1 and 2. DFA is
a member-owned Capper Volstead cooperative of
12,800 farms producing milk in 49 states. DFA
pools milk on nine of the ten Federal Milk
Marketing Orders.

Dairy League Cooperative, Inc., is a
Capper Volstead cooperative of 2,400 farms
producing milk in seven states. Dairy League
pools milk on three of the ten Federal Milk
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Marketing Orders.

DFA is a supporter of Federal Milk Marketing Orders. Orders are an economically proven marketing tool for dairy farmers, and we believe without them dairy farmers' economic livelihood would be worse.

The central issue of this hearing is to refine the definition of fluid milk product so that the classification system can function fairly for dairy farmers and be clearly written to reflect both current industry conditions and technology capabilities in the industry. This hearing is in response to changes in technology now commonplace in the dairy industry.

The proposals we support represent our attempt to modernize Order regulations to keep pace with technology. Failure to address this issue will be detrimental to the members of DFA both in their day-to-day dairy farm enterprises and in the milk processing investments that they have made.

There have been and may continue to be protests concerning what some perceive as an unfair change in the rules. Our position is
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that the Orders always need to be changed to
keep pace with the industry. So long as
classified pricing is part of the Order system,
there will be changes in classification
definitions and rules.

Of course, all changes in
classification would be avoided if all products
were in the same class; but we do not think
that is the best long-run interest of producers
or processors, and the history of regulations
seem to support that opinion.

The dairy industry is constantly
changing. Mergers, plant closings, plant
openings, shifts in consumer tastes and
preference, new cost constraints, new economics
of scale, new packaging and new environmental
constraints and new products are always
cropping up. To expect that the Order system
would remain totally static is neither likely
nor reasonable.

Dairy industry advances in milk
component fractionalization, product
engineering and packaging technology have come
together to form a fertile environment for new
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dairy products. Mergers in the dairy
processing industry and renewed interest by
major players in the food industry in
milk-based beverages make this environment more
likely to spawn new products.

The nationwide footprint of these
new businesses makes it certain that new
products will get wide distribution and market
penetration. This is great news for dairy
farmers. New products can mean new sales for
milk. But the dairy farmers need the structure
provided by Orders to recover their share of
the revenues generated by these new products
and to insure that inequality in bargaining
power in the marketplace will not force them
into accepting a lower price than is available
from market returns.

It is very clear that the existing
fluid milk product standard, FMP, does not
allow the Order system to keep pace with
technology. The fluid milk product standard
currently in place does not adequately
recognize the demand for dairy proteins; thus
it does not price them properly.
The physical characteristics and intended use of many of the new dairy-based beverages clearly position themselves as alternatives to traditional milk beverages - yet their formulation and composition under the current outdated provisions makes them Class II.

In many of, if not most of, these situations, the nonfat solids driven regulation and formulation of these products causes them to fall just below the Class I standard; at the same time it is the characteristics derived from the milk proteins that make the products desirable to consumers. Perhaps some of these beverages were formulated intentionally to fall just short of the existing fluid milk product standard.

The current standard was put in place when processes such as ultra-filtration and milk component fractionalization were textbook predictions for the future. Now that they are mainstream realities, the regulations need to be updated.

We believe that the best solution to
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This problem is through the hearing process. While perhaps slower than we'd like, hearings gather information in a rational and fair manner, allow all interested parties to participate in the gathering and examination of the data and advance, oppose, and dissect how to use the data best in regulating the industry.

This is a better long-run solution than a regulation by administrative action on the part of USDA or request action via Congress.

This is not a new problem for the Order system. A 1974 decision addressing this product classification (39 Federal Register 8714) noted:

"It is possible that a product very similar in composition and form to chocolate milk could be marketed under the label of a milkshake mix for the purpose of having a lower classification apply to the product. Since such a product would actually have the same general form and purpose of other fluid milk products, now classified as Class I under these
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orders, it should be included in the Class I classification.

"It is necessary, though, to provide some means of distinguishing between such a product and the general category of milkshake mixes that are being sold in competition with frozen desserts. For this purpose, the total solids content of the product should be used.

"A standard of 20 percent or more total milk solids should encompass the milkshake and ice milk mixes intended for use as a type of frozen dessert. Mixes with less solids are similar composition to chocolate milk and other flavored fluid milk products and should be a Class I product."

Later in the same decision, a lively debate is concluded as follows: (39 Federal Register 8715):

"The primary concern with any fluid milk product definition is that it clearly defines the product or types of products that are intended to be included in the definition. The fluid milk product definition included herein, which incorporates both the listing of
E. Hollon - Direct

specified products and the use of composition
percentages, should meet this requirement.
Incorporation of this definition in each of the
32 orders will provide a uniform basis for
identifying those products that are to be
defined as fluid milk products."

We continue to advocate the
structural position taken in this decision -
form and use of a product should be the primary
guideline which the Secretary uses in
classifying products. But in addition and in a
supplementary role, the Secretary should
establish guidelines using product composition
and there should continue to be specific
inclusion or exclusion of some products when
appropriate.

Finally, this 1974 decision
anticipated the very situation that we find
ourselves in now when noting (39 Federal
Register 8716):

"A refinement of such standards may
be appropriate once there has been an
opportunity to evaluate the applicability under
actual market conditions."
In so many words, as the industry evolves, the standards and definitions may need review.

The Secretary reached similar conclusions in the reform process when after careful review of the "form and use" test, product composition standards, and inclusion/exclusion process, he concluded that no change in the "6.5 percent nonfat solids standard" was warranted. (63 Federal Register 4824).

However, just as with other issues - such as "dual pooling", performance standards, emergency transportation funding, classification of evaporated and condensed milk, payment dates, and issues surrounding producer handlers, the Secretary has seen fit to recognize changes since the 2000 reform decision, hold hearings, find for and against proposals and issue interim recommended and final decisions. The hearing today is simply another step in this important process of continually updating Federal Order regulations.

Since 1999, there have been a wide
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range of new products formulated and marketed by the dairy industry. (Roger Cryan's statement on behalf of the National Milk Producers Federation lists many of them.)

There have been several administrative decisions dealing with classification of these new beverages, and there is presently a legal proceeding brought pursuant to Section 15(A) of the AMAA (7 USC Section 608c(15)(A)) which challenges the application of the current regulations. Now is the right time to deal with the need to update the fluid milk product definition.

DFA is abandoning its Proposal 1. Upon review, we concluded that it is not the best way to address the changes needed in the fluid milk product definition.

The zero tolerance standard we proposed is overly restrictive and would cause excessive administrative costs to regulate beverages with minor percentages of dairy components.

We fully support Proposal 7 as offered and testified to by the National Milk
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Producers Federation.

We continue to support Proposal 2. It is procedural in nature with no specified language to put into the regulations. It requests that the standard for measure of all the quantity of dairy proteins present in a beverage include any and all dairy protein sources including whey and whey products.

However, for pricing purposes, these same whey and whey products that are sources of proteins in beverages that become fluid milk products as a result of the new language, will not be up-charged as Class I.

We oppose any attempt to dilute the current Class II definition. We oppose Proposal 8 by Dannon, 9 by General, 10 by Novartis, and 11 by Hormel on this basis.

Furthermore, we do not at this time support any proposals that would change or modify the exclusion language now present in Section 15(b). This would include any change in the terms infant feeding, dietary use, meal replacement, or hermetically sealed. The 1993 Order decision (58 Federal Register 12659)
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(March 5, 1993)) noted:

"The amended orders should specify that a Class II classification of milk used to produce formulas especially prepared for infant feeding or dietary use should apply to only formulas that constitute replacement for meals, rather than merely having some added vitamins and minerals.

"In addition, the cost of extra packaging and the Class II attributes of having an extended shelf life and being distributed over a wider area justify Class II classification for hermetically sealed packaging, while fresh product with limited shelf life should be Class I."

We feel there is not sufficient reason or support to make any changes in these criteria at this time.

We think Proposal 7 deals with the issues better than Proposal 4 as offered by Select Milk Producers and Continental Farms. Proposal 5(a) places unreasonable burdens on the Secretary to determine classification and would result in a never-ending challenge of his
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various determinations that would be damaging
to the Orders.

Proposal 5(b), to the extent we
understand it, waters down the Class II
standards and we do not support it either.
Perhaps, after hearing testimony on that
proposal, we may see it in a different light.
But for now we think Proposal 7 is the best
solution.

We thank the Secretary for calling
this proceeding and look forward to the final
decision as the next step in the process of
keeping Orders up to date with the industry.

JUDGE DAVENTPORT: Objection to
his statement as offered? Anything to add, to
correct? Mr. Beshore?

MR. BESHORE: Mr. Hollon is
available for questions.

MR. YALE: Is this going to be
Exhibit 13?

JUDGE DAVENTPORT: Yes, sir.

Mr. Yale?

MR. YALE: Benjamin F. Yale on
behalf of Select Milk Producers and Continental
CROSS-EXAMINATION

BY MR. YALE:

Q. I was afraid you wouldn't get any cross-examination.

A. I knew you would rise to the occasion.

Q. Just a couple of questions I want to elaborate.

As I understand, Mr. Cryan is going to discuss at length the changes that have occurred in the marketplace since 2000 in regards to the new products?

A. He will have some data on new products and some of the technical and math points dealing with the 2.25 protein standard.

Q. But you would agree that since the debate leading up to our reform and even 2000, that we have seen in the marketplace a significant addition of products that were not in existence prior to that time?

A. Yes, I would agree with that.

Q. And Carb Countdown or the low-carb...
E. Hollon - Cross - by Mr. Yale

type mixes or milks, or whatever, are one of those products that was not in existence at that time?

A. Yes, I would agree with that statement.

Q. You would also agree, would you not, that it's the addition of those types of products that has really brought the great concern to make the changes we are making today?

A. That sharpened the focus and led us to conclude we needed to make some changes in the standard.

Q. Okay. Now, you mentioned -- I want to just kind of go through a couple of points. You have gone through, as you call it, a zero tolerance to approximately 2.25 percent protein; right?

A. Yes.

Q. And I understand that Dr. Cryan will explain why the 2.25 is the number as opposed to something else; is that right?

A. Yes.

Q. So I won't ask you that question.
E. Hollon - Cross - by Mr. Yale

But you make a comment at the bottom of the first statement to the effect that formulations will come just below the standard.

A. Yes.

Q. And that would be in any standard that we set; right?

A. There will always be -- if there is a line, there will always be some attempt to get on one side or the other of the line, I agree.

Q. The -- I'll leave it at that.

I wanted to talk to you a minute about the hermetically sealed. How do you distinguish -- by the way, what does it mean to you to be hermetically sealed?

A. I'm really not prepared to dig into that. I've read through some of that, and I do not do a very good job of explaining those things, so I'm going to decline the opportunity.

Q. So you cannot explain the difference between that and an aseptically packaged ESL beverage?

A. That's correct.
E. Hollon - Cross - by Mr. Yale

Q. Can you put a number -- you indicate, of course I know you are quoting the Department, but you talk about an extended shelf life for Class II.

Can you give a number of where the shelf life begins to make it a Class II as opposed to a Class I product?

A. Extended. I don't have -- I do not have a number.

Q. Do you know how you can distinguish between that and say some of the UHT packaged milk?

A. They are packaged in different forms, manners, and processes. But as far as the biology that goes with each one, I suspect you could get into a pretty extensive debate about those, and I'm just not prepared to do that.

Q. Let's talk about packages for a moment.

We just had earlier this morning a description -- one that looks like a little bottle and the other a cup. Is there some way that we can distinguish the packaging that says
E. Hollon - Cross - by Mr. Yonkers

this is Class I as opposed to Class II?

A. I think there's some FDA decision, some FDA language that deals with hermetically sealed that probably would provide some guidelines.

MR. YALE: That's all I have, Your Honor.

JUDGE DAVENPORT: Thank you.

Mr. Williams, are we able to hear in the back?

MR. WILLIAMS: No.

JUDGE DAVENPORT: Yes, sir?

MR. YONKERS: Bob Yonkers with the Milk Industry Foundation.

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CROSS-EXAMINATION

BY MR. YONKERS:

Q. Good morning, Mr. Hollon.

A. Good morning, Mr. Yonkers.

Q. On Page 4, I numbered your pages here, you talk about supporting -- the DFA supports that form and use be the primary guidelines in that first unquoted paragraph there.

Would you support that even if it
E. Hollon - Cross - by Mr. Yonkers

had -- if it was demonstrated that it may have an impact on producer revenue?

A. It begins to get into a question of it's pretty hard to tell where those revenue amounts are drawn. The guideline of form and use has been pretty standard, so I think that's probably where we would draw the first line at, is that something would be form and use, and then we move from there into the composition and specifically inclusion/exclusion.

Q. You said the first line as opposed to primary guideline, as you said in the testimony. So there are other things you would want looked at?

A. Well, it would be those three: form and use, and then composition standard, and then inclusion/exclusion. So form and use --

Q. None of those would be an impact on producer revenue? You are not really concerned with producer revenue impacts?

A. At this time, I would say yes to that question. We would follow those guidelines.

Q. Near the bottom of Page 2, you make
E. Hollon - Cross - by Mr. Yonkers

a statement about the characteristics derived
from milk proteins are what make the products
desirable to consumers.

Do you have market research? Have
you conducted any market research on consumers
that demonstrate that protein is their primary
interest in those products?

A. That statement comes primarily from
the personnel in our Formulated Foods Group
within DFA, who we make some products that fit
this definition as well as others, and in my
discussions with those co-workers like my --
you know, other co-workers as to why this
product formulation is this way, the standard
is that way, this use -- I drew that conclusion
from there.

Q. Are they going to be testifying
later?

A. They are not.

Q. These are people who conduct market
research on the characteristics of products
that are valuable to consumers?

A. These are people who make the
products. People come to them and say, I would
E. Hollon - Cross - by Mr. Yonkers

I like to make product XYZ, I want a beverage there, I want to be able to do that, I want to be able to target the market, and I want to meet the standard.

I don't think anyone in DFA does direct market research; however, the people that come to them with products, with a request to make products, bring that with them.

Q. Okay. Thank you.

I think -- on Page 4, there in the middle, you actually quote from the '74 decision, USDA decision, "A refinement of such standards may be appropriate once there has been an opportunity to evaluate their applicability under actual market conditions."

A. Yes.

Q. You didn't really testify to any actual market conditions. Did you say the National Milk witness would be doing so or --

A. Yes. The market conditions that I would testify to would be new products on the market and where we seen those, looked at some of those, looked at the composition standards, looked at the formulation, made a conclusion
E. Hollon - Cross - by Mr. Yonkers

that the fluid milk product standard needs to be changed.

We have done all the things, and Roger Cryan will have some additional data on that. We looked at that information, and that's what led us to make the proposals that we made and abandoned and modified the one we did.

Q. But you don't have any actual market data on the market share of those products or the market penetration?

A. I do not, other than what's already presented by --

Q. Or their substitutability of the existing products in the fluid milk product definition?

A. I do not have that data.

MR. YONKERS: Thank you very much.

JUDGE DAVENPORT: Other cross?

Mr. Vetne?

MR. VETNE: John Vetne.

JUDGE DAVENPORT: Mr. Vetne, they had a little hard time hearing in the
E. Hollon - Cross - by Mr. Vetne

back, so if you would, make sure you speak into
the microphone, if you would.

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CROSS-EXAMINATION

BY MR. VETNE:

Q. Good morning, Mr. Hollon.

A. Good morning, Mr. Vetne. Welcome home.

Q. Welcome back. Thank you. Am I correct that DFA in this proceeding does not believe that enhancement of producer revenue is a factor in its classification position?

A. We are always interested in producer revenue and think that classified pricing helps producers to accommodate that.

Q. Let me see if I can refine my question. Are you supporting the NMPF proposal?

A. Yes.

Q. Do you do so because you believe it will enhance producer prices?

A. After looking at the proposal that we made and the alternatives that were out -- that were noticed for the hearing and our
E. Hollon - Cross - by Mr. Vetne

objective was to include the fluid milk product definition, we support the National Milk proposal because we think it is the best one to do that.

Q. Do you believe it will enhance producer prices?
A. Yes.

Q. And you believe that enhancement of producer prices should be a significant factor as a matter of policy by the Secretary in classification decisions?
A. Yes.

Q. You refer to history of regulation and you cite some regulatory history. Are you familiar with the 1962 report of the Federal Milk Order Study Committee to the Secretary of Agriculture, also known as the Norris Committee Report?
A. I'm familiar with it.

Q. Are you familiar with it enough to be familiar with the portion that discusses the rationale for classification of products in Class I versus others?
A. Not directly with the Norris report.
E. Hollon - Cross - by Mr. Vetne

I've not read -- you had it put on the Internet now, but I've not gone back and looked through those pieces of it.

Q. Okay. Are you at least familiar with the practice of USDA in evaluating whether a milk beverage is purchased as a substitute for purchases that would otherwise be made in fluid milk products as a criterion in classification decisions?

A. I'm not aware that USDA does that type of analysis.

Q. Do you believe that a measure of whether a product competes directly with traditional fluid milk beverages should be a factor in classification decisions?

A. Well, again, we would look first to form and use, and then the product composition, and then the inclusion and exclusion, and so to some extent that may figure in. I don't know that that would be the primary criteria, but it would be a part of the criteria.

Q. Okay. So let me see if I understand.

If the data -- if market data -- you
E. Hollon - Cross - by Mr. Vetne

refer to change in market conditions. If market data shows that a product offered to consumers does not cause a consumer to buy that product instead of fluid milk, you would still support putting that product in Class I?

A. Well, I need to know some of the other perhaps information about it and -- but yes. Yeah, I would -- yes, we would.

Q. Yes. So your proposal in its structure is essentially indifferent to whether there is consumer product substitution?

A. Consumer product substitution would help to define. You may have a product that now is in Class II that market data may show is being substituted in Class I. I think that would be a criteria that would lead us to want to see that product in place.

Q. The proposal that you support, however, does not contain a component to measure that?

A. That's correct. I think those components sometimes are very argumentative and sometimes hard to have as a standard.

Q. Would it be correct to say that the
E. Hollon – Cross - by Mr. Vetne

product -- the proposal that you support infers irrebuttably that if it has those characteristics, it does substitute for fluid milk consumer purchases?

A. Why don't you try that question again.

Q. Would it be correct to say that the proposal you support infers and does so irrebuttably that the products captured in Class I are substitutes for traditional fluid milk products?

A. So the form and use is beverage product and is similar to other milk beverage products that meets the composition standard defined and it's not specifically excluded, it would be in.

Q. It would not only be in, but with all those characteristics, therefore, consumers would buy that product instead of picking up a gallon of fluid milk?

A. I don't think I would say it that way. I think they would consume those products in the form and use similar to what it is Class I products; therefore, it would be a
E. Hollon - Cross - by Mr. Vetne

Class I product, and producers would be entitled to the value and purchasers would be required to pay the value at minimum basis of other Class I products.

Q. So the proposal in your view does not make an inference one way or the other whether there is actual product substitution, only whether it's consumed in the class?

A. Yes.

Q. Your testimony speaks of improper pricing of dairy proteins. How would the NMPF proposal change the way dairy proteins are priced?

A. The pricing would be driven on a protein basis, not only on just the solids basis. That would provide the signal.

Q. Would it be correct to say that the proteins -- protein composition of milk would not change at all under the NMPF proposal?

A. Protein -- the protein composition of milk from the cow?

Q. The protein pricing. The protein pricing portion of the Federal Order System would not change?
E. Hollon - Cross - by Mr. Vetne

A. That's correct.

Q. Protein would not be priced differently under the NMPF proposal?

A. That's correct.

Q. What would be priced differently would be the water or moisture added to the product?

A. I don't think I would say it that way.

Q. How would you say it?

A. That the determination for whether a product is Class I or Class II would have a different line 2.25 percent protein, and then the pricing of the components would then be driven by the prices underneath.

Q. The processing activity, however, that would add -- that would bring it to Class I is the addition of water to whatever milk component created the Class I classification?

A. I'm not an expert in that area, but I think there are some other solids, both milk and dairy derived, and other solids that are not that affect that composition.
E. Hollon - Cross - by Mr. Vetne

Q. That's true. But to the extent a product meets the NMPF milk protein standard, the difference between whether it's going to be Class I or Class II is the added water? Making a beverage out of that product that has that component base?

A. Again, I think there will be some other components that will figure into that other than just, you know, liquid --

Q. Other in the proposal?

A. No. Other components in the product.

Q. In the product?

A. Yes.

Q. That could be true. But the milk equivalent for purposes of Class I classification is the milk component plus the water, up to whatever natural relationship they have in whole milk?

A. I have no more to add.

Q. You don't know how USDA applies its skim milk equivalent or component equivalent formulas?

A. Is that the same question?
E. Hollon - Cross - by Mr. Vetne

Q. Yes. My question is do you not know how USDA applies its skim milk equivalent or milk component equivalent formulas?

A. To the extent of my investigation into that says that USDA measures the milk into the front door of a plant, classifies all the products, prices the components at the equivalent of the milk at the front door of the plant.

If there is more components than the products going out, then they are priced differently as under the fortification rules.

Q. Does DFA manufacture any or process any milk beverages that would be affected by any of the proposals at this hearing?

A. Yes.

Q. What are those?

A. Sorry, that part is not -- is proprietary, the specific names of the product and the relationships with the manufacturers. But suffice to say that we do manufacture some on both sides of the equation. Some that would not be changed and some that would be.

Q. Is Sport Shake one of those products
E. Hollon - Cross - by Mr. Vetne

that might be affected by one of the proposals?
A. Again, that's a proprietary question.
Q. The proposal that you support, as stated in your testimony, does not propose to change in any way dietary use milk replacement category of dairy beverages; is that correct?
A. We would oppose any of the proposals that may weaken that standard and consider the current standard to be satisfactory.
Q. Are you aware that the USDA in the guidelines of the Market Administrator opined that if there is a legitimate basis for disagreement about whether a product is a meal replacement or meal supplement, that it should be in Class II?
A. I am not aware of that opinion.
Q. Assuming that that is a guideline of the Dairy Programs branch, you propose nothing to eliminate the gray area between a meal replacement or a snack?
A. I have no comment on the opinion part of your question, but we make no proposals to change the current standard, and we would
E. Hollon - Cross - by Mr. Vetne

oppose any that in our view would make it weaker.

Q. On Page 4 of your testimony, you espouse the establishment of guidelines by the Secretary using product composition.

Are you in that portion of your testimony referring to guidelines other than the content of the Code of Federal Regulations?

A. I think that the composition standard I was referring to here was the 2.25 percent protein standard as opposed to the 6.5 percent solids nonfat standard. That's the only change that we are supporting.

Q. You were not addressing guidelines originating from Dairy Programs and going to Market Administrators on how to apply the rules?

A. I don't have any access to what those are nor any opinion on their applicability.

Q. On the fifth page of your statement, at the bottom, you refer to whey and whey products that are sources of protein, and you state that the whey and whey products will not
E. Hollon - Cross - by Mr. Vetne

be up-charged as Class I.

If a product is reclassified from Class II to Class I under the NMPF proposal, what is it that will be up-charged?

A. The portion of the products attributable to equivalent -- I don't know if volume is the right word -- but volume of milk.

Q. Let's take an example. Let's say that a milk beverage contains, among other things -- its only milk deriving ingredient is whey protein isolate, and it has in that protein that is the minimum under the proposal, and water is added to make it a beverage; okay?

In that example, what is it that is being up-charged and how is it being measured?

A. I think in that example there would be no up-charge because the only product is the whey product.

Q. It would not be a Class I product?

A. No. I think it would be deemed a Class I product, but there would be no other -- if that was the only protein that was in it, then that would be -- it would be priced at the whey equivalent price, not the Class I
E. Hollon - Cross - by Mr. Vetne

equivalent price.

Q. Let me see if I understand correctly.

So there would be no skim milk equivalent calculated under your proposal for a beverage that contains only whey protein isolate?

A. I didn't try to do this particular calculation, so I may want to change my mind later, but at the moment, that's what I would say would be no.

Q. Okay. And whey presumably, at least if it comes from a Federal Order source, is a byproduct of cheese has already been priced?

A. That's correct.

Q. And if a whey equivalent is measured, how would that be done? Would it be at the current whey equivalent price or the whey equivalent price at the time of manufacturing?

A. I don't have an opinion on that.

Q. Okay. But you believe that the product I described containing only whey protein isolate as the only milk-derived
E. Hollon - Cross - by Mr. Vetne

Ingredient should not be up-charged on a skim equivalent basis?

A. Again, I think that's correct, but I reserve the right to change my opinion after some consultation.

Q. Okay. And with respect to products that include whey protein isolate, as well as other milk derived ingredients, would a portion be prorated to the whey equivalent price and a portion prorated to, say, solids nonfat?

A. I don't know how they do that math. I need to have to figure that out first before I could answer that.

Q. Do you have an understanding of how or whether that is done currently?

A. I do not.

Q. What other product that contains primarily calcium caseinate, do you have --

A. Rather than go through every possible product, why don't we leave this question line where it is. If there is a change, it would apply to all. If there is not a change, then it wouldn't apply.

Q. Okay. Is there a witness that will
E. Hollon - Cross - by Ms. Grocholski

follow you that may be able to elaborate further on the application of the NMPF proposal to specific milk derivative ingredients?

A. Yes.

Q. Mr. Cryan?

A. Mr. Cryan.

MR. VETNE: That's all I have for now. Thank you.

JUDGE DAVENPORT: Thank you.

Other cross of this witness?

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CROSS-EXAMINATION

BY MS. GROCHOLSKI:

Q. Deb Grocholski for General Mills. Mr. Hollon, are you familiar with yogurt smoothie products produced by Yoplait, Dannon, and others?

A. I am. My daughter is a great fan of those.

Q. That's nice. Do you have any data on how consumers use these products?

A. They eat them. In my household, they are consumed. That would be the only data I have is my own personal experience with them.
E. Hollon - Cross - by Mr. Tipton

MS. GROCHOLSKI: That's all I have. Thank you.

JUDGE DAVENPORT: Mr. Tipton?

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CROSS-EXAMINATION

BY MR. TIPTON:

Q. Mr. Hollon, how are you, sir?
A. Just fine. Good morning.

Q. Good morning. Have you done a study or an analysis of the products that would be included in Class I by this proposal that are not now in Class I?
A. There is some comments on that in Mr. Cryan's testimony, and to the best that we can determine, only some of the low-carb products would perhaps change classification, and they are currently being regulated Class I. So I'm not aware that there is any products that would move from two to one.

Q. So if there is no change except in the low-carb products --
A. And they are already being priced as Class I now.

Q. Even though they are below the
E. Hollon - Cross - by Mr. Tipton

6.5 percent nonfat solids content?

A. That may be a gray area that was debatable. But currently they are priced as Class I.

Q. Would you be happy if it were only the low-carb products that were changed?

A. No. Our overriding goal is that we see some changes on the technological side of the industry and regulations aren't up to speed, and so it's always better to try to be as up with the curve or ahead of the curve as you can.

So that's our overriding goal is to try to make sure that the regulations, as best it can, matches the conditions in the industry.

Q. But you have not done analysis of the market and some products that are out there in which might change the -- which might be changed in classification as a result of this proposal?

A. Again, as I said before, there are a list of products that we could find, and we did not find any whose regulation would be changed.

Q. And Mr. Cryan would present that
E. Hollon - Cross - by Mr. Tipton

A. He's got a list in his statement of some of the products we were able to find in the marketplace.

Q. Do you know whether the USDA has done an analysis of the products that would be changed in classification as a result of this proposal?

A. I'm not aware if they have done analysis or if they have not.

Q. Earlier in comments about revenue to dairy farmers, if you feel that the only product that is captured into the Class I that may not currently be in Class I are the low-carb products, what do you think that does to revenue to the dairy farmers?

A. Well, first of all, you have to say what do we have up to now and then what do we have, you know, out in the future? So up to now, there would perhaps be no revenue change.

Q. So you would make a change in the classification on the speculation that somebody might do something sometime that might have some impact on decreasing producer revenue?
E. Hollon - Cross - by Mr. Tipton

A. Well, it wouldn't be speculation because the technology is there. There are products that are either available or may be changed. In fact, the question about an hour and a half ago where the maker said that they deliberately added stabilizers to their product to evade the Class I regulation, and so --

Q. Would your proposal pick those up?

A. It depends on the protein composition. If it is on the right side of the 2.25 percent, then it would pick those up. If it's not, it would not.

Q. So you don't know whether that would have an impact on producer revenue?

A. Again, if it would -- if it caused formulations to be in Class I, it would be a positive impact.

Q. Now, I didn't understand part of your response. But at this time, you don't know that producer revenue would be increased if this proposal -- if your proposal was adopted?

A. I think at this point in time it would be close to revenue neutral.
E. Hollon - Cross - by Mr. Tipton

Q. The next questions, I made a note here, but I can't find it in your testimony, but I think you mentioned something, used a word ambiguity in the current definition?

A. Yes, sir.

Q. And could you describe what that ambiguity is because given the fact that there is a very concrete standard of 6.5 percent as the nonfat solids as the minimum amount or the maximum amount you have to not be Class I or the minimum amount to be Class I, what is the ambiguity about that?

A. I think that the existing standard when it was put in place, some of the things that could be done technologically weren't either -- either weren't doable or weren't done regularly or maybe weren't conceptualized. Therefore, the standard represented the realities at that point in time, and the measure of a 6.5 percent nonfat solids standard was a reasonable standard.

However, that's no longer reasonable, but the regulation still reflects that. So the conflict, the ambiguity, the
tension, if you will, between what the standard is and what is technologically feasible doesn't match up. That's what needs to be modernized or changed, just like it has been in 2000 and '93 and '72, and somebody referred to an earlier date in the '60s.

Q. But what's the ambiguity in that? Because it's fairly simple, straightforward, the direction given in the decision that accompanied that regulation change was explicit in how it was to be calculated, so what is the ambiguity?

If you have nonfat solids, milk derived nonfat solids, I think there's one excluded, caseins or one of the caseins, what is the ambiguity in that if it's that specific as to what is included and what is not included?

A. I think the -- the way I would answer your question is that the letter of the law would seem reasonably clear. That's what you are driving at. Everybody could measure 6.5 percent. But the spirit of the law which says form and use ought to drive how a product
E. Hollon - Cross - by Mr. Tipton

is classified.

Beyond that, product composition;
beyond that, some specific inclusion and
exclusion, those things are now foggy, and
there are some products that to our point of
view fit the form and use and to be intended as
a beverage should be Class I in our view that
are not or may not be down the road because of
technology.

The word ambiguity, that's the
description of it.

Q. If you were to change to the protein
standard, you really wouldn't have the concern
over the amount of nonfat solids that were in
the product so long as the protein standard
were not --

A. Protein standard would become the
measure and nonfat solids would not be the
measure.

Q. I think in response to some
questions from John Vetne about substitution, I
wanted to follow up on that a little bit.

I don't recall what you said about
substitution, but I think the question really
E. Hollon - Cross - by Mr. Tipton

dealt with the issue are you trying to capture those products which might be substitutes for milk? Is that your purpose?

A. That's one of the purposes. Again, following the guidelines, if there's products that ought to be Class I by using those guidelines, we would like to see them Class I, and some of those are substitutes for milk.

Q. But how important in the hierarchy of things are substitutes for milk in the sense that there are a lot of substitutes for milk, some of which, in fact most of which, by far most of which, don't even have any dairy products in them?

A. I suppose we wouldn't capture any of those.

Q. Right. So do you have any concern about developing products that fit maybe a buffer zone to compete with the products that the Federal Order program doesn't have any jurisdiction over, particularly if it doesn't affect producer revenue?

A. I think that's part of the rationale why we dropped our support of a zero standard
E. Hollon - Cross - by Mr. Tipton

and supported a 2.25 percent standard.

Q. You talked in some of your testimony about the new technology, I think you talked about it several times, the new technology, making it possible to fractionate and have different components and combine them in different ways. Then you talked about mergers and acquisitions. I think you referred to in the dairy business primarily, but making it setting up the dairy industry that there was a lot of this was happening.

Do you know or have you looked at the beverages or drinkable products that are presented in the market today that are produced by dairy processing companies, in quotes, versus nondairy processing companies? Have you made that comparison?

A. We’ve looked at some of them. Not looked -- I don’t know if we looked at all of them or not, but we’ve looked at some of them.

Q. How many products do you have that were produced in the dairy processing -- of these new products that were produced in the dairy processing industry as opposed to
E. Hollon - Cross - by Mr. Farrell

nondairy processing firms?

A. I don't have a number.

Q. Do you have any idea?

A. I don't have a quantity number.

There are some on all sides of the ledger, and there may be in fact some that are, you know, under the market name of X that maybe we make. I don't know the list of all the products that we make.

Sometimes it's not apparent who makes them or what manufacturing arm they are made of, just who it is marketed by.

Q. Thank you.

A. Yes, sir.

JUDGE DAVENPORT: Other cross?

Mr. Farrell?

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CROSS-EXAMINATION

BY MR. FARRELL:

Q. Good morning.

A. Mr. Farrell, I must apologize, I wasn't paying attention when you introduced yourself this morning. I was looking at notes. Can you tell me again who you represent.
E. Hollon - Cross - by Mr. Farrell

Q. Ed Farrell with Blank Rome, representing Fonterra USA.

A. Thank you.

Q. In your statement, and this is picking up on some of Mr. Tipton's questions --

JUDGE DAVENPORT: Just a little louder, Mr. Farrell. I can see hands.

Q. Picking up on some of Mr. Tipton's questions with respect to substitution, you talk in your statement about product engineering, packaging, all these trends that are going on with respect to dairy proteins.

A. Yes, sir.

Q. Are you aware of what is going on with respect to soy proteins?

A. Generally. Not specifically, but generally.

Q. Are there the same source of trends going on?

A. I suspect that there are, and anybody that has a product to sell is looking to market it and sell it in as many ways as they can.

Soy protein or soy products is the
E. Hollon - Cross - by Mr. Farrell

same -- would be the same as dairy products, looking for avenues to develop in the marketplace.

Q. Clearly you are aware of soy milk in the marketplace?

A. Yes, I am

Q. And soy ingredients?

A. Yes, sir.

Q. In your support of the National Milk proposal, have you considered what the impact might be with respect to dairy protein competitiveness with soy protein?

A. Do you want to flesh out the question a little bit more?

Q. Maybe we will take it from a slightly different angle.

A. Okay.

Q. I think this morning you were talking about the people within your organization that come to you talking about product formulation.

A. Yes, sir.

Q. Do they ever come to you and talk to you about competing formulations that they are
E. Hollon - Cross - by Mr. Farrell

going up against?

A. Yes, I do.

Q. That are protein? What do they tell you about that?

A. Generally, there are two or three statements that they make frequently, and bear in mind their background and their, perhaps their day-to-day goals are a little different, but they will frequently say that soy proteins are sometimes a more economical choice than dairy proteins. So as that drives a formula, there is an eye to that.

They will frequently say that the functional characteristics of dairy proteins are considerably better than the soy proteins, and the third thing they say with some consistency is that the soy-based products have a flavor profile that usually has to be masked if you use it in a quantity, a very large quantity, and that's usually not true with the milk proteins.

Beyond that, there's some cost differences, some functionality differences, and flavor differences.
E. Hollon - Cross - by Mr. Farrell

Q. All right. With respect to the cost differences, would the proposal you are supporting increase or decrease those cost differences?

A. It could conceivably increase them if solely cost was the only parameter. You also have, bear in mind, the functionality of the flavor parameters, and you have to take them all into account.

Q. With respect to that one parameter, you would be creating a competitive disadvantage for milk proteins?

A. That's always a moving target and, again, I preface my statement with saying the background of the folks who raised that concern, they will frequently say that soy proteins are a lesser priced alternative.

MR. FARRELL: Thank you very much.

JUDGE DAVENPORT: Yes, sir.

Mr. Yonkers.

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MR. YONKERS: Thank you, Your Honor.
E. Hollon - Cross - by Mr. Yonkers

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CROSS-EXAMINATION

BY MR. YONKERS:

Q. Bob Yonkers for the Milk Industry Foundation again.

Elvin, I'm intrigued. Mr. Vetne -- excuse me, Mr. Hollon, it's so formal here, it's tough for me to do -- he asked some questions about on Page 5 where you were talking about whey, and I looked at your testimony, and you are very careful to, in both places, there to say whey and whey products, whereas your Proposal No. 2 just says the word whey, and Proposal No. 7 of National Milk has a change that stops right before the word whey, so I assume it's intending to have that word whey remain.

Do you draw a distinction between whey and whey products? When somebody says whey, what do you think of? I want USDA to understand what -- Mr. Vetne asked you a few questions about whey protein isolates and some things, when you think of whey, what do you think of?
E. Hollon - Cross - by Mr. Yonkers

A. Again, I'm not the best at running through all the product accountability, but I think the issue at hand is when you reach a point where there is a fortification question, then those products wouldn't be up-charged.

As long as the finished product is proportionate to that of milk going into it, then I think all of these components are going to be priced in Class I. When you reach the fortification issue, they are not going to be up-charged.

Q. Is that kind of a clarification of my misunderstanding of Proposal 2 as you are talking about fortification?

A. Well --

Q. Let me give an example. If you have a product that's got milk protein from a non-whey source of 2 percent protein, and it's got a half a percent whey, as I read Proposal No. 2, that would be more than the 2.25 percent protein threshold, but you would only up-charge the two percent, not the other half percent that came from whey; am I correct?

A. I'm going to stop while I'm still
E. Hollon - Cross - by Mr. Yonkers

behind and clarify that question for the next
time it comes around. It will come from me
again or from Roger again.

Q. Okay. And I believe also you said
in response to one of Mr. Vetne's questions
that whey is already priced and pooled?

A. Yes.

Q. Of course, that only referred to
pool milk?

A. Yes.

Q. Not the nonpool milk?

A. Yes.

Q. It would receive a price, it
wouldn't be a Federal Order price, but that's
not a relevant consideration in your opinion;
is that true?

A. Unless you get into the used to
produce category.

Q. If instead of using a whey derived
or whey product, use the milk protein
concentrate or casein, if there's a plant
manufacturing that, wouldn't that already be
priced and pooled under an order?

A. Yes. If it got pooled into the
E. Hollon - Cross - by Mr. Yonkers

accountability allocation process, it would
flow through that. But, yes, it would have
been priced at some point, the milk.

Q. You are still recommending if the
milk protein content or casein was used, it
would receive that up-charge?

A. Back to where I was a minute ago and
say, let me collaborate a little bit and come
back to that.

MR. YONKERS: Okay. Thank you
very much.

JUDGE DAVENPORT: Other cross?

Mr. Yale?

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CROSS-EXAMINATION

BY MR. YALE:

Q. Benjamin F. Yale on behalf of
Select Milk Producers and Continental Dairy
Products. I have some follow-up questions on
questions and answers that you had. I want to
follow up on Mr. Yonkers, so we understand.

A. Now that line of questioning
again --

Q. I understand. But I think you can
E. Hollon - Cross - by Mr. Yonkers

answer this.

A. All right.

Q. The purpose of the whey protein is -- well, let me back up.

You talk about the fact that because you set a barrier, say a 2.25 percent protein, that there may be people who would formulate the protein at say two percent and bring in some other proteins to get it at a more desired formula, 2.7, whatever the formula is, for the sole purpose of avoiding having to treat it as a Class I product?

A. That would be a likely alternative.

Q. Right. And what the addition of the whey and the whey protein does is that it makes sure that they cannot use dairy proteins to avoid the classification and that scenario because if they had two percent of the casein proteins and added a half a percent of the whey protein, although that would give them a formula above the 2.25, if you don't include the whey, they would be out of the Class I product; right?

A. I think I'm going to collaborate
E. Hollon - Cross - by Mr. Yonkers

with my other guys before I go down this path.

Q. Well, but I -- but that -- so you
don't understand why the whey is added into the
formula? Is that what you are saying?

A. It's the accountability process that
I'm just not very good at.

Q. Okay. And you say you are going to
confer with your colleagues, does that mean you
will be back on the stand to answer this
question or you think they are going to be able
to answer the question?

A. One of the two of those will be the
answer.

Q. Now, I want to -- there was a line
of questions by Mr. Vetne regarding -- I think
even Mr. Tipton -- the idea that if it looks
like regular milk, then that's -- if it
competes with the fluid milk product, that
that's somehow a determinative factor, or at
least that's the implication of the question.

Do you recall those lines of
questions?

A. I recall those questions.

Q. All right. Is it -- the only
E. Hollon - Cross - by Mr. Yonkers

reason -- well, first of all, you would agree
that there's a legitimate reason to classify
the use of milk products so as to protect the
Class I products that we have; is that right?

A. That's correct. That's why you have
a fluid milk product definition.

Q. Right. So the fact that there may
be some products out there that are directly
competing with milk and in fact using milk
proteins and components, it's only appropriate
for the Department to consider making them
Class I in order to protect the classified
pricing system?

A. Yes.

Q. But that's not the only reason, is it?

A. No.

Q. All right. There can be products
out there that are beverages that use milk
components that may not directly compete with
Class I, but they nonetheless ought to be
considered as Class I?

A. That's a part of the rationale. If
it follows the form and use product
E. Hollon - Cross - by Mr. Yonkers

composition, the inclusion/exclusion, if it fits all the parameters of Class I, then the processor should pay the minimum and the producer should receive the revenues.

Q. Part of the rationale is those products are benefits from the dairy proteins the producers are providing?
A. Yes, and the form and use classification.

Q. In a higher use classification?
A. Yes.

Q. And you would consider, would you not, that the use of any dairy protein in a beverage is a higher use than any other product?
A. Yes.

Q. And this is regardless of whether it comes in the form of the protein, nonfat dry milk or whey -- I guess the whey you've taken out; is that correct?
A. That's been the standard since the beginning of the classification system.

MR. YONKERS: And the other -- I'm going to defer until we see if there is
E. Hollon - Cross - by Mr. Leinsol

going to be somebody to answer the question I want to ask. I defer. Thank you.

JUDGE DAVENPORT: What I propose at this time is let's take about a ten-minute break, and let's proceed on after that.

(Recess was taken.)

JUDGE DAVENPORT: All right, ladies and gentlemen, let's get back in session.

Is there any other cross of Mr. Hollon? Mr. Leinsol.

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CROSS-EXAMINATION

BY MR. LEINSOL:

Q I would like to ask you, do you have any doubt or concrete proof that your beverages detract from a Class I state?

A To the extent that they are consumed as a beverage and Class I products are considered to be beverages.

Q Yes, do you have any data to prove that actually the yogurt beverages detract from the sales of Class I?
E. Hollon - Cross - by Mr. Leinsol

A. Detract from the sales of Class I?

Q. Basically, that's why we are here, I guess, because I believe that the main claim is that for farmers got hell because of all kind of beverages, yogurt beverages, Class I sales declined, so this is the main reason why we are here.

My question is if you have any data or concrete proof, evidence that this is the case, that actually the beverages, yogurt beverages, detract from the Class I sales?

A. That's --

Q. That's my question.

A. That's not the main reason why we are here.

Q. That's what my understanding is.

A. Well, the fact that yogurt is consumed as a beverage and some yogurt is priced as Class II would be -- that would be some revenue that farmers wouldn't -- would not receive and so --

Q. Have you considered the beverages, the yogurt beverages, as a milk replacement, basically? This is the case.
E. Hollon - Cross - by Mr. Leinsol

A. Yogurt beverages would be dairy ingredients that are consumed in fluid form, and we are seeking to change the definition to make it fit with the technology that beverages that are consumed in fluid form should be Class I.

Q. Yes. But you do so because you believe that they are milk replacement. That's why you do it. That's exactly why you do it.

A. We would do so because we think --

Q. This is about --

A. I disagree with your assessment.

Q. You disagree. Do you have any proof or concrete evidence, for example, about I would say how much of the soy milk or other milk replacement detract from Class I sales? If you have any data on the soy milk.

A. Our proposal would not price soy, except to the extent that it had more than 2.25 percent dairy protein in it. So I don't have any information about soy milk sales.

Q. Do you have any data how much the trend called wellness industry is affecting the sales of Class I?
E. Hollon - Cross - by Mr. Leinsol

A. I'm sorry, would you repeat that?

Q. If you have any data or information about how much the trend called wellness industry, wellness awareness, is affecting the sales of Class I in the United States?

A. No.

MR. LEINSOL: You don't? No further questions. Thank you.

JUDGE DAVENPORT: Thank you, sir.

Any other cross-examination of this witness? Mr. Tosi?

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CROSS-EXAMINATION

BY MR. TOSI:

Q. Good morning, Elvin. Thank you for appearing at the hearing today.

A. Good morning, Mr. Tosi.

Q. I have several questions I would like to ask you.

Would it be your organization's position that the fluid milk product definition continue to be structured the same as it currently is? By that I mean where part A
E. Hollon - Cross - by Mr. Leinsol

names products and a section that provides for exclusion, or another way to look at that is to continue with a compositional standard?

A. Yes.

Q. To the extent that you are speaking towards the need for provisions for the fluid milk product provision to be updated, if you will, to account for technological changes, what would make you think that updating things in the way that you are proposing, at least, and perhaps others, with respect to looking towards the future, that we're going to address the concerns that you have here about technology?

A. It is apparent that in the way you can take milk components apart and put them back together, that that's a technological change and advancement. It wasn't too many years ago that that wasn't as feasible as it is now, and we think it will become more and more feasible.

To the best that we can determine, the characteristics of dairy proteins that are most desirable from the nutrition and
E. Hollon - Cross - by Mr. Leinsol

functional, flavor point are embedded in the proteins, and as they affect the fluid milk product definition.

So we think that this change will be a better definition along the guidelines of the current Section 15 with its Section A and B, and the way it's pieced together, this will be a better definition than the current one we have and more reflective of the demands of the industry.

So I don't know that we can ever get that regulation -- no regulation of anything can ever get totally ahead of the trend line. I think that would be somewhat impossible. But we try to stay as close to it as we can, and we think the proposal we made does that.

Q: With regard to the imperfect view of the future and knowing exactly what we need today, would you be supportive of a modification to the fluid milk product definition that would allow the Department some degree of latitude to deal with situations that are completely unforeseen by all industry participants at this time to determine what the
E. Hollon - Cross - by Mr. Leinsol

classification of any particular in the future product may be?

A. At the headline level, I would say, you know, that sounds like a good idea. But I think I would want to see some more detail. Sometimes if there's so much latitude given to the regulator, then they get harassed by the industry from every front and they get paralyzed.

There is some comfort in being able to say, here's what it says, here's what I'm going to do. So I'm not -- you know, to borrow an analogy in the performance hearings, we supported giving the Market Administrator some discretion over a certain number of items, but we felt like there was probably some reason to limit that to some extent.

So I -- I can see the concept is not such a bad one, but I think I want to have some more detail because I don't want us to get so hung up that there's a lawsuit every time something new comes out, because we will never get anywhere.

So the thought process, yes. But I
E. Hollon - Cross - by Mr. Leinsol

think I would like to know a little bit more
about the latitude then before I commit any
further.

Q. Okay. Would you be of the opinion
that currently milk order regulations do not
specifically define what is meant by such terms
as infant formula, dietary use, meal
replacement, hermetically sealed?

A. There is some definition and
specificity about those items, and certainly
the industry has operated on practice going
backwards some, and I think there are probably
some FDA -- I know there are some FDA
definitions about some of those terms.

I suppose in any case you can ask --
anybody can say it would be more specifically
defined than it is. Our proposal is such that
we did not offer any more support.

Q. All right. If I understood your
testimony correctly, and I want to ask some
questions about that and make sure that I
understand that that's exactly what --

A. Okay.

Q. -- DFA's position is, is it true
E. Hollon - Cross - by Mr. Leinsol

that you are of the opinion that one of the
criteria for determining when something should
be a Class I product deals with issues that
have to do with substitutability?

A. That would be part of the criteria.

Not the only criteria, but part of the
criteria.

Q. Okay. That part of the criteria
should be whether or not product increases
producer revenue?

A. That should be part of the criteria.

Q. That some of the criteria should be
the expected impact on consumer demand?

A. Yes, that should be part of the
criteria.

Q. Okay.

A. That gets to be a harder criteria to
measure, but that gets to be part of the
criteria.

Q. To the extent that these additional
criteria should give rise to challenging that
our basis for classification are the basis of
intended form and use -- excuse me, on the
basis of form and intended use, what advice
E. Hollon - Cross - by Mr. Leinsol

Would you give the Department about that?

A. I would start off with form and use first and work my way down. Then I would look to the product composition standard because that's a more measurable definable. So we are going to set up in a hearing process where everybody has their opportunity for input instead of criteria. Again for form and use, being consumed and intended to be consumed as a beverage in some form.

And then if there is a compositional criteria, that would come next, and then if there is some reason to specifically include or exclude something, that would come next. And, you know, subsequent arguments I would say would be the burden would be on the arguer to say -- to try to convince the Department that they should fall into the inclusion or exclusion list rather than the other way around.

Q. Yes.

A. I think it's pretty hard for the Department to determine a future product.
E. Hollon - Cross - by Mr. Leinsol

Q. With regard to form and intended use, when something fluid -- excuse me, when something is fluid, would you be of the opinion that most of us would recognize when something is fluid?

   A. I would be of the opinion that most would recognize when something is fluid.

   Q. And now when we look at what intended use means, how do we determine intent, or how should we determine intent?

   A. I think that's going to be "most of us can recognize" type of thing, and there is going to be some gray area. I would suspect that the harder somebody tries to convince you it wasn't intended to be consumed as a beverage, it's more than likely going to be just the opposite.

   Q. So with that in mind, for these gray areas, as you just described, would it be appropriate for the Department to, for example, when in doubt about a particular product classification, that the Department rely on form and intended use?

   A. Yes. That -- I would say that would
E. Hollon - Cross - by Mr. Leinsol
be the ultimate fall-back is when you get --
when it gets to that point, that form and use
would be the first line.
Q. But in that regard, you don't want
to give the Department any latitude to make
that decision? Because I think you testified
that you were concerned that we would end up in
arguments and that we would never get anything
done.
A. Yes. But pressed to that point, I
would say, yes, that form and use as most could
define, that most would accept, would be --
that it would be the ultimate -- the end
result, and perhaps at that level, the less
latitude the better.
MR. TOSI: Okay. That's all I
have. My colleague, Antoinette Carter, has
some questions for you.
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CROSS-EXAMINATION
BY MS. CARTER:
Q. Good morning, Elvin.
A. Good morning.
Q. Antoinette Carter, USDA. I just
E. Hollon - Cross - by Ms. Carter

have a few questions, the first of which are just clarifying questions.

Your Proposal No. 2, you have indicated that you are -- the DFA is in support of Proposal No. 7.

A. Yes, ma'am

Q. Which would remove the 6.5 nonfat standard and replace it with a protein standard?

A. That is correct.

Q. So in Proposal No. 2, you are just simply, I guess, would be striking the "or nonfat milk solids, nonfat solids equivalent basis" from your proposal, and it would be strictly the milk ingredients would be calculated based on a protein equivalent standard?

A. That would be correct.

Q. And along those lines, in terms of any dairy ingredients, can you specifically identify what ingredients would be included or should be included?

A. As soon as I try to do that, Mr. Farrell will come up with one that I had
E. Hollon - Cross - by Ms. Carter

never thought of or never heard of or nobody ever made. So I think that's one of those areas where I will have to give the Secretary some discretion.

If it started out as a dairy ingredient and somehow something got added to it or formulated and modified, I would say it would still be a dairy ingredient, but I don't have an ironclad way to do that.

Q. Would you agree that I guess in providing that the regulations, if your proposal was adopted, should list the types of ingredients but indicate that it's not an all-inclusive listing?

A. That would be -- yes, that would be a good way to do that and the right way to do that.

Q. And I know you are reluctant to start listing, but if I run down a list, could you say yes or no if those are the type of ingredients --

A. Sure.

Q. -- you perceive being included?

Milk protein concentrate?
E. Hollon - Cross - by Ms. Carter

A. That would be included in the calculation of milk protein.

Q. Whey protein concentrate?
A. It would be included.

Q. Milk protein isolates?
A. They would be included.

Q. Whey?
A. It would be included.

Q. Casein?
A. It would be included.

Q. Calcium caseinates?
A. It would be included.

Q. Again, that's not an all-inclusive list?
A. That's correct.

Q. But those are some of the things that you would be including --
A. All of those products would have some amount of real protein, and some would have more and some would have less. Some would have other things in it like calcium caseinate would have calcium in it. The caseinate milk protein piece of it.

Q. In your opinion, what is the role or
E. Hollon - Cross - by Ms. Carter

the intent of the fluid milk product
definition?

A. To define those products that are
Class I that are deserved, if you will, or
would have a higher value associated with them,
and would define -- just like, you know, Class
II defines certain products, Class III defines
certain products, you have to have a definition
if you are going to have a classification
system. No different than an airplane says
this is a first class seat and this is a coach
seat.

Q. I believe earlier you mentioned FDA
had a definition for hermetically sealed, what
constitutes hermetically sealed containers.

What role, in your opinion, should
FDA regulations play with regard to product
classification under Federal Marketing Orders?

A. If it makes it easier for the
Secretary to include some of their definitions,
and Orders do include some of those
definitions, then I think that's the role. I
think the Secretary should be the ultimate
deciding as far as Federal Milk Marketing
E. Hollon - Cross - by Mr. Wilson

Orders go. But if there's some benefit that can be gained by some existing knowledge, then the Secretary should use that.

Q. You mentioned that DFA I guess is comprised of about 12,800 farms.
A. Yes, ma'am.
Q. Are most of those considered small businesses?
A. They are.

MS. CARTER: I think that's all I have.

JUDGE DAVENPORT: Other questions of Mr. Hollon?

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CROSS-EXAMINATION

BY MR. WILSON:

Q. Todd Wilson, U.S. Department of Agriculture.

Good morning, Mr. Hollon.
A. Good morning, Mr. Wilson.

Q. In your Proposal 1, I realize you abandoned that proposal, but if we could discuss maybe parts of that, some of that section.
E. Hollon - Cross - by Mr. Wilson

In that, there is a term that we describe, "concentrated products," and what that term means in the Federal Order System. How would you define a product that has approximately -- well, let's say we have a whole milk product that we concentrate down to 2.5 times, so it would have a total solids content of roughly 30 percent, 32 percent maybe, and if we had a similar product of skim milk, and we also concentrated that down to the same concentration level, 2.5 times, it would fall below that 25.5 percent total solids in the definition, how would you correlate those two together and offer some guidance, maybe?

A. I have no guidance to offer you.

Q. Would you consider them the same product as far as --

A. No.

Q. -- fluid milk product in the definition?

A. Oh, in the fluid milk product definition?

Q. Yes, sir.

A. I had not considered that. I think
E. Hollon - Cross - by Mr. Wilson

on the surface, I would consider them not the same product, but I haven't given that any further thought.

I can see where you have different components that -- different component total, different component volumes, but I haven't contemplated that.

Q. You had alluded that you would maybe with Mr. Cryan would offer some more information on the up-charge of Class I. Would you be --

A. I'm going to defer to him. You can get ready.

MR. WILSON: Very good.

That's all I have.

JUDGE DAVENPORT: Mr. Yale, you are smiling. Does that mean you are going to --

MR. YALE: I have a follow-up to the government's questions, if nobody else has any.

JUDGE DAVENPORT: Come forward, please.

MR. YALE: I appreciate this.
E. Hollon - Cross - by Mr. Yale

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CROSS-EXAMINATION

BY MR. YALE:

Q. You mentioned in response to one of the questions to Mr. Tosi that one of the factors was consumer demand?

A. Yes.

Q. Now, is that a function of the fact that the pricing has an impact on consumer demand that it may be better for producer revenue that if it was a lower price, it would increase demand and, therefore, increase demand for dairy products would yield more money in total to producers as opposed to the higher classification? Is that the consumer demand?

A. It's a mix of all of those issues that are in there.

Q. How does, under the Act, consumer demand itself be a driving force in the classification?

A. I think form and use is the ultimate classification, so there's not a -- it may be one of those "also" factors that may be considered. But form and use is the top
E. Hollon - Cross - by Mr. Vetne

reason. Top classification reason.

Q. Okay. Then there was also, in
talking about the application of whether it
should be Class I, or whatever class it is, and
the Department had the discretion, and
sometimes it's obvious where it belongs and
sometimes there's a gray area, I think you used
the word gray area?

A. Yes.

Q. Would it be your position, if in
doubt, the default would be Class I?

A. That would be our position.

MR. YALE: I have nothing
else. Thank you.

JUDGE DAVENPORT: Mr. Vetne.

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CROSS-EXAMINATION

BY MR. VETNE:

Q. John Vetne, in response to some
questions from the government concerning
discretionary latitude.

The current definition for the
threshold is 6.5 percent solids nonfat. If
Proposal 7 is not adopted and the solids nonfat
E. Hollon - Cross - by Mr. Vetne

standard is retained, do you believe it is necessary to -- it would be advisable to provide more detail in the regulations themselves as to what constitutes solids nonfat?

A. I hadn't really thought of it from that perspective. I would say yes. If the Proposal 7 is not adopted or -- then there might be some need for some additional guidelines, but I'm not prepared to offer any.

Q. Okay. The government also asked you a question about the current structure of Section 15 of the General Provisions and perhaps Section 40, which is classification. Are you aware that in making classification determinations, USDA currently employs a used to produce process in some form for component equivalence of milk derivatives?

A. I'm aware that they do that.

Q. But the Class I rule itself only states disposed of in the form of. Do you believe that this hearing should address whether or not to change that language disposed in the form of a fluid milk product?
E. Hollon - Cross - by Mr. Vetne

A. Ask that again. You trailed off at the end.

Q. Do you believe that this hearing should address whether or not to change that provision of the Order?

A. The --

Q. The one that describes Class I as product, fluid milk product, disposed in the form of fluid milk products?

A. I'm sorry, John, I'm not following your question.

Q. All the other classifications classify milk on the basis of milk used to produce.

A. Okay.

Q. Class I does not.

A. Okay.

Q. And yet USDA to some extent is currently applying a used to produce practice in classification determinations?

A. You mean in terms of coming up with a volume equivalence of the various components?

Q. Yes.

A. Okay.
E. Hollon - Cross - by Mr. Vetne

Q. Do you believe it is advisable -- do you have an opinion on whether it would be advisable to address that portion of the General Provisions?

A. I do not have an opinion. I have not given that any thought.

Q. Okay. And in discussing the characteristics, in response to some questions, the characteristics of the products that you believe ought to be in Class I, with that in mind, can you describe the characteristics of milk beverages that would be retained in Class II under Proposal 7 that make it appropriate for those products to be in Class II rather than Class I so we can differentiate characteristics?

A. The ones that come to mind are the ones that are specifically excluded, and some of them have to do with, you know, are they intended as a meal replacement? Do they have a wide distribution that their packaging gives them a longer, you know, shelf-life time frame?

Those have been discussed in the earlier decisions and we proposed -- we didn't
E. Hollon - Cross - by Mr. Vetne

propose to make any changes in any of those.

Q. How do the characteristics of those products differ from products that you would include in Class I under Proposal No. 7? All of the factors that you listed, I was following them. They are in beverage form, you drink them, they have a certain percentage.

All those things can be applied to some of the products that you propose to retain in Class II. What, if any, are the characteristics of those products that distinguish them from the products you propose to put in or retain in Class I?

A. They somehow meet the specific inclusion or exclusion definition that's already there.

Q. Are there any market characteristics that come to your mind?

A. Again, they would be the definition of the things that are there now.

Q. Are there any consumer response characteristics that come to your mind?

A. They meet the definition of the things that are there now.
E. Hollon - Cross - by Mr. Vetne

Q. Are there any producer price characteristics that come to your mind?

A. They meet the definition of the things that are there now.

MR. VETNE: Thank you.

JUDGE DAVENPORT: Additional cross? Apparently there's none, Mr. Hollon. It looks like you may step down.

Mr. Beshore?

MR. BESHORE: I don't have any redirect at this time, and Mr. Hollon would be stepping down subject to the possibility that he may be re-called after Dr. Cryan.

JUDGE DAVENPORT: If he's here, you are certainly able to re-call him.

MR. BESHORE: Thank you.

JUDGE DAVENPORT: Raise your right hand.

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ROGER CRYAN, Ph. D.,
a witness herein, having been first duly sworn, was examined and testified as follows:

JUDGE DAVENPORT: Please be seated. Tell us your full name, please.
Dr. Cryan - Direct Testimony

THE WITNESS: My name is Roger Cryan, C-R-Y-A-N. I am co-counsel, and I would like to make a prepared statement, and I would ask that that statement that I just handed to the court reporter be entered into the record as a numbered exhibit.

JUDGE DAVENPORT: The exhibit has been marked as Exhibit 14.

(Exhibit No. 14 was marked for identification.)

JUDGE DAVENPORT: You may read your statement.

THE WITNESS: My name is Roger Cryan. I have been Director Of Economic Research for the National Milk Producers Federation, or NMPF, for five years. Before that, I was an economist in the Atlantic Milk Market Administrator's Office in the USDA. I have a Ph.D. in agricultural economics from the University of Florida.

National Milk is the voice of America's dairy farmers representing over three-quarters of America's 67,000 commercial dairy farmers through their memberships in
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NMPF's 33 member cooperative associations. Those members include:

- Agri-Mark; Arkansas Dairy Cooperative Association
- Associated Milk Producers, Incorporated; California Dairies, Incorporated; Cass-Clay Creamery, Incorporated; Continental Dairy Products, Incorporated;
- Cooperative Milk Producers Association; Dairy Farmers of America, Dairymen's Marketing Cooperative, Incorporated; Dairylea Cooperative, Incorporated; Ellsworth Cooperative Creamery; Farmers Cooperative Creamery; First District Association; Foremost Farms USA; Just Jersey Cooperative; Land O'Lakes, Incorporated; Lone Star Milk Producers, Incorporated; Manitowoc Milk Producers Coop.; Maryland-Virginia Milk Producers Cooperative Association, Incorporated; Michigan Milk Producers Association; Mid-West Dairymen's Company;
- Niagara Milk Cooperative, Incorporated;
- Northwest Dairy Association; Prairie Farms Dairy, Incorporated; St. Albans Cooperative Milk Creamery, Incorporated; Scioto County
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Co-op Milk Producers Association; Select Milk Producers, Incorporated; Southeast Milk Incorporated; Swiss Valley Farms Company; Tillamook County Creamery Association; United Dairymen of Arizona; Upstate Farms Cooperative, Incorporated; and Zia Milk Producers.

National Milk developed Proposal No. 7, which was published in the notice of this hearing and now urges its adoption. Proposal 7 would strengthen the current standard for Class I products by closing certain unintended loopholes that have opened in the Federal Order definition of fluid milk product as a result of changes in technology.

Proposal 7 would accomplish this without reclassifying any existing products and following established principles of form and use.

Proposal 7 would first replace the 6.5 percent nonfat milk solids minimum with a 2.25 percent milk protein minimum; and, second, delete whey from the products exempted from the definition so that whey proteins would count towards the 2.25 percent minimum, but without
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establishing reconstitution up-charges for whey ingredients used in these products.

Proposal 7 could be effected by the following changes in the language of the regulations. The language is included in the prepared statement. In effect, it substitutes the 6.5 percent nonfat milk solids provision as a minimum for fluid milk product with 2.25 percent protein derived from milk standards and deletes whey as one of the exemptions.

A conforming provision that is included in this statement would essentially exclude the skim milk equivalent of the protein derived from milk where the proportion of skim milk solids have been modified and except whey or whey solids from the Class I milk pricing.

Processing technology has evolved significantly since the advent of the Federal Milk Marketing Order System. When the Order system was first established 70 years ago, whole milk could be separated into cream and skim milk, and these two components could be recombined to make the limited set of
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traditional dairy products.

Today, whole milk can be
commercially separated into a large number of
distinct components, including numerous
butterfat fractions, various proteins, lactose
and minerals. The components can be recombined
to create a much larger array of products than
was previously possible.

This technological capacity to
segregate and manipulate very discrete milk
components has effectively rendered some
Federal Order definitions and certain elements
of Federal Order accounting obsolete.

For example, the skim milk component
of whole milk can now be further separated
through the process of ultra-filtration into at
least two subcomponents, one containing nearly
all the milk proteins and another containing
mostly lactose.

Although both milk proteins and
lactose are considered to be nonfat solids, all
of the market value of skim milk is in the milk
proteins, while lactose has no or even negative
market value.
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Now that valuable milk protein solids can be separated from worthless lactose solids, defining Class I products or accounting on the basis of total nonfat solid content makes little sense. Dairy components can be manipulated and new products created merely to avoid Class I pricing, which could undermine the purpose of the Federal Order System.

Milk-based beverages can be created that contain 100 percent or more protein contained in unmodified milk but which have less than 6.5 percent by weight nonfat solids because the lactose has been taken out or reduced or replaced with an alternative sweetener.

The requirements of a minimum 6.5 percent nonfat milk solids in the current fluid milk product definition was originally intended to exclude beverages that have been watered down until they no longer resembled milk. See for example 30 Federal Register 11277. I won't offer those citations in the rest of this.

However, with new technology, fluid
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milk-based beverages that contain all the protein value of whole milk which are developed to look like milk and compete with milk can avoid Class I pricing merely because some valueless lactose has been removed and replaced.

This not only undermines the Federal Order System, it also makes no economic sense. Determining the milk equivalent with such a product on the basis of undifferentiated total nonfat milk solids severely undervalues protein and overvalues lactose.

The principles underlying full component pricing are that the value of the components in various classes of dairy products should be paid by handlers and received by producers. That was a principle employed in the Order formula with respect to Class III pricing, producer of milk pricing.

When fluid milk products all contain, more or less, the same portions of skim components defining and pricing fluid milk products using a nonfat milk solids standard was a minor problem. Now that the valuable
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skim components can be separated from the lower valued components, and used in varying proportions, there can be a serious inequity.

New technology has also made the exclusion of whey from the fluid milk product definition a serious problem. The whey exclusion was originally intended to avoid Class I pricing for low-valued liquid whey beverages that did not compete with fluid milk.

Since then, improved technologies and a much more highly developed whey processing industry have create new potential for whey and whey products to serve as a partial substitute for other milk solids.

The authors of the exclusion did not anticipate these technological changes, so the original language did not explicitly limit the exclusion to this single liquid whey beverage. Now, however, the whey exclusion could arguably be applied to many new products that contain some amount of whey ingredients.

Today fluid milk beverages can be created in which some amount of whey is substituted for traditional milk solids so that
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the resulting beverage would fall just below
the 6.5 percent "nonfat solids" threshold in
the fluid milk product definition.

In such a situation, the beverage
would contain most of the valuable protein --
most of the protein value of whole milk, would
resemble and compete with whole milk and yet
would arguably be exempt from Class I pricing.

These are not hypothetical problems.
These are already real-world and concrete
effects. Carb Countdown, which is a trademark
of HP Hood Company, is produced by and under
license to the HP Hood Company, is an example
of the inadequacy of the current rules to deal
with new products.

Carb Countdown has been classified
as both a Class I and a Class II product.
Although it is currently being treated as a
Class I, that classification is being
challenged by its makers under Section
8(c)(15)(A) of the Agricultural Marketing
Agreement Act, because the product contains
less than 6.5 percent nonfat milk solids. This
sub-6.5 percent content is achieved by two
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means at issue in this hearing:

First Carb Countdown contains whey solids which are not currently treated by USDA as a nonfat milk solids for purposes of defining a fluid milk product or pricing Class I milk. Second, the lactose content of Carb Countdown is substantially reduced; so although it contains 150 percent of the protein, or 140 or 130 percent of the protein, including whey protein of a similar volume of milk, it contains less than 6.5 percent nonfat milk solids.

Carb Countdown is clearly designed to be similar in form and use to fluid milk. It is also a market substitute for milk, as is borne out by two separate studies. I have exhibits I will offer at the end of this testimony.

A study by a market research firm IRI of consumer switching behavior indicates that 98.4 percent of Carb Countdown sales are taken from established Class I fluid milk products and only 1 percent of the sales represent expansion of the fluid milk product
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category.

A panel study by the NPD Group indicates that Carb Countdown is used in the same ways that milk is used, that only 14 percent of its customers went from buying no milk to buying Carb Countdown, and that 71 percent are switching from milk to more or less Carb Countdown.

That is, only 14 percent of Carb Countdown buyers are clearly adding to overall milk sales. Another 15 percent didn't know or weren't sure how their Carb Countdown purchases affected their overall use of fluid milk products.

There is also an emerging U.S. market for lactose-free and reduced-lactose fluid milk beverages. NMPF maintains these products are more analogous to fat-free and reduced-fat milk and should be priced under the Order system of Class I products.

The lactose content of milk has no significant value for any consumer sector except for its mild sweetness which can be easily replaced with alternative sweeteners.
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with increasingly little taste difference.

Federal Order data presented by USDA at this hearing indicates that at least 437 million pounds of milk were used to produce
Class I beverages with reduced lactose content under Federal Order regulation and that a larger volume of such products were sold. This is about 1 percent of total Federal Order Class I sales.

The success of a lactose-free "light milk drink" in Finland demonstrates the potential that lactose-free and lactose-reduced milk drinks have to duplicate the growth of fat-free and low-fat milk in the United States. This Finnish product, produced with a new proprietary technology, was introduced in 2001.

By 2004, the company manufacturing the product expected to sell 40 million liters of the product in Finland, which on a per capita basis would be the equivalent of about 5 billion pounds of sales in the United States, and that is an exhibit. That article will be offered as an exhibit.

The objective of this hearing should
be to clarify the status of such products
according to form and use principles underlying
the Federal Order System. NMPF asserts that
these products are Class I in accordance with
those principles. If NMPF's proposed
amendments were adopted, they would be Class I
in fact.

Protein should define fluid milk
products. The regulations should clarify the
Class I status of these products for the same
reasons that skim and reduced-fat milks were
reclassified from Class II to Class I in many
Federal Order markets in the 1950's and 1960's.

In those hearings, USDA specifically
cited the growth of skim or reduced-fat milk
sales, and the resulting price-based
inequities, as a basis for reclassification.
This was based on a decision in 1968 revising
the Section 1002, for example, as of January 1,
1967.

Federal Order pricing should
appropriately reflect changes in technology and
market conditions. In the 1930's, it was
common practice to pay producers strictly
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according to the butterfat in their milk. So initially this practice was made part of the Federal Order language.

Over time, all Federal Orders were changed to reflect and take into account the growing importance in market value of the skim portion of whole milk.

In 1968, the New York-New Jersey order became the last order to make such changes to include skim and reduced-fat milks in Class I, and to price and account for milk on the basis of skim milk as well as butterfat. That is based on the same decision in 1968.

That decision contained nearly all the same logic that must apply in this hearing. I quote, "The butterfat accounting procedure was adopted in recognition of the fact that the states of New Jersey and New York within which the marketing area lies did not permit the standardization of milk for fluid uses. Under such circumstance, a butterfat accounting procedure was considered to be appropriate. "However, standardization has been permitted in New Jersey since mid-1964 and in
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New York since November 1, 1966. Permissive standardization is done to lower butterfat content of the finished product. Accordingly, the butterfat equivalent accounting procedure employed under the Order does not insure a full accounting in Class I of the total value of milk and skim milk actually utilized for fluid purposes.

"Accounting for milk and milk products on a skim milk and butterfat accounting basis and pricing in accordance with the form in which, or the purpose for which such skim milk or butterfat are used or disposed of, is the most appropriate means of securing complete accounting on all milk involved in market transactions.

"Milk is disposed of in the market in a wide variety of forms representing different proportions of butterfat and skim milk components of milk which may be greatly changed from the proportions of such butterfat and skim milk in milk as it is first received.

"Moreover, the present accounting method coupled with the practice of
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standardization does not achieve uniformity of product cost among handlers. Lack of uniformity in the cost of the same product results from difference in the butterfat content of milk received from producers and from differences in the extent to which standardization is practiced.

"The skim and butterfat accounting system herein adopted is the only practical means, in view of standardization, of assuring that the producers will receive the full utilization for their milk." That's 33 Federal Register Page 188, January 5, 1968.

The same decision also put those products, fluid milk products -- the same decision changes the fluid milk product definition to the previous fluid milk product definition in that market only defines Class I products between 3 percent and 5 percent butterfat. This decision in 1968 made the change to include skim and reduced-fat milk products as Class I as well.

The same logic applies in 2005 as the dairy industry confronts the economic
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course dictated by new technology. Simply stated, the total nonfat solids accounting procedure in the 6.5 percent nonfat solids threshold are not outdated; they reflect the prior generation of technology, not technology today.

Total nonfat solids was an appropriate standard before there was standardization of skim milk components for fluid uses. However, standardization has been feasible for some time, and now can be used to lower the total nonfat solids content of the finished product by reducing the least valuable component - lactose.

Accordingly, the total nonfat solids equivalent accounting employed under the orders does not ensure full accounting in Class I of the total volume of milk and skim milk actually utilized for fluid purposes, or the real value of that milk.

Accounting for the skim milk in modified fluid milk products on a protein basis and pricing in accordance with the form in which, or the purpose for which, such skim milk
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and butterfat are used or disposed of, is the most appropriate means of securing complete accounting on all milk involved in market transactions.

There is no real difference in form between a fluid milk product in which lactose has been retained, and a fluid milk product for which the lactose has been removed and replaced by an alternative sweetener, and yet current rules would permit these two products to be priced very differently.

This violates a core principle underlying the entire Federal Order System. There are also no real differences or purpose for many of the new products developed. For example, a drink such as a low-carb milk substitute is used exactly in the same way as milk according to the NPD survey data cited above, which I will also offer into evidence.

But although it contains 150 percent of its measure of milk protein, it might by one interpretation be defined as Class II, under the current nonfat solids standard.

In 2004, an estimated 625 -- in this
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sentence, okay -- in this sentence, it says, in 2004, an estimated 625 million pounds of milk were used to produce various types of carb-reduced drinks building market data for a hearing.

I would have to amendment that based on Mr. Rourke's testimony that Federal Order data represents about 75 percent of fluid milk product marketing in the U.S., this original number was based on 70 percent.

I took the 437 million pounds that Mr. Rourke reported as sales for lactose and carb-reduced and free products, and divided that by 70 percent to arrive at 625 million.

If I divide 437 million pounds by 75 percent, according to the testimony, I get 584 million pounds of milk used to produce these types of carb-reduced drinks.

According to IRI, a market research firm, 98.4 percent of these sales replaced traditional Class I sales, and only 1 percent of sales representing expansion of the fluid milk product category. That's a restatement.

The protein equivalent accounting
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system is the only practical means, quoting from the original decision, the only practical means in view of standardization, of assuring that producers will receive the full utilization for their milk.

In other words, for the same reasons that skim milk and butterfat accounting and the price was deemed appropriate for Class I products in 1968, so in 2005 is it appropriate to fix a protein threshold for fluid milk product.

Because of these problems and obvious inequities, NMPF proposes to replace the 6.5 percent nonfat solids standard in the fluid milk product definition to the 2.25 percent true protein standard. This would define the fluid milk products on the basis of the skim component that has value to producers, to processors, and to consumers, and which contributes fluid milk's most characteristic attributes of nutrition, flavor, and texturing.

Clarifying the status of milk protein concentrates as milk solids. In proposing a protein standard for fluid milk
products, NMPF intends that the protein content of any and all dairy-derived ingredients be counted, including, but not limited to, milk, skim milk, milk protein concentrate, casein and caseinate, whey, whey protein concentrates, and any other milk-derived ingredients, including those not currently defined as nonfat milk solids for the purpose of defining fluid milk product. I would include calcium caseinate, sodium caseinate, and any other dairy-derived protein.

Similarly, in proposing that whey and whey products not be counted toward pricing Class I milk, we do not propose to exclude any other milk-derived ingredient.

The evolution of filtration technology, which allows the fractionation of skim milk components by mechanical means to put skim milk fractions in a different light than when they were obtained by chemical methods. Those older methods altered the proteins and other components sufficiently to provide some justification for distinct treatment.

However, under current technology,
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when these fractions are unaltered and do not
suffer the chemical changes that made their
predecessors a poor ingredient in beverage use.

These fractions, when dried, are
Class IV products, in common with nonfat dry
milk. Given this status, and given the new
technology, justification no longer exists for
distinguishing these products from other nonfat
solids in fluid milk products.

Establishing the protein equivalent
of the 6.5 percent nonfat solids test. We
propose 2.25 percent as the protein standard
for fluid milk products, because it most
accurately reflects the protein equivalent of
the current 6.5 percent nonfat solids
standards.

In other words, NMPF contends that
this standard reflects the "normal" proportions
of nonfat solids to protein in milk. Federal
Order protein standards and measures are unique
because they focus on a measure of true
protein. They are different from nutrition and
labeling standards and measures which are
typically based on "crude" protein, including
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nonprotein nitrogen. Therefore, it is most appropriate to use Federal Order sources to establish standards for protein and nonfat solids test.

One of those can be the average test -- one of these sources is the weighted average nonfat solids and protein tests of producer milk in the Federal Order markets which price the components in producer milk. These are calculated by the Agricultural Marketing Service -- collected and compiled by the Agricultural Marketing Service, and published in their annual Federal Order Statistics and on the Dairy Programs Web site, which data is available at www.ams.usda.gov/dyfmos/mib/fmoms.htm

In the six Federal Order markets for which a full year's component data is available for 2004, the weighted average nonfat solids test was 8.74 percent and the weighted average protein test was 3.04. Therefore, the protein test, which is most equivalent to the 6.5 percent nonfat solids test, can be calculated as follows:
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3.04 percent average protein over 8.74 percent average nonfat solids is a ratio of .3478. When applied to the 6.5 percent nonfat solids standard gives us 2.26 percent protein -- 2.26 percent protein minimum standard.

An alternative source for establishing the proportion between protein and nonfat solids is the current Federal Order language, which establishes standard tests for Class III skim milk of 3.1 percent protein and 9 percent nonfat solids.

Since these are used to establish the Class I price when the advance Class III price is higher than the advance Class IV price, this is an equally valid basis for calculating a minimum protein test for Class I products.

These tests were established during the Federal Order reform process on the basis of milk tests determined to be representative of U.S. producer milk. Using this source, one obtains almost identical results.

3.1 percent protein over 9 percent
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nonfat solids is a ratio of .3444 applied to
the 6.5 percent nonfat solids standard gives a
protein minimum of 2.24 percent.

For a more complete comparison and
collection is a table on this page that
compares the results from using average
component tests since 2000 with the results
from using the component standards in the
Federal Order price formulas and produces a
range from 2.24 to 2.26.

NMPF proposes that 2.25 is the
midpoint of this range and is an appropriate
protein minimum to replace the 6.5 percent
nonfat milk solids minimum

Accounting for protein. We believe
it's important to account for protein to
conform to the protein standard. Establishing
the protein standard for fluid milk products
raises certain administrative issues with
respect to establishing skim milk equivalents
for modified fluid milk products.

Modern practices such as the use of
ultra-filtered fluid milk or reconstitution
using dairy protein concentrates make nonfat
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solids a very poor basis for establishing a
product's fundamental milk content. As
discussed earlier in this testimony, the value
of skim milk lies in the protein.

For this reason, the skim milk
equivalent of Class I beverages in which the
proportions of skim solids are modified should
be established on a protein basis. This should
apply to any beverage whose skim components
include any dairy ingredients with
protein-to-other solids ratio that has been
altered from natural milk.

However, the Class I equivalent
should not be set at greater than the volume of
the product. That is, no more than 100 pounds
of milk equivalent contained in 100 pounds of a
modified fluid milk product should be priced at
Class I. Any such excess by this accounting
should be clearly considered as fortification
and priced accordingly. NMPF asserts that this
accounting can be achieved by the amendment to
Section 1000.40 proposed above.

Deleting the whey exemption. NMPF
asserts that the Federal Order System must
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never retain rules that unintentionally contain incentives to create new dairy drinks based on whey protein for the sole or principal purpose of avoiding Class I regulation.

NMPF's proposal to delete the current whey exemption would correct this problem. It would also address misinterpretation in the treatment of whey ingredients that has developed over the years.

At the same time, NMPF's proposal is balanced. NMPF does not propose to charge Class I for whey ingredients. This will allow for the continued development of new products that are distinct from fluid milk without the burden of regulation under the Federal Orders.

Defining whey. According to the Food And Drug Administration, "Whey is the liquid substance obtained by separating coagulum from milk, cream, or skim milk during the cheese making procedure and may have the acidity adjusted by the addition of safe and suitable ph-adjusting ingredients prior to pasteurization."

This is from a memo available dated
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December 11, 1992, and available at www.cfsan.fda.gov/~ear/M 92-16.html. Various other whey products, including reduced-lactose whey, reduced-minerals whey, and whey protein concentrate are all, according to their respective definitions, derived from "whey," as should any other "whey" product, by reasonable interpretation. This is based on 21 CFR 184.1979.

Since whey and whey products must be derived from the coagulation of cheese, it does not consist simply of certain proteins separated out from milk by any process; rather, it must have been directly affected by the cheese-making process. As such, it is a substitute, but an imperfect substitute, for unaffected milk solids in a beverage.

It is for these reasons that we propose to define whey and whey products as nonfat milk solids with respect to the minimum 2.25 percent protein test for fluid milk products, but to exclude these products from Class I pricing.

We ask that the decision from this...
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hearing make such a definition of whey explicit, to avoid impacts from future alternative interpretations by FDA.

Counting whey toward the definition of fluid milk products. Although the original whey exemption was intended to exclude bottled whey from regulation, it is currently being interpreted to exclude whey and whey products from a product's nonfat milk solids content even when used as an ingredient in a beverage with substantial complete milk content.

In at least one case, a product marketed as a substitute for fluid milk contains enough whey so that were it counted as such in the fluid milk production definition, the product would contain over 6.5 percent nonfat milk solids, although most of the total nonfat milk solids are not whey.

In that case, whey is used to regain some of the flavor, texture, and nutrition of a dilute milk product. Although such product could compete with fluid milk, it would currently be priced at Class II.

To avoid such loophole uses of whey,
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where whey is not the naturally preferred dairy product, we propose that whey be dropped from the list of exclusions from the fluid milk product definition. At the same time, we do not believe that whey should be repriced as Class I for several reasons:

First, whey has already been priced within the Class III formula, and establishing an up-charge procedure for whey is problematic. Second, and more importantly, whey is not a wholly effective substitute for milk and beverage use. A drink made entirely of whey products does not effectively duplicate the form and use of fluid milk, and NMPF does not believe that, at the current time, the innovative use of whey in beverages results in beverages that compete with existing fluid milk products.

For these reasons we have proposed conforming amendments to Section 40 that would exclude whey and whey products from the calculation of Class I values.

The impacts of proposed changes. NMPF estimates that the current impacts on
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producers and processors are expected to be zero or near zero. Rather than making fundamental changes in the Class I standard, these recommendations reinforce the current standards under new technology.

As far as we have been able to determine, there would be no change to the current USDA classification of any established products. Any future impact would be very limited. For the types of products at issue, the difference in raw milk costs between Class I and Class II is a very small share of the retail price.

Producers are paid, on average, after these products are sold at retail. There is no reason for raw milk cost increases to be amplified in the retail price. Consumer demand response to a pass-through of these costs should be small to negligible. To the extent that there is an impact on processors, it would be in the direction of greater equity of milk pricing.

Furthermore, any future product that would be Class II under the current rule, but
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Class I under our proposed change, would be of similar form and use to and a substitute for current Class I products.

In addition, many of the products that are near the current 6.5 percent nonfat solids standard did not exist before that standard was established or were created to take advantage of the price difference.

It is to be expected that many of the products that would come under Class I regulation -- many of the future products that would come under Class I regulation as a result of the change to protein accounting and the inclusion of whey proteins would be similarly formulated to take advantage of this pricing gap and, as such, are not entitled to prospective consideration.

Clarifying the Class I status of current low-carb products maintains their present positive impact on producer revenue. If these were put in Class II based on one possible interpretation of the current standard, the producer revenue would be reduced as a result of the substantial 70 percent to
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almost total 98 percent of their sales that come as substitution for traditional Class I sales, based on the substantial difference between the Class I and Class II prices and based on the significant share of milk proteins in these products that have been imported, and there's an attached table, that I will look at in a moment, that looks at a number of milk drinks that are currently Class I and currently Class II.

It compares their retail prices at a point in time, according to what I can find, on January 12 of this year. It compares the raw milk values of these products based on what I can determine of their formulation on the assumption that all proteins were complete milk proteins, and the difference between Class I and Class II values for the raw milk content and what that difference in raw milk value is as a share of the retail price.

As you can see, for most of these products that retail at the producer level, the difference in the skim value is 16 percent, 16 to 17 percent. But the retail level ranges
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from less than a half a percent to under 6 percent, which substantially reduces the impact on producers with measures of elasticities of demand. That is to say as to the extent to which consumers respond to change in the price, it is cut down proportionally to that share of the retail price.

So, for example, if the retail price -- if elasticity, if the demand elasticity for one of these new products is negative one, and the retail -- the raw milk cost of the product is 5 percent of the retail price, and in effect the similar response to increase the raw milk price would be .05, negative .05 rather than negative 1, which will come to bear I understand tomorrow or the day after.

We also are here to address -- I'm also here to address some of the other proposals which we believe are inconsistent with the proposal we are supporting. We have proposed and are supporting.

NMPF opposes Proposal 5, which would define beverages with less than 6.5 percent
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nonfat milk solids as fluid milk products if it were demonstrated that the beverage competes directly with the other fluid milk products and that Class I pricing of the product would increase producer revenue.

NMPF contends that a less subjective definition, derived from these considerations but rooted in physical characteristics, is necessary for the fair administration of Federal Order pricing. Which is to say that the criteria that had been discussed are -- should be the basis for establishing a rule. But the rule should be cut and dried as much as possible to establish a clear physical basis for defining Class I from Class II.

NMPF opposes Proposal 6. Proposal 6 is intended to allow USDA to include any dried dairy ingredient toward the 6.5 nonfat solids standard for fluid milk products. This would allow whey, whey products, casein, and milk protein concentrates in dry form to be included in the nonfat solids calculation; while presumably liquid and ultra-filtered wet whey and liquid ultra-filtered milk ingredients
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would continue to be defined as nondairy ingredients.

For the reasons detailed in the explanation of our proposal, we believe that fluid milk products should be defined on the basis of their total dairy protein content, regardless of the form of the ingredient, and that the whey ingredients should not be priced in Class I, also regardless of the form of the ingredients.

We can see no justification for this distinction and oppose it as not going far enough to clarify the fluid milk product definition.

NMPF opposes Proposal 8. Proposal 8 would exempt all "yogurt-containing beverages."

Yogurt drinks are similar in form and use, as well as nutritional profile, to other flavored milks, and they are presumably a close market substitute for these. This would severely weaken the fluid milk product definition.

In addition, yogurt drinks are Grade A products subject to the same pasturized milk ordinance as fluid milk and is a highly
perishable dairy product and would depend upon the same regional supply of fresh fluid milk as do fluid milk products.

In fact, the only basis for spoonable yogurt being in Class II is the form and use distinction from fluid milk beverages. Absent that distinction, there is no basis for yogurt drinks to be excluded from the fluid milk product definition. There is no basis for this exemption, and NMPF opposes it as an unjustified weakening of the fluid milk product definition.

NMPF opposes Proposal 10. Proposal 10 would remove the qualification on exempted "dietary use" by removing the words "(meal replacement) that are packaged in hermetically-sealed containers." Removing either the "meal replacement" or the requirement for "hermetically-sealed containers" is problematic.

The meal replacement qualifier is important in defining the nature of the exemption. All milk that is consumed and digested has been put to dietary use, and
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leaving that term unqualified is tantamount to eliminating the fluid milk product definition altogether.

The exemption is intended for products that are specifically formulated to replace a full meal. According to the decision which introduced this definition to several Texas markets, they are "specialized food products prepared for limited use. Such formulas do not complete with other milk beverages consumed by the general public."

That is 39 Federal Register 11277, March 27, 1974, and I also cite 58 Federal Register 12659, March 5, 1993.

Although production of dairy beverages in a "hermetically-sealed" container is now easier than ever and cannot alone be adequate to set a product apart, it remains one important element to distinguishing this limited use from the bulk of fluid milk products. I would cite the same sources.

In demonstration of how technology for hermetically-sealed products has changed, I would like to introduce when I'm completed an
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article titled, "Aseptic In Winchester," which is about a very excellent plant in Winchester, Virginia, which has reached the point now where they can process milk in shelf-stable bottles, plastic pine bottles shelf stable without refrigeration, which is quite a change, and bears very importantly, I think, on considerations of any suggestions that change this definition.

Inclusion of meal replacement is fundamental to this exemption, but until there is adequate basis for a more specific definition of meal replacement, the container qualification is necessary, and may continue to be in any case. For this reason, NMPF opposes any change to this particular exemption.

NMPF opposes Proposal 11. Proposal 11 adds an exemption from the fluid milk product definition for "nutrient enhanced fortified formulas, especially prepared for the health care industry that are packaged in hermetically-sealed containers."

As written, this may be interpreted too broadly. Although an exemption of this
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type might resemble the limited use intended in
the 1974 decision cited above, it must be
defined more clearly to set it apart from fluid
milk products generally. For this reason, NMPF
opposes this proposal as it is currently
written.

Conclusion: National Milk, as a
representative of U.S. dairy producers, asserts
that it is important to strengthen the current
fluid milk product definition without unduly
redefining existing Class II products as
Class I. NMPF's proposal accomplishes these
two objectives.

I thank the Department for the
opportunity to testify. I would ask that
official notice be taken of a number of things:
The Food And Drug Administration Memo M-I-92-16
from December 11, 1992, available at
www.cfsan.fda.gov/~ear/M192-16.html.

I would ask that official notice be
taken of the Federal Order of Market Statistics
Annual Summary for 2004, which will be
published -- is not yet published in paper
form, but most of these are available on the
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Internet at the Agricultural Marketing Service Web site. I would also ask that notice be taken of the Packaged Fluid Milk Sales in Federal Milk Order Markets: By Size and Type Of Container and Distribution Method During November 2003," which is published by the USDA Agricultural Marketing Service, Dairy Programs. I would ask that the predecessor reports dating back to 1957 also be taken notice of.

This exhibit -- this statement has two attachments. Appendix A is a list of the cooperative members of the National Milk Producers Federation and Appendix B is the table I discussed to offer some details on the number of beverage products.

At this time, I would like to offer into the record several exhibits. The first one is -- do I hand them out first? I would ask that the following be entered as exhibits. The first is "Aseptic in Winchester," published in "Dairy Food Magazine," December 2004, Pages 50 through 55 inclusive. I ask that that be entered.

I ask that an article entitled

I ask that a PowerPoint presentation entitled, "Low Carb Milk: Review of Retail Sales & Analysis of Hood Carb Countdown's Source of Volume," given by Dairy Management, Incorporated, on January 13 of this year, be included in the record.

And, finally, that a study entitled, "Carb Countdown Awareness Check," which was issued by the NPD Group on January 19, 2005, also be put into the record.

I had mentioned each of these -- should I stop now?

JUDGE DAVENPORT: I'm going to mark these 14A, 14B, 14C, and 14D for identification at this time.

(Exhibit Nos. 14A through 14D were marked for identification.)

THE WITNESS: I would like to go over very briefly, as I said, "Aseptic in Winchester" demonstrates the extent to which something that could be interpreted as aseptic

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packaging or hermetically-sealed packaging is becoming more standard, improves processing technologies, and the better plants are allowing this type of packaging to become standard, and I think that's important to consider.

The article "Finnish Attitude" from "Tetra-Pak Magazine" demonstrates another technology, a separate technology, that would reduce lactose content of milk products and offers another apparently -- it's another product that could substitute for milk, and it could, according to this article, be something in the neighborhood of 10 or 15 percent of the market now in Finland could be occupied by this lactose-free product which in my thinking demonstrates an analogy to low-fat and fat-free milk 20 or 30 years ago or 30 or 40 years ago.

MR. VETNE: Your Honor, before Mr. Cryan proceeds --

JUDGE DAVIDSON: Let's let him finish with his description of what those exhibits are, and we will take up your objection afterwards.
Dr. Cryan - Direct Testimony

MR. VETNE: Okay.

THE WITNESS: The PowerPoint presentation details the methodology and results of a study taken by IRI Market Research for DMI to examine the marketing expansion, the potential for Carb Countdown to expand the overall milk market and its impacts, potential impacts, on -- its implications for promotion. But the same conclusions are relevant with respect to this hearing.

Finally, the panel study issued by the NPD Group, to which I've included the raw survey data, demonstrates specifically the extent to which Carb Countdown is, first of all, used as a -- used for the same types of things that regular milk is used, and also which is outlined -- it's in there -- and it also describes the extent to which the purchases of Carb Countdown had to replace the purchases of regular milk. That's my description.

MR. YALE: One question. Was that last one 14D?

JUDGE DAVENPORT: 14D, yes.
Dr. Cryan - Direct Testimony

MR. YALE: Can we get copies made of that so we can see it?

JUDGE DAVENPORT: We need additional copies.

THE WITNESS: I've handed out all the copies that I had. There were copies on the back table. I don't know if summaries -- there were summary sheets as well.

JUDGE DAVENPORT: Does that conclude the direct portion of your testimony?

THE WITNESS: Yes.

JUDGE DAVENPORT: Very well. In view of the hour, I would propose that we go ahead and take our break at this time and then I will recognize Mr. Vetne and the others who have objections at that time.

Ladies and gentlemen, what is your pleasure? Maybe an hour and a half to allow everyone to get lunch?

MR. BESHORE: That's fine.

JUDGE DAVENPORT: Let's reconvene.

MR. BESHORE: If there were -- I know Mr. Vetne rose. I'm not sure whether it
Dr. Cryan - Direct Testimony

was to get copies of the exhibits or objections, but if there are objections, it might be useful to know what they are before we consider the exhibits after lunch.

JUDGE DAVENPORT: Very well. Let's just state the basis for the objection, and then we will go from there.

MR. VETNE: Your Honor, John Vetne. I will have some objections. I will know better what they are after I've had a chance to see the exhibit.

I didn't get a copy of -- I didn't get a copy of the exhibits. They appear to be -- they are certainly studies not presented by this witness or conducted by this witness. They appear to be excerpts. We don't know the questions.

They are clearly hearsay. Whether they are the type of reliable hearsay that this record should receive, we don't know. I'm hoping to be able to study a copy of the exhibit so I can make an intelligent objection, but that's just the gist of it.

JUDGE DAVENPORT: Very well.
Dr. Cryan - Direct Testimony

Are there other objections that are going to be offered? That being the case, let's try to be back at 1:30, and we will take it up again.

(Recess was taken lunch.)

JUDGE DAVENPORT: It looks like the hour is upon us again. Mr. Cryan will resume the stand. Mr. Vetne?

MR. BESHORE: I would -- with respect to the objections to the exhibits, before they are acted upon, I would like the opportunity to ask some questions of the witness with respect to the documents.

JUDGE DAVENPORT: Very well. Mr. Vetne, do you wish to yield to Mr. Beshore?

MR. VETNE: If he's going to add foundation to the exhibits, I might refine my objection.

JUDGE DAVENPORT: Very well. Mr. Beshore, it looks like you get first crack.

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CROSS-EXAMINATION

BY MR. BESHORE:

Q. Dr. Cryan, you are an economist by profession; correct?
Dr. Cryan - Cross - by Mr. Beshore

A. By education and profession, yes.

Q. By education and profession, okay.

Now, the exhibits to which preliminary objections have been lodged, marked as Exhibits 14C and 14D, are these studies that's the IRI study and the NPD study, 14C and 14D respectively, are they the type of studies to which -- the type of information upon which you as a professional economist would rely in formulating the professional opinions to which you have testified today?

A. Yes. They are the kind of studies I would rely on as a professional, and the kind of studies I did rely on in developing this testimony.

Judge Davenport: Dr. Cryan, your remarks are sort of tailing off a little bit. Either pull the microphone closer or speak up just a little.

The Witness: Okay.

Mr. Beshore: That's all I have with respect to the exhibits.

Judge Davenport: Very well.

Mr. Vetne?
Dr. Cryan - Cross - by Mr. Vetne

MR. VETNE: Your Honor, I would like to voir dire the witness a little bit about the exhibits before I post my objection.

JUDGE DAVENPORT: Go ahead.

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CROSS-EXAMINATION

BY MR. VETNE:

Q. Mr. Cryan, you referred to the IRI study. Is that the study that you refer to in the last page of your exhibit, Page 14, as low-carb milk retail sales, et cetera, PowerPoint presentation?

A. Yes.

Q. Given by Dairy Management, Inc., and what you propose to mark here as an exhibit is the PowerPoint presentation rather than the study; correct?

A. That's what I have, yes.

Q. You do not have a copy of the study?

A. I do not have a copy of the study.

There was some --

Q. Does anybody in your employ have a copy of the study?
Dr. Cryan - Cross - by Mr. Vetne

A. There is no one in my employ. Nobody -- nobody in National Milk has a copy of the study right now. I attempted to -- there were some hang-ups in the last week trying to get a cleaner copy directly produced by IRI, but this was all -- my understanding is all of this was essentially directly transmitted through DMI from IRI.

Q. Through DMI from IRI?
A. That's right.

Q. DMI is Dairy Management, Inc.?
A. That's right.

Q. And Dairy Management, Inc., is a milk promotion organization of dairy farmers?
A. That's right. They are an agency that administers research and promotion program under the oversight of the Dairy Programs, AMS Dairy Programs.

Q. And the Board of DMI consists of members of those cooperatives that are members of your organization?
A. I'm not sure about -- there is an overlapping membership, but I'm not sure what the administrative structure is.
Dr. Cryan - Cross - by Mr. Vetne

Q. Is this a, to your understanding, a study for which DMI paid?
A. It is, yes. In fact, as a matter of fact -- both of these studies, the MPE study and the IRI study, were both paid for by DMI in the interest of determining whether it made sense to promote the products in question. Whether it made sense to assist in the promotion of products in question, specifically with respect to, you know, selling more milk and whatnot.

Q. All right. Do you have a copy of the solicitation or request for the study which defines any parameters from DMI?
A. I do not.

Q. Does anybody in your organization have a copy of such requests?
A. Not to my knowledge.

Q. Do you know the questions that were asked, how they were presented by IRI?
A. The IRI study is based on analysis of scanner data.

Q. Scanner data?
A. It was based on analysis of
Dr. Cryan - Cross - by Mr. Vetne

Individual customers who were signed up in this. They, when they purchase products, they bring them home and they scan them in the setup that's created so this company can track what people buy.

Q. Is that sort of like the ACNielsen scanner data?

A. I believe so.

Q. So the study shows what people buy?

A. That's right.

Q. It doesn't show why they buy it?

A. In this case, the methodology is based on how people switch from one product to another. How they switch from milk to Carb Countdown or vice versa.

Q. It consists of consumers that are volunteers, to your knowledge?

A. That's my understanding.

Q. Who volunteer to scan, and do you know how many consumers that consists of?

A. I don't.

Q. To your knowledge, does the study differentiate -- does the -- strike that.

Does the study disclose anything
Dr. Cryan - Cross - by Mr. Vetne

about consumers who were going on a 
carb-reduced diet who would have -- who were 
purchasing milk and would have quit purchasing 
milk but for the Carb Countdown alternative 
available to them?

A. Not that specifically. This study 
does not -- this study indicates how folks 
change their -- how folks buy over time. So if 
they seem to be switching from one product to 
another product, it shows up. In the NPD 
survey, there are questions --

Q. I'm just asking -- I'm asking -- I 
don't want to get your answers to my questions 
confused. I'm asking about the IRI study. 
It really says nothing about 
consumer motive or consumer perception, the IRI 
study?

A. It says something -- it tells us 
about what people actually did, which is 
generally more important than what they believe 
or say they are going to do.

Q. Okay. Does the study reveal 
anything about choice of -- choice or changes 
in choices of product for reasons of price?
Dr. Cryan - Cross - by Mr. Vetne

A. I do not believe it does, no.

Q. Now, let's go to the -- oh, I want to go back to that IRI study. Where consumers have -- in the study, is it your understanding that scans are done by the consumers on a volunteer basis, number one; correct?

A. Uh-huh.

Q. And it doesn't reveal anything about either changes in the composition of the household or changes in the diet of members of the household?

A. Not to my knowledge, no.

Q. And, now, with respect to the NPD Group study to which you referred, do you have a copy of the underlying data that was used in assembling that study?

A. Yes. It's been presented as -- it's been presented. It's been offered as an exhibit.

Q. I haven't seen that document you are holding.

A. There were a limited number of copies in the back.
Dr. Cryan - Cross - by Mr. Vetne

Q. And this relates to Carb Countdown, a product produced by my client?
A. That's correct.
Q. That is particularly one I have not seen, but I will ask you about it anyway. I find it surprising that a copy was not provided to me when that's my client and my client's position.
A. I apologize for that. I should have given you a copy of that.
Q. Who paid for that study?
A. I believe DMI paid for that as well.
Q. DMI is Dairy Management, Inc., consisting of producers --

MR. BESHORE: Mr. Hollon offers his personal copy of the exhibit for Mr. Vetne.

Q. And Dairy Management, Inc., is an organization that consists of producers spending promotion assessment money deducted under the Federal Promotion Program correct?
A. It is an organization that's administered -- that administers a program of jargon and speech promotion and research.
Dr. Cryan - Cross - by Mr. Vetne

Q. It comes from producer monies?
A. It's paid for by producer money under mandatory check-up.

Q. And managed by producer representatives?
A. Yes. Indirectly.

Q. Did National Milk Producers Federation or any of its members to your knowledge request DMI to undertake these studies?
A. Not to my knowledge.

Q. Does that mean you don't know, for example, if FDFA asked its members on the DMI Board to start this process?
A. I don't -- I don't know what the process was. I don't know where -- how it was initiated or how they decided to do it.

Q. Again, do you have a copy of the outgoing request for proposals or requests for a study from DMI to the NPD Group describing what they wanted and how they wanted it?
A. I do not.

Q. Do you know whether the -- I have a note here that says this was an Internet study?
Dr. Cryan - Cross - by Mr. Vetne

Questions were asked on the Internet?

A. I am not you aware of that.

Q. Do you know how the questions were asked?

A. I understand that they have a -- they have -- in a similar way, they have people who agree to participate in panel surveys. I don't know if questions are asked -- it would be more efficient, I assume, to ask questions by the Internet.

Q. Do you know whether the questions were structured by Dairy Management, Inc., or by NPD?

A. The questions were developed at DMI.

It is my understanding that --

Q. Do you know whether the results would show consumers and to what degree consumers switched from conventional fluid milk to Carb Countdown because they were going on a diet and would have stopped buying dairy beverage altogether?

A. It -- okay. This data does identify people according to their -- to diet regime, how they -- their self-described diet regime,
Dr. Cryan - Cross - by Mr. Vetne

and there is quite a bit of detail. But I'm not sure that it would specifically identify people who would go onto a specific diet and stop drinking milk and -- because I think it was --

The categories, it asks folks according to the diet regimen if they are on a low-carb diet in the past year, and it separates out the breakdown of these questions.

So if there are folks that bought Carb Countdown, there are several categories of those who bought Carb Countdown, it asks whether they are buying more milk in total now that they are buying Carb Countdown, whether they are buying the same amount of milk but switching from milk to Carb Countdown, whether they are buying less milk now that they are buying Carb Countdown, or whether they are only switching -- whether they are only buying Carb Countdown because they weren't buying milk previously.

Q And this was the household responses?

A I believe so. Household, yes.
Dr. Cryan - Cross - by Mr. Vetne

Q. So the purchaser in a household may be buying milk or beverages of any kind for multiple members of the household, each of whom has different motives, and, again, the motives is not revealed; correct? The motive --

A. The motives would have -- you would have to infer the motives from their descriptions -- from their descriptions of their diet regime and their -- yes.

Q. In some cases, is it your understanding that the survey responder was responding for other members of the household concerning the survey responder's food purchases?

A. I'm not sure. I don't know that.

MR. VETNE: Your Honor, I think that's enough.

Here is the significant problem I find with both of these. One of which we only have PowerPoint presentations and don't have the study at all, and we're asked to draw conclusions from highlights given by the PowerPoint presenter to people that pay for the study or dairy farmers who have stake.
Dr. Cryan - Cross - by Mr. Vetne

The other one, we have apparently some initial data. But with respect to all, Hood, to whom this is specifically directed, has had no opportunity to examine the underlying data, to present the data to a survey expert of its own to determine the quality, neutrality, and reliability.

It is clearly hearsay, and I'm addressing whether this is the kind of reliable hearsay which might be received at this hearing. We just do not know enough about it, and the very interested party to whom this is directed is seeing this NPD survey for the first time and has never seen, and we still don't have available, the underlying survey, the other survey. We just don't know.

We can't even argue its reliability because we haven't been able to present it to experts. I'm not a statistician or a survey person, but I would desperately love to have the opportunity if this is received to present it to a survey expert and would ask that if it is received, that the record remain open until then, and if it's not going to remain open
Dr. Cryan - Cross - by Mr. Vetne

until then, that these exhibits and the
references thereto and the testimony be -- the
exhibits not be received and the testimony be
stricken. Thank you.

JUDGE DAVENPORT: Other
parties to be heard concerning objections to
these exhibits?

MR. YALE: I would say on
behalf of Select and Continental, we have no
objection.

JUDGE DAVENPORT: Any other
party that wishes to advance reasons for
objection? Mr. Yonkers?

MR. YONKERS: Your Honor, Bob
Yonkers, the Milk Industry Foundation. We also
don't have any opportunity to direct any
cross-examination to the actual people who
prepared either one of these studies to
cross-examine them on any of the research
methods used.

MR. VETNE: Your Honor, my
client has advised me of one additional
substantial concern.

Hood apparently asked DMI for the
Dr. Cryan - Cross - by Mr. Vetne

actual study underlying the PowerPoint presentation, and DMI refused to give it to them. This was about a month ago.

We were aware that there was something that had been done, but we asked for the study, and it was declined.

JUDGE DAVENPORT: Very well. I'm going to rule that the Exhibits A through D are admissible. They will be appended as part of his testimony as a partial explanation of his conclusions. For that reason, they will be given such weight by the parties making the decision that may be appropriate.

Of course, Mr. Vetne, you have the opportunity to rebut this in post hearing proceedings.

(Exhibits 14A through 14D were admitted.)

JUDGE DAVENPORT: Is there a cross-examination of Mr. Cryan at this time? Mr. Yale? ----
Dr. Cryan - Cross - by Mr. Yale

CROSS-EXAMINATION

BY MR. YALE:

Q. Good afternoon.

A. Good afternoon, Ben.

Q. Ben Yale on behalf of Select Milk Producers and Continental Dairy Products. I got a small issue because it was kind of a potpourri, so we will kind of balance it out. Your testimony suggested that -- I guess it doesn't really suggest -- the 6.5 percent has been the historic level that the Department issues, and you have explained how to, rather than look at all the solids nonfat, to look at just protein, and you derived this 2.25 percent; is that correct?

A. Right.

Q. Okay. Do you have any reason why the 6.5 percent of solids nonfat and now the 2.25 percent of the protein is an appropriate number? How do --

A. Are you asking why we don't pursue a --

Q. A different number.

A. A different number, something that
Dr. Cryan - Cross - by Mr. Yale

is not equivalent to 6.5 percent?

Q. Right.

A. Well, I guess what it comes down to is that we weren't really looking to, you know, to -- we weren't really looking to change things. We were looking to fix what we've got. We were really looking to clean up the current standard, the -- there may be an argument to -- with new technology, that there may be -- it may be easier to develop products that are under that standard. However, I don't believe there's a substantial record to demonstrate that yet.

Q. Which I think, and I'm not trying to speak for the Department, but kind of the question asked of Hollon leads up to that, at what point and how rapidly does the industry then respond to such a technology that comes up and say, for example, is able to provide any competitive product of 1.8 percent protein? Is that just a situation that would come back and ask for a new number? Is that --

A. I believe if the -- if the circumstances arose that there was reason to
Dr. Cryan - Cross - by Mr. Yale

believe that a product of 1.8 percent protein threatened to undermine the fluid milk product definition, then it would be appropriate to come back for a new hearing.

Q. Okay. So the primary role of this number is a protection of the existing Class I, not just -- that's the primary role; is that correct?

A. Right. It represents -- it represents the status quo rather than any substantial basis for that number itself. We presume that the record at the time it was established is reasonable.

Q. Are you aware of any products that are currently being marketed that use milk protein in a beverage that would not come under this definition?

A. I am not aware of any products that would -- I'm not aware of any products whose current classification by the USDA would change. There may be some, but I'm not aware of any.

Q. Are you aware of any that if it were dropped to 2 percent or 1.5 percent that it
Dr. Cryan - Cross - by Mr. Yale

would change?

A. I think there are a number of products that are just below the standard. At the time that the standard was implemented -- it's my understanding at the time the standard was implemented, there were no products near the standard, near that 6.5 percent but that category of products developed on the basis of that.

I don't know that those products would continue to be manufactured if the standard were reduced. I don't know where the sales would move.

Q. I didn't ask my question right, so I want to try this a different way.

True protein, we are talking about the percent of protein in the product, are you aware of any products currently being marketed as a beverage that contain less than two percent true protein?

A. Yoo-Hoo has a small line.

Q. Do you know what the percentage is?

A. I don't have that with me, no.

Well, I do have it. Let's see. It must be
Dr. Cryan - Cross - by Mr. Yale

about -- give me a moment. It must be about
27 -- about 27 percent protein.

Q. Does that represent the highest --
other than those who are like the Carb
Countdown and the others, but would that
represent the high end of those that are using
some dairy protein but not a significant
amount?

A. No. There's a range of products
that -- my statement includes a table, and it
shows a selected number of products that range
from the 80 'N Sunny, which is a combination of
fruit and milk, and Yoo-Hoo, which both have
about somewhere in that neighborhood of
three-quarters of a percent of protein up to --
up through a number of coffee drinks that are
relatively close to the standard, as are
Hershey's chocolate drink and a few similar
products that are very close to the standard.

Q. While in answer to the prior
question you did some math off of this table,
right, to approximate the percentage of protein
in Yahoo?

A. Yoo-Hoo.
Q. Yahoo we search, Yoo-Hoo we drink.
A. Yes.

Q. Can you explain what the math was so that we have that in the record and be able to --
A. Well, in this case, the table I have is I've shown these products on the milk equivalent on a protein basis where I took the crude protein measures that are on the labels and the labeling standards, and I took whatever those protein standards -- whatever that protein test was, labeled protein test of its product, and divided it by the standard protein content of producer milk according to the USDA's nutritional database.

Q. Okay. But looking here where it says milk equivalent protein basis, for example, Starbucks Frappuccino, coffee-flavored substitute, 72 percent --
A. Those are necessarily they are approximations because the grams -- the protein content is listed in grams.

Q. Right.
A. So you can sort of jump from seven
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grams to eight grams because not all of -- not all of these products have the same serving size, you don't get the same jump with all of products.

Q. But with this number, the 72 percent, can I compute the approximate percent of protein in the product based on the volume or the weight?

A. Approximately, yes.

Q. How could I do that?

A. For the percent or the --

Q. So that I can be able to -- you indicated --

A. The percent of the total line?

Q. You said, for example, Yoo-Hoo you thought was about .7 percent protein?

A. Right.

Q. And --

A. What I did for that was I started with 3 percent -- about 3 percent -- this is approximations, about 3 percent protein in milk, and that times the percentage is being roughly the protein content of each of these products.
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Q. Three times .35 would give me --
A. Three times .35 would give you about 1 percent.

Q. Okay. And down here where the Yoo-Hoo chocolate drink, 24 percent, three times that would give you .75?
A. Yes.

Q. Should it be more than 3.1 times that rather than the 3?
A. Well, it's -- I believe that this is -- this is for whole milk.

Q. Which is 3.1; isn't it? Or is that right?
A. It's -- I don't know if it would be about 2.9, I think.

Q. Okay.
A. Skim would be about 3.1. So I use three as a useful approximation. Many of these are necessarily approximations because of the limitations of the nutritional data in measuring a full gram in a relatively small serving size.

Q. So then in doing that, if one looks up here at the Starbucks Frappuccino, we are
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go ing to be looking at approximately 3 percent, right, protein?

A. The Frappuccino?

Q. Yes. The coffee flavored in the first one.

A. It would be -- it would be about 2.2. It would be just about --

Q. I'm sorry, 2.2. So depending on --

this one here would become very close to the 2.25 percent; right?

A. Pretty close.

Q. Okay. Is there a -- so I understand, your rationale for them not including the Starbucks Frappuccino is because it's not included there now, and your purpose is not to add any new products that would be regulated?

A. As I have testified, the problem I've testified about is a problem of changing technology and changing product compositions. Most of these products -- most of the products that are close to the limit, they -- when they use milk ingredients, they essentially are using milk. They are not using
fractionated proteins. As a result, they would not be affected by the change in the accounting.

Q. Okay.
A. Because what we are really talking about -- what I'm really testifying about today is an accounting problem.

Q. Why do you say it's an accounting problem?
A. Because we have been accounting for these volumes on the basis of nonfat milk solvents. We have been accounting for them and defining them on -- we should be defining them on the basis of the valuable component, which is protein.

Q. Very good. On that basis, then, when -- I use that word "when," as if it's going to happen but it probably will -- but at this point most of the protein products we have seen, they either use the casein products in total or they use the whey proteins, okay, and the question comes with the use of the whey protein isolates.

By the way, let's get some -- can
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you help me define, the record doesn't really
show what the three different types of proteins
are so that it's clear on the record. What is
a -- what is a whey protein?

A. A whey protein is a protein
contained in whey. Whey is, as I define the
product, of the coagulation of cheese.

Q. Okay. And the casein proteins are
what?

A. Casein proteins are the proteins
that remain in the cheese matrix when the
process is completed.

Q. Or the casein micelle?

A. Casein micelle?

Q. Micelle.

A. I don't know what that is.

Q. Then sometimes whey proteins are
called free proteins because they are not
connected to each other, they seem to flow.
Have you ever heard that term?

A. I haven't. I'm not a dairy
scientist.

Q. Whey protein isolates, what is your
understanding of that?
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A. When the whey is separated from primarily the lactose in order to -- much of the standard is for whey. I think it's over 90 percent, something like 90 percent protein. I don't know if that's the correct number. But something like 90 percent protein from whey would be considered a whey protein isolate.

Q. Let's move away from dairy science then, sir, get into another area. I wanted to change subjects here. You indicated that the whey protein is to be used as a basis to determine whether or not the product is Class I or not; is that right?

A. That's right.

Q. So I understand it, the purpose of that is that a product would not be able to be formulated to replace some of the true protein with the whey protein for purposes of staying below the 2.25 percent?

A. Right.

Q. All right. But you are only going to price the true protein and not the whey protein?
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A. Right.

Q. Okay. Now --

A. No, I'm sorry. It's not true protein. It's all true protein. What we are talking about -- I guess what we are really talking about is complete proteins other than whey proteins. Any proteins other than whey proteins. I'm not sure if there is a term that describes that other than to by exclusion.

So we would price all dairy proteins other than whey proteins, but we would count all dairy proteins to determine -- in order to qualify a product as Class I or not.

Q. Let me ask you this question. I lied to you, I'm going to go back to dairy science again so --

Is it your understanding that if there is no cheese process and no coagulation of the cheese, that there are no whey proteins in the milk?

A. That is my understanding, and that would be my preference if the decision specifies that.

Q. All right. Because if that's not
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the case, then the whey proteins actually do exist in the milk --

A. The same proteins that are in whey do exist in the milk, but to my understanding, they are not whey proteins until they are derived from the cheese-making process.

Q. And I want to make this clear, because those same proteins that we did not do the cheese coagulation, did not create the whey proteins, but those proteins do exist with the casein proteins in natural milk, it's not your position that in determining whether or not the 2.25 percent or the pricing is done, that if it's all that milk, that even those proteins need to be included in the pricing; is that right?

A. That's right. Absolutely.

Q. It's only if they are whey proteins which you define as the byproduct of the coagulation of the cheese?

A. That's right. That's very important to make that distinction.

Q. Now, there's two issues I want to bring up with that that I want to also make
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clear.

Are you aware of the fact as we have it now that reconstituted milk, that the plant that produces the powder or the reconstitution, that there's a choice of what order that the milk is pooled under is Class I?

A. I was not aware of that until a discussion less than two hours ago.

Q. Okay. Now, you are not suggesting, are you, that although the whey is included in the Class I, that it can be used to allow the area in which produces the whey to claim the right to that Class I proceeds in the pool, are you?

A. No.

Q. All right. So there's going to be no change there, it will be the plant that has the root distribution -- produces the product and has the root distribution in the marketing area; right?

A. If they are -- again, I'm not aware of that. If I accept the assertion that those provisions exist for the plant shipping, the reconstituted ingredients to have the choice of
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where to pool that milk, I would say --
accepting that that's the fact -- I would say
that it would be very important to define that
as only applying to use of ingredients that are
actually counted in the price of the Class I
milk, that there would be no, you know, no
back-door way for unvalued components to be
used as the basis for capturing Class I value
for market that shipped whey. So I would agree
with that.

Q. Okay. Now, you also indicated in
your testimony that part of the reason that you
don't want to price the whey proteins is that
they are priced already in the Class III.

A. Well, that requires a little bit of
explanation.

The problem is not so much that they
are priced already because, as you know,
Class IV ingredients have also been priced, but
for Class IV ingredients, it's easier to
identify the value that's been assigned to the
ingredients ahead of time and talk about an
up-charge to Class I.

With the whey, whey has been priced
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through the Class III formula, but the share of the value associated with the whey is very -- would be very hard to identify because the whey -- you know, the Class III components, you price the protein, some of that protein ends up in the whey. The other solids are based on the whey price, but they are only applied to nonprotein and components.

So it's establishing an up-charge for whey for Class I is a very, very involved -- very problematic. It's very difficult to say how we are going to do that. I think the cleaner thing, since it's a distinct product and a distinct ingredient that is not a wholly effective substitute for other dairy ingredients in fluid milk, the reasonable thing is to not price it.

Q. I don't recall -- you were not involved in the 2000 proceedings to establish the current make allowances of yields and stuff for Class III?

A. I was working for the Marketing Administrator in Atlanta, so my involvement in that was a little different.
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Q. Right. So I want to ask the question, you can tell me whether you can answer it or not, but isn't it fair to say that the whey proteins in the way the formula was established for Class III are not included in the price of the Class III?

A. No, I wouldn't say that. The complicated thing about the Class III is that the -- that the proteins are being priced on the basis of the cheese yield of the milk.

Q. Right.

A. And the whey value -- the price of whey that feeds back into the Class III, the overall Class III value, includes a whey protein component.

Most of the larger part of the value of whey is the value of the protein in the whey, but because of the -- as I was saying, because of the pricing formulas, they just used that cheese value for all the protein on tests for the milk, and they applied the whey value, which includes some of the protein value, unto the other science.

So they balanced -- they roughly
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balance out, but they are not exactly
calibrated, but they balance out closely enough
to offer a Class III value. So I wouldn't
say -- there isn't anything that's missing from
the overall formulation, they are just not
always -- they are not calibrated on a very --
they are not calibrated exactly right.
Q The 5.9 that's used basically
reflects the value or the amount of lactose and
minerals in the milk; right?
A The approximate volume of --
Q Approximate volume. But the protein
formula that you mentioned has implicit
90 percent protein utilization in the formula;
are you aware of that?
A I believe that -- I vaguely recall
that, but I wouldn't swear that that's correct.
Yes.
Q And that that other 10 percent
represents the whey protein?
A That's right, and the value -- the
approximate value of that whey protein is
captured in the other solids price in the milk.
Q I want to move to another topic
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here. I want to talk about the hermetically-sealed issue.

Frankly, I am a little confused. I think -- I'm going to try to state what I think you were trying to say and see if I am correct. I'm not trying to argue against you, I just want to make sure I understand it.

The hermetically sealed and the meal replacement have to come together, because if you use them individually, you might have some unintended results? Is that in that exclusion or am I missing something?

A. I think until we -- until we establish a better definition for meal replacement, it's -- it is an important distinguishing characteristic of the product to be hermetically sealed.

I believe that that requirement was established originally for a couple of reasons. First of all, if it's durable, it is less dependent on the immediate fresh milk supply.

JUDGE DAVENPORT: Speak a little more directly into the microphone. If you can, keep your voice up.
Dr. Cryan - Cross - by Mr. Yale

THE WITNESS: Okay. I'm losing my voice already.

And the meal replacement certainly as we -- as I discussed, dropping in the meal replacement requirement would allow for any product that is essentially -- well, that is hermetically sealed to become Class II just on that basis.

You know, as processing technology, as packaging technology evolves, that could be everything. We could see -- in ten years, we could see all of our milk being packaged in shelf-stabling packaging. That obviously would undermine the Federal Order Classified Pricing System.

Q. So isn't it really to say that it's a product that is hermetically sealed that is used for meal replacement is really the definition that you are -- so that the hermetically sealed is limited by the uses to which it --

A. That's right. So that there would be no change in the current definition -- in the current exemption for meal replacement and
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Q. And does National Milk have a position on the proposal that a meal replacement could be defined by anyone that contains at least 25 percent of the recommended daily adult allowances of the primary vitamins and nutrients for a diet?

A. I don't know. We have a position against any weakening of the exemptions.

Q. So if this isn't a weakening, it might be?

A. We don't have a position on it.

Q. And this is kind of a follow-up on two questions I asked of Mr. Hollon. You would agree, though, that since 2000, there has been significant change in the market of products that are using the new technologies, is that correct, such as Carb Countdown and the like?

A. They don't represent a large share of the market, but they sure represent a large increase from the almost nonexistent base.

Q. I think your statement was that they moved from, paraphrasing, moved from the
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theoretical to the actual?

A. Yeah.

Q. From the textbook to the marketplace?

A. I would say that is an effective paraphrasing of what I said.

I think the experience in Finland, what little I understand about it, what little I see about it in the magazine article, indicates a substantial potential which has always been -- theoretical potential for carb-reduced and low-carb beverage system becomes as commonplace as low-fat, you know, skim milk.

Q. The potential would be that you could have a 3.1 percent protein and no lactose and they could add Splenda or something, some artificial sweetener, and have a product that's very comparable but noncompetitive with regular milk?

A. I would say that the product that has been engineered by other of your clients -- that is the client that you work for now, Select -- they have reduced the lactose,
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increased the protein, and used lactase enzymes
to break down the remaining lactose so that it
has a -- which is a much sweeter product, much
sweeter sugar. They have not attempted to --
they made a simpler product and have not
attempted to make it a Class II product, and it
is very close to milk in my opinion.

I tasted one of the prototypes, and
it was much closer to milk than any other
low-carb or low-lactose milk substitute that I
have tried. It is probably close enough --
it's certainly close enough that with any
flavoring, it would be -- you wouldn't notice
the difference.

Q. You are aware that that's being
priced as Class I at this point?

A. I recognize it is, yes.

Q. One final question, issue.

In determining the proteins to use
for this Class I, the fact that the plant would
use imported caseins, should that have any
impact on the decision whether or not you
should consider it Class I?

A. For a Federal Order pricing?
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Q. Yes.

A. I think for Federal Order purposes, it would be reconstitutionally like any other. I think the issue in that case would be Grade A requirements and public health requirements rather than Federal Order issues.

Q. Now, that leads me to another question. I was going to bring it up with someone else, but since you brought it up, I will bring it up.

Does the product still have to be a Grade A product to be considered Class I under your proposal? Is that a necessity?

A. I don't think so. I mean, we classify products that are not Grade A products. I don't think there's a reason for that requirement since we are talking about pooling plants, regulated plants, what they use, what they produce.

I guess in theory a plant could be established that could produce a non-Grade A product, and they could receive Grade B milk in order to avoid Federal Order regulation. I don't know whether that would be worth it.
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Q. But my question is that some of these products might not have a Grade A because of their importation or other -- dried products might not be Grade A, but they are still able to sell them, a beverage possibly at the 2.25 percent protein level. Does the fact that it does not have a Grade A designation, does that mean that the Department should not consider that a beverage? That's my question.

A. No.

Q. No, they should not look at that issue?

A. It should be considered a beverage. I mean, if you use non-Grade A ingredients for fortification and reconstitution and thereby avoided Federal regulation, that would have a tendency to undermine -- lead to inequitable pricing.

MR. YALE: I have no other questions. Thank you.

JUDGE DAVENPORT: Mr. Tipton?

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CROSS-EXAMINATION

BY MR. TIPTON:

Q. Hi, Roger.
A. Hi, Tip.

Q. I got a number of questions. I would like to start with a more general question and go to some more detailed ones.

But earlier, and I think you talked about it, too, was the basis for classification being form and use? Did you talk some about that?

A. (Witness nods).

Q. The discussion that I hear is people talking about form and use, and form they often talk about in the case of Class I, that being liquid, and use is use as a beverage is kind of the general characterizations, I gathered.

Now, I would like to ask you to talk a little bit about what is liquid? When is something not liquid?

A. I believe there is a definition in the Order about when it's fluid and when it's not. I don't know the number off the top of my head. 20 percent solids, 40 percent solids. I
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Q. If I have a product, I'm putting up a product, and the product is very viscous, and it is drinkable in the sense that if you tip it up and hold it there for a while, the product will flow out of the container, is that liquid? Is that a beverage?

A. I suppose it depends on how you are marketing it.

Q. No. You are one that's saying, and others of yours saying, that if it's a beverage, if it's intended for a beverage, it's Class I. I'm trying to get at a question of how do you make that determination?

A. It's based on form and use, and if the product is sold as a beverage, it's a beverage.

Q. Well, most of those aren't necessarily sold as beverages, the consumer decides what they actually do with the product. A lot of milk is not consumed as a beverage that's sold to the consumer in containers. There are a lot of other products that are sold
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to consumers in containers that might be a pint
container or might look like a bunch of cream
products that are sold to consumers that are
not intended as beverages but they kind of look
like a milk container.

How do you make that distinction?
What is a beverage?
A. I think it's -- I think most people
recognize when something is being sold as a
beverage.
Q. Tell me what that difference is.
A. It's in a bottle as a beverage.
It's how things are sold to be used. I mean,
that's -- I think it's pretty clear.
Q. Yeah. When you say form, what do
you mean by form? When you say classified
according to form, what do you mean by that?
A. I think -- by form, I mean that I
believe that the standard should be based on a
physical compositional basis such as
2.25 percent protein minimum, less than
9 percent butterfat and so forth.
Q. And use?
A. Beverage use.
Okay. Now, let's go back to form. When you talk about form, I'm going to come back to this viscous product. We used to talk about the straw theory, can you suck it through a straw? If you can, it must be liquid enough that it could be used as a beverage.

How do you determine that? How does the Market Administrator determine that in a consistent way, is it drinkable?

A. Let me look it up for you. It becomes concentrated when it has more than 25.5 percent total milk solids. So according to the Federal Order, it's a fluid milk -- it can be a fluid milk product up to 25.5 percent total milk solids. Anything over that is concentrated milk.

Q. And accepted with a Class I?

A. I can't say that for sure. There's a lot of folks who could answer that question. I wouldn't say that for sure, but that would be my assumption.

Q. So a product, using that definition, a product that has 25 percent total solids, total milk solids, I presume, is not a
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beverage?

A. Apparently not.

Q. Now, the thing that always confuses me when you talk about form and use, the comparison usually goes back to milk, but if you didn't already have milk in Class I, what is the basis for putting it in Class I?

It's not just form and use because other products have form and have specific uses. So that is not a very differentiating criteria. So if you are going to start, what is the basis for putting it in Class I?

A. What is the reason for classifying milk pricing right from the start?

Q. What is the reason for putting it in Class I?

A. What is the reason for -- that's the same as saying, what is the reason for having Class I? Is that the question?

Q. That could be the question. If you want to answer that, go ahead.

A. The Federal Orders were established to provide -- to help insure a steady, reliable supply of fluid milk for the public, and in
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order to minimize the instability of milk marketing within city markets, and now today in larger regional markets, the proceeds from the higher value Class I milk were shared.

There was a -- it was established before the Federal Orders were implemented that there's a higher value and a higher cost to supplying a fluid plant than to supplying manufacturing plants, and that that extra value was -- is shared within the market, and the higher value for Class I is to compensate the market for supplying on a steady basis the beverage milk market.

Q. If you thought that -- the Class I price, do you think that generates more revenue than if you didn't have a Class I -- didn't have Class I?

A. Yes.

Q. If you thought a product or products, or Class I for that matter, the whole category, didn't generate more revenue for dairy farmers, would you keep it?

A. I would have to talk to my Board about that. But right now, our position is
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that -- I maintain that Class I does enhance producer revenue. I don't know that that is necessarily a relevant point for this proceeding, but I believe it does.

Manufactured product prices are downsize limited by world markets and by support prices, and for no other reason, it's a clear bump to producers having Class I differentials.

Q. So you think the current Class I prices enhances producer revenue?

A. I believe they do. But I do not necessarily believe that that's relevant to this hearing.

Q. Now, if you add products to that Class I definition that do not enhance producer revenue, what do you think about those? Should they be added?

A. What is relevant is the degree of similarity in substitution form and use between the larger grouping of products that we think -- because it's important to maintain a clear-cut physical compositional basis for defining Class I, and may or may not have
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products that are, individual products, that would be better one way or the other.

But the underlying principle is to clarify form and use as the basis for the Class I classification.

Q. If I heard you correctly, and correct me if I didn't, but you would say the basis for having that product that does not enhance producer revenue is to protect the Class I uses that you have?

A. I do not -- well, it -- okay. I have -- I have looked over the testimony that we have that this is all leading up to, and more important than the impact on total producer revenue associated with selling more product, or at least as important, is the impact on producer revenue per hundredweight.

One can have a situation where producers have $100 million in revenue and it's -- they are getting the equivalent of $10 hundredweight for that milk. And by adding products that substitute for other products, and to have some net increase in the volume of milk sales, you might have an extra -- you
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know, might have an additional million dollars in sales, but because the net impacts only pay producers another $2 hundredweight for those additional million pounds of sales.

In that case, their total revenue has been increased but their well-being has not. But there is a difference between what is good for producers and what maximizes the total producer revenue.

If you work twice as much for 10 percent more salary, you are not getting a good deal.

Q. So you would favor putting in Class I products that you know are going to reduce producer revenue?

A. That are going to reduce producer revenue? As I said, it all depends on the circumstances. It depends on more than just that simple fact. It's not that simple.

Q. Are there any of these products that you are proposing to put into Class I?

A. We are not proposing to put anything into Class I because right now, according to our interpretation of our proposal, there are
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no products that will change classification
from the way the USDA is presently treating
them.

Q. How is USDA -- on your last sheet of
your paper, you have Starbucks Frappuccino
coffee flavored, and I think I understand what
that milk equivalency protein basis is at
72 percent, but I believe -- would that not
make that possibly a Class I product?

A. Well, it's an approximation. So it
may round up to appear to be Class I, but I
believe it isn't.

Q. So would you change your protein
level if that would be the case here? Because
that is the case. I think if you multiply it
out, that product would probably be in Class I.

If your proposal would put that in
Class I, would you change the protein level?

A. It shouldn't change the -- it
shouldn't be in Class I because it's using milk
in natural proportions. So that is probably a
rounding issue that makes it appear to be over
the limit.

Q. But if it is not a rounding issue?
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A. Would we change our proposal?
Q. Yes.
A. No.
Q. So you would put it in Class I?
A. I think -- I don't think I would be the final word.
Q. Your word wouldn't be the final word?
A. And I don't think that a product -- most of these products that are just below the level can be adjusted up or down in small amounts anyway.

So, again, I believe this is a rounding issue that makes it appear to be Class I because I know that the Market Administrator in Kansas City and other markets where this is being produced are vigilant about this type of thing, and they wouldn't allow a Class II product to contain a Class I level of nonfat milk solids.

Q. It's not Class I now because of the 6.5 percent nonfat solids standard. But apparently under your proposal, as you are suggesting it, which is the milk equivalency of
Dr. Cryan - Cross - by Mr. Tipton

protein, it could go to Class I. So that's part of the problem here.

You talk about the 2.25 percent protein level that would become the -- I understand you would eliminate the 6.5 percent of nonfat solids, that's your proposal?

A. That's our proposal.

Q. And the 2.25 would mean that you would be classifying some products in Class I that -- because that's based off of the 6.5 percent nonfat solids, and skim milk to be skim milk has got to have approximately the 9 percent, or to be skim milk, it has to be 8.25 under the Federal regulations.

If -- so you would have products that would get picked up in Class I, but would you prohibit them from calling them milk because they wouldn't meet the standard, but you process them like milk because you allege that they compete with milk; is that correct?

A. There is -- the connection -- there is no connection today -- there are products like Skim Deluxe which are not allowed to be called milk even though they essentially
Dr. Cryan - Cross - by Mr. Tipton

contain as much as milk does.

There is a wide variety of products that are in essence substitutes for milk that contain practically the same thing as milk that are clearly Class I products according to our current standards that are not allowed to be called milk.

So the idea that -- milk is a very basic product, very basic product. It's the lactose secretion of bovine, that's what it is. Once you start modifying it, start adding modifiers, and once you substantially modify it, you don't call it milk anymore, and that's appropriate.

However, there's a big difference between saying this is Class I or this is Grade A or this can be called milk. There's -- the connection -- I don't really see that the connection is so tight that I'm not sure where you are going with that.

Q Well, I am going with you're proposing to expand the coverage of a lot of different kinds of products. You are also proposing to --
Dr. Cryan - Cross - by Mr. Tipton

A. No, we are not proposing to expand the coverage of anything. We don't see any products that we are going to change the regulation. We are looking to clarify and clean up the accounting currently under the definition currently so that we can put some problems to bed.

Q. Okay. So then why not allow those other products that everybody keeps talking about that are coming down the pike because of the technology that you testified to, why not allow those to remain wherever they are?

If you are trying to get one product, why don't you get that one product instead of applying the regulation to a bunch of products that don't even exist?

A. When you talk about it being one product, you are talking about it being one product in the same way that skim milk is one product.

It's a large category that is going to just continue to grow and ultimately will be -- ultimately could be a very substantial share of fluid milk sales.
Dr. Cryan - Cross - by Mr. Tipton

Q. But it's not now, none of the products are.

A. The carb-reduced and low-carb -- carb-free products are -- they are a reality, and it makes much more sense to make a regulatory change now and a accounting change now when it's still a relatively small product than to wait until every plant in the country has invested in these things on the basis of one -- the sooner we act on this, the better.

Q. Well, I can see that from your viewpoint of being -- of wanting to protect all of the Class I sales from competition, but in the developing markets, might it not be better to let them develop to see if they can gain some market share before regulating?

A. There's no grounds for that kind of exemption in the Act. There's no precedent for that in Federal Order regulation. I don't see the justification for that.

Q. Then you just wouldn't have to change the Order. It's the way it is right now. If you left it the way it is, that would be the result.
Dr. Cryan - Cross - by Mr. Tipton

A. We are essentially leaving it the way it is. There is an issue of whether 6.5 percent, 2.25 are appropriate or whether it should be -- they should be lower.

We concluded that in order to minimize the disruption, in order to simplify this change, that we would pursue -- just switch essentially the change in the accounting rather than the change in the actual level.

We believe that that is more than fair, more than reasonable, and we are sticking to that.

Q. If -- I want to switch to a different subject.

Who gets -- let's say that you are making a product and using imported casein in it, who gets the revenue under your proposal when you calculate the protein equivalency and charge the higher Class I price? Who gets that revenue?

A. The up-charge would go into the pool, the producer pool.

Q. Say they didn't produce milk, that pool didn't -- no producer in that market
Dr. Cryan - Cross - by Mr. Tipton

produced the milk, but they get the benefit?

A. That's right.

Q. Isn't that very similar to putting a tariff on it?

A. No.

Q. Why not?

A. Because it's a market wide pooling program

Q. But you don't have to charge an up-charge?

A. You don't have to use it for fluid use, either.

Q. I know that. But if I bring it into the United States and you are going to take money on that product and put it into the pool and not return it to the people who shipped that product in, it seems to me you are creating a barrier to that product.

A. If you were to -- if you were to produce -- if you were to produce nonfat dry milk in a plant in California and ship it to Alabama and have it be reconstituted as a fluid milk product, the same rules would apply to the up-charge going to the producer pool.

Dr. Cryan - Cross - by Mr. Tipton

Q. I think -- I agree with that. That's a very domestic view. But I'm talking about imported products.

A. I understand you are talking about imported products. But I'm saying the domestic product is treated exactly the same as an imported product.

So it is not a tariff, it is a marketwide pooling program that has no -- makes no distinction, no discrimination between foreign and domestic product.

Q. I suspect you may be an expert in this, if not, I suspect you might want to look at the WTO rules because I suspect it has some WTO problems doing that on the imported products, but we will go on.

On the last page, you list a number of products. Are these the -- how did you arrive at that list? Are these the products that are in the market now? Are there more, are there less?

A. This is a sampling of products that were of interest, that were the numbers -- the relevant numbers were available to a large
Dr. Cryan - Cross - by Mr. Tipton

degree. It's not a thorough or comprehensive list of products. It is a -- it addresses just a handful of things that were known to me or that I could find.

There's an Internet site called bevnet.com and they have information on a number of specific beverages, and I found some of the things on that. They detailed nutritional and ingredient information.

I used those as much as I could, and I also used labeling -- label information for some of the products like Carb Countdown and Hershey's milkshakes and Lactaid and Frappuccino Double Shot.

Q. Do you know whether you or anybody else, including the government, has a list of the products that might be affected by these proposals?

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
Dr. Cryan - Cross - by Mr. Tipton

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 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
Dr. Cryan - Cross - by Mr. Tipton

potentially is to be regulated, so I'm asking you if you got a list that would help identify the universe of the products that are --

JUDGE DAVENPORT: That's been asked and answered, Mr. Tipton.

MR. TIPTON: Excuse me?

JUDGE DAVENPORT: I believe that's been asked and answered.

A. I would be happy to see your partial list.

Q. I don't have one. I was asking for yours.

A. You said you know of a lot that will be regulated by this change. You just said that.

Q. I said I knew a lot that are in this category. Anyway --

With respect to whey, if there are a number of beverages, many of them in the sports drink area, that the only ingredient, only dairy-derived ingredient, that they might contain would be whey, how does your proposal apply to that?

A. If they -- if their only dairy
Dr. Cryan - Cross - by Mr. Tipton

Ingredient is whey, they might be considered technically a Class I product but there wouldn't be any pricing. They would not be priced as a Class I product.

There would be no up-charge because of the -- because they would in effect be converted back to zero volume, the plant would be unregulated because it would be under 150,000 pounds in Class I sales.

Those product pounds would all be converted back to zero, and there would be no regulation.

Q. But would they be subject to reporting?

A. Only to satisfy the Market Administrator that there was less than 150,000 pounds of sales.

Q. And would they be subject to auditing?

A. I think it would be pro forma. I don't think it would be --

Q. But they would be subject to those requirements?

A. They would be subject only to the...
Dr. Cryan - Cross - by Mr. Tipton

extent that they could demonstrate -- to my understanding, only to the extent that they could demonstrate their exemption. Exempt plants only have to demonstrate that they are exempt.

Q. So your intent would be that they not be included under the Order?
A. That they not --

Q. Those plants --
A. That that volume not be regulated.

If the only product the plant was making that contained dairy protein, or was a product that contained only whey protein, then it would not -- in effect, it would not be regulated.

It would be exempt as having less than 150,000 pounds of Class I sales, and so it would be exempted on a size basis.

Q. I have one other question, and I want to go back to the list of the 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's off the market. I'm
Dr. Cryan - Cross - by Mr. Tipton

sure it's 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.

MR. TIPTON: I think that concludes mine.

JUDGE DAVENPORT: Very well.

Yes, sir.

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CROSS-EXAMINATION

BY MR. LEINSOLO:

Q. You just answered the question basically that naturally I'm very concerned about my own plant, its future, so I would like to make it very clear.

This is the product that I produced about 14 years ago (indicating). It has about, I calculate, about 4.5 percent milk solids, nonfat milk powder, and about 1 percent whey protein concentrate.

And your definition, will it affect my product, would classify it as Class I or it will stay Class II?

A. You said it's about 4 percent nonfat milk --

Q. 4.5 and 1 percent solids. 5.5 and one percent whey protein. Together it's 6.5.

A. If it's right at 6.5, part of the component is -- part of the component is nonfat dry milk and the other part is protein --

Q. It's 1.5 percent fat content, but fat content is out of the definition.

A. Right. But the protein, is the whey
Dr. Cryan - Cross - by Ms. Grocholski

protein concentrated?

Q. Concentrated 34 percent.

A. 34, it should be the same. There should be no change.

Q. Should be no change.

A. You should be right at the same level in terms of -- should be right on the line, the same position for -- because 34 percent whey protein concentrate contains the same proportion of protein --

Q. It would be excluded. I just wanted to make sure. Thank you very much.

A. You're welcome.

JUDGE DAVENPORT: Ms. Grocholski.

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CROSS-EXAMINATION

BY MS. GROCHOLSKI:

Q. Okay. Mr. Cryan, is that -- did I get that right?

A. Cryan, right.

Q. You state in your testimony that form and use --

A. I'm sorry, I don't remember who you
Dr. Cryan - Cross - by Ms. Grocholski

Q. Deb Grocholski, General Mills.
A. Thank you.
Q. You state in your testimony that form and use is the primary factor in determining classification; is that correct?
A. Correct.
Q. Okay. In considering use, I note that you focus on whether a product competes with fluid milk. For example, you cite the NPD Group data that you say demonstrates that Carb Countdown is used as a substitute for fluid milk.

So can we agree that the NPD Group data is a respected and widely used source for this type of data?
A. Well, as the cross-examination pointed out -- as I pointed out on cross-examination or as I answered, the questions are -- the questions are designed by the people who commission the study. But the -- but presumably the results --
Effectively, it's a survey commissioned by DMI conducted by NPD. I think
Dr. Cryan - Cross - by Ms. Grocholoski

it's a good study. I think it demonstrates --
it's not perfect, but I believe it demonstrates
that most use is substituting for milk.

Q. So you and I can agree that NPD
Group does a pretty good job of putting this
kind of data together?

A. It seems to me they do, yes.

Q. You indicate in your opposition to
Proposal 8 that yogurt drinks are similar to
flavored milks and might be -- and must be a
close market substitute for flavored milks.

Now, do you have any consumer data
such as the NPD data to support this statement
with respect to yogurt drinks?

A. I do not have data with respect to
that, but they are -- but by form and use, they
are a beverage containing -- if they are in
Class I, they contain over 6.5 percent nonfat
milk solids, so in form and use, they are
Class I.

Q. If they are above the 6.5 percent?

A. Right.

Q. Is your position. But you don't
have any consumer data to show actually how
Dr. Cryan - Cross - by Ms. Grocholoski

yogurt drinks are used by consumers?

A. I do not.

Q. Okay. I also note from your testimony that you do not oppose or you do not have a specific paragraph opposing Proposal No. 9. Does this mean that you support Proposal No. 9? And if you would like, I can read it for you.

A. Proposal No. 9 has such conditions that would make it more restrictive than our proposal because it indicates that it would exclude products with no more than 2.2 percent skim milk protein provided and it contains at least 20 percent yogurt.

Anything with less than 2.2 percent protein under our proposal would be Class II.

Q. I don't know if this was with the commentary or not, but the No. 9 proposal would not calculate whey, add whey into the protein.

A. Okay. That's a separate issue.

Q. Okay. Well, let's talk about whey for a minute.

I note from your testimony that you indicate that the value of whey is the
Dr. Cryan - Cross - by Ms. Grocholoski

protein -- the value of dairy components --

A. Of skim milk components. The primary value of skim milk components is in the protein, especially when it's still in the milk and hasn't been separated because there's costs associated with separation that didn't really capture most of the value.

Most of the price of lactose is associated with the cost of separating it out from the other milk components.

Q. Are there other nutritional differences between nonfat dry milk and whey protein concentrate besides lactose? Let's assume that we are comparing nonfat dry milk to whey protein concentrate at 80 percent.

A. They have a different -- I'm sorry, whey protein concentrate at 80 percent compared to nonfat dry milk?

Q. Right.

A. If you take away the difference in lactose, if you just look at the proteins, they have a different -- they would have a different profile. I guess, you know, in nonfat dry milk, the proteins are about 80 percent casein,
Dr. Cryan - Cross - by Ms. Grocholoski

when in whey they are the other 20 percent. So that exclusively, those are the other 20 percent.

Q. Is there a difference in the level of calcium, potassium, phosphorus?

A. I don't know. I don't know.

Q. Do consumers drink milk to get other nutrients like calcium, potassium, and phosphorus?

A. They get it to -- they drink it to get calcium. I'm not aware of issues of phosphorus, and what was the other one? Potassium?

Q. Calcium, potassium, phosphorus.

A. Okay. I presume from the line of questioning that there is a higher level of potassium and phosphorus in whey protein concentrate than there is in nonfat dry milk.

Q. Well, I don't want to force out our testimony too much, but there is at least ten times the calcium in nonfat dry milk than there is in whey protein concentrate.

One final note, and this isn't a question, it's a clarification: Yogurt
Dr. Cryan - Cross - by Mr. Farrell

smoothies are not all Grade A. Thank you.

JUDGE DAVENPORT: It's three o'clock at this time. Let's possibly take an afternoon break, and can we hold it down to 15 minutes?

(Recess was taken.)

JUDGE DAVENPORT: Do we have additional cross for Dr. Cryan? Mr. Farrell?

MR. FARRELL: Thank you.

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CROSS-EXAMINATION

BY MR. FARRELL:

Q. I need your help on explaining whey to me.

As I understand your testimony, whey would be included in the calculations of milk protein, but it would not be included in the up-charge? There would not be an up-charge on whey; would that be correct?

A. It would be counted in protein in terms of defining the products as Class I, but then it would not be accounted for as part of the skim milk equivalent of the Class I product in the pricing, right.
Dr. Cryan - Cross - by Mr. Farrell

Q. And how about if the product used was milk protein concentrate, how would the -- how would the casein and the whey portions of that ingredient be treated?

A. Milk protein concentrate is not the byproduct of cheese production, cheese coagulation, so it does not have whey components. It may have the same proteins as whey, but it has a complete set of milk proteins, and that, according to our proposal, that would be treated both for defining the product as a Class I, and it would be included in the pricing of the Class I.

Q. So you would -- and how would you calculate the charge on that whey protein?

A. What whey protein?

Q. The whey protein that's in milk protein concentrate.

A. It would be -- it's protein like just like protein in milk. It would be up-charge on the protein equivalent basis, the way I would see it. The administration is up to the Department how they finally decide.

But the way I would see it done is
Dr. Cryan - Cross - by Mr. Farrell

that it would be charged on a protein
equivalent basis, the same way that nonfat dry
milk is up-charge right now for reconstitution.

By the same token, to the extent
that it is beyond reconstitution and
fortification, it would remain -- in effect,
it would remain a Class IV product.

Q       Okay. So just to be clear on the
record, there would be a charge for the whey
protein content in a milk protein concentrate
ingredient, but there would not be a charge for
the whey protein content in a whey protein
concentrate; is that correct?

A       No, that's not correct. There is no
whey protein in milk protein concentrate. Whey
protein is necessarily a byproduct of cheese
production.

Q       Where do you find that definition of
whey protein?

A       I cited it in my testimony.
Q       Could you refer to it for me, please.

A       Whey protein concentrate has a
definition in 21 CFR 184, 1979, again. That's
Dr. Cryan - Cross - by Mr. Farrell

21 CFR, 184, 1979. You are not writing it down.

Q  No. That's the definition of whey protein concentrate.
A  That's right.

Q  I'm trying to understand how you differentiate between the protein in whey protein concentrate and the protein from the whey component of milk protein concentrate. I want to understand exactly how you differentiate between those two proteins.
A  The proteins in milk that has not been turned into cheese are the proteins in milk that are the same proteins in a milk protein concentrate or in skim milk from the farm or --

They are the same set of proteins and they are priced across the board the same way. The only difference we're talking about is whey after cheese-making process.

Q  How about whey after the manufacture of casein?
A  I don't know that -- I don't know whether that's whey. I'm not sure.
Dr. Cryan - Cross - by Mr. Farrell

Q. Cheese production and casein production are --

A. I'm not adequately familiar with the casein production process to know whether --

Q. Well, it produces whey as a byproduct just as the production of cheese does.

A. If it meets the definition according to the FDA memo, then I suppose that would be whey.

Q. Okay. So if, for example, we take the whey, which was the byproduct of casein production, and we incorporate that along with say sodium caseinate into a product, then we will have a different charge calculation than if we add milk protein concentrate?

A. I suppose so. In that case saying we would use -- if it was casein, casein would be accounted for in the protein base just the same as pound for pound -- the same as nonfat dried milk, but then the whey would be priced lower because it's a byproduct of the process.

I have a hard time imagining it would be worth doing that, but -- breaking it
Dr. Cryan - Cross - by Mr. Farrell

out and putting it back together again. But there are elements of Federal Orders that involve different prices that you could --

You could go about, for example, drying powder and put it into a Class II product, and the differential between Class IV and Class II is designed to make sure that that's not quite worth it. So I would assume -- I would be interested to know whether it was worth it, but I can't imagine -- I have to imagine it would have a sufficiently detrimental impact on product quality to break something out of the casein and whey and then put it back into the reconstitution of a fluid milk product.

Q. Why would you make all these assumptions about product development?

A. You are right, I shouldn't. I'll just leave it at that.

Q. Just moving back to some of the whey beverage products that Mr. Tipton was talking about, these sports nutrition products.

A. Uh-huh.

Q. Which are significantly whey --
Dr. Cryan - Cross - by Mr. Farrell

A. Uh-huh.
Q. -- as a source of protein. Now, again, my understanding of your testimony is that it would certainly be a wash. I mean, it would be used in the calculation, but then there would be no charge?
A. Right.
Q. Are these beverages?
A. If they are beverages, they are beverages, yes. He was talking about a beverage, so, I mean --
Q. Well, I'm getting at form and use.
A. Okay.
Q. How is the form and use of those products different than the form and use of some of the products that you have listed on the back of your statement?
A. We believe that whey is a sufficiently imperfect substitute for -- whey proteins are sufficiently an imperfect substitute for whole milk proteins in a beverage that the product whose entire dairy content is whey ingredients is not a sufficient -- is not really competing with
Dr. Cryan - Cross - by Mr. Farrell

Q. How about a beverage product whose sole milk protein ingredient is potassium caseinate? Would you like to drink that?

A. I have never had it, and I won't speculate about product development anymore.

Q. That was -- that's okay. But you would somehow differentiate between a beverage product where the sole milk ingredient was sodium or calcium or potassium caseinate on the one hand and with a product whose sole dairy ingredient was whey on the other?

A. Yes.

Q. Work with me for a minute.

If, for example, these whey beverages were not to be excluded from the charge, what would be the magnitude of the up-charge? I know there are problems calculating it, but just in terms of magnitude, where would that up-charge lie?

A. I couldn't say. It's -- establishing a basis for the up-charge is problematic, as I've said, and I would not start to say what -- how to do it. I don't
Dr. Cryan - Cross - by Mr. Farrell

propose to do it, and I don't -- I wouldn't suggest how to go about doing it.

Q. Would it be fair to say that it would be significantly more than the up-charge, for example, from Class IV to Class I?

A. It depends entirely on how it's calculated.

Q. Okay. I need to understand why it's so hard to calculate.

A. It's difficult to calculate because you have to start -- in order to -- the up-charge has to be based on the Class I value of the component, the ingredients once it's been reconstituted, minus what has already been paid for.

And as I said earlier to Mr. Yale, defining that value is difficult to do because when cheese and whey are produced, the cheese-making process -- the price formula, the Class III price formula, captures -- roughly captures the total value of the milk that goes into it, but it doesn't necessarily assign a protein value for the casein and another protein value for the proteins that end up in
Dr. Cryan - Cross - by Mr. Farrell

the whey, and another value for the lactose.

What it does, it lumps the whey protein values into the price that's paid for the lactose, the other solids, while the protein is being -- the protein that includes the whey protein is being paid for the cheese value.

So that you have this component that is being -- whose value -- the formula really derives from one side but ends up being paid on the other side. So you could either use the protein price, the Class III protein price, for the whey protein as a basis, in which case it probably wouldn't be any higher than the up-charge for Class III -- it may be higher, may be lower, may be in the same magnitude -- or you could use some sort of the protein equivalent value from the other solids value, in which case it would be much lower, and the up-charge would be larger.

So it really depends on how you choose to do it. It's not really clear what the right way to do it is.

Q: Okay. But yet you can figure out a
Dr. Cryan - Cross - by Mr. Vetne

way to assess the up-charge on the whey protein content of the milk protein concentrate that's used as an ingredient?

A. On the complete protein content of the milk protein concentrate, that's right.

MR. FARRELL: Okay. Thank you. I have no further questions.

THE WITNESS: You're welcome.

JUDGE DAVENPORT: Mr. Vetne?

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CROSS-EXAMINATION

BY MR. VETNE:

Q. John Vetne for HP Hood.

Mr. Cryan, there was some documents left on the back table concerning the -- a request originating from National Milk Producers Federation, which was the basis for the data compiled by Agricultural Department Exhibit 12.

Were you involved in preparing that request?

A. I was, sir. Is that my signature?

Q. You know, your letter isn't included. All that's included is material
Dr. Cryan - Cross - by Mr. Vetne

from -- originating from the Department

concerning your request. Not your actual request.

Did you prepare the templates of data for Class I fluid milk product definition hearing, did you provide that to the Department?

A. No, I did not.

Q. You simply told the Department the kind of data that you wanted them to collect; is that correct?

A. That's right. I requested it at the time when our positions were not yet fully established. So there was a degree of exploratory -- there was some exploratory nature to the data.

Q. Mr. Rourke testified that under the line on the table on Exhibit 12, lactose-free beverages, that that includes Lactaid and some other lactose-neutralized products.

May I ask why you requested that item of products in this hearing?

A. I guess the lactose-free beverages include things like Lactaid, which are
Dr. Cryan - Cross - by Mr. Vetne

relatively a well-established category of
products, and we assumed, and I think it was
borne out in the NPD data which is here, that
Lactaid actually is a very strong substitute --
that they are a very strong substitute for one
another.

To some degree, people who consume
Lactaid are -- tend to switch to this, the
other one, the IRI -- will tend to switch --
will tend to try the Carb Countdown as an
alternative because of the lower lactose
content, because a lot of the folks
obviously -- a lot of the folks that use
Lactaid use it because of lactose intolerance,
and that issue is currently addressed by Carb
Countdown.

Q. Do any of the proposals directly or
indirectly suggest a change to the
classification of lactose-free beverages as
identified in Exhibit 12?

A. They do not propose a change to
Lactaid because Lactaid contains all the milk
solids. They are altered, but they are not
removed.
Dr. Cryan - Cross - by Mr. Vetne

The reason we were looking at that was because we wanted to also understand that there is a substantial volume of Class I milk being sold in that category, and it is a category of Class I milk that is a closely related form and use, and it is an economic substitute, a very close economic substitute, with the Carb Countdown.

Q. So that category of milk -- Lactaid is called milk, it's on the label; isn't it?
A. I don't know.

Q. You don't know. Okay. That category was not included as a category that would be affected by some of these proposals, but rather -- that the classification of which could be changed -- but rather as a category of conventional fluid milk products, with which you perceive competition from these beverages?
A. That they serve similar -- they can serve similar uses, yeah. Right. That's right. I would say yes.

Q. Looking at Page 2 of your proposal on this whey thing again, by excluding whey and whey solids, is it your intention that only the
Dr. Cryan - Cross - by Mr. Vetne

product pounds in a fluid milk product that constitutes the whey ingredient would be excluded from the up-charge? The alternative to that is the whey equivalent of those whey solids?

Do you understand my question?

A. If the accounting is done on a protein basis -- I'm sorry, I don't understand the question.

Q. All right. Let me give an example. Let's say I develop a product that has two percent milk protein concentrate and two percent whey protein and isolate --

A. Are you saying -- okay. Are you saying it has two percent protein from an MPC and two percent protein from a whey product?

Q. Yes. So the total is four percent, so it's eligible to be looked at as Class I. And in that product there's added water, it's a beverage.

Would the volume to be up-charged as a skim milk equivalent of the added water be prorated between the whey protein and the milk protein concentrate or would some other
Dr. Cryan - Cross - by Mr. Vetne

accounting method apply to such a product?

A. Again, it's not my decision exactly how to handle this. But if it were, the whey would essentially be treated as if it wasn't there.

Once you've determined it's Class I, and you move on to pricing the product, the whey ingredient, you are treating it essentially as if they weren't there, and the MPCs would be accounted for on a protein basis prorated to what the protein content of normal skim milk, according to the standards, which is 3.1 percent in the skim part.

So if you -- if it's a skim product and it's 2 percent protein from MPCs, it would be accounted for as for, you know, 2 over 3.1 as a share of the milk volume.

Q. You are aware that whey starts out as a liquid, a bit like skim milk; correct?

A. Yes.

Q. And when it's dried, it contains nonfat solids in roughly the same proportion as skim milk, a little bit fewer actually solids to the water? Are you aware of that?
Dr. Cryan - Cross - by Mr. Vetne

A. Yeah, it's about -- yeah.

Q. And then you take -- in both cases, you take those solids and fractionate them further and get proteins.

It's your intention, as I understand it now, that none of the whey protein solids will be treated as if associated with the original moisture contained in it, but the milk protein concentrate protein portion will be treated -- will be allocated to the water as much as possible, until you get to the natural relationship between water and protein and milk?

A. Okay. I can restate it or you can restate it.

Q. Please restate it.

A. Again, for the whey -- the whey would be treated -- once you get past the qualifying product as a Class I product, defined as a fluid milk product, Class I product, the whey would then be treated as if it was a nondairy ingredient again, a nondairy ingredient, and the other would be -- the other proteins that would be accounted for as the
milk equivalent, and so those proteins on a milk equivalent basis would be treated as Class I volume, and that would be the volume. So, for example, if you had 2 percent -- let's say roughly 2 percent protein and it's supposed to be -- and the standard is 3 percent, if it's two-thirds of the protein that would be in milk, then it will affect -- when you have sell 100 pounds of that product, you are credited by the Market Administrator of selling 66 and two-thirds pounds of Class I product.

Q. Okay. What if the whey came in liquid form?
A. It's whey. It's just as if you are using water for reconstitution, once you get past the qualification.

Q. You would exclude from any up-charge all of the whey that came in liquid form?
A. Yes.

Q. But if the whey came in dry form, you would add back or attribute back the water that was originally associated with it?
A. I'm not sure what you mean by that.
Dr. Cryan - Cross - by Mr. Vetne

Q. If whey came in powder form and that was added to a product and made the difference in the protein standard that you propose, the water originally associated with that whey would not be subtracted from --

A. No.

Q. -- the product for up-charge purposes?

A. No. And, again, this is all my suggestion about how this would be administered, and it's not my decision to make.

Q. Your testimony on Page 3 says that the current system undervalues the protein and overvalues lactose.

How does your system, Proposal 7 that you are espousing, provide additional value to protein that is not there now?

A. Proposal 7 would recognize -- by recognizing the protein content of the product as the basis for measuring the value of the milk in the product, it would be more accurately putting the value of the components in proportion -- the value of the product in
Dr. Cryan - Cross - by Mr. Vetne

proportion to the value of the components.

Q Then it would not increase the
protein value of the milk, would it?

A As I've said, it's an accounting
issue. What we are proposing is an accounting
reform rather than a substantial change in the
overall definition of Class I.

Q I'm trying to understand what you
mean by "undervalues protein."

Does either the handler pay more for
protein or the producer receive more for
protein under Proposal 7?

A I'm not sure I can answer that
question because I'm not sure of the details of
how it's being handled right now.

Q Are you aware that the Class I
differential, which would be the up-charge
we're talking about, is returned to the
producer as part of the producer price
differential, PPD?

A Do I -- am I aware of that?

Q Yes.

A If there's anything left, yes.

Q Yes. If there's an up-charge on
these products for reconstituted meal protein concentrate, the protein price wouldn't change, but the PPD might increase a small amount?

A. It might. I'm not sure. I'm sorry, ask me the question again.

Q. If there is an up-charge as a result of any of these proposals, yours included --

A. An up-charge on products that are not currently being up-charged?

Q. On a dairy beverage?

A. Such as MPCs or something along that line?

Q. If there's an up-charge on any dairy beverage as a result of any proposal, including yours, that up-charge would flow to producers, if at all, through the PPD, not in the protein; is that correct?

A. Yes.

Q. And the handler similarly would not pay more for protein but pay a compensatory payment for a differential?

A. If they are paying -- if they are paying for -- they would pay more for protein, if the current accounting --
Dr. Cryan - Cross - by Mr. Vetne

I don't know what the current accounting is right now. But if the current accounting were as might be implied from the language of the Orders, then a product that had -- that had five percent protein but only six percent nonfat solids was going to pay, you know, two-thirds -- pay for two-thirds of the Class I value, that is six-ninths.

If the normal composition is nine pounds of nonfat solids per 100 pounds of milk and a handler with five pounds of protein and only one more pound of lactose is going to pay on the basis of the nonfat solids, if it's being prorated on the basis of nonfat solids, in that case, the handler is underpaying for the protein that they are using.

They are underpaying into the Class I pool for the quantity of milk that they are putting in because they are really using 100 pounds of milk and cutting the nonfat solids down, so it's only 66 pounds of milk, in effect.

So what this offers is a more accurate and equitable accounting system for to
Dr. Cryan - Cross - by Mr. Vetne

establish a milk equivalent and for defining
the product as Class I or not.

Q The additional amount, if any, that
would be paid however is accounting a pound
payment in the form of a differential?

A It establishes a more equitable
definition of how -- what the volume of product
is. That's right.

Q And that extra payment is on the
fluid portion, not the protein portion?

A Well, in Class I -- that's a matter
of interpretation.

Q Further along in the same sentence,
you use the words "serious inequity." Now that
skim components can be separated, et cetera,
there can be serious inequity.

Inequity between whom? Whose
interests are you suggesting are harmed by
inequity and whose interests would be bettered
by putting more equity into your proposal?

A There is inequity between the
handler who is in a lactose-reduced formulation
and paying for a smaller volume of milk based
on that accounting and the handler who is using
Dr. Cryan - Cross - by Mr. Vetne

milk containing complete nonfat milk solids and is paying the full value.

I do not know that that's how that's being accounted right now. That is a matter of contention. That contention and that confusion are one of the reasons that we are here so that we can clarify these standards and these procedures to make everything more fair and in line with the principles of the form and use.

Q. So the more fair and the more equitable attributes of your proposal are handler versus handler issues; am I correct?

A. Well, yes, for an example. That was an example.

Q. I asked what you meant by serious inequity, and that's the answer you gave me. If there is more to it, please continue.

A. Well, there are also inequities between handlers who are using 100 pounds of milk to produce 100 pounds of product but they are only accounting for 60 pounds of product and producers who are seeing their protein, full measure of their protein, being put into a product but only getting the Class I value for
Dr. Cryan - Cross - by Mr. Vetne

two-thirds of it. That's a hypothetical.

Q. And that inequity is not a competitive inequity, as you described before, it's perceived to be a revenue inequity that producers aren't getting paid enough for one of their products; am I correct?

A. They are not getting paid in a way that's consistent with the underlying principles behind the Federal Order Pricing System.

Q. But the latter thing that you described as inequity, would you agree, is not competitive inequity?

A. Yes. But the example of the two handlers is a competitive inequity.

Q. Notwithstanding your perception of competitive inequity between handlers, are you aware of any handler that has a proposal that either asserts or proposes to cure interhandler inequity?

A. O-AT-KA is one handler who proposes to.

Q. O-AT-KA is a handler in that it's -- it makes reports, it's owned by farmers'
Dr. Cryan - Cross - by Mr. Vetne

cooperative associations; correct?

A. That's correct. It doesn't make
them any less a handler.

Q. I agree with that. Let me rephrase
the question then.

Are you aware of any processor of
milk that complains at this hearing of
competitive inequity with another proprietary
processor of milk that complains of competitive
inequity between another proprietary processor
because the current system results in unfair
costs?

A. Well, they were not sufficiently
troubled to carry a position with their
organization or to come here and testify, no.

Q. But you still believe this is for
handlers' own good?

A. I didn't say that. I said that
there are -- can be inequities between handlers
of one type of product and handlers of the
other following that exact same logic that
carried in the issue of skim and low-fat milk
in the New York-New Jersey Order in 1968. The
issues are practically identical.
Dr. Cryan - Cross - by Mr. Vetne

Q. The bottom of Page 3, you testified that Carb Countdown has been classified both as a Class I product and as a Class II product. What is your source of knowledge for that?

A. I think it was one of your clients.

Q. Okay.

A. And I'll take his word for it.

Q. On the next page, you opine -- or state, rather -- that whey solids in Carb Countdown are not currently treated by USDA as nonfat milk solids for purposes of defining a fluid milk product in pricing Class I milk. What is the source of your knowledge to make that statement?

A. I talked to somebody at Dairy Programs. If it's incorrect, I would be happy to correct it.

Q. When did you talk to somebody in Dairy Programs?

A. Sometime in the last four months, at least.

Q. At the bottom of Page 6, in the underscored paragraph first line, you again use
Dr. Cryan - Cross - by Mr. Vetne
the term "obvious inequities."
Do you mean anything by that use
other than what we discussed previously?
A No. I think probably those two
issues of competitive inequities between
handlers and processor and producer is probably
covered.
Q The bottom of Page 7 under the
heading, "establishing the protein equivalent,"
at the end of the third line, National Milk
Producers Federation contends that this
standard of 2.25 percent protein reflects
"normal" proportions of nonfat solids to
protein in milk.
Now, milk doesn't normally contain
as little as 2.25 percent protein.
A Contains a normal -- it normally
contains some ratio of nonfat solids to
protein, and that ratio I believe is normally
the same ratio of 2.25 to 6.5 percent.
Q Oh, okay. So you're not claiming
that 2.25 percent is normal, only that the
relationship between 2.25 and 6.5 is about the
same?
Dr. Cryan - Cross - by Mr. Vetne

A. That's right.

Q. At the bottom of Page 9, "deleting the whey exemption," you reference a misinterpretation in the treatment of whey ingredients that has developed over the years. What misinterpretation are you talking about?

A. It is my understanding that the whey, as I indicated in my testimony, it is my understanding that the whey exemption was originally intended for liquid whey in a bottle, and that the treatment of whey ingredients over time as a nondairy ingredient versus a pricing qualification is something of an -- is an unintended distortion of that.

Q. All right. Now, moving to Page 10, middle of the page, the paragraph beginning, in at least one case, a product marketed as a substitute for milk contains enough whey, et cetera, et cetera, what case are you talking about?

A. It's my understanding that Carb Countdown is such product, and, again, I would be happy to be corrected.
Dr. Cryan - Cross - by Mr. Vetne

Q. Is that the one case?
A. That's the one I'm aware of.
Q. You conclude, "Although such product could compete with fluid milk, it would be currently priced at Class II."
A. Actually, that's a typo. It should say, quote, currently could be priced at Class II. This was touched by several hands, and I would appreciate if that would be changed in the record from would to could.
Q. All right. You opine on Page 11 and several times in your testimony in response to cross that no product currently classified would be changed as a result of your proposal. How do you know that?
A. I would be happy to be corrected.
Q. Did you speak without any inquiry whatsoever?
A. I examined every product that I could find information on, every product that was brought to my attention, and I did not find any that were -- that were -- that would have changed the regulation.

That doesn't mean that I saw every
Dr. Cryan - Cross - by Mr. Vetne

single product, but I saw a substantial
sampling of products, and I didn't find any
that fell into that category.
Again, I would be very happy to know
of any because it's been -- I have been
questioned, and I would be happy to say there
are some exceptions, and then to be immediately
asked how could I possibly know there are none.

Q. These are products that you are
referring to on the last page of your
testimony?

A. The last page?

Q. Page 16.

A. Yes.

Q. Okay. How did you become aware of
the Class II classification of the products
listed there as Class II now?

A. I -- well, I checked some of the
ones -- I checked with manufacturers or I
checked with USDA folks or I just assumed in
the case of products with very low protein
tests that they were Class II.
Again, I would be happy to be
corrected if any of these are wrong.
Dr. Cryan - Cross - by Mr. Vetne

Q. Okay. What USDA offices did you contact for that information when you checked with the USDA?

A. I know I have asked Cliff Carmen of Dairy Programs about several products. I am not sure if I talked to anybody else about that. The procedure is that they will not provide a list of products, but they will answer any inquiries about individual products.

Q. Are you aware that USDA has a list?

A. I’m not aware, but they can usually look up something either in a file or a memo or by calling somebody.

Q. All right. Let’s take a look for a moment at products which are not specifically identified as proteins of milk or whey but may be derived from such as lactoferrin.

If that’s an ingredient, how would it be, if at all, tallied in the 2.2 percent?

A. Well, it is a component of milk. If it’s derived from whey, per se, then it would be treated as a whey solid. If it was derived from filtration of -- mechanical filtration separation without achieving the process, then
Dr. Cryan - Cross - by Mr. Vetne

it would be treated as one component for pricing in Class I for Class I products.

Relatively high value. It is a separate protein. I understand it's a relatively high value product, but I don't know the difference between Class I and Class II really amounts to anything. It is a component in milk, per se. It's just one protein among many.

Q. Well, as a component, it may have a high price, regardless, but it will produce a price for the water if it's Class I and not if it's Class II. That's -- that's really what we're talking about is the difference between Class I and II.

A. We are talking about something like -- yeah, I'm talking about something like the difference between Class I and Class II for a gallon of raw milk is about 22 cents based on projections for this year at the beginning of the year, but that may be different. But it's in the neighborhood of 18, 20, 22, 24 cents.

Q. One of the merits, as I understand it, you perceive of the Proposal 7 is that it
Dr. Cryan - Cross - by Mr. Vetne

will not change products classified under the current rules? Am I correct that you see that as a merit?

A. In practical terms, we see that as a merit.

Q. Okay. And if that turns out to be wrong, do we start from scratch?

A. If it turns out to be wrong, it turns out to be wrong, marginally incrementally. I don't think we can expect to have zero change at all.

If there is a product that falls into that -- into that narrow category or it would change, I would not change our position.

Q. If there is -- however, if something comes up that is significantly affected between the current rules and proposed rules, would you suggest that maybe the Department would start from scratch and look at the whole thing again?

A. No. Our decision-making process looking at this was really about whether we were going to support the change in the accounting at the same level or change the accounting and lower the level, and the
Dr. Cryan - Cross - by Mr. Olsen

Conclusion was that the equitable thing was to change the -- or to reform the accounting and leave the level where it was.

MR. VETNE: I have no further questions at this time. Thank you.

JUDGE DAVENPORT: Other cross? Please identify yourself for the court reporter and also the organization that you represent.

MR. OLSEN: I'm Aaron Olsen on behalf of the National Yogurt Association. Just a couple of quick questions following up.

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CROSS-EXAMINATION

BY MR. OLSEN:

Q. You stated in your testimony that yogurt-containing beverages are presumably a close market substitute for flavored milks; is that correct?

A. It's my presumption.

Q. Do you have any data that demonstrates people buy these products instead of buying flavored milk?

A. I don't have that data, but I would say on the basis of form and use, they are
Dr. Cryan - Cross - by Mr. Olsen

close substitutes, and there is not really adequate basis for separating them out.

Ultimately, even if an individual product doesn't fit the mold exactly right, the general category -- the definitions have to be clear.

Q. Do you have any data demonstrating that people use these products in the same way that they use fluid milk?
A. I don't have data on that.

Q. Do you have any data on how the products are marketed, that they are marketed in competition with flavored milk?
A. They are marketed in bottles for the use as a beverage.

Q. Do you have any data that shows that they are marketed in competition with fluid milk?
A. I don't, except form and use.

Q. But you don't have data that shows that people use them in the same way that they use flavored milk?
A. There is some -- I don't have anything I can enter. We've looked at a study,
Dr. Cryan - Cross - by Mr. Olsen

actually, that compared a number of dairy
products, including yogurt drinks, and they
were -- there was some substitutability between
yogurt drinks and flavored milk that was pretty
substantial, but I'm not sure if I have enough
to put into the record.

I don't think I really have -- I
didn't -- I wasn't interested in -- I wasn't
pursuing yogurt. So I guess we do have some
data, but I don't have anything to present at
this hearing.

Q. We have your presumption but no
data?

A. It's not a presumption. We have --
there was a study that IRI did for DMI that
looked at a whole range of products. They were
looking for opportunities in areas where they
could pursue new beverages.

In fact, they are looking for
Class II beverages they can promote without
affecting Class I sales. I believe that was
roughly what they were doing.

What they found is there is kind of
a scattering, and they are all -- the yogurt
Dr. Cryan - Cross - by Mr. Yonkers

drinks did fall in relatively close to other
flavored milk drinks on the count of on the
low-fat side.

I know that's not a very
satisfactory answer, but I don't have anything
to present. But you asked the question, so
that's the best I have for you right now.

MR. OLSEN: Thank you.

THE WITNESS: Sure.

JUDGE DAVENPORT: Yes, sir.

Mr. Yonkers?

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CROSS-EXAMINATION

BY MR. YONKERS:

Q. Bob Yonkers, Milk Industry

Foundation.

Roger, I'm going to take you back to
a time in your life which, something I had to
go through also many years probably before you
did, but let's talk about economics.

You have used the term either in
your direct testimony or in answers in
cross-examination market substitute or products
being close substitutes for each other.
Dr. Cryan - Cross - by Mr. Yonkers

From an economic perspective, if somebody said, I want you to do a consumer demand analysis and tell me if a product has a substitute or a complement, or a substitute or not a substitute, how would you design that analysis? What would you look for? What would you do?

A. Well, one approach is to just eyeball things. The first step really is to look at -- look at form and use. Things that are similar in form and use are the first candidates for substitution.

I would also be interested in -- there's a lot of ways to approach it, but among the ways to approach it would be looking at sales patterns and looking -- and then surveying folks, like NPD has, about how they use things and what they are replacing with.

And then, of course, there's also, if you got the time and data, you can do demand estimations, you know, estimations demand systems based on, you know, approximating elasticities of products.

Q. Could you, you know, to the extent
Dr. Cryan - Cross - by Mr. Yonkers

that you are familiar with either from your training or your continuing keeping up with the profession of agricultural economics, have you seen any consumer demand analysis papers published in peer review journals like the "American Journal of Agricultural Economics" or "Review of Agricultural Economics" that uses form and use or sales patterns to establish whether their products, two products they are looking at are substitutes or complements?

A. The academic and economic profession is very driven by using fancier, more complicated mathematical models. So to the extent that a simpler methodology doesn't meet that professional itch, doesn't scratch that professional itch, you are not going to see much of that.

Q. I'm familiar with the "publish or perish," trust me.

I guess the point that I'm trying to get at is doesn't substitute have a very specific meaning in economics, agricultural economics? When you talk about two products being substitutes, doesn't that have a very
Dr. Cryan - Cross - by Mr. Yonkers

specific meaning in the economic literature, in textbooks?

I'm not just talking about journals
now, textbooks, how do you define --

A. In one particular framework, you
know, in specifically the, you know, the
neoclassical framework that serves as a basis
for most mathematical -- well, not for most --
for most equations -- that's not right
either -- for the kind of framework where you
do econometric estimations, you are often going
to use a measure of the price relationship and
cross-price elasticities as the basis for substitution.

But, of course, you know, that's
not -- that's not the beginning and end of
substitution. You know, those -- that's really
just one indicator of substitution that is
really about a relationship between two
products being similar in form and use and
being perceived by folks as something they can
use one for the other.

And which there are other ways of
demonstrating that they do that like, for
example, asking them. When you ask them and they say, well, we stopped using this because we are using the other thing instead. When you stopped reading "The Post" because you are getting "The Times," or when you start drinking -- when somebody says in a survey that I'm using Carb Countdown, so I stopped using milk, those kinds of things are also indicators of substitution.

Whether or not that is directly, you know -- whether that satisfies methodologically or not is -- I will leave to you. But it is just as valid an indicator of the economic concept of substitution.

Q Well, if you ask them and they did indicate that they had substituted one for the other, wouldn't that show up in the type of demand analysis I'm talking about using an econometric model? Wouldn't you see that?

A I would -- I expect if it was designed right, yes.

Q You mentioned that after talking about the form and use and sales patterns and surveying folks, you mentioned if you had
Dr. Cryan - Cross - by Mr. Yonkers

enough time and money doing -- time and data
doing, time and data, you would do a demand
system in elasticity?

A. In your hypothetical scenario where

somebody came to me and said --

Q. Right.

A. Yes. I'm not saying I'm going to go
do it.

Q. But we have had time to do this. I

mean, the first USDA request for additional
comments and proposals was made at the summer
of 2003. You know, we're two years later now,
so there has been a fair amount of time.

I'm just curious why NMPF, National
Milk Producers Federation, didn't think of
doing that and clearly could have shown that
there was product substitution using a demand
analysis as economists would look at a demand
analysis system

A. Well, we talked to -- I spent a good
amount of time talking to Matt Stockton who was
working with Jug Capps, in addition to your
study. I assume you will be presenting that
today?
Dr. Cryan - Cross - by Mr. Yonkers

Q. If I could just state for the record, they didn't do any work for the Milk Industry Foundation. They did work for another organization which I do some work for, and because of we can't use that data in the same framework, so -- our contract does not permit us to use that data in the same framework.

A. Okay. That could explain some other things. And we talked about the methodology, and we talked about the approach, and it was pretty clear that the kind of model that you are talking about when you are breaking out, you know, elements of the fluid milk sector, fluid milk products, that it really starts to explode. It's very difficult to do that kind of a model, especially looking at substitution among these related -- these related products.

So there were some practical difficulties even conceiving of doing a study that would deal with, you know, yogurt drinks and semi-milks and carb-reduced milks and all these fine gradations within the dairy category.

It just wasn't practical to start
Dr. Cryan - Cross - by Mr. Yonkers

talking about large numbers of categories in
that kind of a demand analysis, and then if you
start to only to use those limited numbers
of -- limited number of subcategories, then you
don't have a large enough universe to give you
an accurate picture of the substitution.

So even though in theory that's a
nice thing to do, it doesn't necessarily --
it's not necessarily workable.

Q. I guess I'm not quite getting your
understanding.

Certainly if you are using like a
weekly data, you mentioned a study from IRI,
obviously they have weekly supermarket scanner
data for numerous weeks. If you have large
categories, what is the limiting factor there
when you have a lot of observations that you
can use in a time series that's not very long
in terms of the time period it shows? What is
the constraint?

A. The constraint for --

Q. Why can't you do a study like that?

What is the problem from having a large number
of categories? Econometrically, what is the
Dr. Cryan - Cross - by Mr. Yonkers

problem?

A. What IRI did isn't econometrics. It's a much simpler calculation. The more complicated the calculation gets, the larger your number -- your data has to be. It almost has to increase geometrically as your calculation gets more complicated in order to get good results.

Q. Valid results.

A. Valid --

Q. Statistically significant results.

A. Statistically significant.

Q. Okay. I'm going to come back to the two studies you mentioned just briefly because -- were you involved in the meeting when -- I know the IRI was a PowerPoint, I don't know about the NPD study, it didn't look like a PowerPoint.

It even mentions in the IRI it was one of -- the third slide I believe says something about an October 20 meeting. I assume there was probably a meeting where this PowerPoint presentation was made.

Were you present in any of those
Dr. Cryan - Cross - by Mr. Yonkers

meetings?

A. I don't -- I was at a meeting in Chicago, but I don't remember if I was -- I don't remember -- I was never -- I was never at a meeting where this particular study was presented.

Q. So you don't know what the discussion was around it or if there was any additional materials presented as part of that study?

This could have been an excerpt from a larger presentation or larger discussion or even a full paper?

A. It's my understanding this was their entire presentation that was made in the DFA offices on January 13. But I don't -- I don't -- I was not there, so this was the -- this was the version that I had access to.

Q. And you weren't present at the October 20 meeting that's referred to in --

A. I am not sure if I was at that meeting or not. If this same data was presented, I was not there. But I may not have been -- it may not have been. So I was at a
Dr. Cryan - Cross - by Mr. Yonkers

meeting in Chicago that fall. I don't know if I would --

Q. Had they discussed research around dairy-based beverages during that meeting you were at in the fall?

A. Yes. We talked about it.

Q. Do you know if anyone from AMS -- I've been fortunate enough through my other job that I wear that I can share data -- to be at two meetings at DMI headquarters where we discussed research relating to dairy products. In that case they happened to be about elasticity studies that was done by researchers at the University of Wisconsin and Cornell, but it indicates there was someone presenting from Marketing Services, Dairy Division of Marketing Services, at those meetings.

Do you know if anybody from the Ag. Marketing Services were present at either the January 13 or the October 20 or at any other meeting where these results were discussed?

A. If the October 20 meeting was the one I was at, then there was -- then there was somebody from AMS, it was a committee meeting
Dr. Cryan - Cross - by Mr. Yonkers

of the DMI Board. But I don't -- I don't know
if I was there.

Q  Okay. Whether that was the same
one?

A  Right.

Q  You mentioned -- well, did you get
written permission from anyone to use this --
if you weren't present at the meeting,

obviously you weren't the one who was handed
the study at the meeting, the January 13
meeting.

Did someone hand this to you and say

you can use it for this purpose? Did you

obtain written or oral permission, from anyone

at DMI to introduce it into this hearing

record?

A  I had -- for this presentation? For
this one?

Q  The IRI one, yes.

A  I don't remember. I mean, I --

Q  Do you remember where you got that

PowerPoint from?

A  I must have gotten it from either

Alan Reid at DMI or somebody at DFA. I believe
Dr. Cryan - Cross - by Mr. Yonkers

It's all we discussed, but I couldn't tell you exactly when or with who.

MR. YONKERS: All right.

Thank you. I have no further questions.

JUDGE DAVENPORT: Cross?

Mr. Yale?

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CROSS-EXAMINATION

BY MR. YALE:

Q. Ben Yale on behalf of Select Milk and Continental Dairy Products.

There has been a lot of talk about comparing the use of yogurt and substitution of bottled milk and others. You were here this morning and you heard the testimony of Elvin Hollon; right?

A. Yes.

Q. And you heard the cross-examination?

A. Yes.

Q. And the question was asked regarding, and I'm going to ask you the same question, the Department or the Secretary has the authority and the obligation to classify milk products based upon what?
Dr. Cryan - Cross - by Mr. Yonkers

A. Form and use.

Q. And that does not -- and the use, if it's a higher value use, it can be at a higher classification, is that correct, if the Department -- if the Department finds that?

A. Yes.

Q. Is there any obligation that within that higher class that they have to substitute one for the other?

A. I don't think so.

Q. So if the Department finds that a drinkable yogurt, for example, has a higher use value than other products, they can -- the Department is within its prerogative to classify that as Class I even if it does not absolutely substitute for Class I, or bottled milk as we know it?

A. I would have to look at the Act again, but that sounds right.

MR. YALE: Okay. I don't have any other questions.

JUDGE DAVENPORT: Other cross?

Mr. Beshore?

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Dr. Cryan - Cross - by Mr. Beshore

CROSS-EXAMINATION

BY MR. BESHORE:

Q. I have just a couple of questions, Roger.

Just to follow through on Ben's last questions there, we've got in classification, milk product classification, we've got all sorts of products in the same class that are not substitutes for each other, such as butter and powder in Class IV; do you agree?

A. Yes.

Q. In Class II, for instance, ice cream and yogurt?

A. Yes.

Q. Whatever else, fluid creams and ice cream correct?

A. Uh-huh.

Q. So substitutability is not a requirement for classification in the same class? I mean, absolute substitutability; correct?

A. Correct. Between any two products, right.

Q. Now, let's talk about, you were
Dr. Cryan - Cross - by Mr. Beshore

asked by Mr. Vetne, I think, about competitive
equity and, you know, who's got -- you know,
it's kind of like whose got a dog in the fight,
I guess.

Among the National Milk producer
members, are any of those cooperatives also
Class I processors?

A. Of who?

Q. The members of the National Milk
Federation?

A. Yes. Quite a number. I can tell
you a few of them

Q. It's Exhibit A to Exhibit 14. How
many of them have Class I processing facilities
of their own?

A. Cass-Clay Creamery, Dairy Farmers of
America.

Q. There is a few joint ventures?

A. Foremost Farms, I believe. I don't
know all of them Maryland-Virginia has a
number, has several claims, Berry Farms Dairy,
Swiss Valley Farms, Upstate Farms. A number of
them have Class I operations.

Q. Northwest Dairymen?
Dr. Cryan - Cross - by Mr. Beshore

A. That's, of course, Northwest Dairy has quite a number of plants. Quite a large volume.

Q. So when your membership was evaluating the position to advance in this hearing, would it be fair to say that they were taking all of their interests into account, including their Class I processing --

A. I would say so. Their share of the fluid market is not inconsiderable.

Q. Now, let's look at it another way. As looking at the dairy farmer members just as sellers to other companies for processing, is it in the sellers' interests to have equity between its customers in terms of the classification of pricing of the raw milk product?

A. Absolutely.

Q. And isn't it one of the favorite games in the business, if you look at it that way, for the buyers to work on the price with the seller because of competitive inequities that may be, you know, arguments about competitive equity that may be available to
Dr. Cryan - Cross - by Mr. Beshore

them?

A. Yes.

Q. And in the marketplace, as the
saying goes, the last load and the lowest price
controls?

A. Yes. Yes.

Q. You've mentioned DMI and the DMI
studies and that sort of thing.

Just so the record is complete, DMI
is subject to USDA oversight and supervision
because it administers the required by law milk
promotion funds; correct?

A. That's right. Everything they do is
subject to the USDA oversight. These studies
were, like I said, were part of an attempt to
understand the return to producers of promoting
products, promoting -- or assisting with the
promotion and development of particular types
of products which they are actively involved in
across the board.

Q. And, in fact, they, DMI, and its
dairy farmer directors, use promotion funds to
fund the promotion of proprietary products if
they determine that it would enhance producer
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revenues?

A. That's right.

Q. And that was the purpose for exploring how low-carb milks work in the marketplace; correct?

A. Yes.

Q. Now, you've been --

A. The bottom line is if they spend money promoting a product and that is expanding sales, it's win-win. It's good for everybody. If they spend resources and funds promoting a product that's just robbing Peter to pay Paul, then it's a waste of the farmers' money.

Q. Now, the data that Mr. Rourke placed in the record was a result of your request to him, as has been testified; correct?

A. That's right.

Q. Do you have any objection to making your written request for purposes of clarification as it's been referred to a number of times an exhibit here?

A. No, I don't object.

MR. BESHORE: Okay. I think I've got one copy but only one copy. Let me
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see if we can identify that and ask Mr. Cryan to identify it, and then we will see that copies are obtained.

I have a two-page letter dated April 26, 2005, that I would ask to be marked --

JUDGE DAVENPORT: Let's tender it as Exhibit 5 for identification -- or 15, excuse me, for identification.

(Exhibit No. 15 was marked for identification.)

Q. See if you can identify it.

A. I believe, yes, this is the letter.

I would make a point -- make a note that there were some minor changes in the effective request based on requests for clarification.

I asked for carbohydrate-reduced beverages and carbohydrate-free beverages, and in discussion with Mr. Rourke, I indicated that I was interested as well in Lactaid, and he pointed out that those are not carbohydrate reduced because of the carbohydrates are broken down to other carbohydrates then removed from the product.
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I indicated that I was interested in the lactose-free beverages as well as carb-reduced beverages. Otherwise, I believe we just followed through with the original request.

Q. Okay. So Exhibit 15, with the oral clarification that you have just testified to, represented the request that you made that resulted in the data Mr. Rourke presented?

A. That's right. And he did a wonderful job putting it all together, putting together data that didn't really exist until it was extracted from the raw data of the Federal Orders.

MR. BESHORE: I would ask that Exhibit 15 be received, Your Honor.

JUDGE DAVENPORT: Any objection? Exhibit 15 for identification will be admitted as Exhibit 15.

(Exhibit 15 was admitted.)

JUDGE DAVENPORT: Other questions? Mr. Tosi?

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Dr. Cryan - Cross - by Mr. Tosi

CROSS-EXAMINATION

BY MR. TOSI:

Q. Good afternoon, Roger. I want to thank you for being at the hearing today.

A. Thank you.

Q. I wanted to ask you some questions that are similar or identical to the ones that I asked Mr. Hollon earlier this morning.

Is National Milk Producers Federation satisfied with respect to the structure of the fluid milk product definition where we describe fluid milk products both by naming products and then providing some sort of criteria for the exclusion of products that would not be fluid milk products?

A. Are we satisfied with the current structure?

Q. Yes.

A. We're satisfied with the current structure in -- I mean, as I said -- well, let's see.

We have a position to amend it, and, otherwise, we are satisfied with the --

Q. I understand that you are proposing
Dr. Cryan - Cross - by Mr. Tosi

what you are proposing in Proposal 7, but the
notion that we are going to name products like
we do in paragraph A, part 15, Section 15 --
maybe if I help you out here.

A. I guess so.

Q. When you look at your fluid milk
product definition that you were kind enough to
put in your written testimony --

A. Yes, I see that it says products --

Q. Part A names products, for example,
low-fat milk, white milk, fat-free milk, et
cetera?

A. Right.

Q. I'm referring to that as naming
products.

A. I think that's probably a helpful
illustration for clarity, especially for folks
who are not especially familiar with the
Federal Order.

Q. And then in part B where we talk
about things that would not be fluid milk
products or it establishes certain
compositional standards that helps us decide
whether or not something is a fluid milk
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product, you are satisfied with those two key features of how the definition is structured?

A. Well, I think in that case it goes beyond illustration. I guess it tends to define.

I suppose it might be better to establish physical standards a little more specific than the list of products. However, in some sense, that's done because you have definitions of what these products are later on and are kind of based on physical standards.

I'm not sure -- I don't -- I'm not sure to what extent these definitions are based on FDA definitions products and to what extent they are not. I suppose it is important that there not be any gaps. On occasion we may have a definition for this product that goes up to a certain test --

JUDGE DAVENPORT: To the extent we might be talking about two different things, Mr. Tosi, is the gist of your question as to the format of the regulation as opposed to the actual content?

MR. TOSI: Yes, sir. That's
Dr. Cryan - Cross - by Mr. Tosi
correct, Your Honor.
   A. So was I answering your question or
was I rambling?
   Q. I got a little bit of each out of
it.
   What I was trying to relate is that
the notion that the '74 classification decision
that's been referred to several times here at
this hearing made a purposeful decision to name
products as well as provide compositional
standards, and my line of questioning was
trying to get to do you think that's still the
appropriate way to approach the structure of
how we decide if something is or is not a fluid
milk product?
   A. Well, I suppose ideally there would
be some sort of -- you know, to name products,
sort of define points within a set where the
ideal may be to define the boundaries of the
set. So I think they are both useful.
   I suppose there's a certain balance
that's necessary in -- just off the top of my
head, I don't know exactly what that is, but I
certainly trust you to come up with it.
Q. Would you agree that even if your proposal were adopted, that there may still be instances of some time in the future we would have gray areas of trying to determine whether or not a product should or should not be a fluid milk product?

A. I think the current gray area is really a result of a good faith effort to reconcile traditional principles of form and use with outdated regulations. I don't doubt that that may happen again.

We're dealing with it today, and hopefully that will take care of it for a while. But, inevitably, it's the nature of Federal Orders that as market conditions change, we have to go back and make some changes in the Federal Order language.

Q. I had asked Mr. Hollon this question or a similar question, and I would like to ask the same of you.

To the extent that there comes a situation that sometime in the future where we're in a gray area, would you be supportive of any modifications to your proposal that
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would give the Department a little bit of
latitude for interpretation provided if that
was on the basis of form and intended use?

A. Such as a provision that says, "or
such other products as determined by the
Secretary," that kind of thing?

Q. That may be one way of handling it.

Then I was going to ask you what advice you
would give us on how to do that.

A. Well, I think clear rules are
important up front, but it's -- but we have
seen how difficult they can be when you are
kind of caught in between a rock and a hard
place.

I suppose maybe some sort of interim
authority to handle it, depending if a hearing
would make sense.

Q. All right. Let me give you a
hypothetical situation.

Let's assume there is a product out
there that its form and intended use is fluid,
and its intended use is to be used like milk,
things that we know -- traditionally think of
when we think of milk.
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To the extent that we're riding on some exclusionary factor that may arise in the future, for example, 2.23 percent protein, that there comes some technology that sometime in the future where we can take protein and fractionate it and fractionate it again such that it may give rise to challenging the protein standard, its applicability, would you want the Department to have some flexibility in saying perhaps that product is best classified as a fluid milk product because of its intended form and use?

A. No. Now, this answer is just on my own, obviously. This is -- I would say that it might be reasonable to, again, to offer some interim authority if the underlying -- what we want are regulations that are as clear as possible that are set out in black and white what rules are. If those cease to be adequate, then they need to be changed, and then that means a hearing.

However, recognizing the problems associated with, you know -- recognizing the potential for problems for products that come
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In before you have time to do that, you know how long this process can take, I would say that it would be reasonable to have some sort of interim authority pending a hearing to make a determination outside of that, outside of that standard.

That may be a reasonable approach. But that would really be something that should depend on a very substantial change in the circumstances. I'm not sure how you would do that.

Q. Well, let's try a real example. Let's use Carb Countdown, for example. Would you be of the opinion that it's a Class I fluid milk product based on what you think you understand about how this product -- what its composition is and how it's intended to be used?

A. I --

Q. Form and use?

A. I believe the form and use and a lot of the things, it's fundamentally a Class I product, yes.

Q. And if the manufacturers of this
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product say, well, we don't think so, we think it should be Class II, and they give us their because, are you saying then that every time we come into a potential conflict in the future, that we should come to a hearing to resolve that product's classification?

A. I think if the rules are inadequate to the circumstance, it's time to go back to hearing, yes.

Q. And so you are saying no latitude to the Department in terms of --

A. No, I'm not saying -- I'm saying perhaps an interim -- latitude on an interim basis pending a hearing. I don't think -- I think that -- I think that's the only thing that's fair to everybody involved.

I think Elvin's right, there is a lot of pressures involved, and it ultimately has to be decided out in the open. It's a difficult -- it's very -- I know this has been a very difficult -- this product has been a very difficult situation for a lot of folks, and there has to be some light at the end of the tunnel for -- at least for a hearing.
Dr. Cryan - Cross - by Mr. Tosi

I think for somebody to come up and face a set of rules and then be told, well, we think for some deeper underlying principles, this may be a problem. So I think as an interim on some emergency basis pending a hearing, it might be reasonable.

But I wouldn't say as a permanent thing that it makes -- that it's -- I would say it shouldn't be a permanent thing. If the rules are broken, they've got to be fixed.

Q. If the rules are broken, they have to be fixed?

A. Yeah. If the rules are broken, they got to be fixed. I understand that you have -- there has to be a stopgap sometimes while you fix them.

Q. Well, rules are what they are. How would they be broken?

A. I think what we had in this case is, as I said, we had the underlying principle of form and use that was difficult to reconcile with the language in the Order as it stands.

It's created -- it created a bit of a mess, and because we didn't anticipate the
Dr. Cryan - Cross - by Mr. Tosi

technology the last time we wrote them up, and
now we are here to fix it. I think that's the
way the system's supposed to work.

Q. So what is broken with the rules as
they are --

A. I think --

Q. -- with respect to let's use Carb
Countdown as a way as an example?

A. The whey exemption is -- offers a
big opening for some of this creative
formulation, and I guess I understand that the
language in 15(B) is not as clear -- is not
clearly -- it's not as clear regarding the
choice of disposition as a basis for Class I
and for some of these modified products -- for
accounting for these modified products, it
obviously left some holes when we're talking
about nonfat milk solids.

I think there's some confusion about
what the rules mean, and it's better to make
them clear.

Q. Do you think that the Order should
specifically define such terms as infant
formula, dietary use, meal replacement,
Dr. Cryan - Cross - by Mr. Tosi

hermetically sealed, more than what they
currently do, what the Orders currently do?

   A. Well, we don't -- we don't have a
   position on that.

   Q. Should substitution be a criteria
   that the Department should consider when
determining whether or not something should or
should not be a fluid milk product? I'll let
you define substitution in whatever way you
feel is appropriate to the issue at hand.

   A. I think substitution is more of an
underlying issue in helping to define the
rules, and that certainly on a case-by-case
basis, it's often the unwielding. It would be
very difficult to use that as a basis for
class -- for qualifying and classifying
products on a product-by-product basis.

   So while I do think that
substitution is very important criteria as we
define the categories, when we get into too
much detail on the product-by-product basis,
that can create some -- we can draw things with
too fine a brush.

   Q. I guess in that regard, whether or
not a new product competes with something that we currently understand that's -- or currently defined as a fluid milk product, should that be a criteria the Department should rely upon?

A. On a case-by-case basis or in defining the rule in this proceeding?

Q. You can feel free to answer both ways.

A. I don't think it's appropriate for -- I think defining -- generally defining form and use on the basis of physical composition and beverage, intended use as a beverage, should be the basis for the case-by-case accounting. I think consideration of the substitution is going to be a basis for deciding what the rules are going to be.

Again, we think the rules right now are good except for these exceptions that we are asking for based -- they have stood up pretty well, and we are dealing with a substantial hole that's been generated by new technologies, and that's the kind of thing we have to respond to.

Q. Should one of the criteria be
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whether or not classification in Class I
increases -- or, excuse me, yeah, Class I --
whether or not it increases producer income,
producer revenue? Should that be a criteria?

A. I don't -- I don't really see how --
that was a criterion established in the program
itself. I'm not sure how we can really say
that it can be a criteria in defining Class I.

I think that's -- I think that it
either falls out from the other criteria or it
doesn't. I don't think it's an appropriate
basis for considering that in this proceeding.

Q. You've had a lot of questions
regarding how you came to know the
classification that's of the various dairy
products that you have on Page 16 of your
testimony in Appendix B, and on your sources,
you say how you came up with these things had
to do with product labels and consultation of a
couple of different web sites, and USDA.

If you were able to contact USDA and
get the names of individual products and what
classification that they are under, what was
your need to rely on these other things like
Dr. Cryan - Cross - by Mr. Tosi

other sources like product labels, bevnet.com, and peapod.com?

A. Well, the objective here was to -- I don't think -- if I call you all and you give me -- tell me what class the product is in, you are not necessarily going to tell me -- I never asked, but I didn't think you were going to tell me -- give me a copy of the label or tell me what the retail price is.

So one of the objectives of this table is to show on a protein accounting basis what proportion of the product is milk and to kind of line them up from top to bottom to get some sort of sense that it was kind of an exercise in showing the list -- show the list of people and say, well, where do you think the line ought to be?

Some people will look at the list and say -- all the way down at the bottom, when we were getting started with this stuff, I had -- I had what I called a Yoo-Hoo test. I would say, "Do you think Yoo-Hoo should be Class I or Class II?" And, basically, you could tell just from that answer to that
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question where people were going to fall out on this whole issue.

And then, of course, getting the retail price in there and Class I, Class II values, the average Class I, Class II values, all that allows us to make a reasonable comparison of the impact of reclassification -- well, the impact of the difference between Class I and Class II, what that has on the retail price. That is what it is, a retail price.

Which this isn't a retail price -- the difference based on the numbers prices I projected for Class I, II, and IV, for 2005 at the beginning of the year, I expected that the Class I price for raw milk would be 16.6 percent higher than the Class II price.

If I contrast the reclassification of -- well, 'N Sunny would increase to 64 ounce package from -- by 2.6 cents, only 9.9 percent, so you see the differences in the impact of the -- you see the differences among these products, types of products, and the volumes and the sizes of the products and how
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an increase from two to one would affect their retail price, assuming it passed the --

Q I understand what your Appendix B is, the information and what the intent of the information that you are portraying. I'm just getting at your knowledge of how the products that you are saying are currently Class I are Class I; products that you are saying are Class II, how you know those things.

If USDA was going to -- all you had to do was call them and say, hey, by the way, what is the classification on Raging Cow, for example, that we would give it to you.

A I'm sorry, I don't understand the question. Why --

Q Well, you are saying that the sources of -- you named products here?

A Yes. I could have --

Q Actually existed --

A I could have asked you for any of it is my understanding. I could have gone and asked one by one, I think, and gotten -- I don't remember. I mean, it's been a while.

Q Right.
Dr. Cryan - Cross - by Mr. Tosi

A. I -- you know, I've asked -- I've talked to a lot of people about a classification price, but it's generally been consistent. It's been very consistent when I had a product by the content suggested itself to be a Class II product, it was a Class II product.

    It was only a handful of products that were on the line when I checked, and almost always there was consistency in that. They were always -- so I didn't check all of them because --

Q. I was asking you in furtherance to the previous questions that Mr. Vetne was asking you and concern about the potential release of information the Department considered to be proprietary --

A. Okay.

Q. -- and a confidential matter between the Department and the manufacturer of a product.

A. Okay.

Q. So I just -- it just struck me as curious that why would you need to consult
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product labeling, bevnet.com, and peapod.com if you could have called us? Your testimony suggested that people at the Department told you what the classifications were of some of these products.

A. Well, I don't remember. I mean, I probably -- it might have been -- okay. Let's see.

I had most of the things -- I had these compositions laid out, and it might have been, you know, translated to hypotheticals. I don't know. I'm sorry, I'm not sure what --

Q. That's all right. Just leave it at that.

If we adopt the proposal, and if it turns out that the adoption of your proposal would cause certain products that are currently classified as something other than Class I, something lower than Class I, to the extent that it would result in them meeting the fluid milk product definition, how would you suggest that the Secretary give notice to folks that the product that they are currently producing is no longer, for example, Class II, and that
Dr. Cryan - Cross - by Mr. Tosi

as a result of these changes that we're considering, their product is now a Class I milk product and would be priced accordingly?

A. I guess I wouldn't -- I wouldn't suggest a way to do it. I mean, I know that when changes are made in order form, the Market Administrators kind of did a campaign to inform all handlers what the changes are and how they are going to be affected.

They brought staff out to the plants to explain things and made sure there were no misunderstandings. I assume you would take some approach like that, but I wouldn't presume to tell you how to go about doing that.

Q. For example, would you think that giving the industry 60 days' notice would be reasonable? 90 days? Six months, 12 months?

A. I suppose whatever is normal for the implementation of an order memo. I don't know why this would be different, again, I'm not -- since I'm not aware of any products that would be affected by this.

Q. Okay. Antoinette, my colleague, would like to ask you a few questions. Thank
Dr. Cryan - Cross - by Ms. Carter

you, I appreciate your answers.

A. You're welcome.

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CROSS-EXAMINATION

BY MS. CARTER:

Q. Antoinette Carter, USDA. Good afternoon, Roger.

A. Good afternoon, Antoinette.

Q. I have a few questions regarding Appendix B. If you could just kind of walk through that with me.

You mentioned some projections for the Class I, II, and IV prices for 2005.

A. Right.

Q. Are those annual projections or --

A. Those were projections as of the beginning of the year for the class prices for Class I, II, and IV. The only reason I had four in there for the products that are over 100 percent -- over 100 percent milk equivalent, I calculated out the value based on for the Class I products.

For the Class II products, I calculated the value total milk equivalent at
Dr. Cryan - Cross - by Ms. Carter

Class II, and for the ones that are Class I, I calculated up to 100 percent in Class I, and then the balance of Class IV is fortification.

Q. Could you run through those projections in terms of those prices. I think you mentioned them real briefly earlier.

A. Well, I made projections at the beginning of the year. I presume the table could be changed, but the beginning of the year I put this table together, not when I first -- when I first put this version of the table together, I had projected Class I, II, and IV prices for the calendar year, but I don't have those with me.

They were roughly what the futures markets were predicting first week or two of January. That's when I put the table together. There may be some differences based on later projections.

Q. If you could, could you walk through the raw milk value, Class I, Class II, and the difference in how you calculated percentage for the retail.

A. Sure. For example, take the
Dr. Cryan - Cross - by Ms. Carter

simplest example, italicized and highlighted, the line that says "producer milk and producer price." I took the projected Class I and Class II prices that was projected for the year and scaled those down to a gallon, 128 ounces, and that gave us $1.32 and $1.10 per gallon as the raw milk prices in Class I and Class II. The difference between those two is 22 cents per gallon, and for retail price, I just went ahead and put the Class I value. The difference from going from one to two is 16 percent (check).

To take a related example, the whole milk one below that is also based on the gallon and protein-basis, I worked that to 98 percent of a gallon based on the compositional information I had from the USDA -- the ARS nutritional database, the protein test was 98 percent of the protein test for a gallon of producer milk.

The retail price I found on peapod.com, which is the Giant delivery on-line shopping groceries -- I'm sorry, peapod.com is on-line grocery retailer run by Giant in the
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Washington area and a few other cities. The retail price they were offering through that site for whole milk was $3.99, which was about the time -- which was about the same as the store price.

A gallon of 98 percent milk at the Class I price I had projected was $1.26, Class II was $1.04. The difference one for the other was 21.6 cents, and that difference was equal to 4. -- 5.4 percent of the retail price of $3.99. So that in all these cases, the objective is to show the difference in the raw milk cost between Class I and Class II as a percentage of the retail price.

So that we could get a better sense of what the real impact is when you raise the raw milk cost in some study that I've seen, I believe will be presented later this week, there are comparisons of -- comparisons of two different products, and the impact based on certain demand elasticities, elasticities of demand that don't really take into account the fact that certain products have a much higher share of the retail price in the raw milk than
Dr. Cryan - Cross - by Ms. Carter

others do.

If the raw milk value is a small
share of the retail value, then the increase in
that one particular raw product cost is not
going to have -- if that is increased by one
percent, retail price of the product drive is
not going to go up by one percent, it's going
to go up by some smaller share based on its
proportion with the retail price.

Q. As part of your proposal, I think
you have referred to it as in switching from a
6.5 nonfat milk solids standard to a protein
equivalent standard, that you're really sort of
providing a better accounting method.

But in addition to that, as part of
your proposal, you are also requesting that
additional milk-derived ingredients be included
in calculating that standard?

A. Yes, that's a change.

Q. Is it your -- if your proposal is
adopted, do you suggest that those milk-derived
ingredients or dairy ingredients be codified
and be a part of the code?

A. Do you mean do I suggest they be
Dr. Cryan - Cross - by Ms. Carter

Q. Right.
A. The way you list the other products in the Class I category?
Q. Yes.
A. I don't see why not to say products such as these would but not limited to that kind of thing, sure.
Q. In your opinion, what is the justification for including these milk-derived ingredients in the calculation of a protein equivalent standard?
A. I think the larger issue is what is the justification for excluding them? I don't see the justification for excluding them. I -- there was a processing technology, who is right or wrong?

I'm not sure why they made a specific decision to exclude, for example, sodium caseinate at one time. If it's going to be used in a beverage, then why not include it? If it's not suitable for beverage use, why worry about excluding it?

I would say that really the better
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question is what the justification is for excluding it. If we include them, then we are in a better position with respect to advances in technology. If we think that they are not satisfactory -- if they are satisfactory products for use in dairy beverages, then we should include them now because they should be in there now, and if they are not satisfactory, then we should put them in there for prospective reasons.

Q. If adopted and these milk-derived ingredients are included, do you foresee any additional reporting requirements that would be placed on handlers?

A. I guess -- I suppose ingredients used for fortification or reconstitution would probably have to include specifications of protein content. If -- there shouldn't be any changes for use of nonfat dry milk.

Any ingredients that don't change the portions of protein to nonfat solids from the milk, I don't see the reason to change the accounting for the ingredients that are protein concentrated or protein dilute, whey.
Dr. Cryan - Cross - by Ms. Carter

For whey protein concentrates or whey protein dilute, anything that has -- any dairy ingredient that has some sort of unusual proportions of protein to nonfat solids, there would probably need to be some accounting if the product goes into Class I utilization. At least for qualification.

So there would -- there may have to be some additional reporting of protein tests for ingredients.

Q. In your opinion, do you think these additional reporting requirements would be minimum or place a significant burden in terms of reporting on handlers?

A. You know, added on to the -- added on to the requirements of audit, I don't see what -- that it would be a substantial burden. I think when you use an ingredient, you know what the composition is. The formulation is based on the -- what the ingredient is.

So if you are keeping records, usually those records should include the accounting of what the ingredient is and access to the specs, so I don't know that that should
Dr. Cryan - Cross - by Ms. Carter
really be a substantially great burden.

Q. So your testimony is that that
information should already be available to the
handlers and that they would just be reporting
it now or be required to report that as part of
the report to utilization?

A. Yes. There might be some slight --
for most of them, I don't imagine there would
be additional recordkeeping, but for some there
might be some if they are not keeping track of
individual ingredients for each batch.

But I think that that's a standard
practice. Of course -- well, okay.

Q. On Page 10 of your statement, it's
the second full paragraph, you state that on
your request that the decision from this
hearing makes such a definition of whey
explicit to avoid impacts from future
alternative interpretations by FDA.

Could you explain what you mean by
that statement.

A. FDA does make changes from time to
time in how they define things, as we all know.
Their purposes are not always the same as
Dr. Cryan - Cross - by Mr. Wilson

purposes of the Federal Order in defining products.

So I think it would be reasonable to recognize this -- essentially the convenience of using the current definition, but to incorporate it independently of the FDA regulations so it's clear for purposes of this regulation that the objective is to provide a pricing exemption only for whey that's been derived from the process of coagulation of the cheese.

MS. CARTER: Thank you.

That's all I have.

THE WITNESS: Thank you.

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CROSS-EXAMINATION

BY MR. WILSON:

Q. Good afternoon, Roger. Todd Wilson, U.S. Department of Agriculture.

A. Nice to see you.

Q. Again, I would like to ask a couple of questions or a few questions that I also asked Mr. Hollon.

In the fluid milk product definition
Dr. Cryan - Cross - by Mr. Wilson

that you identified in your testimony, there is
a description of what a concentrated product is
as used in this part.

As that relates to total solids, do
you have an opinion whether or not that
definition is outdated as the solids nonfat
definition that is in your current proposal,
you are modifying that to now look at protein?

A. I'm sorry, which definition? The
25.5 percent?

Q. Yes.

A. Per concentrated milk?

Q. Yes.

A. I always assumed that those
percentages were based somehow on, you know,
the functional ability -- the viscosity of the
milk product. That there was some assumption
if you had over 25.5 percent milk solids, it
was not drinkable. If you had over 50 percent,
you couldn't really pump it.

But I don't know -- I don't know --
that's just my guess, and I shouldn't even say
that because it's just a guess, but I'm not
sure what the basis for that would be.
Dr. Cryan - Cross - by Mr. Wilson

Q. Let me ask it a different way.
The definition of the concentrated product in that definition is anything between 25.5 and 50 percent total solids, so as the language is written, if it's less than 25.5 percent total solids, it's not a fluid milk product?

A. If it's less than 25.5 percent it's not a fluid milk product; is that what you are saying?

Q. Correct.

A. So there's a gap between -- I'm sorry, I don't understand.

Q. If a product has 26 percent total solids, it's a concentrated product.

A. Okay.

Q. If the product has 15 percent total solids, it's not a concentrated product.

A. Okay.

Q. And thus not a fluid milk product in this definition possibly, what is your opinion of that?

A. I am not aware of that. I do think -- it's important that definitions abut
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and don't leave gaps so that you know how to
treat any product of any composition.

That's been an issue for I guess in
some cases here, and I know it's been an issue
for the simple reporting at NAS, and these are
the kinds of things that should be addressed.

If there are gaps between products
where you have gaps where product falls into
some category that nobody knows what they are
or the Class II catch-all without being
intended to, I guess we should fill the gaps.

Q. The composition standards that
you've identified that you are modifying the
2.25 percent protein as product is
concentrated, sometimes it leaves the point of
processing and then is used to -- when it gets
to the consumer, the consumer then modifies it
through another process at the consumer level.

Would you have -- would you offer
some insight to at what time do we apply those
composition standards? Is it at the time when
the product is made at the facility or is it at
the intended use to the consumer?

A. I don't think we would propose to
Dr. Cryan - Cross - by Mr. Wilson

start charging Class I for, you know, consumer practice of nonfat dry milk. I think that's -- I think we should, unless there's some issue that hasn't been raised -- unless there's some issue I'm not aware of -- I think we probably should stick with the way we've been doing it. And there may be an issue I'm not aware of. There are some of those.

Q. I'm thinking of a product that might be in it's concentrated form, and when it leaves the facility, it's packaged in a unique container that is specific to a machine that only takes that particular container, and then is possibly rehydrated, reconstituted at the consumer level with water at that -- at the consumer level.

A. Like a soda dispenser?

Q. Yes. Or even a milk dispenser or --

A. It's the same principal. There's a concentrate that's --

Q. Exactly.

A. Okay. Well, I guess I don't have any say about that. I don't -- I don't know enough about it.
Dr. Cryan - Cross - by Mr. Wilson

Q. When you identify the whey and the whey products, whey solids in your definition, are you aware of any products that currently combine whey solids with, for instance, MPC solids or flavoring solids and then market that as a special blend and how would you -- would you count only those MPC solids, for instance, in the up-charge in your proposal?

A. Are you talking about some sold as a liquid or some sold as a powder?

Q. Dry powder.

A. I wouldn't propose to up-charge those if they are sold to consumers as a dry mix, I don't know -- I don't know that I would recommend that we up-charge that. That would be a change from the current procedure; isn't that right?

Q. If MPC is dried at a facility from fresh milk and whey is dried at a facility from coagulated cheese production and those two are combined into one blended powder that is then reprocessed into a fluid milk beverage that it meets all the definitions in your proposal, so we have --
Dr. Cryan - Cross - by Mr. Wilson

A. We are not talking about the consumer buying the dry mix, you are talking about --

Q. A processing facility.

A. -- a dry mix being sent to another plant and being reconstituted?

Q. Correct.

A. I suppose it would -- I suppose if there's -- if the facility is processing over 150,000 pounds, they would become regulated as a plant. If it's a cafeteria that's doing, you know, 3,000 pounds a month, there would be nothing to do on that basis.

Q. In your proposal you are exempting whey and whey solids from the up-charge portion of your proposal. Would you also exclude the whey and whey solids of that blended mixed product, powder that is, from the up-charge also?

A. If you are calling it a Class I -- if you are -- if there's -- I mean, it's --

Q. Let me rephrase, please.

A. Okay.

Q. If you have nonfat dry milk and you
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combined it with whey powder to make it a blended specialty powder and there's a lot of -- I believe there's a lot of specialty powders out on the market that processors can utilize -- and they take this product and they put it into 2 percent milk to fortify their 2 percent milk --

A. Okay.

Q. -- would you up-charge only the nonfat dry milk or would you up-charge the nonfat dry milk in the whey solids that are part of that special blend?

A. You mean because of the volume added to -- because of the fortification?

Q. Because of the proposal of exempting whey solids.

A. I'm not sure I -- if you are using it to fortify milk; correct?

Q. Yes.

A. And you are putting this whey powder MPC blend into the -- into milk for fortification?

Q. Correct.

A. And you are talking about the
Dr. Cryan - Cross - by Mr. Wilson

up-charge here. You are only talking about that small volume that increases --

Q. Right. Correct.

A. That's a pretty fine point. I -- I will leave it to you. Pretty small point on a small volume.

Q. Well, it might be a small volume on 2 percent milk, but what if you were to take the same powder, put water back in and reconstitute and make a fluid milk product 2.25 percent protein?

A. I think the key there is to treat the whey as if it was sugar or dirt, or whatever else they put in some of the stuff, and then there's not really a real question after that.

You know how to treat starch and chocolate and sugar and stuff like that, so I would treat it the same way. I don't see why you would treat it any differently.

Once you've established that you are qualifying the product as a Class I product, that any whey ingredient added to the product is -- should really be treated as if it was a
nondairy ingredient.

Probably most of the questions about that kind of thing just fall out from that and most of the answers just fall out from that.

Q. On Page 6 of your testimony, you made reference to a protein equivalent. Are you talking about a milk equivalent based on protein in that context?

A. Yes. I believe so. Yes. I say the protein equivalent accounting system.

Q. I don't know. I have to look at the document. The protein equivalent accounting system paragraph.

A. By that I mean counting these modified fluid milk products, that is the skim solid modified fluid milk products, on the basis of the milk equivalent on the protein basis.

And I would one more time, or more than one more time, emphasize again how similar the argument for skim and butterfat is -- skim and butterfat and reclassifying skim and low-fat milk into the Class I in the '60s -- how similar that is to what the situation we
Dr. Cryan - Cross - by Mr. Wilson

are looking at now.

They are so close that you have to -- if you believe -- if you believe the logic from 1968, you have to believe the logic from 2005 because it's the identical argument.

Q On Page 8 of your testimony, you have some ratios. One of them is the average test, I believe protein test, versus the average nonfat solids test, and then another one, the middle of the page, is protein nonfat solids, also.

When we're looking at those ratios, the top one is impacted by butterfat; would you agree?

A. The ratio between protein and nonfat solids is impacted by butterfat or the absolute numbers of protein and nonfat solids?

Q I believe the absolute numbers.

A. Yes, the absolute numbers are affected. The ratio between the two should not.

Q The middle column or the middle ratio is not. It's on the skim milk portion basis, 3.1 percent protein and skim milk is
Dr. Cryan - Cross - by Mr. Wilson

What the pricing formulas are based on?

A. Right.

Q. When you go to Page 9, the second paragraph, the very last sentence, protein to other solids?

A. Yes.

Q. Okay.

A. I'm sorry?

Q. You referenced other solids in that?

A. Protein -- well, the -- I'm changing -- okay. Because I'm not referring to any specific number there, that still follows logically, but I couldn't understand why it would be more consistent to talk about total nonfat solids.

But either way, you can change that if you want in either case, because I'm not talking about specific numbers, the logic still follows. Consistent protein to other solids ratio is the same as consistent -- consistent protein to other solids ratio is the same as consistent protein to nonfat solids ratio.

Q. You revert back a little bit to whey and whey products in your exclusion.
If I understand it correctly, in your proposal, if you were to take a product and add it to a whey solid, the casein protein, would that then be a fluid milk product?

A. I'm sorry, I don't understand your question. To take -- if it was added to a casein and whey proteins?

Q. Let me rephrase. I may have stated it wrong.

If in fractionization you were able to fractionate out the proteins from the lactose, if you would take that casein protein and replace it with whey --

A. Whey produced from the cheese-making process?

Q. Yes. So you end up having a term we call permeate, it's the portion of the casein and is removed?

A. Right. So adding --

Q. If you combine that with whey protein, you are just replacing protein; correct? Whey protein from coagulated cheese process with milk protein?

A. In what product?
Dr. Cryan - Cross - by Mr. Wilson

Q. In a fluid product, in a beverage.
A. Okay.
Q. In a formulated product.
A. So you have a product where you have whey protein, and you separate it from lactose and recombining it with lactose to make a fluid milk product, that's the hypothetical?
Q. That's correct.
A. Okay.
Q. Is it a fluid milk product?
A. Well, if it's over 2. -- according to my proposal -- according to National Milk's proposal, if it's over 2.25 percent protein, it is a fluid milk product, but if all the protein is whey, then it's not priced, so the volume is equivalent to zero.
Q. Do you know if whey protein solids can be manufactured through anything but the cheese-making process?
A. It's my presumption that you can separate the same proteins in other ways, and if you cannot now, I'm sure you will at some point.

But, again, this proposal for the
Dr. Cryan - Cross - by Mr. Wilson

treatment of whey depends specifically on the whey being derived from the cheese-making process, which is why I suggested that that definition be enshrined in the language.

Q. If you were to look at a whey powder, will you be able to tell the difference between that whey made from the cheese process and possibly in the future a whey powder made from another process without ever going through the cheese process?

A. Well, I think there's -- I guess there's a lot of situations where you can't necessarily tell from your finished product as to whether the product has one component or another. So you really have to depend on the accounting at the plant and that's -- that would probably be the case there, too.

I don't know whether there's a way to separate it out to find it, you know, in the lab or not, so -- but I'm sure when you look at the whole system there are ways to address it.

Q. There was a previous question to Mr. Hollon, I believe Mr. Vetne posed it, that talked about currently there's some processes
Dr. Cryan - Cross - by Mr. Wilson

whereby used to produce, a form of used to produce, is accounted for for Class I products. For example, flavored milk might be one case. We don't account for the entire volume of what is in the container for flavored milk, we factor out the flavorings and things. Do you see any advantages in your proposals that might lead to a Class I used to produce category?

A. You think a consistent protein accounting is only -- if you have a consistent protein accounting, the disposition in used to produce are identical in respect to those nonstandardized products. In fact, I can't think of a way that they wouldn't be identical. If you are doing -- maybe I am missing something, but it certainly brings them closer together. Using consistent, you know, protein-based milk equivalent accounting for these nonstandardized products does get to be relatively close to establishing used to produce for these category products.

Of course, used to produce is
Dr. Cryan - Cross - by Mr. Wilson

another way to address these things. But, again, you have to establish the basis for defining the volume of the used to produce since used to produce by itself still leaves some questions, some holes, because you can have milk -- you can have a volume of milk used to produce several things and was told used to produce would be some volume of the original volume of milk.

If you fractionate and you use all the lactose to do one thing and all the casein to do another thing and all the whey to do something else -- the whey fractionated proteins that would be in whey -- to do something else, and you account for each one of the volumes on the basis of milk used to produce the product, you could use 100 pounds of milk, but according to accounting, you used 200 pounds of milk to produce all these products.

So there should be some consistent accounting approach, accounting basis for skim solids. A total protein accounting basis for skim solids is the best way to bring all these
Dr. Cryan - Cross - by Mr. Wilson

things in line with one another. Once you do
that, it hardly matters whether you are doing
it on the basis of disposition or used to
produce.

Q. Basically getting back to 100
pounds?

A. Yes. That's what I think off the
top of my head, but I'm not sure. I think I
have that right. You better double-check that
before we put it in the regulation.

Q. One last question. Also including
in the product definition as we currently have
it and you have put in your testimony, I would
like to discuss maybe another product or
another composition standard, the nine percent
butterfat standard.

If a product is manufactured that
has greater than nine percent that's used as an
energy drink or, you know, some kind of other
drink, do you think that should be a fluid milk
product?

A. It has more than nine percent?

Q. And can be used as a beverage.

A. Well, nine percent butterfat is not
Dr. Cryan - Cross - by Mr. Yonkers

going to be used as a dodge because butterfat
is expensive, and I think that the decisions
that led to the nine percent were reasonably or
really getting into a cream product.

I don’t have a problem with leaving
the nine percent top limit in there because it
is a relatively straightforward, consistent
physical product composition test. I think
it’s reasonable.

MR. WILSON: That’s all I
have. Thank you very much.

THE WITNESS: Thank you.

JUDGE DAVENPORT: Mr. Yonkers?

MR. YONKERS: I have a quick
follow-up question.

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CROSS-EXAMINATION

BY MR. YONKERS:

Q. I believe it was a question
Ms. Carter had, Roger.

In your Appendix B on producer milk
where you have the raw milk value, it’s 1.32
per gallon; do you see that?

A. Uh-huh.
Dr. Cryan - Cross - by Mr. Yonkers

Q: What Class I differential did you assume when you calculated that? I think you answered her about how you got your milk price forecast for 2005, but you had to assume some Class I differential.

A: I don't know if I used -- there's a weighted average for the country about 2.58. I don't know if I used that or not. I'm not sure. I would have to do the calculations to double-check, go back with the spreadsheet.

Q: When you called that the raw milk value, did you include over-order premiums?

A: I doubt it.

Q: So if you had -- we only have published over-order premiums on Class I, I've never seen any on Class II, that would increase that difference; wouldn't it?

A: There are premiums on Class II in a lot of markets, but they are not as large as they are in Class I. So it would increase the difference.

Q: Thank you.

A: That's assuming that they are treated the same way. I mean, that's assuming
that these Class II beverage uses don't have any demands on suppliers that are over and above normal Class II supplier requirements, and that there's no special premium for these products compared to any other Class II products. But it's probably a reasonable assumption.

MR. YONKERS: Thank you.

JUDGE DAVENPORT: Given the hour, this appears to be a good time to recess for the evening. The starting time in the morning is eight o'clock; is that still okay?

MR. BESHORE: Eight o'clock. Are we concluded? Is Dr. Cryan concluded?

JUDGE DAVENPORT: Let's ask if there are any additional questions in the morning, and then if not, then he will stand excused at that time.

MR. YALE: Could we in the morning have a list of who else is going to be testifying?

JUDGE DAVENPORT: I think that's probably a good thing, and also a proposed schedule for the morning, and also
identifying any people that have specific needs as they appear. I want to assure you that I will make sure that everybody has an opportunity to be heard and heard in a reasonable fashion.

MR. YONKERS: Can we do that the first thing in the morning before eight, is come down and --

JUDGE DAVENPORT: We can do that at eight.

MR. YONKERS: On the record or off is my question?

JUDGE DAVENPORT: You know, if you want to come up, if you want to meet informally prior to eight, I have no objection to you all doing that.

(Whereupon, the above-entitled matter was adjourned at 5:36 p.m., this date.)

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CERTIFICATE

I hereby certify that the proceedings and evidence are contained fully and accurately in the stenographic notes taken by me on the hearing of the within cause and that this is a correct transcript of the same.

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