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USDA - FEDERAL MILK ORDER HEARING

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

Tuesday, June 21, 2005
8:00 a.m.

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

TRANSCRIPT OF PROCEEDINGS

VOLUME II

Reported by:
Sandra J. Mastay
Professional Court
Reporter

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1

2 APPEARANCES:

3 U. S. Department of Office of the General
4 Agriculture: Counsel
 by Garrett B.
5 Stevens,
 Deputy Assistant
6 General Counsel

7 U. S. Department of Gino M. Tosi
8 Agricultural Marketing Antoinette M. Carter
 Specialists: Erin C. Taylor
 Richard L. Cherry

9 Texas Market Todd Wilson
10 Administrators:

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

13 Select Milk Producers, Yale Law Firm
14 Inc., and Continental by Benjamin F. Yale,
 Dairy Products, Inc.: Esq.

15 General Mills: Deb Grocholski,
 Associate General
16 Counsel

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

19 HP Hood and Chelsea Lois Jewell &
20 Mass.: Associates, P.C.
 by John H. Vetne,
 Esq.

21 National Yogurt Cooley Godward, LLP
22 Association: by Aaron F. Olsen,
 Esq.

23

24

25

1

2 APPEARANCES (CONT.):

3 Bravo! Foods Inter- Linwood Tipton
4 national Corp.,
5 Lifeway Foods, Inc.,
6 Pepsico, Starbucks
7 Corporation, and
8 Unilever:

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

12 Dannon Company, Inc.: James Box

13 Milk Industry
14 Foundation: Robert Yonkers

15 Farm Wives United: Tinamarie Carlin

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P R O C E E D I N G S

JUDGE DAVENPORT: Mr. Carlin,
why don't you come forward at this time. Raise
your right hand, please.

GERALD CARLIN

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

JUDGE DAVENPORT: Would you
tell us your full name, please.

THE WITNESS: My name is
Gerald Carlin.

JUDGE DAVENPORT: And is that
C-A-R-L-I-N?

THE WITNESS: Right.
(Exhibit No. 16 was marked for
identification.)

JUDGE DAVENPORT: Mr. Carlin,
you have a statement. I have marked that
statement as Exhibit 16. Are you prepared to
read your statement into the record at this
time?

THE WITNESS: Okay. Your

1 G. Carlin - Direct Testimony

2 Honor, thank you for allowing me to testify
3 today. My name is Gerald Carlin. My wife,
4 four children and I own and operate a dairy
5 farm in Susquehanna County, Pennsylvania. I am
6 here today because I believe the issues being
7 discussed are very important. The outcome of
8 this hearing could have a profound impact on my
9 business, on U.S. dairy farmers in general, and
10 on the quality and integrity of dairy products.

11 Of particular concern to me are a
12 number of proposals before the Department of
13 Agriculture, Agricultural Marketing Services,
14 which would legitimize and allow the use of
15 caseinates and milk protein concentrates in
16 Class I fluid milk products. Please note that
17 MPC still does not have Generally Regarded As
18 Safe status with the Food and Drug
19 Administration.

20 There have been petitions before the
21 FDA now for over five years, and they have not
22 been approved yet. It is not allowed in
23 standardized cheese. In fact, in a FDA warning
24 letter to Kraft Foods North America, Inc.,
25 dated December 18, 2002, Kraft Foods was found

1 G. Carlin - Direct Testimony
2 in violation of Title 21 Code of Federal
3 Regulations, part 133 (21 CFR 133). Please
4 note on page two, paragraph one, and page
5 three, paragraph three, that Kraft products
6 were misbranded in that it purported to be or
7 is represented as a food for which a definition
8 and standard of identity have been established.
9 Fluid milk is held to an even higher standard
10 than cheese.

11 According to an August 13, 2003,
12 letter from Center for Food Safety and Applied
13 Nutrition, Department of Health and Human
14 Services, to John Bunting, no scientific
15 studies have been done on human safety of
16 consuming MPC.

17 It is a curious thing to me why
18 after so much pressure has been applied there
19 is still refusal by the industry to do safety
20 testing on MPC. Perhaps it is because there is
21 no standard of identity for milk protein
22 concentrate. Harmonized Tariff Schedule 404901
23 covers milk protein concentrates with protein
24 levels of 40 to 90 percent. Harmonized Tariff
25 Schedule 3501 covers milk protein concentrates

1 G. Carlin - Direct Testimony

2 with protein levels over 90 percent.
3 Regulatory agencies have not agreed on any
4 standard of identity for milk protein
5 concentrates.

6 It is my understanding that, in
7 general, the more a food is processed, the less
8 nutrients are digestible. Proteins are quite
9 delicate, and a change in structure could
10 affect the way the body utilizes them.

11 Clearly, there is a distinction
12 between Grade A and Grade B milk. The two are
13 not to come in contact with each other.
14 Equipment must be thoroughly washed and
15 sanitized between the handling of Grade B and
16 Grade A milk. Yet if proposals are approved
17 allowing MPC and casein in Class I milk,
18 Grade B product would be mixed right in with
19 Grade A.

20 The Grade A pasteurizing milk
21 ordinances, especially pages 17 through 21,
22 talk about the examination of milk and the
23 enforcement of rules, and it is my
24 understanding that there really is not
25 examination of milk products that come in from

1 G. Carlin - Direct Testimony

2 other countries, certainly not examination by
3 the FDA or any other U.S. regulatory agency on
4 the farms where it is produced.

5 In reference to inspection, a milk
6 sample is taken from every dairy farm in the
7 United States every time the milk is picked up,
8 and a sample is taken from every compartment of
9 every bulk milk truck when it is delivered to
10 the plant. Yet according to GA0-01-326,
11 Ultra-Filtered Milk, page nine, paragraph two,
12 "Products such as milk protein concentrates,
13 which are believed to pose minimal safety
14 risks, are frequently released automatically.
15 FDA annually inspects or conducts laboratory
16 analyses on less than 2 percent of all types of
17 imported food shipments."

18 It is a slap in the face to U.S.
19 dairymen to allow uninspected and unregulated
20 dairy products to be mixed in with our
21 regulated and inspected domestic milk.

22 Almost all MPC and caseins are
23 imported. These products come from many
24 countries. Even though there is an effort to
25 produce MPC and casein domestically, such

1 G. Carlin - Direct Testimony

2 production is not economically feasible without
3 subsidy. I believe the bill in Congress,
4 HR 4223, would give evidence it is not feasible
5 without subsidy since there is an effort to
6 subsidize it.

7 Even though we are a milk deficit
8 nation, where will this extra milk come from?
9 MPC imports are increasing and casein imports
10 remain as strong as ever. Any claim that only
11 domestic MPC or casein would be used in fluid
12 beverage milk would be preposterous. Domestic
13 production of MPC or casein only serves to
14 cloud any distinction between domestic and
15 imported dairy products while giving a false
16 impression of better quality.

17 I realize that the proposals to
18 apply Class I price to milk proteins in fluid
19 milk that are derived from MPC and casein give
20 the illusion of increasing farm milk prices.
21 Really, though, who will get the money from
22 these proteins? Will foreign producers
23 benefit? I think it is quite clear that
24 processors will benefit by these proposals, or
25 at least the coops will, because they will

1 T. Carlin - Direct Testimony
2 probably hold that extra money from the dairy
3 proteins while the farmer, the dairy farmer's
4 pay price, will be eroded by diluting the
5 Class I market. Not only so, but milk's image
6 could be tarnished by allowing questionable
7 ingredients to be added and legitimizing that
8 which is illegitimate.

9 I strongly urge USDA to maintain its
10 current definition for Class I milk. Thank
11 you.

12 JUDGE DAVENPORT: Very well.
13 Examination of this witness?

14 Mr. Carlin, you may step down.
15 Mrs. Carlin, do you want to step forward.
16 Mrs. Carlin, will you raise rise your right
17 hand.

18 -----

19 TINAMARIE CARLIN

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

22 -----

23 JUDGE DAVENPORT: Your name is
24 Tinamarie Carlin?

25 THE WITNESS: Yes.

1 T. Carlin - Direct Testimony

2 JUDGE DAVENPORT: It's

3 T-I-N-A-M-A-R-I-E Carlin, C-A-R-L-I-N?

4 THE WITNESS: Yes.

5 JUDGE DAVENPORT: You are

6 Gerald Carlin's wife?

7 THE WITNESS: Yes.

8 JUDGE DAVENPORT: Very well.

9 Please, as you speak, speak into the microphone
10 and keep your voice up because we have a lot of
11 people that are here today.

12 THE WITNESS: Thank you. Your
13 Honor, I am Tinamarie Carlin, a member of Farm
14 Wives United, a group of farm wives from
15 New York and Pennsylvania who are concerned
16 with the injustices going on in agriculture
17 here in the United States.

18 My husband Gerald is a fourth
19 generation dairy farmer. We farm in
20 Susquehanna County, Pennsylvania. Our farm has
21 been in Gerald's family for over a hundred
22 years. Together we are raising our son, age
23 15, and three daughters ages 15, 13 and 12, and
24 they are the reason why I am here today.

25 One of the major reasons for the low

1 T. Carlin - Direct Testimony

2 milk prices being paid to dairy farmers here in
3 the United States is that many cheese
4 processors illegally use an inexpensive and
5 plentiful imported product called milk protein
6 concentrate. By using MPC, these processors
7 inflate their profits and deflate the milk
8 prices paid to dairy farmers. In some cases,
9 MPC is a by-product left over from the
10 manufacturing of dairy products or it is a
11 mixture of casein and nonfat dry milk.

12 I am very concerned about the
13 proposals which would allow MPC and casein to
14 be used in fluid milk. Traditionally, casein
15 has only been used in imitation products, and
16 MPC has not been safely tested by the Food and
17 Drug Administration and does not have Generally
18 Regarded As Safe status. Even though there has
19 been considerable pressure on the dairy
20 processing industry to do safety testing on
21 MPC, none has been done to date. What is the
22 processing industry trying to hide?

23 The biggest offender of the illegal
24 use of MPC is Kraft Foods North America, Inc.
25 Kraft has sidestepped FDA standards of identity

1 T. Carlin - Direct Testimony

2 by changing of their Kraft Singles with MPC as
3 an ingredient from "pasteurized process cheese
4 food" to "pasteurized prepared cheese product."

5 MPC has made what used to be a good
6 cheese into a product that is almost like
7 plastic. The cheese has a bad taste and does
8 not melt like it used to. It is no wonder that
9 Kraft is advertising that they add a little
10 magic into their Kraft Singles.

11 Our children watch these ads and
12 believe that what they are eating is good for
13 them when, in turn, these products have not had
14 any kind of safety testing done to them. The
15 more a food is processed, the fewer digestible
16 nutrients are available. Again I ask, What is
17 the processing industry trying to hide?

18 Another item that I would like to
19 mention is the "REAL" seal. According to the
20 guidelines for use of the "REAL" Seal, the
21 product must be a domestic consumer product.
22 This means it must be manufactured or processed
23 in a domestic facility and contains only
24 domestically produced dairy ingredients made in
25 the USA. The product cannot contain any

1 T. Carlin - Direct Testimony

2 casein, caseinate, vegetable oil or nondomestic
3 dairy protein or ingredient, or any cheese
4 substitute or cheese analog in it. I have
5 provided proof of that from the "REAL" Seal
6 website itself in my testimony.

7 I have found a product in our local
8 supermarket that has both the "REAL" Seal and
9 milk protein concentrate listed as one of its
10 ingredients. How is it that the processors can
11 get away with adding a nondomestic ingredient
12 and still be able to have the "REAL" Seal on
13 it? Also, how can these products be allowed in
14 Class I fluid milk?

15 I personally try to read labels and,
16 as a practice, will not intentionally buy
17 products with MPC listed on them. This is very
18 hard to do because there are over four dozen
19 products that my family enjoys eating that have
20 MPC as an ingredient.

21 As the wife of a dairy farmer and
22 mother of four, please do not change the
23 current regulations on fluid milk. Keep milk
24 wholesome in the United States. To do
25 otherwise would put our consumers at risk and

1 T. Carlin - Direct Testimony
2 devastate our dairy farmers by displacing
3 superior products with inferior products.
4 Thank you.

5 JUDGE DAVENPORT: Do we have
6 any examination of this witness?

7 Very well, Mrs. Carlin. You may
8 step down. Your exhibit is Exhibit 17. It
9 will be added to the record.

10 (Exhibit No. 17 was marked for
11 identification.)

12 JUDGE DAVENPORT: Mr. Farrell.
13 Counsel, this is No. 18 for identification at
14 this time.

15 (Exhibit No. 18 was marked for
16 identification.)

17 JUDGE DAVENPORT: Will you
18 raise your right hand.

19

20

CRAIG S. ALEXANDER

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

23

24

MR. HARNER: My name is Tim

25

Harner. I am representing O-AT-KA Milk

1 C. Alexander - Direct Testimony

2 Products Cooperative. Please state your name,
3 position and title.

4 THE WITNESS: My name is
5 Craig S. Alexander. I am currently the manager
6 of dairy ingredient sales and regulatory
7 affairs for O-AT-KA Milk Products.

8 MR. HARNER: Please state your
9 educational background.

10 THE WITNESS: I received a
11 bachelor of science degree at the State
12 University of New York at Albany and a master
13 of science degree in agricultural economics at
14 Cornell University in 1985.

15 MR. HARNER: Could you state
16 your experience in the dairy industry?

17 THE WITNESS: For the past
18 20 years, I have worked for Upstate Farms
19 Cooperative, Dairy Institute of California,
20 Cornell University, and O-AT-KA in a variety of
21 capacities involved with dairy economics,
22 market analysis, regulatory impact of state and
23 Federal Orders, and bulk milk and dairy
24 commodity sales. I have testified at numerous
25 state and federal hearings.

1 C. Alexander - Direct Testimony

2 MR. HARNER: Have you prepared
3 a statement marked as Exhibit 18?

4 THE WITNESS: I have.

5 MR. HARNER: Please read it.

6 THE WITNESS: O-AT-KA is owned
7 by the farmers belonging to Upstate Farms
8 Cooperative, Inc., Niagara Milk Cooperative,
9 Inc., and Dairylea Cooperative, Inc. Total
10 membership of these cooperatives is over 2,000
11 producers located in several northeastern
12 states.

13 O-AT-KA processed over 550 million
14 pounds of milk in 2004. O-AT-KA has about 300
15 employees. O-AT-KA manufactures a full line of
16 canned evaporated milk products, butter, nonfat
17 dry milk, and a variety of long shelf-life
18 specialty beverages in cans and glass bottles.
19 Included among these specialty beverages are
20 formulas for specialized dietary use, alcoholic
21 beverages, infant formulas, drinks with dairy
22 ingredients containing less than 6.5 percent
23 nonfat solids, including coffee products, and
24 formulas especially prepared for animal use.

25 None of O-AT-KA's long shelf-life

1 C. Alexander - Direct Testimony

2 products are currently classified as a Class I
3 use as administered by USDA under the fluid
4 milk definition. Either they contain less than
5 6.5 percent nonfat solids, or they are exempt
6 under the dietary use provision of the fluid
7 milk definition and packaged in
8 hermetically-sealed containers.

9 This hearing arises from the
10 petition by the Dairy Farmers of America to
11 change the fluid milk product definition as
12 there were growing concerns over the
13 introduction of new beverage products
14 containing milk ingredients. In particular,
15 beverages using ultrafiltered milk protein
16 concentrates were being produced and sold in
17 retail groceries in gallons and half-gallon
18 containers next to traditional fluid milk
19 products.

20 O-AT-KA Milk Products understood
21 that USDA was applying the intent of the
22 6.5 percent nonfat solids rule and classifying
23 the products as Class I. Thus, the marketers
24 of these new beverages would not be able to use
25 protein concentrates to fall under 6.5 percent

1 C. Alexander - Direct Testimony

2 nonfat solids content to achieve lower Class II
3 costs while producing a product looking like
4 fluid milk and claiming on the product label as
5 much or more protein content as traditional
6 fluid milk products.

7 These products should be Class I
8 fluid milk products, and we agree with DFA that
9 additional clarification of the fluid milk
10 definition might be necessary. At the same
11 time, O-AT-KA cautioned in our letter of
12 January 31, 2005, in response to a request for
13 proposals that care must be taken to
14 distinguish between products targeted to
15 compete in the same category as traditional
16 fluid milk products versus the use of milk
17 solids as an ingredient in beverage products
18 that are targeted to compete with other
19 nondairy beverages.

20 O-AT-KA originally sent in a
21 proposal to adopt a protein standard similar to
22 the proposal from National Milk Producers
23 Federation. At the request of the USDA, we
24 also provided some possible additional
25 clarification to the dietary use exemption as

1 C. Alexander - Direct Testimony

2 it relates to nutritional meal replacement
3 drinks and provided proposals for additional
4 specific exemptions for high protein drinks,
5 alcoholic beverages, and products specifically
6 formulated for animal use.

7 We have since further reviewed the
8 issue and have determined that additional
9 industry discussion and consensus is needed as
10 they relate to our proposals. Therefore,
11 instead of the language in our proposals,
12 O-AT-KA supports the proposed language as
13 submitted by the National Milk Producers
14 Federation as well as the testimony by the
15 National Milk Producers Federation witness Dr.
16 Roger Cryan.

17 O-AT-KA believes it is necessary for
18 USDA to move forward to adopt a protein
19 standard as there is a clear need to resolve
20 this issue and there is a consensus within the
21 National Milk Producers Federation to proceed.
22 O-AT-KA also supports the National Milk's
23 proposal to count whey protein when used in
24 dairy beverages, reclassifying it but not
25 repricing it.

1 C. Alexander - Direct Testimony

2 No other changes should be made to
3 the fluid milk definition at this time, and
4 USDA should not change the interpretation of
5 current provisions relating to the exemption
6 for long shelf-life products currently produced
7 by O-AT-KA.

8 In particular, O-AT-KA firmly
9 believes that the nutritional drinks we produce
10 have not competed in traditional fluid milk
11 markets and should remain as Class II products
12 under the specialized formulas for dietary use
13 in hermetically-sealed containers that are
14 exempt in the current fluid milk definition.

15 While further clarification on these
16 products may be needed at some point, we
17 believe that, at present, current provisions
18 and USDA interpretation are sufficient to
19 properly classify these products.

20 National Milk's proposal should be
21 adopted. O-AT-KA supports the National Milk's
22 proposal to convert the 6.5 percent nonfat
23 solids exemption on beverages containing milk
24 ingredients to 2.25 percent protein. Our
25 understanding is that USDA is already in effect

1 C. Alexander - Direct Testimony

2 using this benchmark.

3 Therefore, National Milk's proposal
4 simply provides additional clarification to the
5 de facto administration of the rules. In
6 essence, the National Milk Producer's
7 Federation proposal clarifies the rules on
8 calculating a protein equivalent of protein
9 when skim milk has been ultrafiltered to
10 concentrate the proteins.

11 As a result of this proposed change,
12 beverage formulators will have a better
13 understanding that protein is the key
14 ingredient for establishing what is and is not
15 a Class I product. At the same time,
16 maintaining an exemption for beverages that
17 contain less than 2.25 percent protein allows
18 several positive benefits to the dairy industry
19 and dairy producers.

20 First, beverage formulators can
21 continue to add dairy ingredients at minimal
22 levels, adding positive nutrients to beverages
23 at prices that can allow them to be more
24 competitive with lower cost alternative soft
25 drinks. It is likely that overall more dairy

1 C. Alexander - Direct Testimony

2 ingredients can continue to be sold as a
3 result.

4 Second, additional regulation of
5 such ingredients and processors that are not
6 currently regulated could discourage them from
7 using dairy ingredients.

8 Third, the high cost of tracking
9 minimal amounts of dairy ingredients and
10 auditing additional plants will not be incurred
11 by the industry. This task could be especially
12 difficult as these products are often in long
13 shelf-life containers and are distributed
14 through warehouses and nontraditional outlets.

15 In fact, the situation has not
16 fundamentally changed since USDA stated in its
17 1974 Federal Order decision on classification
18 that infant and dietary formulas which are
19 being sold in hermetically-sealed glass or
20 all-metal containers are specialized food
21 products prepared for limited use. Such
22 formulas do not compete with other milk
23 beverages consumed by the general public.
24 Similarly, fluid milk products containing only
25 a minimal amount of nonfat milk solids are not

1 C. Alexander - Direct Testimony

2 considered as being in the competitive sphere
3 of the traditional milk beverages.

4 Specially formulated dietary use
5 products in hermetically-sealed containers
6 should remain exempt.

7 USDA should make no changes in the
8 application of its interpretation of the
9 exemption for "formulas especially prepared for
10 infant feeding or dietary use (meal
11 replacement) that are packaged in
12 hermetically-sealed containers." While there
13 has been some discussion about clarification of
14 this language, it is apparent that there is not
15 sufficient understanding of what the problem
16 is, nor is there a consensus of what, if any,
17 changes to make to the language at this point.

18 O-AT-KA co-packages several of these
19 products for other beverage companies. We make
20 high protein shake drinks that are packaged in
21 hermetically-sealed cans and commercially
22 sterilized for long shelf life. These are
23 often sold through health stores or on-line web
24 sites.

25 They historically have been exempt

1 C. Alexander - Direct Testimony

2 under the dietary use exemption interpretation.

3 They have very high protein content, from
4 double to more than five times the amount of
5 protein normally found in fluid milk products.

6 They typically are made using blends of
7 imported dry caseinates, milk protein
8 concentrates and whey protein concentrates.

9 They are sold for use by athletes and
10 body-builders in a ready-to-drink beverage as
11 an alternative to the original powdered
12 formulas and used as a meal replacement or meal
13 supplements to add protein to the diet. They
14 are not sold as an alternative to milk.

15 We also co-package specialized long
16 shelf-life nutritional meal replacement-type
17 drinks intended for dieters and for geriatric
18 and pediatric use. Many of these
19 ready-to-drink products also were developed
20 originally as powdered formulas.

21 Formulation often requires dry
22 caseinates or milk protein concentrates and
23 addition of significant added vitamins and
24 minerals. The products are often labeled as
25 complete and balanced nutrition on the

1 C. Alexander - Direct Testimony

2 principal display panel.

3 Our goal at O-AT-KA is to develop
4 the technology to use our own producers' milk
5 and ultrafiltered proteins on a cost
6 competitive basis to be able to replace the
7 purchased imported proteins in these specially
8 formulated beverages. Additional regulation
9 could handicap that effort.

10 USDA had suggested changing the
11 language related to the dietary use (meal
12 replacement) exemption in the Proposed Rule for
13 Federal Order Reform in 1998. This would have
14 deleted the "dietary use" and
15 "hermetically-sealed" terms while maintaining
16 "meal replacement" as the restrictive
17 requirement for exemption.

18 As discussed in the explanation in
19 the proposed Rule, this would change the
20 application of the exemption to exclude "shake
21 products that are designed for people who are
22 trying to gain or lose weight. Neither would
23 the term apply to products that are advertised
24 as protein supplements or instant breakfasts."

25 The Final Rule for Federal Order

1 C. Alexander - Direct Testimony

2 Reform withdrew the proposal as not supported
3 by the comments from the industry, and no
4 changes were made to the language or to how the
5 dietary use (meal replacement) exemption was
6 applied.

7 The term "meal replacement" is not
8 defined in either the current rule nor was it
9 defined in the Proposed Rule for Federal Order
10 Reform. As we reviewed possible ideas for
11 clarification, we found that, importantly, FDA
12 does not define this term either. O-AT-KA
13 believes until there is further study and
14 consensus, no changes should be made in the
15 language or application of this exemption.

16 These specialized dietary use
17 products in hermetically-sealed containers
18 should remain exempt for several additional
19 reasons.

20 As stated, such specially formulated
21 dietary use drinks are not competing with fluid
22 milk consumption as they are fundamentally
23 different products often sold through different
24 distribution channels and product categories,
25 sold in different containers (typically all

1 C. Alexander - Direct Testimony

2 metal cans), certainly taste much different
3 and, therefore, do not compete in the same
4 competitive sphere as traditional milk
5 products.

6 Second, the additional protein and
7 vitamins are already high cost ingredients, and
8 when added to the costs of hermetically-sealed
9 canning and commercially sterilized are not
10 competing on a cost basis with traditional
11 fluid milk products. The additional costs to
12 regulate these products as a Class I fluid milk
13 product, even if applied to the normal amount
14 of skim equivalent of the protein only and not
15 to any fortified amount, it could be a
16 disincentive for marketers to use milk
17 ingredients in ready-to-drink formulas.

18 Third, just the additional
19 regulatory paperwork and Class I price
20 uncertainty for marketers unaccustomed to milk
21 order regulation would be a disincentive for
22 use. Alternatively, marketers might go back to
23 focusing on powdered sales.

24 Fourth, soy proteins are used in
25 many of our formulations, and the use of soy

1 C. Alexander - Direct Testimony

2 could increase if the beverage products become
3 regulated as a fluid product, therefore
4 reducing dairy ingredient usage. Already soy
5 protein is a lower cost ingredient. For
6 example, we purchased soy protein isolate
7 recently at \$1.80 per pound as compared to
8 caseinate at \$3.60 per pound.

9 Fifth, these products are often
10 distributed nationally. California does not
11 regulate processors of similar beverage
12 products as Class I fluid milk products. With
13 substantial sales in California, it would be a
14 disincentive to produce such products in plants
15 regulated by Federal Milk Orders and O-AT-KA
16 could lose sales as a result.

17 Sixth, the National Milk proposal
18 supports reclassification but not pricing of
19 whey protein. Therefore, the classification of
20 skim milk solids, milk protein concentrates and
21 caseinates to Class I when used in the
22 currently exempt dietary use beverages would
23 discourage use of these milk ingredients as
24 compared to what would become relatively
25 cheaper whey protein alternatives.

1 C. Alexander - Direct Testimony

2 Past USDA decisions established
3 sound principles when discussing the dietary
4 use exemption and the desire of one producer
5 group to classify both the hermetically-sealed
6 drinks as well as fresh milk used in dietary
7 use beverages as Class I products.

8 In its 1993 Final Decision, USDA
9 stated "...the fresh product has taste,
10 nutrition, and convenience advantages over
11 other products with which it may compete. In
12 addition, the cost of extra packaging and the
13 Class II attributes of having an extended
14 shelf-life and being distributed over a wider
15 area justify Class II classification for
16 hermetically-sealed packaging while fresh
17 product with limited shelf life should be
18 Class I."

19 Summary. In summary, O-AT-KA
20 supports the National Milk Producers Federation
21 proposal to replace the 6.5 percent nonfat milk
22 solids standard with 2.25 percent protein. We
23 believe that this proposal best clarifies
24 current rules to fairly and equitably price
25 fluid milk products arising from the advent of

1 C. Alexander - Direct Testimony

2 new milk concentration technologies. O-AT-KA
3 believes that the pace of technological and
4 marketing changes in this arena, however,
5 warrants continued study and industry attention
6 before further regulatory changes are made.

7 In the meantime, the current
8 exemptions and interpretation of those
9 exemptions under the fluid milk definition
10 should be continued. This will allow
11 continuation of the marketing of beverages that
12 contain dairy ingredients to be able to compete
13 with beverages with nondairy ingredients and
14 other food products. This, in turn, benefits
15 the dairy producers and the dairy industry.

16 MR. HARNER: Thank you. We
17 ask that Exhibit 18 be made part of the record,
18 and we will take any questions.

19 JUDGE DAVENPORT: Exhibit 18
20 for identification will be admitted to the
21 record as Exhibit 18.

22 (Exhibit No. 18 was admitted
23 into evidence.)

24 JUDGE DAVENPORT: Do we have
25 examination of this witness? Mr. Yale.

1 C. Alexander - Cross - by Mr. Yale

2

3

CROSS-EXAMINATION

4

BY MR. YALE:

5

Q. Good morning.

6

A. Good morning.

7

Q. Ben Yale for Select Milk Producers,

8

and Continental Dairy Products, Inc.

9

Mr. Alexander, when you talk about

10

the separation of whey protein from casein and

11

caseinate, but if the whey proteins are in the

12

milk protein concentrate, they are to be paid.

13

How do you distinguish --

14

A. That's correct.

15

Q. I have two questions with that. How

16

can you justify having two different pricing

17

schemes for the same proteins?

18

A. Well, I think Dr. Cryan testified

19

yesterday that it is identifiable. It is not

20

like you can't identify whey. He testified

21

that whey, as he described it, would be from

22

the process of cheese making and that milk

23

protein concentrate would be a different

24

product and, bound together with the portion

25

of the proteins that are serum proteins, are

1 C. Alexander - Cross - by Mr. Yale
2 not -- have not gone through the cheese-making
3 process.

4 Q. Is it your understanding that the
5 only way that whey proteins can be separated is
6 through a cheese-making process?

7 A. Technically that may be the case if
8 you call them whey proteins. If you identified
9 them in other terms from a food science point
10 of view, they may be able to be separated
11 through membrane fractionation, but then they
12 are not, I don't believe, technically
13 considered whey proteins. At least as
14 Dr. Cryan described it, only the proteins that
15 have gone through the cheese-making process are
16 considered whey proteins.

17 Q. Do you happen to know the names of
18 the proteins that are found in whey? I am not
19 trying to challenge you. I'm just --

20 A. Yes. Now you are starting to
21 stretch the boundaries. I think I know, but I
22 am not going to speculate.

23 Q. I want to change subjects here a
24 second. You talked a moment about the
25 containers, and then at an earlier decision

1 C. Alexander - Cross - by Mr. Yale
2 they used to talk about sealed cans and
3 bottles. The materials and the packaging today
4 has changed dramatically in terms of their
5 ready use, dramatically even in the last five
6 or six years. Would you agree with that?
7 Aseptic packaging.

8 A. There is more packaging out in the
9 marketplace.

10 Q. So the aseptic packaging cannot be
11 defined in terms of the container it is in but
12 in the process by which it is processed and
13 packaged; is that correct?

14 A. Now you're again -- by training I am
15 an economist, not a packaging expert.

16 Q. That could lead me up to a followup,
17 but I'm not going to follow up.

18 A. Okay.

19 Q. If I ever got on the stand, you
20 would have pot shots. I've got to protect
21 myself.

22 The use of proteins in milk in these
23 sports drinks that you call them, diet for
24 weight gain or weight loss, are those products
25 sold at a higher price than milk that we see in

1 C. Alexander - Cross - by Mr. Yale
2 the grocery store?

3 A. Yes.

4 Q. And, on a milk equivalent basis,
5 higher than cheese, most cheeses?

6 A. Some cheeses; maybe some cheeses
7 not.

8 Q. The common cheeses?

9 A. Probably.

10 Q. I want to talk a bit about the meal
11 replacement. Is it your position that the use
12 of the meal replacement is one of a complete
13 food as opposed to a beverage, although it is
14 in a beverage form?

15 A. To the extent it is used as a meal
16 replacement, yes. I mean, I think obviously
17 you could drink it. That's kind of the point
18 that you can drink it, but it is used instead
19 of having a meal.

20 And so in the case of diet protein
21 drinks, however, it is really kind of adding
22 additional meals. So that's kind of the point
23 there.

24 MR. YALE: I don't have any
25 other questions.

1 C. Alexander - Cross - by Mr. Farrell

2 JUDGE DAVENPORT: Other

3 examination? Mr. Farrell.

4 MR. FARRELL: Good morning,

5 Your Honor.

6 -----

7 CROSS-EXAMINATION

8 BY MR. FARRELL:

9 Q. Good morning. This is Edward
10 Farrell on behalf of Fonterra USA.

11 I still remain confused about the
12 whey question, counting whey for purposes of
13 determining whether a product is Class I but
14 then excluding from the upcharge some forms of
15 whey protein but not excluding other forms.

16 I gathered from your response to the
17 earlier questions on this issue that you see a
18 distinction between the protein form of the
19 whey protein in milk protein concentrate and
20 the protein form in whey protein out of a
21 cheese strip?

22 A. I am going to rely on Dr. Cryan's
23 testimony. He testified at length about this
24 yesterday. But basically his description of
25 the whey protein that would be classified but

1 C. Alexander - Cross - by Mr. Farrell
2 not repriced is that whey protein which is the
3 result of the cheese-making process, and that's
4 protein only.

5 Q. So to draw an analogy, if I take
6 seawater and treat it and get sodium chloride
7 on the one hand and on the other hand I produce
8 sodium chloride in some other fashion, one
9 would be subject to an upcharge and the other
10 wouldn't?

11 A. That's a hypothetical which doesn't
12 make any sense to me.

13 Q. It is not a hypothetical. It is an
14 analogy.

15 A. Okay. It is an analogy that doesn't
16 make sense to me as a dairy economist. So you
17 can throw a lot of analogies out there, but,
18 you know -- put it in terms of my testimony and
19 I will answer it.

20 Q. I am trying to comes to grips with
21 how you distinguish between whey protein on the
22 one hand which is in milk protein concentrate
23 and whey protein on the other hand which is
24 whey from a cheese strip. How do you
25 analytically distinguish between those whey

1 C. Alexander - Cross - by Mr. Farrell

2 proteins?

3 A. I am not a milk analyst.

4 Q. Okay. So the answer is --

5 A. In terms of -- I don't know. I'm
6 not qualified to answer that question.

7 Q. So the only way you would
8 distinguish then from what you know is the
9 method of production of the product?

10 A. That's my understanding.

11 Q. I asked this question to Dr. Cryan
12 yesterday with respect to whey produced as a
13 by-product of casein production. How would you
14 see that being treated?

15 A. I don't know.

16 Q. So you don't know whether --

17 A. I don't know what the -- I would
18 support what Dr. Cryan said at this point. I
19 believe it is through the cheese-making
20 process, and my understanding is the production
21 of casein is not cheese.

22 Q. Well, actually I believe Dr. Cryan's
23 testimony was that he would treat whey out of
24 casein production in the same way as whey out
25 of cheese production would be treated.

1 C. Alexander - Cross - by Mr. Farrell

2 A. Okay.

3 Q. So it is whatever he said you go
4 along with?

5 A. Sure.

6 Q. In your testimony you indicate that
7 there are several good reasons for adopting
8 this 2.25 percent protein, one of which is
9 that, and I quote, "Beverage formulators can
10 continue to add dairy ingredients at minimal
11 levels adding positive nutrients. It is likely
12 that through this process more dairy
13 ingredients will be used."

14 Why is 2.25 percent magical for that
15 concept?

16 A. Well, I think basically it is, in
17 essence, the status quo, that beverage
18 formulators can continue to use that type of
19 addition of dairy ingredients.

20 At the same time, at least in the
21 past and I think at this point in time and into
22 some point in the future, those products have
23 not competed directly with fluid milk products,
24 and I think the USDA coined the term
25 "competitive sphere," and I think we will go

1 C. Alexander - Cross - by Mr. Farrell
2 along with that. You get above that level, I
3 think then you are starting to directly enter
4 the competitive sphere of food milk products
5 potentially.

6 Q. Potentially. But you are not
7 aware of any particular products that might or
8 might not compete with fluid milk at over
9 2.25 percent?

10 My point here is that by
11 establishing this benchmark you are presuming
12 that a protein content above that benchmark
13 could never be in a product like the ones you
14 described which are not competing with fluid
15 milk; is that not correct?

16 A. I think USDA has to set some
17 guidelines, and they have done that in the
18 past, to try to determine what is and is not
19 fluid milk product, and that's what the point
20 of the theory is about.

21 Q. But I do take it from your testimony
22 that you are concerned that these guidelines
23 not inhibit your ability, for example, to
24 compete with soy?

25 A. In our product category for our

1 C. Alexander - Cross - by Mr. Farrell

2 canned beverages, yes.

3 Q. So that is something that you would
4 think is important for USDA to take into
5 consideration, --

6 A. Yes.

7 Q. -- that it not create a benchmark
8 that would lead to that result, that the result
9 being --

10 A. In our very narrow limited use
11 category, yes.

12 Q. And you don't believe that same
13 concept would apply to other use categories
14 other than your own?

15 A. I think it is the point of this
16 hearing to talk about those issues, and I would
17 be interested to hear what other folks have to
18 say.

19 Q. But you would certainly be open to
20 the concept that --

21 A. I think we put forward our proposal
22 yesterday, and we support that at this point
23 today.

24 Q. But overall you would like to see
25 dairy proteins competitive?

1 C. Alexander - Cross - by Mr. Vetne

2 A. I think over time all these issues
3 are evolving, and I can't really speculate as
4 to at what point what products might be
5 changed. At this point in time, this is our
6 proposal.

7 MR. FARRELL: Okay. Thank you
8 very much.

9 JUDGE DAVENPORT: Other
10 examination? Mr. Vetne.

11 MR. VETNE: John Vetne of
12 H. P. Hood.

13 -----

14 CROSS-EXAMINATION

15 BY MR. VETNE:

16 Q. good morning, Mr. Alexander.

17 A. Good morning.

18 Q. Your vitae, as you describe it,
19 includes a sojourn in California with the Dairy
20 Institute of California?

21 A. Yes.

22 Q. And in that capacity you were
23 involved in learning, understanding and
24 explaining California's classified pricing
25 system and fluid systems?

1 C. Alexander - Cross - by Mr. Vetne

2 A. Once upon a time. Things change.

3 Q. When did you last -- when were you
4 last with the Dairy Institute?

5 A. 1997.

6 Q. You explained in your testimony on
7 page 8 that there are a number of dairy
8 beverages that are distributed nationally, and
9 California does not regulate the processors of
10 similar beverage products as Class I products.

11 Is it not the case that, by statute,
12 California has a category of milk all dairy
13 beverages?

14 A. (Witness nodded affirmatively.)
15 Correct.

16 Q. You have to actually answer.

17 A. I said correct.

18 Q. And those beverages are defined by
19 statute as products containing milk, fluid milk
20 ingredients, but which do not meet either the
21 FDA or the state standard of identity for milk?

22 A. I believe that's correct. I haven't
23 reviewed that statute recently.

24 Q. Okay. So that would encompass --

25 You are aware that the federal

1 C. Alexander - Cross - by Mr. Vetne
2 standard is 8.25 percent solids nonfat?

3 A. Yes.

4 Q. And the California standards are
5 somewhat higher depending on the product?

6 A. Correct.

7 Q. So products which have milk and are
8 marketed as beverages fall below that are
9 Class II in California or not Class I?

10 A. Correct.

11 Q. Do you know that that would include
12 Carb Countdown, for example?

13 A. I do not know that.

14 Q. But it would --

15 A. I also don't know if Carb Countdown
16 is marketed in California.

17 Q. But it would include, based on your
18 experience when you were in California, it
19 would include products that are marketed as
20 dairy beverages that contain between
21 6.5 percent solids nonfat and something less
22 than 8.25 percent solids nonfat?

23 A. I don't recall of any products that
24 were produced in that category. But, yes, that
25 would be at least my understanding the last I

1 C. Alexander - Cross - by Mr. Vetne
2 knew. It has been some time since I reviewed
3 that.

4 Q. So your answer was yes, if there
5 were such products they would be not Class I
6 nonfat?

7 A. Right.

8 Q. You also refer in your testimony to
9 products that compete or do not compete on a
10 cost basis with traditional fluid milk
11 products. Is it your opinion that milk or
12 milk-based beverages that are offered at a
13 price comparable to or below fluid milk are
14 likely or intuitively likely to be substituted
15 by consumers when they go to the store to buy
16 fluid milk?

17 A. If it is the same product at a lower
18 cost, yes.

19 Q. Do you have any data that relates to
20 the proposition that consumers are likely to go
21 to the store to buy milk but purchase something
22 else when it costs significantly more than
23 milk?

24 A. Did you say that I needed data to --

25 Q. Are you aware of any data that would

1 C. Alexander - Cross - by Mr. Vetne
2 support the proposition that consumers going to
3 a store to buy milk are likely to buy something
4 else instead of their intended purchase when
5 that something else costs more than milk?

6 A. I guess I haven't studied that
7 issue.

8 Q. Would you agree that intuitively or
9 applying economic principles that consumers are
10 not likely to buy something more expensive?

11 A. That's hard to say. There's a lot
12 of things that go through a consumer's mind
13 when they are walking through the grocery
14 aisles.

15 Q. An individual consumer basis. What
16 about on the aggregate basis, product
17 substitution?

18 A. If the same product is priced at
19 less than another product, then, yes,
20 intuitively one would think that consumers
21 would buy the cheaper product.

22 Q. And conversely --

23 A. Yes, if it is the same product.

24 Q. And conversely, if some things cost
25 more, consumers are not likely to purchase that

1 C. Alexander - Cross - by Mr. Vetne

2 more costly product?

3 A. Correct.

4 Q. Concerning the definition that you
5 proposed to maintain for hermetically-sealed
6 meal supplements. I note on your testimony you
7 used the word -- well, you combined the word
8 meal replacement or meal supplements. Is it
9 your understanding that products that are meal
10 supplements are currently deemed by USDA to be
11 in that category?

12 A. I believe that to be the case.

13 Q. Okay. Is there a distinction in
14 the --

15 Are you aware of any differences
16 among products that fall in the categories of
17 meal replacement and meal supplements?

18 A. I'm sorry. Could you repeat the
19 question?

20 Q. Are you aware of differences among
21 products that fall in those categories of meal
22 replacement and meal supplements? By
23 "differences" I mean in the composition of
24 ingredients or vitamins or nutrients.

25 A. No, I am not aware of that issue.

1 C. Alexander - Cross - by Mr. Vetne
2 Really what I am stating is the knowledge of
3 what our products are and my understanding of
4 how they are classified.

5 Q. Meal replacements or meal
6 supplements are justifiably excluded -- are
7 they justifiably excluded, in your opinion,
8 because they are marketed to a very limited
9 group of consumers?

10 A. I think that's been the
11 interpretation. That has been, you know, kind
12 of a limited category, and that coupled with
13 the type of container that it is in.

14 Q. Do you believe that products in that
15 category, dietary use category, should be
16 Class II if they are labeled or marketed as a
17 meal replacement or meal supplement but the
18 identical product with a different label should
19 not be in Class II but, rather, be in Class I?
20 In other words, is this a --

21 A. I think the labeling is less
22 important than the composition and the
23 container that it is in and how it is marketed
24 and distributed.

25 Q. Let me ask the question -- refine it

1 C. Alexander - Cross - by Mr. Vetne
2 a little bit. Would it be inadvisable for
3 purposes of regulatory consistency, regulatory
4 policy, to classify one of these dietary use
5 products as Class I if it is not labeled as a
6 meal replacement and classify virtually
7 identical or similar products as a Class II
8 simply because of the label or market?

9 A. I believe USDA would have to be
10 careful in doing that.

11 Q. It is not your objective in the
12 proposals that you make or seek to maintain to
13 accomplish that effect, the effect being a
14 different classification?

15 A. Correct.

16 Q. Does O-AT-KA protein test its
17 finished products?

18 A. Yes.

19 Q. Do the protein tests that O-AT-KA
20 make on its finished products distinguish
21 between whey protein and casein protein?

22 A. That I do not know.

23 Q. Do you know whether they distinguish
24 between dairy protein and soy protein?

25 A. That I do not know.

1 C. Alexander - Cross - by Mr. Vetne

2 Q. Do you know if the protein tests are
3 essentially an eyeball of or estimate of
4 protein based on nitrogen content?

5 A. I don't know.

6 Q. Are you aware that testing for
7 nitrogen is the common surrogate for protein
8 content?

9 A. Yes.

10 Q. Do you know whether any of the
11 products that are tested by O-AT-KA or that
12 might be tested under a protein regimen contain
13 nitrogen from sources other than protein?

14 A. I know there's nonprotein nitrogen
15 inherent in milk. As far as other nonprotein
16 nitrogen, I don't know the answer to that
17 question.

18 Q. You don't know if other food
19 ingredients would show up as nitrogen?

20 A. Correct.

21 Q. If under the formula that you now
22 support, and it is also relevant to the
23 proposal you made, if casein protein -- well,
24 let me maybe create an example here.

25 In 100 pounds of milk there are

1 C. Alexander - Cross - by Mr. Vetne
2 about 3.2 pounds of protein; correct?

3 A. Okay.

4 Q. All right. The bulk --

5 A. Is this pure protein or total
6 protein?

7 Q. About three pounds either one.

8 A. Okay.

9 Q. Let's just assume it for the
10 question. And let's say that the casein
11 portion of that protein is further fractionated
12 so as to produce two pounds of alpha casein
13 protein. All right?

14 A. I don't know how you would do that,
15 but go ahead.

16 Q. The casein has different kinds of
17 protein, alpha, beta.

18 A. Okay. All right.

19 Q. And alpha protein is what is used in
20 a milk beverage. Well, let's say we now have
21 2.25 percent alpha protein.

22 When the upcharge is created under
23 your proposal, would the upcharge be based on
24 the ratio of protein to water in milk, skim
25 milk as it comes from the farm, or would it be

1 C. Alexander - Cross - by Mr. Vetne
2 based on the ratio of alpha protein to the
3 water as it comes from the farm that is
4 attributing to the finished product protein
5 that is not actually contained in the product?

6 A. I think it would be protein to water
7 as it comes from the farm, but that one is
8 getting a little bit speculative on my part.

9 Q. You don't propose by your proposal
10 you support to create any protein equivalent
11 requirement on the Department to attribute to
12 the finished product protein that is not there
13 in order to arrive at a subsequent skim
14 equivalent?

15 A. I believe that's the intent.

16 Q. The intent is not to do so?

17 A. Right.

18 MR. VETNE: Thank you,
19 Mr. Alexander.

20 THE WITNESS: Thank you.

21 JUDGE DAVENPORT: Other
22 examination? Ms. Carter.

23 MS. CARTER: Antoinette Carter
24 with the USDA.

25 -----

1 C. Alexander - Cross - by Ms. Carter

2 CROSS-EXAMINATION

3 BY MS. CARTER:

4 Q. Good morning.

5 A. Good morning.

6 Q. In your opinion, what is the intent
7 or the purpose of the fluid milk product
8 definition?

9 A. The purpose is to identify those
10 products for purposes of classification that
11 fall into Class I category from those products
12 that do not.

13 Q. What factors in your opinion should
14 be considered in determining the
15 classificational requirements?

16 A. That is a pretty sweeping question,
17 but certainly I think the Federal Order history
18 has been based on trying to evaluate the values
19 of milk in different product categories for
20 then the purposes of returning those values and
21 pooling them back to dairy producers, and the
22 reason being is to provide for an adequate
23 supply of milk for the consuming public.

24 So there has to be by necessity some
25 evaluation by the industry and USDA to

1 C. Alexander - Cross - by Ms. Carter
2 determine the different categories or classes
3 of milk products and then the appropriate
4 values.

5 Q. Okay. Let me just ask it another
6 way. Should marketing and the distribution of
7 products be considered in determining their
8 classifications?

9 A. Yes.

10 Q. How much weight do you feel should
11 be given to those factors?

12 A. Well, I think that was kind of
13 discussed extensively between Mr. Hollon and
14 Mr. Cryan yesterday in terms of kind of the
15 different criteria, if you will, that should go
16 into classification. The form and the intended
17 use is kind of the first benchmark to -- or
18 default to look at.

19 But then looking at such issues as
20 how it is marketed and the competitive sphere,
21 if you will, of competition between products is
22 something that USDA has looked at in the past
23 and should continue to look at going forward.

24 Q. In your testimony you indicated that
25 you support milk-derived ingredients being

1 C. Alexander - Cross - by Ms. Carter
2 included in the calculation of a proposed
3 protein standard. Why should those ingredients
4 be included in the calculation in your opinion?

5 A. Where are you referring to?

6 Q. You referenced caseinates and milk
7 protein concentrate and dairy ingredients,
8 milk-derived ingredients, for solids.

9 A. Could you just help me --

10 JUDGE DAVENPORT: Ms. Carter,
11 would you also put the microphone closer.
12 Thank you.

13 A. I will cut to the chase. I will
14 answer it. I will state yes, and then I will
15 add that I am not sure that I said that in
16 particular someplace. But I will state that,
17 yes, those ingredients should be included.

18 Q. My question is what is the
19 justification for including those in
20 calculating the protein standard?

21 A. Well, clearly technology. Again,
22 this was discussed extensively yesterday.
23 Technology has changed. There is the ability
24 to isolate proteins from the nonfat dry milk
25 solids, and the implication is that some of

1 C. Alexander - Cross - by Ms. Carter
2 those can be used and, therefore, the
3 6.5 percent nonfat solids criteria by itself is
4 no longer sufficient.

5 So we need to look at those other
6 ingredients that can potentially be used; and
7 also, that's why we are suggesting that the
8 standard needs to be changed from 6.5 percent
9 nonfat solids

10 Q. I know you have had a few questions
11 with regard to meal replacement and certain
12 products under the current fluid milk product
13 definition being excluded. In your opinion
14 what constitutes a meal replacement?

15 A. Well, I think that's something that
16 we are all kind of grappling with I guess. The
17 FDA hasn't defined it. In our proposal we took
18 a stab at it, but we really weren't sure that
19 that was the right approach, and that kind of
20 generated some other questions and issues
21 related to currently exempt products under that
22 definition.

23 So to be honest with you, we are not
24 sure, and that's why we, in essence, withdrew
25 our proposal and we are now supporting National

1 C. Alexander - Cross - by Ms. Carter

2 Milk with no changes in that language.

3 Q. In terms of high protein beverages,
4 what category do you feel they fall in? Do you
5 consider those -- I don't know. What category
6 do you feel they fall in?

7 A. Well, they potentially can be used
8 as meal replacement, but, in essence, they are
9 almost meal additions in the sense that the
10 body builders that use them don't necessarily
11 forego other meals. They are looking for
12 adding, in essence, meals and protein.

13 So it is a product that really isn't
14 serving exactly the same purpose as some of the
15 other meal replacement-type drinks where, you
16 know, people that are diabetics or dieters or
17 for geriatric use where they can't eat a
18 regular meal. It is a little different -- it
19 is a little different approach to it.

20 Nonetheless, it has been interpreted
21 as falling within the dietary use meal
22 replacement exemption, and until we can come up
23 with a better approach, we would suggest
24 leaving them in that.

25 Q. I believe USDA has stated in at

1 C. Alexander - Cross - by Mr. Wilson
2 least a past decision that simply adding
3 additional vitamins and minerals to a product
4 doesn't constitute or necessarily put that
5 product as a meal replacement. The high
6 protein beverages that you make, --

7 A. Yes.

8 Q. -- do those have additional I
9 guess ingredients or attributes or is this not
10 simply an addition of vitamins and minerals
11 that would --

12 A. Well, in the case of the high
13 protein drinks, yes. It is a significant
14 amount of protein in many cases.

15 MS. CARTER: That's all I
16 have. Thank you.

17 THE WITNESS: Thank you.

18 JUDGE DAVENPORT: Mr. Wilson.

19 MR. WILSON: Todd Wilson,
20 USDA.

21 -----

22 CROSS-EXAMINATION

23 BY MR. WILSON:

24 Q. Good morning, Mr. Alexander.

25 A. Good morning.

1 C. Alexander - Cross - by Mr. Wilson

2 Q. In the proposal that Mr. Cryan
3 testified about and you are supporting, in
4 the accounting and -- you're saying that to
5 account for all the proteins whether they
6 come from ultrafiltered MPCs or whey protein
7 or whey protein solids, to count the standard;
8 correct?

9 A. Yes.

10 Q. But in classification you are saying
11 to exclude the whey in whey solids protein?

12 A. Well, I may have not correctly
13 stated it in the written testimony, but I
14 believe that what the intent is to classify the
15 whey protein but not to price it.

16 Q. When accounting for and classifying
17 the MPCs, there is a milk equivalent to
18 those --

19 A. Yes.

20 Q. -- based on protein?

21 A. Right.

22 Q. Is there a milk equivalent based on
23 protein of whey in whey solids?

24 A. I don't know. I would assume you
25 can calculate something on that, but I have not

1 C. Alexander - Cross - by Mr. Wilson

2 done that.

3 Q. If there was, if there is a milk
4 equivalent in the same fashion as milk protein
5 concentrates based on the protein to come back
6 to an equivalent, would you support the
7 exclusion of that entire milk's equivalent or
8 simply just the dry or liquid portion of the
9 concentrate itself?

10 A. I would have to think about that
11 one.

12 Q. You have a -- O-AT-KA has several
13 plants on Federal Order rules, correct, that
14 are regulated?

15 A. I'm sorry. Could you repeat that
16 question?

17 Q. O-AT-KA operates pool plants in the
18 Federal Order system?

19 A. No, we do not.

20 MR. WILSON: Thank you.

21 That's all I have.

22 JUDGE DAVENPORT: Mr. Beshore.

23 MR. BESHORE: Marvin Beshore
24 for Dairy Farmers of America.

25

1 C. Alexander - Cross - by Mr. Beshore

2 CROSS-EXAMINATION

3 BY MR. BESHORE:

4 Q. Craig, you have provided in your
5 testimony some price information of soy protein
6 versus dairy protein. It is two-to-one --

7 A. Yes.

8 Q. -- recently, I take it. My question
9 is --

10 And there have been questions about
11 we need to be concerned about price sensitivity
12 and that competitive relationship.

13 A. Yes.

14 Q. My question is if the cost is
15 50 percent for soy protein, why is dairy
16 protein used at all?

17 A. That's a very good question. There
18 are some functional limitations to soy: taste,
19 the ability to use it in certain products in
20 terms of how it holds up over time, and that
21 does provide some limitations.

22 However, you know, five, ten years
23 ago those limitations were greater than they
24 are today, and so the technology continues to
25 march forward in terms of how it is used.

1 C. Alexander - Cross - by Mr. Beshore

2 In some of the high protein drinks
3 that we use there is a real positive attribute
4 to milk-derived proteins as opposed to soy
5 proteins that has been built up over time.

6 In some of the other nutritional
7 drinks, though, it is not the same kind of
8 attributes that's been identified the same as
9 the high protein drinks. So probably in some
10 of those categories they might be a little more
11 sensitive to soy and the use of soy.

12 Q. Now, the products that O-AT-KA makes
13 are packaged in cans I think you testified?

14 A. Correct.

15 Q. Are there other packages also?
16 Bottles?

17 A. We also package some of the drink
18 products in bottles.

19 Q. And those packages are what's
20 necessary to make them hermetically-sealed? Is
21 that --

22 A. Well, the term "hermetically-sealed"
23 and what package is able to be
24 hermetically-sealed is getting a little out of
25 my area.

1 C. Alexander - Cross - by Mr. Beshore

2 Q. In any event, those are the packages
3 that your products are in?

4 A. Basically the idea is that a
5 hermetically-sealed container doesn't allow
6 contaminants, microorganisms in once it is
7 sealed, and then our products go through
8 commercial sterilization after putting it in a
9 can or a bottle.

10 Q. What is the average shelf life of
11 those products?

12 A. Typically it is a year or more.

13 Q. A year or more?

14 A. Correct.

15 Q. You were asked --

16 By the way, the category of the
17 exemption of Class I is not just
18 hermetically-sealed but it is
19 hermetically-sealed plus meal replacement;
20 correct?

21 A. It is very important that those two
22 are together. Yes.

23 Q. You were asked by John Vetne about
24 higher priced categories -- higher priced
25 products and whether they are competitive with

1 C. Alexander - Cross - by Mr. Beshore

2 lower priced products. Do you recall that?

3 A. Yes.

4 Q. Within milk have you observed the
5 price differences in organic fluid milk versus
6 nonorganic fluid milk?

7 A. Sure. There's higher prices for
8 organic milk.

9 Q. Do you have any recollection about
10 how high? Is it substantial?

11 A. It is pretty significant, the
12 difference.

13 Q. Should that be taken out of Class I
14 because it's got a higher price?

15 A. No. And as I said to Mr. Vetne, it
16 is more than just price. There are other
17 attributes to that product that contribute to
18 the consumer's decision and lead to competition
19 between products.

20 That's why I qualified my statement
21 to him it's the same product. Organic and
22 regular milk are not considered by the consumer
23 to necessarily be the same product.

24 MR. BESHORE: Thank you.

25 JUDGE DAVENPORT: Mr. Yonkers.

1 C. Alexander - Cross - by Mr. Yonkers

2 MR. YONKERS: Thank you, Your
3 Honor.

4 -----

5 CROSS-EXAMINATION

6 BY MR. YONKERS:

7 Q. Craig, I think that you said in
8 response to Mr. Beshore's question that there
9 are some limitations with soy proteins and they
10 were greater five to ten years ago than they
11 are today?

12 A. Yes.

13 Q. Why is that?

14 A. Technology and incentives of
15 marketers to utilize different ingredients. I
16 think the soy folks have done a good job in
17 promoting some of the attributes of their
18 product.

19 Q. Do you have any reason to believe
20 that the situation as it exists today in terms
21 of limitations will be the same situation it
22 will be five to ten years from now are you
23 going to stop doing those things?

24 A. I expect that technology and
25 research marches on. It won't be the same.

1 C. Alexander - Cross - by Mr. Yonkers

2 MR. YONKERS: Thank you.

3 JUDGE DAVENPORT: Other

4 questions?

5 Mr. Alexander, it looks like
6 you may step down. Thank you. Mr. Tipton?

7 MR. TIPTON: I just wanted to
8 let you know the witness I spoke about earlier
9 is here and available at any time if you would
10 like to take her.

11 JUDGE DAVENPORT: If there are
12 no objections, should we take this witness at
13 this time?

14 MR. BESHORE: When will
15 Dr. Cryan go back and finish his examination?

16 JUDGE DAVENPORT: I guess --

17 MR. BESHORE: Maybe there
18 aren't any other questions.

19 JUDGE DAVENPORT: Are there
20 any other questions for Dr. Cryan as well? I
21 guess that answers that question.

22 MR. BESHORE: Thank you.

23 JUDGE DAVENPORT: Mr. Farrell,
24 I saw you getting ready to stand up.

25 MR. FARRELL: I don't know if

1

2 you were going to call Simon, at least get out
3 his direct testimony.

4

MR. HARNER: If we could do
5 him next, that would be fine.

6

JUDGE DAVENPORT: Mr. Yale?

7

MR. YALE: While we're at it,
8 I would like to have kind of a list of who else
9 is -- maybe by noon or something, maybe we
10 could kind of have a rough idea of what is to
11 be expected for the rest of the hearing.

12

JUDGE DAVENPORT: Well, I do
13 know that we have Dr. Stephenson who does want
14 to participate today. I understand there are
15 some other witnesses that are present.

16

Mr. Vetne?

17

MR. VETNE: Yes. H. P. Hood
18 has a witness, Mike Suever, who plans to
19 testify. We were also told at the very
20 beginning of this hearing that USDA expected to
21 have a witness, Todd Wilson, who can explain a
22 little bit about how USDA is doing things now
23 and the testing process and the
24 interpretations.

25

Hood feels that it is very important

1

2 to have a USDA witness explain what they are
3 doing, what guidelines they follow, how they
4 run tests, how they may test for a protein as a
5 backdrop to how things are proposed to be
6 changed, and we would like to ask you to make
7 Mr. Wilson available for that purpose.

8

9

JUDGE DAVENPORT: Ms. Carter,
do you want to respond to that?

10

11

MR. STEVENS: Yes. Just a
minute, Your Honor.

12

13

14

Your Honor, this is Garrett Stevens,
Office of General Counsel, U. S. Department of
Agriculture.

15

16

17

18

19

20

We have consulted on testimony by
Mr. Wilson, and we have some requests from
certain participants for him to testify. He is
willing to testify, and he will testify. We
were waiting to see at the appropriate time
within the hearing when this would take place.

21

22

23

24

So, Your Honor, we are willing to
have him testify. We had thought it might
happen later in the hearing at some time, but
he is available.

25

JUDGE DAVENPORT: Very well.

1 S. Tucker - Direct Testimony

2 I guess my only concern at this point is to
3 make sure that we get to the people that do
4 have time constraints. I think that's probably
5 more important than having, in other words,
6 necessarily a sequence of witnesses because it
7 is all going to be in the record at some point
8 anyway.

9 So at this time, Mr. Tipton, I guess
10 if your witness is ready and able to testify,
11 let's bring him on up.

12 MR. TIPTON: I am perfectly
13 happy to do that or I am happen to defer to the
14 request of Mr. Farrell, whenever you want.

15 JUDGE DAVENPORT: All right,
16 Mr. Farrell.

17 -----

18 SIMON TUCKER

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

21 JUDGE DAVENPORT: Your
22 statement is being marked as Exhibit 19 for
23 identification at this time.

24 (Exhibit No. 19 was marked for
25 identification.)

1 S. Tucker - Direct Testimony

2 MR. FARRELL: Thank you. For
3 the record again it is Edward Farrell on behalf
4 of Fonterra USA.

5 Mr. Tucker, would you introduce
6 yourself, please.

7 THE WITNESS: My name is Simon
8 Tucker. I am the vice president of government
9 relations and trade, North America, of Fonterra
10 Cooperative Group and Fonterra USA,
11 Incorporated.

12 MR. FARRELL: Did you prepare
13 a statement for this hearing?

14 THE WITNESS: I did prepare a
15 statement.

16 MR. FARRELL: Will you please
17 read the statement.

18 THE WITNESS: I very much
19 appreciate the opportunity to appear before you
20 today to discuss several issues of concern to
21 Fonterra USA, Incorporated, a wholly owned
22 subsidiary of Fonterra Cooperative Group
23 Limited. Fonterra USA is headquartered just
24 outside of Harrisburg, Pennsylvania, a little
25 ways down the Pennsylvania Turnpike from where

1 S. Tucker - Direct Testimony

2 we are today.

3 First I thought a bit of background
4 might be useful. Fonterra Cooperative Group
5 Limited is a New Zealand-based, multinational
6 dairy company. As well as supplying fresh milk
7 to New Zealand consumers, we manufacture and
8 export dairy ingredients and consumer products
9 to over 140 countries worldwide.

10 While Fonterra is New Zealand's
11 largest company, we produce only about
12 2 percent of world milk production, less, for
13 example, than either California or Wisconsin.
14 That Fonterra is the world's largest exporter
15 of dairy products reflects the small number of
16 domestic consumers in New Zealand, our ideal
17 conditions for producing milk, and our
18 innovative approach to dairy processing and
19 products development.

20 The company is owned by 12,000
21 mostly family dairy farmers in New Zealand who
22 produce milk predominantly through pastoral
23 farming. These farmers compete in one of the
24 world's most open economies. They receive no
25 direct producer support from the New Zealand

1 S. Tucker - Direct Testimony

2 government, no export subsidies, and no
3 protection from imports.

4 Given the wholesale deregulation of
5 the New Zealand dairy industry in 2001,
6 including the abolition of the New Zealand
7 Dairy Board, Fonterra faces competition within
8 New Zealand from milk suppliers and competes
9 with other New Zealand companies in dairy
10 export markets.

11 Fonterra has a long-standing
12 relationship with the U.S. market and a
13 significant presence here on the ground. We
14 are part of the fabric of the U.S. dairy
15 industry, both as a supplier of quality dairy
16 ingredients and through the manufacture and
17 export of dairy products produced in the U.S.
18 from U.S. milk.

19 Partnering with some of the key
20 players in the U.S. dairy industry has led
21 Fonterra to make significant investments in
22 capital and intellectual property in the United
23 States.

24 For example, through our partnership
25 with Dairy Farmers of America, we are

1 S. Tucker - Direct Testimony

2 manufacturing dairy products at ten sites
3 across the country, including the first plant
4 to manufacture milk protein concentrate in the
5 United States.

6 Located in Portales, New Mexico,
7 this plant, which was manufacturing milk powder
8 that went mostly to federal storehouses, is now
9 profitably supplying product to American
10 customers. In fact, such is the success of
11 this plant that this year we will commence
12 exporting U.S. MPC to Mexico.

13 As an unsubsidized exporter that
14 enjoys no government protection, Fonterra has
15 had to make its living by trading in the
16 international marketplace and living off of
17 those returns. It has brought that experience
18 to the U.S. as well as other markets, where we
19 seek to work cooperatively with dairy farmers
20 and companies to increase dairy consumption, to
21 grow the dairy pie so that we can each have a
22 larger slice. Fonterra's investments in the
23 U.S. which I have just described reflect this
24 philosophy. It also leads to our concerns with
25 the proposals before you in this hearing.

1 S. Tucker - Direct Testimony

2 Whether they are supermarket chains
3 or global food manufacturers, customers have
4 two fundamental requirements of their
5 suppliers. First is that we help them respond
6 to consumer trends; and, second, that we enable
7 them to do this cost effectively and
8 profitably.

9 In meeting these requirements there
10 is no doubt that there are some forces that
11 dairy must vigorously resist because these will
12 dictate our development, in this case for the
13 worse, not better. To see this one need only
14 walk through any supermarket and look at the
15 products positioning themselves directly as
16 dairy substitutes. We see products made of
17 soy, rice, nuts, grains and oils, all marketed
18 with the names consumers have associated with
19 dairy. Many of these products are aggressively
20 marketed, some with scientifically-based health
21 claims being made and verified to encourage
22 demand and to position these products as a
23 superior choice over dairy.

24 The claim by the soy industry
25 linking soy to reducing the risk of heart

1 S. Tucker - Direct Testimony

2 disease has FDA approval. Scandinavian
3 authorities have approved a health claim for
4 cheese where all the milkfat has been replaced
5 by canola oil.

6 You may well ask what does this have
7 to do with the issues before you today. The
8 answer I think is straightforward. To the
9 extent that the proposals you are considering
10 would impose an upcharge on dairy ingredients,
11 they serve as a disincentive to our customers
12 to purchase dairy ingredients for their
13 products.

14 It is a simple market reality that
15 if you offer a customer an ingredient which
16 will drive up his or her cost of manufacture
17 vis-a-vis a competing ingredient, you are at a
18 marketing disadvantage and will eventually lose
19 market share, and such loss of market share is
20 not theoretical.

21 The table included in my testimony
22 shows that in nutritional applications alone,
23 between 1999 and 2003 the use of soy protein in
24 nutritional applications has enjoyed an average
25 annual growth rate of 16.5 percent, while milk

1 S. Tucker - Direct Testimony

2 protein has increased by only 10.1 percent.
3 Soy is clearly eroding the dominant market
4 position of these products once enjoyed by milk
5 protein.

6 We understand the concern voiced by
7 many here that some innovative beverage
8 products which contain milk ingredients but are
9 not currently Class I products may compete with
10 Class I milk, and if not assessed a Class I
11 upcharge, have an advantage in that
12 competition; however, we would caution, in the
13 words of the old adage, "Be careful what you
14 ask for."

15 Until far more is known about the
16 nature of competition in the overall beverage
17 market and the position of these various new
18 beverages in that competitive framework, one
19 may well level the playing field with fluid
20 milk in, say, 10 percent of the market but
21 create a disadvantage for milk ingredients in
22 90 percent of the market, a result which
23 benefits no one in the dairy sector.

24 We would also caution that this type
25 of regulatory constraint creates a disincentive

1 S. Tucker - Direct Testimony

2 to innovation in the dairy sector which places
3 the dairy industry at a long-term and
4 significant disadvantage to other sources of
5 protein, notably soy. Thank you.

6 MR. FARRELL: Thank you,
7 Mr. Tucker. One question to clarify the
8 statement if I may. The table which appears on
9 page four of your statement, what is the source
10 for that information?

11 THE WITNESS: These are
12 figures that Fonterra has drawn up for its own
13 market research and analysis. We do a lot of
14 this sort of thing in many of the 140 markets
15 we have.

16 The source of the data is a number
17 of sources, in fact. The United States ITC,
18 the American Dairy Products Institute, and
19 various soy publications. We also have some of
20 our own market research data in it.

21 MR. FARRELL: Without
22 objection could we move this into the record?

23 JUDGE DAVENPORT: Objections?
24 There being none, this Statement 19 will be
25 admitted into evidence at this time.

1 S. Tucker - Direct Testimony

2 (Exhibit No. 19 was admitted
3 into evidence.)

4 MR. FARRELL: And I just have
5 a couple of questions to clarify some issues
6 which were raised by earlier witnesses.

7 First, this morning we heard some
8 concern that the production of milk protein
9 concentrate in the United States cannot be
10 undertaken without subsidy. Would you respond
11 to their comment?

12 THE WITNESS: Sure. We would
13 actually completely refute that statement.
14 Fonterra, working with our partners, Dairy
15 Farmers of America, have established an MPC
16 plant in Portales, New Mexico, which is
17 currently operating very profitably. We cannot
18 keep up with demand for the product coming out
19 of there. It is attracting a price premium
20 over imported MPC as it is a Grade A MPC
21 product.

22 We think that this is a pretty good
23 example of how you can make MPC profitably in
24 the U.S. without any subsidy.

25 In fact, as I mentioned in my

1 S. Tucker - Direct Testimony

2 testimony, the plant in Portales used to make
3 nonfat dry milk powder. We are now taking milk
4 off that strain to put on the MPC strain
5 because of its profitability.

6 I might just also note that other
7 manufacturers of dairy ingredients in the U.S.
8 are commencing production of MPC, and we are,
9 in fact, working with United Dairymen of
10 Arizona to make MPC in Phoenix.

11 MR. FARRELL: Thank you.
12 There was also some concern about a product
13 which contained a label showing MPC as an
14 ingredient that was also marked Grade A.
15 Could you explain the source of that MPC
16 ingredient?

17 THE WITNESS: If it is MPC
18 labeled Grade A, it must have been manufactured
19 in the U.S. at the Portales plant from U.S.
20 milk.

21 MR. FARRELL: Thank you. That
22 concludes our direct testimony.

23 JUDGE DAVENPORT: Examination?
24 Yes, sir.

25 MR. BUNTING: John Bunting. I

1 S. Tucker - Cross - by Mr. Bunting
2 am representing the National Family Farm
3 Coalition.

4 JUDGE DAVENPORT: Could you
5 spell your last name for the reporter.

6 MR. BUNTING: Yes.

7 B-U-N-T-I-N-G.

8 -----

9 CROSS-EXAMINATION

10 BY MR. BUNTING:

11 Q. Mr. Tucker, when did Fonterra or
12 New Zealand, more correctly, begin importing or
13 manufacturing MPCs, to the best of your
14 knowledge?

15 A. In New Zealand?

16 Q. Yes.

17 A. I am not authoritative on the
18 subject. I don't really want to guess, so I
19 won't. But it was well over a decade ago.

20 Q. I'm sorry? What?

21 A. Well over a decade ago.

22 Q. Twenty years ago?

23 A. It was?

24 Q. That's what you --

25 A. No. I'm saying more like --

1 S. Tucker - Cross - by Mr. Bunting

2 Q. Ten years ago, rather? Ten to 20
3 years ago?

4 A. Yes.

5 Q. Now, you mentioned the Portales
6 plant, and there's quite a bit of discussion in
7 terms of how much MPCs are there, being
8 manufactured there. I realize that's a
9 proprietary question, but nonetheless it
10 is critical and important because the claim
11 is being made by many manufacturers that they
12 are obtaining their MPCs from the Portales
13 plant.

14 Q. Could you give us an idea, roughly
15 speaking, to the volume that is being produced
16 of MPCs in that plant? You don't have to be
17 precise, but --

18 A. Yes. I would rather not get into
19 that. I am happy to say that a significant
20 proportion of our customers' demand for MPC in
21 the U.S. is being met in Portales.

22 Q. So we have no idea, roughly
23 speaking, in terms of the total MPC use within
24 the country of what proportion the Fonterra
25 joint venture would be?

1 S. Tucker - Cross - by Mr. Bunting

2 A. I would rather not say.

3 MR. FARRELL: That is
4 proprietary information.

5 MR. BUNTING: Yes, I realize
6 that. I am just trying to get a generalized
7 statement there. I am not trying to push the
8 thing. It is very difficult to find.

9 Q. People are making the claim that
10 they are getting Grade A or MPCs from that
11 plant, but there's no way to verify whether, in
12 fact, they are. Is that what you said, it's
13 true?

14 A. Well, I can tell you that we are
15 meeting a significant proportion of customers'
16 claims, and so we know there is a lot of
17 Grade A MPC being used in the U.S.

18 Q. Is Fonterra importing MPCs as well
19 to the U.S.?

20 A. Yes.

21 MR. BUNTING: Thank you.

22 JUDGE DAVENPORT: Other
23 examination of this witness? Mr. Vetne.

24 -----

25

1 S. Tucker - Cross - by Mr. Vetne

2 CROSS-EXAMINATION

3 BY MR. VETNE:

4 Q. Mr. Tucker, my name is John Vetne of
5 J. P. Hood.

6 The MPC that's being made now in
7 Portales, New Mexico, is that made from
8 pressure producer milk as well as nonfat dry
9 milk or one or the other?

10 A. Yes.

11 Q. Is it made from both?

12 A. Well, it is a start-to-finish MPC
13 plant. You put milk in at one end and MPC
14 comes out the other. We are not playing with
15 that process in any way.

16 Q. Is the MPC produced from milk that
17 has been previously manufactured as nonfat dry
18 milk by others?

19 A. To the best of my understanding, no.

20 Q. And MPC is a dry ingredient and
21 Class IV in the American system?

22 A. I understand so, yes.

23 Q. What is the by-product of the MPC
24 processing?

25 A. I know lactose is a by-product.

1 S. Tucker - Cross - by Mr. Vetne

2 Q. Is that dried and marketed?

3 A. That's a good question. I assume
4 that it is. I am not completely familiar with
5 the lactose market in the U.S. I am afraid.

6 Q. All right. New Zealand, you say it
7 has been completely deregulated. Does that
8 mean that there is no regulated classified
9 pricing system whereby revenues from fluid are
10 cross-subsidized in manufactured uses?

11 A. The fluid market in New Zealand is
12 very small. We only have 4,000,000 people. I
13 don't know the exact details, but I would
14 suspect you can do very little
15 cross-subsidizing of the volume of ingredients
16 that we make off the bat to 4,000,000 fluid
17 milk consumers.

18 Q. Did New Zealand at one point have a
19 classified pricing system by regulations
20 similar to that in the United States?

21 A. I am afraid I don't know.

22 MR. VETNE: Thanks.

23 JUDGE DAVENPORT: Other
24 examination? Mr. Beshore.

25 MR. BESHORE: Marvin Beshore

1 S. Tucker - Cross - by Mr. Beshore
2 for the Dairy Farmers of America.

3 -----

4 CROSS-EXAMINATION

5 BY MR. BESHORE:

6 Q. Good morning, Mr. Tucker. I want to
7 congratulate Fonterra USA on its choice of
8 locations for its headquarters in Harrisburg,
9 being a Harrisburg resident.

10 You mentioned in your testimony a
11 distinction between Grade A and Grade B MPC and
12 their uses, or you noted that. Could you
13 elaborate on that?

14 You said that the Portales
15 production is Grade A and, therefore, that uses
16 that were not available -- if I understood your
17 testimony correctly -- that were not available
18 to the nonGrade A production of MPC that would
19 be imported from New Zealand. Did I understand
20 that correctly?

21 A. I am not an expert in Grade A
22 regulations, but I do understand that for the
23 product, the dairy product, to receive Grade A,
24 it must be manufactured in the U.S. under the
25 current rules.

1 S. Tucker - Cross - by Mr. Beshore

2 As the Portales plant is currently,
3 to the best of my understanding, the only plant
4 in the U.S. which is manufacturing MPC, and I
5 do know it does have Grade A standard there,
6 and I think you can -- that's what I say about
7 that.

8 Q. Okay. Can you provide any
9 information on the limitations of the usage of
10 MPC if it does not have Grade A certification?

11 A. Again, that is outside of my area of
12 expertise, so I wouldn't want to speak to that.
13 I do know, for example, you can use MPC of any
14 sort in standardized cheese. But apart from
15 that, I am afraid I am getting into areas I am
16 not completely familiar with.

17 Q. Okay. Let me go to the table on
18 page four of Exhibit 19. Can you tell me, what
19 geographic market area does that data
20 represent?

21 A. I understand it is a global data
22 set. My belief is that given the US stands in
23 the forefront of uses of protein ingredients
24 with a soy or dairy-based protein that would be
25 dominated by U.S. data, and while I didn't do

1 S. Tucker - Cross - by Mr. Beshore
2 the calculation myself, looking at the fact
3 that its USRTC and ATPI data predominantly, it
4 is my guess that most of it is U.S. data.

5 Q. It is a global data set, but you
6 believe most of it to be U.S., however?

7 A. Correct.

8 Q. What products are included in the
9 base for the data?

10 A. Milk protein, casein, whey and soy
11 uses in nutritional applications.

12 Q. I guess my question was more like
13 what do you consider nutritional applications,
14 what all sorts of products?

15 A. Well, I don't want to answer that
16 because I am not fully confident of my answer.
17 Perhaps just the point of that table, and it is
18 not supposed to be an authoritative picture, we
19 do this sort of research because we are
20 constantly looking out 15 to 20 years where the
21 use of dairy ingredients is going.

22 I wouldn't say that these figures
23 are definitive, but they are very suggestive to
24 us that soy over a five-year period, a
25 four-year period, has made inroads into the use

1 S. Tucker - Cross - by Mr. Beshore
2 of dairy protein.

3 The purpose of having the table in
4 my testimony is really just to indicate that
5 fact, which I think goes to the heart of our
6 overall message here that we need to be
7 constantly mindful of the fact that dairy is
8 competing against other protein sources in the
9 U.S. nutritional food market, and anything we
10 do to disadvantage the use of dairy is likely
11 to lead to the overall cost of the dairy
12 industry going forward.

13 Q. I understand that your contention
14 and the table shows that -- your statement is
15 that the table shows that soy has made inroads
16 into the markets, but you haven't defined the
17 products, other than those just generally
18 nutritional products, the products in which soy
19 is used. I am wondering what --

20 You don't market soy, do you,
21 Fonterra?

22 A. No, we do not. We are 100 percent
23 dairy.

24 Q. Then what would be -- do you know
25 what the basis was for the information about

1 S. Tucker - Cross - by Mr. Beshore

2 the volumes of soy?

3 A. From what I understand from our
4 people who put this table together, they got
5 that data from various soy publications which
6 talked about the use of soy as an ingredient in
7 nutritional applications.

8 Q. Now, do you have any information
9 with respect to what subset, if any, of that
10 data related to beverages?

11 A. No, I don't. And I think that
12 really underscores one of the problems that we
13 are grappling with. There is really not very
14 much information around about the use of
15 different protein sources in different
16 applications in the U.S. food industry.

17 We would like to see a lot more work
18 done in this area before we start changing the
19 rules too hurriedly, because I am not convinced
20 that anybody has really an accurate picture of
21 just how much soy, for example, is being used
22 vis-a-vis dairy in the marketplace.

23 Q. With respect to -- you understand --

24 Let me ask you if you do understand
25 that the only so-called upcharge that could

1 S. Tucker - Cross - by Mr. Beshore
2 result from this hearing would be with respect
3 to milk proteins in fluid milk products?

4 A. Yes, I do understand that.

5 Q. Okay. So that the only possible
6 competitive effect versus soy, if there is any,
7 would be with respect to soy versus dairy
8 proteins in fluid milk products. Do you
9 understand that?

10 A. I do. I mean, I think it is -- it
11 is an interesting question and it really goes,
12 again, to the heart of the industry we are
13 looking at here, which is a fast evolving one.

14 In some ways we are at least
15 interested in the situation today, but we are
16 wondering what the situation is going to be
17 like in 15, 20 years' time. We already have
18 data on the record today that suggests that soy
19 as a protein ingredient is coming into the
20 market at 50 percent less than dairy protein,
21 which would be consistent with our
22 understanding of the market as well.

23 Today we see that there is not
24 perhaps much soy compared to dairy in the use
25 of fluid beverages. I wouldn't want to be

1 S. Tucker - Cross - by Mr. Carlin
2 assured that in 15 to 20 years that will remain
3 the case if dairy is twice or more expensive as
4 an ingredient such as soy.

5 Q. Are you aware that there are
6 100 percent soy protein so-called milks out
7 there?

8 A. I have never tasted one, but I have
9 seen them on the supermarket shelves.

10 Q. I haven't tasted one either.

11 JUDGE DAVENPORT: In view of
12 the hour, let's take our morning break at this
13 time, and let's be back at five after ten.

14 (Recess taken.)

15 JUDGE DAVENPORT: Do we have
16 other examination of Mr. Tucker?

17 MR. CARLIN: Yes, sir.

18 JUDGE DAVENPORT: Mr. Carlin.

19 MR. CARLIN: My name is Gerald
20 Carlin.

21 -----

22 CROSS-EXAMINATION

23 BY MR. CARLIN:

24 Q. Mr. Tucker, what percentage of
25 New Zealand milk did Fonterra market?

1 S. Tucker - Cross - by Mr. Carlin

2 A. Of total milk produced in
3 New Zealand, probably about 95 percent.

4 Q. So there is limited competition?

5 A. Well, it depends. In terms of the
6 domestic U.S. -- sorry. In terms of the
7 domestic New Zealand market, Fonterra has about
8 40 percent market share. We are not the
9 largest player in the New Zealand dairy
10 industry.

11 We are the largest exporter,
12 although we compete here in the U.S. with two
13 other New Zealand dairy companies, Wisland
14 Foods and Tattour, and we expect to soon be
15 competing with two new dairy companies which
16 started in New Zealand, Open Country Cheese and
17 Zidalone

18 So we are by far the largest
19 exporter. We have the minority of the market
20 in New Zealand, and we do compete with other
21 New Zealand companies. So that's the
22 situation.

23 Q. Is MPC used in New Zealand's
24 domestic market?

25 A. I understand so. I am not an expert

1 S. Tucker - Cross - by Mr. Carlin
2 in the New Zealand domestic market, but that is
3 my understanding.

4 Q. You say -- it is Portales or
5 Portales, New Mexico?

6 A. I pronounce it Portales, but some
7 people tell me I've got an accent, so --

8 Q. You say that the Portales plant is
9 providing MPC for Grade A markets in the United
10 States, yet MPC imports, especially the 4049,
11 increased 54 percent this year from January to
12 April over last year at the same time. How
13 would you explain that?

14 A. I think there's a number of factors
15 at play in the U.S. MPC market. I think if you
16 go back through just the first four months of
17 this year as opposed to the first four months
18 of last year, you see a picture of MPC imports
19 being up and down.

20 In fact, MPC serum imports have been
21 I think relatively flat over the past four or
22 five years. We have seen those growth rates in
23 the first part of this year. Some of them we
24 think are explained by some inventory
25 management issues that we have been through

1 S. Tucker - Cross - by Mr. Carlin

2 ourselves.

3 I guess my answer is that I suspect
4 over the course of 2005 MPC imports may be up a
5 bit and that reflects good demand for this
6 product. It reflects the fact that 2004 was a
7 relatively low year of MPC imports, but
8 fundamentally I think it reflects the demand
9 for MPC in the U.S., which frankly is one of
10 the reasons why we are exploring the options to
11 manufacture here in the U.S.

12 New Zealand doesn't really --
13 Fonterra doesn't really want to manufacture
14 more MPC than it is currently in New Zealand.

15 We have a very strong whole milk
16 powder business particularly in Asia, which is
17 driving extremely high returns. Obviously if
18 you make whole milk powder you don't make
19 anything else.

20 So for product mix reasons there is
21 a strong theme to manufacture more here in the
22 U.S.

23 Q. Now, when did the Portales plant
24 start producing MPC?

25 A. Roughly three months ago. It was

1 S. Tucker - Cross - by Mr. Wilson
2 built over the -- in terms of full commercial
3 production in its current configuration, I
4 think around about the beginning of 2004 was
5 about the time it came on stream fully.

6 MR. CARLIN: Okay. That's all
7 the questions. Thank you.

8 JUDGE DAVENPORT: Other
9 examination of this witness? Mr. Wilson.

10 MR. WILSON: Todd Wilson,
11 U. S. Department of Agriculture.

12 -----

13 CROSS-EXAMINATION

14 BY MR. WILSON:

15 Q. Good morning. The product that you
16 made in the Portales facility, the MPC, do you
17 support -- or when accounting for that product,
18 do you account for it on a protein basis or do
19 you account for it on a milk equivalent basis
20 on protein?

21 A. I am afraid you are outside of my
22 area of expertise.

23 MR. WILSON: That's all I
24 have.

25 JUDGE DAVENPORT: Very well.

1 S. Tucker - Cross - by Mr. Bunting
2 Other examination of this witness? This is
3 Mr. Bunting again.

4 -----

5 CROSS-EXAMINATION

6 BY MR. BUNTING:

7 Q. You brought up a question in my
8 mind, and that is that you said Fonterra
9 domestically, that is, within New Zealand,
10 prefers to limit the production of MPCs because
11 they have a large market for whole milk powder.

12 Are you suggesting that it is more
13 profitable to make whole milk powder than MPCs
14 for Fonterra domestically?

15 A. That is an extremely complicated
16 question. We have over 100 people who sit in
17 an office in Auckland and work out things like
18 that. I think it is probably profitable for
19 Fonterra to make both.

20 Q. But the profit from MPCs is not
21 superior to whole milk powder? I don't know
22 whether I am allowed to make an assumption, but
23 it would seem to me from your statement that
24 they are compatible. Would that be roughly
25 speaking?

1 S. Tucker - Cross - by Mr. Bunting

2 A. I wouldn't draw that conclusion. I
3 am afraid I don't know the exact way in which
4 the milk is carved up for different uses. I do
5 know that MPC is a profitable business. I do
6 know that whole milk powder is a profitable
7 business. Our aim is to fulfill our customers'
8 requirements with both products.

9 Q. Would you say it is not likely that
10 Fonterra would be making whole milk powder and
11 selling that when they could be making MPCs
12 more profitably?

13 A. Well, I think there's a strong
14 global demand for both products. It is our
15 business to try to meet our customer
16 requirements, so we want to make both products.

17 New Zealand only has a certain
18 quantity of milk. You know, there are
19 different calculations about where it makes
20 sense to make different products, but one of
21 the things driving our desire to make more MPC
22 in the U.S. is because of the strong demand for
23 the product here.

24 The dairy industry in the U.S. is a
25 very strong performing one. It makes sense to

1 P. Lovera - Direct Testimony

2 make MPC here for you, its customers.

3 Q. Would you say that the bulk of
4 Fonterra's customers in their purchasing of
5 MPCs domestically, in the United States, are
6 doing so for reasons of economy?

7 A. You would be better off to ask them,
8 I am afraid, not us.

9 MR. BUNTING: Okay. Thank you
10 very much.

11 JUDGE DAVENPORT: Other
12 examination of this witness?

13 Very well. Mr. Tucker, thank
14 you again for your testimony. You may step
15 down.

16 Mr. Tipton, I do have one lady
17 who assures me that her testimony may be brief.
18 Would you raise your right hand.

19

20

PATRICIA LOVERA

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

23 JUDGE DAVENPORT: Please tell
24 us your full name, please, and spell your last
25 name for the hearing reporter.

1 P. Lovera - Direct Testimony

2 THE WITNESS: Patricia Lovera,
3 L-O-V-E-R-A.

4 JUDGE DAVENPORT: Very well,
5 Ms. Lovera. You have given me a statement and
6 provided a copy to the hearing reporter. It
7 has been marked as Exhibit 20 for
8 identification. We will proceed to read it at
9 this time.

10 (Exhibit No. 20 was marked for
11 identification.)

12 THE WITNESS: My name is
13 Patricia Lovera, and I am deputy director of
14 the Energy and Environment Program at Public
15 Citizen.

16 Public Citizen is a national,
17 non-profit consumer advocacy organization based
18 in Washington, D.C. The organization was
19 founded in 1971 to represent consumer interests
20 in Congress, the executive branch and the
21 courts, and currently has approximately 150,000
22 members.

23 The food team at Public Citizen has
24 focused on many issues over the years ranging
25 from meat inspection, food irradiation, food

1 P. Lovera - Direct Testimony

2 labeling, aquaculture, intensive livestock
3 operations, and international food trade. In
4 the last year or so, we have started to monitor
5 dairy issues, especially the controversy
6 surrounding the growing use of milk protein
7 concentrate.

8 I am here today to state Public
9 Citizen's opposition to the proposal to change
10 the definition of milk. Our opposition is
11 based on concerns with the specific details of
12 the proposal as well as the process by which
13 this change is being considered.

14 First is Safety Concerns. Public
15 Citizen shares the concerns of many dairy
16 farmers and other food experts about the use of
17 MPC. The lack of approval by the Food and Drug
18 Administration as a food ingredient and the
19 failure of companies using MPC to conduct the
20 research necessary to determine if MPC meets
21 Generally Regarded as Safe standards are
22 extremely troubling.

23 While I understand that these are
24 issues which fall under the authority of the
25 FDA, not the USDA, they should not be ignored

1 P. Lovera - Direct Testimony

2 in the debate over these proposals to expand
3 the definition of milk to include the use of
4 MPC.

5 Public Citizen feels that the use of
6 MPC should not be allowed in processed foods or
7 cheese. To allow the use of MPC in a liquid
8 that is legally allowed to be called "milk" is
9 similarly unacceptable, but is also deceptive
10 to consumers who have a long held understanding
11 of what milk is, and that understanding does
12 not include the addition of untested,
13 unregulated substances.

14 While the questions surrounding the
15 wholesomeness and purity of MPC are a critical
16 factor in our opposition to the proposal to
17 allow the re-definition of milk to include the
18 use of solids such as MPC, they are not our
19 only concern.

20 The impact that increased imports of
21 MPC are having on domestic dairy producers is
22 also extremely worrisome. The displacement of
23 milk and powdered milk by imported MPC is
24 further exacerbating the economic hurdles faced
25 by domestic dairy farmers. Encouraging the use

1 P. Lovera - Direct Testimony

2 of MPC in even more products, as this proposed
3 re-definition will do, will only serve to
4 further disadvantage domestic producers.

5 The marketing order system utilizes
6 Grade A milk, a designation which is based on a
7 system of farm inspection. Since the vast
8 majority, if not all, MPC is produced outside
9 of the U.S., how can MPC be considered as a
10 component in a product that is dependent on
11 this USDA class-based pricing system? MPC is
12 generated from places that do not receive the
13 Grade A designation and it should not be
14 allowed into products labeled as "milk."

15 The second category I have is due
16 process concerns. The controversy over the use
17 of MPC in food products is not a new one. This
18 has been a subject of debate not only for the
19 dairy industry but for Congress, the FDA, and
20 consumers. Therefore, it is worrisome that an
21 action as significant as changing the
22 definition of milk could happen through the
23 milk market order system, a process that most
24 consumers have never heard of. The FDA and
25 USDA recently announced a joint initiative to

1 P. Lovera - Cross - by Mr. Beshore
2 modernize the standards of identity for foods,
3 a process which should involve somewhat more
4 transparency and opportunity for input from the
5 public than this hearing process.

6 Public Citizen opposes any change
7 to the definition of milk that would allow the
8 use of MPC, and we will voice that opposition
9 in any forum where this issue arises. But in
10 the interest of transparency and involving all
11 of the parties impacted by such a change,
12 especially the consumers who drink the product
13 in question, such a fundamental change should
14 be the subject of a much broader and much more
15 public debate. Thank you.

16 JUDGE DAVENPORT: Questions of
17 this witness? Mr. Beshore.

18 MR. BESHORE: Marvin Beshore
19 for Dairy Farmers of America.

20

21

CROSS-EXAMINATION

22 BY MR. BESHORE:

23 Q. Ms. Lovera, what has led Public
24 Citizen to think that the proposals, any
25 proposals in this hearing, might change the use

1 P. Lovera - Cross - by Mr. Beshore
2 of MPCs and fluid milk?

3 A. Well, I mean, the Federal Register
4 notice that I read that alerted me to this
5 process, there was one that exclusively
6 mentioned MPCs, and then the other proposed
7 amendment seems to indicate that ingredients
8 such as MPC continues to adjust these protein
9 issues.

10 Q. If I were to suggest to you that the
11 proposals supported by Dairy Farmers of America
12 and the National Milk Producers Federation
13 would only change the pricing of the protein or
14 make a difference in the manner in which the
15 pricing of protein in Class I, protein
16 ingredients in Class I is calculated, and
17 wouldn't allow or disallow the use of any
18 proteins in any way, would that change your
19 thinking about the proposals at all?

20 A. Well, I mean, I understand that the
21 topic here, the debate here has been about
22 pricing, but it is my understanding that that's
23 not all that these marketing orders affect in
24 reality what the consumers see in the stores.

25 I mean, we have been hearing about

1 P. Lovera - Cross - by Mr. Beshore
2 competition from other types of beverages, and
3 we are very concerned about what labels
4 represent to consumers, and if there's going to
5 be competition from the beverages that contain
6 these substances and they are being marketed
7 and they are allowed to be priced as milk, we
8 have a lot of concerns about --

9 THE REPORTER: I can't hear
10 you.

11 THE WITNESS: Okay.

12 A. Our big concern for consumers is the
13 integrity of labels, what information that they
14 will give them so that they can make choices on
15 an informed basis.

16 I understand that this marketing
17 order is not exactly a label, but it is one of
18 the factors in how this product is presented to
19 people.

20 We have been hearing a lot about
21 competition between different beverages and
22 fluid milk, and all of that plays into how
23 consumers are going to decide what they are
24 buying and what they think they are buying.

25 Q. Would you agree that protein, dairy

1 P. Lovera - Cross - by Mr. Beshore
2 proteins in milk, in beverage products, fluid
3 milk beverage products, which are supplied by
4 MPCs should be priced commensurate with the
5 protein content of other fluid milk products?

6 A. Until they achieve GRAS status, I
7 don't think they should be used. So I think
8 pricing should come second to that.

9 Q. Well, assuming that they can be used
10 because they are a Grade A.

11 A. We have other concerns about MPCs
12 besides their grading. The grading is the
13 thing that I brought up because that is the
14 USDA's domain, but we have a lot of FDA
15 concerns about why this product should even be
16 used.

17 Q. Assuming they can be used for
18 purposes of discussion, would you not agree
19 that that protein should be priced
20 commensurately with protein in fresh fluid
21 milk? It shouldn't get a price break? It
22 shouldn't be priced lower or allowed to avoid
23 the price of protein in fresh fluid milk?

24 A. My understanding of the use of MPCs
25 is that in some instances it is replacing fluid

1 D. Davis - Direct Testimony

2 milk, and in that case I would defer to people
3 who produce milk like the farmers who tell me
4 that it shouldn't be used at all. That's where
5 we should stop and not worry about the pricing
6 indications.

7 Q. But if it were used, shouldn't it
8 have at least the same price? Should it be
9 priced at Class I like fresh fluid milk protein
10 is?

11 A. It is not fresh fluid milk.

12 Q. Okay. Thank you.

13 A. I mean, it is a different product.

14 JUDGE DAVENPORT: Other
15 examination of this witness? Very well,
16 Ms. Lovers, you may step down. Thank you for
17 your testimony.

18 Now, Mr. Tipton, it looks like you
19 are up. Mr. Davis, raise your right hand.

20 -----

21 DREW DAVIS

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

24 JUDGE DAVENPORT: Would you
25 please state your name for the record.

1 D. Davis - Direct Testimony

2 THE WITNESS: My name is Drew
3 Davis, D-A-V-I-S. I am here today representing
4 the American Beverage Association. I have been
5 employed by them for 32 years. I am a lawyer.
6 I have worked on a number of issues affecting
7 beverages across the spectrum from those today,
8 the dairy-based beverages to traditional
9 carbonated beverages, juices, bottled waters,
10 et cetera.

11 (Exhibit No. 21 was marked for
12 identification.)

13 JUDGE DAVENPORT: Very well.
14 You have a statement which has been marked
15 as Exhibit 21. Would you to read that,
16 please.

17 THE WITNESS: Yes, Your Honor.
18 I am Drew Davis, Vice President of Federal
19 Affairs for the American Beverage Association.
20 The American Beverage Association
21 has been the trade association for America's
22 nonalcoholic refreshment beverage industry for
23 more than 85 years. Founded in 1919 as the
24 American Bottlers of Carbonated Beverages and
25 renamed the National Soft Drink Association in

1 D. Davis - Direct Testimony

2 1966, ABA today represents hundreds of beverage
3 producers, distributors, franchise companies
4 and support industries. ABA's members employ
5 more than 211,000 people who produce U.S. sales
6 in excess of \$88 billion per year.

7 According to the American Economics
8 Group, Inc., direct, indirect and induced
9 employment in the beverage industry means
10 more than three million jobs that create
11 \$278 billion in economic activity. At the
12 state and federal level, beverage industry
13 firms pay more than \$30 billion of business
14 income taxes, personal income taxes, and other
15 taxes, with over \$14 billion in taxes paid to
16 state governments alone. In 2003 it is
17 estimated that beverage companies donated
18 \$326 million to charities.

19 With innovation and creativity, our
20 member companies have been developing a wide
21 range of new products to maintain and expand
22 consumer choices. Our members market literally
23 hundreds of brands, flavors and packages,
24 including carbonated soft drinks,
25 ready-to-drink teas and coffees, bottled

1 D. Davis - Direct Testimony

2 waters, fruit juices, fruit drinks, and sports
3 drinks.

4 In addition, a number of our members
5 have developed new products that utilize milk,
6 or components thereof, as an ingredient. These
7 new beverage products are generally classified
8 as Class II because they contain less than
9 6.5 percent nonfat milk solids.

10 In response to the initial Dairy
11 Farmers of America request that the
12 Agricultural Marketing Service initiate a
13 hearing to modify the fluid milk product
14 definition, the American Beverage Association
15 submitted a comment urging that AMS not proceed
16 to a hearing.

17 We did not believe that there was
18 any basis to suggest that the current
19 definition is failing to properly classify
20 products. Rather than forcing parties to
21 proceed to the time and cost of a hearing, we
22 argued that AMS should conduct an economic
23 analysis to examine if these new products were,
24 in fact, competing with fluid milk for
25 consumers.

1 D. Davis - Direct Testimony

2 Unfortunately, AMS has ignored our
3 request and proceeded to this public hearing
4 without conducting any economic analysis and
5 despite the fact that there is no demonstrable
6 evidence that the current system is not
7 working.

8 Nevertheless, I am pleased to be
9 here today to reiterate the American Beverage
10 Association's position with respect to the
11 proposals to amend the fluid milk product
12 definition.

13 In general, AMS is required to
14 classify products according to their form and
15 use. In particular, the fluid milk product
16 definition is intended to cover products that
17 compete with or substitute for fluid milk.

18 Fluid milk is a higher value product
19 than other dairy products. By treating dairy
20 products that compete with fluid milk for
21 consumer dollars as Class I, the fluid milk
22 product definition, in theory, helps to ensure
23 that producers receive more of a benefit from
24 those products than they would receive if the
25 products were Class II or some other

1 D. Davis - Direct Testimony

2 classification.

3 The fundamental framework of the
4 current classification system was established
5 in 1974. In that 1974 decision, AMS excluded
6 products that contained less than 6.5 percent
7 nonfat milk solids from the fluid milk
8 definition because they do not compete with
9 fluid milk. To quote part of the decision,
10 "Fluid products containing only a minimal
11 amount of nonfat milk solids are not considered
12 as being in the competitive sphere of the
13 traditional milk beverages."

14 The decision goes on to state that
15 the "6.5 percent standard is used to exclude
16 from the fluid milk product definition those
17 products which contain some milk solids but
18 which are not closely identified with the dairy
19 industry, such as chocolate-flavored drinks in
20 pop bottles."

21 The 6.5 percent exception has not
22 been changed since it was established in 1974,
23 and we believe that neither the petitioners nor
24 AMS has presented sufficient evidence to
25 warrant any change at this time. In fact, AMS

1 D. Davis - Direct Testimony

2 decided against changing the 6.5 percent nonfat
3 milk solids exception during the Federal Milk
4 Marketing Order reform that was conducted in
5 1998 and 1999.

6 At that time AMS noted that
7 modifying or eliminating the standard would
8 greatly expand the fluid milk market category
9 to include many essentially nonmilk products
10 that contain very little milk in them.

11 AMS also commented on how such a
12 change could skew competition in the market by
13 giving a competitive advantage to products that
14 do not use dairy products and could lead to
15 less use of dairy products as manufacturers
16 reformulate their recipes to use little or no
17 fluid milk in their products.

18 These factors hold true today. Any
19 modification to the terms or application of the
20 6.5 percent nonfat milk solids standard would,
21 in AMS's own words, "Greatly expand the fluid
22 milk market category to include many
23 essentially nonmilk products that contain very
24 little milk in them."

25 In general, agencies bear a heavy

1 D. Davis - Direct Testimony
2 burden to justify changes to long-standing
3 regulatory provisions. Given such a recent
4 reconsideration of this provision, any effort
5 to modify the current standard must be
6 supported by compelling evidence, evidence
7 which we submit has not been generated by
8 petitioners or AMS. AMS should therefore
9 refrain from making any changes to the current
10 classification system.

11 Certainly, a wide array of new
12 drinkable products in which milk is an
13 ingredient continue to be developed by food and
14 beverage manufacturers, and these products have
15 been and continue to be appropriately
16 classified under the current definition. The
17 fact that some of these new products may fall
18 outside of the Class I definition does not mean
19 that the current definition needs to be
20 changed.

21 As I noted, the fundamental goal of
22 the fluid milk definition is to cover products
23 that compete with fluid milk. We do not
24 believe there is any evidence demonstrating
25 that these new products that contain milk as an

1 D. Davis - Direct Testimony

2 ingredient are competing with or substituting
3 for fluid milk.

4 Rather, we believe that these
5 products are competing against soft drinks,
6 juices, bottled waters, fruit drinks, not fluid
7 milk. There is simply no factual basis upon
8 which to conclude that any products that our
9 member companies produce are competing with
10 fluid milk for the same consumers.

11 The decline in fluid milk
12 consumption started long before our member
13 companies began developing new products that
14 utilize dairy as an ingredient. In fact,
15 producers should applaud these new products,
16 not try to penalize them by including them in
17 the fluid milk product definition.

18 By increasing the cost of the dairy
19 ingredients, reducing or eliminating the
20 6.5 percent standard, or the application
21 thereof, could stifle innovation and could slow
22 or even halt the development and introduction
23 of new products.

24 Products that are currently
25 profitable may become unprofitable, while

1 D. Davis - Direct Testimony

2 products that are marginally unprofitable but
3 hold promise may simply be dropped. This would
4 not only hurt companies and consumers, but it
5 would also hurt producers by driving companies
6 away from the use of milk as an ingredient in
7 their products, leading to lower producer
8 income.

9 In conclusion, the American Beverage
10 Association believes that there is no basis to
11 justify changing the current fluid milk product
12 definition. Producers should be embracing the
13 development of these new products that utilize
14 milk or milk components which are helping to
15 expand the demand for milk and increase dairy
16 producer income. And any effort to narrow the
17 scope or application of the 6.5 percent
18 exception or expand the Class I definition will
19 result in companies seeking alternative
20 ingredients wherever possible.

21 If AMS believes that some action is
22 necessary, then instead of making changes to
23 the current regime, AMS should first conduct a
24 thorough economic analysis to determine which
25 products, if any, are competing with or

1 D. Davis - Direct Testimony

2 substituting for fluid milk, and it should
3 provide the opportunity for public comment on
4 such analysis before it moves forward with any
5 recommended decision to modify the current
6 fluid milk product definition.

7 We are confident that such an
8 analysis would demonstrate that our members'
9 products are not competing with fluid milk,
10 that our members help to expand the demand for
11 dairy, thereby helping dairy producers, and
12 that modifying the terms or application of the
13 current fluid milk product definition would
14 lead manufacturers to use other nondairy
15 ingredients in their products.

16 We appreciate the opportunity to
17 comment on this matter, and we thank you for
18 your consideration.

19 JUDGE DAVENPORT: Examination
20 of this witness? Mr. Beshore.

21 First, before you get to that,
22 objections to receiving this statement into the
23 record?

24 Very well. The statement will be
25 admitted into the record as Exhibit 21.

1 D. Davis - Cross - by Mr. Beshore
2 (Exhibit No. 21 was admitted
3 into evidence.)

4 -----

5 CROSS-EXAMINATION

6 BY MR. BESHORE:

7 Q. Good morning, Mr. Davis. Marvin
8 Beshore for Dairy Farmers of America.

9 A. Good morning.

10 Q. Mr. Davis, do you have any data to
11 provide the record here with respect to your
12 members' use of milk ingredients in their
13 products?

14 A. In terms of volume or number?

15 Q. Any data.

16 A. No, I do not.

17 Q. Okay. Do you have any data with
18 respect to the types of products and what their
19 ingredients, the components of dairy
20 ingredients are in your members' products?

21 A. I am aware of a number of the
22 products. In terms of the formulas of the
23 product, no, I don't have that information;
24 but, I mean, I can name you some of the
25 products that are out on the market today using

1 D. Davis - Cross - by Mr. Beshore

2 dairy.

3 Q. Some of them were on Mr. Cryan's
4 table, Dr. Cryan's table. Did you hear his
5 testimony?

6 A. I did not.

7 Q. Okay. Can you tell us, are there
8 any products which your members make whose
9 classification would be changed by the adoption
10 of Proposal 7 advanced by the National Milk
11 Producers Federation, Dairy Farmers of America?

12 A. We are concerned that there are a
13 number of the products that are emerging in
14 this area that are very close to the milk
15 solids percentage that is currently the litmus
16 test and that any change in that might bring
17 some of these products under your proposed
18 change.

19 Q. Can you tell us what any of those
20 products are and what the present ingredients
21 in terms of nonfat milk solids are?

22 A. I can tell you that some of the
23 products out there, such as Swerve, Raging Cow,
24 some of the Starbucks frappucinos are in that
25 area. Again, in terms of the formulation, I

1 D. Davis - Cross - by Mr. Beshore

2 have no knowledge of that.

3 Q. Well, if you don't have any
4 knowledge of the formulation, are you aware
5 that, for instance, Proposal 7 would allow
6 additional uses of nonprotein nonfat milk
7 solids, lactose, to be used in your members'
8 products without the classification being
9 impacted? Are you aware of that?

10 A. Yes.

11 Q. Okay. Wouldn't that be a favorable
12 impact of Proposal 7?

13 A. Well, again I go back to the point
14 that where is the economic analysis that shows
15 that the current system is not working?
16 Certainly, the petitioners bear the burden to
17 bring that forward if there is, indeed, a
18 rationale for this change.

19 Q. Are you aware of the difference
20 in --

21 Do your members consider all nonfat
22 milk solids to be of equal value in their
23 products?

24 A. I have no idea, sir.

25 Q. But you are aware, are you not, that

1 D. Davis - Cross - by Mr. Beshore
2 the difference in market value of milk proteins
3 versus lactose is ten-to-one or better?

4 A. I will accept your word for that.

5 Q. Okay. So you accept the fact that
6 the value placed on these ingredients in the
7 marketplace, protein versus nonfat solids
8 versus lactose, is ten-to-one, but you want
9 them to be evaluated equally on the basis of
10 weight in your products. Is that your
11 testimony?

12 A. No. My testimony is that absent any
13 economic analysis that there is a need for the
14 change, we suggest that no change be made.
15 There are a lot of alternative products that
16 could provide protein in some of these new
17 emerging products, many of which are nondairy.

18 I am simply saying that those
19 factors need to be taken into consideration to
20 determine what the impact is going to be if the
21 changes you are proposing are made.

22 Some may be beneficial to my members
23 but some may not. Some may be beneficial to
24 consumers but some may not.

25 I am simply saying that the question

1 D. Davis - Cross - by Mr. Beshore
2 is important enough that the data needs to be
3 there to justify the change.

4 Q. Let's talk about the data that we
5 have. The data we have includes the fact that
6 presently protein, which is worth ten times as
7 much as lactose, is considered equal in
8 determining whether these beverages are fluid
9 milk products or not. You understand that?

10 A. I understand that.

11 Q. Okay. And is it your testimony that
12 that is economically justified?

13 A. My testimony I think is pretty
14 straightforward. The fact that there is this
15 price classification system, I will leave it to
16 those in the dairy industry to justify its
17 existence.

18 My point is that if you are going to
19 make changes as people come out and roll out
20 new products under the current system, then
21 let's have some basis for making changes. We
22 are all playing by the current rules. If you
23 are going to change the rules, then justify the
24 change.

25 Q. And a ratio of ten-to-one in value

1 D. Davis - Cross - by Ms. Carter
2 of ingredients does not provide, in your
3 opinion, does not provide any economic basis
4 for changing the analysis --

5 A. I --

6 Q. Let me finish my question, please,
7 Mr. Davis. It is your testimony that a
8 ten-to-one economic ratio in the value of the
9 milk solids is not an economic basis for
10 reevaluating the test for classification?

11 A. I don't believe that it by itself is
12 a reason for doing that. I think you have to
13 look at the bigger picture than the ratio of
14 two particular sources of protein.

15 MR. BESHORE: Thank you.

16 JUDGE DAVENPORT: Other
17 examination? Ms. Carter.

18 MS. CARTER: Antoinette Carter
19 with USDA.

20 -----

21 CROSS-EXAMINATION

22 BY MS. CARTER:

23 Q. Just one question for you. In your
24 opinion should Federal Milk Marketing Order
25 regulations reflect current marketing

1 E. Olsen - Direct Testimony
2 conditions and current technologies?

3 A. Absolutely.

4 MS. CARTER: Thank you.

5 JUDGE DAVENPORT: Other
6 questions of Mr. Davis?

7 Very well, Mr. Davis. Thank you for
8 your testimony. You may step down.

9 MR. DAVIS: Thank you, Your
10 Honor, for your time.

11 JUDGE DAVENPORT: Mr. Olsen.

12 -----

13 ERIC OLSEN

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

16 JUDGE DAVENPORT: Okay.

17 Please tell us your full name and spell your
18 last name for the hearing reporter.

19 THE WITNESS: Eric Olsen,
20 O-L-S-E-N.

21 JUDGE DAVENPORT: Very well.
22 With Mr. Olsen is also Mary Keough Ledman. I
23 gather that you are going to step in at some
24 point and read the balance of the statement.

25 MS. KEOUGH LEDMAN: Yes, sir.

1 E. Olsen - Direct Testimony

2 JUDGE DAVENPORT: I will swear
3 you separately at that time.

4 (Exhibit No. 22 was marked for
5 identification.)

6 JUDGE DAVENPORT: Very well.
7 Mr. Olsen, you have a statement which has been
8 marked as Exhibit 22. Do you want to proceed
9 to read the first part of this statement.

10 THE WITNESS: My name is Eric
11 Olsen, and I am an attorney with Patton Boggs,
12 a Washington, D.C.-based law firm.

13 Before coming to Patton Boggs in
14 2001, I worked directly for the United States
15 Secretary of Agriculture for seven years,
16 including as Chief of Staff and counsel for
17 domestic policy.

18 On behalf of the Secretary, I was
19 involved in Federal Milk Marketing Order reform
20 and the Northeast Dairy Compact, among many
21 other issues. Prior to coming to Washington,
22 D.C., as an attorney with Farmers Legal Action
23 Group, I was involved in litigation challenging
24 the Class I differential system on behalf of
25 the Minnesota Milk Producers Association.

1 E. Olsen - Direct Testimony

2 With me today is Mary Keough Ledman,
3 who is an agricultural economist providing
4 consultation to the dairy industry. Mary's
5 previous public service includes employment
6 with USDA's Federal Order 30, Glen Ellyn,
7 Illinois, the Foreign Agricultural Service, and
8 the National Agricultural Statistic Service in
9 Washington, D.C. Her private sector experience
10 includes Manager of Dairy Economics for Kraft
11 Foods and Director of Materials Planning for
12 Stella Foods.

13 For the past ten years, she has been
14 employed by Keough Ledman Associates, Inc., a
15 dairy economic consulting firm that provides
16 monthly dairy product and milk price
17 forecasting, economic financial and policy
18 analysis, dairy product and milk sourcing
19 strategies, domestic and international market
20 information, and expert witness testimony.

21 We appear here today on behalf of
22 the National Yogurt Association, NYA. NYA is
23 the national nonprofit trade association
24 representing the producers of live and active
25 culture yogurt products as well as suppliers to

1 E. Olsen - Direct Testimony

2 the yogurt industry.

3 NYA's member companies are among the
4 largest yogurt manufacturers in the United
5 States. NYA sponsors scientific research on
6 the health benefits associated with the
7 consumption of yogurt with live active culture
8 and serves as an information resource to the
9 American public about these attributes.

10 In our testimony today, we will
11 first provide an overview of the classification
12 system and the application of the concepts of
13 form and use. We will then argue that
14 yogurt-containing products that happen to be
15 drinkable, which we will refer to as
16 yogurt-containing products, are food products
17 that should be classified as Class II, and we
18 will conclude by arguing that dairy producers
19 should focus on expanding the market for their
20 products, not creating incentives for food
21 manufacturers to use nondairy ingredients.

22 The Agricultural Marketing Agreement
23 Act requires that milk be classified in
24 accordance with the form in which or the
25 purpose for which it is used. AMS rulemakings

1 E. Olsen - Direct Testimony

2 over the years discuss the application of the
3 concepts of form and use to the fluid milk
4 product definition and classification system.

5 The current regulations provide
6 that fluid milk product means any milk products
7 in fluid or frozen form containing less than
8 9 percent butterfat that are intended to be
9 used as beverages, and goes on to list examples
10 of products that fall with that definition.

11 The fluid milk product definition
12 excludes, among other things, formulas
13 especially prepared for infant feeding or
14 dietary use (meal replacement) that are
15 packaged in hermetically-sealed containers, any
16 product that contains by weight less than 6.5
17 percent nonfat milk solids, and whey.

18 In determining if a product should
19 fall within the definition of a fluid milk
20 product and, therefore, be Class I, AMS has
21 evaluated a number of factors, including but
22 not limited to storability, shelf life, serving
23 sizes, percentage of nonfat milk solids and
24 butterfat, packaging, and the location at which
25 products are processed and the area over which

1 E. Olsen - Direct Testimony

2 they are distributed.

3 AMS has also looked at issues like
4 health requirements, price elasticity compared
5 to fluid milk, and whether a product is a
6 surplus or balancing use of milk.

7 While these and other factors have
8 been utilized, the fundamental concept that AMS
9 has applied in defining Class I products is
10 that dairy products that "compete with or
11 substitute for" fluid milk should be classified
12 as Class I. Simply put, products that compete
13 for consumers with fluid milk should be priced
14 like fluid milk.

15 For example, flavored milk, flavored
16 milk drinks, and buttermilk were included as
17 Class I in 1945 because "these products are
18 disposed of in a form and for a use more nearly
19 similar to the form and use of fluid milk than
20 any other milk product."

21 In discussing filled milk in 1969,
22 AMS noted that it is "mainly intended as a
23 beverage substitute" and that it "is clearly
24 marketed for the same use as whole milk and is,
25 in fact, designed as a substitute for whole

1 E. Olsen - Direct Testimony

2 milk."

3 In deciding that sterilized milk
4 should be Class I, the 1974 decision stated
5 that "sterilized milk products are generally
6 intended for use in place of their unsterilized
7 counterparts and are competing for the same
8 consumers."

9 Similarly, the exclusion of products
10 that contain less than 6.5 percent nonfat milk
11 solids from the definition of fluid milk was
12 established because "fluid milk products
13 containing only a minimal amount of nonfat milk
14 solids are not considered as being in the
15 competitive sphere of the traditional milk
16 beverages."

17 In the early 1990s, AMS considered
18 the classification of yogurt-containing
19 products using the term liquid yogurts.
20 Despite evidence that these products do not
21 compete with fluid milk, that they are more
22 price sensitive than fluid milk, and that
23 production is done by a small number of plants
24 and product is shipped over great distances,
25 unlike fluid milk, AMS nevertheless classified

1 E. Olsen - Direct Testimony

2 these products as Class I, stating that they
3 are clearly intended to be consumed as
4 beverages and are packaged as beverage milk
5 products.

6 Rather than focusing on product
7 characteristics, AMS used the descriptive terms
8 of "drinkable" and "spoonable" to identify the
9 form and use of products. Thus, AMS decided
10 that because of its characteristics as a
11 beverage milk product, liquid yogurt should be
12 considered Class I.

13 As demonstrated below, we believe
14 that these yogurt-containing products are
15 fundamentally different than fluid milk.
16 Consumers use them as food, not as beverages,
17 and they should be classified with Class II
18 like other yogurt products.

19 Yogurt-containing products are
20 fundamentally different than fluid milk in a
21 number of respects. They are produced by only
22 a few plants and are shipped across the U.S.,
23 unlike fluid milk. The shelf life of these
24 products averages 30 to 60 days, far exceeding
25 the shelf life of fluid milk that has not been

1 E. Olsen - Direct Testimony

2 heat treated.

3 They have a thicker texture and
4 greater viscosity than fluid milk, and they
5 have a different taste profile than fluid milk.
6 Not surprisingly, none of these products meet
7 the standard of identity of fluid milk.

8 In supermarkets they are generally
9 sold next to yogurt, not fluid milk. They are
10 not sold in half-gallons or gallons but,
11 rather, are in single serving size containers,
12 most if not all of which are hermetically
13 sealed.

14 Let's turn to an examination of how
15 these products are used by consumers. In so
16 doing, it is essential to examine if, in fact,
17 these products are competing for the same
18 consumers or are in the competitive sphere of
19 the traditional milk beverages.

20 Our member companies will present a
21 variety of consumer data demonstrating that
22 consumers use these products as food. In other
23 words, simply because a product is drinkable
24 does not mean that consumers use the product as
25 a beverage.

1 E. Olsen - Direct Testimony

2 Rather, the evidence that our member
3 companies will present will establish that
4 these are food products that are marketed, sold
5 and used as such by consumers. Consumers
6 purchase these yogurt-containing products
7 instead of other food products, not fluid milk.
8 Put another way, these products compete with
9 and are substitutes for other food products,
10 not fluid milk, and they should be classified
11 as such. Because these products neither
12 compete with nor substitute for fluid milk,
13 they should not be Class I products.

14 Food manufacturers have made yogurt,
15 a food product, more convenient for today's
16 consumers by making it drinkable. That does
17 not mean, however, that these products compete
18 with fluid milk for the same consumers or that
19 dairy producers are somehow being deprived of
20 their fair share of the value from the
21 marketplace. In fact, we believe that efforts
22 to change the fluid milk product definition
23 will end up hurting dairy producers by driving
24 manufacturers to use other ingredients for
25 their products.

1 M. Keough Ledman - Direct Testimony

2

3

MARY KEOUGH LEDMAN

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

6

7

MR. YALE: Your Honor, do we

8

get to cross-examine this witness?

9

JUDGE DAVENPORT: I am going

10

to let him come back and you can have a crack

11

at both of them. Okay?

12

MR. YALE: Okay. Thank you.

13

JUDGE DAVENPORT: Please tell

14

us your name and spell your middle and last

15

name.

16

THE WITNESS: Yes, sir. My

17

name is Mary Keough Ledman, K-E-O-U-G-H

18

L-E-D-M-A-N.

19

Can dairy compete with other food

20

ingredients and products? Why are we at this

21

hearing today? What are the objectives of the

22

proposed changes? Is it to enhance the volume

23

of Class I milk within the Federal Orders?

24

Clearly, per capita consumption of

25

fluid milk products has been on a steady

1 M. Keough Ledman - Direct Testimony

2 decline since the 1980s. Since 1980 per capita
3 fluid milk consumption has decreased from
4 approximately 250 pounds per person to 207
5 pounds per person in 2003.

6 It is my opinion that proposals to
7 broaden the Class I fluid milk definition to
8 include a wide variety of beverages containing
9 dairy ingredients appear to be an attempt to
10 throw out a regulatory net to see what
11 additional volume could be captured into the
12 ever shrinking Class I pool of milk.

13 Unfortunately, this attempt to
14 enhance the pool is more likely to reduce the
15 pool long term. The dairy sector is one of, if
16 not the highest, regulated ingredient in the
17 food sector. In terms of new product
18 development, I have witnessed a venture
19 capitalist walk away from a new dairy beverage
20 start-up company due to the complexity and lack
21 of long-term forward pricing for milk.

22 In the competitive, ever changing
23 world of beverages, product developers do not
24 need to use dairy ingredients to manufacture a
25 nutritious beverage. In particular, the soy

1 M. Keough Ledman - Direct Testimony
2 industry is very aggressive in finding new
3 market opportunities for soy protein. In some
4 cases, soy and milk proteins are being used
5 together in applications that were once
6 considered dairy only.

7 Economists can and will debate what
8 the net financial impacts of changing the fluid
9 milk definition within the Federal Orders may
10 be to dairy producers. In my analysis, had all
11 of the 14.1 billion pounds of Class II producer
12 milk in 2004 been priced at the Class I price
13 during 2004, the producer blend price would
14 have increased by 42 cents hundredweight. I
15 estimate that perhaps 10 percent, at the most,
16 of this volume is used in beverage form,
17 suggesting a net blend impact of less than a
18 nickel.

19 Again, economists may debate the
20 relevance of a nickel per hundredweight, but
21 there can be little debate as to the financial
22 impact to dairy producers from increased demand
23 for dairy products.

24 Take, for example, the increased
25 global demand for domestically produced skim

1 M. Keough Ledman - Direct Testimony
2 milk powder, which is a Class IV product. The
3 Class IV price plus a 70 cent premium
4 establishes the Class II skim milk price.
5 During the first half of 2005, the regulated
6 Class II skim price averaged \$7.40 per
7 hundredweight, 78 cents higher than the prior
8 year, due to increased demand.

9 My point is a simple one. Let's
10 create market opportunities for dairy
11 ingredients, not erect barriers to new product
12 development and innovation.

13 According to USDA's Report to
14 Congress on the National Dairy Promotion and
15 Research Program and the National Fluid Milk
16 Processor Promotion Program, America's dairy
17 farmers and milk processors now spend over \$350
18 million annually to help drive demand for fluid
19 milk and dairy products.

20 USDA claims to strongly support
21 national commodity research and promotion
22 initiatives such as these which provide
23 industry with important self-help tools for the
24 development, maintenance and expansion of
25 domestic and international markets for dairy

1 M. Keough Ledman - Direct Testimony

2 products.

3 As an economist, I see the industry
4 trying to drive demand through research,
5 education and promotion while the regulatory
6 environment hinders the growth and supply of
7 new dairy products.

8 Perhaps the objective of those
9 seeking to expand the Class I fluid milk
10 definition is to create an equal playing field.
11 Some Federal Orders may interpret
12 classification differently than others. Some
13 in the industry may perceive that the growth in
14 nonClass I beverages that contain dairy
15 ingredients has come at the expense of the
16 traditional higher-priced class fluid milk
17 sector.

18 It is my opinion as an economist and
19 as a consumer that these yogurt-containing
20 products and fluid milk are not substitutes.

21 I purchase six gallons of milk per
22 week and at least one eight-pack of
23 yogurt-containing products for a family of
24 three adults and two children. My milk
25 purchases have been stable over the last

1 M. Keough Ledman - Direct Testimony

2 decade; however, the addition of these new
3 yogurt-containing products has only occurred in
4 the past couple of years.

5 In our home milk is consumed as a
6 beverage at meals, an ingredient for cereals
7 and baking, and a complement product with
8 cookies. These yogurt-containing products, in
9 contrast, are a midday snack.

10 As a consumer, I like the
11 convenience of the product. I can grab it and
12 go. It packs a lot of nutrition without a lot
13 of calories. I don't feel like I need to have
14 something sweet to eat with it. In other
15 words, I don't dunk my Oreos in my drinkable
16 yogurt. It is a stand-alone product and it is
17 just two Weightwatchers points.

18 For those who are concerned about
19 creating a level field in the marketplace, I
20 would point out that the state of California
21 produces one-fifth of the nation's milk supply
22 and plays by different rules. Yogurt drinks in
23 California are Class II and there is no minimum
24 yogurt requirement. UHT and ultrapasteurized
25 milk products are also Class II if sold outside

1 M. Keough Ledman - Direct Testimony
2 of California.

3 The fact that food manufacturers can
4 create a wide variety of products that are
5 drinkable, some of which are Class I while
6 others are Class II, does not mean that there
7 is disorderly marketing. It means that
8 companies are behaving exactly as they should,
9 trying to be as efficient and innovative as
10 possible to create new products for today's
11 consumers.

12 Setting up a new fluid milk product
13 definition will just disrupt the market and
14 drive companies away from dairy ingredients.
15 Companies will also work to minimize the cost
16 of the remaining dairy ingredients that are
17 absolutely necessary for their products.

18 The Federal Orders regulate less
19 producer milk today than in 2000.
20 Historically, the Federal Orders regulated
21 70 percent of the nation's milk supply. In
22 2004 the Federal Orders regulated just
23 60 percent of producer milk, down from
24 65 percent in 2003. As a result, there is a
25 greater opportunity to produce products in

1 M. Keough Ledman - Direct Testimony
2 unregulated areas that tend to be subject to
3 less regulation.

4 It is my opinion that any action
5 that broadens the Class I fluid milk
6 definitions or the application thereof will
7 lead to a shift in the production of these
8 products to the West whenever possible.

9 I would also assert that the level
10 of complexity and cost to the Orders as it
11 traces every dairy component brought on by
12 broadening the Class I definition does not
13 merit the potential and questionable increase
14 in producer revenue.

15 We believe that the evidence
16 presented at this hearing conclusively
17 demonstrates that these yogurt-containing
18 products are food products and should be
19 classified as such. They are marketed as food.
20 They are consumed. They are used by consumers
21 as food, and they compete with other food
22 products, not milk.

23 USDA cannot simply ignore this
24 evidence by asserting, as it has in the past,
25 that they should be Class I beverages simply

1 Olsen/Keough Ledman - Cross - by Mr. Yale
2 because they are drinkable rather than
3 spoonable. This simplistic notion does not
4 overcome the actual evidence as we have
5 submitted into the record, and it is upon this
6 record that USDA must base its decision.

7 Thank you for the opportunity to
8 testify today.

9 JUDGE DAVENPORT: Very well.
10 Mr. Olsen, you will bring your chair up and sit
11 side-by-side and we can take questions.

12 Examination of these witnesses?
13 Mr. Yale. It's not often you get a two-for.

14 MR. YALE: What happens when
15 they disagree?

16 JUDGE DAVENPORT: I guess we
17 will listen to both of them.

18 MR. YALE: I am going to
19 direct this first question to Ms. Ledman. By
20 the way, this is Ben Yale on behalf of Select
21 Milk Producers and Continental Dairy Products,
22 Inc.

23 You indicate that in California that
24 drinkable yogurts are Class II?

25 MS. KEOUGH LEDMAN: Yes.

1 Olsen/Keough Ledman - Cross - by Mr. Yale

2 MR. YALE: All right. But if
3 they market their product within the -- into a
4 Federal marketing area, the market
5 administrator within this area has the
6 authority to seek compensatory payments; is
7 that right?

8 MS. KEOUGH LEDMAN: Yes, it
9 is.

10 MR. YALE: So that there is
11 not a competitive disadvantage between those
12 regulated under the Class I in the Federal
13 Orders than those coming from California?

14 MS. KEOUGH LEDMAN: There is a
15 competitive advantage if the market
16 administrator does not find the product, is not
17 knowledgeable about the product being in the
18 marketplace.

19 MR. YALE: Now, you said that
20 you don't dip your Oreos in drinkable yogurt?

21 MS. KEOUGH LEDMAN: That's
22 correct.

23 MR. YALE: Have you tried it?

24 MS. KEOUGH LEDMAN: It doesn't
25 even seem appealing, and then it wouldn't be

1 Olsen/Keough Ledman - Cross - by Mr. Yale
2 two Weightwatchers points now, would it?

3 MR. YALE: What is the --
4 whoever can answer this. What has been the
5 sales growth or lack of growth of drinkable
6 yogurt in the last five years?

7 MR. OLSEN: I think that
8 question may be better directed to the member
9 companies. We don't have any data that we are
10 presenting on behalf of the Association.

11 MR. YALE: You have no
12 knowledge of that, either one of you?

13 MS. KEOUGH LEDMAN: (Witness
14 indicated negatively.)

15 MR. YALE: I guess that's a no
16 from both.

17 I will direct this to Ms. Ledman
18 because she is the consumer. Is the yogurt on
19 a milk equivalent basis higher priced than the
20 fresh milk, or lower priced?

21 MS. KEOUGH LEDMAN: I don't
22 know from the standpoint that what we're
23 talking about is when I buy yogurt, I am buying
24 a drinkable yogurt. I am buying more than just
25 milk. There's fruit or other ingredients,

1 Olsen/Keough Ledman - Cross - by Mr. Yale
2 maybe vitamins added to that. So we are really
3 not comparing apples to apples.

4 MR. YALE: I am not asking --
5 I am asking on a milk equivalent basis, do you
6 know whether it is a higher priced product than
7 the beverage in the U.S.? Typical --

8 MS. KEOUGH LEDMAN: No, I have
9 never done the calculation.

10 MR. YALE: Does yogurt,
11 drinkable yogurt, require or -- I shouldn't use
12 the word "require."

13 Is fresh milk used to make drinkable
14 yogurt?

15 MS. KEOUGH LEDMAN: It doesn't
16 have to be.

17 MR. YALE: I understand. But
18 is it used?

19 MS. KEOUGH LEDMAN: In some
20 applications, yes.

21 MR. YALE: And it is currently
22 used today; right?

23 MS. KEOUGH LEDMAN: Yes.

24 MR. YALE: And it is currently
25 priced at Class I under the Federal Orders

1 Olsen/Keough Ledman - Cross - by Mr. Yale
2 today, to the drinkable yogurt?

3 MS. KEOUGH LEDMAN: Some
4 products.

5 MR. YALE: What drinkable
6 yogurt products are not treated as Class I?

7 MS. KEOUGH LEDMAN: I would
8 defer to the member companies for that.

9 MR. YALE: The bulk of your
10 testimony, Ms. Ledman, had to deal with the
11 idea that it doesn't compete with Class I
12 products. Is that the only basis by which the
13 Department can make a decision of whether it
14 should be classed as I or II?

15 MS. KEOUGH LEDMAN: I believe
16 that form and use is the most appropriate
17 justification for classification.

18 MR. YALE: Does the Department
19 have the authority to determine what use is to
20 determine the classification?

21 MR. OLSEN: The Department is
22 guided by the statutory authority which
23 requires it to classify products in accordance
24 with form and use, and given the long-standing
25 interpretation of those terms, there would be

1 Olsen/Keough Ledman - Cross - by Mr. Yale
2 some parameters as to how it must determine
3 that.

4 We believe that based on the
5 evidence here those terms require
6 classification of these products as Class II.

7 MR. YALE: Where in the Act
8 does it require that drinkable yogurt be
9 treated as Class I?

10 MR. OLSEN: It requires that
11 the products be classified according to their
12 form and use and that the Department's
13 interpretation of those terms over the years
14 has looked at classifying products that compete
15 with fluid milk as a Class I.

16 These products do not compete with
17 fluid milk. They compete with food, and so
18 they should be classified with food products.

19 MR. YALE: You talk about the
20 Department's interpretation. The current
21 interpretation of form and use includes yogurt,
22 a drinkable yogurt, as a Class I; is that
23 correct?

24 MR. OLSEN: That's correct.

25 MR. YALE: How long has that

1 Olsen/Keough Ledman - Cross - by Mr. Yale
2 been the case?

3 MR. OLSEN: The decision was
4 made in the 1993 hearing.

5 MR. YALE: Okay. What market
6 conditions have changed since 1993 in this
7 record that justifies a change in that
8 interpretation?

9 MR. OLSEN: I would first off
10 state that we do not agree that the '93
11 decision was, in fact, supported by the record.
12 I think that you will hear more evidence from
13 our member companies in terms of consumer data
14 about what actually occurs in the marketplace
15 and how these products are used that I do not
16 believe was present in the 1991, 1993 hearing.

17 MR. YALE: Was this position
18 regarding drinkable yogurt submitted to the
19 Department during the Order reform?

20 MR. OLSEN: I don't know.

21 MR. YALE: I go back to my
22 question. Forget whether or not it was
23 justified in 1993 or not. What market
24 conditions are evidenced in this record showing
25 change from what they were, say, in 2000 that

1 Olsen/Keough Ledman - Cross - by Mr. Beshore
2 would justify the Department to change its
3 position?

4 MR. OLSEN: Again, I think you
5 will hear more detail from the member
6 companies. I think that in terms of consumer
7 lifestyles and the demand for on-the-go foods
8 that those are conditions that weren't present
9 in the early 1990s during that hearing.

10 I think that the products are more
11 prevalent. There is more innovation in the
12 marketplace. I think there's a number of
13 factors that are different than what was in
14 place in 1993.

15 MR. YALE: Thank you.

16 JUDGE DAVENPORT: Other
17 examination? Mr. Beshore.

18 MR. BESHORE: Marvin Beshore
19 for Dairy Farmers of America. Good morning,
20 Ms. Ledman and Mr. Olsen.

21 I had a feeling listening to your
22 statement that maybe we're shadowboxing here to
23 a degree. You didn't mention any proposals
24 that you were opposing or supporting. How much
25 of this is addressed in proposal No. 1 which

1 Olsen/Keough Ledman - Cross - by Mr. Beshore
2 the FAA has abandoned?

3 MR. OLSEN: Our testimony is
4 meant to demonstrate that these products, these
5 yogurt-containing products, are food products.
6 It is really to set the stage for our member
7 company testimonies. We are not taking as an
8 Association a position with respect to any
9 proposal other than we believe
10 yogurt-containing products should be Class II.

11 MR. BESHORE: Let me see if I
12 can frame it in terms of some proposals. You
13 have talked about broadening, expanding. I
14 didn't mark all the words or the number of
15 times that broadening or expanding the Class I
16 category was noted as the target of your
17 testimony.

18 Now, you have heard Dr. Cryan's
19 testimony and Mr. Hollon and Mr. Alexander that
20 Proposal 7 is intended to, in essence, change
21 the accounting of the existing status quo. Is
22 that broadening and expanding the category?

23 MR. OLSEN: As I understand
24 it, the proposal seeks to include whey in the
25 protein calculation where it is not presently

1 Olsen/Keough Ledman - Cross - by Mr. Beshore
2 included. So I think it is broadening the
3 application.

4 MR. BESHORE: It changes the
5 accounting for whey solids; correct?

6 MR. OLSEN: So it is a
7 broadening of the application.

8 MR. BESHORE: So your
9 testimony is intended to oppose Proposal 7 as a
10 broadening of the -- I presume a broadening of
11 the fluid milk product definition; is that
12 correct?

13 MR. OLSEN: The Association is
14 not taking a position with respect to any
15 rules.

16 MR. BESHORE: For or against?

17 MR. OLSEN: Correct. Other
18 than to argue that these products are food
19 products and to set the stage for our member
20 company testimonies.

21 MR. BESHORE: Is the
22 Association or the two of you, either of you as
23 authorities in the area, presenting any,
24 offering any guidance with respect to the
25 manner in which you would propose to exclude

1 Olsen/Keough Ledman - Cross - by Mr. Beshore
2 these products?

3 MR. OLSEN: We believe that
4 yogurt-containing products should be Class II
5 products.

6 MR. BESHORE: If it's got any
7 yogurt in it, it should be Class II? Is that
8 the proposal that you are putting forth?

9 MR. OLSEN: Yes.

10 MR. BESHORE: That would be a
11 good way to get a lot of Class I products off
12 the shelf if any yogurt ingredient would take
13 it out of Class I. But that's what you are
14 advocating. Do I understand you correctly?

15 MR. OLSEN: We are advocating
16 that yogurt-containing products are food
17 products and are used by consumers as food and
18 they should be classified as such.

19 MR. BESHORE: Now, the
20 comments that have been made with respect to
21 distinguishing between nutrition and calories
22 in these ingredients. Nutrition refers to
23 protein, I take it, Mary?

24 MS. KEOUGH LEDMAN: Not
25 necessarily, but --

1 Olsen/Keough Ledman - Cross - by Mr. Beshore

2 MR. BESHORE: Protein,
3 calcium, things of that sort?

4 MS. KEOUGH LEDMAN: Correct.

5 MR. BESHORE: And calories
6 refers to lactose for the most part?

7 MS. KEOUGH LEDMAN: Not
8 necessarily.

9 MR. BESHORE: Well, isn't that
10 where the calories come from? The sugar
11 generates the calories in the product?

12 MS. KEOUGH LEDMAN: And in
13 many of the lower calorie versions it has been
14 replaced with Splenda or some sort of reduced
15 caloric sweetener.

16 MR. BESHORE: So as a consumer
17 you would certainly agree that there is a
18 significant difference in consumer value
19 between the nutrition of protein and the
20 calories of lactose?

21 MS. KEOUGH LEDMAN: Could you
22 repeat your question?

23 MR. BESHORE: Is there not a
24 difference in value to consumers as you have
25 testified, as it says at the bottom of

1 Olsen/Keough Ledman - Cross - by Mr. Beshore
2 page five, between nutrition and calories,
3 nutritional ingredients and ingredients that
4 primarily provide calories?

5 MS. KEOUGH LEDMAN: When I buy
6 the drinkable yogurts, I am buying them not
7 because it is yogurt. Some of them have
8 vitamins in it. They also have -- like
9 depending upon what fruit is in there, the
10 peach has more fiber in it than perhaps the
11 blueberry or strawberry version.

12 So I am looking at these products
13 and making a decision about a variety of
14 nutritional information, not just one -- not
15 just protein, for example.

16 MR. BESHORE: Okay. When you
17 talked about the products at page three,
18 Mr. Olsen -- this is your testimony primarily
19 -- the products, most if not all of which are
20 hermetically-sealed, what do you mean by that?
21 What is the shelf life of drinkable yogurt, by
22 the way?

23 MR. OLSEN: I believe it is --
24 is it 30 to 60 days?

25 MS. KEOUGH LEDMAN: It never

1 Olsen/Keough Ledman - Cross - by Mr. Beshore
2 stays in my house that long.

3 MR. BESHORE: Well, what is
4 the shelf life?

5 MR. OLSEN: I believe it is 30
6 to 60 days.

7 MR. BESHORE: And when you say
8 that it is -- you heard Mr. Alexander's
9 testimony that these hermetically-sealed
10 products have a shelf life of a year? You
11 heard that this morning?

12 MR. OLSEN: I don't recall
13 that.

14 MR. BESHORE: What do you
15 mean by "hermetically-sealed"? What is the
16 basis for your claim that they are
17 hermetically-sealed?

18 MR. OLSEN: I would urge you
19 to direct that question to the member
20 companies. It is my understanding --

21 MR. BESHORE: It is your
22 testimony, sir.

23 MR. OLSEN: Correct. It is my
24 understanding that there are various
25 definitions of hermetically-sealed --

1 Olsen/Keough Ledman - Cross - by Mr. Beshore

2 MR. BESHORE: Which one --

3 MR. OLSEN: -- in the FDA

4 regulation and that the AMS regulation does not
5 incorporate any particular definition as
6 opposed to being in the regulation.

7 MR. BESHORE: What definition
8 are you using when you made that claim in your
9 testimony?

10 MR. OLSEN: The products that
11 our members make, there are a variety of
12 different products. In terms of the particular
13 definition, I can't give you that other than
14 that in general, as my testimony states, most
15 of these products are hermetically-sealed.

16 MR. BESHORE: What definition
17 of that are you using?

18 MR. OLSEN: I would urge you
19 to direct that question to the member
20 companies.

21 MR. BESHORE: Do you not know
22 what definition you used when you made that
23 contention?

24 MR. OLSEN: I have to answer
25 the question. The different products are

1 Olsen/Keough Ledman - Cross - by Dr. Cryan
2 covered under these products, and in terms of
3 what particular seal each product has, I don't
4 have that information.

5 MR. BESHORE: Okay. Thank
6 you.

7 JUDGE DAVENPORT: Other
8 examination? Dr. Cryan.

9 DR. CRYAN: Thank you. I am
10 Roger Cryan, C-R-Y-A-N, with the National Milk
11 Producers Federation. Good morning. It is
12 still morning.

13 First, I think I might as well
14 indicate for the record that there is
15 definition of hermetically-sealed in the FDA
16 regulations at 21 CFR 113.3. The definition of
17 hermetically-sealed is at J and requires that
18 the product be designed to be sealed to
19 maintain commercial sterility, which is defined
20 at paragraph E in that. I think that will be
21 useful in the general topics.

22 Mr. Olsen, good morning. How are
23 yogurt drinks different from other fluid milk
24 products?

25 MR. OLSEN: They are consumed

1 Olsen/Keough Ledman - Cross - by Dr. Cryan
2 as food, not as a beverage, and that as our
3 member companies will testify, consumers don't
4 use them in the same way that they use milk
5 products, beverage products.

6 DR. CRYAN: Why do they make
7 them drinkable? Why do the manufacturers make
8 them drinkable if they are --

9 MR. OLSEN: I would urge you
10 to direct that question to the manufacturers.

11 DR. CRYAN: They have the
12 same -- they have a different flavor and
13 texture, I understand. They have the same
14 composition generally as milk; isn't that
15 correct?

16 MR. OLSEN: I believe that's
17 incorrect. I think they are yogurt products,
18 yogurt-containing products. They are closer in
19 composition to yogurt.

20 DR. CRYAN: Aren't they
21 produced from milk?

22 MR. OLSEN: Milk is an
23 ingredient that is used in the production of
24 these yogurt-containing products but it is only
25 one ingredient. There's fruit, flavoring,

1 Olsen/Keough Ledman - Cross - by Dr. Cryan
2 vitamins, depending on the product.

3 DR. CRYAN: So are you making
4 any specific proposal about the treatment of
5 yogurt drinks?

6 MR. OLSEN: We believe that
7 the yogurt-containing products should be
8 Class II food products and that is how they are
9 used by consumers, and so they should be
10 classified as such.

11 DR. CRYAN: How would you
12 define a yogurt-containing drink that would be
13 in Class II? How would you define those as
14 separate from Class I drinks? Would they be
15 100 percent yogurt or --

16 MR. OLSEN: The Association
17 does not have a particular definition. We
18 believe that these products are Class II food
19 products.

20 DR. CRYAN: Do you believe
21 there is some point where you can draw a line
22 between the Class II yogurt products and some
23 blended product that ought to be Class I?

24 MR. OLSEN: I think if you
25 look at the form and use that you will see that

1 Olsen/Keough Ledman - Cross - by Dr. Cryan
2 these products are food products and that they
3 are not beverages that compete with fluid milk.
4 Consumers don't use them like they use fluid
5 milk. They use them like food. That's the way
6 they compete within the market, and that's what
7 they should be classified as.

8 DR. CRYAN: Ms. Ledman, you
9 said you don't dunk your Oreos in drinkable
10 yogurt.

11 MS. KEOUGH LEDMAN: That's
12 right.

13 DR. CRYAN: Do you have milk
14 with your yogurt?

15 MS. KEOUGH LEDMAN: No.

16 DR. CRYAN: So your drinkable
17 yogurt substitutes for milk and cookies?

18 MS. KEOUGH LEDMAN: You can
19 tell by the way I look I still eat a healthy
20 amount of milk and cookies. I would say it is
21 in addition to, that the drinkable yogurt is
22 really -- it is really convenient.

23 Somebody asked earlier what is a
24 meal replacement. Well, I will tell you what.
25 As a working mom, that meal replacement depends

1 Olsen/Keough Ledman - Cross - by Mr. Vetne
2 upon whether I've got 15 seconds, five minutes
3 or 15 minutes. So I view --

4 Like I said, over the past I would
5 say my fluid milk of six gallons a week has
6 been steady. These yogurt-containing products
7 are really in addition to the other milk
8 products that I buy.

9 DR. CRYAN: Thank you.

10 JUDGE DAVENPORT: Other
11 examination? Mr. Vetne.

12 MR. VETNE: I am John Vetne
13 for H. P. Hood. I direct this question to Mary
14 Ledman.

15 You gave an answer on the issue of
16 competitive advantage or disadvantage with
17 yogurt beverages emanating from a nonFederal
18 Order source, and your answer was that if the
19 market administrator doesn't find it, there's a
20 competitive disadvantage. With that in mind, I
21 am going to ask you a few questions.

22 Are many drinkable yogurts or yogurt
23 beverages, wherever packaged, marketed
24 nationally or in large parts of the country
25 from a single plant?

1 Olsen/Keough Ledman - Cross - by Mr. Vetne

2 MS. KEOUGH LEDMAN: I think
3 the geographic distribution of
4 yogurt-containing products is greater than
5 traditional fluid milk.

6 MR. VETNE: All right. The
7 distribution of yogurt-containing products from
8 a Federal Order source does not end at the
9 Federal Order border, does it?

10 MS. KEOUGH LEDMAN: No, it
11 does not.

12 MR. VETNE: Yogurt from
13 Federal Order sources is distributed in that
14 huge black hole in the Northwest where there
15 used to be a Federal Order, as well as in
16 California, in a little bit of Virginia, a tiny
17 bit of Missouri, portions of Pennsylvania and
18 Maine, all of which are not Federal Order
19 areas?

20 MS. KEOUGH LEDMAN: Yes.

21 MR. VETNE: And distribution
22 is made in some of those areas at least by
23 Federal Order sources in competition with
24 nonFederal Order yogurt sources such as those
25 from California?

1 Olsen/Keough Ledman - Cross - by Mr. Vetne

2 MS. KEOUGH LEDMAN: Correct.

3 MR. VETNE: And is not a
4 Federal Order processor of a yogurt beverage at
5 a competitive disadvantage overall if some of
6 its product is marketed in an unregulated area
7 in competition with California source yogurt
8 beverages at Class II?

9 MS. KEOUGH LEDMAN: That's
10 very likely.

11 MR. VETNE: Ms. Ledman, you
12 are very familiar with how the Federal Order
13 systems operated and the classification,
14 protein price end, component pricing, that kind
15 of thing; correct?

16 MS. KEOUGH LEDMAN: Yes.

17 MR. VETNE: Mr. Beshore asked
18 you some questions about the relative value of
19 protein versus lactose and he's asked others.
20 Let me ask you.

21 In examining these proposals, have
22 you found anything that would change the way
23 producers receive a price for the protein in
24 the product when milk is a component price?

25 MS. KEOUGH LEDMAN: I have not

1 Olsen/Keough Ledman - Cross - by Mr. Vetne
2 done that analysis.

3 MR. VETNE: Is it not true
4 that when milk is converted to protein as an
5 ingredient in products that producers receive
6 greater value already for their protein than
7 for lactose in component price orders?

8 MS. KEOUGH LEDMAN: Yes.

9 MR. VETNE: So it doesn't
10 require reclassification to return the protein
11 value to producers. It is there already in the
12 system?

13 MS. KEOUGH LEDMAN: In
14 component price orders.

15 MR. VETNE: Okay. And the
16 differential value, the difference between
17 Class II and Class I, is that not distributed
18 to producers in the form of a producer price
19 differential?

20 MS. KEOUGH LEDMAN: Yes.

21 MR. VETNE: So you are not
22 aware of any -- as you think about it sitting
23 here, you are not aware of any way in which any
24 of the proposals would generate more revenue to
25 producers or a higher cost to a producer, to

1 Olsen/Keough Ledman - Cross - by Mr. Vetne
2 processors, for the regulated price of protein
3 as a commodity?

4 MS. KEOUGH LEDMAN: I have not
5 analyzed the proposals for that purpose, but
6 I --

7 MR. VETNE: Do you want to
8 shoot from the hip?

9 MS. KEOUGH LEDMAN: It sounds
10 like it could be logical, but if I -- I can
11 address it on a post hearing brief as well.

12 MR. VETNE: Let me ask if
13 either of you know the answer to this question.
14 When yogurt is produced and made into a
15 beverage, is it not the case that the process
16 or at least the beginning of the process of so
17 doing is taking yogurt that is spoonable in a
18 curd and stirring it, shaking it, whipping it
19 or something to break the curd, which simply
20 makes a liquid version of what was at one point
21 curd?

22 MS. KEOUGH LEDMAN: I can't
23 discuss the member companies' process, but I
24 can tell when you I have made drinkable yogurts
25 at home, I spoon the curd into my blender and

1 Olsen/Keough Ledman - Cross - by Mr. Beshore
2 add the peaches to it with a little package of
3 Splenda.

4 MR. VETNE: Thank you.

5 JUDGE DAVENPORT: Other
6 examination of these witnesses? Mr. Beshore,
7 additional questions?

8 MR. BESHORE: Thank you. Just
9 one thing I forgot to inquire about.

10 Are both of you familiar with the
11 information that Mr. Rourke presented? I know
12 Mr. Olsen was here.

13 MS. KEOUGH LEDMAN: I'm sorry,
14 I didn't see it.

15 MR. BESHORE: Well, it shows
16 that presently in the Federal Order system
17 yogurt-based beverages are classified both in
18 Class I and Class II. Set the volumes aside
19 for the moment.

20 So therefore your members under the
21 present system can choose, by virtue of their
22 recipes, their formulations of the products,
23 whether to market them as Class I or Class II.
24 You are aware of that?

25 MR. OLSEN: Yes.

1 Olsen/Keough Ledman - Cross - by Mr. Beshore

2 MR. BESHORE: And the same
3 thing would apply under Proposal 7. The test
4 has just changed from 6.5 percent nonfat solids
5 to 2.25 percent dairy proteins. But
6 nevertheless, depending on the ingredients of
7 the product, it could be made and marketed as
8 either Class I or Class II; correct?

9 MR. OLSEN: If the products
10 aren't classified as food products and they
11 continue to be within the scope of the fluid
12 milk definition, then presumably the companies
13 would be able to manufacture the products. But
14 as I noted, while we are not taking a position
15 on Proposal 7, there is a difference from the
16 status quo of the current system where whey is
17 not included and you are including it in your
18 calculations. So there is a difference under
19 your proposal.

20 MR. BESHORE: But at the
21 present time, some members choose to market
22 their products as Class I; correct?

23 MR. OLSEN: Judging from that
24 chart I would say that's correct.

25 MR. BESHORE: Okay. And some

1 Olsen/Keough Ledman - Cross - by Mr. Beshore
2 choose to market them as Class II; correct?

3 MR. OLSEN: Correct.

4 MR. BESHORE: By the way, was
5 the gentleman from Long Island, was he a member
6 of your association that had the --

7 MR. OLSEN: I do not know.

8 MR. BESHORE: You know, he
9 left after ascertaining that Proposal 7
10 wouldn't change his product classification in
11 any way.

12 I guess my question is, what is the
13 basis, if you can tell us, that your members
14 choose to market as either Class I or Class II
15 products?

16 MR. OLSEN: I would urge you
17 to direct that question to the members.

18 MR. BESHORE: In any event,
19 your intention is to rather than maintain the
20 present Class I classifications, you would
21 contract them under your position; correct?

22 MR. OLSEN: We believe that
23 the products that are yogurt-containing
24 products --

25 MR. BESHORE: Yes or no. You

1 Olsen/Keough Ledman - Cross - by Ms. Carter
2 would contract present Class I definitions;
3 correct?

4 MR. OLSEN: We believe
5 food products should be classified as
6 Class II, correct.

7 MR. BESHORE: And therefore
8 you contract the Class I?

9 MR. OLSEN: They would be
10 removed from the Class I and classified other
11 food products, correct.

12 MR. BESHORE: Thank you.

13 JUDGE DAVENPORT: Other
14 examination before we go to Ms. Carter?
15 Ms. Carter.

16 MS. CARTER: Good morning.
17 Antoinette Carter with the USDA.

18 MR. OLSEN: Good morning.

19 MS. CARTER: This is directed
20 to either one of you. In your opinion what
21 should be the basis for excluding certain
22 products from the fluid milk product
23 definition?

24 MR. OLSEN: I think that the
25 Department needs to first look to the statutory

1 Olsen/Keough Ledman - Cross - by Ms. Carter
2 authority which requires it to classify
3 products in accordance with form and use and
4 then to look at how those terms have been
5 applied over the years.

6 With respect to the products that we
7 are talking about, the Department has used the
8 fluid milk product definition to identify those
9 products that are competing with or
10 substituting for fluid milk.

11 So we think you should look at are
12 the products in question actually doing that.
13 Are they in the market? Do people buy them
14 instead of fluid milk? Do they use them
15 instead of fluid milk? Do they use them in the
16 same way or a different way than fluid milk?

17 We believe that the record that we
18 will provide at this hearing will demonstrate
19 that they are food products and should be
20 classified as such.

21 MS. CARTER: So are you
22 indicating that other factors besides form and
23 use should be given consideration in
24 determining the classification of products?

25 MR. OLSEN: I think that if

1 Olsen/Keough Ledman - Cross - by Ms. Carter
2 you look historically, the Department has
3 analyzed a range of factors, and certainly
4 there are a number of factors where these
5 products are different than fluid milk in terms
6 of their production and distribution, in terms
7 of their composition, in terms of their shelf
8 life.

9 There's a lot of factors that USDA
10 has historically used that would also support
11 differentiating these from fluid milk and
12 classifying them as a food product.

13 MS. CARTER: To your knowledge
14 is there any difference between, say,
15 buttermilk culture and yogurt culture?

16 MR. OLSEN: I don't know the
17 answer to that.

18 MS. KEOUGH LEDMAN: That's
19 outside the scope of my expertise.

20 MS. CARTER: Just one final
21 question. Have you had a cultured buttermilk
22 product that had a yogurt culture as one of the
23 ingredients in the product? Under your
24 proposal what you are suggesting or
25 recommending is that product would be Class II

1 Olsen/Keough Ledman - Cross - by Ms. Carter
2 because it had yogurt culture as one of the
3 ingredients, or any product?

4 MS. KEOUGH LEDMAN: I think
5 what we're saying has the yogurt -- in
6 California, the yogurt, the drinkable yogurts
7 that are Class II in California, the yogurt
8 within that product has to be the standard of
9 identity for yogurt, and I don't know if just
10 having a yogurt culture does that. But that's
11 the information I can share with you.

12 MS. CARTER: So you are saying
13 these yogurt-containing beverages have to meet
14 you're saying it is an FDA standard of identity
15 for yogurt?

16 MS. KEOUGH LEDMAN: Yes. The
17 yogurt-containing beverages, the yogurt within
18 that product has to meet the standard of
19 identity for yogurt.

20 MS. CARTER: The yogurt, the
21 ingredient yogurt in the product?

22 MS. KEOUGH LEDMAN: Correct.
23 What I'm saying is I don't know a yogurt
24 culture meets that litmus test.

25 MS. CARTER: Thank you.

1 Olsen/Keough Ledman - Cross - by Mr. Wilson
2 That's all.

3 JUDGE DAVENPORT: Mr. Wilson.

4 MR. WILSON: Todd Wilson,
5 USDA. Mary, this is for you.

6 In your testimony you talked about
7 the decrease in Federal Order milk, decreasing
8 from 70 percent of the nation's milk supply
9 down to 60 percent. Can you possibly explain
10 that or give your opinion?

11 MS. KEOUGH LEDMAN: I was
12 actually talking of Mr. Rourke when I went
13 through those numbers, and that 60 percent
14 really jumped out. We all know that the
15 Western order was voted out.

16 So then I went back one more year to
17 2003 and was really surprised that it was
18 65 percent in 2003. I am not sure how much
19 depooling we had in 2003. I think that became
20 a greater issue in 2004 as well.

21 So coming down five percentage
22 points from 2000 to 2003 I think is pretty
23 significant.

24 MR. WILSON: Do you think that
25 significance is because of the termination of

1 Ol sen/Keough Ledman - Cross - by Mr. Wilson
2 the Western order and the depooling that did
3 happen versus the increase of production in
4 those unregulated areas?

5 MS. KEOUGH LEDMAN: Those are
6 definitely factors, but what I'm trying to say
7 is that even -- you know, getting down to
8 60 percent in 2004 was definitely due to voting
9 out of the Western order and the amount of
10 depooling in 2004.

11 I am just telling you that I was
12 surprised that he said that the number had gone
13 from 70 percent to 65 percent from 2000 to
14 2003.

15 MR. WILSON: And then you made
16 an opinion after that as saying that you felt
17 like the Class I fluid milk definition would,
18 because of that decrease, shift the production
19 to those areas?

20 MS. KEOUGH LEDMAN: I can tell
21 you when I have people ask me where they should
22 put a milk plant or if they are looking at
23 developing new products, those unregulated
24 areas are more appealing to them as, quite
25 frankly, so is the California market. It

1 Olsen/Keough Ledman - Cross - by Mr. Wilson
2 depends what products they are going to
3 produce.

4 For example, if they are producing a
5 product for export, it could be Class IV(A) in
6 California. So it just depends when people
7 contact me what they are looking to do.

8 MR. WILSON: Just to follow up
9 on another question. I forget who asked it. I
10 believe it was Mr. Yale.

11 Whenever product is produced in
12 those unregulated areas and they come back into
13 Federal Order areas, the producers in those
14 Federal areas benefit from an upcharge to those
15 unregulated or partially regulated plants;
16 correct?

17 MS. KEOUGH LEDMAN: I am aware
18 of compensatory payments, if we want to use
19 that terminology. But, again, that's when you
20 find the product. There's been more than one
21 occasion where I have called the market
22 administrator and said, hey, have you seen this
23 product.

24 Quite honestly, I think you folks
25 have a lot to do, and I don't think your

1 Olsen/Keough Ledman - Cross - by Ms. Grocholski
2 primary job responsibility is to be a dairy
3 detective, but that's what these regulations
4 are really imposing upon you.

5 MR. WILSON: That's all I
6 have.

7 JUDGE DAVENPORT: Ms.
8 Grocholski.

9 MS. GROCHOLSKI: Deb
10 Grocholski from General Mills. Just one very
11 quick clarifying question and either of you can
12 answer it I think.

13 When you talk about
14 yogurt-containing products, beverages, do you
15 mean yogurt that meets the standard of
16 identity-free yogurt under Federal regulation?

17 MS. KEOUGH LEDMAN: Yes.

18 MS. GROCHOLSKI: I don't know
19 if either of you are familiar with the standard
20 of identity. Would you agree with me that it
21 requires two very specific yogurt cultures at
22 certain levels and other parameters contained
23 in the standard of identity?

24 MS. KEOUGH LEDMAN: I will
25 take your word for it.

1 M. Stephenson - Direct Testimony

2 MS. GROCHOLSKI: Okay. That's
3 all I have.

4 JUDGE DAVENPORT: Other cross
5 of these witnesses? Very well, Mr. Olsen,
6 Ms. Ledman, you may step down.

7 It looks like at this time this
8 might be a good time for us to take our lunch
9 break. I would ask that you come back at ten
10 minutes after one.

11 (At this juncture, a luncheon
12 recess was taken.)

13 JUDGE DAVENPORT: Is there
14 anyone else in the audience that has time
15 constraints before we put Dr. Stephenson on?
16 Very well.

17 Dr. Stephenson, do you want to come
18 up? Do you want to raise your right hand.

19

20

MARK W. STEPHENSON

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

23 (Exhibit No. 23 was marked for
24 identification.)

25 JUDGE DAVENPORT: Your name is

1 M. Stephenson - Direct Testimony

2 Mark W. Stephenson?

3 THE WITNESS: It is.

4 JUDGE DAVENPORT: And you have
5 prepared a statement which I have marked as
6 Exhibit 23 for identification. Are you
7 prepared to read it at this time?

8 THE WITNESS: I could, Your
9 Honor. If it would be more expedient, I would
10 ask that it might be submitted as the exhibit
11 and just offer testimony that summarizes.

12 JUDGE DAVENPORT: Well, for
13 the purpose of the record, why don't you just
14 read it into the record and then we will take
15 questions from that.

16 THE WITNESS: All right. I
17 will do that.

18 I am appearing today before you to
19 offer my views and expertise on dairy markets
20 and policy in general and dairy product
21 classification in particular. I especially
22 want to share relevant insights from the
23 research my colleagues and I have done at
24 Cornell.

25 To the extent that my views may

1 M. Stephenson - Direct Testimony

2 suggest specific policy actions, they do not
3 represent any official statement by Cornell
4 University.

5 The research about which I am
6 testifying had its roots in a meeting that our
7 Cornell Program on Dairy Markets and Policies
8 sponsored. In June of 2003, AMS Dairy Programs
9 received a request for a hearing to consider
10 changes in product definition for Class I dairy
11 products. AMS appeared ready to grant that
12 request on very short notice.

13 I was contacted independently by
14 several constituents of the dairy industry and
15 asked if our program would host an informal
16 meeting to exchange ideas and concerns
17 regarding changes in the Class I definition
18 prior to an announcement of the hearing.

19 We held that meeting in Chicago on
20 October 7, 2003. A broad cross-section of the
21 dairy industry was invited and attended,
22 including representatives of dairy
23 cooperatives, processors, product brokers,
24 federal price regulators and academics. Much
25 of the discussion from that meeting focused on

1 M. Stephenson - Direct Testimony

2 demand elasticities of dairy products in
3 question and the need to have more information
4 about those elasticities.

5 After leaving the meeting, my
6 colleagues and I felt that we had the tools to
7 conduct research which might answer the
8 question of "How important is it to know these
9 elasticities with great precision?"

10 Today I wish to outline the research
11 methods and findings which I hope will be
12 useful to you as you listen to concerns from
13 the dairy industry. But before I provide
14 detailed comments, the conclusions from that
15 research are: One, over a broad range of
16 market and product characteristics, the impact
17 of reclassification of new products from
18 Class II to Class I is likely to be small, less
19 than plus or minus one percent of discounted
20 revenues for dairy producers or, roughly, plus
21 or minus one cent per hundredweight.

22 However, if there is a
23 substitution of nondairy ingredients for
24 dairy ingredients -- in other words, product
25 reformulation in response to

1 M. Stephenson - Direct Testimony

2 reclassification -- the negative impacts on
3 dairy producer revenues are much larger, about
4 minus 1.8 percent of discounted revenues, or 23
5 cents per hundredweight.

6 One way to interpret these results
7 is that there is little upside potential from
8 reclassification but significant downside
9 potential.

10 A more general implication is that a
11 broad range of product characteristics can and
12 should be taken into account in the
13 classification of new dairy products.

14 Parameter values such as demand elasticities or
15 physical characteristics such as form and use
16 are useful, but they are incomplete guidelines
17 for classification if the goal is the
18 maximization of producer revenues. Accounting
19 for dynamic, potentially offsetting effects
20 will provide better insights about the outcomes
21 of product classification.

22 The use of classified pricing for
23 milk pre-dates the establishment of Federal
24 Milk Marketing Orders by at least four decades.
25 Our interpretation of the history is that

1 M. Stephenson - Direct Testimony

2 producers and their organizations realized that
3 fluid markets were able to sustain higher
4 prices and generate higher returns to
5 producers.

6 Classified pricing was implemented
7 to take advantage of this opportunity,
8 recognizing that other product markets would
9 have to receive a lower price to ensure that
10 the markets cleared. Sharing the proceeds of
11 higher markets with producers who didn't sell
12 to fluid processors but who conceivably could
13 have -- that is, pooling -- was necessary to
14 avoid what has been called destructive
15 competition. Whether the early cooperatives
16 knew it or not, they were employing a technique
17 that economists call price discrimination.

18 It is important to take note of two
19 things in the price discrimination model.
20 First, although producers have the ability to
21 charge different prices to different buyers,
22 they do not have the ability to charge whatever
23 they please to everyone.

24 The basic market law that supply
25 must equal demand remains in effect. Over

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2 time, combination of prices must be found under
3 which total production equals total
4 consumption.

5 Second, in order for price
6 discrimination to result in higher net prices
7 to producers, one set of buyers or consumers
8 must be less price sensitive than the other set
9 of buyers. Economists refer to this price
10 sensitivity as the own price elasticity of
11 demand.

12 Although there are a wide range of
13 empirical estimates of demand elasticities for
14 fluid milk and other dairy products, there is
15 a general agreement that the demand for fluid
16 milk is the most inelastic, but other dairy
17 products also have inelastic demands. Thus,
18 charging a higher price for beverage milk will
19 increase producer revenues, but there are
20 offsetting consequences in the rest of the
21 manufactured product markets.

22 In the short run, the higher price
23 charged for the proportion of the milk supply
24 sold to fluid processors will result in higher
25 returns even though sales of fluid milk will

1 M. Stephenson - Direct Testimony

2 decline somewhat. The combination of reduced
3 sales to fluid markets and the stimulus to
4 increased milk production from higher returns
5 means that there will be more milk that has to
6 clear the market through sales to
7 manufacturers.

8 Manufacturers, even if they have the
9 capacity readily available, will not purchase
10 additional milk unless they can do so at a
11 lower price. This lower price will be
12 necessary for them to subsequently reprice
13 their outputs, such as cheese, so that
14 consumers will buy more finished dairy
15 products. Thus, the price discrimination model
16 requires that the higher price in one market be
17 partially offset by a lower price in the other
18 market compared to what that price would have
19 been if all buyers paid the same.

20 Because the demand for manufactured
21 products is also inelastic, lowering the price
22 means lower producer revenues from sales of
23 milk to manufacturers. In this case, price
24 discrimination results in an increase in
25 revenues from fluid milk sales and a decrease

1 M. Stephenson - Direct Testimony

2 in revenues from manufacturing milk sales.

3 In basic theory, producers will
4 always come out ahead, and the magnitude of the
5 positive net effect is determined in large part
6 by the spread between the elasticities in the
7 two markets.

8 Two questions are posed in our
9 research: First, how much gain is there for
10 producers because of classified pricing given
11 the conditions in today's market? And, does
12 the answer offered by conventional theory
13 change when one takes into account more
14 explicitly the dynamic effects of adjustment in
15 supply and interactions with a more complicated
16 but also more accurate understanding of milk
17 composition?

18 A dynamic model of the U.S. dairy
19 markets with four products, two perishable
20 products, one storable product, and a stylized
21 new product, was developed to assess the extent
22 to which new product introductions and the
23 classification of milk used to make them
24 influenced producer revenues.

25 Demand for the new product is

1 M. Stephenson - Direct Testimony

2 assumed to grow over time, reaching its full
3 market potential over five years. The model
4 explicitly includes pricing for Class I,
5 Class II, and a combined manufacturing class
6 that we call Class III in this model, and it
7 assumes the Class III is a residual claimant on
8 the milk supply.

9 The inclusion of a milk supply in
10 Class III product sectors allows the model to
11 account for dynamic effects of the new product
12 on milk supply and classified prices. The
13 approach is used to simulate a scenario in
14 which there is no new product and a second that
15 we are calling base case scenario in which a
16 new product with specific characteristics is
17 introduced.

18 We then examined the impacts on the
19 all-milk price and the cumulative discounted
20 producer revenues compared to these two
21 scenarios under the alternative assumptions
22 about the characteristics of new product and
23 the classification of milk used to make it.

24 To assess the outcomes of the
25 classification decision, we compare the

1 M. Stephenson - Direct Testimony

2 scenarios in which the new product is assigned
3 to Class II for the entire simulation to
4 scenarios that assume that the milk used for
5 the new product is essentially assigned to
6 Class II and then switched to Class I at one
7 year into the model simulation.

8 The difference in outcomes under
9 these two scenarios indicates the impacts of
10 the classification decision. The model uses
11 the system's dynamics approach modeling first
12 developed and applied to the business and
13 economic research questions at the Sloan
14 Institute of Management at MIT. For the model
15 estimates we used data from 2001 to initialize
16 many of the model parameters.

17 Some of the key characteristics of
18 the model include four products: fluid, soft,
19 manufactured, and a stylized new product.
20 Growth and demand for the new product is
21 assumed to grow over time. It assumes that the
22 product is successful and it uses an S-shaped
23 growth curve. The new product reaches full
24 market potential in five years.

25 It takes about 2 1/2 percent of the

1 M. Stephenson - Direct Testimony

2 previous milk supply; that is, it assumes a
3 large demand for the new product.

4 Explicitly, it includes pricing
5 formulas for classified pricing, I, II and,
6 again, this combined manufacturing class called
7 Class III.

8 It assumes that manufacturing is a
9 residual claimant on the milk supply. The
10 manufacturing sector gets what's left over
11 after the milk demands for I, II and the new
12 product are satisfied. If there is more than
13 enough milk for I and II and the new product,
14 then manufacturing will process more.

15 It uses 2001 base year data
16 developed in detail for other modeling work we
17 had been doing.

18 It does not include the Dairy Price
19 Support Program or trade policy, and it doesn't
20 explicitly address the issue of divergent
21 Class III or Class IV prices, but it could
22 easily be modified to do so.

23 There are a wide variety of market
24 factors and new product characteristics that
25 will influence the outcomes of a new product

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2 classification decision; that is, it is not
3 just demand elasticity for the new product.
4 Our model includes many of the factors that
5 influence the outcomes of classification.

6 More specifically, our model allows
7 us to assess the effects of a milk supply
8 response, how much and how quickly. Product
9 demand elasticities for fluid, manufacturing
10 and the new product. By-products added to the
11 supply of milk processing in manufacturing, the
12 baseline is that there are no by-products.

13 Effects of the new product price on
14 fluid milk sales. On the baseline, no effect.
15 Cannibalization of fluid sales by the new
16 product. In our baseline there is none. The
17 amount of milk input that's required for the
18 new product. The baseline is that half of the
19 milk unit is used in the new product.

20 We assumed the size of the market
21 for the new product. The potential is somewhat
22 less than 2.5 percent of the final milk supply
23 and is equal to 2 1/2 percent of the initial
24 milk supply. The rate of growth in sales, full
25 market potential reached in about five years.

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2 The margin over milk input costs for the new
3 product, this indicates what proportion of the
4 selling price is due to the milk input because
5 it has been argued that an increase in the milk
6 cost will have little impact on milk impact or
7 sales when the milk input value is relatively
8 small to the selling price.

9 Substitution of nonmilk ingredients
10 or, in other words, the formulation for the new
11 product in response to increases in the cost
12 due to classification, that is, beverage
13 manufacturers choose to use more nondairy
14 ingredients in response to the increase in the
15 price of milk due to the reclassification from
16 I to II.

17 Our model assesses the impacts of
18 classification of the new product by comparing
19 a situation in which the product is always in
20 Class II with a simulation in which the new
21 product is initially in Class II and then
22 switched to Class I early on in the demand
23 growth phase.

24 The impact of classification is the
25 difference in key outcomes observed between

1 M. Stephenson - Direct Testimony

2 these two situations; that is, it is not
3 comparing the outcomes over time with the
4 situation in the initial year.

5 Although the model generates a broad
6 range of information, our focus is on the
7 impact of the classification decision on dairy
8 producer revenues. This is a better indicator
9 than milk price because it accounts for both
10 the price and the quantity of milk sold. In
11 some cases we discount the value of dairy
12 producer revenues to explicitly account for the
13 time value of money and add them up to provide
14 a single summary measure for comparison.

15 Because many of the parameter values
16 in the model are uncertain, we conducted a
17 broad range of sensitivity analyses -- in other
18 words, making changes in parameters over some
19 reasonable range -- to assess the impact of
20 those changes on the outcomes.

21 In this regard, we can speak of
22 three types of sensitivity to changes in
23 parameter values: One, is there a numeric
24 sensitivity, the actual numeric values change,
25 and this is almost always the case. Two,

1 M. Stephenson - Direct Testimony

2 behavioral sensitivity. Both the numeric
3 values and the qualitative patterns of behavior
4 change over time. Three, policy sensitivity.

5 The change in parameters changes the
6 preferred policy. In this case, the preferred
7 policy is assumed to be one that maximizes
8 discounted cumulative producer revenues.

9 Our focus is on policy sensitivity;
10 that is, do the changes in parameter values
11 change the decisions about which class the new
12 product should be in to maximize cumulative
13 producer discounted revenues.

14 The key model results. New product
15 introductions always benefit dairy farmers. I
16 should probably stress that. They always
17 benefit dairy farmers, increase cumulative
18 discounted revenues because they increase the
19 demand for milk. Initially they reduce the
20 milk available for manufacturing, which
21 increases product prices. This increases
22 Class III milk prices and the all-milk price.

23 Over time there is a milk supply
24 response that will increase milk supplies,
25 which means the milk prices will adjust over

1 M. Stephenson - Direct Testimony

2 time also. In equilibrium, after adjustment to
3 the new product introduction, the all-milk
4 price returns to a level near the original, but
5 dairy producer revenues are higher because more
6 milk is being sold.

7 Moving the new product from Class II
8 to Class I early on has two possibly main
9 effects: No. 1, it increases the cost of
10 making the new product, which may increase the
11 price paid by consumers of the product,
12 reducing product sales and, therefore, the milk
13 required for making the product; and, No. 2, it
14 initially increases the all-milk price compared
15 to the situation in which the product is left
16 in Class II and, therefore, increases milk
17 supplies compared to the situation again when
18 the product is left in Class II.

19 The combination of these effects
20 means that more milk is available to the
21 manufacturing sector which must also use it to
22 make product. Therefore, more manufactured
23 product is made and it increases inventories,
24 which in turn puts downward pressure on product
25 and Class III prices which rise by less than

1 M. Stephenson - Direct Testimony

2 they would have if the product had remained in
3 Class II.

4 The effects of reclassification are
5 offsetting. There is an initial increase in
6 the all-milk price that arises from an increase
7 in the proportion of milk in Class I, but
8 ultimately the offsetting negative effect on
9 Class II markets. The net effect on the dairy
10 producer revenue depends on the relative
11 magnitude of these two effects.

12 In general, these effects will tend
13 to balance each other out, and thus, the
14 expected differences in revenue from
15 reclassification are small. Consideration of
16 only the short-term increase in revenues due to
17 increasing Class I utilization will certainly
18 overstate the impact on producer revenues for
19 reclassification.

20 Over a broad range of parameter
21 values for product demand elasticities, the
22 effects of new product price on fluid milk
23 demand, milk supply response characteristics,
24 milk input requirements, new product margin,
25 mature market size, sales growth rate,

1 M. Stephenson - Direct Testimony
2 by-product production and yield in
3 manufacturing, and the assumed proportion of
4 fluid milk sales cannibalized by the new
5 product, the differences in cumulative
6 discounted dairy producer revenues due to
7 reclassification are small, ranging from a
8 total decline of \$170 million to a positive
9 value of \$162 million over the eight-year time
10 period.

11 That is, for some scenarios
12 reclassification increases dairy producer
13 revenues, and in other cases reclassification
14 decreases dairy producer revenues. These
15 figures represent absolute-value differences of
16 less than plus or minus 0.1 percent of total
17 cumulative discounted producer revenues, or
18 about plus or minus one cent per hundredweight
19 on the all-milk price over this timeframe.

20 One parameter, however, has a much
21 larger impact on dairy producer revenues: The
22 extent of substitution of nondairy ingredients
23 for milk in the formulation of the new product.
24 This is not possible for all new products, but
25 it may be relevant for a broad range of them.

1 M. Stephenson - Direct Testimony

2 When new product manufacturers
3 substitute nondairy ingredients for milk rather
4 aggressively in response to reclassification,
5 there are significant negative impacts of the
6 reclassification on dairy producer revenues.
7 This negative effect is about \$3.2 billion over
8 the nine years that we simulated. This
9 represents about minus 1.8 percent of producer
10 revenues or about a negative 22 cents per
11 hundredweight of milk sold. This negative
12 effect arises because the demand for milk
13 components increases much less as demand for
14 the new product grows over time.

15 Over the past year and a half we
16 have developed and refined a dynamic model of
17 the U.S. dairy industry to specifically look at
18 the question of new product classification.
19 This effort has not been supported by grants
20 from any dairy industry participants. We have
21 viewed the inquiry from the perspective of
22 dairy farmers and asked the question, In a
23 dynamic and complex industry, what product
24 classification would make producers better off?

25 The answer to this question is that

1 M. Stephenson - Direct Testimony

2 over a broad range of market and product
3 characteristics, the impact of reclassification
4 is likely to be small, less than, again, plus
5 or minus 1 percent of discounted revenues.

6 However, if there is substitution of
7 nondairy ingredients for dairy components in
8 response to reclassification, the negative
9 impacts on dairy producer revenues are much
10 larger, minus 1.8 percent of discounted
11 revenues. One way to interpret these results
12 is that there is little upside potential from
13 reclassification but significant downside in
14 potential is important.

15 A more general implication is that
16 the broad range of product characteristics can
17 and should be taken into account in the
18 classification of new dairy products.
19 Parameter values such as demand elasticities or
20 physical characteristics such as form and use
21 are a part of the answer, but they are
22 incomplete guidelines for classification if the
23 goal is to maximize producer revenues.

24 Accounting for dynamic, potentially
25 offsetting effects will provide better insights

1 M. Stephenson - Cross - by Dr. Cryan
2 about the outcomes of classification.

3 I have tables in the appendix that
4 indicate a variety of scenarios, model
5 parameters and outcomes.

6 JUDGE DAVENPORT: Very well.
7 Do we have questions of this witness?
8 Dr. Cryan.

9 DR. CRYAN: Thank you. I'm
10 Roger Cryan, C-R-Y-A-N, with the National Milk
11 Producers Federation.

12 -----

13 CROSS-EXAMINATION

14 BY DR. CRYAN:

15 Q. Hi, Mark.

16 A. Hi, Roger.

17 Q. Your model is very good. You guys
18 do a good job up there. You do as good a
19 job -- a better job than anybody doing this
20 type of modeling. As we have talked about
21 already, though, I disagree with some of your
22 assumptions. So let's get into it.

23 The first thing, you have a scenario
24 for a low carb milk product that you identify
25 as the low carb scenario. The thing that just

1 M. Stephenson - Cross - by Dr. Cryan
2 caught my eye now is on Table 4 and Table 6, I
3 believe, should demonstrate the impacts of the
4 products if they are assigned to Class I and II
5 and then if they are assigned to the producer
6 revenue maximizing class; is that right?

7 A. Table 4 is the cumulative discounted
8 producer revenues when the new product is
9 assigned a Class II by different scenarios.

10 Q. Okay. And in Table 6 it is the same
11 thing if they are assigned to the class that
12 maximizes producer revenue?

13 A. That is correct. The first
14 column -- actually, the second column in that
15 table indicates the class in which producer
16 revenues are maximized.

17 Q. In that Table 6 you indicate that
18 the producer maximizing class for the low carb
19 scenario is Class I?

20 A. That is correct.

21 Q. But then the numbers, the numbers
22 following that are the same numbers that are in
23 the Class II table except for the next to the
24 last number that says "difference from the
25 base"?

1 M. Stephenson - Cross - by Dr. Cryan

2 A. Yes.

3 Q. Is that a typo?

4 A. No, I don't think that it is. You
5 are referring to the Table 4 here, the
6 comparison; is that correct?

7 Q. The comparison in the next to the
8 last line in Table 4 and the next to the last
9 line in Table 6.

10 A. Yes. The question I think you may
11 have is one with regard to the title here. The
12 base case is that the product stays in
13 Class II, and what we are comparing it to here
14 is the switch of Class II to Class I in all
15 cases.

16 So we would expect that the LeCarb
17 line, for example, should match the Table 6
18 line; however, if you take a look at some of
19 the product simulations like input
20 substitution, for example, it may be a bit
21 different in here.

22 Q. So which numbers measure the
23 difference between putting it in Class I and
24 Class II?

25 A. Which table represents the

1 M. Stephenson - Cross - by Dr. Cryan

2 difference between Class I and Class II?

3 Q. Yes.

4 A. Well, for the LeCarb example that
5 you indicated, they both do.

6 Q. They both do?

7 A. Yes.

8 Q. Okay. I also saw from the
9 parameters you lay out for the LeCarb example
10 that the volume associated with that was about
11 one-tenth of the volume for your base scenario
12 for several of these other scenarios; is that
13 correct?

14 A. Could you be more specific about
15 what scenario it is?

16 Q. Table 2, Continued, where you lay
17 out some of the parameters for the various
18 scenarios, in the next to the last column --
19 the last two columns for the LeCarb scenario
20 and the Swerve scenario.

21 A. Yes.

22 Q. Then NP, new product market size in
23 billion pounds per month, for both of those
24 products you have about 34 million pounds a
25 month where the other scenarios are 344 million

1 M. Stephenson - Cross - by Dr. Cryan

2 pounds a month, about ten times the volume.

3 A. That must be a typo, Roger. I am
4 not sure which one it is.

5 Q. They also show a lower rate of
6 market growth, and there are a couple other
7 indications that you are talking about a
8 smaller scale, and I would not be surprised if
9 the model was intended to show a smaller scale
10 impact because of those products were
11 relatively small, when you started those were
12 both relatively small categories.

13 A. Right. Yes. Table 2 is my column
14 heading outlining the parameters that we used
15 in the different scenarios here. So these are
16 showing with the LeCarb, for example,
17 parameters that were set in the model, what it
18 was that was changed or different from
19 baseline. I better look at a different color
20 version that I have.

21 Your question was with regard to the
22 new product market size. No. Those were
23 correct. They were actually changed to the
24 .0343 for those two model runs, and this was
25 actually to reflect something that we thought

1 M. Stephenson - Cross - by Dr. Cryan
2 was happening at the time in these product
3 markets relatively small.

4 Q. Okay. So any impacts, any positive
5 producer revenue impacts associated with those
6 scenarios, in order to properly compare those
7 with the input substitution that you described,
8 the 23 cent per hundredweight losses for
9 substitution away from dairy products, in order
10 to make the proper comparison, any producer
11 impacts would have to be multiplied by ten; is
12 that right?

13 A. No, that is not correct. The base
14 case here is the case where all products are in
15 Class II under a different set of scenarios and
16 what happens when we simply reclassify them to
17 Class I. That doesn't mean that you would have
18 to multiply everything by ten to get the
19 correct answer for that, no.

20 Q. It is a nonlinear model, so just
21 multiply it by ten?

22 A. Yes.

23 Q. However, it would be substantially
24 larger based on 344 million pounds than it
25 would be based on 34 million pounds?

1 M. Stephenson - Cross - by Dr. Cryan

2 A. For these two product runs, you
3 know, that would be correct. These were
4 specific product runs that we were trying to
5 market at the time.

6 The stylized product that we were
7 talking about for all of these other scenarios
8 that were run were assumed to achieve
9 2 1/2 percent of the milk supply over that
10 five-year time period. That was not true for
11 the LeCarb and the Swerve products.

12 Q. Okay. I see. But that doesn't mean
13 that your estimates of the losses associated
14 with the input substitution away from dairy
15 depend on that large 2 1/2 percent share of the
16 supply; is that right?

17 A. Yes. You know, we felt that it was
18 important to think about what the magnitudes of
19 a very successful product launch would look
20 like, so in some cases you could think of it as
21 a best case or a worse case sort of scenario
22 depending on your point of view.

23 Q. Okay.

24 A. But for input substitution it was
25 clearly for the larger volume.

1 M. Stephenson - Cross - by Dr. Cryan

2 Q. The larger case. But in any case,
3 for the LeCarb scenario, the producer revenue
4 maximizing scenario was a Class I, was
5 optimized to Class I? I'm sorry.

6 In your LeCarb scenario, producer
7 revenue was maximized by putting the product in
8 Class I?

9 A. That is correct.

10 Q. That scenario also increased the
11 producer price; is that correct? Putting it
12 into Class I increased the producer price?

13 A. Yes, it did, by a very marginal
14 basis. We can see that I guess in -- well,
15 cumulative discounted revenues were relatively
16 small in the --

17 In the second year we were
18 anticipating one of the larger responses I
19 guess. In Table 5, for example, we have a
20 second year and the last year of the model run.
21 This gives you some indication of what happens
22 to producer revenues in a particular year.

23 In the second particular year that
24 we were looking at with the LeCarb scenario
25 here, we have about \$20 million in producer

1 M. Stephenson - Cross - by Dr. Cryan
2 revenue increases by moving it to Class I.

3 In the final year of the model, as
4 milk supply responses have increased, we have
5 about \$6 million in producer revenues that are
6 increased, and over the entire time period the
7 discounted revenues for the entire time period
8 are about \$81 million. Relatively small. It
9 is less than a half of one percent of the
10 difference.

11 Q. And again, just to clarify the
12 record, that is based on the market size of
13 34 million, not the larger base size?

14 A. That's correct.

15 Q. I am going to hand you a copy of my
16 testimony.

17 A. I'm sorry I missed that.

18 Q. I think you -- okay. I'm sorry you
19 weren't here, too.

20 On the table on the back, I lay out
21 some comparisons of the raw milk value with the
22 retail value of a number of products. For a
23 product similar to LeCarb, in many ways
24 comparing that product to whole milk, I showed
25 that if there was a 16.6 percent increase in

1 M. Stephenson - Cross - by Dr. Cryan
2 the raw milk cost, which is approximately what
3 I projected the difference between Class II and
4 Class I to be over a year, the result in the --
5 that increase applied to the whole milk price,
6 the regular whole milk price at the retail
7 level, would increase the whole milk retail
8 price by 5.4 percent. The same increase in the
9 raw milk cost, in the raw milk price,
10 translated directly into the retail level would
11 increase the retail price of the low carb drink
12 by 2.7 percent, which happens to be almost
13 exactly half.

14 Would you say that if that same raw
15 milk price increase has a -- it has a
16 one percentage change increase in whole milk
17 retail price and twice the percentage change
18 impact on the -- I'm sorry -- and half the
19 percentage change impact on the low carb
20 drinks, could this affect the practical impact
21 of the different demand elasticities? Have you
22 taken that difference into account?

23 A. If I think I understood your
24 question, we did look at product scenarios in
25 here where we have the cost of the value of the

1 M. Stephenson - Cross - by Dr. Cryan
2 milk in the product varying over -- let me see
3 if I can find what the range in variance
4 actually was that was covered here. I thought
5 I had that on the table.

6 Well, it is not quite the same I
7 guess, but in Table 7 we do have something
8 where we looked at sensitivity analysis of what
9 we called the new product margin. In other
10 words, over what range was the milk value
11 looked at in here. We looked at range in
12 values from 5 percent to 100 percent, and
13 the difference in this was something like
14 0.1 percent of the largest value.

15 So in some sense we did take a look
16 at that, Roger, to try to estimate what the
17 value differences were for product at retail
18 and what proportion of milk value is going into
19 the selling price of the product, the markup
20 margin.

21 Q. But in your scenarios, except for
22 the -- except for one that was the low input
23 department, is that right, the low milk value
24 share, all the other scenarios just stuck with
25 the single?

1 M. Stephenson - Cross - by Dr. Cryan

2 A. It did. It stayed with the value of
3 15 percent, I believe it was.

4 Q. Is that the same value you used for
5 the cost of perishable products?

6 A. Well, I will take a look and see.
7 This has been more than a few months since I
8 looked at many of these in any kind of detail.

9 Yes. It was 15 percent in all cases
10 with the exception of the lower milk value
11 share run that we did.

12 Q. So would you say then that if in
13 actuality the milk share of one is double the
14 milk share of the other, that is to say, if the
15 impact, the direct impact of an increase in the
16 raw milk price is double as a percentage of the
17 regional price for one than it is for the
18 other, that that would essentially create a
19 two-to-one -- that would essentially dilute the
20 impact of the demand elasticity more from one
21 to the other?

22 Let me ask it more specifically.
23 Would that relationship suggest a smaller
24 demand impact on the higher value added
25 LeCarb-type product than on whole milk from the

1 M. Stephenson - Cross - by Dr. Cryan

2 same exchange in raw milk prices?

3 A. Could you say that again, Roger?

4 I'm trying to follow all the bits and pieces
5 here.

6 Q. Well, the scenario, the model
7 assumes a demand elasticity of negative .25 for
8 Class I products.

9 A. Right.

10 Q. And negative .5 for the new
11 products.

12 A. Correct.

13 Q. If, however, the share, the raw milk
14 share of what changed into -- if the raw milk
15 share of whole milk is twice the raw milk share
16 of the value added product, shouldn't that end
17 up balancing out so that the effect of the rise
18 on demand elasticity for the raw milk with
19 respect to those products will be equal?

20 A. If I again think I understand your
21 question, it is not going to be equal, no. We
22 have some indication of this from this Table 7
23 where we ran the wide range of parameters on
24 here. I can't tell you without specifically
25 running it. It is a nonlinear model.

1 M. Stephenson - Cross - by Dr. Cryan

2 But we find that over -- a number of
3 the parameters that were changed from over a
4 very large range that we had a relatively small
5 impact on producer revenues.

6 I would expect more, you're right,
7 but I couldn't possibly tell you what the
8 number would be. I would think that the range
9 would be smaller. It is something that we
10 could run if the industry was interested in
11 seeing that.

12 Q. Well, let me put it this way.
13 If you increase the raw milk price by
14 16.5 percent --

15 A. Okay.

16 Q. In fact, let me take a look at that
17 page. Increase in the raw milk price by 16.5
18 percent Class I, from Class II to Class I,
19 would increase the cost of a gallon of raw milk
20 by 22 cents. If that same 22 cents represents
21 5.4 percent of the retail price for whole milk
22 but only 2.7 percent of the retail price of a
23 gallon of Carb Countdown, wouldn't that mean,
24 in effect, that the retail price change for
25 whole milk is doubled, is doubled in percentage

1 M. Stephenson - Cross - by Dr. Cryan
2 terms for what it is for the Carb Countdown, so
3 that the increase to which the elasticity is
4 applied becomes doubled for the one product
5 compared to the other?

6 A. The direction I don't quibble with.
7 Again, maybe I'm just being dense here, but I'm
8 having a little bit of a difficult time
9 following the question specifically except that
10 I doubt that it is going to be doubled from the
11 question as you laid it out. We've got demand
12 changes for prices in a model, so --

13 Q. What we are talking about here is
14 just the very first step of the analysis where
15 we are talking about a straight increase in the
16 raw milk cost and translating that --

17 A. Okay. If you are just looking at
18 the product accountability, yes. I mean,
19 following the math through the increase of
20 Class II to Class I, yes, I would agree with
21 that.

22 Q. Okay. So at that first step it was
23 just a straight application of demand
24 elasticity, just in that first step without
25 looking at the whole model, then essentially

1 M. Stephenson - Cross - by Dr. Cryan
2 the doubled percentage impact in the price
3 would neutralize the doubled demand elasticity.
4 So that the effects at the first step, just the
5 first simple analysis applying the first demand
6 elasticity, would be similar, very similar?

7 A. With an elasticity of minus .5, is
8 that what you are suggesting?

9 Q. You have the net value product with
10 an elasticity, a demand elasticity, of .5, and
11 the other, a Class I product with a demand
12 elasticity of .25, which is half.

13 A. Yes. So you're correct if you
14 double that.

15 Q. Thank you. Would that suggest then
16 a smaller demand impact on LeCarb than on whole
17 milk with the same change in --

18 Well, that would tend to suggest a
19 more equal impact on price change than your
20 scenario where they both have the same value
21 added?

22 A. Say it again, Roger, please.

23 Q. In the model both products,
24 essentially they have the same margin, the same
25 value added from the farm to the retail level,

1 M. Stephenson - Cross - by Dr. Cryan
2 and that's the difference we're talking about
3 here is the difference between the farm value
4 and the retail value.

5 So if we essentially correct that
6 scenario, take into account that doubled
7 impact, that would tend to bring the price
8 impact so they are not -- it keeps the products
9 closer together, the raw price impacts on
10 demand of the products closer together?

11 A. It is going to bring them somewhat
12 closer together.

13 Q. So would that suggest then a more
14 positive impact on producer revenue and price
15 from the LeCarb product being put into Class I
16 as opposed to Class II than the scenario as to
17 the model?

18 A. Than were actually shown here?

19 Q. Yes.

20 A. Right. We can expect that there
21 would be some small increase from that. I
22 think that given the model runs that we have
23 done, the kind of feeling that I have for the
24 results and output from the model,
25 qualitatively we're headed in the direction

1 M. Stephenson - Cross - by Dr. Cryan
2 that you are talking about. I am not sure
3 quantitatively what kind of magnitude you are
4 trying to lead me toward, but my suggestion is
5 it is going to be small.

6 Q. What I am really trying to do, and I
7 will be perfectly frank because I don't believe
8 you are going to change your answers based on
9 this.

10 What I am trying to do is
11 demonstrate the ways in which I believe the
12 assumptions are inaccurate. Moving towards the
13 more accurate assumption would tend to increase
14 the positive impact on future revenues and
15 increase the positive impact on future revenues
16 relative to the impact from input substitution
17 that you are discussing.

18 So let's go there. You don't need
19 to answer that. I am just explaining what I am
20 doing for your sake and for the record.

21 In your LeCarb scenario you have
22 cannibalization, that is to say, the loss of
23 Class I sales to the LeCarb-type product at
24 10 percent?

25 A. Yes.

1 M. Stephenson - Cross - by Dr. Cryan

2 Q. If that number was larger, would
3 that also suggest a more positive impact for
4 producer revenue from moving a product -- from
5 confirming the product as a Class I product
6 rather than as a Class II product?

7 A. You are talking about the change now
8 from Class II to Class I?

9 Q. That's right.

10 A. It does have a very, very marginal
11 impact. You have cannibalization regardless of
12 which class that you are in. We looked at
13 cannibalization over a range from zero to
14 100 percent, and surprisingly it has one of the
15 smallest impacts on producer revenues.

16 Q. But it does move in that direction?
17 If the cannibalization is increased, it does
18 move in that direction?

19 A. In an almost immeasurable amount, it
20 does move in that direction.

21 Q. If the model took into account the
22 idea that storable products, cheese, butter and
23 powder, are traded on the world market at world
24 prices that react very little to this model,
25 which is essentially a closed U.S. model, would

1 M. Stephenson - Cross - by Dr. Cryan
2 that also -- would that change also generate a
3 more positive impact on producer revenue and
4 price from keeping the LeCarb product in
5 Class I as opposed to putting it into Class II?

6 A. Now, you indicated traded on the
7 world. Are you thinking about traded in both
8 directions or are you --

9 Because one of the questions that
10 you are talking about here is, is the supply
11 elasticity the same as we have assumed in here,
12 and the other is, is the demand elasticity for
13 products the same given the world market.

14 Q. Well, if the supply elasticity for
15 storable products is infinite at the current
16 market price, would that increase the impact on
17 future revenue associated with the product
18 being classified as I rather than II?

19 A. If the supply elasticity is
20 infinite, if we can bring as much of this
21 product in at no additional cost to suppliers
22 is basically what you are saying, they are
23 prepared to buy as much as we possibly want at
24 that price.

25 Q. And at the same price, if the U.S.

1 M. Stephenson - Cross - by Dr. Cryan

2 suppliers also supply it at the same price?

3 A. And the U.S. suppliers would supply
4 at the same price. The supply elasticity on
5 those manufactured products is -- let me think
6 about this here in the model, will that
7 influence supply.

8 If we have the infinite supply of
9 storable products, then moving additional
10 products into the marketplace is going to
11 provide, I believe, an even worse case scenario
12 for some of the higher -- the periods of time,
13 in other words, when prices of the storable
14 products are higher during the early adoption
15 of the new product.

16 In other words, when we are moving
17 milk from our manufacturing process into the
18 new product and we haven't caught up with the
19 milk supply yet, we would be bringing new
20 product -- or storable product in from
21 overseas, this would tend to lower the
22 discounted producer revenue extreme. That's a
23 time period when we get relatively higher
24 producer prices.

25 Q. So that assumes a sluggish domestic

1 M. Stephenson - Cross - by Dr. Cryan

2 supply response? That assumes that the
3 capacity is not immediately available?

4 A. We have assumed that capacity for
5 processing is available, but we have two kinds
6 of supply response to our milk supply here.
7 One is a milk per cow response that we assume
8 to be relatively short in term and nature, and
9 the other is additional capital on farms that
10 is required that takes a slightly longer period
11 of time to put in place to build new
12 facilities.

13 Q. Okay. Is it your understanding that
14 the goal of Federal Order regulations is to
15 maximize future revenues?

16 A. I have never read that. It
17 certainly is one of the goals that is talked
18 about quite often, that along with stabilizing
19 prices and a number of others, but I don't
20 recall ever reading that the goal of Federal
21 Milk Marketing Orders was to maximize producer
22 revenues.

23 But it seemed to us that this was a
24 reasonable approach to take in this research
25 project, to simply strip away the clutter of

1 M. Stephenson - Cross - by Mr. Vetne
2 trying to think about intermediate goals and
3 let's say go right for the biggest one we could
4 look at.

5 DR. CRYAN: Okay. Thank's
6 very much.

7 JUDGE DAVENPORT: Other
8 examination of Dr. Stephenson? Mr. Vetne.

9

10 CROSS-EXAMINATION

11 BY MR. VETNE:

12 Q. Mr. Stephenson, I'm John Vetne. I
13 represent H. P. Hood.

14 I tremble at getting up here and
15 asking you questions about this because I am
16 way out of my league. I suspect that many
17 people who read this record will scratch their
18 heads at this, so maybe you can treat me as
19 though I just have a high school education and
20 try to explain what some of these terms mean.

21 On Table 2 and on Table 7 you talk
22 about NP. That's new product elasticity?

23 A. Yes.

24 Q. We will start with the first
25 numbered column. Minus .5, what does that

1 M. Stephenson - Cross - by Mr. Vetne

2 mean?

3 A. This is an indication of the
4 responsiveness of consumers to a change in
5 price. Quite literally what it means is that a
6 one percent change in the price of a product,
7 the new product, would indicate a half a
8 percent change in the consumption of the
9 product. So if the product increased by
10 one percent, you would have a half a percent
11 decrease in the volume product being purchased.

12 Q. Okay. And then SP elasticity?

13 A. SP is the storable product.

14 Q. Storable product. So there is less
15 response to price changes in the storable
16 product than the new product?

17 A. That's correct.

18 Q. Okay. Where do we have an
19 inelasticity for the perishable product?

20 A. The fluid milk product is an
21 inelasticity of .25. So it is more inelastic
22 than the storable product and quite a bit more
23 than the new product.

24 Q. Is that on these tables here?

25 A. It is somewhere. On Table 1 you

1 M. Stephenson - Cross - by Mr. Vetne
2 have a Class I perishable product under the
3 Demand Characteristics where it says demand
4 elasticity, minus .25.

5 Q. Got it. The Class I and Class II
6 perishable product demand elasticities and the
7 Class III storable product demand elasticities,
8 are they based upon historical observation?

9 A. These are based on a compilation of
10 work that has been done over the past decade or
11 so, a number of studies. They are reasonably
12 closely based to the elasticities that Tom Cox
13 uses in the model that he is often quoted from
14 and that FAPRI is using in their model.

15 So we didn't try to go out and do a
16 study of elasticities of various products. We
17 did a research, a literature review to look at
18 what's been done lately, what's been used
19 recently, and these are a synopsis of those.

20 Q. The demand elasticity for the new
21 product that you used, how did you arrive at
22 that number?

23 A. We had frank discussions among
24 ourselves as to what we thought some of these
25 new products might be, and to be quite honest

1 M. Stephenson - Cross - by Mr. Vetne
2 with you, we sort of pulled this number a
3 little bit out of the air. But, again, we
4 varied this from very inelastic to elastic.

5 So we did look at a broad range over
6 the scenarios. This is what we thought was our
7 best estimate of some of these products.

8 Q. Am I correct that your assumption
9 that caused you to apply a demand elasticity of
10 0.5 for the new product incorporates your
11 assumption that the new product is a very
12 successful and aggressively marketed new
13 product?

14 A. In part. It also embodied the
15 notion that we felt that many of these new
16 products may be viewed more as a luxury item
17 than a necessity item. In other words, there's
18 something that consumers might spend
19 discretionary money on than something that they
20 had to have.

21 Q. In selecting the number of 0.5, did
22 you also consider or survey or refer to the
23 number of new dairy-based beverages that are
24 introduced but failed?

25 A. No, we did not. I mean, we didn't

1 M. Stephenson - Cross - by Mr. Vetne
2 have access to that kind of data. We thought
3 about a variety of things, even going outside
4 of the dairy industry to look at new product
5 launches to see if there was some literature on
6 what sorts of elasticities might be for
7 comparable products in other sectors. Again,
8 this was a value judgment on our part alone to
9 use minus .5, but with some justification.

10 Q. Okay. Let me see if I understand
11 this. If there is a 10 percent increase in
12 your model in the price of milk and the milk
13 costs \$2 a gallon before the increase and it
14 now costs \$2.20, there will be a 2.5 percent
15 reduction in purchases; am I correct?

16 A. That's correct.

17 Q. If there is a 10 percent increase in
18 the cost of the new product and the new product
19 starts out at \$3 per gallon, it will now be
20 30 cents more per hundredweight, and in your
21 model there's a reduction of one-half of that
22 5 percent?

23 A. That's correct.

24 Q. And it doesn't matter to your model
25 that the degree of price increase differs

1 M. Stephenson - Cross - by Mr. Vetne
2 20 cents for one product and 30 cents for
3 another product?

4 A. No, it doesn't. These are point
5 elasticities that were being used with a
6 constant elasticity of supply. A technical
7 term, but it just means that across the entire
8 demand curve we expect the same elasticity.

9 Q. You also use a term "cross-price
10 elasticity" of new product on perishable
11 product.

12 A. Uh-huh.

13 Q. Let's see. That's on Table 2,
14 cross-price elasticity. It doesn't say on what
15 product to the other, but I assume the third
16 line on Table 2 is new product to the
17 perishable product?

18 A. Not to the perishable product.
19 Actually, to the Class I product. No. To the
20 perishable product. That's correct. I'm
21 sorry. There is only one scenario where we
22 used that. The base case scenario, we didn't
23 have any cross-price elasticities.

24 Q. The cross-price elasticity to
25 perishable product, first of all, does it

1 M. Stephenson - Cross - by Mr. Vetne

2 include both perishable products?

3 A. This is a cross-price elasticity
4 between the Class I milk that we modeled, the
5 beverage milk, and this new product. So it is
6 an indication of how sensitive are you to the
7 fluid milk, the Class I milk that we think of
8 today, relative to the price change in this new
9 product.

10 Q. Okay. You describe PP, perishable
11 product, as two categories. For purposes of
12 cross-price elasticity, you are just comparing
13 it to one of those two categories?

14 A. That's correct.

15 Q. Now, explain to me what cross-price
16 elasticity means.

17 A. The sensitivity of a consumer to
18 price changes in another category. So, in
19 other words, if there is a change in this new
20 product price, how might it impact my
21 willingness to purchase another product
22 category that I am specifically looking at. If
23 we say something like Swerve, for example, as a
24 beverage, this is suggesting that there is a
25 possible impact between the change in the price

1 M. Stephenson - Cross - by Mr. Vetne
2 of Swerve to your desire to purchase fluid milk
3 products.

4 Q. Am I correct again that for purposes
5 of this analysis it doesn't matter that Swerve
6 started out at \$4 a gallon and milk was \$2 a
7 gallon at the base point before the price
8 change?

9 A. No, it doesn't matter from the
10 starting point. That's correct.

11 Q. How is a consumer's likelihood to
12 choose a \$4 product over a \$2 product at the
13 beginning factored into any of this, if at all?

14 A. We assume the product growth curve
15 starting out at basically nothing and in an
16 S-shaped growth curve pattern typical of new
17 product launches that are successful that there
18 is an increasing rate of sales for a period of
19 time at an increasing rate and then an
20 increasing sales at a decreasing rate in the
21 latter part of the time period. So that's the
22 assumption. And at full sales potential five
23 years out that there's 2.5 percent of the
24 initial milk supply that would have been used
25 in this successful new product launch

1 M. Stephenson - Cross - by Mr. Vetne
2 irregardless of the price.

3 Q. My question related to your analysis
4 of cross-price elasticity or your assumptions
5 about cross-price elasticity. You make some
6 assumption that consumers with five bucks in
7 their pocket are going to go to the store and
8 in some scenarios buy milk instead of the new
9 product or the new product instead of milk. Am
10 I correct about that?

11 A. Yes.

12 Q. That is not an assumption that you
13 have tested; that is something that you simply
14 plug into your model?

15 A. That's correct.

16 Q. Okay. There is nothing in your
17 model that actually follows or results from a
18 measure of consumer behavior?

19 A. Many of these parameters are based
20 on consumer behavior. A good example are the
21 inelasticities of the perishable product, fluid
22 milk, the storable products, cheese, butter,
23 powder. They are based on observations of
24 consumer responses, not a single study but a
25 conglomeration of a few studies.

1 M. Stephenson - Cross - by Mr. Vetne

2 Q. I understand that on an individual
3 product line-to-product line basis there have
4 been those observations. But, for example, is
5 there any study that would indicate that a
6 consumer with \$5 to spend would choose cheese
7 over milk or milk over cheese so that there is
8 a cross-price elasticity factored in it?

9 A. Those studies have been done. It
10 has been quite a while. Since I am aware,
11 studies have been done to look at that
12 specifically. We have some scanner data
13 studies more recently, but most of that data is
14 not published here.

15 Q. Or, for that matter, calcium
16 fortified orange juice over milk?

17 A. True.

18 Q. With respect to a new product, any
19 new dairy product, with the new product in your
20 studies, was there any basis for assumptions in
21 your model that consumers in some scenarios
22 would purchase new product over Class I
23 beverage milk or, with the price changes, one
24 over the other?

25 A. There were a couple opportunities in

1 M. Stephenson - Cross - by Mr. Vetne
2 these scenarios that were run, different
3 scenarios where that could have happened.
4 Certainly one of them was in the cross-price
5 elasticity. That would give consumers the
6 opportunity to consider relative prices and
7 make decisions about them.

8 The other is where we looked at
9 cannibalization of sales rather directly where
10 we said if you purchase a unit of the new
11 product, it is going to cost you something in
12 terms of the sale of the Class I fluid milk
13 product.

14 Q. Okay. How would you factor in, if
15 at all, a consumer's desire to avoid a
16 particular product? For example, carbohydrates
17 in milk, nuts to which the consumer is
18 allergic, shrimp to which a consumer is
19 allergic versus other products that the
20 consumer can spend his money on? Maybe an
21 allergy to peanut butter but not to cashew
22 butter. There would be no cross-price
23 elasticity in that kind of circumstance, would
24 there, because that consumer would only buy the
25 one product?

1 M. Stephenson - Cross - by Mr. Vetne

2 A. Well, I would certainly reply,
3 Mr. Vetne, that that was beyond the scope of
4 the project for us to look at or consider
5 closely.

6 Q. All right. Your study looked at a
7 beverage called LeCarb, and before you got here
8 there was a lot of talk about a beverage called
9 Carb Countdown but not much about LeCarb. Are
10 the two products very similar in that there has
11 been lactose removed?

12 A. Yes. At the time that we were
13 beginning this modeling work, there were two
14 new products that were somewhat controversial.
15 One of them was LeCarb. Carb Countdown didn't
16 exist at this point in time, but it is
17 essentially an ultra-filtered milk product.

18 There was also the Coca-Cola product
19 Swerve that was being introduced in limited
20 market areas which contained milk proteins.

21 So we wanted to take a look at those
22 two different products that actually existed,
23 but, again, use them as sort of stylized
24 products.

25 Q. Okay. Did you make an assumption at

1 M. Stephenson - Cross - by Mr. Vetne
2 the beginning of your study that these products
3 would be Class II?

4 A. They were in Class II at the time,
5 and the base case scenario that is in here says
6 that the products are in Class II. Any of the
7 scenarios that were run were looking at
8 shifting the product to Class I at a time of
9 12 months into the product growth phase.

10 So the products were introduced in
11 Class II and then changed to Class I and that's
12 the basis for the comparison.

13 Q. Okay. How would your results differ
14 if the shift happened at, say, month three
15 instead of month 12 or day two instead of day
16 one?

17 A. Qualitatively not at all.
18 Quantitatively you might have seen small
19 differences in the outcome here. This was at a
20 point in time when the growth phase was
21 relatively flat of the new product. They
22 really hadn't started to take off yet in our
23 S-shaped growth curve for the new product, but
24 they were growing.

25 Q. Is Swerve still a growing product;

1 M. Stephenson - Cross - by Mr. Vetne

2 do you know?

3 A. Not that I am aware of.

4 Q. Do you know whether it continues to
5 be sold?

6 A. You might ask Mr. Alexander. I
7 don't believe that it is.

8 Q. Would you agree with me that a
9 product developer, a product innovator who
10 knows from the inception that use of dairy
11 ingredients will result in a Class I upcharge
12 rather than a Class II treatment, may from the
13 inception formulate a new product with other
14 ingredients to avoid that upcharge?

15 A. Well, it would be pure speculation
16 on my part to say so, but solely based on -- if
17 product taste and functionality were identical
18 and the price were less for a nondairy
19 ingredient, I would expect food formulators to
20 use the nondairy ingredient.

21 Q. Well, isn't that an execution of
22 academic intuition?

23 A. That is, yes.

24 Q. Your model didn't do anything to try
25 to measure the disincentive of weak

1 M. Stephenson - Cross - by Mr. Vetne
2 classification on new product development or
3 expanding markets, did it?

4 A. No, it didn't. When we had the
5 input substitution scenarios in here, which
6 were varied over a wide range of percentages,
7 they were just a percentage input substitution.

8 Q. Would you agree that if there were
9 no threat of reclassification or a threat of
10 Class I where it would otherwise be Class II
11 that the demand for dairy-derived ingredients
12 would be greater than if they would be in
13 Class I?

14 A. That would be the corollary to the
15 statement I made earlier, yes.

16 Q. And if that happened, the demand
17 increases, then the Class IV or, for some
18 products, the whey-derived Class III products
19 would increase?

20 A. The demand for whey prices at
21 Class IV prices?

22 Q. If the demand for milk-derived
23 ingredients increased, then prices for
24 manufactured products with milk would also
25 increase?

1 M. Stephenson - Cross - by Mr. Beshore

2 A. Yes. That's correct

3 Q. Which would improve producer prices
4 across the board?

5 A. It does, particularly in the early
6 years. It certainly improves producer
7 revenues. Producer prices by the time we have
8 offsetting impact of supply responses tend to
9 equilibrate.

10 MR. VETNE: Thank you.

11 JUDGE DAVENPORT: Other
12 examination of this witness? Mr. Beshore. I
13 also have an envelope that was left with me
14 over the noon break for Robert Anderson. Do
15 you want to come up and get that?

16 -----

17 CROSS-EXAMINATION

18 BY MR. BESHORE:

19 Q. Good afternoon, Dr. Stephenson.
20 Marvin Beshore for Dairy Farmers of America.

21 Would you turn to Table 1 for a
22 moment. The demand elasticities Class I, II
23 and III which you have the new product which
24 you have assumed, did you say that the class --
25 what is your source of the Class II demand

1 M. Stephenson - Cross - by Mr. Beshore
2 elasticity?

3 A. This was an elasticity, I believe,
4 that FAPRI is using in their model?

5 Q. My economist tutors suggest to me
6 that in classic economics a revenue maximizing
7 price discrimination model establishes the --
8 puts the most inelastic products in the highest
9 price category, the next most inelastic
10 products in the intermediate product category,
11 and the most elastic products in the lowest
12 price category, that that is the classic model
13 for maximizing revenues through price
14 discrimination. Is that fair?

15 A. That is fair. Yes.

16 Q. Okay. Now, this model of
17 elasticities that you assumed deviates from
18 that model by making Class II the most -- it
19 has the highest negative demand elasticity. Is
20 that the system we have today in the Federal
21 Orders?

22 A. This is the estimation of some
23 people who have done work in the area. Again,
24 this was not a number that we necessarily came
25 up with through our studies. This is just the

1 M. Stephenson - Cross - by Mr. Beshore
2 observation of these are the products in these
3 different classes, and other researchers who
4 have looked at elasticities in different
5 product categories have used these elasticities
6 in their modeling efforts.

7 But in a world of maximizing
8 producer revenues, you are correct, we should
9 be lowering Class II prices if you believe
10 this.

11 Q. And increasing Class III prices I
12 guess?

13 A. That's your battle.

14 Q. Well, no. I'm just suggesting if
15 these elasticities are correct, in our system
16 Class II products should have the lowest prices
17 in order to maximize revenues; correct?

18 A. That would be correct.

19 Q. Okay. So if that's the base point
20 and your base assumption of elasticity for the
21 new product is that the revenue maximizing base
22 for the lowest price class, doesn't it just
23 follow A follows B that the product of the
24 model is going to say that the way you get the
25 most revenues is to put it at the lowest price

1 M. Stephenson - Cross - by Mr. Beshore
2 class of your options?

3 A. For the new products?

4 Q. Yes.

5 A. Well, for the new products we have
6 inelasticity that is an inelasticity of its
7 own. It does happen to be the same as the
8 Class II in here for the base case scenario,
9 but we do vary that over a very wide range of
10 possible outcomes. So that's separate from the
11 observation that current Class II products have
12 an inelasticity of about minus .5.

13 Q. Now, one of the footnotes or similar
14 text somewhere tells me that your scenarios ran
15 new product elasticity options from minus 1.5
16 to minus .2 I think or something to that
17 effect. Actually, it is on Table 7, minus 1.5
18 to minus .3.

19 A. Yes.

20 Q. Can you point me to -- I have not
21 been able to identify a table which shows the
22 results of a scenario for the new product using
23 a hypothetical demand elasticity of less than
24 .5.

25 A. Of less --

1 M. Stephenson - Cross - by Mr. Beshore

2 Q. Of a lower --

3 A. Well, one way to do that, the very
4 last page has a chart that you might see, and
5 this is a chart that shows on the vertical axis
6 storable product elasticities and on the
7 horizontal axis new product elasticities. You
8 will notice that up in the upper right-hand
9 corner is a little cross that says this is
10 where the base values are. This is our
11 minus .35 or whatever it was and minus .5.

12 On here you can run all the way down
13 if you want to -- excuse me -- all the way over
14 if you want to into this direction where we
15 have minus 1.5 on this graph and it will give
16 you some idea about the change in producer
17 revenues.

18 Q. Okay. But if I wanted to look at
19 scenarios for the new product where the price
20 elasticity was closer to Class I, okay, that
21 is, where it was a lower negative.

22 A. Class I is at minus .25.

23 Q. Right. Where would I find, for
24 instance, a minus .25 on that table?

25 A. On this chart you can see it. You

1 M. Stephenson - Cross - by Mr. Beshore
2 could move it over in this direction here
3 (indicating) more toward this upper right-hand
4 corner. That would move the new product
5 elasticity over in the range of minus .35. We
6 don't get all the way to .25 on here. I guess
7 it didn't include that. But it does show you
8 the change in direction.

9 Q. Okay. So there's no point -- I
10 couldn't actually plot a point on this for an
11 assumed elasticity for the new product equal to
12 Class I products?

13 A. Not quite, but you can probably
14 extrapolate and get in the ballpark here for
15 it.

16 Q. I don't think I could.

17 A. I think even you could, Marvin.

18 Q. Okay. Are those numbers anywhere in
19 the tables?

20 A. They aren't in the tables, no.

21 Q. Are there any numbers less than
22 minus 0.5 in the tables for new product?

23 A. Well, let's see. We did vary those.
24 In which scenario it was I will have to look.
25 New product elasticities.

1 M. Stephenson - Cross - by Mr. Beshore

2 No, we didn't move it in that
3 direction I guess on the table.

4 Q. A question from that is, if you are
5 assuming basically the results of moving the
6 product up in price and basically moving the
7 elasticity up in responsiveness to price, I
8 think I could even conclude the results are not
9 going to work out very well. Isn't that fair?

10 A. If you are moving the new product up
11 in price --

12 Q. Up in class and up in price, which
13 is what your scenarios are. They are Class II
14 versus Class I.

15 A. Sure. Where we moved it up in a
16 12-month time period, yes.

17 Q. And the scenarios are basically
18 plotting it being more and more and more
19 elastic, you're going to have a bad result in
20 terms of sales revenues necessarily, aren't
21 you?

22 A. Yes, the revenues fall off a bit in
23 here, but they don't drop off the chart. I
24 probably should have brought information that
25 showed you more of the intermediate results on

1 M. Stephenson - Cross - by Mr. Beshore

2 here I guess, Marvin, and I didn't do that.

3 But, again, we have looked at this
4 over really a broad range of outcomes. There's
5 nothing I have been trying to hide from the
6 output or the outcome from the model results.

7 Q. I am not saying you are trying to
8 hide anything, but it is not in here?

9 A. Yes. Well --

10 Q. Okay. So when I look at then the
11 results, most of the results here on Table 4
12 where you are looking at the different results
13 of the product, assuming -- I'm just doing a
14 hypothetical, a new product -- assuming it
15 stays in Class II. Now, are all these
16 scenarios assuming the minus .5 elasticity
17 except for the one that says "NP more elastic"?

18 A. Yes. That's correct.

19 Q. So on this whole table we don't have
20 any results that show, that test the NP being
21 less than minus .5; is that correct?

22 A. That is correct.

23 Q. Therefore, the fact that they are
24 mostly negative kind of follows A, B after
25 that, does it not?

1 M. Stephenson - Cross - by Mr. Beshore

2 A. "B" being what?

3 Q. Well, if you are testing -- if you
4 got the highest elasticity -- drop that.
5 Forget it.

6 When I look at this, I am
7 wondering -- and this is just a real lay person
8 look -- if you've got a new product, assume you
9 got more sales for milk with the new product.

10 A. Absolutely.

11 Q. It is a successful new product. Why
12 are most of the results negative?

13 A. Well, you need to remember they
14 aren't. The base case --

15 Q. Versus the base. I'm sorry.

16 A. The base case is the one where we
17 say we leave it in Class II the whole time
18 period. So all of the comparisons to base are
19 from leaving it in Class II versus putting it
20 in Class I.

21 Now, the scenarios that we have in
22 here are saying what if we change some of these
23 model parameters when we did move it into
24 Class I, what difference does that make.

25 Under all circumstances here with a

1 M. Stephenson - Cross - by Mr. Beshore
2 new product introduction, producer revenues are
3 positive by a fairly substantial amount with
4 the exception of where we allow input
5 substitutions to some degree. That's where we
6 begin to lose new product sales.

7 Q. So Table 4 with new product assigned
8 to Class II by scenario assumes that the new
9 product has been assigned to Class I?

10 A. Yes. This is saying, under the base
11 case scenario, what if you left it in Class II
12 forever. The change in this is what if you
13 moved it to Class I; and now, let's go down and
14 look at the scenarios here, are what about a
15 number of other parameters in the model that
16 might be contentious.

17 So, for example, what if the new
18 product were actually more elastic than it is,
19 or what if the cross-price elasticity were
20 different. So this is just an attempt to look
21 at sensitivity of our assumptions in the model
22 to a variety of parameters that can be changed.

23 Q. Okay. Let's look at that. And the
24 difference between Table 4 and Table 6 is that
25 in Table 4 everything went to Class I for the

1 M. Stephenson - Cross - by Mr. Beshore
2 whole time and in Table 6 some of them remained
3 in Class II?

4 A. That's right. Table 6 says, quite
5 simply, you have your choice between leaving it
6 in Class II or putting it in Class I, where do
7 you maximize producer revenues. In Table 4 it
8 just says you are going to move it from
9 Class II to Class I and we are going to again
10 look at these possible parameter changes.

11 Q. Okay. Now, in Table 4, when you
12 make -- in the scenario that says NP more
13 elastic, it looks like you do better when it is
14 more elastic in that scenario than the majority
15 of the other scenarios?

16 A. By moving it into Class I?

17 Q. By moving it into Class I.

18 A. Yes.

19 Q. Even though your demand is more
20 elastic and you are moving it up?

21 A. That's correct. Because we are
22 selling relatively less of this new product.
23 Under this scenario here we don't -- we don't
24 take the product away from Class III and move
25 it in the short run, so we don't have a larger

1 M. Stephenson - Cross - by Mr. Beshore
2 supply response in the long run.

3 Q. In terms of supply response, when
4 revenues go up, the supply response goes up and
5 then the price goes back down, does the supply
6 response contract because of that reduction in
7 price in your model?

8 A. Yes, it does.

9 Q. Now, the substitution scenario, let
10 me see if I understand that. Are you basically
11 saying there that if you have a new product
12 which is displacing some otherwise milk product
13 sales and you begin satisfying the demand for
14 that new product with nonmilk ingredients that
15 dairy farmers lose money?

16 A. That's correct. Relative to the
17 case where we don't either have that input
18 substitution or if we didn't move it into
19 Class I. I mean, we have two different things
20 going on here. One is that we can allow input
21 substitution and --

22 The input substitution that was
23 allowed under that scenario with nonmilk
24 ingredients, the response is assumed to be
25 fairly large. A 10 percent increase in milk

1 M. Stephenson - Cross - by Mr. Beshore
2 costs reduces milk use in the new product by
3 50 percent and a 15 percent increase in milk
4 costs decreases milk use by about 75 percent.

5 This is just for illustrative
6 purposes. What if we had that tipping point
7 reached in prices and we had reasonable
8 functionality substitute for ingredients in the
9 products that allowed food formulators to swap.

10 Q. Well, the line for input
11 substitution allowed on both Table 4 and
12 Table 6 is the same. I am looking at it;
13 right?

14 A. Yes. That's correct, because --
15 maybe that shouldn't be the same.

16 No, it should the same. The reason
17 is that in Table 4 --

18 No, I am not sure that it should be.
19 I take that back. I might have a mistake in
20 the table.

21 Q. Do you know which one is correct?

22 A. I don't without looking back at the
23 data.

24 MR. BESHORE: Okay. Thank
25 you.

1 M. Stephenson - Cross - by Dr. Cryan

2 JUDGE DAVENPORT: We are
3 getting right up to quarter to three. Why
4 don't we take our afternoon break at this time
5 and let's be back at three.

6 (Recess taken.)

7 JUDGE DAVENPORT: Dr.
8 Stephenson, can you come back up here, please.
9 Is there other examination of Dr. Stephenson?
10 Mr. Cryan again.

11 DR. CRYAN: I'm Roger Cryan,
12 C-R-Y-A-N, and I will try to be shorter this
13 time.

14 JUDGE DAVENPORT: That sure
15 would be appreciated.

16 -----

17 CROSS-EXAMINATION

18 BY DR. CRYAN:

19 Q. Mark, do you have some reason to
20 believe that the demand elasticity for the
21 LeCarb-type product in your scenarios --

22 JUDGE DAVENPORT: Mr. Cryan,
23 we are getting some significant noise from next
24 door. Can you make sure that you speak
25 directly into the microphone so that everybody

1 M. Stephenson - Cross - by Dr. Cryan

2 can hear.

3 DR. CRYAN: Okay.

4 Q. Mark, could you tell me whether you
5 have any reason to believe that the price
6 elasticity of demand for the LeCarb products in
7 your LeCarb scenario differ substantially from
8 that for other fluid milk products?

9 A. No, Roger, we don't. As I indicated
10 before on questioning, we didn't have data or a
11 study or other basis upon which to determine
12 what the elasticities of these new products
13 might be. We chose .5, minus .5, for the new
14 products and, you know, this was just based on
15 judgment.

16 Q. Does it make some intuitive sense
17 that the product like the low carb milk which
18 sort of represents a lifestyle shift would have
19 a more similar demand elasticity to fluid milk
20 than does, say, something like Swerve or
21 another flavored soda pop-type drink?

22 A. Intuitively I would imagine that
23 that might be the case, but, again, as I said,
24 I have no data to base that on.

25 Q. I understand. You talked about your

1 M. Stephenson - Cross - by Dr. Cryan
2 model has a scenario for input substitutions
3 and you talked a good bit about the
4 substitution of vegetable proteins, essentially
5 vegetable protein products for dairy proteins.

6 Isn't it true that dairy protein
7 prices are substantially higher than vegetable
8 protein prices right now?

9 A. It is my understanding that that is
10 the case, although some of those numbers are a
11 little hard to find. I don't believe that NASS
12 publishes those.

13 But, yes. It is my understanding --
14 we had testimony early this morning that that
15 would be the case in at least a couple of
16 instances.

17 Q. If that is the case, would it make
18 sense that there has to be some substantial
19 benefit in terms of superior attributes to
20 dairy proteins for that type of a price
21 discrepancy to hold up over time?

22 A. Yes. Although, you know, again, one
23 of the things -- we do a great deal of work,
24 our group does a great deal of work with food
25 scientists at Cornell working on milk fractions

1 M. Stephenson - Cross - by Dr. Cryan
2 and a number of other dairy product
3 ingredients.

4 In discussions with the food
5 scientists, they are telling us that they are
6 making headway almost at least as fast in
7 vegetable proteins as they are in dairy
8 proteins, and the concern is not where we are
9 today necessarily but where we may be moving in
10 a short period of time.

11 Q. The scenario where there is a
12 wholesale switch from dairy proteins to
13 vegetable proteins is more a worse case future
14 scenario than a likely scenario in the present?

15 A. It was part of a range of scenarios
16 that we ran and put substitutions from
17 relatively small to relatively large.

18 Q. Okay. I understand that. Finally,
19 the demand elasticities in your study, are they
20 all intended or do they all represent retail
21 demand elasticities?

22 A. They do represent retail demand
23 elasticities, that's correct.

24 DR. CRYAN: Okay. Thank you
25 very much.

1 M. Stephenson - Cross - by Mr. Wilson

2 JUDGE DAVENPORT: Other
3 examination of this witness? Mr. Wilson.

4 MR. WILSON: Todd Wilson,
5 USDA.

6 -----

7 CROSS-EXAMINATION

8 BY MR. WILSON:

9 Q. Good morning, Mr. Stephenson.

10 A. Good morning. Afternoon.

11 Q. Dr. Stephenson, good afternoon. We
12 have been going through some tables and stuff,
13 and I admit I may be getting lost in some of
14 the Class I, Class II, where it is and things,
15 but I wanted to clarify one of the descriptions
16 that you have on page five, the fourth bullet.

17 A. Yes.

18 Q. At the very end of that in
19 parentheses you are saying that "the increase
20 in price of the milk input due to the
21 reclassification from I to II."

22 A. Oh, I am sorry. That is backwards.
23 It should be from II to I.

24 Q. Rather than a decrease?

25 A. Yes. "The beverage manufacturers

1 M. Stephenson - Cross - by Mr. Wilson
2 choose to use more nondairy ingredients in
3 response to the increase in the price of the
4 milk input due to a reclassification from II to
5 I."

6 Q. Thank you. As was mentioned
7 previously I think in a response that you had
8 to one of the questioners, you had indicated
9 that new products are typically classified
10 before they are marketed. Do you agree with
11 that?

12 A. Typically I believe that's the
13 case, although I don't think I said that
14 earlier, but --

15 Q. Maybe not in those words. Sorry.
16 If that is typically the case, dairy
17 programs is asked to classify new products on
18 the market but they haven't been marketed yet,
19 and as I understand your testimony in saying
20 that price elasticities, demand elasticities
21 should be a determining factor in
22 classification, how would you offer that those
23 two things be congruent?

24 A. Well, one of the statements in here,
25 I believe, is that demand elasticities and form

1 M. Stephenson - Cross - by Mr. Wilson
2 and use are important, but they aren't the only
3 things that should be considered in the
4 decision. So I don't think that I -- at least
5 I hope I didn't make a statement to suggest
6 that we need to know what the elasticities of
7 demand are going to be before a product has
8 been launched or introduced. I didn't try to
9 make that statement.

10 Q. Do you believe that the form and use
11 that the Act has in it is adequate or
12 inadequate for classification?

13 A. You know, that's a value judgment I
14 guess, and it is probably beyond the scope of
15 what I wanted to or feel qualified to discuss
16 here today. I wanted to report primarily on
17 the research that we have done in this area.

18 Q. You had made a statement on page two
19 that the demand elasticities or physical
20 characteristics of form and use are useful but
21 incomplete.

22 What other characteristics or what
23 other things should the Department look at?

24 A. Well, this model gives you some idea
25 about the things that we think are important to

1 M. Stephenson - Cross - by Mr. Wilson
2 be captured at least in the dairy industry and
3 it is probably not complete either, but one of
4 the more important factors is to think about
5 the supply response or the supply elasticity I
6 guess, if you will. Producers will respond to
7 higher milk prices, and if you are thinking
8 about maximizing producer revenues, that can't
9 be neglected.

10 Additional possibilities can be some
11 of these products are looking at primarily
12 interest in the milk proteins for a new product
13 usage. One of the by-products of using a fair
14 amount of milk just to get milk proteins may be
15 butterfat, and in our classification formulas
16 this has implications for producer revenues as
17 well.

18 Q. One of the assumptions that you made
19 was you did not include the Dairy Price Support
20 Program?

21 A. Correct.

22 Q. You mentioned the supply, calling on
23 your previous answer. How would that impact
24 your outcome of the Price Support Program in
25 effect?

1 M. Stephenson - Cross - by Mr. Wilson

2 A. We have built models like this that
3 did incorporate the Dairy Price Support
4 Program. We chose not to add that complexity
5 to this particular model's building effort.

6 One of the things that happens in
7 here as we have a producer response to higher
8 milk prices is that we have more product that
9 finds its way to manufacturing, and over a
10 period of time inventories of those storable
11 products can build. It is those inventories as
12 they are building that provide a feedback
13 signal to lower product prices in manufactured
14 classes.

15 Theoretically, if those prices got
16 low enough in here that the Dairy Price Support
17 Program would kick in to purchase additional
18 products, that might take some of the penalty
19 off of excess production for a period of time.

20 Part of what you have to be
21 concerned with I think is also what happens to
22 those dairy products under Dairy Price Support
23 Program, how do they return themselves into the
24 market, under what conditions do they disappear
25 in export markets for animal feed or something

1 M. Stephenson - Cross - by Mr. Wilson

2 else.

3 Q. When you have a new product entered
4 into the marketplace, are you specifically
5 targeting a product that is manufactured from
6 excess, such as a powder, or could a new
7 product be just a new flavor of milk or a new
8 concept of milk with another ingredient added?

9 A. The two stylized new products that
10 we looked at were products that -- one of the
11 products was something that contained milk
12 proteins, was not merely a flavored milk but
13 something that was rather Swerve-like in its
14 product components, and the other was a reduced
15 lactose white milk product, a UF milk product,
16 if you will.

17 So we looked at those two different
18 items in here. We weren't trying to look at
19 just another flavor of white milk, for example.

20 Again, part of the feedback from
21 some of these newer products that we were most
22 interested in capturing was the notion that
23 there are some by-products that are a little
24 bit different from the two things. So we were
25 looking at the products that were of interest

1 M. Stephenson - Cross - by Mr. Wilson
2 to the dairy industry at the time.

3 Q. And on both of those new products
4 you assumed a price inelasticity of equal value
5 for both products?

6 A. We did. Yes.

7 Q. Would you agree that they probably
8 had a different demand or price elasticity?

9 A. I am almost positive that they
10 would. I don't know what they would be.

11 Q. Am I saying the right word? Price
12 or demand?

13 A. Go ahead and finish your statement.
14 I don't remember what you said.

15 Q. I think I said price, but I meant
16 demand elasticity.

17 A. Demand elasticity.

18 Q. You have a minus .5

19 A. Minus .5, that's correct.

20 Q. Either one would have a different
21 demand elasticity?

22 A. It is inconceivable that they would
23 be exactly the same. I don't know what the
24 magnitude of the differences would be between
25 them.

1 M. Stephenson - Cross - by Ms. Carter

2 Q. But if one of them was, for
3 instance, the --

4 Well, either one possibly could be
5 more elastic than even white milk?

6 A. More inelastic you mean. We have
7 them more inelastic right now, relatively
8 speaking.

9 So you mean they're less price
10 responsive than even white milk. Yes, it is
11 conceivable that they could.

12 MR. WILSON: That's all I
13 have.

14 JUDGE DAVENPORT: Ms. Carter.

15 MS. CARTER: Antoinette Carter
16 with USDA.

17 -----

18 CROSS-EXAMINATION

19 BY MS. CARTER:

20 Q. Good afternoon, Dr. Stephenson.

21 A. Good afternoon.

22 Q. On page four of your statement you
23 list the key characteristics that were included
24 in the model, and one of the items listed is
25 the 2001 base year data developed in detail for

1 M. Stephenson - Cross - by Ms. Carter
2 other modeling work. Specifically what types
3 of data are you referring to there?

4 A. Okay. When the model is being tuned
5 to give us base level data, and by "base" I
6 don't mean the base that we are talking about
7 in here, but to provide information that looks
8 very much like a year that we had, we look at
9 such things as class prices, do they, as we are
10 generating these, determine class prices that
11 are very similar in 2001. Do the utilizations
12 in product categories look the same. Does the
13 milk supply look essentially the same. Those
14 are the kind of parameters that we are using in
15 a modeling year.

16 Q. You referenced that you looked at
17 short run period. What time period are you
18 talking about in terms of short run with
19 regards to the results?

20 A. The model is a monthly model. So
21 there are 12 months in a year. This was run
22 over a 100-month time period, something less
23 than nine years in length. The short run
24 determination might be used for something like
25 milk supply response, for example.

1 M. Stephenson - Cross - by Ms. Carter

2 We indicate that in the short run
3 producers can respond by changes in milk
4 production per cow quite quickly as in a
5 one-month lag period. Over the longer term
6 they might acquire additional capital to more
7 cows, more facilities, more buildings. That
8 takes a little bit longer period of time. And
9 as we have to generate additional genetics to
10 milk more cows, that's built into this longer
11 run cycle.

12 So that's the kind of time
13 difference we have between short run and long
14 run in milk supply response.

15 Q. Five years were used for the I guess
16 full growth potential of a product that's
17 performing successfully in the market.
18 Generally is that the typical time period for a
19 product that's performing well in the market,
20 or what was the basis for the five-year period?

21 A. We talked with our food industry
22 management program that works quite a bit with
23 retailers and asked them about successful new
24 product launches. We did a little bit of
25 literature review.

1 M. Stephenson - Cross - by Ms. Carter

2 Of products that seemed to make it
3 in the marketplace, five years was a fairly
4 ordinary period of time for a product to pretty
5 well fully express its growth potential as the
6 product exists. If they make changes in the
7 product such as new and improved, then that
8 product cycle might be extended for a period of
9 time.

10 Q. Did the model look at the
11 distribution of the new products in terms of
12 the products being marketed nationally and/or
13 regionally? Was that built in?

14 A. This model was a U.S. domestic
15 model. So, you know, we sort of said here's
16 the whole U.S. We didn't indicate that a
17 product was launched in the Southwest and
18 mostly used in schools in that area or
19 something like that. No. We looked at this as
20 a U.S. model.

21 And again, the kind of product
22 launches that we were looking at here we think
23 are very optimistic for most new products. I
24 mean, something that would have gained as much
25 as 2.5 half percent of the milk supply over a

1 M. Stephenson - Cross - by Ms. Carter
2 five-year time period would be a very
3 successful product to have, but we also felt
4 that, if anything, that would overstate the
5 results.

6 Q. If I could just direct your
7 attention to the diagram, which is I guess the
8 second to the last page of your statement.

9 A. Okay.

10 Q. Could you briefly summarize what
11 this is detailing?

12 A. This is the one with all of the
13 arrows and words?

14 Q. Yes.

15 A. Okay. It probably would have been a
16 lot easier if I hadn't included this, but I did
17 want to at least give you -- and this is the
18 simplified version.

19 This shows you at least the major
20 pieces that we have included in the model. The
21 areas where you see boxes in there like new
22 product inventory, storable product inventory,
23 farm capital, those are indicative of, in the
24 model verbiage, what we call stocks or
25 inventories, and the arrows moving into it and

1 M. Stephenson - Cross - by Ms. Carter

2 out of it are considered to be flows.

3 Then there are a variety of impacts
4 that can happen that provide what's called
5 feedback loops. They can be either positive or
6 negative. So, for example, coming out of farm
7 capital here you see that there is a plus on
8 that moving down toward milk production. That
9 indicates that if farm capital increases, that
10 has a positive feedback on milk production
11 which can have a positive feedback on this
12 residual milk, if you will.

13 It is a bit detailed, but it is
14 included here I guess to let you walk through a
15 little bit the pieces that were considered in
16 this model.

17 Again, it is a model. It is a
18 simplification of reality, but it does help us
19 I think to take a look at some of the bits and
20 pieces in a decision like this that may or may
21 not be important,

22 MS. CARTER: That's all I
23 have. Thank you.

24 JUDGE DAVENPORT: Other
25 questions? Dr. Stephenson, thank you for your

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2 testimony here today. You may step down.

3 Mr. Box.

4 -----

5 JAMES R. BOX

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

8 JUDGE DAVENPORT: Could you
9 please state your full name for the record.

10 THE WITNESS: My name is
11 James R. Box.

12 JUDGE DAVENPORT: Could you
13 spell your last name for the hearing reporter.

14 THE WITNESS: B-O-X.

15 (Exhibit No. 24 was marked for
16 identification.)

17 JUDGE DAVENPORT: You have a
18 statement which has now been marked as Exhibit
19 24. Are you prepared to read it at this time?

20 THE WITNESS: Yes. For those
21 of you who have a copy of the statement, I
22 would like to on the face page of the statement
23 please correct the ZIP code to 10603.

24 The Dannon Company expresses
25 appreciation to the Secretary for the

1 J. Box - Direct Testimony

2 opportunity to appear and support our proposal
3 to amend the fluid milk product (FMP)
4 definition under the Federal Milk Marketing
5 Order. Within the body of our testimony we
6 will oppose other specific proposals submitted
7 for consideration at this hearing.

8 The Dannon Company, Inc., General
9 Information: Dannon is a wholly owned
10 subsidiary of The Danone Group headquartered in
11 Paris, France. Group Danone is a publicly
12 traded company trading under the symbol DA and
13 is listed on the New York Stock Exchange. The
14 Group's sales in 2004 were in excess of
15 \$17 billion. Employees of the Group Danone are
16 in excess of 89,000.

17 Globally, the three primary areas in
18 which we function are fresh dairy products,
19 water and cookies. There are other areas in
20 which we operate, but these are the most
21 significant. We produce yogurt and fresh dairy
22 products in 40 countries around the world.

23 Manufacturing Plants: Dannon is
24 part of the North American zone of dairy
25 operations for the Group. In the U.S., Dannon

1 J. Box - Direct Testimony
2 operates three yogurt manufacturing locations:
3 Minster, Ohio; Ft. Worth, Texas; and West
4 Jordan, Utah. We have a co-packing
5 relationship with one processor for some of our
6 production. The North American corporate
7 headquarters for the Group is located at
8 100 Hillside Avenue, White Plains, New York,
9 10603.

10 The Dannon Company's Raw Milk
11 Supply: The supply of raw milk for our yogurt
12 production in our Ohio, Texas and Utah
13 locations comes through a dairy cooperative.
14 Dannon has no independent dairy farmers from
15 whom it purchases milk directly. To our
16 knowledge, with the exception of perhaps a
17 couple of times during the last eight years,
18 the milk we receive from the supplying
19 cooperative is pooled milk.

20 For the calendar year 2004, Dannon
21 purchased in excess of 675 million pounds of
22 milk for use in making yogurt products. Dannon
23 is a major producer of regular yogurt and
24 yogurt-containing beverages sold in the U.S.
25 and, as such, has a significant interest in

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2 these proceedings.

3 The Dannon Company pays the
4 announced Federal Milk Order price for raw milk
5 purchased from our supplying cooperative and
6 the announced premium for the classes of milk
7 for the area in which each one of our plants is
8 located. Milk is our most important raw
9 material, and milk cost is the major component
10 of our raw material cost.

11 Changes in the milk cost come
12 through market evolution, the premiums we pay
13 our milk suppliers, and the classification of
14 the products once produced. Evolution of these
15 cost drivers will affect very significantly our
16 cost of doing business.

17 Yogurt-containing beverages are
18 Class II under the California State Order. As
19 outlined in the California Dairy Statistics
20 Annual 2004, page 49, yogurt and
21 yogurt-containing beverages produced and sold
22 within California are classified as Class II.
23 We would like to request official notice of
24 that now.

25 Those products enjoy the benefit of

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2 a lower price, whereas products manufactured
3 outside of the state of California would
4 compete in the California market priced as
5 Class I.

6 This results in inequitable
7 treatment of yogurt-containing beverage
8 processors, particularly when there are those
9 of us who manufacture such products in a
10 federally regulated area and market the
11 products in the state of California.

12 Reaction To Other Submitted
13 Proposals: Proposal 1, DFA. We are opposed to
14 the adoption of Proposal 1 as listed in the
15 Notice of Hearing. All beverages containing
16 some milk or milk derivatives are not in
17 competition with fluid milk, as we will prove
18 for yogurt and yogurt-containing drinks in the
19 body of our direct testimony. To us it just
20 doesn't seem within the realm of possibility
21 that all beverage products containing any milk
22 or milk solids can be deemed to be competing
23 with fluid milk.

24 Consumers have a variety of reasons
25 for consuming beverages such as smoothies. All

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2 drinkable beverages, including yogurt, do not
3 compete with the sales of fluid milk.

4 Proposal 2, DFA. Dannon is also
5 opposed to including whey when calculating the
6 milk solids not fat contents of the product.
7 That was not the original intent of the
8 definition when it was adopted.

9 We usually think of whey as the
10 product of some type of cheese making. There
11 are solids in whey that have uses in other
12 products for texture or other functions. The
13 fact that a processor may use whey in making a
14 food product should not have an impact on
15 whether the product meets the definition of
16 fluid milk product.

17 The volume of solids has been priced
18 once, and a secondary use of a by-product
19 should not count in making that product meet
20 the definition of FMP.

21 Proposal 3, O-AT-KA. Dannon is
22 opposed to Proposal 3 because we are not in
23 favor of the Federal Milk Marketing Program
24 moving to a protein specific threshold in the
25 definition of fluid milk products. We will

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2 address the opposition to protein threshold in
3 Section 3.11.

4 Moving to a specific protein content
5 for the fluid milk product definition does
6 nothing to help determine whether a product is
7 really competing with fluid milk beverages.

8 Proposal 4, Select Milk Producers.
9 Dannon has no position on this proposal.

10 Proposal 5, H. P. Hood, LLC. Dannon
11 has no position on this proposal.

12 Proposal 6, H. P. Hood, LLC. Dannon
13 has no position on this proposal.

14 Proposal 7, National Milk Producers.
15 Dannon is opposed to Proposal 7.

16 JUDGE DAVENPORT: Excuse me,
17 Mr. Box. In your testimony you are saying 3.11
18 and that should be, for the record, both of
19 them, 3.7 and 3.2.

20 THE WITNESS: Correct. 2.1
21 and 3.1.

22 JUDGE DAVENPORT: Very well.
23 Thank you.

24 THE WITNESS: In both places.

25 Proposal 9, General Mills. Dannon's

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2 opposition to this proposal comes only with
3 respect to the content of a protein threshold
4 in the Fluid Milk Product definition. With
5 respect to the yogurt content of the product,
6 we support the proposed 20 percent minimum
7 level offered by General Mills.

8 Proposal 10, Novartis. Dannon is
9 opposed to Proposal 10 because it would remove
10 the 6.5 percent milk solids not fat from the
11 definition.

12 Proposal 11, Hormel Foods. Dannon
13 has no comment on Proposal 11.

14 General Comment For Protein
15 Threshold: We oppose the adoption of a protein
16 specific level in the definition of fluid milk
17 product. The FMP definition states 6.5 percent
18 milk solids not fat as the threshold for
19 determining a product's classification. There
20 is no mention of protein or the relationship
21 protein has to the defined MSNF content. It
22 was assumed to be the regular relationship of
23 2.24 percent, but what if it weren't?

24 That case is not addressed in the
25 definition, and since there is no protein

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2 level specifically addressed, we do not believe
3 one can be assumed. The only measurable
4 threshold the industry has is that of MSNF
5 at 6.5 percent.

6 No Merits of Protein Threshold For
7 The Product: Movement to a specific protein
8 level for determining a product that meets the
9 definition of FMP does not solve the
10 classification problem for the Department.
11 Under a protein threshold scenario, more
12 products will most likely meet the FMP
13 definition and thereby be classified as Class I
14 when they are not necessarily competing with
15 fluid milk sales.

16 The Act specifically includes the
17 defining "form and use" challenge and does not
18 specifically include an MSNF or protein
19 challenge. The MSNF criteria was included by
20 the Department in an attempt to provide an easy
21 measure for "form and use."

22 Under a protein specific level and
23 current Class I pricing rules, processors
24 producing Class I products would still be
25 charged on the skim equivalent and butterfat

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2 used in those products that are Class I, not
3 necessarily on the protein used in the
4 production of those products.

5 There will be some standard set for
6 determining the skim equivalent of the protein
7 used by source. That skim equivalent will then
8 be used as the invoicing volume. In other
9 words, Class I would be charged based on
10 protein utilization while protein, in general,
11 has never been a key driver for products in
12 fluid milk classification.

13 Protein should not serve that
14 function for determining Class I products. We
15 do not see merits for such a rule from a
16 product standpoint.

17 Consequences Of A Protein Threshold
18 On Use Of Dairy Protein: Use of a protein
19 specific level for a threshold to determine the
20 first hurdle in classification is unnecessary
21 and burdensome to the industry. We believe
22 that if the Department finds it necessary to
23 employ a protein specific threshold in the FMP
24 definition, the industry may be encouraged to
25 seek nondairy protein for formulating products.

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2 The Department should not use the fluid milk
3 product definition to encourage the dairy
4 industry to use nondairy protein in the
5 formulation of products.

6 Alternative source costs of dairy
7 protein are regularly reviewed internally at
8 Dannon when formulating or reformulating
9 products.

10 Conclusion: A protein threshold is
11 I have the next word as unnecessary and can
12 encourage and change implement a wrong
13 incentive for the industry.

14 Except for yogurt and
15 yogurt-containing beverages, which should not
16 be classified as Class I as we will demonstrate
17 later, we encourage the Department to continue
18 to use the 6.5 percent milk solids nonfat
19 threshold as the standard for measuring the
20 nonyogurt-containing beverages classification.
21 That measurement is well known by the industry
22 and should continue to serve as the standard.

23 The Dannon Company's Proposal. Our
24 proposed version of Section 1000.15(b)(1).

25 We propose that Section

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2 1000.15(b)(1) be amended to read: Plain or
3 sweetened evaporated milk/skim milk,
4 sweetened/condensed milk/skim milk, formulas
5 especially prepared for infant feeding or
6 dietary use (meal replacement) that are
7 packaged in hermetically-sealed containers,
8 yogurt-containing beverages, any product that
9 contains by weight less than 6.5 percent nonfat
10 milk solids, and whey.

11 Specifically, the paragraph above is
12 an amendment to the current definition that
13 would clarify that beverages containing yogurt
14 are not considered to be fluid milk products.
15 Such beverages may contain as much as
16 100 percent yogurt or as little as 20 percent.
17 Under the California order there is no minimum
18 requirement for yogurt in the finished product.

19 Definition of Yogurt-containing
20 Beverages: A yogurt-containing beverage is any
21 beverage that contains at least 20 percent
22 yogurt.

23 Current Classes Of Products At The
24 Dannon Company: Dannon is engaged in producing
25 yogurt products that are classified and priced

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2 under the Federal Milk Marketing Orders as both
3 Class I and Class II. All U.S. manufacturing
4 locations produce Class II products while
5 Class I products are produced at the Fort
6 Worth, Texas, plant and the West Jordan, Utah,
7 locations.

8 The products we produce that
9 currently are classified as Class I are
10 drinkable Danimals low fat yogurt and Danactive
11 probiotic cultured dairy drink. Other
12 yogurt-containing drinks we produce that are
13 Class II are Smoothies under the Frusion,
14 Light 'n Fit and Carb Control brand names.

15 Dannon did not consider any of its
16 products to be competitive with fluid milk.
17 All of the products we produce comply with the
18 standard of identity for yogurt, low fat yogurt
19 and nonfat yogurt, as appropriate, or are
20 yogurts-containing beverages that do not meet a
21 standard of identity.

22 Yogurt and yogurt-containing
23 beverages do not compete with fluid milk for
24 several reasons that we will point out.

25 Historical Background: Why is form

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2 and use of the essence? The Agricultural
3 Marketing Agreement Act of 1937 mandates that
4 the Secretary classify milk "in accordance with
5 the form in which or the purpose for which it
6 is used." These broad guidelines offer little
7 guidance to the Department with the many new
8 products that have appeared in the market in
9 recent years.

10 Over the years when the Department
11 has opened any part of the classification
12 system for consideration, the base operatives
13 for classifying products have always been
14 reduced to what is in the Act, "form and use."

15 In the 60s, 70s, 90s and with the
16 reform that occurred in 2000, the Department
17 always relied on form and use for purposes of
18 classification. We urge the Department to
19 carefully remain focused on the statutory
20 language and retain only the form and use
21 argument.

22 The Nourse Report: In April 1962
23 the Federal Order Study Committee appointed by
24 then Secretary Orville Freeman made their
25 report to the Secretary. That report widely

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2 became known as the Nourse Report. Many of the
3 guidelines presented in the report for the
4 industry are equally as applicable in today's
5 market as they were at that time.

6 Mr. Nourse points out that
7 classified pricing plans under the Federal
8 Orders have as their primary objective
9 increasing returns to producers and,
10 secondarily, to assure that prices established
11 for the lower classes are sufficiently low
12 enough to allow milk that is surplus to fluid
13 use in a market to clear.

14 The Committee's report notes that
15 effectively administering a Federal Milk Order
16 Program that is "in the public interest" as
17 mandated by the Act requires that the Secretary
18 recognize the positions of dairy farmers,
19 processors and consumers, each of which has its
20 own set of demands and needs.

21 The Nourse Report also contained the
22 following in its observations for Secretary
23 Freeman. "Universally, the high priced
24 category (Class I) includes milk used as fluid
25 whole milk and generally includes closely

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2 related fluid products, such as skim milk and
3 flavored milk." Then it goes on to say,
4 "Observation indicates a close correlation
5 between the types of products included in the
6 high-priced categories and the existence of
7 conditions that might lessen potential
8 competition from alternative sources.

9 "The principal reason for including
10 milk and its related fluid by-products in
11 Class I is that because of sanitary
12 requirements, transportation costs and other
13 reasons, supplies tend to be limited to a
14 relatively local milkshed. Further, the
15 consumer demand for these products is such that
16 relatively high prices can be charged without
17 substantially reducing the quantities that will
18 be absorbed by the market."

19 Conclusion: With respect to
20 Dannon's logistics and distribution patterns,
21 we have three plants to serve the entire
22 nation. A yogurt drink produced in Utah may be
23 sold in Florida while a Texas-produced drink
24 may be sold in California and Maine.

25 Yogurt logistics are not limited to

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2 local consumption as fluid milk tends to be
3 because we have extended shelf life over fluid
4 milk. All of our products are distributed in
5 all of the United States and the Virgin
6 Islands.

7 The 1962 Committee had the same 1937
8 Act to guide it as the Department has today.
9 We would like to call the Department's
10 attention to "closely related fluid products"
11 as contained in the excerpt.

12 The committee was clearly indicating
13 that it believed that products that should
14 be included in the Class I category should
15 be very similar to fluid milk and that they
16 should be competitive with fluid milk. Neither
17 of these elements occurs with yogurt and
18 yogurt-containing beverages.

19 The Committee traced the roots of
20 classified pricing back to 1903, so the
21 industry has been working on a solution to the
22 issue for quite some time.

23 Class I, a Simple Answer To a
24 Complex Problem: Historically, the Department
25 has classified fluid or beverage uses of milk

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2 in the highest priced classification, Class I.
3 This is a simple solution for a complex issue.
4 The issue becomes more complex with each
5 innovative dairy drink product that is
6 introduced in the marketplace.

7 The classification tenet of fluid or
8 beverage form equals Class I is invalid and
9 should not be retained as a fundamental part of
10 the classification process under the Orders.
11 Beverages containing some milk or milk
12 derivatives do not necessarily, nor
13 automatically, compete with sales of fluid
14 milk. There are fundamental differences that
15 distinguish yogurt beverages and
16 yogurt-containing beverages from fluid milk.

17 The next title I changed to Use to
18 Consumers. Yogurt consumes less than 3 percent
19 of the U.S. milk production. Each year when
20 the Department publishes its annual summary for
21 Federal Milk Order Market statistics, Table 2
22 of that publication indicates certain dairy
23 industry statistics for the various Federal
24 Orders, like the number of markets, population
25 within the markets and so forth.

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2 One striking point in decline is the
3 percentage of utilization of milk pooled on
4 Federal Orders that goes into fluid milk for
5 Class I purposes. That number has declined
6 from 65 percent in 1947 to 41 percent at the
7 end of 2003.

8 During that same period, the volume
9 of producer milk pooled on the Federal Orders
10 has moved from 15 billion pounds in 1947 to
11 111 billion pounds in 2003.

12 The National Agricultural
13 Statistical Service (NASS) in its annual report
14 for dairy products issued in April of this year
15 reported that there were 2.5 billion pounds of
16 plain and fruit-flavored yogurt produced in 98
17 plants in 2004.

18 Dannon understands that the reported
19 production data is for cup yogurt only.
20 Drinkable yogurt data is not reported. Even if
21 drinkable yogurts are placed at the same volume
22 as cup yogurt, which would be high, the total
23 yogurt use would be about five billion pounds
24 for 2004.

25 NASS's milk production report

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2 estimates that total U.S. milk production in
3 2004 was 170.5 billion pounds. That would mean
4 that the maximum total yogurt use of milk was
5 around 2.9 percent of the milk produced with,
6 at most, 1.45 percent going into yogurt drinks.

7 It is understandable that some
8 parties have concerns over the decreasing
9 percentage of producer milk on Federal Orders
10 that ends up going into the highest priced
11 class of utilization. There is apparently less
12 money to build the producer blend price
13 differential, but is that actually the case?

14 Class I, A Limit To Innovation: The
15 situation can exist, and does in our case and
16 others, where pricing the products in the
17 highest priced class can actually impair
18 producer returns over a long run. No company
19 will produce a product that will not yield a
20 return in the marketplace.

21 Placing all new products in Class I
22 would be a strong signal to the industry to
23 rethink product innovation.

24 Product innovation is an avenue that
25 the dairy industry must have to continue to

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2 develop products that appeal to consumers in
3 terms of taste, texture, packaging and cost
4 regardless of the class of utilization.

5 Stifling innovation would bring a
6 sure, swift halt to research for products
7 currently under development, and both
8 processors and producers will suffer as a
9 result.

10 The yogurt market is driven by
11 innovation. For instance, in 2004 over
12 37 percent of the volume sold in the U.S. by
13 Dannon came from products that were introduced
14 in the last five years.

15 Innovation is very important to us,
16 as I am sure it is to every other processor.
17 We do not believe that that is the objective of
18 the Department, and we encourage the Department
19 to employ all avenues possible to keep product
20 innovation thriving for the benefit of the
21 industry so that dairy farmers and processors
22 may continue to serve in harmony.

23 A Quantitative Model Assessment From
24 Cornell University: Drs. Mark Stephenson and
25 Charles Nicholson of Cornell University

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2 developed a model assessing market impact on
3 the types of new products that prompted the
4 original request for this hearing. Their
5 analysis indicates that if new products are all
6 placed in Class I, it will have such a small
7 effect on the value in the total pool that
8 producers really will not have a significantly
9 improved base overall from which their producer
10 price differential is developed.

11 Dannon assumes that part of the
12 rationale behind holding a hearing of this
13 nature is to hear from the industry regarding
14 proposals that will increase producer revenue
15 and, thus, producer incomes.

16 The model developed by Cornell
17 looked at several different scenarios, one in
18 which the new product was initially classified
19 as Class II, then shifted to Class I; one in
20 which the new product was introduced as
21 Class II and stayed under that classification.

22 With regard to the quantity of milk,
23 Cornell deliberately assumed a relatively large
24 quantity equal to -- change that 5 percent to
25 2.5 percent of the U.S. milk supply when sales

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2 of the new product reached their full growth
3 potential so that the potential positive
4 effects of a classification shift for producers
5 could be assessed.

6 Subsequent work from Cornell shows
7 that the size of the market potential for the
8 new product does not influence which class
9 maximizes producer revenues.

10 According to the results of their
11 study, an increase in demand for milk for the
12 new product benefits producers regardless of
13 the class to which the new products are
14 assigned, and the bigger the increase in demand
15 for the milk, the more the dairy producers will
16 benefit. This is, however, a separate issue
17 than what happens due to changing
18 classification for the new products.

19 In previous work Cornell tried to
20 describe separately the effects of the increase
21 in overall milk demand from the effects of
22 shifting new products from Class I to Class II.
23 Cornell's model results indicate that there are
24 some situations (assumptions, parameters) in
25 which dairy producers would be better off even

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2 in the longer term with the new product in
3 Class I, and there are other situations where
4 producers would be worse off. The base case
5 shows producers slightly worse off, but others
6 show them slightly better off.

7 For the situations in which
8 assigning new products to Class I increases
9 producer revenues, the increase is always
10 small, less than 0.1 percent. For the
11 situations where producer revenues are
12 decreased by moving new products from Class II
13 to Class I, the decrease is also small unless
14 there is substitution for nondairy ingredients
15 to make the new product.

16 With that kind of substitution there
17 is the possibility of a large decrease in
18 producer revenues if new product manufacturers
19 have formulation options and they are price
20 sensitive.

21 Overall, under a very aggressive
22 hypothesis regarding milk consumption for new
23 products, there is more downside for the
24 producers to have the new products priced under
25 Class I because of the protein reformulation

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2 potential, because of increased supply
3 triggered by Class I ultimately pushing all
4 classes down through an excess of milk
5 production.

6 Producers' gains are similar between
7 Class I and Class II scenarios, but losses may
8 be big with a small likelihood under the
9 Class I scenario, which in expectancy makes the
10 producers better off under the Class II
11 scenario than the Class I situation.

12 Yogurt and Fluid Milk Have
13 Significant Different Price Elasticities: A
14 base price elasticity of minus 1.1 means that a
15 10 percent increase in the base price results
16 in an 11 percent decrease in volume sold. For
17 Dannon, according to a study carried out in
18 2004, price elasticities ranged from minus .64
19 for Frusion, minus .93 for Light 'n Fit
20 Smoothie, to minus 1.17 for La Creme cup
21 yogurt. The average for our yogurts is
22 minus .96 for Dannon.

23 Including other yogurts in the same
24 sample, the average elasticity is still minus
25 0.96 with a 95 percent confidence interval of

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2 minus 1.38 to minus .54.

3 The commonly adopted standard value
4 for fluid milk-based products is -- I say .2,
5 and I think that Dr. Stephenson reported .25,
6 which is not included in the 95 percent
7 confidence level for the elasticities of the
8 Dannon products. In other words, yogurts and
9 fluid milk-based products have significantly
10 different elasticities.

11 The elasticities of the Dannon
12 drinkable yogurts are generally two to three
13 times as high as fluid milk products. As a
14 consequence, any move that would result in
15 classifying more yogurt-containing beverages
16 into Class I would result in a decrease of
17 sales, meaning ultimately a decreased milk
18 demand.

19 A decreased milk demand from yogurt
20 manufacturers has two negative impacts on
21 producer revenues through lower overall demand
22 and lower average pricing since the supply
23 cannot adjust quickly to the demand.

24 The Uniqueness Of Yogurt-containing
25 Beverages: Technically, the products that we

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2 produce are, regardless of their form, yogurt
3 or yogurt-containing foods made from cows'
4 milk. These products or their principal
5 ingredient meet a standard of identity as
6 defined at 21 CFR, Section 131.200, Section
7 131.203 and Section 131.206 covering yogurt,
8 low fat yogurt and nonfat yogurt, respectively.

9 In all three sections cited, yogurt
10 is described as a food. The consuming public's
11 perception is that yogurt is a food regardless
12 of the form in which it is purchased. All
13 three CFR sections cited state that "yogurt is
14 the food that is produced by culturing one or
15 more of the optional ingredients specified in
16 the section with a characterizing bacterial
17 culture that contains the lactic acid-producing
18 bacteria *Lactobacillus bulgaricus* and
19 *Streptococcus thermophilus*.

20 Unique Cultures: Both *Lactobacillus*
21 *bulgaricus* and *Streptococcus thermophilus*
22 cultures acidify the milk. The specific
23 combination of strains provides the
24 characteristics of the yogurt, tartness,
25 acidity, texture, flavor.

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2 Within each product we carefully
3 select individual strains of cultures that
4 bring unique attributes. Each strain will
5 behave differently depending upon the process
6 of fermentation. How long and at what
7 temperature is the fermentation to take place?

8 All Streptococcus thermophilus
9 cultures will not build the same texture. At
10 Dannon, as it is throughout the Danone Group,
11 we select our strains of culture and define our
12 production processes with advanced technology
13 to achieve the specific targets of taste,
14 texture and claims we make for our products.
15 With this knowledge we have the ability to
16 produce a mild, thick and creamy yogurt-like
17 La Creme to be consumed as an indulgent product
18 for dessert; or we can produce a more fluid
19 product like Light 'n Fit Smoothies with a
20 target consumer of someone on the go.

21 The type of fruit, color and
22 flavoring agents are also components that
23 differentiate our products further from fluid
24 milk.

25 Unique Technology: The traditional

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2 manufacturing process used to produce yogurt is
3 very different from the process used to produce
4 bottled fluid milk. We heat treat the raw
5 milk, skim the milk and move the skim milk to
6 sterilized holding tanks. These initial steps
7 are similar to those a bottling plant would
8 take in packaging milk for fluid use. I know
9 it's exciting, isn't it?

10 However, the similarities cease at
11 that point. From the holding tanks our milk is
12 mixed with other ingredients, then pumped into
13 a vat where it is inoculated and fermented four
14 to eight hours. Change that six hours

15 Following the fermentation process,
16 the yogurt is cooled, sheared, stored in a vat
17 and then is pumped to the filler lines. Bulky
18 flavors, for example, fruit puree, fruit juice,
19 flavors and, where appropriate, water, in the
20 case of certain yogurt drinks, are added at
21 this point. It is then packaged. The shearing
22 process allows us to ensure the smoothness of
23 the yogurt and to establish the right
24 viscosity.

25 In each case, after the fermentation

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2 process, the white mass that results meets the
3 standard of identity for the yogurt noted
4 above.

5 In a fresh dairy plant, milk is
6 usually pasteurized and is cooled from there
7 through the rest of the packaging process.
8 Fresh dairy plants do not have to deal with
9 heating, inoculation and fermentation processes
10 in their operations. The yogurt process is
11 significantly different from a fluid milk
12 operation.

13 A fluid milk processor will not be
14 able to make yogurt without significant
15 additional investment in equipment and lines
16 for product flow.

17 Differences With Buttermilk: There
18 is already a cultured product in the category
19 of Class I: cultured buttermilk. Yogurt
20 differs from that product as well. The
21 cultures used to produce cultured buttermilk
22 are the same type of cultures traditionally
23 used to produce fresh cheese and other
24 fermented dairy products. The cultured
25 buttermilk product is fermented at 68 degrees

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2 Fahrenheit for 12 to 15 hours. To make yogurt,
3 milk is fermented at over 100 degrees for four
4 to eight hours, depending on the process
5 employed.

6 The cultures used for buttermilk
7 impart to the product a "cheese-like" flavor.
8 Our cultures actually give the product a tart
9 taste.

10 Cultured buttermilk is defined by
11 FDA under the cultured milk standards found at
12 21 CFR, Section 101.112. One of the
13 requirements for cultured buttermilk at that
14 section is that the finished product must
15 contain not less than 8.25 percent milk solids
16 not fat. In the case of yogurt, we must meet
17 that minimum before the addition of bulky
18 flavors. California classifies cultured
19 buttermilk as Class II.

20 Conclusion: Yogurt-containing
21 Beverages Are Significantly Different From
22 Class I Products. We may start with the same
23 raw milk as a fluid processor does, but we use
24 it to make a different product, yogurt. The
25 Department has traditionally classified yogurt

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2 in the Class II category. We agree with and
3 accept this classification.

4 We build a liquid texture through
5 technology, culture strain selection and other
6 ingredients selection to make a product with
7 specific characteristics that address consumer
8 tastes and preferences. Through this use of
9 technology and ingredient selection, we do not
10 change the fact that the product meets the
11 standard of identity of yogurt, low fat or
12 nonfat, as appropriate, or that yogurt is the
13 principal ingredient in the finished food.

14 Whether water, fruit or other
15 ingredients were added does not alter the
16 classification of the product. If one takes a
17 cup of our spoonable yogurt, a Class II
18 product, opens it and turns it on its side on a
19 table, the yogurt will flow out of the cup. It
20 will not run out as quickly as our beverage
21 yogurt would, but it will eventually flow out
22 of the cup.

23 We cannot embrace the concept that
24 we produce a Class I product from a Class II
25 product through the addition of fruit puree,

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2 fruit juice, and in some cases water. We
3 cannot accept the idea that any of our products
4 compete with fluid milk.

5 Yogurt-containing beverages result
6 from a unique combination of technology,
7 ingredients and cultures, allowing the consumer
8 to easily single out yogurts and
9 yogurt-containing beverages from any other
10 Class I product, making competition between
11 Class I product and yogurt-containing beverages
12 nonexistent.

13 Form of Yogurt-containing Beverages.
14 Packaging differences with other Class I
15 products. There is no disputing the fact that
16 our yogurt-containing beverages are in plastic
17 bottles just like fluid milk is usually found,
18 though milk may also be purchased in glass
19 bottles or gabled cartons.

20 The size of our bottles ranges from
21 3.1 ounces to 10 ounces. Most fluid milk
22 packages range from eight ounces to a gallon.
23 Usually fluid milk is purchased in containers
24 that have multiple servings in one container or
25 in the container. Most yogurt-containing

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2 beverages are purchased in single-serve
3 containers.

4 The packaging of the
5 yogurt-containing beverages has been designed
6 to meet the lifestyle and the consumption
7 habits of our consumers. Our on-the-go
8 packaging influenced significantly the success
9 of our products in the marketplace.

10 Taste And Mouth Feel Differences
11 With Other Class I Products: The taste, mouth
12 feel and texture of our products are not like
13 those of fluid milk. Our yogurt beverage
14 products are significantly different from fluid
15 milk by taste and texture.

16 Some flavored milks are marketed
17 that meet the fluid milk product definition,
18 but the texture will not be the same because
19 they were not made from yogurt.

20 The thick, creamy texture of our
21 beverages arises primarily because they are
22 yogurt or contain as their principal ingredient
23 the standardized food, yogurt. It isn't the
24 same product as a glass of fluid milk and its
25 use is not the same to the consumer.

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2 To the consumer, yogurt remains a
3 healthy, nutritious food however it is
4 purchased, in a bottle or in a cup, on the
5 shelf at the retail level.

6 Fluid milk and yogurt-containing
7 beverages do not compete with each other. The
8 products do not sit side-by-side in the same
9 display case in the grocery store, as evidenced
10 by the following "planogram" which shows that
11 yogurt-containing beverages are placed in the
12 grocery store in the same section as cup
13 yogurt.

14 In most grocery stores, one will
15 find a display case for fluid milk products and
16 a separate case located elsewhere in the store
17 for displaying yogurt products. The consumer
18 has to make a conscientious effort and decision
19 to buy each of the two products. The sale of
20 one does not displace sales of the other. Each
21 product is purchased for its own use. The next
22 page is the planogram.

23 Shelf-Life Differences With Other
24 Class I Products: Fluid milk and cultured
25 buttermilk both have a shelf life of about 21

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2 days. The shelf life for yogurt is at least
3 37 days and most of the time nearly three times
4 longer than the shelf life for bottled milk.
5 Process and packaging differences allow yogurts
6 and yogurt-containing beverages to offer a
7 significant shelf-life difference to the
8 consumer.

9 Conclusion: Yogurt-containing
10 Beverages' Form is Unique. Through their
11 unique texture coming from fermentation,
12 through their convenient on-the-go packaging,
13 and through their location within retail shops,
14 yogurt-containing beverages differentiate
15 themselves clearly from Class I fluid milk
16 products and do not compete against them.

17 Use Of Yogurt-containing Beverages:
18 Yogurt-containing beverages, yogurts and other
19 fluid milk beverages are not substitutes.
20 Dannon's yogurt Smoothies are purchased as a
21 healthy, convenient, portable food snack for
22 consumers on the go. Fluid milk is purchased
23 for daily consumption as part of a snack or a
24 meal.

25 Cannibalization occurs within each

1 J. Box - Direct Testimony

2 of the two product categories and not as a
3 product from one category displacing the sale
4 from the other. They are not substitutable
5 products.

6 Even baking or cooking recipes will
7 call for one or the other product, but it will
8 not say either/or. The uses of the products
9 are not the same and warrant segregation in the
10 same manner the Federal Orders use to
11 discriminate the classes of utilization with
12 pricing.

13 Market Research For Kids'

14 Yogurt-containing Beverages: In June and July
15 2003, Dannon commissioned an outside market
16 research firm to conduct a study consisting of
17 678 interviews conducted in 12 geographically
18 dispersed locations: Atlanta, Boston, Chicago,
19 Detroit, Houston, Dallas, Jacksonville,
20 New York, Los Angeles, Memphis, San Francisco
21 and Trumbull. Respondents were females, aged
22 18 to 59, who do at least half of the household
23 shopping over the course of a year and buy
24 refrigerated yogurt, not necessarily
25 children's, for a three- to eleven-year-old

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2 child in their household.

3 The consumers were also asked what
4 food or beverage the Drinkable Danimals XL
5 purchase would replace. Twenty-nine percent
6 said it would replace food; 6 percent said it
7 would replace a beverage.

8 Those 6 percent can be broken down
9 as follows: 1 percent said the purchase of XL
10 would replace the purchase of fluid milk.
11 Two percent said the purchase of XL would
12 replace the purchase of juice. Two percent
13 said they did not know. The figures do not add
14 up because of rounding. Sixty-four percent of
15 the purchasers of XL would replace the purchase
16 of another yogurt product.

17 In conclusion, less than 1 percent
18 of the potential Danimals Drinkable XL
19 consumers claimed they would replace fluid milk
20 by our yogurt-containing beverages. After six
21 months out in the marketplace -- change that
22 "on the shelf" to out in the marketplace -- we
23 found that 95.5 percent of those buying the
24 yogurt-containing beverage Danimals XL were
25 already yogurt buyers and switched consumption

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2 to Danimals XL. Another 3.4 percent increased
3 their yogurt category consumption, and only
4 1.1 percent were new to the category. Again,
5 per this study, newcomers to the category only
6 represent 1.1 percent.

7 Market Research For Adult

8 Yogurt-containing Beverages: A study conducted
9 at Dannon's request over 26 weeks ending
10 August 24, 2003, examined the source of the
11 volume for Adults Shakes and Drinks segments
12 and the Frusion Smoothie, Dannon-producing
13 consumers are coming from. Eighty-six percent
14 are brand switching within the yogurt category,
15 9 percent are increasing their consumption
16 within the category, and new buyers to the
17 category represented only 5 percent.

18 Yogurt category is defined by the
19 following segments: blended yogurts,
20 traditional yogurts, plain yogurts, kids'
21 yogurts and light yogurts.

22 Advertisement Positioning: For kids
23 and for adults, Dannon positions its
24 yogurt-containing beverages' line as
25 substitutes for snacks. The Frusion storyboard

1 J. Box - Direct Testimony

2 below presents the Frusion yogurt-based
3 beverage as a healthy alternative to muffins,
4 bagels and donuts. Below we show the story of
5 how we are positioning that particular product
6 in the marketplace.

7 The Danimals storyboard below
8 presents the Danimals yogurt in its beverage
9 and cup version as a healthy snack alternative
10 for kids to cookies, gummi bears and potato
11 chips. Those are storyboard pictures for
12 Danimals.

13 Both commercials were aired either
14 on TV or on radio within the last 12 months in
15 a national or regional setup.

16 Conclusion: Yogurt-containing
17 Beverages' Use Is Unique. Clearly, our drinks
18 are not competing with fluid milk. We are
19 competitive within the yogurt category, not
20 with fluid milk. Yogurt is a separate,
21 identifiable dairy subcategory.

22 Yogurt-containing beverages are not
23 competing with fluid milk sales and thus should
24 not be linked with fluid milk definition. The
25 consumers, adults and children, differentiate

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2 between yogurt products and fluid milk. The
3 source of volume for the yogurt-containing
4 beverages comes overwhelmingly from within the
5 yogurt category. Our studies show no evidence
6 of significant cannibalization of fluid milk
7 based on products by yogurt-containing
8 beverages.

9 Conclusion: As we have
10 demonstrated, yogurt-containing beverages
11 should be classified under Class II because the
12 cost of milk is the most important component of
13 the raw materials we purchase. Yogurt
14 beverages and yogurt-containing beverages are
15 truly different from fluid milk.

16 The taste, mouth feel and texture
17 derived through knowledge of technology and
18 ingredient selection differs greatly between
19 the two categories. The products are not
20 packaged in the same way. The products are not
21 located side-by-side in the grocery store,
22 where about 70 percent of all yogurt sales
23 occur. The consumer makes a conscious decision
24 about buying each product type depending on
25 consumer preferences in taste, texture and

1 J. Box - Direct Testimony

2 usage occasion.

3 The actual manufacturing process is
4 more technical and intensive with yogurt than
5 with fluid milk, requiring, in the case of
6 yogurt-containing products, extensive
7 investments in research and development,
8 innovative ingredients and processes.

9 Consumer purchases of
10 yogurt-containing beverages are not made at the
11 expense of fluid milk purchases. The products
12 are consumed for specific and different
13 purposes. The products cannot be substituted
14 for each other. Yogurt moves nationally, not
15 locally or regionally as fluid milk does.

16 Consumers, even children, know the
17 two products are not the same, and they treat
18 them as different products when purchased. The
19 beverage children drink most with yogurt is a
20 glass of milk.

21 Growth in the yogurt category is
22 highly dependent upon product innovation.

23 The yogurt category in total absorbs
24 less than 3 percent of total milk produced in
25 the U.S. but is growing through product

1 J. Box - Direct Testimony

2 innovation. A change in classification will
3 have an insignificant impact on dairy farmer
4 income but will be a significant threat to
5 product innovation.

6 The Cornell economic model shows
7 that dairy farmers and processors benefit best
8 when the new products are classified in
9 Class II.

10 One last note. Yogurt drinks are in
11 the Class II category under the California Milk
12 Order. Thus, California classified their
13 products appropriately.

14 Some criticism has been directed at
15 regulations that find their roots in the Act
16 that was passed by Congress in 1937 and amended
17 many times since. That Act and amendments have
18 provided sufficient latitude for the Department
19 to respond to consumer and industry fundamental
20 and preferential changes over the years and
21 continues to do so today.

22 The Federal Order program has been
23 widely called a "producer program," but we
24 recognize the Department has always been
25 cognizant of processors' needs as well. To us

1 J. Box - Cross - by Mr. Yale
2 the Department has tried to balance the
3 producer, processor and consumer requirements
4 equitably.

5 It is in this light and background
6 that Dannon respectfully requests that the
7 Secretary grant our proposal to specifically
8 eliminate all yogurts and yogurt-containing
9 beverages from the definition of fluid milk
10 product under the Federal Milk Marketing
11 Orders.

12 Thank you for this opportunity to
13 appear and express the reasons for our request.

14 JUDGE DAVENPORT: Do we have
15 examination of this witness? Mr. Yale.

16 MR. YALE: Ben Yale on behalf
17 of Select Milk Producers, Inc., and Continental
18 Dairy Products.

19 -----

20 CROSS-EXAMINATION

21 BY MR. YALE:

22 Q. Good afternoon.

23 A. Good afternoon.

24 Q. What has changed in the marketplace
25 since 1993 in yogurt sales, the drinkable

1 J. Box - Cross - by Mr. Yale

2 yogurt sales? What has changed?

3 A. Since 19 --

4 Q. 1993.

5 A. I guess there are a lot of things
6 that have changed, Mr. Yale. Would you be a
7 little more specific?

8 Q. On yogurt, on the sales of drinkable
9 yogurt, what's changed in the market since
10 1993? Anything? I mean, is it a different
11 market today than it was?

12 A. It very probably is. I think
13 consumers change their tastes and preferences
14 all the time. That's one of the reasons that
15 we have to have innovation.

16 Q. So the change would be in terms of
17 the demand for the product, either more or less
18 demand, since 1993? Is that how you would
19 describe it?

20 A. As far as the yogurt category goes,
21 the yogurt category has grown, yes.

22 Q. It has grown?

23 A. Yes, sir.

24 Q. Has the drinkable yogurt grown?

25 A. I'm sure it has.

1 J. Box - Cross - by Mr. Yale

2 Q. Was there any study done that showed
3 that the drinkable yogurt would have grown
4 differently had the price been different during
5 that period of time than what it was?

6 A. I'm sure there probably would have
7 been some differences had it been priced
8 differently, but I can't specifically respond
9 to any point that you are trying to lead me to
10 I don't think.

11 Q. Well, I'm not trying to lead you
12 anywhere. I'm just trying to ask for
13 information. As the spokesman for Dannon, are
14 you aware of any study that Dannon did to
15 determine what their sales would have been had
16 they not paid Class I price but instead paid
17 the Class II price for their drinkable yogurt?

18 A. No, sir, I am not aware of any study
19 like that.

20 Q. You have been involved in Federal
21 Orders for -- I am not going to say for a long
22 time but for a while. I have got to be careful
23 because it is kind of --

24 A. There is a gentleman in the audience
25 that has been around longer than me.

1 J. Box - Cross - by Mr. Yale

2 Q. Which means longer than me, so I
3 feel a little bit better.

4 Okay. You say you have some
5 familiarity with it. Where is it in the Act
6 that says that the Department, in determining
7 the use, that if it is a national versus a
8 regional or local it is to be viewed
9 differently?

10 A. Where is that in the Act?

11 Q. Yes.

12 A. It is not in the Act. It is in the
13 Nourse Report.

14 Q. In fact, the authority to the
15 Secretary to -- and you may remember this or
16 not. I mean, you remember the language that
17 authorized the base excess programs in the
18 Southeast? Do you recall that?

19 A. Somewhat.

20 Q. Okay. And that authority
21 disappeared?

22 A. Correct.

23 Q. All right. At the same time that
24 that was in effect, the Department was supposed
25 to look in terms of the demand and supply of

1 J. Box - Cross - by Mr. Yale

2 milk within the marketing area at that time.

3 Do you recall that?

4 A. I think so.

5 Q. And that also expired; right?

6 A. Correct.

7 Q. So there is no authority now to the
8 Department to look within the supply demand
9 within the marketing area itself specifically
10 in making these decisions; isn't that correct?

11 A. Not contained within the Act? Is
12 that --

13 Q. Right.

14 A. Yes.

15 Q. I mean, you make the comment about
16 the local, the fact that it is local and --

17 A. Well, I think -- yes. Let me
18 respond to that just a little bit further.
19 Okay?

20 Q. Sure.

21 A. I think as we have evolved as an
22 industry, certainly when the Nourse Report was
23 made, milk tended to be much more local in
24 supply to fluid milk processors than it is
25 today.

1 J. Box - Cross - by Mr. Yale

2 I do believe that fluid milk sales
3 have become more regional now than they were
4 even at the time that report was made.

5 The point that I was trying to make
6 in that particular area was to say we do go
7 national with everything we do.

8 Q. Okay. In terms of a milk
9 equivalent, if you can, is the yogurt more
10 expensive than milk or is it the same price as
11 bottled milk? Are the portion sizes more
12 expensive or less expensive than bottled milk;
13 do you know?

14 At retail, if I were to go to a
15 store and pick up one of your yogurts and got
16 it in the volume, whatever the size of the cup
17 or the container is --

18 A. On an equivalent basis it is
19 probably more expensive, but it is not the same
20 thing either.

21 Q. Now, we had some statistics that
22 were presented by the Department that show that
23 there are some Class II yogurts and some
24 Class I yogurts in the United States.

25 A. Correct.

1 J. Box - Cross - by Mr. Yale

2 Q. Dannon has the ability -- Dannon is
3 going to try to, I think like all businesses,
4 is going to try to market the product that
5 produces the most profit; right?

6 A. That's the objective of any
7 processor.

8 Q. Has Dannon reformulated any of its
9 products to avoid being treated as Class I?

10 A. Have we had any product become
11 classified as a Class I?

12 Q. No. Have you had product -- have
13 they reformulated any product that they either
14 had marketed or were going to introduce so that
15 it would not be Class I but it would instead be
16 treated as Class II?

17 A. The answer to that is no.

18 Q. Are you aware of whether Dannon or
19 any other manufacturer of yogurt has pursued a
20 challenge under 15(a) to the Department to
21 challenge the rationale of using Class I
22 instead of --

23 A. I am not aware of any 15(a) being
24 filed by any yogurt company.

25 Q. You know what I meant by the 15(a)?

1 J. Box - Cross - by Mr. Beshore

2 A. Yes, sir.

3 MR. YALE: All right. Very
4 good. I have no other questions. Thank you.

5 JUDGE DAVENPORT: Thank you.
6 Other examination? Mr. Beshore.

7 MR. BESHORE: Marvin Beshore
8 for the Dairy Farmers of America.

9

10 CROSS-EXAMINATION

11 BY MR. BESHORE:

12 Q. Good afternoon, Mr. Fox.

13 A. Good afternoon, Mr. Beshore.

14 Q. Do all of Dannon's yogurt and yogurt
15 products have the same ratio of protein and
16 nonfat solids as is presented in the raw milk
17 that goes into the product?

18 A. Are you asking the question do all
19 of our products use the same white mass?

20 Q. I'm not sure what that means so I
21 don't know if I'm asking that question or not.

22 JUDGE DAVENPORT: Rephrase the
23 question.

24 A. The white mass is the yogurt that
25 meets the standard of identity.

1 J. Box - Cross - by Mr. Beshore

2 Q. Okay.

3 A. It is the base from which we make
4 the product.

5 Q. Do they all use the same white mass?

6 A. No. I asked you if you were asking
7 that.

8 Q. Well, let me ask you that.

9 A. That's no.

10 Q. Do your products have different
11 ratios of milk protein by weight?

12 A. Yes.

13 Q. Do you produce drinkable yogurt
14 products that are both Class I and Class II?

15 A. No. No. No, we only have one
16 drinkable yogurt product and it is Class I.

17 Q. Okay. On page 10 of your statement,
18 Exhibit 24, current classes of products at the
19 Dannon Company.

20 A. Okay.

21 Q. Okay. You listed in the second
22 paragraph there, "Products we produce currently
23 are classified as Class I are Drinkable
24 Danimals Lowfat Yogurt and Danactive Probiotic
25 Cultured Dairy Drink."

1 J. Box - Cross - by Mr. Beshore

2 A. Right.

3 Q. Okay. So you have at least those
4 two that are classified as Class I?

5 A. Right.

6 Q. Are they the only drinkable products
7 that Dannon produces?

8 A. Drinkable Class I?

9 Q. No. Just drinkable period.
10 Drinkable.

11 A. Right.

12 Q. So none of your products that are
13 currently classified as Class II are drinkable
14 as far as you are concerned?

15 A. None of the Class II products are
16 considered to be drinkable except for the
17 Smoothies that I indicated.

18 Q. So Smoothies are drinkable, but they
19 are considered Class II?

20 A. They are what we would consider to
21 be a yogurt-containing beverage.

22 Q. Is Frusion also a yogurt-containing
23 beverage?

24 A. Yes.

25 Q. And Light 'n Fit is also a

1 J. Box - Cross - by Mr. Beshore

2 yogurt-containing beverage?

3 A. Correct.

4 Q. Carb Control, is that also a
5 yogurt-containing beverage?

6 A. That's correct.

7 Q. And they are listed on the same page
8 here on page 10; right?

9 A. Uh-huh.

10 Q. Now, would any of those be -- if the
11 2.25 percent protein test, protein standard,
12 were implemented as set forth in Proposal 7,
13 would any of those products be reclassified to
14 Class I as they are presently formulated by
15 Dannon?

16 A. You are talking about the
17 yogurt-containing beverages?

18 Q. Yes.

19 A. No.

20 Q. Would any of the presently Class I
21 products become Class II products under
22 Proposal 7?

23 A. Under your proposal they would not.

24 Q. What is the difference in protein
25 between your Class I and your Class II

1 J. Box - Cross - by Mr. Beshore

2 products, the same weight? How much --

3 A. Those that are classified as Class I
4 have more in them.

5 Q. How much more?

6 A. I'm not going to tell you that.

7 Q. Does it show on the label?

8 A. It is obviously more than what you
9 are proposing, more than .25.

10 Q. Do your Class II products have added
11 nonprotein solids to them?

12 A. Yes. Nonprotein solids, yes.

13 Q. What nonprotein solids do you use?

14 A. Fruit, puree.

15 Q. Non protein dairy solids?

16 A. Nonprotein dairy solids. They have
17 some of that, too.

18 Q. What do you add?

19 A. Other dairy products.

20 Q. Such as?

21 A. You asked about protein, didn't
22 you? Other nondairy proteins, no.

23 Q. Okay. How about nonprotein dairy
24 solids?

25 A. Nonprotein dairy solids, no.

1 J. Box - Cross - by Mr. Beshore

2 Q. When did Dannon first --

3 JUDGE DAVENPORT: Mr. Box, did
4 you understand his question as nondairy solids,
5 nondairy protein solids?

6 THE WITNESS: Yes, sir, I did.

7 JUDGE DAVENPORT: Okay.

8 Q. When did Dannon first market any of
9 the drinkable yogurts or drinkable yogurt
10 beverages or yogurt-containing beverages? Do
11 you know when?

12 A. When did we start?

13 Q. Yes.

14 A. To the best of my knowledge, around
15 2000.

16 Q. What percentage of your aggregate
17 sales are those products?

18 A. I won't answer that.

19 Q. I assume when you formulated those
20 products, under the present standards you are
21 aware that some of them would be classified
22 Class I and some of them would be classified as
23 Class II?

24 A. The answer to your question is yes.

25 Q. The price elasticity studies that

1 J. Box - Cross - by Mr. Beshore
2 you report on page 14, you allude somewhere in
3 the text here to the elasticities for the
4 drinkable yogurts, but you don't report them.
5 Were they in the same study?

6 A. I'm sorry. Which page are you on,
7 Mr. Beshore?

8 Q. Well, 14 and 15.

9 A. Okay. And your question is?

10 Q. At the top of page 15 you say, "The
11 elasticities of the Dannon drinkable yogurts."
12 I assume you mean the Class I products; is that
13 correct?

14 A. Yes. Yes.

15 Q. "Are two to three times as high as
16 fluid milk products." So what were the
17 elasticities of the drinkable yogurts according
18 to the Dannon studies?

19 A. I will see if we can get that for
20 you.

21 Q. Okay. Well, you have used the .2 as
22 the elasticity for fluid milk, minus .2.

23 A. I said .2 and I think Dr. Stephenson
24 said .25.

25 Q. Okay. Let's use either one. If

1 J. Box - Cross - by Mr. Beshore
2 your information at the top of page 15 here is
3 correct, say they were twice or three times as
4 high as .2 or .25, they would be in the range
5 of minus .6 to minus .75?

6 A. I would expect that.

7 Q. Okay. Therefore, I gather they
8 were, those drinkable yogurts were more price
9 inelastic than your Class II yogurt products?
10 Was that what your study showed?

11 A. Yes. It very well -- you could say
12 also the initial --

13 The initial target for the Frusion
14 brand when we came out with it was to be a
15 teenager, someone in that category, late
16 teenage, and they may be more price sensitive
17 at that point because they are the ones that
18 are purchasing some product. That would make
19 sense to us.

20 MR. BESHORE: Thank you. I
21 have no other questions.

22 JUDGE DAVENPORT: Other
23 examination of this witness? Ms. Carter.

24 MS. CARTER: Antoinette Carter
25 with USDA.

1 J. Box - Cross - by Ms. Carter

2 -----

3 CROSS-EXAMINATION

4 BY MS. CARTER:

5 Q. Good afternoon, Mr. Box.

6 A. Good afternoon, Ms. Carter.

7 Q. In your opinion what role should FDA
8 regulations play in product classification?

9 A. I knew you were going to ask me
10 that. I think they should serve as somewhat of
11 a guideline for us because we have to live with
12 those regulations as well as the regulations
13 produced by USDA. So for us to meet the
14 standard of identity, we have to look at those
15 regulations as well.

16 As far as playing a part in
17 classification -- and I think that was the
18 question that you asked, what part should they
19 play in what classification we go under -- I am
20 not sure that that is a direct connect because
21 the classification of milk and its uses falls
22 under the power of the Secretary of
23 Agriculture, not under Food and Drug.

24 Q. On page 10 of your statement, under
25 4.2 you have a definition of yogurt-containing

1 J. Box - Cross - by Ms. Carter
2 beverages. If your proposal is adopted, should
3 this definition be used as a threshold in terms
4 of determining if a beverage is a yogurt
5 containing?

6 A. We would prefer that, yes.

7 Q. On page 12 of your statement, the
8 paragraph under 4.5 you reference fundamental
9 differences between yogurt beverages and
10 yogurt-containing beverages from fluid milk
11 products. Specifically what differences are
12 you referencing there?

13 A. Okay. All of the things that I
14 subsequently covered in the body of the
15 testimony regarding the fact that you can't
16 substitute them, they don't compete against
17 each other, they don't sit side-by-side in the
18 grocery store, they don't taste the same. The
19 texture, mouth feel. Everything about the
20 product is different from milk. Even though we
21 started with milk, we didn't finish with a
22 milk.

23 MS. CARTER: That's all I
24 have. Thank you.

25 JUDGE DAVENPORT: Mr. Wilson.

1 J. Box - Cross - by Mr. Wilson

2 MR. WILSON: Todd Wilson,

3 USDA.

4 -----

5 CROSS-EXAMINATION

6 BY MR. WILSON:

7 Q. Hello, Jim. The proposals that you
8 have outlined in your testimony, you gave
9 reference to proposing certain proposals that
10 dealt with the protein standard versus a
11 solids, milk solids nonfat standard. Could you
12 maybe elaborate your view or opinion of that?

13 A. Why we oppose that?

14 Q. Yes.

15 A. Yes. The reason that we oppose it
16 is because there is no gain by moving to a
17 protein standard. Simply because the industry
18 has the technology to do it doesn't warrant
19 doing it. What is the need to do it? What do
20 we gain as an industry by moving to a protein
21 threshold?

22 We have learned to fractionalize
23 what we have now categorized as milk solids
24 nonfat and moved to a component within that to
25 classify or to define the hurdle for meeting

1 J. Box - Cross - by Mr. Wilson

2 the definition of fluid milk product.

3 Where did we change anything? What
4 have we changed? What have we gained by that?
5 Where do we gain?

6 Q. As we have heard in testimony, we
7 have the ability in industry to fractionate
8 milk out into different components and have
9 varying levels of fat, varying levels of
10 protein, varying levels of lactose.

11 As the industry changes to be able
12 to do that, do the regulations also need to
13 change to incorporate that technology?

14 A. I don't know of any fluid milk
15 bottling plant processor who drives his plant
16 using proteins in a fluid milk product.

17 Q. I'm sorry. Who drives --

18 A. He doesn't make the determination
19 that he's going to produce 2 percent fluid milk
20 today or whole milk because it's got X amount
21 of proteins in it. That doesn't happen. What
22 you want to determine, what Class I is based on
23 the protein. It is incongruent.

24 Q. In the Act you referenced form and
25 use, form or use?

1 J. Box - Cross - by Mr. Wilson

2 A. Yes, sir.

3 Q. Are those two terms sometimes on
4 opposite ends of a particular product?

5 A. Can you explain what you mean by
6 that?

7 Q. Can a product take the form of a
8 similar-type milk product but its use be
9 somewhat different than what a similar product
10 would be?

11 A. I suppose that's a possibility. I
12 think we're different from yogurt and
13 yogurt-containing beverages. We're different
14 from both form and use.

15 Q. Whenever those two terms are
16 different or have different implications, which
17 one should the Department look at in making
18 their determination of classification?

19 A. I think that probably use would be
20 more towards defining competition with fluid
21 milk than form.

22 MR. WILSON: That's all I
23 have. Thank you.

24 JUDGE DAVENPORT: Other
25 questions of this witness? Mr. Bunting.

1 J. Box - Cross - by Mr. Bunting

2 MR. BUNTING: John Bunting.

3 -----

4 CROSS-EXAMINATION

5 BY MR. BUNTING:

6 Q. I remember when you couldn't find
7 yogurt in a lot of smaller stores, and I
8 realize it has grown tremendously over the
9 years and filled a product niche.

10 It seems to me -- and you know more
11 than I -- that the whole point of the Federal
12 Orders and Classified Pricing System is
13 fairness to all the producers involved, to the
14 public and so forth. It is an attempt at
15 fairness you might say.

16 So my question -- you may not know
17 the answer to it -- but over the time that
18 yogurt grew from virtually nothing to being a
19 standard product found in most stores, has the
20 farmers' share of the consumer dollar grown,
21 stayed the same, or diminished?

22 A. I don't know the answer to that. My
23 guess would be that it probably has not to the
24 extent that other dairy products have grown as
25 well. You specifically point out yogurt.

1 J. Box - Cross - by Mr. Bunting

2 Q. Yes. Well, I mean, I don't have
3 data, I don't believe, on yogurt. There is the
4 PPI and the CPI. You have fluid milk, you have
5 cheese. So you can see in those products that
6 the farmers' share of, let's say, the plastic
7 gallon jug has diminished over time, and you
8 can look at one-pound of cheddar in the store,
9 and you see that the farmers' share has
10 diminished over time.

11 The point I am trying to make I
12 think is that yogurt is an innovative product,
13 you continue to innovate, and I would guess
14 since you are classified mostly as Class II
15 that the farmers' share has actually, in fact,
16 diminished.

17 A. Well, to the extent that the yogurt
18 category has grown, we have lessened that
19 diminishment.

20 Q. You know, as a percentage of the
21 consumer's dollar.

22 A. As a percentage of the consumer's
23 dollar?

24 Q. Right.

25 A. I think that --

1 J. Box - Cross - by Mr. Bunting

2 Q. I mean, you increased the use of
3 category two, there is no doubt about that.

4 A. As our category, the total yogurt
5 category has increased in its use on milk.
6 That has generated more dollars to pay back to
7 the dairy farmers because that is above
8 Classes III and IV.

9 Q. Right. I don't doubt that. I agree
10 with that. My point is that it seems to me
11 that much of the proposition that we are
12 dealing here with is that the farmer will
13 benefit from new product innovation if we have
14 the protein-based pricing system. It does not
15 appear to be, looking at yogurt, that --

16 A. I understand.

17 Q. -- the percent, that, in fact, if we
18 use yogurt as an innovative example that the
19 farmers' share on a percentage basis of the
20 dollar has gained. I don't know whether you --

21 A. I don't have an answer to that.

22 MR. BUNTING: Okay. Thanks
23 very much.

24 JUDGE DAVENPORT: Mr. Beshore.

25

1 J. Box - Cross - by Mr. Beshore

2 CROSS-EXAMINATION

3 BY MR. BESHORE:

4 Q. Mr. Box, could you turn to page 23
5 of 26 in Exhibit 24, which is your storyboard
6 for the Danimals. That's one of your Class I
7 drinkable yogurt products; correct?

8 A. It is a drinkable product, yes,
9 except for the cup version that you see on that
10 page.

11 Q. Now, I wonder if you would look at
12 the storyboard. This is how you are presenting
13 your product to your target consumers. Tell
14 us, what dairy ingredient do you promote for
15 sales of your product on your storyboards?

16 A. Vitamins, protein, calcium.

17 Q. Protein, do you promote that? Do
18 you promote the sugar, lactose anywhere?

19 A. No.

20 MR. BESHORE: Thank you.

21 JUDGE DAVENPORT: Other
22 examination of Mr. Box? Very well, Mr. Box.
23 Thank you for your --

24 Dr. Cryan.

25 DR. CRYAN: Good afternoon. I

1

2 would also like to enter as an exhibit, these
3 are pages from the Worldwide Web from the
4 Agricultural Research Service, USDA website.
5 They have a nutritional nutrient data
6 laboratory from which you can download the
7 nutrient content value of 6,000 products.

8 JUDGE DAVENPORT: Is this the
9 entire web page?

10 DR. CRYAN: This is not the
11 entire web page.

12 JUDGE DAVENPORT: Is it in any
13 way an extraction or editing out of the web
14 page?

15 DR. CRYAN: No, it is not. It
16 is printed directly from the web page.

17 JUDGE DAVENPORT: That's not
18 my question. My question is, is the complete
19 set of data on that particular data entry
20 portion?

21 DR. CRYAN: Yes. This is the
22 complete record regarding the data for whole
23 milk and for yogurt.

24 JUDGE DAVENPORT: Very well,
25 Dr. Cryan. This will be marked as Exhibit 25

1 J. Box - Cross - by Dr. Cryan
2 for identification.

3 (Exhibit No. 25 was marked for
4 identification.)

5 -----

6 CROSS-EXAMINATION

7 BY DR. CRYAN:

8 Q. Mr. Box; is that right? Jim?

9 A. Yes.

10 Q. These two tables from the USDA
11 website seem to demonstrate to me that the
12 nutrient content in yogurt is practically
13 identical to the nutrient content of milk. Is
14 that consistent with your understanding of the
15 products?

16 THE WITNESS: Your Honor, I
17 don't feel confident to answer that question.

18 JUDGE DAVENPORT: I think then
19 your answer is, I am not prepared to respond to
20 that, Dr. Cryan.

21 A. I am not prepared to respond to
22 that.

23 Q. Could you go over again what it is
24 that makes -- summarize what it is that makes
25 yogurt, other than taste, texture and mouth

1 J. Box - Cross - by Dr. Cryan

2 feel, what it is that separates yogurt from
3 milk? How is it different?

4 A. It doesn't compete with fluid milk.

5 Q. Is yogurt a beverage? Is drinkable
6 yogurt a beverage?

7 A. There are a lot of beverages --

8 The answer to your question is yes,
9 but there are other additional beverages also
10 that you can drink that are from the dairy
11 industry and do not compete with fluid milk.

12 DR. CRYAN: Thank you.

13 JUDGE DAVENPORT: Other
14 examination of this witness?

15 Very well, Mr. Box. You may step
16 down. Do you have a companion witness?

17 MR. BOX: No, sir. That's it.

18 JUDGE DAVENPORT: Okay. It is
19 quarter of five at this point. Do we have
20 anyone else that needs to be heard today? If
21 not, then I guess we can recess for today until
22 tomorrow morning.

23 UNIDENTIFIED SPEAKER: Why
24 don't we see how much witnesses we have.

25 JUDGE DAVENPORT: That's also

1

2 a good point. My understanding is we have some
3 yogurt witnesses tomorrow from General Mills.

4 Are you prepared to be here at 8:00?

5 MR. YALE: Yes.

6 JUDGE DAVENPORT: Mr. Yale,
7 how many witnesses do you have?

8 MR. YALE: One who will
9 testify and a total of three will be available
10 to take questions.

11 JUDGE DAVENPORT: Very well.
12 For the purpose of the audience, his answer was
13 that there is going to be one principal witness
14 and then there are going to be three resource
15 people that may answer any questions that is
16 not within his area of expertise.

17 How many other witnesses are
18 planning to be called? Mr. Tipton, I
19 understand that you are going to be testifying.

20 MR. TIPTON: Correct.

21 JUDGE DAVENPORT: How long do
22 you think you are going to testify?

23 MR. TIPTON: It will take
24 about 20 minutes to introduce the statement.

25 JUDGE DAVENPORT: Very well.

1

2 I also understand Mr. Bunting wants to testify.

3 How long do you think your testimony will be?

4 MR. BUNTING: Probably 15
5 minutes, approximately.

6 JUDGE DAVENPORT: Was it your
7 request to go first in the morning?

8 MR. BUNTING: Not necessarily.
9 As long as I can be out of here in the morning
10 session.

11 JUDGE DAVENPORT: Very well.
12 Mr. Yonkers?

13 MR. YONKERS: I will be
14 testifying.

15 JUDGE DAVENPORT: How long do
16 you think your testimony will be?

17 MR. YONKERS: I think my
18 testimony will take about 15 minutes. I don't
19 know about how long cross will take.

20 JUDGE DAVENPORT: In other
21 words, nobody has any idea how cross goes
22 sometimes.

23 MS. TAYLOR: Sue Taylor from
24 Leprino Foods. I hope to testify tomorrow,
25 approximately 20 minutes on direct.

1

2

JUDGE DAVENPORT: Very well.

3

Mr. Stevens? We have Mr. Wilson by popular

4

request has been asked to come forward. And

5

Mr. Vetne?

6

MR. VETNE: Mike Suever from

7

Hood. Direct testimony probably will take

8

20 minutes or so.

9

JUDGE DAVENPORT: Very well.

10

Is there anyone else? Does that give people a

11

pretty good feel for --

12

UNIDENTIFIED SPEAKER: Your

13

Honor, I have just been informed that we

14

anticipate there will be a testify witness from

15

Hormel who is not here right now. We

16

anticipate he will be here tomorrow.

17

JUDGE DAVENPORT: Okay.

18

Mr. Stevens, I guess the question

19

is, is Mr. Wilson prepared today?

20

MR. STEVENS: I don't believe

21

so but let me check.

22

MR. BESHORE: May I provide

23

Exhibit 15 copies for the record?

24

JUDGE DAVENPORT: Thank you,

25

Mr. Beshore. Make sure that one gets to the

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court reporter.

MR. STEVEN: Your Honor, with respect to Mr. Wilson, I believe that he is not really prepared to testify today. Tomorrow would certainly be better for us.

JUDGE DAVENPORT: Very well. That being the case, is there anyone else that wants to come forward and utilize the balance of this evening?

If not, we will be in recess until 8:00 in the morning. Thank you all.

(At this juncture, the proceedings were adjourned at 4:50 p.m.)

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C E R T I F I C A T E

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.

SANDRA J. MASTAY