

**4 December 2015**

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**Re: Submission on the Dairy Competition Review Draft Report**

- 1.1 We refer to the Commerce Commission's (**Commission's**) draft report in relation to its review of the state of competition in the New Zealand Dairy Industry dated 6 November 2015 (the **Draft Report**).
- 1.2 This letter briefly sets out comments from Nutricia Ltd and Danone Nutricia NZ Ltd (collectively referred to in this letter as **Danone Nutricia**) on the Commission's conclusions and recommendations set out in the Draft Report. In summary, Nutricia considers that:
- (a) the Draft Report correctly concludes that there is limited competition at the factory gate and identifies the importance that the regulation under the Dairy Industry Restructuring Act (**DIRA**) plays in ensuring the price of milk does not increase beyond competitive levels;
  - (b) while the Commission acknowledges that deregulation at this time would risk Fonterra increasing the price of raw milk at the factory gate, we further consider that there is a risk Fonterra would have the ability and the potential incentive to further restrict independent processors (**IPs**) at the farm gate; and
  - (c) while we acknowledge the Commission's reasoning for resetting the market share thresholds at 30%, this level is too low and may result in the Commission undertaking another review prematurely.
- 1.3 Our views are set out in further detail below.
- 2. Limited competition and role of DIRA regulations**
- 2.1 We agree with the Commission's assessment that there is limited competition at the factory gate but that the DIRA regulations currently prevent Fonterra from increasing the price of raw milk that it supplies under those regulations above competitive levels. We also agree that the factory gate market also benefits from the regulations at the farm gate, particularly the open entry and exit regulations.

- 2.2 The Commission has recognised that without the DIRA regulations there is a real risk that Fonterra would exercise its market power to increase the price of raw milk at the factory gate above competitive levels. This in turn would have the effect of decreasing the competitiveness of independent processors that acquire raw milk from Fonterra in downstream retail markets.
- 2.3 Accordingly, Danone Nutricia supports the continued application of the DIRA regulations to the New Zealand dairy industry.

### 3. **Ability to foreclose IPs at the farm gate**

3.1 We agree with the Commission's finding that Fonterra may have an incentive to foreclose competitors that compete at the farm gate to soften the competition for farmer suppliers. However, we disagree that Fonterra would not have the ability to do so via entering into long-term agreements with farmers. Indeed, there is precedent for such behaviour in other industries overseas where an incumbent faced similar incentives that Fonterra would face in the event of deregulation:

- (a) Pharmaceutical company Pfizer entered into contracts that induced the long term supply of a drug for which it previously held a patent in order to prevent competitors obtaining market access once the patent expired.<sup>1</sup>
- (b) National Grid, in response to the deregulation of the gas meter market, entered into a number of long term supply agreements to prevent competitors from gaining access to that market once it was opened to competition.<sup>2</sup>

3.2 Accordingly, Danone Nutricia considers that in the absence of regulation there is a real risk that the dominant player, in this case Fonterra, could seek to contract with farmers for long periods (e.g. 5 years+) limit growth of competitors particularly in areas where it considers competition is likely.

### 4. **Market share thresholds**

4.1 The Draft Report identifies that while the 20% market share threshold in the South Island has been reached, competition remains insufficient. Accordingly, the Draft Report recommends that the market share thresholds be reset from 20% to 30%, which should trigger another report on the state of competition in the New Zealand dairy industry.

4.2 Danone Nutricia welcomes the acknowledgement by the Commission that a 30% market share threshold would be viewed as low in foreign contexts<sup>3</sup> and acknowledges the Commission's

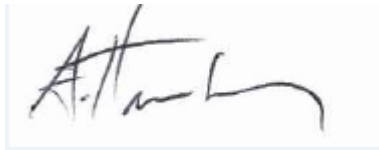
<sup>1</sup> ACCC v Pfizer Australia Pty Ltd [2015] FCA 113.

<sup>2</sup> National Grid PLC v Gas and Electricity Markets Authority [2009] CAT 14.

<sup>3</sup> Draft Report at 7.25.4.

rationale for setting this lower threshold. However, we consider that a review of the dairy industry at this level would be likely to reveal the same issues present at the 20% threshold are likely to still be present at the 30% threshold. In Germany, the Federal Cartel Office (FCO) states that no milk purchaser has a dominant market position on any of the regional markets in Germany (r. 41, para. 101 of the report) - though at the time market dominance was presumed under German law whenever market shares exceeded 33%. However, the FCO is still very concerned about "relatively strong" market positions and long-term contracts as well as a high degree of market transparency (p. 10, para.3).<sup>4</sup>

Yours faithfully,



Ailish Hanley  
General Secretary, Danone Nutricia Oceania

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<sup>4</sup> [http://www.bundeskartellamt.de/SharedDocs/Publikation/DE/Sektoruntersuchungen/Sektoruntersuchung%20Milch%20-%20Abschlussbericht.pdf?\\_\\_blob=publicationFile&v=4](http://www.bundeskartellamt.de/SharedDocs/Publikation/DE/Sektoruntersuchungen/Sektoruntersuchung%20Milch%20-%20Abschlussbericht.pdf?__blob=publicationFile&v=4).