

Milk Price Calculation Workshop

Session One: Asset beta

90 Minute Session

23 May 2017



Session purpose

Help generate the necessary information to allow us to conclude on the practical feasibility of the notional producer's asset beta



Session plan

Start	9:25 am
Commission introduces	9:25-9:35 am
Fonterra's presentation	9:35-9:55 am (20 min)
Q&A	15 min
IP's presentation	10:10-10:30 am (20 min)
Q&A	15 min
Discussion	10:45-10:55am (10 min)
Close	10:55 am



Last year's final report

- Unable to conclude that Fonterra's asset beta estimate of 0.38 for notional producer was practically feasible for an efficient processor
- Insufficient justification for downward adjustment to observed range of 0.41 to 0.61
- Reason given: comparable set of companies do not have the ability to make ex-post adjustments to pass through variances between forecast and actual milk price
- But, some evidence that dairy processors do update prices throughout the season and set final price at end of season



This year's focus

Exposure to systematic risk

- What is the ability of processors in the comparator sample to transfer risk to farmers via farmgate price adjustments?
- How does that ability compare to the Notional Producer's?
- How does that ability compare to NZ independent processors'?

The Notional Producer

- What ability to transfer risk to farmers via farmgate price adjustments is consistent with the contestability criterion?
- Is it practically feasible for a NZ efficient processor to transfer risk to farmers to the same extent as the Notional Producer? Why?

Milk Price Calculation Workshop

Session Two:

Amendment to include off-GDT sales for WMP, SMP and AMF

45 Minute Session



Outline of this session

Item	Details	Duration
Commission introduction	Commission to outline our conclusion on the amendment from the Manual review and our intended scope for our review of the calculation	10 minutes
Fonterra's comments	Fonterra to provide an outline of determining those sales which inform the milk price, the changes to assumptions adopted, input costs and processes used in the calculation due to the amendment	15 minutes
Independent processors comments	Independent processors to provide comments on their substantive concerns as to the impact of this change to the calculation of notional revenues and details of any costs they consider should also be included	15 minutes
Commission wrap up	Confirm any further information from the session and the key points from the discussion	5 minutes



The amendment

Fonterra removed the requirement that only GDT prices be used to determine Milk Price Revenue for WMP, SMP and AMF.

“The practical implication of this change is to align the approach used to determine WMP, SMP and AMF to the approach currently used for Butter and BMP, by including sales undertaken off the GDT platform of similar specification product and sold on similar terms to GDT sales.”

- Fonterra ‘Reasons’ Paper in support of Fonterra’s Milk Price Manual for the 2016/17 Season (1 August 2016), p7.



The legislation

Dairy Industry Restructuring Act (The Act), Part 1, s 5:

commodity means a product made by the processing of milk that is—

(a)

traded in significant quantities in **globally contested markets**; and

(b)

characterised by uniform **technical specifications**



Our Milk Price Manual conclusion

In principle, we consider the new inclusions of off-GDT prices in the Manual to be consistent with s 150A of the Act. However, we have concerns about the lack of detail about how Fonterra will implement this change.



Our preliminary assessment

- We have completed a preliminary assessment of confidential analysis provided by Fonterra which provides us assurance as to the reasonableness of the revenues which inform the milk price.



Our intended scope for on this topic

- Ensuring the associated notional costs, revenues or other assumptions taken into account in calculating the base milk price remain practically feasible
 - We invite independent processors to provide comparable information outlining revenue received on WMP, SMP and AMF products following the workshop.
- Consideration for the change in visibility of data that informs the revenue calculation in the milk price calculation
 - We invite independent processors to provide an outline of what information (and when) could be provided to correct this.



Invitation for Fonterra to comment

We now invite Fonterra to provide comments on:

- The source of sales which inform the milk price
- The additional associated costs now included in the calculation as a result of the inclusion of sales data
- Changes to the assumptions adopted, inputs and processes used in the milk price calculation due to this change of source data.



Invitation for independent processors to comment

We now invite independent processors to provide comments on:

- Concerns as to the impact of this change on the calculation of notional revenues
- A description of the associated cost changes which they would consider appropriate¹
- An outline of information concerns with this change.

¹ This will help to inform the scope of our review.



Commission wrap up

- Key points from discussion
- Any further agreed information following session to assist us in defining the scope of our review
 - We note the above information is due to us no later than **Thursday 8 June**





Competition Matters 2017

20 and 21 July

Competition and Regulation Conference

Te Papa · Wellington · New Zealand

www.comcom2017.co.nz

