

Review of Fonterra's 2024/2025 Milk Price Manual:

Dairy Industry Restructuring Act 2001

Draft report

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Table of Contents

CHAPTER 1	INTRODUCTION AND HOW YOU CAN PROVIDE YOUR VIEWS	3
	PURPOSE OF THIS REPORT	3
	HOW THIS REPORT IS STRUCTURED	3
	HOW YOU CAN PROVIDE YOUR VIEWS	3
CHAPTER 2	OUR REVIEW FRAMEWORK.....	6
	OUR APPROACH FOR THE MANUAL REVIEW	6
	SCOPE OF THIS REVIEW	7
CHAPTER 3	DRAFT CONCLUSIONS AND RECOMMENDATIONS.....	10
	PURPOSE OF THIS CHAPTER	10
	SUMMARY OF DRAFT CONCLUSIONS.....	10
CHAPTER 4	ASSESSMENT OF MANUAL RULES RELATED TO S 150B ASSUMPTIONS.....	11
	PURPOSE OF THIS CHAPTER	11
	OUR APPROACH TO ASSESSING MANUAL RULES RELATED TO THE S 150B ASSUMPTIONS.....	11
	RULE 1 – VOLUME OF MILK PROCESSED	13
	RULE 6 – FARMGATE MILK PRICE PRODUCTION PLAN	14
	RULE 7 – PRODUCT YIELDS	16
	RULE 26 – CAPACITY OF STANDARD PLANTS	17
	RULE 27 – ALLOCATION OF STANDARD PLANTS TO REGIONS	20
	RULE 33 – SURPLUS CAPACITY	22
	RULE 34 – SHORTFALLS IN CAPACITY	23
	RULE 35 – SITE FOOTPRINT	25
CHAPTER 5	ASSESSMENT OF AMENDMENTS TO THE 2024/2025 MANUAL	28
	PURPOSE OF THIS CHAPTER	28
	AMENDMENTS ARISING FROM THE 2023/2024 MANUAL REVIEW	28
	OTHER AMENDMENTS TO THE 2024/2025 MANUAL	30
ATTACHMENT A	GLOSSARY	36

Chapter 1 Introduction and how you can provide your views

Purpose of this report

1. This report sets out our draft conclusions from our statutory review of the extent to which Fonterra's 2024/2025 Milk Price Manual (the **2024/2025 Manual**) is consistent with the purposes of the base milk price monitoring regime (**monitoring regime**) under subpart 5A of the Dairy Industry Restructuring Act 2001 (**DIRA**).¹
2. The Manual contains the methodology that will be used to calculate Fonterra's base milk price for the 2024/2025 season.

How this report is structured

3. Chapter 2 explains our review framework and the scope of our 2024/2025 Manual review.
4. Chapter 3 sets out our draft conclusions.
5. Chapter 4 provides our assessment of the way in which relevant Manual rules incorporate s 150B(1)(a), (b), and (d) of DIRA, and the extent to which these rules are consistent with the s 150A purpose.²
6. Chapter 5 provides our assessment of amendments to the 2024/2025 Manual and their consistency with the s 150A purpose.
7. Attachment A provides a glossary of the key terms and abbreviations used in this draft report.

How you can provide your views

Invitation to comment

8. As required under DIRA, we are consulting with Fonterra on this draft report.³ We have also extended our consultation process to other interested parties.

¹ DIRA, s 150A.

² We assessed the way in which Rule 10 incorporates the s 150B(1)(c) foreign exchange assumption, and the extent to which Rule 10 is consistent with the s 150A purpose, in the 2023/2024 Manual review.

³ DIRA, s 150U.

9. We welcome stakeholder views on any aspects of this draft report before we finalise our conclusions. Your views on our draft report will help inform our final conclusions for our review.⁴

Deadline for submissions

10. To allow us time to consider your views, submissions on this draft report must be provided to us no later than **12 noon, Friday 15 November 2024**.⁵
11. Our final report on the 2024/2025 Milk Price Manual will be published on or before 16 December 2024.

Format of submissions

12. Please address all submissions to:

Andrew Harrison, Manager Dairy

c/o dairy@comcom.govt.nz

Subject line: Milk Price Manual 2024/2025

13. We prefer submissions in both a format suitable for word processing (such as a Microsoft Word doc), and a 'locked' format (such as a PDF) for publication on our website.
14. The protection of confidential information is something the Commission takes seriously. The process requires you to provide (if necessary) both a confidential and public version of your submission and to clearly identify the confidential and public versions.
15. When including commercially sensitive or confidential information in your submission, we offer the following guidance:
 - 15.1 Please provide a clearly labelled confidential version and public version of your submission. We intend to publish all public versions on our website.
 - 15.2 The responsibility for ensuring that confidential information is not included in a public version of a submission rests entirely with the party making the submission.

⁴ DIRA, s 150U.

⁵ A submission from Fonterra, or notification that it does not wish to make a submission, is required not later than 15 November 2024 for this season's Manual review – see s 150M(2) of DIRA.

16. Please note that all submissions we receive, including any parts that we do not publish, can be requested under the Official Information Act 1982. This means we would be required to release material that we do not publish unless good reason existed under the Official Information Act 1982 to withhold it. We would normally consult with the party that provided the information before any disclosure is made.

Chapter 2 Our review framework

Our approach for the Manual review

17. This report should be read along with 'Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation' (**Approach paper**), which we have applied in this review and which forms part of this report. The Approach paper provides an overview of the approach we take in our reviews of Fonterra's Manual and base milk price calculation and includes:⁶
 - 17.1 an overview of how the base milk price is set,
 - 17.2 our interpretation of the key legislative provisions guiding our statutory reviews, and
 - 17.3 our analytical and practical approach to our statutory reviews.
18. The monitoring regime is intended to provide incentives for Fonterra to act efficiently, while providing for contestability in the market for the purchase of raw milk from farmers. The regime also promotes greater transparency of Fonterra's base milk price setting processes.⁷
19. We undertake a review of the Manual for each season. The Manual contains the methodology Fonterra uses to calculate its base milk price. As such, the Manual contains a set of definitions, rules and formulas specifying the inputs and processes to be followed in calculating the base milk price.
20. We consider the extent to which the Manual is consistent with the purpose of subpart 5A of DIRA. In particular, our review considers the 'efficiency' and 'contestability' dimensions of the s 150A purpose as required by DIRA. Our review therefore focuses on whether the methodology and rules used in the Manual:
 - 20.1 provide an incentive for Fonterra to operate efficiently (the 'efficiency dimension'), and
 - 20.2 adopt assumptions, inputs and processes that would be practically feasible for an efficient processor (the 'contestability dimension').⁸

⁶ Commerce Commission ["Our approach to reviewing Fonterra's milk price manual and base milk price calculation"](#) (1 August 2023).

⁷ Dairy Industry Restructuring Amendment Bill (Government Bill) 2012, at 2.

⁸ We consider the same 'efficiency' and 'contestability' dimensions when we carry out our base milk price calculation review.

21. As set out in the Approach paper, the efficiency dimension is met if Fonterra uses notional inputs in calculating the milk price (independent from Fonterra's actual data).
22. Contestability is considered to be provided for if any notional costs, revenues, or other assumptions taken into account in calculating the base milk price are practically feasible for an efficient processor.⁹
23. To satisfy the purpose of s 150A, our interpretation is that our statutory review must assess the extent to which the Manual is consistent with both dimensions. We attach equal weight to both dimensions in our reviews. Our analytical approach to the efficiency and contestability dimensions is described in chapter 4 of the Approach paper.¹⁰
24. In practice, we mostly focus our review each year on changes to the Manual from the previous year's Manual and on any unresolved issues carried over from our previous reviews.
25. We will also consider the amendments to DIRA that are relevant to our review functions when deciding where to focus our reviews.

Scope of this review

26. DIRA requires Fonterra to provide us with the following information for consideration in our Manual review:¹¹
 - 26.1 the Manual for the current season,
 - 26.2 any recommendations by the Milk Price Panel (**MPP**)¹² in relation to the milk price Manual,¹³

⁹ DIRA, s 150A(2).

¹⁰ Commerce Commission Approach paper, above n 6.

¹¹ DIRA, s 150L.

¹² The MPP is a committee that Fonterra is required to establish and maintain under s 150D of DIRA. The MPP is required, for each season, to supervise the calculation of the base milk price; advise Fonterra on the application of the Manual; and recommend the base milk price to Fonterra. See also Fonterra ["Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024"](#) (15 August 2024), at page 27.

¹³ Fonterra has "interpreted this provision as in fact relating to recommendations by the Milk Price Panel in relation to amendments to the Milk Price Manual." (See Fonterra ["Reasons Paper in support of Fonterra's Milk Price Manual for the 2022/23 season - 1 August 2022"](#) (23 August 2022), at footnote 1). We agree with this interpretation.

- 26.3 notification of any change in the economic and business environment that, in Fonterra's view, requires a change to the Manual,
- 26.4 certification on the extent to which Fonterra considers that the Manual is consistent with the s 150A purpose, and
- 26.5 the reasoning behind the views expressed in Fonterra's certification.
27. The above information, where relevant, has been provided by Fonterra and has been considered as part of our review. Specifically, Fonterra has provided us with: the Base Milk Price Manual for the 2024/2025 season (marked-up version),¹⁴
- 27.2 a Reasons paper in support of Fonterra's Milk Price Manual for the 2024/2025 season (**Fonterra's Reasons paper**), which contains the information noted in paragraphs 26.3, 26.4 and 26.5,¹⁵
- 27.3 the MPP's recommendations to Fonterra's Board with respect to amendments to the 2024/2025 Manual.
28. The 'marked up' version of the 2024/2025 Manual shows the changes that have been made to the previous season's version of the Manual. Fonterra has stated in its Reasons paper that the 'marked up' version of the 2024/2025 Manual identifies all amendments to the Manual.¹⁶ In addition, we have reviewed the MPP's recommendations to Fonterra's Board and confirmed that all recommended amendments are reflected in the 2024/2025 Manual.
29. The amendment to sections 150B and 150I of DIRA now expressly provide that we can assess the way in which Fonterra uses the assumptions in s 150B(1)(a) to (d) in setting the base milk price.¹⁷
30. We assessed the way in which Rule 10 incorporates the s 150B(1)(c) foreign exchange assumption, and the extent to which Rule 10 is consistent with the s 150A purpose, in the 2023/2024 Manual review.¹⁸

¹⁴ Fonterra's marked up 2024/2025 Manual, above n 12, page 27.

¹⁵ Fonterra "[Reasons Paper in support of Fonterra's Milk Price Manual for the 2024/25 season - 1 August 2024](#)" (15 August 2024).

¹⁶ Ibid, page 3.

¹⁷ DIRA, ss 150B(2) and 150I(1A).

¹⁸ Commerce Commission "[Review of Fonterra's 2023/24 Milk Price Manual: Final report](#)" (15 December 2023), pages 11-16.

31. We indicated in the 2023/2024 Manual review that we intended to review the rules related to s 150B(1)(a), (b), and (d) as a matter of priority to enable us to address them fully as part of our 2023/2024 Calculation and 2024/2025 Manual reviews.¹⁹
32. We completed our review of how the s 150B(1) assumptions are applied to the base milk price calculation through our 2023/2024 Calculation review.²⁰
33. In this Manual review, we have assessed how the s 150B(1)(a) national network, (b) processing capacity and (d) yields assumptions are incorporated into the manual rules and the extent to which these rules are consistent with the s 150A purpose. Our assessment of these rules is outlined in Chapter 4.
34. Fonterra has made several minor amendments to the Manual for the 2024/2025 season. Some of the amendments align parts of text with each other, others are minor wording adjustments. One amendment clarifies the ownership of Global Dairy Trade. There are three amendments which reflect the suggestions we made in our 2023/2024 Manual review.²¹ Our assessment of these changes is outlined in Chapter 5.

¹⁹ Commerce Commission's 2023/2024 Manual review, above n 18, paragraph 22.

²⁰ Commerce Commission "[Review of Fonterra's 2023/2024 base milk price calculation](#)" (16 September 2024).

²¹ Recommendations are contained in the Commerce Commission's 2023/2024 Manual review, above n 18, paragraphs 69, 71, and 76.

Chapter 3 Draft conclusions and recommendations

Purpose of this chapter

35. This chapter sets out our draft conclusions on the extent to which the 2024/2025 Manual is consistent with the s 150A purpose.

Summary of draft conclusions

36. Based on the assessment we have undertaken, our overall draft conclusion is that the Manual is consistent with the statutory purpose set out in s 150A.
37. Regarding our assessment of Manual rules related to s 150B(1)(a), (b), and (d), our draft conclusions are that they are each consistent with the statutory purpose set out in s 150A. Notwithstanding our draft conclusions, we recommend that Fonterra:
 - 37.1 consider whether the wording of the objective of Rule 26 could be adjusted to ensure that it will be read in a similar way as the detail of the rule,
 - 37.2 clarify what is meant by 'Standard Plants of Fonterra' referred to in the Key Assumptions section, and
 - 37.3 correct the glossary definition of site footprint to refer to Rule 35 instead of Rule 36.
38. Regarding Fonterra's amendments to the Manual since last year's review, our draft conclusion is that the amendments made are consistent with the statutory purpose set out in s 150A. However:
 - 38.1 We recommend Fonterra also remove "For each Financial Year subsequent to F2008" from page 24, in line with the removal of "For each Financial Year subsequent to F2012" in this season's amendments to the Manual.

Chapter 4 Assessment of Manual rules related to s 150B assumptions

Purpose of this chapter

39. This chapter sets out our assessment of the way in which relevant rules incorporate the s 150B(1) assumptions, and the extent to which these rules are consistent with the s 150A purpose.

Our approach to assessing Manual rules related to the s 150B assumptions

40. In our 2023/2024 Manual review, we focused on assessing how the s 150B(1)(c) assumption relating to foreign currency gains and losses is incorporated into the Manual rules, and specifically into Rule 10.²²
41. In this Manual review, we have focused on assessing the way in which relevant rules incorporate the three remaining assumptions (s 150B(1)(a), (b), and (d)), and the extent to which these rules are consistent with the s 150A purpose.
42. We have identified eight Manual rules that we consider to be the most relevant to s 150B(1)(a), (b) and (d), outlined in Table 1. These are Rules 1 (volume of milk processed), 6 (Farmgate Milk Price Production Plan), 7 (product yields), 26 (capacity of Standard Plants), 27 (allocation of Standard Plants to Regions), 33 (surplus capacity), 34 (shortfalls in capacity), and 35 (site footprint).

²² Commerce Commission's 2023/2024 Manual review, above n 18, pages 11-16.

Table 1: Manual rules relevant to s 150B assumptions

DIRA section and paragraph	Assumption text from DIRA	Related Manual rules
s 150B(1)(a)	That new co-op operates a national network of facilities for the collection and processing of milk.	1, 6, 7, 27, 33, 34, 35
s 150B(1)(b)	That the size of new co-op's assumed units of processing capacity approximates to the average size of new co-op's actual units of processing capacity.	26
s 150B(1)(c)	That gains and losses experienced by new co-op resulting from foreign currency fluctuations, including from new co-op's foreign currency risk-management strategies, are incorporated in the base milk price.	10 (assessed in the 2023/24 Manual Review) ²³
s 150B(1)(d)	That all milk collected by new co-op is processed into commodities at yields that are practically feasible.	1, 6, 7, 33

43. When assessing these rules we have considered the following matters:

- 43.1 How does the rule incorporate, engage or reference the s 150B(1) assumption?
- 43.2 Does the use of the s 150B(1) assumption in the rule correctly apply the s 150B(1) assumption? Or as the Approach paper puts it, has Fonterra correctly interpreted the meaning of the s 150B(1) assumption?²⁴
- 43.3 To what extent is the way in which the s 150B(1) assumption is used in the rule consistent with s 150A (but leaving out an examination of the s 150B assumption in itself)?²⁵

²³ Commerce Commission's 2023/2024 Manual review, above n 18, pages 11 - 16.

²⁴ Commerce Commission's Approach paper, above n 6, paragraph 59. As follows from s 150B(2) we note that there may be more than one correct way of applying a s 150B(1) assumption.

²⁵ In practice, once we have concluded that the rule has applied an assumption correctly, we move directly to the question whether the rule, with that assumption as used, is consistent with s 150A.

Rule 1 – volume of milk processed

Use of the s 150B assumption in the Manual rule

Table 2: Rule 1, volume of milk processed²⁶

Objective	Rule
The Farmgate Milk Price Commodity Business will manufacture all milk collected in New Zealand by Fonterra into Reference Commodity Products.	The Farmgate Milk Price Production Plan calculation will reflect all Milk collected by Fonterra in New Zealand, including Milk sold to third party processors in accordance with DIRA. An implication of this provision is that any difference between the Farmgate Milk Price and the price received by Fonterra for milk supplied to third party processors in accordance with Fonterra's obligation under DIRA to supply Milk to third party processors will accrue to Fonterra.

44. Rule 1, in conjunction with Rule 6 (Farmgate Milk Price Production Plan), incorporates s 150B(1)(d) through the requirement that the Farmgate Milk Price Production Plan calculation reflects all milk collected by Fonterra in New Zealand. This rule specifically includes milk sold to third party processors in accordance with DIRA.
45. Rule 1 also indirectly incorporates s 150B(1)(a) through the reference to "all milk collected in New Zealand by Fonterra". This implies the necessity of a national network of facilities for the collection and processing of milk. However, as the rule primarily relates to s 150B(1)(d) we have limited our assessment here to this assumption.

Does the rule apply the s 150B(1) assumptions correctly?

46. Rule 1 explicitly requires that the Farmgate Milk Price Production Plan uses Fonterra's actual milk collection, including milk sold to third party processors under DIRA. We consider this an appropriate interpretation of s 150B(1)(d) within the context of the rule.

Does the rule, with the assumption as used, provide for consistency with s 150A?

47. Use of all Fonterra milk supply for conversion into commodities (via the Farmgate Milk Price Production Plan) is directly consistent with s 150B(1)(d) and so does not detract from achieving the s 150A objectives. Our draft conclusion is that we therefore consider this rule consistent with the efficiency and contestability dimensions of s 150A.

²⁶ Fonterra's marked up 2024/2025 Manual, above n 12, page 35.

Rule 6 – farmgate milk price production plan

Use of the s 150B assumption in the Manual rule

Table 3: Rule 6, Farmgate Milk Price Production Plan²⁷

Rule	Application
<p>The Farmgate Milk Price Production Plan should:</p> <ul style="list-style-type: none"> • Be feasible given the configuration of the Farmgate Milk Price Fixed Asset Base. • Result in the conversion of all Milk Supply into Reference Commodity Products. • Be consistent with the objective of maximising the sum of the Aggregate Farmgate Milk Price and the profits of the Farmgate Milk Price Commodity Business, having regard to the relative returns of different Reference Commodity Products. • Result in Fonterra facing strong incentives to optimise its Product Mix. 	<p>The Farmgate Milk Price Production Plan:</p> <ul style="list-style-type: none"> • Will be calculated to utilise all Milk Supply (including all Milk sold in liquid form by Fonterra), given the product yields established under Rule 7. • Should reasonably reflect Fonterra’s actual allocation of milk to different Reference Commodity Products, subject to that allocation being commercially supportable by reference to relevant information available at the time the allocation is made. • Will be calculated to be feasible given the composition of the Farmgate Milk Price Fixed Asset Base.

48. Rule 6 directly incorporates s 150B(1)(d) through the requirement that the production plan should result in the conversion of all milk supply into Reference Commodity Products (**RCPs**). RCPs are further refined in the Manual to an individual specification for each of the five commodities which are currently assumed to make up the reference basket. The rule also requires the production plan to reasonably reflect Fonterra's actual allocation of milk to different RCPs.
49. In its Reasons paper for the 2023/2024 calculation, Fonterra confirms that the base milk price has been calculated under the assumption that all milk collected by Fonterra is converted into RCPs.²⁸
50. Rule 6 tangentially incorporates s 150B(1)(a) through the requirement for the production plan to be feasible given the configuration of the Farmgate Milk Price Fixed Asset Base. This later term is defined as "the Standard Plants and other Reference Assets which are in aggregate required to produce the Reference Commodity Products included in the Farmgate Milk Price Production Plan".

²⁷ Fonterra’s marked up 2024/2025 Manual, above n 12, page 37.

²⁸ Fonterra [“Reasons paper in support of Fonterra’s base milk price for the 2023/24 season”](#) (17 June 2024), at page 11.

Does the rule apply the s 150B(1) assumption correctly?

51. Rule 6 explicitly requires that the Farmgate Milk Price Production Plan uses Fonterra's actual milk collection and results in the conversion of this milk into specified dairy commodities. We consider this an appropriate interpretation of s 150B(1)(d) within the context of the rule.
52. Rule 6 requires that the production plan is feasible given the configuration of the Farmgate Milk Price Fixed Asset Base. This asset base is defined in Rule 24 as comprising the fixed assets required by the Notional Processor, given the volume of milk processed by the business, the Reference Basket and the Site Footprint. When read in conjunction with other rules (in particular, Rules 27 (allocation of Standard Plants to Regions) and 35 (site footprint)), we consider this an appropriate application of s 150B(1)(a) within the context of the rule.

Does the rule, with the assumption as used, provide for consistency with s 150A?

53. Use of all Fonterra milk supply for conversion into commodities is directly consistent with s 150B(1)(d) and so does not detract from achieving the s 150A objectives. The notional allocation of milk to sites is aligned to Fonterra's actual allocation and so is practically feasible.
54. The asset base and production plan established through the way the national network assumption is used are notional, so Rule 6 is consistent with the efficiency dimension.
55. While not directly related to a s 150B(1) assumption, the application of the rule also requires the production plan to reasonably reflect Fonterra's actual allocation of milk to different RCPs. In conjunction with the rule's requirement to be feasible within the Notional Processor's asset base, we consider this consistent with the contestability dimension.
56. We have previously considered the use of Fonterra's actual RCP product mix allocation and noted that the use of actual data does provide Fonterra with some incentive to improve efficiency.²⁹
57. Overall, our draft conclusion is that we consider Rule 6 to be consistent with the efficiency and contestability objectives of s 150A.

²⁹ Commerce Commission "[Review of Fonterra's 2014/15 base milk price calculation: Final report](#)" (15 September 2015), page 79.

Rule 7 – product yields

Use of the s 150B assumption in the Manual rule

Table 4: Rule 7, product yields³⁰

Rule	Application
<p>The yield factors used to convert Milk Supply into the Farmgate Milk Price Production Plan will reflect the composition of standard specification commodity product and a target level of losses that is consistent with the efficient manufacture of the products included in the Farmgate Milk Price Production Plan and the configuration of the Standard Plants.</p>	<p>The yield assumptions used to determine the Farmgate Milk Price Production Plan for a Season will reflect:</p> <ul style="list-style-type: none"> • The Composition Target for each Reference Commodity Product; and • The Allowable Yield Losses for each Reference Commodity Product. <p>The yield assumptions will be subject to review in each Review Year.</p>

58. Rule 7 discusses that yield factors and losses must be consistent with efficient manufacture of products defined under the Farmgate Milk Price Production Plan (referencing s 150B(1)(d)) and with the configuration of Standard Plants (referencing s 150B(1)(a)) in that it must reflect the configuration determined under other Manual rules which more directly reference s 150B(1)(a) such as Rule 35 (site footprint). As the rule primarily relates to s 150B(1)(d) we have limited our assessment here to this assumption.
59. In its Reasons paper for the 2023/2024 base milk price calculation, Fonterra states that Rule 7 provides that "the yield assumptions must be calculated by reference to supportable assumptions with respect to product specification, including the relevant Codex requirements, and manufacturing losses." It goes on to confirm that the yields used in the conversion of milk into RCPs are practically feasible.³¹
60. In our 2023/2024 calculation review, we concluded that the way in which yields are determined meets the purposes of DIRA.³²

Does the rule apply the s 150B(1) assumption correctly?

61. We consider that the detail of the rule accounts for components of yields which will result in a practically feasible outcome, as provided by s 150B(1)(d).

³⁰ Fonterra's marked up 2024/2025 Manual, above n 12, page 37.

³¹ Fonterra's 2023/2024 Reasons paper for the calculation, above n 28, page 11.

³² Commerce Commission's 2023/2024 calculation review, above n 20, paragraph 3.3.

Does the rule, with the assumption as used, provide for consistency with s 150A?

62. The way in which s 150B(1)(a) is used in Rule 7 allows for the efficient manufacture of commodities. It does not prescribe how efficiency is determined; nor does it prevent the use of independent notional benchmarks, which we consider typically incentivises efficiency. Our draft conclusion is that the rule is consistent with the efficiency dimension of s 150A.
63. When considered in conjunction with the relevant definitions, it is practically feasible for an efficient processor to use the process outlined in Rule 7 to determine yield factors to convert milk supply into commodity products. Our draft conclusion is that the rule is consistent with the contestability dimension of s 150A.

Rule 26 – capacity of Standard Plants

Use of the s 150B assumption in the Manual rule

Table 5: Rule 26, capacity of Standard Plants³³

Objective	Rule
<p>The average processing capacity of a Standard Plant should reflect Fonterra's weighted average processing capacity of plants used to manufacture the relevant Primary Reference Commodity Product.</p>	<p>The Standard Plant specified in a Review Assessment Year for each:</p> <ul style="list-style-type: none"> • Primary Reference Commodity Product should have an average daily processing capacity that will result in the overall weighted average daily processing capacity of all Standard Plants for the manufacture of that Reference Commodity Product projected to be included in the Farmgate Milk Price Fixed Asset Base at the end of the subsequent Review Period being materially consistent with the overall weighted average daily processing capacity of the plants projected to be used (or able to be used) by Fonterra to manufacture the relevant Reference Commodity Product at that time. • Secondary Reference Commodity Product should have an average daily processing capacity that is consistent with the capacity of plants currently available from equipment suppliers, and, where these fall in a range, erring toward the average capacity of the plants currently included in the Farmgate Milk Price Fixed Asset Base.

64. Rule 26 directly references s 150B(1)(b), stating that the average processing capacity of a Standard Plant should reflect Fonterra's weighted average processing capacity used to manufacture the relevant primary RCP. Section 150B(1)(b) requires that new co-op's assumed units of processing capacity approximate the average size of new co-op's actual units of processing capacity - that is, we interpret this to mean that

³³ Fonterra's marked up 2024/2025 Manual, above n 12, pages 50-51.

the Notional Processor's assumed average processing capacity is approximately the same as Fonterra's actual processing capacity for primary RCPs.

65. In its Reasons paper for the 2023/2024 calculation, Fonterra confirms that the average capacity assumed in the milk price is materially consistent with Fonterra's current weighted average WMP and SMP capacity, being 2.1 million litres per day available to manufacture either commodity.³⁴

Does the rule apply the s 150B(1) assumption correctly?

66. Rule 26 provides for the overall weighted average daily processing capacity of all Standard Plants to be materially consistent with Fonterra's overall weighted average daily processing capacity of plants projected to be used (or able to be used) for the manufacture of the relevant primary RCP in the relevant period. We consider this is an appropriate interpretation of s 150B(1)(b).
67. For secondary RCPs (ie butter, AMF and BMP), Rule 26 states that average daily processing capacity should be consistent with the capacity of plants available from equipment suppliers, and if this is a range, that average capacity should err towards the average capacity of the plants included in the current Farmgate Milk Price Fixed Asset Base, that is the fixed assets assumed to be required by the Notional Processor. Rule 24, which sets out the Farmgate Milk Price Fixed Asset Base, states that Standard Plants should be reasonably representative of the average capacity of the Fonterra plants used to produce RCPs. Rules 26 and 24, when read in conjunction with one another, indicate consistency with s 150B(1)(b); however, it could be clearer in Rule 26, which is the key rule intended to reflect s 150B(1)(b), that the average daily capacity of plants for secondary RCPs should equate to Fonterra's average daily capacity, as indicated in Rule 24.

Does the rule, with the assumption as used, provide for consistency with s 150A?

68. The way in which s 150B(1)(b) is used in Rule 26 provides for the overall weighted average daily processing capacity of all Standard Plants to be materially consistent with Fonterra's overall weighted average daily processing capacity. Our draft conclusion is that we consider that the use of Fonterra's weighted average capacity appropriately incentivises efficiency, meeting the efficiency dimension of s 150A.
69. Our draft conclusion is that the way in which s 150B(1)(b) is used in Rule 26 is consistent with the contestability dimension.

³⁴ Fonterra's 2023/2024 Reasons paper for the calculation, above n 28, page 10.

Concerns about drafting clarity

70. The way in which the objective of the rule is written seems to imply that there is only one Standard Plant specification in the model, though the detail of the rule illustrates that this clearly isn't the case, as it specifies a Standard Plant added in a Review Year.
71. Fonterra could consider adjusting the wording of the objective of Rule 26 to ensure that it will be read in a similar way as the detail of the rule.
72. In 'Key Assumptions' in the Manual, Fonterra outlines that the methodology assumes that the average processing capacity of 'Standard Plants of Fonterra' is greater than, or at least equal to, the average processing capacity of Fonterra's efficient near-term competitors, and if this is not the case, that the methodology should be reviewed.³⁵ It is not clear which plants this actually means, though we assume this is intended to refer to the Notional Processor's Standard Plants or Fonterra's average plant size. We consider that 'Standard Plants of Fonterra' should be either defined, or the relevant paragraph on page 14 of the Manual should be more clearly written so that there is no confusion over which plants are being referred to.
73. The Independent Dairy Processors (**IDPs**) queried the definition of a Standard Plant in their submission on the draft report on the 2023/2024 base milk price calculation review. They questioned the Manual's definition of Standard Plants in referring to Rule 26, and the consistency of references to Standard Plants and Reference Assets. In fact, the definition of Standard Plant (contained in Part C, 1.4 of the 2024/2025 Manual) refers to Rule 25 (not Rule 26 as the IDPs assert). Rule 25 outlines how Standard Plants and other Reference Assets are determined. The definition for Reference Asset states that it comprises both a Standard Plant and any other capital asset required. Given these factors, there does not appear to be an issue with how Standard Plants are defined.

³⁵ Fonterra's marked up 2024/2025 Manual, above n 12, page 14.

Rule 27 – allocation of Standard Plants to Regions

Use of the s 150B assumption in the Manual rule

Table 6: Rule 27, allocation of Standard Plants to Regions³⁶

Objective	Rule
Standard Plants are to be allocated to Regions so as to materially align notional and actual regional capacity.	Standard Plants are to be allocated to each Region on a basis which will provide for all Milk to be processed, and with a commercially supportable provision for buffer capacity. The aggregate daily processing capacity of the Standard Plants allocated to each Region must be materially aligned to Fonterra’s actual aggregate daily processing capacity in the Region, adjusted where necessary to account for Milk collected but not processed by Fonterra.

74. Rule 27, in conjunction with Rule 35 (site footprint), and Rule 26 (capacity of Standard Plants) provides the basis for the national network of facilities for the collection and processing of milk described in s 150B(1)(a). The rule requires Standard Plants to be allocated to Regions so as to materially align the Notional Processor's assumed regional daily processing capacity with Fonterra's actual regional daily processing capacity. 'Region' is defined as either the North Island or the South Island.

Does the rule apply the s 150B(1) assumption correctly?

75. Rule 27 provides for material alignment of notional and actual daily processing capacity at a regional level. Standard Plants are to be allocated to each Region on a basis which will provide for all milk to be processed, and with a commercially supportable provision for buffer capacity.
76. The rule's requirement that Standard Plants are allocated to Regions does not apply the s 150B(1)(a) assumption as closely as if Standard Plants were instead allocated to sites. However, in our 2023/2024 Calculation review, we considered this was a modelling simplification which avoids a situation whereby the milk price model effectively replaces all of Fonterra’s assets at each site with the Notional Processor’s asset base, which would be excessively complex, costly, and not necessary to determine a milk price that is consistent with the dimensions of contestability and efficiency.³⁷ We therefore consider that this rule is a valid simplification to apply the s 150B(1)(a) assumption.

³⁶ Fonterra’s marked up 2024/2025 Manual, above n 12, page 51.

³⁷ Commerce Commission 2023/2024 calculation review, above n 20, paragraph 4.19.

Does the rule, with the assumption as used, provide for consistency with s 150A?

77. Rule 27 reflects a modelling simplification, which we consider provides for contestability when read in conjunction with Rules 35 (site footprint) and 26 (capacity of Standard Plants). The implied aggregate daily processing capacity for the Notional Processor and Fonterra are materially aligned at a Region level, and in association with the objective of Rule 35, also at a site level. Our draft conclusion is that the way in which s 150B(1)(a) is used in the rule is consistent with the contestability dimension of s 150A.

78. The asset base (including the Standard Plant unit specifications and numbers of Standard Plants) implied for the Notional Processor under Rule 27 is notional at a Region level, and when Rule 35 is factored in, is also notional at a site level. Our draft conclusion is that we consider the way in which s 150B(1)(a) is used in the rule is consistent with the efficiency dimension of s 150A.

Rule 33 – surplus capacity

Use of the s 150B assumption in the Manual rule

Table 7: Rule 33, surplus capacity³⁸

Objective	Rule
<p>Where peak Milk Supply in a Region has decreased by an amount that results in one or more Standard Plants being surplus to requirements, the Farmgate Milk Price Fixed Asset Base must be adjusted.</p>	<p>In a Review Year, the MPG will determine whether the Farmgate Milk Price Commodity Business has surplus Standard Plant capacity in any Region, having regard to:</p> <ul style="list-style-type: none"> • Fonterra’s current Milk Supply in the region and Fonterra’s projections of future Milk Supply in the region, in turn having regard to current and future competitor entry in the Region. • Planned initiatives of Fonterra to improve peak utilisation of existing capacity. <p>The necessity of maintaining a prudent level of buffer capacity to cover variations in year on year supply and unplanned plant downtime.</p> <p>In a circumstance where the MPG has identified an excess of Standard Plant capacity, the Standard Plant (or Plants) in the Region with the earliest deemed acquisition date (or dates) will be removed from the Farmgate Milk Price Fixed Asset Base.</p> <p>The financial implications of removing a Reference Asset under this Rule, being either the remaining stream of annuities or an annual amount or amounts with the same present value, may not be deducted in calculating the Farmgate Milk Price.</p>

79. Rule 33 provides for the Farmgate Milk Price Fixed Asset Base to be adjusted should milk supply in a region (with ‘Region’ being the North Island and the South Island) reduce. It references s 150B(1)(a) by requiring that the available facilities for the collection and processing of milk are adequate given current actual and forecast milk supply. It also references s 150B(1)(d) as it requires consideration be given to planned improvements in utilisation. The rule states that it is assessed in a Review Year (being a four-year cycle), so it is not subject to the month-to-month and season-to-season variations in milk supply that typically occur in New Zealand but has a longer-term view.

³⁸ Fonterra’s marked up 2024/2025 Manual, above n 12, page 53.

Does the rule apply the s 150B(1) assumption correctly?

80. Rule 33 should be read in conjunction with other rules that directly reference s 150B(1)(a), such as Rule 27 (allocation of Standard Plants to Regions) and Rule 35 (site footprint). Rules 33 and 34 (shortfalls in capacity) both allow Fonterra to adjust the Farmgate Milk Price Fixed Asset Base to be reflective of the assets required to process the volume of milk available, at a regional level. Rule 33 reflects Fonterra's same requirements to process available milk supply, without adding additional cost to run an asset that is not adequately supplied. Given the modelling simplification as discussed in relation to Rule 27, we consider that assessing surplus capacity at a regional level is also an acceptable simplification for the purposes of the model.

Does the rule, with the assumption as used, provide for consistency with s 150A?

81. Rule 33 incentivises efficiency as its goal is to match the available asset base with available milk supply, accounting for efficiency in utilising capacity and ensuring buffer capacity is available to cover variations in milk supply. The rule also requires that the Standard Plant with the earliest acquisition date is removed first. Our draft conclusion is that we consider the way in which s 150B(1)(a) and (d) are used in the rule are consistent with the efficiency dimension of s 150A.
82. An efficient firm competing in the market is likely to have regard to the same factors outlined in the rule were it to also aim to have a national network of facilities and to process all milk collected at yields that are practically feasible. Our draft conclusion is that this rule is consistent with the contestability dimension of s 150A.

Rule 34 – shortfalls in capacity

Use of the s 150B assumption in the Manual rule

Table 8: Rule 34, shortfalls in capacity³⁹

Objective	Rule
Where peak Milk Supply in a Region has (or is reasonably expected to) increased by an amount that would result in the commissioning of an additional Standard Plant, the Farmgate Milk Price Fixed Asset Base will be adjusted accordingly.	An additional Standard Plant will be added to the Farmgate Milk Price Fixed Asset Base if peak Milk Supply increases in circumstances where Fonterra has increased its actual processing capacity in a region, and where a requirement for increased processing capacity is otherwise indicated by an increase in actual or reasonably foreseeable peak supply in the Region.

83. Rule 34 allows for a Standard Plant to be added to the Farmgate Milk Price Fixed Asset Base if there is excess milk supply in a region (being the North Island or South

³⁹ Fonterra's marked up 2024/2025 Manual, above n 12, page 53.

Island) that existing available capacity is unable to meet. It allows for available capacity to be increased in the circumstance that Fonterra has increased its capacity, reflecting the assumption (s 150B(1)(a)) that the Notional Processor has the same national network of facilities as Fonterra.

Does the rule apply the s 150B(1) assumption correctly?

84. The rule aligns assumed processing facilities of the Notional Processor with Fonterra's actual processing facilities, directly applying s 150B(1)(a). If Fonterra increases its processing capacity in a region, this allows the Notional Processor to do the same, which is consistent with s 150B(1)(a).

Does the rule, with the assumption as used, provide for consistency with s 150A?

85. Rule 34 does not detract from the efficiency dimension as it only permits for Standard Plants to be added to the model should circumstances justify doing so. It allows for plants to be added 'where a requirement for increased processing capacity is otherwise indicated' implying that a notional measure could be used should Fonterra choose not to add capacity where circumstances would otherwise dictate that this should occur. Our draft conclusion is that we consider the way in which s 150B(1)(a) is used in this rule is consistent with the efficiency dimension of s 150A.
86. It is practically feasible for an efficient processor to also add a plant in a situation where available milk supply would justify increased processing capacity. Our draft conclusion is that the way in which s 150B(1)(a) is used in this rule is consistent with the contestability dimension.

Rule 35 – site footprint

Use of the s 150B assumption in the Manual rule

Table 9: Rule 35, site footprint⁴⁰

Objective	Rule
<p>The Site Footprint of the Farmgate Milk Price Commodity Business, comprising the number of Sites, their location, and their peak processing capacity, will be materially aligned to Fonterra’s actual commodity product manufacturing site footprint, comprising the Sites to which Fonterra delivers raw milk for processing into commodity products.</p>	<p>The initial Site Footprint is aligned to Fonterra’s actual commodity product manufacturing site footprint. The number and locations of sites included in the Site Footprint will be adjusted:</p> <ul style="list-style-type: none"> • When Fonterra adds a new commodity product manufacturing site, or • Closes a site or ceases production of commodity ingredients at a site. <p>Where an additional manufacturing site is included in the Site Footprint:</p> <ul style="list-style-type: none"> • A reasonable provision for the cost of land will be included in the Farmgate Milk Price Fixed Asset Base, established with regard to the cost or market value of the land. • Reasonable provisions for Ancillary Assets and dry stores assets will be included in the Farmgate Milk Price Fixed Asset Base, established by regard to the peak volume of milk expected to be processed, and the Reference Commodity Products assumed to be manufactured, at the site. <p>Where a manufacturing site is removed from the Site Footprint, a reasonable provision for the difference (if any) between the assumed market value of the land and assets allocated to the site, and the current value allocated to the land and assets in the Farmgate Milk Price Business Fixed Asset Base, will be included in the calculation of the Farmgate Milk Price in the year in which the site is removed.</p> <p>Inputs to the Farmgate Milk Price that are to be calculated by reference to the Site Footprint comprise Milk Collection Costs, Freight Costs, Site Overheads, Ancillary Assets and dry stores capital.</p>

87. Rule 35 is the primary rule within the Manual which gives effect to the national network of facilities for the collection and processing of milk described in s 150B(1)(a).

⁴⁰ Fonterra’s marked up 2024/2025 Manual, above n 12, page 54.

88. Rule 35 states that the site footprint, comprising the number of sites, their location, and their peak processing capacity, will be materially aligned to Fonterra's actual commodity product manufacturing site footprint.
89. The rule also prescribes the process for adding or removing sites, and the associated treatment of the market value of land and ancillary and dry store assets.

Does the rule apply the s 150B(1) assumption correctly?

90. The stated objective of Rule 35 provides for alignment in the number of sites, their location, and their peak processing capacity, between the Notional Processor and Fonterra. In our 2023/2024 Calculation Review, we noted that we consider that s 150B(1)(a), relating to the national network, should be interpreted to mean that there is a national network of facilities with the same processing capacity footprint as Fonterra. We consider that the objective of Rule 35 has applied this interpretation of s 150B(1)(a) appropriately.
91. The detailed text of the rule describes how the Notional Processor will maintain the same number of sites, and their location, as Fonterra. We consider this applies our interpretation of s 150B(1)(a) appropriately.

Does the rule, with the assumption as used, provide for consistency with s 150A?

92. Rule 35 directly gives effect to the national network assumption s 150B(1)(a). It results in the Notional Processor having the same site footprint and materially the same peak processing capacity at each site as Fonterra. Our draft conclusion is that we consider the way in which s 150B(1)(a) is used in the rule is consistent with the contestability dimension of s 150A.
93. While the number of sites, location, and peak processing capacity are features of Fonterra's actual manufacturing footprint, the assumed processing assets on each site are notional. Our draft conclusion is that we consider the way in which s 150B(1)(a) is used in the rule meets the efficiency dimension of s 150A.
94. Furthermore, we examined the way in which Notional Processor capacity is distributed from a Region to a site level to achieve material alignment with Fonterra site capacity in our 2023/2024 base milk price calculation review.⁴¹ There we were satisfied that the way in which it is applied in the calculation met the s 150A purpose.

⁴¹ Commerce Commission's 2023/2024 calculation review, above n 20, paragraphs 4.12 – 4.30.

Drafting correction

95. The glossary definition for site footprint refers to Rule 36 instead of Rule 35. We recommend that Fonterra correct this.

Chapter 5 Assessment of amendments to the 2024/2025 Manual

Purpose of this chapter

96. This chapter sets out our assessment of the extent to which amendments to the 2024/2025 Manual are consistent with the s 150A purpose. Details of the changes can be found in Fonterra's marked up Manual for the 2024/2025 season.⁴²

Amendments arising from the 2023/2024 Manual Review

97. Fonterra has made the following amendments to the 2024/2025 Manual:
- 97.1 'Operating at arm's length' added to the description of the Milk Price Group.
 - 97.2 Additional references to all information disclosure requirements contained within the DIRA in regard to information supplied to the Commission, and aligning the introductory wording with the wording in the DIRA.

98. Fonterra noted in its Reasons paper in support of the Manual that these are:⁴³

Minor changes to language introduced in 2023/24 regarding the relevant provisions of the Dairy Industry Restructuring (Fonterra Capital Restructuring) Amendment Act 2022, as proposed by the Commerce Commission in its Final Report on the Manual for the 2023/24 season.

Description of the Milk Price Group

99. In our 2023/2024 Manual review, we suggested that Fonterra could also reference the Milk Price Group operating at arm's length in line with s 150EA(3)(b), in its amendment to Part A, Section 5.3, Milk Price Group.⁴⁴

100. Fonterra has amended the text in the section to:⁴⁵

The day-to-day administration of the Manual will be carried out by an independent party **operating at arm's length from Fonterra** (the Milk Price Group) appointed by the Board in accordance with subsection 150EA(1) of DIRA, who will be responsible for calculating the Farmgate Milk Price and otherwise undertaking the functions and responsibilities assigned to the Milk Price Group under the Manual. In making this appointment, the Board must comply with the requirements of subsections 150EA(2)-(4) of DIRA. The Milk Price Group will report to the Panel in relation to all matters, including matters relating to, or arising from, the

⁴² Fonterra's marked up 2024/2025 Manual, above n 12.

⁴³ Fonterra's Reasons paper for the 2024/2025 Manual, above n 15, page 4.

⁴⁴ Commerce Commission's 2023/2024 Manual review, above n 18, paragraph 69.

⁴⁵ Fonterra's marked up 2024/2025 Manual, above n 12, page 28.

administration, operation and application of the Manual and the performance of the Milk Price Group.

101. The amendment is consistent with our recommendation. It does not affect efficiency or contestability in regard to s 150A, but we consider it reflects DIRA.

Information disclosure requirements

102. In our 2023/2024 Manual review, we suggested that Fonterra could also reference s 150QA to more fully reflect the disclosure requirements in its amendment to Part A, Section 6.1 (e).⁴⁶ We suggested that a reference to s 150JA could be added to Part A, Section 6.4 for completeness.⁴⁷ We also suggested that the text of the introduction be better aligned with the new disclosure regime.⁴⁸

103. Fonterra has amended the text in section 6.1 to:⁴⁹

(e) The non-sensitive information (as defined in subsections 150JA(2) and 150QA(2) of DIRA) made publicly accessible by Fonterra in accordance with subsections 150JA(1) and 150QA(1) of DIRA.

104. Fonterra has amended the text in section 6.4 to:⁵⁰

Except to the extent they contain information which Fonterra reasonably considers is commercially sensitive, subject to legal professional privilege, or personal information, Fonterra will make publicly available, ~~modified where necessary to protect the disclosure of information that would be prejudicial to Fonterra's legitimate commercial interests,~~ the Reports prepared for a Year by Fonterra under:

- a) Section 150L of the Dairy Industry Restructuring Act 2001 which, among other things, certifies to the Commerce Commission the extent to which Fonterra considers the Manual is consistent with the purpose of Subpart 5A of the Dairy Industry Restructuring Act 2001; and
- b) Section 150T of the Dairy Industry Restructuring Act 2001 which, among other things, certifies to the Commerce Commission the extent to which Fonterra considers the assumptions adopted and the inputs and process used by Fonterra in calculating the Farmgate Milk Price for the relevant Season are consistent with the purpose of Subpart 5A of the Dairy Industry Restructuring Act 2001.

Fonterra will also make publicly available all information requested by or provided to the Commerce Commission in relation to the Commission's review of the base milk price for a Year (**s 150QA**) and the Commission's review of this milk price manual (**s 150JA**), other than

⁴⁶ Commerce Commission's 2023/2024 Manual review, above n 18, paragraph 71.

⁴⁷ Ibid, paragraph 74.

⁴⁸ Ibid, paragraphs 75-76.

⁴⁹ Fonterra's marked up 2024/2025 Manual, above n 12, page 31.

⁵⁰ Ibid, page 33.

information which Fonterra reasonably considers is commercially sensitive, subject to legal professional privilege, or personal information.

105. The amendments are consistent with our recommendations. They do not affect efficiency or contestability in regard to s 150A, but we consider they reflect DIRA.

Other amendments to the 2024/2025 Manual

106. Fonterra has also made several other minor amendments.

107. In its Reasons paper, Fonterra explains the rationale for the changes.⁵¹

Minor amendments to better align the explanations in Part A of the Manual of the operative rules contained in Parts B and C to the rules.

108. The amendments do not affect efficiency or contestability in regard to s 150A. We consider they largely reflect DIRA. The next sections outline each change and our consideration of the change.

Part A, 1.1 Background

109. Fonterra has amended the background, which now reads:⁵²

Fonterra processes a large proportion of New Zealand's total Milk, no other processor purchases Milk New Zealand-wide, and most of Fonterra's competitors use the Farmgate Milk Price as the benchmark for their market offerings rather than establishing their own independent milk prices. This means that there is not enough depth in the market for Milk supplied in New Zealand to establish a New Zealand-wide 'market price' for Milk that is independent of the price paid by Fonterra. It ~~has~~ therefore ~~become~~ necessary for Fonterra to ~~establish~~ **utilise** an alternative mechanism to determine the aggregate price for Milk supplied to Fonterra in New Zealand. This is the Aggregate Farmgate Milk Price.

Under the Constitution, the Board sets the price for Milk, and for this purpose may from time to time adopt a Farmgate Milk Price policy. This policy may ~~from time to time~~ address the circumstances where the Board could pay more for Milk than the amount calculated under the Manual. If the requirement to do so arises, however, this would represent grounds to review the operational details of the Manual against the Principles.

110. This amendment does not affect efficiency or contestability in regard to s 150A. It is a minor wording adjustment, and we consider it consistent with DIRA.

Part A, 3. Key Assumptions

111. Fonterra has amended the text of the Key Assumptions to read:⁵³

⁵¹ Fonterra's Reasons paper for the 2024/2025 Manual, above n 15, page 5.

⁵² Fonterra's marked up 2024/2025 Manual, above n 12, page 5.

⁵³ Ibid, page 13.

It is not feasible to include in the Manual an exhaustive set of tests for determining whether any particular market price which might emerge in New Zealand is an appropriate substitute for the Farmgate Milk Price. However, the primary test in considering whether it is appropriate to substitute a particular market-derived milk price for the Farmgate Milk Price should be whether the price reasonably reflects the amounts Fonterra's efficient near-term competitors would be willing to pay for Milk which will be converted into **Commodity Products** for export.

112. This amendment does not affect efficiency or contestability in regard to s 150A. The amendment makes it clear that competitors are those producing commodities, not any product derived from milk. We consider it consistent with DIRA.

Part A, 4.2 Farmgate Milk Price Commodity Business

113. Fonterra has amended the text describing the Farmgate Milk Price Commodity Business to read:⁵⁴

The first element of the Farmgate Milk Price Methodology is the definition of the Farmgate Milk Price Commodity Business. The details of this definition are set out in Section 1 of Part B and Section 1.1 of Part C of the Manual. The definition is based on the following design rules:

- The Farmgate Milk Price Commodity Business should reflect the characteristics and Product Mix of Fonterra's efficient near-term competitors in New Zealand **for milk for use in manufacturing Commodity Products**. Other things being equal, this should result in a Farmgate Milk Price which over time is on average equal to the price which Fonterra's efficient near-term New Zealand-based competitors for Milk of a comparable scale would pay in a competitive market (on the basis of the assumptions set out in Section 3 under the heading of 'Nature and activities of competitors').
- The boundaries of the Farmgate Milk Price Commodity Business should facilitate benchmarking of Fonterra's performance to external comparators. The international market is deepest and most transparent for milk powders and cream products, implying that it is more straightforward to benchmark the prices achieved on the sale of powder stream product (i.e., WMP and SMP, and their by-products Butter, AMF and BMP) than for other Product Streams (such as cheese and its by-products, or casein and its by-products). In addition, externally verifiable Benchmark Selling Prices are generally available on a FAS basis for these products, which means it is viable to carve out a commodity manufacturing business which ~~delivers~~ **sells its** product to its customers for **shipment from** ~~delivery to~~ the New Zealand wharf.
- The revenues of the Farmgate Milk Price Commodity Business should be based on objective market prices, and the costs of the business should reflect the costs of selling for ~~delivery~~ **shipment** to customers ~~from at~~ the New Zealand wharf.

On that basis, and having regard to Section 3 (under the headings 'Nature and activities of competitors' and 'Capacity of competitors' plants'):

⁵⁴ Fonterra's marked up 2024/2025 Manual, above n 12, page 18.

- The Farmgate Milk Price Commodity Business will convert all Milk collected by Fonterra into Reference Commodity Products from four 'base' milk powder streams, comprising four combinations of WMP or SMP, butter or AMF, and BMP. Going forward, the Reference Basket of the Farmgate Milk Price Commodity Business may be adjusted if Fonterra faces a material and sustainable level of likely future competition for milk in New Zealand from producers of commodity products other than the then current Reference Commodity Products, and it is expected that inclusion in the Reference Basket of one or more of those other commodity products will result in a higher average Milk Price over time.
- The Farmgate Milk Price Commodity Business will sell its entire product on arm's length terms for **shipment from delivery to** the New Zealand wharf ~~as (i.e., on free alongside ship, or FAS, terms).~~

114. Fonterra states in its Reasons paper that the amendments relating to the shipping terms are:⁵⁵

A contextual amendment to better align the explanation in this section with the detailed rules in part B, which provide for the inclusion in the Milk Price revenue calculation of price-informing sales on a range of industry-standard terms, including cost-insurance-freight (CIF) as well as FAS [Free Alongside Ship] terms.

115. The first amendment in this section is consistent with that made in the Key Assumptions section. As noted in paragraph 112 the amendment makes it clear that competitors are those producing commodities, not any product derived from milk.
116. The remaining amendments in this section align the terms of sale among sections of the Manual, covering more terms of sale than only FAS.
117. These amendments do not affect efficiency or contestability in regard to s 150A. We consider them consistent with DIRA.

Part A, 4.3 Farmgate Milk Price Revenue

118. Fonterra has amended the text describing Farmgate Milk Price Revenue to read:⁵⁶

The next element is the determination of the Farmgate Milk Price Revenue. Key features of the determination are:

- The revenue of the Farmgate Milk Price Commodity Business should be the maximum amount available to Fonterra to pay for Milk consistent with the Principles, before the deduction of relevant costs, under the assumption that all Milk collected by Fonterra in New Zealand is converted into Reference Commodity Products for sale to external customers ~~at from~~ the New Zealand wharf (refer Section 2.3).

⁵⁵ Fonterra's Reasons paper for the 2024/2025 Manual, above n 15, page 4.

⁵⁶ Fonterra's marked up 2024/2025 Manual, above n 12, pages 19- 20.

Selling Prices: When the Benchmark Selling Prices are applied to the sales plan of the Farmgate Milk Price Commodity Business, Farmgate Milk Price Revenue (in USD) will be determined. Benchmark Selling Prices should:

- Reflect actual prices realised by Fonterra on the sale of Reference Commodity Products across a range of contract terms consistent with normal market conventions.
- Result in Fonterra facing strong incentives to optimise its Product Mix.
- Result in Fonterra facing strong incentives to maximise its Benchmark Selling Prices.

Between F2011 and F2016, Benchmark Selling Prices for WMP were established solely by reference to prices achieved through GlobalDairyTrade, and this approach was also applied for SMP and AMF between F2012 and F2016. GlobalDairyTrade is owned by Fonterra, **the European Energy Exchange (EEX) and New Zealand Exchange (NZX) in equal one-third shareholdings, and but** is operationally and physically separate from Fonterra. GDT has a clear governance structure. An independent Oversight Board oversees GDT's rules and structures so that they are monitored and developed in a neutral and transparent manner.

119. Fonterra states in its Reasons paper that the amendment relating to Global Dairy Trade is:⁵⁷

A tidy up amendment to reflect ownership of GDT.

120. There is one amendment in this section which is consistent with other amendments describing the terms of sale (a change from 'at the New Zealand wharf' to 'from the New Zealand wharf'). As noted in paragraphs 116 and 117 these amendments do not affect efficiency or contestability in regard to s 150A and we consider them consistent with DIRA.

121. The amendment regarding the ownership structure of GDT is appropriate to reflect in the Manual as this change in ownership occurred in 2022. It does not affect efficiency or contestability in regard to s 150A, and we consider it consistent with DIRA.

Part A, 4.4 Farmgate Milk Price Cash Costs

122. Fonterra has amended the text describing the Farmgate Milk Price Cash Costs to read:⁵⁸

- The other overhead costs of the Farmgate Milk Price Commodity Business, including site overheads, research and development costs, general overheads and corporate costs, will be established in every Review Period, based on **an assessment of the budgeted costs of Fonterra in the Review Year, adjusted for difference between**

⁵⁷ Fonterra's Reasons paper for the 2024/2025 Manual, above n 15, page 4.

⁵⁸ Fonterra's marked up 2024/2025 Manual, above n 12, page 22.

~~budgeted costs and~~ the costs Fonterra could **reasonably** be expected to incur if it only manufactured the Reference Commodity Products **and undertook the activities performed by the Farmgate Milk Price Commodity Business**. In intervening years, these costs will be increased by the annual movement in an appropriate index, such as the Producers Price Index or the Labour Cost Index, **to the extent they can reasonably be anticipated to be relatively constant across time. and will be checked for continued reasonableness by the Milk Price Group against movements in Fonterra's actual and budgeted costs, having particular regard to any significant change in Fonterra's overhead costs (such as any change resulting from a restructuring).**

- The Farmgate Milk Price Commodity Business will also be treated as incurring certain costs of a non-recurring nature which are not otherwise provided for under a specific Rule, such as costs due to actual milk supply in a Region exceeding the level of processing capacity provided for in that region in the Farmgate Milk Price Fixed Asset Base, or costs arising from a natural disaster.
- **If there is reason to believe that the value of an input determined in a Review Year does not accurately reflect the actual value of that input that Fonterra would face if it manufactured the Reference Commodity Products using currently appropriate technology, and where the difference is material, the Milk Price Group will undertake a Within Period Review to determine an amended value.**

123. Fonterra states in its Reasons paper that the first set of amendments in this section is:⁵⁹

A contextual amendment to better align the explanation in this section with amendments in recent years to the relevant operative rule, Rule 18 in Part B.

124. Fonterra states in its Reasons paper that the second set of amendments (the third bullet point) in this section is:⁶⁰

A contextual amendment to align the explanation in this section with the operative rule, Rule 23 in Part B, which was amended in 2021.

125. These amendments align the descriptive text with the related rules, as Fonterra has explained. These amendments do not affect efficiency or contestability in regard to 150A. We consider them consistent with DIRA.

Part A, 4.5 Farmgate Milk Price Capital Costs

126. Fonterra has removed the below text in the description of the Farmgate Milk Price Capital Costs:⁶¹

⁵⁹ Fonterra's Reasons paper for the 2024/2025 Manual, above n 15, page 4.

⁶⁰ Ibid, page 5.

⁶¹ Fonterra's marked up 2024/2025 Manual, above n 12, page 25.

For each Financial Year subsequent to F2012

127. This is a minor wording adjustment and does not affect efficiency or contestability in regard to s 150A. We consider it consistent with DIRA.
128. However, there is similar wording on page 24 of the Manual which could also be removed for consistency. The wording referred to reads:

For each Financial Year subsequent to F2008

Part B, Rule 4 Sale for shipment from the NZ wharf

129. Fonterra has changed the title of this rule from ‘Sale for delivery to the NZ wharf’, to ‘Sale for shipment from the NZ wharf’.
130. Fonterra has also amended the text of this rule, which now reads:⁶²

The Farmgate Milk Price Commodity Business will sell all its product on arm’s length terms for ~~delivery shipment from to~~ the New Zealand wharf ~~on a FAS equivalent basis~~.

131. These amendments are consistent with other amendments describing the terms of sale. As noted in paragraphs 116,117 and 120, these amendments do not affect efficiency or contestability in regard to s 150A and we consider them consistent with DIRA.

Glossary

132. Fonterra has adjusted the review years in the definition of Review Year. The text now reads:⁶³

Review Year means the first Financial Year in a Review Period, and for:

The review by the MPG of the matters described in paragraph (d) of section 5.4 of Part A of the Manual, means the 2019/20, ~~and~~ 2023/24 ~~and~~ **2027/28** Seasons.

Rule 13 (Fixed manufacturing costs), Rule 17 (Sales Costs) Rule 18 (Site overheads, general overhead costs & R&D costs) and Rule 20 (Certain supply chain costs) means the ~~2015/16,~~ 2019/20, ~~and~~2023/24 ~~and~~ **2027/28** Seasons, and

133. These amendments simply add an additional review year to the schedule where relevant, along with removing the reference to an earlier review year for Rules 13, 17, 18 and 20. They do not affect efficiency or contestability in regard to s 150A and we consider them consistent with DIRA.

⁶² Fonterra’s marked up 2024/2025 Manual, above n 12, page 36.

⁶³ Ibid, page 92.

Attachment A Glossary

Term/Abbreviation	Definition
DIRA	Dairy Industry Restructuring Act 2001. Where legislative provisions are referred to in this document, they relate to provisions of DIRA.
Approach paper	Commerce Commission's overview of the approach we take in our reviews of Fonterra's Manual and base milk price calculation.
Base milk price	Base milk price, in relation to a season, means the price per kilogram of milk solids (kgMS) that is set by Fonterra for that season.
Calculation review	Commerce Commission's review of Fonterra's base milk price calculation for the prior season.
Manual review	Commerce Commission's review of Fonterra's Milk Price Manual for the current season.
AMF	Anhydrous milk fat
BMP	Butter milk powder
Dairy season	1 June to 31 May annually
EEX	European Energy Exchange
Farmgate Milk Price Fixed Asset Base	Defined in Fonterra's milk price Manual as the Standard Plants and other Reference Assets which are in aggregate required to produce the RCPs.
Farmgate Milk Price Production Plan	The production plan described under Rule 6 of the Manual, outlined in chapter 4 of this report.
GDT	Global Dairy Trade, online auction platform used to sell dairy commodities
IDP	The Independent Dairy Processors (IDPs); Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products.
MPG	Milk Price Group
Milk Price Manual or the Manual	Fonterra's Milk Price Manual
MPP	Milk Price Panel

Term/Abbreviation	Definition
Notional Processor	The notional commodity business that is used to calculate the base milk price (in its Reasons paper Fonterra uses the term notional producer).
NZX	New Zealand Exchange
Reasons paper	Fonterra's Reasons paper which is provided alongside the Manual for each dairy season (this is also provided when Fonterra discloses its base milk price calculation at the end of each dairy season).
Reference Asset	Defined in Fonterra's milk price Manual as a Standard Plant or any other capital asset that is required by the Notional Processor, given its requirement to collect milk, produce and store RCPs, and deliver those products to a New Zealand wharf.
Region	Defined in Fonterra's milk price Manual as the North Island or the South Island.
RCP	Reference Commodity Product. These products, manufactured and sold by the Notional Processor, are in the Reference Basket. They currently include whole milk powder, skim milk powder, buttermilk powder, butter and anhydrous milk fat.
Reference Basket	The RCPs used to calculate the base milk price.
SMP	Skim milk powder
Standard Plant	Defined in Fonterra's milk price Manual as a plant for the manufacture of a RCP that is a Standard Product Offering, the component parts and costs of which have been established under Rule 25.
WMP	Whole milk powder