



Matthew Lewer  
Regulation Branch

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Dear Matthew,

We would like to thank you for giving Synlait Milk Limited (Synlait) the opportunity to make a submission on the Draft Report on the 2019/20 milk price calculation review (the draft report).

Our submission will focus on the qualifying materials that make up the off-GDT sales. In the draft report Fonterra explains, in relation to the term 'relatively undifferentiated commodity' product that:

*there are a number of separate commodities within each Reference Commodity Product category as sellers provide technical specifications at this 'sub reference Commodity Product' level, and not at the Reference Commodity Product level. For SMP, these separate commodities include low heat SMP, medium heat SMP, and instantised SMP, among other specifications.<sup>1</sup>*

We do not believe that Instantised SMP (ISMP) meets the milk price manual definition of standard product offering and should therefore not be included as a qualifying material. We have included in our submission additional technical information around ISMP to demonstrate this.

With one of three above disclosed sub reference commodity groups not meeting the standard product offering description in our opinion, we are concerned as to what other sub reference commodities make up each reference commodity. In the interests of improving transparency and driving meaningful engagement, we believe the full list of sub reference commodities with an indication of relative scale should be disclosed. This will help interested parties to assess whether the remaining sub reference commodities are appropriate as well as help in the assessment of other calculation inputs.

#### Instant Skim milk powder (ISMP)

The inclusion of ISMP as a sub reference commodity is a surprise to Synlait. ISMP is essentially medium heat SMP with an extra step required, being further agglomeration to make the product truly 'instant'. An additional step is then undertaken by some processors of spraying minute quantities of the natural surfactant or wetting agent, soy lecithin, on to the powder in a fluid bed. The main function of lecithin in

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<sup>1</sup> Commerce Commission "Draft Report – Review of Fonterra's base milk price calculation 2019-20" (17 August 2020), paragraph 2.20.

ISMP is to help glue or hold the fragile agglomerates together. In IWMP the purpose is to overcome the hydrophobic (water-hating) nature of traces of free fat on the surface of the particles. It is not clear whether Fonterra undertake this step but an additional complication here is that the process of lecithination introduces an allergen.

ISMP is a particularly fragile product, with a high level of fines needing to be returned to the dryer for agglomeration. Because of this fragility it requires very gentle powder handling, which reduces throughput. While we acknowledge that it might be possible to readily transfer between a medium heat SMP and ISMP in a plant designed and set up in a certain way, this would not be possible across Synlait's sites. On top of this, due to having lower bulk density in ISMP relative to regular SMP there is less efficient pallet stacking and container loading.

ISMP is not a product sold by Fonterra on GDT. Therefore, to qualify as a standard product offering, it needs to meet the generic product specifications which are captured in the screenshot below, taken from this seasons marked up milk price manual.

Standard Product Offering	Reference Commodity Product specifications that are: 1. Sold on GDT, or 2. Generic product specifications which: <ul style="list-style-type: none"><li>▪ Are sold in multiple regions</li><li>▪ Are sold to multiple customers</li><li>▪ Are sold through Fonterra's standard sales channels</li><li>▪ <del>Can be manufactured in Standard Plants</del>, and</li><li>▪ Can be substituted for other Standard Product Offerings.</li></ul>
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Looking at substitutability, we do not believe ISMB would generally be accepted as a substitute for regular SMP by our customers. As a result, we do not believe ISMP meets the criteria of a standard product. For the average consumer, standard powders, because of their fine dusty nature, do not reconstitute well in water. Instant powders have been developed to counter this. ISMP is generally repacked as a consumer product, unlike regular powders which are used in secondary processing. Regular SMP is an ingredient into a range of consumer goods from burger patties to cookies to ice cream.

We note the Commerce Commission's assessment of the change in the total amount of qualifying products year on year.<sup>2</sup> Our overall reading of the draft report however is that the assessment around qualifying materials is focused on the process by which Fonterra determines the products, or sub reference commodities, for inclusion, as opposed to the sub reference commodities themselves. We see limited assessment of the actual qualifying materials which are the outcomes of this process.

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<sup>2</sup> Commerce Commission "Draft Report – Review of Fonterra's base milk price calculation 2019-20" (17 August 2020), paragraph 2.30.

One of only three revealed 'qualifying' sub reference commodities in the draft report, ISMP, appears to Synlait to not meet the definition of qualifying material. We believe it is appropriate for the Commerce Commission to take a closer look at the qualifying materials at this level at a minimum. A SKU level assessment would be the next step but this would be significantly more time consuming.

## Improving transparency

In paragraph 2.47 of the draft report, the Commerce Commission ask what further information is required to facilitate meaningful stakeholder engagement.<sup>3</sup> We believe the full list of sub reference commodities, with their sales volume contribution towards the reference commodity group is necessary and would considerably improve transparency and engagement. This could be either at a total sales level or at the off-GDT sales level.

Improving the transparency here would have dual benefits. As evident from our analysis of ISMP, different sub reference commodities have subtle, but materially different characteristics. The Commerce Commission could benefit from support from the independent processors to improve their assessment of the sub commodity groups.

Secondly, these subtle differences between sub reference product groups affect other inputs to the notional producer model such as yield, losses, production costs etc. For this reason, having volumes at a sub commodity level will improve our ability to engage not just on the revenue side of the calculation but across other inputs also.

The table below is an example of what this information for SMP might look like:

	<b>Sales volume of reference commodity (SMP)</b>
<b>Low Heat SMP</b>	30%
<b>Medium Heat SMP</b>	40%
<b>Instantised SMP</b>	30%

## Other matters

We believe Fonterra have made updates as to the achieved performance of the notional producer through off-GDT sales three times over the last twelve months. These were in the November, March and May Global Dairy Updates. We continue to support these updates being made quarterly in line with Commerce Commission appeals.<sup>4</sup>

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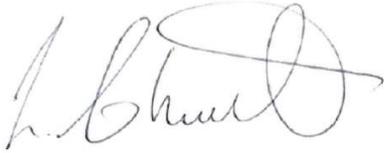
<sup>3</sup> Commerce Commission "Draft Report – Review of Fonterra's base milk price calculation 2019-20" (17 August 2020), paragraph 2.47.

<sup>4</sup> Commerce Commission "Draft Report – Review of Fonterra's base milk price calculation 2019-20" (17 August 2020), paragraph 2.47.

# Synlait

We note that it has been a few seasons since the last milk price workshop was held. We believe workshops, when set up correctly to focus on specific problem areas, add value to the review process.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'L. Clement', with a large, stylized flourish at the end.

Leon Clement

CEO Synlait Milk Limited