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By email

The Commissioners
Commerce Commission
44 The Terrace
Wellington

REVIEW OF FONTERRA'S 2021/22 BASE MILK PRICE CALCULATION: DAIRY INDUSTRY RESTRUCTURING ACT 2001

We have reviewed the Commission's draft report on the above review. We appreciate the work undertaken by the Commission on the review to date and acknowledge the Commission's draft overall conclusion that "subject to consideration of the further information [the Commission has] recently requested from Fonterra on the material change in the impact of off-GDT pricing on the contestability dimension of section 150A, ... the assumptions adopted, and the inputs and processes used by Fonterra to calculate the 2021/22 base milk price are consistent with the contestability and the efficiency dimensions of the section 150A Purpose."

Reasons for the increase in off-GDT returns

We have separately responded in detail to the Commission's request for further information on the factors underpinning the increase in 2021/22 of the impact of including certain off-GDT sales of WMP, SMP and AMF.

In summary, the information we have provided to the Commission demonstrates that differences in market conditions between 2020/21 and 2021/22 provide the primary explanation. From December 2021 on, there was increasing evidence of lower near-term milk supply, relative to previous forecasts, both in New Zealand and in other major dairy exporting regions. In addition, lower returns to WMP relative to other dairy products provided an incentive for major manufacturers, including Fonterra, to divert milk away from WMP production. Fonterra's primary off-GDT customers, which are all large multinational firms with significant capability to understand market dynamics, were consequently prepared to pay higher premiums over GDT to compensate Fonterra for supplying them RCPs (and WMP in particular) rather than diverting milk to other uses.

In support of this explanation, we have provided the Commission with transaction-level data for the SKUs which contributed ~90 percent of the increase in off-GDT returns, which demonstrates that a consistent customer base, purchasing under common contractual terms in both 2020/21 and 2021/22, was willing to pay higher premiums in 2021/22, particularly over the period when there was the greatest uncertainty over market conditions. In addition, the data provided to the Commission also demonstrates a 'mix impact', with an increase in off-GDT sales to customers willing to pay higher premiums to secure supply, and a reduction in sales to other customers.

Other matters

We note the Commission's:

- Observation with respect to the continued inclusion of Fonterra data in the comparator set used to estimate the asset beta. As suggested by the Commission we will consider this matter in our next review of the asset beta, scheduled for 2023/24.
- Recommendation that the Manual be revised to include the requirements of the cascable product rule as it is applied, which we will consider when addressing amendments to the Manual for the 2023/24 season.

Yours sincerely

 Andrew Cordner
Director of Legal