NZ SPECIALIST CHEESEMAKERS ASSOCIATION

The Registrar
Competition Branch
Commerce Commission
PO Box 2351
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Commerce Commission – Submission on the Dairy competition Review Consultation Paper 12 June 2015

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This submission by no means represents the views of all our members, who range from large multinational companies through small domestic supply companies, to individual members who have an interest in cheesemaking.

What this submission does represent is some of the views of some of our members, and it raises a number of the concerns of our members. All members who have specific concerns have been encouraged to make their own submission.

Firstly with regard to your interpretation of sufficient and insufficient (29 – 37) "efficient operation of New Zealand dairy markets", to quote your document, is just as vague as sufficient and insufficient. What is an efficient market? Efficient and beneficial to whom? New Zealand companies? New Zealand consumers? Movement of milk from the farm to the world consumer?

Clarification of how you are measuring "efficient" would be of value to our membership.

Pt 62 page 11 – We agree with the notion that regardless of whatever the thresholds are, when reached, it should trigger a comprehensive competition analysis. We would prefer such analysis was more widely targeted than simply farm gate and factory gate markets. It may lead to change in regulations and/or phasing out of some and phasing in of other regulations rather than simply regulation removal.

Pt 63 – Our membership does not know enough about competition theory except to know that it is not straight forward. 80% seems a reasonable starting point to widely assess true competition.

Issues/Concerns/Background/Views raised by NZSCA members in no particular order.

- Generally and historically dairy companies/co-operatives do not like, and therefore contractually prohibit, a farmer supplier to supply another entity. (Dual supply)

- Historically there were a number of Dairy Co-ops in an area, so farmers often had some, though limited, choice in which company they supplied. Currently the new Dairy Companies do not support farmers in dual supply, neither do they supply milk to other entities (factory gate).

- Fonterra is forced to allow (with certain conditions attached) up to 20% farmer production to go to another entity. Fonterra is also regulated to provide milk to those who require it, also subject to various conditions. Fonterra historically and currently also supply milk at "market" price. Market price in theory is based on the current marginal return of the next best production option for Fonterra.

- In reality this market price is not quite "market" price. Members received letters last week informing them that the price of regulated milk (both estimated and fixed), for the current first quarter is $5.25/kgMS (matching the current milk price forecast) and the market price is $5.86/kgMS. Assorted premiums and delivery charges additionally charged. The letter was dated 16th June. AgriHQ's milk price calculator, using Global Dairy Trade figures on June 16th put the current spot milk price at $4.24/kgMS. Even allowing for significant error in the AgriHQ figures, in the current market the Fonterra "market" price for milk is very high.

- The current DIRA controlled situation does allow choice for small entities.
  Can get milk directly off farm
  Can get milk from Fonterra – delivered

- Without the open entry/exit clause in DIRA there would be no choice.

- Without regulated milk, small entities without milk collection infrastructure, or whose volume requirements are too small to contract a whole farms supply, would have no choice. No-one is required to provide milk to anyone else and there is no "factory gate" market.

- The "regulations" as they stand now, are likely to reduce the "regulated milk" demand, at least in the short term as some of the newer large exporting Dairy Companies will begin to supply themselves entirely. Our concern as small dairy manufacturers, is that the size of the regulated milk demand should not dictate the importance of the market, particularly since only about 5% of milk produced in New Zealand is used domestically.

To Quote the Commerce Commission Report: Consideration of whether to initiate a Commerce Act part 4 inquiry into milk prices, August 2011.

"160. In theory it might be relatively straightforward for an existing independent processor who already collects milk, to supply raw milk to an existing town milk manufacturer or another processor. In practice, independent processors supply relatively little milk to the factory gate. Given the opportunity costs involved (see Appendix 3 paragraph 26 below), we consider independent processors will generally only supply raw milk to the factory gate at times when they have excess supply. We therefore do not consider they are likely to be a material competitive constraint on Fonterra's pricing in this market on a consistent basis. An alternative explanation would be that the price/convenience of default milk means that it is hard for rival suppliers to get business."

161. Any new competitor in this market would need to contract with farmers and invest in infrastructure for the collection of milk for delivery at the “factory gate” (or direct to processors as is the case with Fonterra). We consider the only realistic candidates to supply raw milk to the factory gate are current or future processors. Any future processor seeking to enter this market would also need to overcome the conditions of entry and expansion in one or more downstream milk processing and wholesale distribution markets.

162. We consider it likely that Fonterra has little or no competition in the supply of factory gate milk in both the North Island and the South Island. We also consider it likely that there is little or no likelihood of a substantial increase in competition in these markets. This is not a surprising conclusion given the intention of the Regulations was to address this issue of limited competition by ensuring independent processors could obtain raw milk at a regulated price.”

Our view is that little has changed in the “factory gate” market since 2011.

If and when deregulation occurs/begins we would like to see the open entry/exit extended to all collecting milk companies. This has two benefits. Firstly small entities will always have the option to take small quantities of a willing farmers supply, and secondly to promote easy entry/exit from one company to another for farmers, thereby keeping companies honest – price-wise.

Also we think there needs to be an on-going reliable source of milk for domestic use. The “factory gate” market is going to be a long time coming. The current situation where 250 million litres is guaranteed to a single company, which is not necessarily a domestic company, to provide competition in a domestic market seems to have some contradictory implications.

Thank you.

If you need or wish to clarify anything written here please feel free to contact Diana Hawkins at the above email address.