

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

Dairy Industry Restructuring Act 2001

Final report

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Chapter 1 Introduction

Purpose of this report

1. This report sets out our 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 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 We received a joint submission on our draft report from Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products ('the Independent Dairy Processors' (**IDPs**)).³ We respond to the issues raised in their submission in this chapter. Fonterra did not make a substantive submission.⁴
6. Chapter 5 provides our assessment of amendments to the 2024/2025 Manual and their consistency with the s 150A purpose.
7. Attachment A outlines other issues raised in submissions that are outside the scope of our current review.
8. Attachment B provides a glossary of the key terms and abbreviations used in this report.

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 Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products ["Submission on the review of Fonterra's base milk price manual 2024-2025"](#) (15 November 2024).

⁴ Fonterra ["Submission on the review of Fonterra's base milk price manual 2024-2025"](#) (15 November 2024).

Chapter 2 Our review framework

Our approach for the Manual review

9. 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:⁵
 - 9.1 an overview of how the base milk price is set;
 - 9.2 our interpretation of the key legislative provisions guiding our statutory reviews; and
 - 9.3 our analytical and practical approach to our statutory reviews.
10. 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.⁶
11. 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.
12. 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:
 - 12.1 provide an incentive for Fonterra to operate efficiently (the 'efficiency dimension'); and
 - 12.2 adopt assumptions, inputs and processes that would be practically feasible for an efficient processor (the 'contestability dimension').⁷

⁵ Commerce Commission ["Our approach to reviewing Fonterra's milk price manual and base milk price calculation"](#) (1 August 2023).

⁶ Dairy Industry Restructuring Amendment Bill (Government Bill) 2012, at 2.

⁷ We consider the same 'efficiency' and 'contestability' dimensions when we carry out our base milk price calculation review.

13. 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).
14. 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.⁸
15. 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.⁹
16. 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.
17. We also consider the amendments to DIRA that are relevant to our review functions when deciding where to focus our reviews.

Scope of this review

18. DIRA requires Fonterra to provide us with the following information for consideration in our Manual review:¹⁰
 - 18.1 the Manual for the current season;
 - 18.2 any recommendations by the Milk Price Panel (**MPP**)¹¹ in relation to the Manual;
 - 18.3 notification of any change in the economic and business environment that, in Fonterra's view, requires a change to the Manual;

⁸ DIRA, s 150A(2).

⁹ Commerce Commission "[Our approach to reviewing Fonterra's milk price manual and base milk price calculation](#)" (1 August 2023).

¹⁰ DIRA, s 150L.

¹¹ 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), page 27.

- 18.4 certification on the extent to which Fonterra considers that the Manual is consistent with the s 150A purpose; and
- 18.5 the reasoning behind the views expressed in Fonterra's certification.
19. 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);¹²
- 19.2 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 18.3, 18.4 and 18.5;¹³
- 19.3 the MPP's recommendations to Fonterra's Board with respect to amendments to the 2024/2025 Manual.
20. 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.¹⁴ 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.
21. The main focus of our review for the 2024/2025 season is the way in which relevant Manual rules incorporate ss 150B(1)(a), (b), and (d) of DIRA, and the extent to which these rules are consistent with the s 150A purpose. Sections 150B and 150I of DIRA 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 and in relation to the Manual.¹⁵
22. 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.¹⁶

¹² Fonterra ["Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024"](#) (15 August 2024), at page 27.

¹³ Fonterra ["Reasons Paper in support of Fonterra's Milk Price Manual for the 2024/25 season - 1 August 2024"](#) (15 August 2024).

¹⁴ Fonterra ["Reasons Paper in support of Fonterra's Milk Price Manual for the 2024/25 season - 1 August 2024"](#) (15 August 2024), page 3.

¹⁵ DIRA, ss 150B(2) and 150I(1A).

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

23. 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.¹⁷
24. 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.¹⁸
25. 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.
26. Fonterra has made several minor amendments to the 2024/2025 Manual. 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.¹⁹ Our assessment of these changes is outlined in Chapter 5.
27. We published our draft report on 15 October 2024.²⁰ We received a joint submission on our draft report from Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products.²¹ Fonterra did not make a substantive submission on the draft report.²²
28. The IDPs have raised a variety of points in their submission, the most substantive of which we have addressed in the relevant chapter or sub-chapter, and others which we have addressed in Attachment A.

¹⁷ Commerce Commission [“Review of Fonterra’s 2023/24 Milk Price Manual: Final report”](#) (15 December 2023), paragraph 22.

¹⁸ Commerce Commission [“Review of Fonterra’s 2023/2024 base milk price calculation”](#) (16 September 2024).

¹⁹ Commerce Commission [“Review of Fonterra’s 2023/24 Milk Price Manual: Final report”](#) (15 December 2023), paragraphs 69, 71, and 76.

²⁰ Commerce Commission [“Review of Fonterra’s 2024/2025 Milk Price Manual: Draft report”](#) (15 October 2024).

²¹ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products [“Submission on the review of Fonterra’s base milk price manual 2024-2025”](#) (15 November 2024).

²² Fonterra [“Submission on the review of Fonterra’s base milk price manual 2024-2025”](#) (15 November 2024).

Chapter 3 Conclusions and recommendations

Purpose of this chapter

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

Summary of conclusions

30. Based on the assessment we have undertaken, our overall conclusion is that the Manual is consistent with the statutory purpose set out in s 150A.
31. Regarding our assessment of Manual rules related to s 150B(1)(a), (b), and (d), our conclusions are that they are each consistent with the statutory purpose set out in s 150A. Notwithstanding our conclusions, we recommend that Fonterra:
 - 31.1 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;
 - 31.2 clarify what is meant by ‘Standard Plants of Fonterra’ referred to in the Key Assumptions section;
 - 31.3 consider adjusting the wording of Rule 15, and elsewhere in the Manual if appropriate, to increase clarity and consistency regarding the use of the terms “Standard Plants” and “Reference Assets”; and
 - 31.4 correct the glossary definition of site footprint to refer to Rule 35 instead of Rule 36.
32. Regarding Fonterra’s amendments to the Manual since last year’s review, our conclusion is that the amendments made are consistent with the statutory purpose set out in s 150A. However:
 - 32.1 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(1) assumptions

Purpose of this chapter

33. 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(1) assumptions

34. 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 10.²³
35. 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.
36. 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).²⁴

²³ Commerce Commission "[Review of Fonterra's 2023/24 Milk Price Manual: Final report](#)" (15 December 2023), pages 11-16.

²⁴ Terms that are capitalised are defined terms in the Manual.

Table 1: Manual rules relevant to s 150B(1) 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) ²⁵
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

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

- 37.1 How does the rule incorporate, engage or reference the s 150B(1) assumption?
- 37.2 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?²⁶
- 37.3 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)?²⁷

²⁵ Commerce Commission ["Review of Fonterra's 2023/24 Milk Price Manual: Final report"](#) (15 December 2023), pages 11-16.

²⁶ Commerce Commission ["Our approach to reviewing Fonterra's milk price manual and base milk price calculation"](#) (1 August 2023), 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.

²⁷ 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.

Submissions on the draft report

38. The IDPs submitted that s 150B(2) means the way the s 150B(1) assumptions are used must meet the purpose of s 150A. They further submitted that this requires “changes in substance to the way Fonterra calculates the base milk price”.²⁸
39. The IDPs also requested that we clarify what we meant by “with that assumption as used” in footnote 28, noting that this phrase suggests that the assumptions themselves continue to carry weight in our assessment.²⁹ They further submitted that we continue to grant “safe harbour” status to the assumptions themselves, for example, by allowing Fonterra to include workarounds and simplifications on the grounds that these are needed to enable the s 150B assumptions to be used.³⁰
40. We agree that s 150B(2) means we are required to assess whether the ways the s 150B(1) assumptions are used in the Manual (and calculation) are consistent with the s 150A purpose. However, for the reasons discussed in the remainder of this chapter, we maintain our draft view that the way Fonterra has used the assumptions in relation to the Manual are consistent with s 150A.
41. We further consider that our approach to assessing the rules using the s 150B(1) assumptions is appropriate. As set out in our Approach Paper, Fonterra is entitled to use the s 150B(1) assumptions, and we cannot conclude that the choice of, or adoption of assumptions themselves is inconsistent with s 150A.³¹ Accordingly, once we have determined that the s 150B(1) assumption has been correctly interpreted in a rule (in the sense that the rule’s adoption of the assumption is appropriate based on the meaning of the s 150B(1) assumption), we assess whether the rule is consistent with s 150A.
42. In assessing whether the rule is consistent with s 150A, we assess the methodology of how the s 150B(1) assumption(s) are used which includes an assessment of any material modelling simplifications. In assessing modelling simplifications, we consider whether the outcomes of those simplifications could lead to a materially different outcome for the milk price compared to a more complex (and costly) modelling approach.

²⁸ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products [“Submission on the review of Fonterra’s base milk price manual 2024-2025”](#) (15 November 2024), paragraphs 23 to 25.

²⁹ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products [“Submission on the review of Fonterra’s base milk price manual 2024-2025”](#) (15 November 2024), paragraphs 26 and 27.

³⁰ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products [“Submission on the review of Fonterra’s base milk price manual 2024-2025”](#) (15 November 2024), paragraph 29.

³¹ Commerce Commission [“Our approach to reviewing Fonterra’s milk price manual and base milk price calculation”](#) (1 August 2023), paragraphs 57 and 58.

Our assessment of the Manual rules related to the s 150B(1) assumptions

Rule 1 – volume of milk processed

Table 2: Rule 1, volume of milk processed³²

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.

43. 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.
44. 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?

45. 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?

46. 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 conclusion is that we therefore

³² Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), , page 35.

consider this rule consistent with the efficiency and contestability dimensions of s 150A.

Rule 6 – farmgate milk price production plan

Table 3: Rule 6, Farmgate Milk Price Production Plan³³

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.

47. 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.
48. 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.³⁴
49. 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

³³ Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), , page 37.

³⁴ Fonterra [“Reasons paper in support of Fonterra’s base milk price for the 2023/24 season”](#) (17 June 2024), at page 11.

Reference Assets which are in aggregate required to produce the Reference Commodity Products included in the Farmgate Milk Price Production Plan".

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

50. 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.
51. 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?

52. 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.
53. 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.
54. 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.
55. 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.³⁵
56. Overall, our conclusion is that we consider Rule 6 to be consistent with the efficiency and contestability objectives of s 150A.

³⁵ Commerce Commission "[Review of Fonterra's 2014/15 base milk price calculation: Final report](#)" (15 September 2015), page 79.

Rule 7 – product yields

Table 4: Rule 7, product yields³⁶

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>

57. 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.
58. 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.³⁷
59. In our 2023/2024 calculation review, we concluded that the way in which yields are determined is consistent with the efficiency and contestability dimensions of s 150A.³⁸

³⁶ Fonterra ["Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024"](#) (15 August 2024), , page 37.

³⁷ Fonterra ["Reasons paper in support of Fonterra's base milk price for the 2023/24 season"](#) (17 June 2024), page 11.

³⁸ Commerce Commission ["Review of Fonterra's 2023/2024 base milk price calculation"](#) (16 September 2024), paragraph 3.3.

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

60. 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).

Submissions on the draft report

61. IDPs submitted that yields 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 objectives. Rule 7 therefore relates at least equally to s 150B(1)(d) and to the assumptions on which the Notional Processor's production facilities are based (ss 150B(1)(a) and (b)).³⁹ They point out that Rule 7 notes the "configuration" of the Notional Processor's factories are an important input to product yields, further stating that "configuration" will include the technical specification of the plant and importantly the capacity of the plant.⁴⁰
62. The IDPs consider that the production plan is not commercially feasible – including how capacity is determined – and as a result neither are the yields determined for the Notional Processor.
63. Standard Plant capacities are specified in each Review Year with the purpose of achieving material alignment of the notional average WMP/SMP plant capacity of the Notional Processor, with the actual average WMP/SMP plant capacity of Fonterra. Standard Plants are allocated to Regions, reflecting the Standard Plant capacity specification at the time they were added to the Fixed Asset Base. We consider that the way in which Fonterra aligns the Notional Processor's capacity to its own is consistent with the s 150A purpose, as discussed in the 2023/2024 base milk price calculation review.⁴¹
64. In addition, yield losses are built up using a building blocks approach, with a range of equipment on specific loss events over time.⁴² These are determined to reflect the same equipment that the Notional Processor is assumed to use. And, in paragraph 122 we discuss that the model includes an on-product time assumption to reflect the unavoidable inefficiencies which occur in the manufacturing process. Later in the report we also discuss the way in which capacity is allocated under Rules 33 and 34,

³⁹ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products ["Submission on the review of Fonterra's base milk price manual 2024-2025"](#) (15 November 2024), paragraph 110.

⁴⁰ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products ["Submission on the review of Fonterra's base milk price manual 2024-2025"](#) (15 November 2024), paragraph 111.

⁴¹ Commerce Commission ["Review of Fonterra's 2023/2024 base milk price calculation"](#) (16 September 2024), paragraphs 4.12 – 4.30.

⁴² Commerce Commission ["Review of Fonterra's 2023/2024 base milk price calculation"](#) (16 September 2024), pages 22 -26.

and the way in which the site footprint is determined under Rule 35. We have found each of these elements to be consistent with the s 150A purpose.⁴³

65. We consider that the way in which s 150B(1)(a) and (b) are reflected in Rule 7 are consistent with the s 150A purpose.

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

66. The way in which s 150B(1)(d) 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 conclusion is that the rule is consistent with the efficiency dimension of s 150A.
67. 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 convert milk into commodities at yields determined using the process outlined in Rule 7. Our conclusion is that the rule is consistent with the contestability dimension of s 150A.

⁴³ Rules 33, 34 and 35 are discussed on pages 24 – 30. Conclusions on our assessment of these rules are in paragraphs 99, 100, 103, 104, 110 and 111.

Rule 26 – capacity of Standard Plants

Table 5: Rule 26, capacity of Standard Plants⁴⁴

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.

68. 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) allows for new co-op's assumed units of processing capacity to approximate the average size of new co-op's actual units of processing capacity. Fonterra has interpreted this to mean that the Notional Processor's assumed average daily processing capacity across all Standard Plants is approximately the same as Fonterra's actual weighted average daily processing capacity for primary RCPs.
69. 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.⁴⁵

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

70. 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

⁴⁴ Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), pages 50-51.

⁴⁵ Fonterra [“Reasons paper in support of Fonterra’s base milk price for the 2023/24 season”](#) (17 June 2024), page 10.

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).

71. 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?

72. 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 conclusion is that we consider that the use of Fonterra's weighted average capacity appropriately incentivises efficiency, meeting the efficiency dimension of s 150A.
73. Our conclusion is that the way in which s 150B(1)(b) is used in Rule 26 is consistent with the contestability dimension.

Concerns about drafting clarity

74. 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.
75. 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.
76. 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.⁴⁶

⁴⁶ Fonterra ["Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024"](#) (15 August 2024), page 14.

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.

Submissions on the draft report

77. In their submissions on both the 2023/2024 base milk price calculation review,⁴⁷ and the 2024/2025 draft Manual review,⁴⁸ IDPs questioned the Manual's definition of Standard Plants and the way plant capacity runs through the base milk price calculations, centred around Rule 26. Here we outline our understanding of the meaning and purpose of the 'Standard Plant' concept and the rationale for its inclusion in the Manual.
78. Standard Plant capacities are specified in each Review Year with the purpose of achieving material alignment of the notional average WMP/SMP plant capacity of the Notional Processor, with the actual average WMP/SMP plant capacity of Fonterra. By implication, this means that there may be different Standard Plant sizes for an RCP depending on which Review Year they were included in the model (either as 'new' or 'replacement' plants). Standard Plant capacities have remained unchanged in each of the three reviews Fonterra has undertaken since 2012, although WMP and SMP capacities were increased in the initial 2012 review.
79. Standard Plants are allocated to Regions reflecting the Standard Plant capacity specification at the time that they were added to the Fixed Asset Base. This means that there is a specifically allocated mix of Standard Plants in each Region depending on which Review Year they were included in the model (either as "new" or "replacement" plants).
80. IDPs assert that s 150B(1)(b) permits the Notional Processor to have factories for each RCP that have a uniform capacity that is equivalent to the average processing capacity of all Fonterra relevant plants. However IDPs consider that the Rule 26 "Standard Plants", ie Standard Plants for WMP/SMP with differing capacity based on when they were added to the Fixed Asset Base, are not the same as the plants contemplated in s 150B(1)(b).⁴⁹

⁴⁷ IDPs "[Joint submission on the Commerce Commission draft report: "Review of Fonterra's 2023/24 base milk price calculation"](#)" (15 August 2024), paragraph 31.

⁴⁸ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products "[Submission on the review of Fonterra's base milk price manual 2024-2025](#)" (15 November 2024), paragraph 65.

⁴⁹ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products "[Submission on the review of Fonterra's base milk price manual 2024-2025](#)" (15 November 2024), paragraph 68.

81. In our 2015/2016 Manual Review, we stated that "we consider that the alignment of the average capacity of the standard plants with Fonterra's WMP and SMP plants is consistent with the safe harbour provision in s 150B(b) of the Act."⁵⁰ We remain of the view that this is an appropriate interpretation of s 150B(1)(b) because it aligns the Notional Processor's average capacity with Fonterra's average capacity. We consider that in order for s 150B(1)(b) to be used, there logically needs to be a mechanism to adjust the average Notional Processor plant size, as it should be anticipated that Fonterra's average plant size could (and has) changed over time. Adjusting the capacity of Standard Plants entering the model via optional review-year adjustments is the way that Fonterra has chosen to implement this.

Rule 27 – allocation of Standard Plants to Regions

Table 6: Rule 27, allocation of Standard Plants to Regions⁵¹

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.

82. 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 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?

83. 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

⁵⁰ Commerce Commission ["Review of Fonterra's 2015/16 milk price Manual: Final report"](#) (15 December 2015), paragraph 105.

⁵¹ Fonterra ["Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024"](#) (15 August 2024), page 51.

basis which will provide for all milk to be processed, and with a commercially supportable provision for buffer capacity.

84. 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.⁵² We therefore consider that this rule is a valid simplification to apply the s 150B(1)(a) assumption.

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

85. 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 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.
86. 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 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.

Submissions on the draft report

87. The IDPs submitted that the Commission appears to place weight on s 150B(1)(a) itself in its assessment of Rules 27 and 33. The IDPs submitted that the Commission is not able to conclude s 150B(1)(a) is used in a manner which is commercially feasible unless the "actual" Notional Processor plants are allocated to sites and shown to be able to meet the objectives of a commercially feasible production plan for each site. 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 Notional Processor yields and reduce costs.

⁵² Commerce Commission "[Review of Fonterra's 2023/2024 base milk price calculation](#)" (16 September 2024), paragraph 4.19.

88. Paragraphs 41 to 42 outline our approach to assessing the way in which s 150B(1) assumptions are used.
89. Section 150B(1)(a) could potentially be applied in several ways while still achieving the s 150A purpose.
90. Fonterra has indicated that if an alternative approach were to be adopted which allocated capacity to sites rather than Regions, it would be necessary to have multiple Standard Plant sizes. Because unit capital costs decrease with capacity, Fonterra considers that this would likely result in a small net reduction in capital costs for the Notional Processor. Fonterra has also indicated that they expect that higher unit operating costs for smaller plants would be offset by lower unit costs for larger plants, and estimates that the net impact from this approach would likely result in an immaterial net increase in the milk price, but with material additional modelling complexity. We have reviewed capital cost quotes for three WMP plant sizes, sourced from a 2024 report by Aurecon which Fonterra commissioned, and consider that this provides sufficient evidence on which we conclude that the simplification associated with adopting single Standard Plant sizes per RCP in each review period is consistent with s 150A.

Concerns about drafting clarity

91. 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. However, the IDPs assert that there is a lack of a consistent nexus between Reference Assets and Standard Plants. The IDPs cite Rule 15, which states that “The Farmgate Milk Price Commodity Business may recover Fonterra’s actual Milk Collection costs, adjusted for any material differences between actual costs and the costs that would have been incurred by Fonterra if it only manufactured Reference Commodity Products according to the Farmgate Milk Price Production Plan *and the allocation of Reference Assets to Sites.*” Rule 15 could be read to imply that all Reference Assets are allocated to sites, while Rule 27 requires that Standard Plants (which are included in the Reference Assets definition) are allocated to Regions.
92. Fonterra has indicated that the italicised section was intended to refer to assets which are allocated to sites under Rule 24, such as Ancillary Assets.
93. While we accept Fonterra’s clarification, we agree with the IDPs that the current wording of Rule 15 could cause confusion. As such, we are of the view that Fonterra could consider adjusting the wording of Rule 15, and elsewhere in the Manual if appropriate, to increase clarity and consistency regarding the use of the terms “Standard Plants” and “Reference Assets”.

Rule 33 – surplus capacity

Table 7: Rule 33, surplus capacity⁵³

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>

94. 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.

⁵³ Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), page 53.

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

95. 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.

Submissions on the draft report

96. The IDPs submitted that no processor, including Fonterra, would make plant investment decisions solely based on the aggregation of milk in each of New Zealand's main islands. The IDPs contend that the Commission has not considered the commercial feasibility of the Rules independently of s 150B(1)(a) and (b) and does not have a basis for concluding they meet the purposes of s 150A. The IDPs submitted that the Manual should require the Reference Assets in the Notional Processor's Fixed Asset Base are allocated to the Notional Processor's sites, and that surplus or shortfall capacity be determined at a site level.⁵⁴
97. We sought information from Fonterra regarding how its own plant investment decisions are made. Fonterra indicated that:
- 97.1 In practice, Fonterra's evaluation of whether to add or remove a plant from its asset base will reflect an evaluation of a broad range of factors, a number of which are not directly relevant to the Notional Processor, including a much broader range of product mix-related considerations and the fact that Fonterra's actual asset base includes a number of older and less efficient plants, the continued operation of which may require significant capital expenditure (whereas equivalent plants in the Notional Processor's asset base are effectively 'automatically' retired).
- 97.2 In a review of business cases and other internal supporting material for Fonterra's most recent plant closures, all references to milk supply were at the Island level. The stated rationale for the selection of specific plants and sites for closure all relate to consideration of plant age and capability, and to product mix considerations. The closure of Brightwater, in particular, resulted in a decrease in the alignment of local processing capacity to local milk supply.

⁵⁴ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products ["Submission on the review of Fonterra's base milk price manual 2024-2025"](#) (15 November 2024), paragraphs 106 – 108.

- 97.3 Fonterra’s decisions in the ~2010 – 2017 era to add significant powder capacity at Darfield in the South Island and Pahiatua and Lichfield in the North Island were informed primarily by anticipated growth in milk supply at the Island level, with both local supply (including anticipated growth) and the existing local asset footprints then relevant in identifying plant location.
98. These points indicate that while Region (Island) level milk aggregation is not the sole consideration on which a processor with the scale of the Notional Processor might make plant investment decisions, it is likely to be a primary consideration. We therefore consider it reasonable for the Notional Processor to consider milk supply at a Region level when making such decisions as indicated in Rules 33 and 34, and consistent with the efficiency and contestability dimensions of s 150A.

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

99. 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 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.
100. 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 conclusion is that this rule is consistent with the contestability dimension of s 150A.

Rule 34 – shortfalls in capacity

Table 8: Rule 34, shortfalls in capacity⁵⁵

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.

101. 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

⁵⁵ Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), 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?

102. 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?

103. 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 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.
104. 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 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

Table 9: Rule 35, site footprint⁵⁶

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>

105. 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).

⁵⁶ Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), page 54.

106. 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.
107. 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?

108. 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, can be interpreted to mean that there is a national network of facilities with the same processing capacity footprint as Fonterra.⁵⁷ We consider that the objective of Rule 35 has applied this interpretation of s 150B(1)(a) appropriately.
109. 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?

110. 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 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.
111. 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 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.
112. 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.⁵⁸ There we were satisfied that the way in which it is applied in the calculation met the s 150A purpose.

⁵⁷ Commerce Commission "[Review of Fonterra's 2023/2024 base milk price calculation](#)" (16 September 2024), paragraph 4.26.

⁵⁸ Commerce Commission "[Review of Fonterra's 2023/2024 base milk price calculation](#)" (16 September 2024), paragraphs 4.12 – 4.30.

Drafting correction

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

Commercial feasibility*Submissions*

114. In their submission on the draft report, the IDPs expressed their view that the way in which the s 150B assumptions are used, including the Notional Processor's business model itself, are not commercially feasible. The IDPs consider that the Notional Processor's costs and yields should reflect Fonterra performance across its actual commodity business. They suggest this would be commercially feasible (at least for the dominant processor in the market) while ensuring consistency across the calculations of Notional Processor selling prices, costs and yields calculations. The IDPs also state that the Commission may consider their suggested approach does not align to its interpretation of the s 150A(1) efficiency purpose.⁵⁹
115. To support their view regarding overall commercial feasibility, the IDPs also submitted that:
- 115.1 The Notional Processor produces an inflated volume of RCPs which is not commercially feasible because that volume cannot achieve the selling prices attributed to the Notional Processor.⁶⁰
- 115.2 The Notional Processor 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 five products. The Commission 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 s 150B(1)(d) and the use of that assumption to permit commercially infeasible benefits of scale. In this respect, the Commission seems to consider s 150B(1)(d) remains a safe harbour and has not subjected its "use" to s 150B(2).⁶¹
- 115.3 The Notional Processor's production plan does not capture the typical costs and production plan sub-optimisation that occurs when balancing

⁵⁹ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products ["Submission on the review of Fonterra's base milk price manual 2024-2025"](#) (15 November 2024), paragraphs 32, 113 and 114.

⁶⁰ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products ["Submission on the review of Fonterra's base milk price manual 2024-2025"](#) (15 November 2024), paragraphs 50 and 111.

⁶¹ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products ["Submission on the review of Fonterra's base milk price manual 2024-2025"](#) (15 November 2024), paragraphs 50, 110, 111 and 112.

production priorities with sales plan and customer priorities, and with normal daily production disruptions.⁶²

Commission's response

116. Paragraphs 41 to 42 outline our approach to assessing the way in which s 150B(1) assumptions are used.
117. The Commission does not consider that all elements of the milk price model must be reflective of Fonterra's actual costs and yields to be practically feasible (including commercial feasibility). Our Approach Paper notes that “we consider the methodology for calculating the base milk price in the Manual will provide an incentive for Fonterra to operate efficiently where the Manual provides for independent notional benchmarks for the revenue and cost inputs in the calculation.”⁶³ The Approach Paper also provides that practical feasibility means that it must be possible for an efficient processor to replicate or achieve the component being assessed.⁶⁴ Fonterra's performance across its actual commodity business is evidence of the costs and yields that are practically feasible but they are not determinative of the costs and yields that can be achieved by an efficient processor.
118. To achieve the purpose in s 150A, s 150C(1)(a) requires that the base milk price must be set in a way that is consistent with the principle that “revenue taken into account in calculating the base milk price is determined from prices of a portfolio of commodities at the times that those commodities are contracted to be sold by new co-op”. While sales of only Standard Specification Products (**SSPs**) in the volumes and prices implied for the Notional Processor may not be achievable in the real world, the assumptions used reflect the application of s 150C(1)(a) which requires the use of prices that are consistent with those prevailing when Fonterra contracted for the SSPs to be sold.⁶⁵
119. The base milk price model could be made more complex to reflect yields from a broader range of product specifications. But in the alternative approach offered by IDPs, if costs and yields were increased to reflect a more complex product mix, average selling prices applied to the Notional Processor would also need to be adjusted to reflect this more complex sales mix. As indicated by the IDPs, an approach which requires the use of Fonterra's actual average yields could raise concerns in relation to the efficiency limb of s 150A.

⁶² Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products [“Submission on the review of Fonterra’s base milk price manual 2024-2025”](#) (15 November 2024), paragraphs 50 and 111.

⁶³ Commerce Commission [“Our approach to reviewing Fonterra’s milk price manual and base milk price calculation”](#) (1 August 2023), paragraph 45.

⁶⁴ Commerce Commission [“Our approach to reviewing Fonterra’s milk price manual and base milk price calculation”](#) (1 August 2023), paragraph 51.

⁶⁵ This was also stated in Commerce Commission [“Review of Fonterra’s 2023/2024 base milk price calculation”](#) (16 September 2024), paragraph 4.78.

120. The Commission considered the production plan and components of yields in the 2023/2024 Calculation review under the commercial feasibility of yields focus area. Our conclusion was that the way in which s 150B(1)(d) is used in the base milk price calculation is consistent with both the contestability and efficiency dimensions of s 150A.⁶⁶
121. Fonterra is permitted to use the assumption that all milk collected by Fonterra is processed into commodities at yields that are practically feasible (s 150B(1)(d)). Under s 150C the base milk price is also required to reflect a profitable portfolio of commodities that use all components of the milk. We consider that the use of all Fonterra milk supply for conversion into commodities is directly consistent with s 150B(1)(d) and does not detract from achieving the s 150A purpose, as noted at paragraph 46.
122. The IDPs further submitted that the production plan for the Notional Processor does not capture the unavoidable inefficiencies and normal daily supply disruptions which occur during manufacturing. While this is not a matter directly applicable to our review of the Manual, we note that the effective peak processing capacity assumed for the Notional Processor is adjusted downwards by an on-product-time (**OPT**) assumption. This assumption is based on Fonterra historical achieved plant availability performance over peak. In the 2023/2024 season, the milk price powder plant OPT was set at 95.7% for the peak processing period of October – November 2023, and was based on steady state operation of Fonterra plants over the past ten years. The OPT assumption is relevant to determining whether the Notional Processor has sufficient capacity to manufacture all milk into standard specification milk powders, or whether adjustments such as partial standardising of the finished product need to be made.⁶⁷

⁶⁶ Commerce Commission "[Review of Fonterra's 2023/2024 base milk price calculation](#)" (16 September 2024), paragraphs 4.12 – 4.30.

⁶⁷ Fonterra provided the most recent On Product Time report completed by the Milk Price Group's independent expert to us during the 2023/2024 base milk price calculation review. It has been released under s 150QA information disclosures for the 2023/2024 season, available at <https://www.fonterra.com/nz/en/investors/farmgate-milk-price/dira-disclosures.html> under 'Other' and 'Documents'.

Chapter 5 Assessment of amendments to the 2024/2025 Manual

Purpose of this chapter

123. 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.⁶⁸

Amendments arising from the 2023/2024 Manual Review

124. Fonterra has made the following amendments to the 2024/2025 Manual:

- 124.1 'Operating at arm's length' added to the description of the Milk Price Group.
- 124.2 Additional references to all information disclosure requirements contained within the DIRA regarding information supplied to the Commission, and aligning the introductory wording with the wording in the DIRA.

125. Fonterra noted in its Reasons paper in support of the Manual that these are:⁶⁹

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

126. 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.⁷⁰
127. Fonterra has amended the text in the section to:⁷¹

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

⁶⁸ Fonterra ["Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024"](#) (15 August 2024).

⁶⁹ Fonterra ["Reasons Paper in support of Fonterra's Milk Price Manual for the 2024/25 season - 1 August 2024"](#) (15 August 2024), page 4.

⁷⁰ Commerce Commission ["Review of Fonterra's 2023/24 Milk Price Manual: Final report"](#) (15 December 2023), paragraph 69.

⁷¹ Fonterra ["Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024"](#) (15 August 2024), page 28.

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

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

Information disclosure requirements

129. 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).⁷² We suggested that a reference to s 150JA could be added to Part A, Section 6.4 for completeness.⁷³ We also suggested that the text of the introduction be better aligned with the new disclosure regime.⁷⁴

130. Fonterra has amended the text in section 6.1 to:⁷⁵

(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.

131. Fonterra has amended the text in section 6.4 to:⁷⁶

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

⁷² Commerce Commission [“Review of Fonterra’s 2023/24 Milk Price Manual: Final report”](#) (15 December 2023), paragraph 71.

⁷³ Commerce Commission [“Review of Fonterra’s 2023/24 Milk Price Manual: Final report”](#) (15 December 2023), paragraph 74.

⁷⁴ Commerce Commission [“Review of Fonterra’s 2023/24 Milk Price Manual: Final report”](#) (15 December 2023), paragraphs 75-76.

⁷⁵ Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), page 31.

⁷⁶ Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), page 33.

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

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

Other amendments to the 2024/2025 Manual

133. Fonterra has also made several other minor amendments.

134. In its Reasons paper, Fonterra explains the rationale for the changes:⁷⁷

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.

135. 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

136. Fonterra has amended the background, which now reads:⁷⁸

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.

⁷⁷ Fonterra "[Reasons Paper in support of Fonterra's Milk Price Manual for the 2024/25 season - 1 August 2024](#)" (15 August 2024), page 5.

⁷⁸ Fonterra "[Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024](#)" (15 August 2024), page 5.

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

Part A, 3. Key Assumptions

138. Fonterra has amended the text of the Key Assumptions to read:⁷⁹

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.

139. This amendment does not affect efficiency or contestability regarding 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

140. Fonterra has amended the text describing the Farmgate Milk Price Commodity Business to read:⁸⁰

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

⁷⁹ Fonterra "[Reasons Paper in support of Fonterra's Milk Price Manual for the 2024/25 season - 1 August 2024](#)" (15 August 2024), page 13.

⁸⁰ Fonterra "[Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024](#)" (15 August 2024), page 18.

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'):

- 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).~~

141. Fonterra states in its Reasons paper that the amendments relating to the shipping terms are:⁸¹

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.

142. The first amendment in this section is consistent with that made in the Key Assumptions section. As noted in paragraph 139 the amendment makes it clear that competitors are those producing commodities, not any product derived from milk.

143. The remaining amendments in this section align the terms of sale among sections of the Manual, covering more terms of sale than only FAS.

144. These amendments do not affect efficiency or contestability regarding s 150A. We consider them consistent with DIRA.

⁸¹ Fonterra "[Reasons Paper in support of Fonterra's Milk Price Manual for the 2024/25 season - 1 August 2024](#)" (15 August 2024), page 4.

Part A, 4.3 Farmgate Milk Price Revenue

145. Fonterra has amended the text describing Farmgate Milk Price Revenue to read:⁸²

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).

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.

146. Fonterra states in its Reasons paper that the amendment relating to Global Dairy Trade is:⁸³

A tidy up amendment to reflect ownership of GDT.

147. 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 143 and 144 these amendments do not

⁸² Fonterra "[Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024](#)" (15 August 2024), pages 19- 20.

⁸³ Fonterra "[Reasons Paper in support of Fonterra's Milk Price Manual for the 2024/25 season - 1 August 2024](#)" (15 August 2024), page 4.

affect efficiency or contestability regarding s 150A and we consider them consistent with DIRA.

148. 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 regarding s 150A, and we consider it consistent with DIRA.

Part A, 4.4 Farmgate Milk Price Cash Costs

149. Fonterra has amended the text describing the Farmgate Milk Price Cash Costs to read:⁸⁴

- 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 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.**

150. Fonterra states in its Reasons paper that the first set of amendments in this section is:⁸⁵

⁸⁴ Fonterra ["Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024"](#) (15 August 2024), page 22.

⁸⁵ Fonterra ["Reasons Paper in support of Fonterra's Milk Price Manual for the 2024/25 season - 1 August 2024"](#) (15 August 2024), page 4.

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.

151. Fonterra states in its Reasons paper that the second set of amendments (the third bullet point) in this section is:⁸⁶

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

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

Part A, 4.5 Farmgate Milk Price Capital Costs

153. Fonterra has removed the below text in the description of the Farmgate Milk Price Capital Costs:⁸⁷

For each Financial Year subsequent to F2012

154. This is a minor wording adjustment and does not affect efficiency or contestability regarding s 150A. We consider it consistent with DIRA.

155. 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

156. Fonterra has changed the title of this rule from ‘Sale for delivery to the NZ wharf’, to ‘Sale for shipment from the NZ wharf’.

157. Fonterra has also amended the text of this rule, which now reads:⁸⁸

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~~.

158. These amendments are consistent with other amendments describing the terms of sale. As noted in paragraphs 143,144 and 147, these amendments do not affect

⁸⁶ Fonterra [“Reasons Paper in support of Fonterra’s Milk Price Manual for the 2024/25 season - 1 August 2024”](#) (15 August 2024), page 5.

⁸⁷ Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), page 25.

⁸⁸ Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), page 36.

efficiency or contestability regarding s 150A and we consider them consistent with DIRA.

Glossary

159. Fonterra has adjusted the review years in the definition of Review Year. The text now reads:⁸⁹

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

160. 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 regarding s 150A and we consider them consistent with DIRA.

⁸⁹ Fonterra [“Base Milk Price Manual for the 2024/25 season \(marked up version\) - 1 August 2024”](#) (15 August 2024), page 92.

Attachment A Other matters raised in the joint IDP submission

Topic	Key points raised by the submitter	Our response
<p>Commission's approach</p>	<p>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 base milk price calculations.⁹⁰</p>	<p>Our Approach Paper provides that practical feasibility means that it must be possible for an efficient processor to replicate or achieve the component being assessed. Fonterra's performance across its actual commodity business is evidence of the costs and yields that are practically feasible but they are not determinative of the costs and yields that can be achieved by an efficient processor.⁹¹</p> <p>The Commission has previously sought independent advice in relation to yields assumed for the Notional Processor.⁹² Given Fonterra's approach to the calculation of yields has not changed, we consider it unlikely that another independent review would result in materially different conclusions.</p>

⁹⁰ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products ["Submission on the review of Fonterra's base milk price manual 2024-2025"](#) (15 November 2024), paragraph 13.

⁹¹ Commerce Commission ["Our approach to reviewing Fonterra's milk price manual and base milk price calculation"](#) (1 August 2023), paragraph 51.

⁹² Commerce Commission ["Review of Fonterra's 2012/13 base milk price calculation: Final report"](#) (16 September 2013), pages 62-64.

Topic	Key points raised by the submitter	Our response
Processing capacity	<p>The IDPs suggest that the Commission considers the entire Notional Processor yields are appropriately based on the largest Notional Processor plants achieving the most efficient scale processing. At the same time other Notional Processor calculations include smaller plants (e.g. cost of capital). This therefore results in higher yields than can be achieved across the actual Notional Processor plants and is not commercially feasible across the actual plants. Yields based on the Rule 25 incremental standard plant cannot be commercially feasible because other elements of the model are not based on the same assumption.⁹³</p>	<p>Notional Processor yields are calculated using a building blocks approach, using a range of equipment on specific loss events over time, at a range of Fonterra plants and plant sizes. The loss surveys on which yield losses are based were outlined in the 2023/2024 final Calculation review report. Examples of loss events on which testing has occurred include a tanker & trailer clean; start-up; shut down; Clean-In-Place flush to drain on raw milk, cream, buttermilk and treated milk silos, separators (including desludges); standardising lines or evaporators (including concentrate filters and tanks); or drier wash (including feedline and bag house washes), and on fat recovery lines in cream plants. Testing occurred at plants at Te Awamutu, Clandeboye, Edendale, Pahiatua and Lichfield, as well as Darfield. We found the methodology used to be consistent with the s 150A purpose in the 2023/2024 Calculation review.⁹⁴</p>

⁹³ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products [“Submission on the review of Fonterra’s base milk price manual 2024-2025”](#) (15 November 2024), paragraphs 74, 75, and 111.

⁹⁴ Commerce Commission [“Review of Fonterra’s 2023/2024 base milk price calculation”](#) (16 September 2024), page 25.

Topic	Key points raised by the submitter	Our response
Processing capacity	The IDPs stated that the Commission seems to have a different understanding of the Notional Processor capital cost than indicated in the Manual. "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)." The IDPs consider the Commission interpretation is not consistent with the Manual. ⁹⁵ (Commission note: This refers to para 4.27 of the 2023/2024 Calculation review report). ⁹⁶	We agree that the 2023/2024 Calculation report could have more accurately stated that " <i>The total aggregate cost of the asset base is estimated by assuming that for each RCP, processing units added within each review period reference a single plant specification.</i> " ⁹⁷ We consider the adoption of a single plant specification for new plants added within each review period is an appropriate simplification that results in an outcome consistent with s 150B(1)(b)."
Processing capacity	The IDPs requested that the Commission advise if their understanding of the Notional Processor's production facilities, as outlined in their submission, is incorrect. ⁹⁸	We have addressed aspects of this request elsewhere in this report. ⁹⁹ We note that files released by Fonterra under s 150QA information disclosures for the 2023/2024 season, such as the 'Capital costs' models, may also further clarify elements relating to the Notional Processor's production facilities. ¹⁰⁰

⁹⁵ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products "[Submission on the review of Fonterra's base milk price manual 2024-2025](#)" (15 November 2024), paragraphs 62, 65, 74, and 111.

⁹⁶ Commerce Commission "[Review of Fonterra's 2023/2024 base milk price calculation](#)" (16 September 2024)., paragraph 4.27.

⁹⁷ To date the notional WMP and SMP Standard Plant capacity specification has only changed once, increasing from an average daily processing capacity of approximately 1.9m litres for plants added to the asset base prior to the 2013 season, to approximately 2.5m litres for plants added since the 2013 season.

⁹⁸ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products "[Submission on the review of Fonterra's base milk price manual 2024-2025](#)" (15 November 2024), paragraph 60.

⁹⁹ For example, see paragraphs 63-64, 78-81.

¹⁰⁰ <https://www.fonterra.com/nz/en/investors/farmgate-milk-price/dira-disclosures.html>

Topic	Key points raised by the submitter	Our response
<p>Network of facilities</p>	<p>The Manual does not in fact provide for a network of facilities. Rather it provides for a network of “capacity processing” delinked from actual Notional Processor plants. With the Notional Processor 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 Notional Processor plants if these were allocated to actual sites.¹⁰¹</p>	<p>The Manual does provide for a network of facilities, with certain assets allocated to sites under Rule 24. However, this does not include Standard Plants, which are allocated to Regions rather than sites.</p> <p>The model assumes the same number and location of commodity manufacturing sites as is actually maintained by Fonterra. The Commission 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. We were satisfied that the way in which it is applied in the calculation was consistent with the s 150A purpose.¹⁰²</p> <p>We consider that the IDPs have provided no further evidence or information that would change this view.</p>

¹⁰¹ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products [“Submission on the review of Fonterra’s base milk price manual 2024-2025”](#) (15 November 2024), paragraph 111

¹⁰² Commerce Commission [“Review of Fonterra’s 2023/2024 base milk price calculation”](#) (16 September 2024), paragraphs 4.12 – 4.30.

Topic	Key points raised by the submitter	Our response
Network of facilities	<p>Rule 27 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 s 150B(1)(b), this cannot be considered commercially feasible.¹⁰³</p>	<p>Standard Plants are allocated to Regions reflecting the Standard Plant capacity specification at the time that they were added to the Fixed Asset Base. This means that there is a specifically allocated mix of Standard Plants in each Region depending on which Review Year they were included in the model.</p>

¹⁰³ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products [“Submission on the review of Fonterra’s base milk price manual 2024-2025”](#) (15 November 2024), paragraph 78.

Topic	Key points raised by the submitter	Our response
<p>DIRA s 150A purpose</p>	<p>The IDPs consider the efficiency purpose would be better served if the base milk price processes were required to show they do NOT disincentivise Fonterra efficiency or do NOT stand in the way of incentivising efficiency. The base milk price (Commission note: we assume that IDPs mean “Notional Processor”) would accordingly not be permitted to artificially enlarge the base milk price by comparison to Fonterra commodity performance.¹⁰⁴</p>	<p>The interpretation of the efficiency dimension set out here by the IDPs is not consistent with the Commission's interpretation of s 150A. The Commission’s approach seeks to achieve an appropriate balance in promoting Fonterra's incentives to operate efficiently and providing for contestability while recognising that our role is not to set the base milk price ourselves but to assess Fonterra's base milk price processes against the s 150A purpose. The Commission’s interpretation of the contestability and efficiency dimensions under s 150A, as set out in our Approach Paper, hasn’t changed since it was considered by the High Court. There the Court concluded that “This approach was open to the Commission and is consistent with its statutory obligations” (Open Country Dairy Limited v Commerce Commission [2020] NZHC 334, para 61).</p>

¹⁰⁴ Miraka, Open Country Dairy, Synlait Milk and Westland Milk Products [“Submission on the review of Fonterra’s base milk price manual 2024-2025”](#) (15 November 2024), paragraph 20.

Attachment B 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