

15 November 2024

**IDP Joint submission on the Commerce Commission draft report:
“Review of Fonterra’s 2024/25 Milk Price Manual” (issued 15.10.24)**

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Subject: Milk Price Manual 2024/25

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(Independent Dairy Processors – IDPs)

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Abbreviations and other references

AMF – Anhydrous Milk Fat

Approaches Paper – Commerce Commission reference paper: “Our approach to reviewing Fonterra’s milk price manual and base milk price calculation” (issued 1 August 2023)

BMP - Base Milk Price

DIRA - Dairy Industry Restructuring Act 2001

Draft Report, 24/25 Manual – Commerce Commission draft report issued 15 October: “Review of Fonterra’s 2024/25 Milk Price Manual”, the subject of this submission

Final Report, 23/24 BMP Calculations – Commerce Commission final report issued 16 September 2024: “Review of Fonterra’s 2023/24 base milk price calculation”

Fonterra Reasons, 23/24 BMP Calculations – ‘Reasons’ Paper in Support of Fonterra’s Base Milk Price for the 2023/24 Season, issued 17 June 2024

IDPs – Miraka, Open Country Dairy, Synlait Milk, and Westland Milk Products jointly referred to in this submission as the Independent Dairy Processors (IDPs)

IDP Submission, 23/24 BMP Calculations - IDP Joint Submission (15 August 2024) on the Commerce Commission draft report: “Review of Fonterra’s 2023/24 base milk price calculation”

IPC - Incremental Product Cost (an adjustment which has a purpose of restating the selling price of a product to an equivalence with its relevant SSP)

Manual – Fonterra’s Farmgate Milk Price Manual (2024/25 Mark-up Version)

NP - Notional Processor

RCP - Reference Commodity Product; the RCPs comprise a range of products

SMP - Skimmilk powder

SSP - Standard Specification Product - the 5 products the NP is assumed to manufacture, and which are a proxy for the RCPs in the BMP calculations model

WMP – wholemilk powder

Introduction and Overview

1. All statutory references in this submission are to the DIRA; all references to Assumptions in this submission are to the assumptions in s 150B (1) (a) to (d).
2. All references to Rules in this submission are to Rules in the Manual.
3. This submission refers to “commercial feasibility” in the place of the s 150A requirement for “practical feasibility”. The IDPs consider “commercial feasibility” more meaningfully captures the intent of the s 150A test of contestability (the practical feasibility test).
4. The Commission has used this latest review (of the 2024/25 Manual) to complete a review of the way the s 150B Assumptions are used. This follows a 2022 amendment (enacting s 150B (2)) which now requires the Assumptions be used in a manner which meets the purposes of s 150A (incentivising Fonterra efficiency while remaining contestable/commercially feasible). Previously, s 150B had the effect that any use of the Assumptions was deemed to meet the s 150A purposes (they were “safe harbours”) and the Commission was not able to consider compliance with the s 150A purposes.
5. The latest review addresses Assumptions (a), (b) and (d): network of facilities, plant capacity, and milk volume/production yields. The Commission has reviewed the way these assumptions are used in the Manual and whether that use is both consistent with the relevant Assumption and meets the purposes of s 150A.
6. The IDPs consider the purpose of the three Assumptions under review was to remove any doubt that the BMP can include the benefits of Fonterra scale advantages.¹ It was perhaps considered necessary to clarify this because Fonterra dominance in the raw milk market means its scale advantages are not available to any of Fonterra’s actual or potential processing competitors.
7. The IDPs have always submitted the Assumptions are however used in a manner which goes beyond Fonterra scale advantages and has the effect of artificially enlarging those advantages and therefore the BMP itself. The BMP scale advantages, as reflected in the BMP yields and costs, are not only unavailable to Fonterra competitors, they are also unavailable to Fonterra itself.
8. Noting its dominance in the NZ dairy processing market, Fonterra itself is the benchmark for commercially feasible maximum scale advantages (yields and costs) achievable in New Zealand. The IDPs consider the BMP cannot therefore include scale advantages (as represented by yields and production costs) that exceed those which Fonterra can reasonably achieve across its commodity business. This includes that the BMP should not be able to cherry pick and extrapolate specific Fonterra scale advantages for the purpose of determining

¹ The remaining Assumption (c) - foreign currency conversion rate - was more likely permitted to simplify the BMP calculations. The Commission has previously reviewed this assumption. It considers the NP conversion rate calculation procedure is consistent with Assumption (c) and meets the purposes of s 150A. The IDPs do not agree, but this is not a priority issue for the IDPs at this time.

NP wide assumed performance, if those advantages are not representative of the Fonterra overall commodity business.

9. Together with its previous reviews, the Commission has now concluded that the Manual and all BMP calculations that use the Assumptions are consistent with the S 150A purposes. The Commission has thus concluded no changes are required to the BMP following the s 150B (2) amendment and that amendment has no effect in practice.
10. This submission lays out why the IDPs do not agree with this conclusion. The IDPs consider the Commission continues to give weight to the Assumptions themselves and approaches them as if they retain a “safe harbour” character. The Commission for example has not directly addressed the consequences of the NP itself not being commercially feasible, giving undue weight to Assumption (d). The Commission also considers certain workarounds and simplifications are justified because they minimise complexity for using the Assumptions. Priority thus appears to be given to enabling the (optional) assumptions to be used, even though the workarounds and simplification have the effect of artificially enlarging scale advantages of the NP.
11. **The IDPs request the Commission reconsider the approach it has taken to the review of the Assumptions and reconsider its conclusions.**
12. **The IDPs submit that the use of the s 150B Assumptions cannot be commercially feasible and meet the purposes of s 150A if they provide for scale advantages that exceed those demonstrated across Fonterra’s commodity business (as the maximum possible benchmark for scale processing efficiency in New Zealand).**
13. **The IDPs recommend the Commission seek an independent review of the costs and yields reasonably achieved across the Fonterra commodity business and that these should form the basis of the BMP calculations.**

Fundamental disagreement – s 150A and s 150B

14. S 150A sets out two overarching purposes for the BMP:
 - a. to incentivise Fonterra to operate efficiently; and
 - b. to provide contestability in the NZ raw milk market
15. The IDPs consider that the Commission’s reviews do not properly address either of the s 150A purposes, and that the reviews have the effect of validating processes which artificially enlarge the BMP in a manner which is not consistent with those purposes.
16. In the case of incentivising Fonterra efficiency, the Commission primarily focuses on incentivising Fonterra cost efficiencies² (including for example production performance and yields). In practice, the Commission tends to consider the BMP will incentivise Fonterra to operate efficiently where the underlying assumptions are independent of Fonterra and where their achievement would require improvements in Fonterra performance.

² Approaches Paper, para 4.3

17. The assumed incentivisation in this case comes from the commercial objective of improving efficiency to sustain or increase profits. This results in BMP costs which are lower and production yields which are higher than Fonterra can be expected to achieve across its commodity business. This will tend to artificially enlarge the BMP depending on the enthusiasm with which difficult targets are set. Fonterra willingly participates in setting difficult targets in the BMP assumptions (e.g. NP yields). The IDPs interpret this to mean Fonterra is comfortable with a procedure that results in a relatively higher BMP. This is unsurprising given it is consistent with Fonterra's Constitution and with its commercial objectives for securing milk supply (and presumably discouraging competitors from entering the market or growing within it). This is not a criticism of Fonterra. It is though a criticism of the approach to reviewing the BMP.
18. The IDPs have always maintained that the Commission's presumption of incentivising efficiency relies on a false understanding of Fonterra business priorities and drivers. It assumes that Fonterra has the same profit drivers as a typical corporate, prioritising returns to invested capital. Fonterra however is also a co-operative. Fonterra is undoubtedly motivated to maximise total returns to its co-operative members. Those total returns are delivered through the combined milk price and profits/dividends. Total returns are unaffected by the calculation processes for the BMP. Fonterra incentives to prioritise milk price compared to profits are unrelated to efficiency drivers. Fonterra prioritises the milk price because that meets its competitive objectives to maximise milk supply, and because members place greater emphasis on the milk price as a measure of Fonterra performance. This latter includes because the milk price is a key driver for determining farm capital values, while the Fonterra share price – and profit expectations - is much less significant (and of declining significance with the recent changes in the Fonterra share standard). Maximising the milk price is a requirement of the Fonterra Constitution³. Fonterra is able to subsidise the milk price from returns achieved in value adding segments. Apart from minimum profit objectives perceived necessary to retain credibility in capital markets, there is no obvious disincentive for Fonterra to maximise this subsidy where it is able to do so through the BMP calculations.
19. Noting that Fonterra places a high priority on maximising the milk price, any artificial enlargement of performance of that objective is more likely to disincentivise Fonterra efficiency. It becomes easier for Fonterra to represent that it is performing through delivery of a high milk price. This is especially because there is no comparable reporting of Fonterra actual commodity performance. The IDPs consider the BMP itself does not (and cannot) incentivise Fonterra efficiency and the Commission's approach to the s 150A efficiency requirement is misplaced.
20. **The IDPs consider the efficiency purpose would be better served if the BMP processes were required to show they do NOT disincentivise Fonterra efficiency or do NOT stand in the way of incentivising efficiency. The BMP would accordingly not be permitted to artificially enlarge the BMP by comparison to Fonterra commodity performance.**
21. The dual purpose of s 150A also requires that the BMP provide contestability in the raw milk market. In principle this should limit the extent to which the BMP can be artificially enlarged to

³ Relevant parts of the Fonterra Constitution are included in the Manual (Part A section 2)

meet Fonterra objectives. S 150A clarifies that contestability requires the BMP to be practically feasible for an efficient processor.

22. The IDPs consider “commercial feasibility” more meaningfully captures the intent of the s 150A contestability test. Practical feasibility carries a sense of mere “technical feasibility”. “Commercial feasibility” on the other hand makes it clear that the BMP must also be feasible for an efficient commercial operation. In its Approaches Paper, the Commission similarly considers that
*“practical feasibility includes commercial feasibility in the sense that it must be possible for an efficient processor operating in New Zealand to replicate or achieve the component [of the BMP] being assessed”*⁴⁵
23. The IDPs have always maintained the BMP assumptions are not in fact practically or commercially feasible because the s 150B “safe harbour” assumptions shielded key BMP calculations from s 150A. The contestability requirement in s 150A had accordingly never been an effective counterweight to Fonterra incentives to artificially enlarge the BMP. The IDPs had understood the 2022 amendment to s 150B removed that shield. New s 150B (2) now required that the way the s 150B assumptions are used must meet the purposes of s 150A. This now means all BMP calculations must meet the contestability test – i.e. they must be commercially feasible.
24. With the 2024/25 review of the Manual the Commission is now completing its assessment of the new requirement that the s 150B assumptions be used in a manner that is consistent with the purposes of s 150A⁶. In summary, the Commission has concluded the s 150B (1) assumptions in their entirety (both as addressed in the Manual and as reflected in the BMP calculation) remain compliant with s 150A. The Commission thus considers the s 150B (2) amendment does not require any changes of substance to the way Fonterra calculates the BMP and that the amendment is effectless.
25. The IDPs fundamentally disagree with his conclusion.
26. In reviewing the use of the s 150B assumptions, the Commission explains that it has focussed on the way in which Rules in the Manual incorporate the Assumptions. The Commission first assesses consistency of the Rules with the Assumptions⁷, and then considers:
*“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)”*⁸.
By way of footnote, the Commission goes on to say:

⁴ Approaches Paper, para 51

⁵ The Commission further clarifies in Approaches Paper para 55 that an “efficient processor” includes existing and “potential entrants” that “may enter the market for the purchase of milk from farmers”

⁶ The review commenced with the 22/23 BMP calculations review in which the Commission considered the s 150B (1) (c) – Notional Processor conversion rate assumption.

⁷ Draft Report 24/25 Manual, para 43.2

⁸ Ibid, para 43.3

“in practice, once we have concluded that the rule has applied an assumption correctly, we move directly to the question of whether the rule, with the assumption as used, is consistent with s 150A.”⁹ [underlining not in the original]

27. The IDPs consider that an assessment of compliance of the Manual with s 150A purposes must be divorced from the s 150B assumptions themselves. This seems to be the approach the Commission follows – i.e. that “an examination of the s 150B assumption in itself” is not required, because it is not relevant. Put another way, the assumption cannot itself sanction the use of the assumption because that use is now only permitted if it meets the purposes of s 150A. Less clear is what the Commission means by “with the assumption as used” in the noted footnote. This suggests the assumptions themselves continue to carry weight in the assessment of commercial feasibility. The Commission is requested to clarify what is meant by “with the assumption as used”.
28. The IDPs consider that the Assumptions carry no special status other than to confirm they are permitted where that might have been in doubt (for example to confirm the BMP can assume scale advantages only available to Fonterra itself in the NZ market). To the extent Fonterra chooses to use these assumptions, they can now only be used in a way that is consistent with the purposes of s 150A. If Fonterra is unable to use the assumption in that way, it is under no obligation to use the assumption and would need to develop an alternative (and properly commercially feasible) approach.
29. The Commission on the other hand appears to continue to grant status to the Assumptions themselves. For example, where Fonterra includes workarounds and simplifications these are justified on the grounds these are needed to enable s 150B assumptions to be used. The Commission appears then to weigh the benefits of those simplification and workarounds over an objective assessment of commercial feasibility.
30. More fundamentally, Assumption (d) is used to construct the NP business model on a basis which is not commercially feasible. Together with the workarounds and simplifications this has the effect of attributing scale advantages to the NP that are not available to any feasible processor including Fonterra itself. The Commission does not address this overarching problem of the commercially infeasible NP in its assessment of the Manual. It instead takes a piecemeal approach to compliance of individual Rules in the Manual without considering them in relation to the infeasible business model itself.
31. The IDPs consider the s 150B (2) amendment requires a fundamental change in approach to the BMP calculations. The BMP must be “practically feasible for an efficient processor”. Fonterra remains the benchmark for the efficient processor of scale in New Zealand. It is unreasonable to consider a more efficient processor of scale can emerge given Fonterra dominance in the NZ raw milk market. In the absence of compelling evidence, the Assumptions should not be able to be used in a manner that results in NP scale advantages that exceed the advantages Fonterra can demonstrably achieve across its commodity business.

⁹ Ibid, footnote 25

32. **The way the s 150B assumptions are used, including the NP business model itself, are not commercially feasible. The IDPs therefore submit the NP costs and yields should reflect Fonterra performance across its actual commodity business. This would be commercially feasible (at least for the dominant processor in the market) while ensuring consistency across the calculations of NP selling prices, costs and yields calculations. The Commission may consider that approach does not align to its interpretation of the s 150A (1) efficiency purpose. The IDPs have responded to that concern as summarised in paragraph 20 above.**
33. **The IDPs consider the Commission review of the s 150B (2) amendment falls short of what is required, and request the Commission revisit the approach it has taken and the conclusions of its review.**
34. **The IDPs also propose that the Commission seek an independent assessment of the costs and yields that are feasibly achieved in Fonterra’s commodity business. This would provide an appropriate basis for setting the Rules and the BMP cost and yield assumptions.**

Commission Review of s 150(B) (1) (a), (b) and (d)

35. The Commission reviews have focussed on the Rules in the Manual which rely on the s 150B assumptions¹⁰. Assumption (c) and associated Rules were considered in the 2022/23 calculations review and the 2023/24 Manual review. The remaining Assumptions (a), (b) and (d) were considered in the 2023/24 calculations review and in this latest 2024/25 Manual review. The assumptions concern the NP network of facilities, plant capacity, and milk volumes/production yields respectively.

S 150B (1) (d) - Assumption (d)

“That all milk collected by [Fonterra] is processed into commodities at yields that are practically feasible.”

36. The IDPs consider the purpose of Assumption (d) was to make explicit that the BMP can include scale advantages available to Fonterra. The need to make this explicit could have been because those scale advantages are not available to any other processor in New Zealand and reflect Fonterra’s dominance of the raw milk market. Implicitly Fonterra itself provides the appropriate benchmark for scale advantages relevant to an assessment of a contestable milk price. With the clarification now provided by s 150B (2) it is now the case that the NP scale advantages must be commercially feasible. In the absence of compelling evidence, scale advantages exceeding those Fonterra (as the dominant processor) actually achieves across its commodity business could not reasonably be considered commercially feasible.
37. The Commission identified the following rules rely to a varying extent on Assumption (d):
 - Rule 1 - volume of milk processed
 - Rule 6 – production plan
 - Rule 7 – product yields

¹⁰ Draft Report, 24/25 Manual, pg 12 Table 1

- Rule 33 – surplus capacity
38. Rules 7 (product yields) and 33 (surplus capacity) depend on a commercially feasible synthesis of Assumption (a) (b) and (d). These Rules are accordingly considered later in this submission (paragraphs 105 to 114).

Rule 1 – Volume of milk processed

39. Rule 1 is largely a restatement of the “milk volume” limb of assumption (d). It sets a “foundation” for attributing scale advantages to the NP. It does not address how those scale advantages are determined and accordingly establishes no “uses” of the assumption which would be subject to s 150B (2).

Rule 6 - Production Plan

40. Rule 6 sets the scene for the twists and turns in the use of assumptions (a) and (b), leveraged by assumption (d), to attribute scale advantages to the NP.
41. Rule 6 provides that the Rule 1 volume of milk (Fonterra total milk) is processed into the 5 RCPs. This is consistent with Assumption (d). It is also an interpretation of s 150C (all NP milk must be processed into commodities). The resulting Production Plan itself is though not commercially feasible because the volume of RCPs substantially exceeds Fonterra actual commodity production and would undermine the NP selling prices. This is admittedly a conundrum, but the implications of the commercially infeasible Production Plan cannot simply be ignored. The Commission however has not addressed this issue.
42. Putting aside the overall infeasible production volumes, the Production Plan also does not reflect the elements of a commercially feasible plan. Such plan would be based (at least) on daily milk volumes processed at each factory site. That plan would provide for milk processed, site processing facilities, day to day site status (e.g. provision for maintenance schedules and breakdowns), site production objectives, and management of production schedules to meet customer demand.
43. The Manual does not address the level of detail required to be maintained in the NP Production Plan. The Commission however explains the Plan is calculated at a monthly level for each site. That site level plan though seems merely incidental to calculating diversion costs for sub-components of milk (cream and buttermilk)¹¹. It is a proxy for these other calculations and does not serve as a commercially feasible plan. It is for example not required to provide for sub-optimal but normal processing that reflects competing priorities to meet customer requirements (of the actual range of products assumed sold by the NP), variability of daily milk deliveries, or unscheduled downtime.
44. Key elements in the Manual that determine the NP Production Plan are understood to be that:
- The NP factory sites shadow Fonterra actual sites to the extent that they process the same daily milk volumes and produce the same range of RCPs
 - An aggregate NP production plan is established by

¹¹ Final Report, 23/24 BMP Calculations, para 4.17 and 4.20

- allocating total NP milk between WMP and SMP in the same relative proportion as that (smaller) part of Fonterra actual milk which is allocated between commodity WMP and SMP; and
 - allocating cream between Butter and AMF in the same proportion that Fonterra actually allocates its cream.
45. The ratios of NP production are aligned to Fonterra and the ratios themselves are commercially feasible (although the resulting overall production volume is not). Alignment of the NP Production Plan to Fonterra commodity production ratios provides a line of sight to Fonterra’s commodity sales mix. It is then assumed the NP selling prices are the same as relevant RCP selling prices of Fonterra itself. Those prices are not feasible for the assumed NP scale of operations. Fonterra is however required to base NP revenues on its own actual selling prices (s 150C). In this way, Assumption (d) permits the NP to produce and sell a commercially infeasible volume of commodities while requiring selling prices to be based on Fonterra’s lower (but commercially feasible) commodity sales.
46. By contrast, DIRA no longer permits commercially infeasible scale advantages to be derived from that same Assumption (d) processing volume. Thus these two contradictory but matching elements should now be in place if Assumption (d) is used:
- selling prices are commercially feasible but higher than would be feasible with Assumption (d) volumes
 - scale advantages are (required to be) commercially feasible but lower than might be technically feasible with Assumption (d) volumes
47. Assumption (d) refers to the NP processing milk into “commodities”. Commodities are only loosely defined in the DIRA. Rule 6 however refers to these “commodities” as the “Reference Commodity Products” or RCPs. The Commission further clarifies that
- “RCPs are further refined in the Manual to an individual specification for each of the five commodities [the RCPs] which are currently assumed to make up the reference basket”¹²*
48. While the Commission confirms the NP Production Plan is based on the 5 SSPs, the Commission concludes Rule 6 meets the purposes of s 150A without directly addressing the feasibility of this use of Assumption (d). The conversion of the NP milk into the RCPs is itself not commercially feasible and this is magnified by the assumption that the NP milk is processed into just one product within each RCP group of products. It also simplifies the NP Production Plan by comparison with a commercially feasible and more complex Plan that would be required to match the wider range of product the NP is assumed to sell. The simplified NP Production Plan is then used to establish increased capacity optimisation, higher yields and lower costs than would be the case for a feasible plan for the NP full product range, or is reasonable to expect for Fonterra overall commodity business.

¹² Draft report, 24/25 Manual, para 48. Note that the referred “individual specifications” are defined in the Manual as the Standard Specification Products. Factory costs, yields, and capital investment are established by reference to these SSPs, even though the NP revenue is based on a much wider product mix.

49. When previously raising objections that the Production Plan does not reflect the products sold by the NP, the Commission has responded that this is corrected by the IPC procedure. The IDPs consider there is insufficient information to show that the IPCs can adequately provide for the complex adjustments required.
50. In summary, the Production Plan cannot be considered commercially feasible because:
- the total volume of RCPs in the Plan is not commercially feasible
 - the product range is simplified and does not deliver the range of products sold by the NP
 - it does not provide for the normal sub-optimisation of balancing production efficiency with a commercial sales plan, customer service objectives, along with normal daily production disruptions.
51. The process by which the NP capacity is allocated to sites is addressed below (commencing at paragraph 76). The IDPs submit this process is also not commercially feasible and is further reason to conclude the NP site Production Plan is not commercially feasible.
52. The Commission however considers Rule 6 meets the purposes of s 150A and is commercially feasible. The IDPs believe this is because the Commission has not addressed the fundamental inconsistency between the scale of operations permitted by Assumption (d) and the use of that assumption to permit commercially infeasible benefits of scale. In this respect, the Commission seems to consider Assumption (d) remains a safe harbour and has not subjected its “use” to s 150B (2).
53. The IDPs recognise this poses a challenge to the interpretation of Assumption (d) but note that Assumption (d) is not mandatory. Fonterra has chosen to use it and the Commission cannot ignore the consequences of its use in its assessment of commercial feasibility.
54. **The IDPs submit that the NP Production Plan is not commercially feasible for the reasons outlined above. The IDPs submit the Commission has not considered the consequences of the commercially infeasible NP scale of operations, inferring Assumption (d) remains a safe harbour.**

S.150B (1) (a) and (b) - Assumption (a) and Assumption (b)

Assumption (a): “that new co-op operates a national network of facilities for the collection of milk”

Assumption (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”

55. The IDPs consider the purpose of these assumptions was to make explicit that the BMP can include the commercial benefits arising from Fonterra’s own geographic footprint and the scale of its own processing facilities.
56. The Commission considers the following rules rely in part or in full on Assumptions (a) and (b):
- Rule 1 - volume of milk processed
 - Rule 6 – production plan
 - Rule 7 – product yields

- Rule 26 – capacity of standard plants
 - Rule 27 – allocation of standard plants to regions
 - Rules 33 and 34 – surplus or shortfall in capacity
 - Rule 35 – Site footprint
57. Rules 1 and 6 were addressed above (commencing at paragraph 39). Rule 6 (Production Plan) will be further addressed in this section as the site-level disaggregation of the Production Plan relies directly on Assumptions (a) and (b).
58. The substance of Assumptions (a) and (b) runs through a tangle of rules and definitions that establish a framework for the NP production facilities including:
- Definition of production facilities:
 - Fixed Asset Base
 - Reference Assets
 - Standard Plants
 - Allocation of production facilities for milk processing
 - Regions
 - Site footprint
 - Production Plan
59. Elements of this framework for the production facilities are incoherent (e.g. Standard Plants) while the thread linking the elements is not consistent with a commercially feasible manufacturing operation (e.g. processing sites comprise “capacity” but not “plants”). The rules and definitions such as they are do not appear to be applied consistently across related parts of the framework (e.g. the fixed asset base and associated capital cost does not appear to be based on what might be interpreted as standard plants, and production yields do not appear to be based on the plants that comprise the NP Fixed Asset Base).
60. Below describes the framework for the NP production facilities as understood by the IDPs. The Commission is requested to advise if this interpretation is incorrect in any way.

Production facilities: Fixed Asset Base, Reference Assets, Standard Plants

61. The Manual (Part C, 1.4) defines the NP Fixed Asset Base as the “Standard plants and other Reference Assets” of the NP. The Manual then unhelpfully defines individual Reference Assets as “A Standard Plant or any other capital asset”. The concepts of “standard plants” and “reference assets” encompass each other and are not clearly distinguishable. Their dual presence makes the components of the Fixed Asset Base unnecessarily opaque, including the way by which those components are used in calculations such as yields, and production and capital costs.
62. **The IDPs submit the definition of production facilities should be rationalised by removing one of either the concepts of Reference Assets or of Standard Plants. “Standard plant” seems the best candidate because a “standard” for the “Standard Plant” does not in fact exist.**
63. The Manual (page 24) explains that:

- The Fixed Asset Base comprises notional production facilities assessed as at 31 May 2008 adjusted for subsequent plant de-commissioning (surplus capacity, end of economic life) or newly commissioned plants (replacement plants, capacity shortfall).
 - According to the Manual, the capacity of each of the NP plants as at 31 May 2008 was equivalent to Fonterra average actual capacity for relevant plants at the time. The number of these then “standard capacity” NP plants was determined by extrapolation to match the capacity required to process the relevant NP production plan at the time (implicitly determined at a “Region” - North or South Island - level, and as such not commercially feasible).
 - Capital costs of these “standard sized” plants were assessed as at 31 May 2008 and then discounted by relevant price indices to achieve “an even spread of deemed acquisition dates”¹³. Those deemed acquisition dates presumably trigger the end of the plant economic life and commissioning of a replacement plant (depending on the artificial assessment of capacity requirements in accordance with Rules 33 and 34).
64. A DIRA amendment in July 2012 (new Sub-Part 5A) introduced the framework for the current regulation of the BMP. 31 May 2008 predates the initiation of the current framework, and the significance of the date is not clear. It might refer to now superseded requirements of the DIRA. In any event, the gap between that date and the first season of the BMP calculations (2012/13) obscures a full understanding of the Fixed Asset Base.
65. The Manual does not provide a coherent definition for “Standard Plants”. In their submission on the 2023/24 BMP Calculations the IDPs requested the Commission “seek a clarification of the meaning and purpose of Standard Plants”¹⁴. This was in relation to the way plant capacity runs through the BMP calculations and centred around Rule 26 (which defines the capacity of Standard Plants). At that time, the Commission deferred consideration of the IDP submission on the grounds that “the definition of Standard Plants is to be considered in the 2024/2025 Manual Review”¹⁵. Despite that commitment, the Commission has deflected consideration of the issues raised by the IDPs in relation to Rule 26 by focussing instead on Rule 25. Rule 25 neither addresses nor defines the capacity of the Standard Plants.
66. **The Commission has not yet addressed the substance of the IDP submission noted above. The IDPs request this now be addressed in the Commission’s Final Report on the 2024/25 Manual.**
67. There is no “standard” for the NP Standard Plants and their description as such throughout the Manual is at best ambiguous. Based on various disclosures, the NP Fixed Asset Base in fact includes a range of plant sizes. As summarised in the attached Appendix, in the case of WMP and SMP plants:
- Plants commissioned since 2013 have a capacity of 2.5M litres per day

¹³ According to the Manual (Rule 28), this spread was “reasonably consistent with the age profile of Fonterra’s actual fixed assets at the time”.

¹⁴ IDP Submission, 23/24 BMP calculations, Para 32

¹⁵ Final Report, 23/24 BMP Calculations, pg 48

- Legacy plants have an average capacity of 1.9M litres per day and may have a range of capacities depending on the assumptions made in the “black hole” between 31 May 2008 and 31 May 2012.
 - The average capacity of all NP WMP and SMP plants are variously described as being “2,000 cubic metres/day (average of new and old plants)”¹⁶ and as “materially consistent with Fonterra’s current weighted average WMP and SMP processing capacity circa 2.1 million litres per day”¹⁷.
 - Combining available data, the average capacity of the NP WMP and SMP plants appears to be 2.1M litres/day.
68. It seems that plants assumed commissioned since 2013 (2.5M litres per day) reflect the plant capacity for “standard plants” as defined by Rule 26. This “Standard Plant” cannot then be the same as the plants permitted by Assumption (b) but are rather some 20% larger than the “average size of [Fonterra’s] actual units of processing capacity”. There is no intrinsic objection to that, but it should be clear that the Rule 26 “Standard Plants” are not the same as the plants contemplated in Assumption (b).
69. The Commission has recommended that Rule 26 be changed to in effect recognise there is no single “standard” for standard plants¹⁸. This will not address the wider problem. References to “Standard Plants” permeate the Manual, and in most cases it is unclear what is being referred to. For example, in the case of WMP and SMP plants, “Standard Plants” might at various times refer to plants with capacities of:
- 2.5M litres per day (the Rule 26 “review year” plants); or
 - 2.1M litres per year (average capacity of all NP plants); or
 - A portfolio of plants comprising the reference assets with varying capacities including the post 2012 plants (2.5M litres/day) and the pre 2012 plants (average capacity of 1.9M litres/day).
70. **The IDPs request the Commission consider this wider issue before finalising the current review of the Manual.**
71. In the case of the Rule 7 yields, in their submission on the 2023/24 BMP Calculations, the IDPs noted that Fonterra calculates product yields based on plants that are not representative of the NP Fixed Asset Base (including plants as large as 4.5M litres/day) and therefore not consistent with other NP calculations.¹⁹ The Commission responded that
- “We have defined an efficient processor as considering the costs of an efficient ‘incremental plant’ (as per paragraph 54 of the Commission’s Approach paper) - therefore, the use of yields better than Fonterra averages but achievable by the latest Fonterra plants is consistent with our view of efficiency and practical feasibility.”²⁰*

¹⁶ Fonterra Reasons, 23/24 BMP Calculations, pg 45

¹⁷ *ibid*, pg 9

¹⁸ Draft Report, 24/25 Manual, para 70 & 71

¹⁹ IDP Submission, 23/24 BMP Calculations, para 41 ff.

²⁰ Final Report, 23/24 BMP Calculations, Attachment A, pg 49

72. It is assumed the Commission is here referring to the Rule 26 plants – the incremental plants – each with a capacity 2.5M litres/day. Putting aside that Fonterra also uses the performance of at least one larger plant (4.5M litres/day) to determine yields, yields could indeed be based on plants with a capacity of 2.5M litres/day. To be commercially feasible however, that assumption would need to run through the BMP model i.e. the Model would need to assume that same 2.5M litres/day plant for purposes of capital costs, production costs, plants allocated to sites including potentially sub-optimal processing on smaller sites, and the related measures of processing at less than full capacity). In most cases, the lack of a clear definition of Standard Plants means it is difficult to determine how the relevant Rules are interpreted to calculate these items. It is though more clear in the case of capital costs.

73. Rule 29 states that:

*“Updated estimates [Rule 25 Review Year estimates for “Standard Plants”] of installation costs, Standard Plant capacity and economic lives will only be applied to Reference Assets notionally installed in or after the Review Year”, and
“The revised estimates will not give rise to any adjustment to any annuity calculation in respect of any Reference Asset added to the Farmgate Milk Price Fixed Asset Base prior to the Review Year” [underlining not in the original]*

This is interpreted to mean the Fixed Asset Base is built up over time, not adjusted retrospectively, and NP capital cost is thus based on NP variously sized plants for example as described in the attached Appendix.

74. The Commission seems to have a different understanding of the NP capital cost than indicated in the Manual. The Commission states that:

“The total aggregate cost of the asset base is estimated by assuming that all processing units are the same size. This simplification is consistent with s 150B(1)(b). We are satisfied that it enables a reasonable estimate of the capital cost of a more diverse asset base, such as the Notional Processor is assumed to operate in the rest of the model.”²¹ [underlining not in the original]

75. The Commission interpretation is not consistent with the Manual. At least in the case of capital costs, this illustrates the confusion over the ambiguous definition of “Standard Plants”. Thus yields based on the Rule 25 incremental standard plant currently understood to be 2.5M litres/day can not be commercially feasible because other elements of the NP model, according to Rule 29, are not based on the same assumption.

Allocation of production facilities: Region, Site Footprint, Production Plan

76. The Manual defines “Regions” as comprising the North and South Island of New Zealand. Rule 27 of the Manual states that:

“Standard Plants are to be allocated to each Region” to materially align “to Fonterra’s actual aggregate dairy processing capacity” in each of the North and the South Islands.

77. It is again unclear what “Standard Plants” means in Rule 27.

78. Putting that problem aside, in the first instance of determining the Region-level plants, commercial feasibility require allocation of “actual” plants in the NP Fixed Asset Base (i.e.

²¹ Final Report, 23/24 Review of BMP Calculations, para 4.27

reference assets as for example described in the attached Appendix). The allocation would need to explicitly consider how the variously sized plants are distributed between the Regions/Islands. Rule 27 however confusingly refers to “Standard Plants” and the actual allocation process is left ambiguous. It appears likely that an average is in this case established for the “standard plant” (possibly of 2.1 M litres/day capacity) and is used for allocation of the plants to the Regions. If so, actual plants in the Fixed Asset Base are assumed to be blended and re-formed into plants with uniform capacity. Regardless of Assumption (b), this cannot be considered commercially feasible.

79. Rule 35 of the Manual explains that the NP site footprint shadows the Fonterra site footprint by geographic location and peak milk processing capacity. The NP Production Plan also assumes the NP processes the same monthly volume of milk as Fonterra at each site. The range of RCPs processed at each NP site matches the range of RCPs Fonterra processes at each site (although compared to the Fonterra product range and the product range assumed sold by the NP, the NP Production Plan is simplified down to just one representative product for each RCP, leading unjustifiably to processing optimisation advantages noted in paragraph 48 above). The footprint of NP factories at each site would be substantially different to the actual Fonterra factories at each site because of the limited NP product range and the larger volume of milk processed into each of the RCPs compared to Fonterra.
80. A footprint of actual NP factories at each site does not however exist. The process of attributing a geographic location to the NP assets goes no further than identifying the Island on which they reside (and as already noted, it is unclear if this allocation is of actual NP plants or a commercially infeasible blended average).
81. Instead, it is simply assumed that the NP plants will be able to efficiently process site level milk provided the NP aggregate processing capacity in each of the North Island and the South Island (together with an undisclosed “prudent level of buffer capacity”²²) is consistent with aggregate peak milk for each Island. No assessment is made of the commercial feasibility of the NP Fixed Asset Base in relation to milk processing requirements at each site as the Fixed Asset Base evolves.
82. The NP Fixed Asset Base is dynamic. Based on the Table in the attached Appendix,
 - In the 14 years from May 2012 to May 2024 the NP has commissioned 14 large WMP and SMP dryers all with a processing capacity of 2.5M litres/day or a total aggregate capacity of 35M litres/day. That amounts to 39% of NP total WMP and SMP capacity in 2023/24.
 - Of these 14 new dryers 9 were replacement dryers with an aggregate capacity of 22.5M litres/day.
 - During that same period 16 smaller dryers were decommissioned. These dryers each had a capacity of 1.9M litres/day (more or less)²³ or 30.4 M litres/day in aggregate. This amounts to 36% of the NP’s WMP and SMP processing capacity available as at May 2012 which was decommissioned by May 2024.

²² Rule 33 (Surplus Capacity); Rule 34 should but does not carry a similarly explicit requirement to provide for a buffer when assessing a shortfall in capacity.

²³ These plants were part of the cohort of “pre-2012 plants which have an overall average capacity of 1.9M litres/day. It is unclear whether the cohort comprises a range of different size plants.

- All of these changes in the Fixed Asset Base will have been determined by a comparison of aggregate processing capacity in each of the North and the South Islands, with aggregate peak milk in each of the North and South Islands (Rules 33 and 34).
 - During that period since May 2012 (and possibly since May 2008), despite the substantial changes in the NP Fixed Asset Base, no assessment appears to have been made (or is required by the Manual) to confirm that the change in scale and number of plants allocated to each of the North and South Island can still provide an efficient factory footprint for each processing site. The replacement of smaller (on average) 1.9M litre/day plants with the larger 2.5M litres/day plants means a match would be increasingly difficult to achieve.
 - There has also been no assessment of whether each site can physically accommodate the larger plants and support services.
 - Finally, there is no assessment that the reduced flexibility created by larger plants provides the most efficient (or even feasible) processing option to service the actual NP sales mix and customer service requirements (shipment schedules) on which the NP revenue is determined and which a commercial operation can only manage at a site/factory level.
83. By comparison during the same 14-year period Fonterra is understood to have commissioned 3 new dryers (a 4.5M ltr/day plant, and two 2.5M ltr/day plants) at two sites (Darfield and Pahiatua). The NP investment in new and larger plant is more dynamic and intensive than Fonterra and includes a rapidly changing number and scale of plants.
84. **Noting the degree of change in the NP Fixed Asset Base since 2012, the IDPs submit the Commission is not in a position to conclude the Region level allocation of the Fixed Asset Base is commercially feasible. A site level allocation of actual NP plants must be performed and compared to a commercially feasible production plan to determine commercial feasibility.**

Rule 26 - Capacity of Standard Plants

85. The Commission considers Rule 26 applies Assumption (b) correctly²⁴. The IDPs do not agree. In comparing the capacity of NP plants and Fonterra actual plants Assumption (b) draws a clear distinction – i.e.
- “the size of [NP] assumed units of processing capacity” is permitted to approximate “the average size of [Fonterra’s] actual units of processing capacity”*
86. In other words, Assumption (b) permits that NP factories for each RCP can have a uniform (standard) capacity equivalent to the average processing capacity of all Fonterra relevant plants. This is clearly not the case in the NP Fixed Asset Base (attached Appendix) and it is at best unclear that it is intended to be the case in the way Standard Plants are defined. In any event, the Commission has concluded there is no standard for Standard Plants, and Standard Plants can comprise plants of different capacities (para 69 above).

²⁴ Draft Report, 24/25 Manual para 66

87. The only instance at which the NP plants appear to have had a uniform capacity was when the May 2008 foundation assessment of the NP Fixed Asset Base was made. This may be the source of the difference in the capacity measurement unit in Assumption (b) between Fonterra plants (average capacity) and the NP plants (uniform for all plants).
88. Since the 31 May 2008 establishment of the NP Fixed Asset Base, Rule 26 has been used²⁵ to determine the processing capacity of any incremental plant that might be commissioned over the next four years (the period between review dates for Rule 25). These “incremental plants” are referred to confusingly as Standard Plants. The capacity of the incremental plants for each RCP is determined so that when added to the NP Fixed Asset Base over the next four years the average capacity of plants in the NP Fixed Asset Base (net of retirements) would be approximately the same as projected Fonterra plants in four years’ time. In this way, rule 26 merges the NP investment in capacity with Fonterra actual capacity and processing efficiency planning. The NP portfolio of processing plants is accordingly of varying capacity (attached appendix) and is not consistent with Assumption (b).
89. This is only pointed out because it would simplify and clarify review of the BMP calculations if Assumption (b) were simply put aside. This would then focus attention clearly on the commercial feasibility of the actual plants in the NP Fixed Asset Base to efficiently process milk at NP sites. The key issue is whether Rule 26 results in incremental changes to the Fixed Asset Base so that the NP can continue to feasibly and efficiently process the milk delivered to each of its sites.
90. The Commission also considers Rule 26 is consistent with the purpose of s 150A. The IDPs do not agree that conclusion can be made because actual NP plants are not allocated to NP sites and are not scrutinised by comparison to a commercially feasible production plan. It is even doubtful that “actual” NP plants are allocated to Regions let alone the sites.
91. **The IDPs submit that the Manual does not set rules which of themselves can be concluded to mean the NP Fixed Asset Base remains commercially feasible. Rule 26 should instead provide that incremental plants through to the next Review year must be determined so that the Fixed Asset Base remains feasible and efficient across the NP sites. It should provide for more than one incremental plant size. Fonterra could for example choose to determine efficient and feasible investment in incremental assets based on a range of its own plants with appropriate adjustments. The IDPs do not consider this is an onerous exercise, and it is in any event necessary to assure commercial feasibility of the NP Fixed Asset Base.**

[Rule 27 - Allocation of Standard Plants to Regions, and Rule 35 - Site Footprint](#)

92. The Commission considers Rules 27 and 35 are consistent with Assumption (a) and with the purposes of s 150A. The IDPs disagree on all counts as explained above (commencing at paragraph 76).
93. The Commission recognises that elements of these Rules are not commercially feasible because of the workarounds and simplifications that are used, but considers these are justified to avoid complex modelling processes. The Commission also concludes that despite the use of the assumptions not being commercially feasible the outcomes of resulting calculations

²⁵ The current regulatory framework for the BMP has been in effect since the 2012/13 Season. It must though be the case that Rule 26 has been applied retrospectively to the period commencing 1 June 2008.

remain commercially feasible. The IDPs do not agree and consider the Commission has prioritised permitting the assumption to be used over a proper assessment of the commercial feasibility of the way the assumptions are used. The Commission thus appears to attribute a “safe harbour” character to Assumption (a).

94. In justifying the simplification, the Commission refers to its review of the 23/24 BMP Calculations.²⁶ The IDPs consider that review drew extraordinary and unfounded conclusions especially in paragraphs 4.18 to 4.22 of the final report. Those paragraphs are discussed below.

95. Paragraph 4.18 (Final Report, 2023/24 BMP Calculations):

This methodology to establish the Notional Processor’s site capacity in a given season differs from a processor operating in the real world, where plants are permanently fixed at specific sites, and there is minimal flexibility in the maximum volume of milk a plant can process from season to season. However, we consider that the approach adopted is an appropriate modelling simplification which does not adversely impact consistency with the efficiency or contestability dimensions of s 150A. [Underlining not in original]

The IDPs agree the methodology is far removed from the real world. The Commission in effect puts this aside on the basis that the simplification does not result in a modelling outcome that is different from the real world. No reason is given for this conclusion and the IDPs do not consider it can be drawn from the information available.

96. Paragraph 4.19 (Final Report, 2023/24 BMP Calculations):

We consider the allocation of plants to ‘Regions’, and not individual sites, is 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. We consider this would be excessively complex, costly, and not necessary to determine a milk price that is consistent with the dimensions of contestability and efficiency. [Underlining not in original]

The Commission again appears to give more weight to prioritising the use of Assumption (a) over the commercial feasibility of the way the assumption is used. The IDPs consider it is reasonable and not onerously complex to maintain a commercially feasible fixed asset base reflecting efficient production at the NP sites. This is not least because, having established the location of a plant it remains fixed to the location, reflecting the commercial rigidities of real-world capacity investment management. Fonterra could alternatively choose to model the BMP based on a simple but commercially feasible business model with minimum complexity. Either way, it is not clear how the Commission has concluded that the simplification remains commercially feasible.

97. Paragraph 4.20 (Final Report, 2023/24 BMP Calculations):

The distribution of capacity to sites is a secondary calculation for the purposes of determining the Notional Processor production plan and associated diversion and supply chain costs. We consider that there does not need to be a whole number of Standard Plants capacity equivalents allocated to a given site. The way capacity is distributed results in an outcome consistent with our interpretation of s 150B(1) (a), that there is a national network

²⁶ Draft Report, 24/25 Manual para 76 and 90 to 94

of facilities with the same processing capacity footprint as Fonterra. [Underlining not in original]

98. This paragraph 4.20 is problematic in several ways:

- It mis-states the DIRA. Assumption (a) states
“that [Fonterra] operates a national network of facilities for the collection and processing of milk”

Assumption (a) is a simple statement of fact, its purpose being to make clear that the BMP calculations can include the benefits that can be derived from a “national network of facilities” similar in scale to that of Fonterra. Those “benefits” must though still be commercially feasible for the NP. Contrary to the Commission interpretation, Assumption (a) refers to a “Network of Facilities” not to a “Network of Capacity” which is of course not itself feasible. The Fonterra network comprises plant and equipment, as must any commercially feasible assumption for the NP. While it might be inconvenient that the NP has invested in increasingly large factories which might be difficult to “fit” into the jigsaw of capacity required to process site-based milk deliveries, that reflects the commercial trade-offs between the increased efficiency and reduced flexibility of larger plants. The cost of those trade-offs needs to be reflected in commercially feasible NP calculations. The NP network of facilities will be different to Fonterra because of the differences in product mix at each site. That difference cannot be expunged in any commercially feasible way by the alignment of NP and Fonterra “capacity”. The commercial feasibility of the NP investment in plant can only be confirmed through the proper establishment of the NP Network of Facilities incorporating the plants in the NP Fixed Asset Base.

- Regardless of how Assumption (a) is interpreted by the Commission, the interpretation is not relevant if the assumption is used in a way that is not commercially feasible. It is self-evident that factories in the real world must be “whole numbers”. The Commission however considers “whole” plants are not important. This again suggests a safe harbour character to Assumption (a), and commercial feasibility of its use is secondary.
- The Commission relegates the site level production plan to a “secondary calculation”. This fails to recognise the significant impact that day-to-day management of factory level production on determining the commercial outcomes of an efficient processor. A daily plan needs to balance sub-optimal processing to meet customer requirements in the face of variable daily milk volumes. By contrast, the NP Production Plan is a proxy for a plan which optimises allocation of investment in processing capacity (as opposed to processing plants). This is far removed from a commercially feasible Production Plan.

99. Paragraph 4.21 (Final Report, 2023/24 BMP Calculations):

The way in which Notional Processor production capacity is distributed for the purposes of developing a production plan may result in small variances in implied site-level capacity from season-to-season compared to a situation where Standard Plants were individually allocated (and fixed) to Notional Processor sites. However, we consider that the impact on yields of any such variances is likely to be negligible so long as Notional Processor capacity at both a Region and site-level remains materially aligned to Fonterra’s in a given season.

[Underlining not in original]

It is unclear on what the Commission bases this conclusion. It seems to reflect an assumption that processing efficiencies are indifferent to factory configurations but are only dependent on the overall volume of milk processed. The IDPs consider it is only feasible to make this

assessment on a real-world basis, which requires actual NP factories to be allocated to NP sites.

100. Paragraph 4.22 (Final Report, 2023/24 BMP Calculations):

Our assessment of analysis provided by Fonterra is that appropriate consideration has been given to the implications of the implied Notional Processor site capacity configuration on losses at a milk catchment level. This analysis is discussed in paragraphs 4.36 and 4.37. We did not identify any material inconsistencies in assumptions between this analysis and the way in which capacity is allocated to develop the Notional Processor's production plan.
[Underlining not in original]

101. The Commission seems to refer to this analysis as evidence that the allocation of capacity rather than factories to sites does not materially affect the commercial feasibility of the NP Fixed Asset Base. The referred paragraphs 4.36 and 4.37 address an analysis of adjustments related to plants operating at less than full capacity. The analysis was provided by Fonterra. That analysis seems to be based on a comparison of daily site-based milk processing to an artificial calculation attributing a uniform capacity to all NP assets. It again is not an assessment based on the variously sized reference assets that comprise the NP Fixed Asset Base. This therefore provides no evidence that the process of allocating capacity as opposed to factories is commercially feasible. It is simply another illustration of that artificial allocation of capacity.
102. In summary, the Commission justifies simplifications in the allocation of the NP Fixed Asset base to enable Assumption (a) to be used without undue complexity. That simplification in effect treats NP capacity as infinitely flexible. This departs from reality and thus commercial feasibility. The Commission nevertheless concludes the resulting BMP calculations would remain consistent with the s 150A purposes. The Commission does not offer adequate reasons for this conclusion.
103. **The Commission appears to place weight on Assumption (a) itself in its assessment of Rules 27 and 33. The IDPs submit that the Commission is not able to conclude Assumption (a) is used in a manner which is commercially feasible unless the "actual" NP plants are allocated to sites and shown to be able to meet the objectives of a commercially feasible production plans for each site.**
104. **Given their artificiality, the IDPs consider Rules 27 and 33 are not commercially feasible, and the use of the Rules is likely to artificially enlarge NP yields and reduce costs.**

Rule 33 - Surplus Capacity, and Rule 34 - Shortfall in Capacity

105. Rules 33 and 34 require capacity surpluses and shortfalls to be managed by ensuring aggregate capacity allocated to each Island (Region) is consistent with aggregate peak milk supply in each Island. The Commission concludes (paragraph 82) that:
- "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"*
106. The IDPs do not agree with this conclusion. While capacity decisions will include consideration of the distribution of capacity beyond individual milk catchment zones or existing manufacturing sites, investment in plant would never be without reference to those existing sites and projections of milk volumes able to be efficiently accumulated at those existing sites.

No processor, Fonterra or otherwise, would make plant investment decisions solely based on the meaningless aggregation of milk in each of New Zealand's main islands.

107. **The issues with Rules 33 and 34 are the same as discussed above for Rules 27 and 35. The IDPs submit the Commission has not considered the commercial feasibility of the Rules independently of Assumptions (a) and (b) and does not have a basis for concluding they meet the purposes of s 150A.**
108. **The IDPs submit that the Manual should require the Reference Assets in the NP Fixed Asset Base are allocated to the NP sites, and that surplus or shortfall capacity be determined at a site level.**

Rule 7- Product yields

109. The Commission considers Rule 7 meets the purposes of s 150A. The IDPs do not agree and consider that including with the other relevant Rules, Rule 7 permits the artificial inflation of the NP yields in a manner which is not commercially feasible.
110. The Commission indicates it has limited its assessment of Rule 7 to Assumption (d) (milk volume/product yields) on the basis that Rule 7 primarily relates to that Assumption (d).²⁷ In reality, yields will depend on milk volumes processed at each site, the production facilities at each site, and the commercial production plan which determines the scheduling of production to meet sales plan objectives. Rule 7 thus relates at least equally to Assumption (d) and to the Assumptions on which the NP production facilities are based (Assumptions (a) and (b)).
111. An assessment of the commercial feasibility of the NP yields necessarily touches on all the issues that have been raised in this submission. The IDPs have submitted that none of the Assumptions are used in a way that can reasonably be considered commercially feasible. It is useful to summarise the conclusions of this submission and consider how they are likely to artificially inflate the NP yields:
- Assumption (d): milk volume and production yields
 - The NP produces an inflated volume of RCPs which is not commercially feasible because that volume cannot achieve the selling prices attributed to the NP
 - The NP nevertheless sets a simplified production plan based on that production volume. The resulting production plan captures inflated yield advantages based on the commercially infeasible sales volume and the simplified production plan for 5 products
 - The NP production plan does not capture the typical costs and production plan sub-optimisation that occurs when balancing production priorities with sales plan and customer priorities.
 - Assumption (b): Capacity of processing units
 - Rule 7 notes the “configuration” of the NP factories is an important input to product yields. “Configuration” here will include the technical specification of the plant but most importantly refers to the capacity of the plant.

²⁷ Draft Report, 2024/25 Manual, para 58

- The Manual does not clearly define plant capacity assumptions (“Standard Plants”) and it is not possible to determine if capacity assumptions in the Manual are commercially feasible.
 - The Commission considers the entire NP yields are appropriately based on the largest NP plants achieving the most efficient scale processing. At the same time other NP calculations include smaller plants (e.g. cost of capital). This therefore results in higher yields than can be achieved across the actual NP plants and is not commercially feasible across the actual plants.
 - Assumption (a): Network of facilities
 - The Manual does not in fact provide for a network of facilities. Rather it provides for a network of “capacity processing” delinked from actual NP plants. With the NP Production Plan based on this artificially optimised allocation of capacity to perfectly match processing demand, this will have the effect of inflating yields by comparison to the actual NP plants if these were allocated to actual sites.
112. In summary, given the entire NP production framework is not commercially feasible or is not defined in a meaningful way, it is implausible that the yields determined within that framework are commercially feasible.
113. **The IDPs submit the scale of the NP Production Plan is not commercially feasible (it is inflated) and is simplified compared to the NP sales plan. Production yield efficiencies extrapolated from that Production Plan are therefore inflated, thus artificially enlarging the BMP. The IDPs further submit that the Rules establishing the NP production framework are not commercially feasible and that it is implausible to conclude the yields based on that framework are commercially feasible.**
114. **The IDPs consider that in the absence of a commercially feasible model to determine the NP yields, NP yields should be based on actual Fonterra yields observed across the Fonterra commodity business.**

Authorisation

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Appendix: Notional Processor WMP and SMP Plants

Notional Processor WMP and SMP Plants Fixed Asset Base			
	Plant Capacity	2023/24 Season (2)	2011/12 Season (2)
Commissioning date	M Litres/day	Prod'n Units	Prod'n Units
Pre-2012 (3)	1.9	29	45
Post 2012 (3)	2.5	14	
Total Plants		43	45
		M Litres/day	M Litres/day
Peak Processing Capacity - Total		90.1	85.5
Peak Processing Capacity - Avge per Plant		2.1	1.9

- (1) Fonterra discloses the capacity of this grouping of plants in its annual Farmgate Milk Price Statement (for example, page 11 of the 2023/24 Statement).
- (2) Fonterra discloses plant numbers in its annual Reasons Papers supporting the BMP calculations (Attachment 2 in the case of the 2023/24 Reasons Paper). It is understood the 4 Buttermilk Powder plants identified by Fonterra are "Pre-2012" plants and have been excluded from this table.
- (3) In its Reasons Papers, Fonterra distinguishes between "Pre-2012" plants and "New Plants Post-2012" presumably because the BMP regulatory regime was initiated in the 2012/13 Season. The "Pre-2012" plants will include the Standard Plants as at 31 May 2008 determined in accordance with the Manual (page 24) and any changes to the NP Fixed Asset Base through to 31 May 2012.

The Manual explains (page 24) that the Standard Plants as at 31 May 2008 for each RCP all assumed the same processing capacity. That capacity has not been disclosed. 31 May 2008 is the only instance that can be identified where the NP Fixed Asset Base was consistent with Assumption (b) of S150B.

Changes in the Fixed Asset Base between 31 May 2008 and 31 May 2012 were presumably determined in a manner consistent with Rules 25, 33 and 34 of the Manual (Review Year Plants, Surplus capacity, Shortfalls in capacity respectively) but are similarly unknown. With over 60% of the NP WMP and SMP processing capacity still attributable to the "pre-2012" plants those further capacity details are relevant to considering commercial feasibility of the NP Fixed Asset base and need to be disclosed.