22nd June 2015

Commerce Commission
44 The Terrace
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Wellington 6140


1. This submission is made on behalf of Talley’s Group Limited whose interest in New Zealand dairy markets stems from both a 75% shareholding in Open Country Dairy Limited and as a purchaser of raw milk for its own ice cream operation at Port Motueka.

Executive Summary

2. We submit that there is insufficient competition in the New Zealand Dairy Industry to either repeal or relax the DIRA provisions as they relate to the farm gate or factory gate market.

3. It is imperative that specific protections (ie: DIRA) against anticompetitive behaviour in the industry remain until such time as Fonterra’s market share falls below acceptable thresholds.

Thresholds

4. The issue of what constitutes as appropriate market ‘threshold’ was considered extensively by NERA in 2010 (the ‘NERA report’). We have read and support the findings NERA made, many of which remain relevant 5 years on. In particular:

   4.1 NERA note that for any entity with a market share of around 70% means it’s likely the Commerce Commission would find it had market power and be dominant. Further they note in some cases Co-operatives with shares as low as 60-70% have the ability to exercise market power.

   4.2 Today Fonterra remain at around 86% share of the farm gate market. Even at 80-82% NERA reported both regulatory precedent and economic literature find that firm’s (including co-operatives) with such market share have the ability to exercise significant market power.
4.3 The risk is not an idle one. Consistently with our view NERA opined that with such market power Fonterra would and could behave strategically against independent competitors (ie: anti-competitively). They note a “smorgasbord” of cases involving predatory activity by co-ops against their rivals in the USA.

4.4 The risk is best summed up when they stated: “On balance we think in the absence of the DIRA Fonterra would have an incentive to use its market power to damage IP’s as a means of winning suppliers and increasing milk throughput.” concluding that “when the DIRA triggers are met there is a material probability that Fonterra would have at least some ability and the incentive to use its market position to restrict competition in the farm gate market” an occurrence which has high “potential costs to the New Zealand economy”.

4.5 Given the risk is substantiated by economic and academic authority in New Zealand and abroad (and so recently) the threshold for repeal of DIRA should not be before the dominant player has less than “60-70%” market share of the farm gate market. There is no basis on which to repeal DIRA at the current threshold.

**Barriers to Entry**

5. The removal of free entry and exit policies and thereby limiting the ability of farmers to switch is the biggest risk faced by new competitors and to the New Zealand dairy industry generally. As noted by NERA free entry exit is not entrenched in the Fonterra constitution and relies solely on DIRA for its authority. The removal of DIRA and the free entry/exit provision remains the major competitive threat.

6. In our view open entry/exit is the singularly most important policy in the DIRA regime. The requirement not to discriminate, accept supply and to ensure that a certain percentage of farm gate milk with any point in New Zealand (currently 160km radius) is not contracted beyond 12 months is imperative to guard against anti-competitive practice and promote competition. These provisions must stay until the threshold appropriate is triggered. Failing that it is easy to foresee a situation where Fonterra lock in suppliers to long term contracts significantly diminishing the ability of new entrants to access milk.

**Regionalization**

7. NERA also found that workable competition requires at least 2 IP’s against Fonterra in each relevant geographic and product market (emphasis own). It’s important any review by the Commission address specifically the absence of regional competition in New Zealand. The location of factories and cost of freight means in many instances farmers have no choice but to supply Fonterra in their area. Margins simply don’t allow the freighting of long distances to be economically viable. As a result these ‘regional monopolies’ provide Fonterra the ability to subsidize areas where there is competition by reducing farm gate prices in those areas there is not – ie: tactical pricing.

8. The North Island and South Island geographical distinction drawn by the current DIRA regime is a convenient one - that is all. It is not based on any market or
geographical analysis which supports an ‘Island’ based approach. It should not be the basis on which to conclude whether an area or New Zealand as a whole has/has not adequate competition. We believe each region needs to be assessed individually. We further submit Fonterra should not be able to regionally price (tactically) whilst they have such exclusive market power in most geographical locations.

**Commerce Act v DIRA**

9. We agree with NERA that constraining Fonterra’s ability to act only through the provisions of the Commerce Act would be inadequate and costly. A specific and targeted legislative/regulatory regime such as DIRA is required given the unique position of the New Zealand dairy industry.

10. We are happy to provide further information.

Kind regards,

[Signature]

Andrew Talley