



Hristina Dantcheva
Principal Economist
The Commissioners
Commerce Commission
44 The Terrace
Wellington

15 November 2021

Dear Hristina,

Open Country Dairy Limited: Submission on Commission's Milk Price Manual Draft Report 2021/22 season

Thank you for the opportunity to comment on the Commerce Commission's (Commission's) review of Fonterra's base milk price manual for the 2021/22 season. This submission responds to the Commission's draft report dated 15 October 2021 (Draft Report).

Open Country Dairy Limited (Open Country) has repeatedly submitted on the issues addressed in this submission. The current milk price setting regime under the Manual, driven by Fonterra's incentives, undermines the contestability dimension in DIRA.

This submission addresses two matters:

- Asset beta rule should be aligned with the change to the law
- Sales of RCPs should be conducted indisputably on freely contested global markets supported by improved transparency.

Asset beta rule should be aligned with the change to the law

We support the Commission's draft conclusion that:¹

Rule 42 of the 2021/22 Manual is inconsistent with the new requirements set out in s 150C and thus inconsistent, with the statutory purpose set out in s 150A

We agree with the Commission that the change is inconsistent with the law. Section 150C is clear that the asset beta used in the milk price calculation must be "consistent with the estimated asset betas of other processors of dairy and other food products that are: traded in significant quantities in globally contested markets; and characterized by uniform technical specifications". Fonterra's proposed amendment to the

¹ Draft Report, para. 32.1



manual is incorrect in law. We are surprised that it took the Commission's review for this basic fact to be made apparent to Fonterra. It is a basic obligation to comply with the specific legislation that applies only to Fonterra.

In earlier submissions, we have consistently drawn the Commission's attention to the underlying incentives that exist at Fonterra to use a low asset beta. We have repeatedly canvassed how a lower asset beta has material impact on earnings, the base milk price level and this negatively impacts contestability. For instance, in our September 2019 submission, we had highlighted that a 0.1 change in asset beta translates to a \$45 to \$60 million impact on annual earnings for Fonterra and an approximate 3-4 cents effect on the base milk price. We note that Miraka has similarly pointed out the impact of errors in calculating the notional processor WACC.

Sales of RCPs should be conducted indisputably on freely contested global markets with improved transparency

We note that the Commission has not commented substantively on the addition to the Manual of a reference of "freely-contested global market" in its Draft Report. Any plain interpretation of a freely contested global market would not include Fonterra's off-GDT sales which remain opaque and unable to be properly tested.

Open Country and other processors have repeatedly highlighted that Fonterra's selection of RCP sales is problematic. Given the incentives—acknowledged by the Commission—to favour selection of RCP sales that reflect high prices, the Commission should act to enforce this transparency. The Commission now has an opportunity to comment on Fonterra's introduction of the "freely contested global markets" wording and demand the transparency it has requested (for example in paragraph 54 of the Draft Report).

As the Commission knows, off-GDT sales are a high proportion of total RCP sales. Those off-GDT sales can be at a premium to benchmark on-GDT prices. All the RCPs are sold on GDT and sales on that platform reflect prevailing prices. Again, we question how the Commission can accept that on-GDT prices are not the benchmark for prevailing prices, and still accept Fonterra's opaque off-GDT sales information as the basis for the notional processor revenues. Fonterra's use of off-GDT sales that have opaque terms and conditions for RCP prices should be matched with improved disclosure of the impact of off-GDT pricing on sales revenues.

The Commission has an opportunity with the proposed amendment to freely contested global market to insist on a set of compulsory disclosures in the Manual such as the Generic Product Specifications. We request that the Commission require Fonterra to provide:

- Monthly updates to impact of off-GDT sales on RCP prices, or at least more regularly in-line with milk production months, so that publication aligns with milk production volumes
- Less lag between period under review in its "Global Dairy Update" publications and publication date. This has been up to three months' lagged and is typically published with about two months' lag.

Questions and issues for the expert to review the list of qualifying materials



We note that the Commission proposes to engage an independent expert ahead of the 2022/23 Manual review to review the list of qualifying materials. We are happy to provide possible questions and specific issues for that expert to address. We look forward to hearing of your process and timeframes for this.

Regards,

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