

**IN THE HIGH COURT OF NEW ZEALAND
WELLINGTON REGISTRY**

**I TE KŌTI MATUA O AOTEAROA
TE WHANGANUI-A-TARA ROHE**

**CIV-2018-485-957
[2020] NZHC 334**

BETWEEN OPEN COUNTRY DAIRY LIMITED
 Applicant

AND COMMERCE COMMISSION
 First Respondent

AND FONTERRA CO-OPERATIVE
 Second Respondent

Hearing: 27, 28 and 30 August 2019

Appearances: J A MacGillivray, K E Cornege and F G Biggs for Applicant
 D A Laurenson QC and J L W Wass for First Respondent
 J D Every-Palmer QC, S P Pope and S C Keen for Second
 Respondent

Judgment: 28 February 2020

**JUDGMENT OF GRICE J
(Judicial review)**

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Introduction

[1] The applicant, Open Country Dairy Limited (OCD), is an independent dairy processor. It purchases milk from farmers and processes it into dairy products for sale.

[2] OCD competes with Fonterra which is the largest dairy processor in New Zealand. Open Country is the second largest dairy processor. They and a number of smaller independent dairy processors compete for the supply of raw milk from farmers in New Zealand.

[3] Fonterra is a cooperative. Farmers supplying milk to Fonterra must purchase shares in Fonterra in proportion to the amount of milk they supply. In addition, they receive a dividend as a return on share capital invested. Independent investors may invest in Fonterra by the purchase of managed investment units in Fonterra's Shareholders' Fund. Those investors derive a return entirely from dividends.

[4] The Dairy Industry Restructuring Act 2001 (DIRA) allowed the establishment of Fonterra through the merger of two large dairy cooperatives that collectively purchased approximately 96 per cent of milk produced in New Zealand. At present it processes around 80 per cent of the milk produced. In comparison OCD which is not a cooperative, processes about 8 per cent.

[5] Subpart 5 of the DIRA has the purpose of promoting the efficient operation of dairy markets in New Zealand.¹ Fonterra or the "new co-op" as it is referred to in the DIRA, was expected to take a dominant role in the farmgate milk market. That subpart sets out a statement of principle and provisions which apply to regulate the activities of Fonterra in the milk market.²

[6] In 2012 the DIRA was amended following a review of the operation of the market. Subpart 5A was introduced. It provided for the Te Komihana Tauhokohoko Commerce Commission (the Commission) to play a role in the oversight of Fonterra in relation to setting the base milk price.

¹ Dairy Industry Restructuring Act 2001, s 70.

² Section 71 sets out the principles.

[7] The Commission is a statutory body with specialist expertise and experience in reviewing and developing economic models. The base milk price is a notional price construct developed using economic modelling.

[8] The DIRA requires Fonterra to set a notional base milk price (also called the “farmgate milk price” or FGMP) each season. The DIRA sets out certain assumptions which must be adopted and inputs and processes which must be used in setting it. The DIRA does not set out in detail what must be included in the calculation nor the exact process by which Fonterra should set the base milk price, although there are some general provisions which must be followed.

[9] Although notional figures are generally used as inputs for revenue and cost components in the calculation of the notional price, some actual Fonterra data is used where notional figures are not available or are difficult to calculate. Actual data used includes Fonterra’s revenue for the sale of certain commodity milk products sold on the global dairy trade (GDT) auction platform as well as revenue from sales by Fonterra in privately negotiated commercial transactions (off-GDT).

[10] Following the review of the operation of the DIRA, in 2012 subpart 5A to the Act was introduced. This included a framework for the Commission to review and report annually on both Fonterra’s calculation of the season’s base milk price and the related milk price manual (Manual) prepared by Fonterra.³ The Commission’s role in reviewing and reporting on the setting of the base milk price for the 2017/18 season is the focus of OCD’s application for judicial review.

[11] Fonterra must prepare the Manual and carry out the notional base milk price calculation each season. It must provide the Commission with the assumptions it adopts and the inputs and process it uses in the calculation. Fonterra must also certify to the Commission with reasons the extent to which the assumptions adopted and the inputs and process used are consistent with the statutory purpose relating to efficiency and contestability dimensions.⁴

³ Dairy Industry Restructuring Act 2001, s 150O.

⁴ Sections 150A and 150T.

[12] The Commission must then review and report on the extent to which the listed factors used in the base milk price calculation are consistent with the efficiency and contestability purpose set out in s 150A of the DIRA.

[13] The Commission's role does not extend to developing an alternative approach to calculating the base milk price nor to suggesting alternative components for the calculation that it might consider better promotes the efficiency and contestability purpose under the DIRA.

[14] Moreover, in making its report on the calculation the Commission is not required to calculate the costs of an independent processor and it is expressly prohibited from stating what it considers the base milk price should be.

[15] The Commission has published a paper setting out its approach to the review of and reporting on the Manual and the base milk price calculation (the Our Approach paper). It updates this paper with any major changes in its approach and builds on each annual review.⁵

[16] Every year the Commission selects issues relevant to the base milk price for deeper analysis. For the 2017/18 year it focussed on the asset beta multiplier (asset beta) used by Fonterra to calculate the weighted average cost of capital (WACC) which in turn is a component in the notional cost calculation of producing milk as part of the base milk price.

[17] The asset beta is a figure which is generally applied as a multiplier to adjust for the risk to the capital invested, in this case, by a notional processor. The asset beta selected for use is based on an analysis and review of information gathered from industries which have the same or similar risk factors to that of the dairy industry in New Zealand. An appropriate asset beta will usually be within a range of figures. Fonterra must select a figure in the range to use in the calculation.

⁵ Commerce Commission *Our approach to reviewing Fonterra's 2017/18 Milk Price Manual and base milk calculation*: (Public version, project no. 16.03/15837, 15 August 2017) ("*Our approach 2017/18*").

[18] In the 2017/18 report the Commission reported that the asset beta figure used by Fonterra of 0.38 to calculate the base milk price for that season did not meet the contestability dimension set out at s 150A. The Commission reported its view that the Fonterra asset beta estimate was unlikely to be practically feasible as a milk processor would be unlikely to achieve that asset beta.

[19] OCD says it agrees with the Commission's conclusion that the Fonterra asset beta was not practically feasible. But it says this conclusion was not reported clearly enough by the Commission. It says that it follows that the Commission should have concluded and reported that as a result of the asset beta figure being not practically feasible the base milk price itself was not consistent with either the contestability or efficiency dimensions set out in s 150A.

[20] Additionally OCD says that the Commission should not have allowed Fonterra to use revenue information obtained from off-GDT sales as they were not transacted through the transparent GDT auction process.

[21] OCD now seeks judicial review of the decisions of the Commission in its reporting on the asset beta. As well it seeks to review the Commission's decision to approve of Fonterra's use of confidential off GDT sales revenue information in the notional base milk price calculation for 2017/18.

[22] OCD's position is that the Commission's obligations to review and report have not been exercised in accordance with the statutory purposes of the DIRA which are intended to promote contestability and efficiency in the operation of the New Zealand milk market.

[23] The proceedings initially included other grounds raised by OCD relating to the Commission's decisions on various other inputs and assumptions used by Fonterra. However, at the hearing those claims were abandoned and the issues were narrowed to the asset beta estimate and the use of off-GDT sales.

The claims

[24] OCD formulated the claims as follows:

- (a) The Commission did not properly report that the asset beta multiplier adopted by Fonterra for its 2017/18 price was not consistent with the relevant purpose set out in the DIRA and therefore, the Commission acted unreasonably by ultimately stating the base milk price set was consistent with the relevant purpose.
- (b) The Commission erred in determining that Fonterra's adopted assumptions and inputs and processes were consistent with the relevant purposes of the DIRA in that Fonterra included sales of product which had not been transacted on the Global Dairy Transactions platform or "off-GDT" commercial sales.

[25] OCD says as a result of those errors the Commission's reported conclusions on the asset beta were unreasonable and a misleading impression was given in the report. It says allowing Fonterra to include off-GDT sales revenue was an error of law, unreasonable and failed to take into account relevant considerations.

[26] OCD notes that the context of the base milk price setting is that Fonterra is a competitor for supply of milk from farmers, so has incentives to manipulate the base milk price to the detriment of the other independent milk processors. Therefore, it says the Commission should have been vigilant in its review and robust in its report on Fonterra's assumptions, inputs and process. It should also not have allowed Fonterra to use information (off-GDT transactions) which was not public and it did not share with OCD or the other independent milk processors.

Judicial review – principles

[27] In this case OCD has alleged the Commission made errors of law, acted unreasonably and failed to take into account relevant considerations.

[28] The purpose of judicial review in circumstances such as here is to guard against unlawful decision making. The intensity of the standard of review must take into account the nature of the decisions at issue. Decisions of specialist bodies in areas requiring the application of technical expertise generally do not attract a high level of

intensity of review. The approach to judicial review in those circumstances was summarised by the High Court in *New Era Energy Inc* as follows:⁶

[67] In deciding whether the decision making process was lawful, the Court can – and does – vary the standard or “intensity” of its analysis. The factors governing that were described in the following way by Arnold and Ellen France JJ in their judgment in the Court of Appeal in *Lab Tests Auckland Ltd v Auckland District Health Board* [2008] NZCA 385 per Arnold and Ellen France JJ at [80]:

In assessing the standard of review (or scope of the procedural obligations) to be applied, it is necessary to look at the nature of the public body, the particular function being performed, the context within which that function is being performed and what it is said has gone wrong.

[68] Review of a specialist body making highly technical decisions, as is the position here, is not an occasion for a high level of intensity of review. ...

[29] Errors of law, as alleged in this case, generally fall into two general categories of unlawfulness. The first is where the decision maker has committed a true error of law by misunderstanding its statutory task. The second is where the exercise of the decision making function is so misconceived that it constitutes an unlawful decision.⁷

[30] In considering whether or not there is an error of law in this case the Court must ascertain what was required of the Commission under the statute. While the intensity of review may vary the Court will not hesitate “to pronounce on the correct interpretation of the law”.⁸ At the same time, where a statute confers on an expert body a broadly expressed power to achieve economic objectives, the Court will exercise a degree of caution. The Supreme Court set out the approach as follows:⁹

[55] Often, as in this case, a public body, with expertise in the subject-matter, is given a broadly expressed power that is designed to achieve economic objectives which are themselves expansively expressed. In such instances Parliament generally contemplates that wide policy considerations will be taken into account in the exercise of the expert body’s powers. The courts in those circumstances are unlikely to intervene unless the body exercising the power has acted in bad faith, has materially misapplied the law, or has exercised the power in a way which cannot rationally be regarded as coming within the statutory purpose.

⁶ *New Era Energy Inc v Electricity Commission* [2010] NZRMA 63 (HC) (“*New Era Energy Inc*”) at [67]-[68].

⁷ *Chorus Ltd v Commerce Commission* [2014] NZHC 690 at [14].

⁸ *New Era Energy Inc*, above n 6, [68] citing *Major Electricity Users’ Group Incorporated v Electricity Commission and Anor* HC WG CIV-2007-485-2504 24 March 2008 (“*Major Electricity*”) at [80].

⁹ *Unison Networks Ltd v Commerce Commission* [2007] NZSC 74, [2008] 2 NZLR 43 at [55].

[31] Judicial review does not provide an opportunity for dissatisfied stakeholders to review the underlying merits of a decision made by an expert body in a technical area. For instance, Wild J noted a high level of intensity of review was not called for in relation to a decision of the Electricity Commission. The Judge noted he had made that point in an earlier decision when he had commented:¹⁰

[80] *A Judge, with the benefit only of counsel’s submissions and unexamined affidavit evidence, is not well placed to review decision making processes in such situations. It is for that reason that review will succeed only if the decision making process is exposed as unreasonable.* To emphasise that this is a tough threshold, bygone Judges have resorted to such terms as “irrational” and “perverse”, and have spoken of the decision maker “taking leave of its senses”. With respect, such hyperbole adds little to the need to establish an unreasonable decision making process.

[69] Thus, where New Era claims that the Commission acted unreasonably, it must be unreasonableness in the classical sense. ...

[Emphasis added.]

[32] The primary question in this case is whether the Commission has failed to properly review and accurately report in accordance with the express statutory requirements as informed by the purpose of the legislation.

[33] I now turn to consider the statutory function of the Commissioner and its obligations under the DIRA and in particular the purpose of subpart 5A the Act (as inserted into the DIRA in 2012).

Statutory interpretation

[34] The usual rules of statutory interpretation apply here. Interpretation commences with the text of the statutory provision. The text and the purpose will determine the correct interpretation.¹¹ In addition to the legislative context the objectives of the particular legislation may be relevant.¹² Even if the meaning of the text may appear plain in isolation of the purpose, it is necessary to crosscheck that meaning against its purpose.¹³ I therefore turn to consider the legislation.

¹⁰ *New Era Energy Inc.*, above n 6, at [68]-[69] citing *Major Electricity*, at [80].

¹¹ Interpretation Act 1990, s 5 and *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36; [2007] 3 NZLR 767 (“*Commerce Commission v Fonterra*”) at [22].

¹² *Westfield (NZ) Ltd v North Shore City Council* [2005] NZSC 17, [2005] 2 NZLR 597.

¹³ Interpretation Act 1990, s 5 and *Commerce Commission v Fonterra*, above n 11, at [24].

[35] A 2012 Regulatory Impact Statement prepared by the Ministry of Agriculture and Forestry at the time of the introduction of subpart 5A of the DIRA described the purposes of the DIRA as twofold, being to:¹⁴

- a. enable Fonterra to capture efficiencies of scope and scale in the collection and processing of raw milk produced by dairy farmers in New Zealand and to compete in international markets to the overall benefit of New Zealand; and
- b. regulate the activities of Fonterra in New Zealand in relation to its farmers and potential competitors to promote the long term and dynamic efficiency of the New Zealand dairy markets.

[36] In 2011 a Cabinet paper had been prepared following a review of Fonterra's milk price setting process. It noted that the DIRA did not provide for direct intervention in Fonterra's milk and share price setting processes but the intention was that the supply side freedom of entry and exit stipulated in the DIRA would strengthen Fonterra's commercial incentives to price its milk and shares efficiently over the long term.

[37] Officials commented that "despite Fonterra's incentives to set an efficient milk price over the longer term, Fonterra may, if faced with competitive pressure, be incentivised to pay farmers a higher than efficient milk price in order to encourage entry to, and discourage exit from, Fonterra in the short to medium term".¹⁵ The paper noted that Fonterra exported the vast majority of its production and faced strong competitive pressure in international dairy markets.

[38] The 2011 review paper concluded that Fonterra's approach to setting the base milk price was a "reasonable proxy for how the milk price would be set in a workably competitive market".¹⁶ However, the paper continued, the assumptions utilised by Fonterra in the calculation of the base milk price, had the potential "to affect the extent to which the milk price acts as a barrier to efficient entry" of processors.¹⁷ The paper

¹⁴ Te Manatū Ahuwhenua, Ngāherehere | Ministry of Agriculture and Forestry *Regulatory Impact Statement: Fonterra's Milk Price Setting, Capital Restructure and Share Valuation* (Te Manatū Ahuwhenua, Ngāherehere | Ministry of Agriculture and Forestry, March 2012) ("RIS") at [2] (footnotes omitted).

¹⁵ Cabinet Economic Growth and Infrastructure Committee "Dairy Regulation Framework – Fonterra's Milk Price Setting (Part 1)" Sub11-043 at [8].

¹⁶ Regulatory Impact Statement, above n 14, at [26].

¹⁷ Above at [27].

noted that up to September 2011 there had been a lack of transparency as to how Fonterra set its milk price so it was difficult to assess whether Fonterra's milk price was consistent with the contestability aims of the legislation.

[39] The original subpart 5 of the 2001 Act dealt with the regulation of dairy markets and placed obligations on the "new co-op" (Fonterra). The purpose of the subpart 5 is set out as follows:¹⁸

70 Purpose

The purpose of this subpart is to promote the efficient operation of dairy markets in New Zealand.

[40] Subpart 5 contains the milk supply "open entry and exit" provisions which protect farmers ability, among other things, to withdraw or reduce their supply of milk to Fonterra.¹⁹ Fonterra supplying farmers are also entitled to allocate up to 20 per cent of their weekly production to independent processors.²⁰

[41] Subpart 5 allows for regulations to be made by Order in Council to require Fonterra to publish information about its business such as "forecasts of the price of dairy goods and services, including components of those prices and information used to calculate those prices".²¹ Such regulations have never been made.

[42] A legislative amendment implemented the policy decisions made by Cabinet following the 2011 review of Fonterra's milk price setting processes and its methodology. Subpart 5A came into effect in July 2012.²² It required the Commission to undertake an annual review of the Manual at the beginning of each season and to review Fonterra's annual calculations of the base milk price. It must report on those reviews annually.²³

¹⁸ Dairy Industry Restructuring Act 2001, s 70.

¹⁹ Section 97.

²⁰ Section 108.

²¹ Section 116(1)(a)(v).

²² Dairy Industry Restructuring Amendment Act 2012, s 14.

²³ At the same time, the Cabinet paper proposed that the legislation embed Fonterra's then current milk governance arrangements and require Fonterra to publicly disclose information in relation to its milk price calculation. The Cabinet paper also outlined the options available to Cabinet to regulate.

[43] As I have stated, the Commission must report on the extent to which the assumptions adopted and inputs and process used by Fonterra are consistent with the purpose in s 150A. The Commission must have regard to information provided and submissions made by Fonterra.²⁴ Importantly, the Commission is not required to calculate the costs of an independent processor and it must not state the amount of the base milk price according to its own calculations.²⁵

[44] Section 150A provides as follows:

150A Purpose of this subpart

- (1) The purpose of this subpart is to promote the setting of a base milk price that provides an incentive to new co-op to operate efficiently while providing for contestability in the market for the purchase of milk from farmers.
- (2) For the purposes of this subpart, the setting of a base milk price provides for contestability in the market for the purchase of milk from farmers if any notional costs, revenues, or other assumptions taken into account in calculating the base milk price are practically feasible for an efficient processor.

[45] Section 150C requires that for the achievement of the s 150A purpose the base milk price must be set in a way that is consistent with the revenue determined from prices of a portfolio of commodities contracted to be sold by Fonterra. The costs must take into account capital costs and a return on capital as well as costs of collecting the milk, processing it into the portfolio products and selling those commodities.²⁶

[46] Fonterra must maintain a publicly available Manual which sets out how the base milk price is to be calculated.²⁷ At the beginning of each season the Commission must review the Manual and publish a report on the extent to which the Manual is consistent with the purpose of subpart 5A (at s 150A).²⁸

[47] The Manual covers the methodology employed by Fonterra in calculating the base milk price. The base milk price for the season is the result of the calculation

²⁴ Dairy Industry Restructuring Act 2001, s 150P(2).

²⁵ Section 150P(3).

²⁶ Section 150C(1)(b).

²⁷ Sections 150F(1) and (2).

²⁸ Sections 150(H) and (I).

using the assumptions adopted and inputs and process used in the relevant year. The annual calculation must be reviewed and publicly reported on by the Commission each season.²⁹

[48] The Commission's reports are mandated by s 150P of the DIRA. The section provides as follows (emphasis added):

150P Commission's report

- (1) The Commission must make a report on **the extent** to which the assumptions adopted and the inputs and process used by new co-op in calculating the base milk price for the season are consistent with the purpose of this subpart (see section 150A).
- (2) In making the report, the Commission must—
 - (a) have regard to the information provided to it by new co-op ...; and
 - (b) have regard to any submission made by new co-op under section 150U(2)(a) or under the procedure agreed under section 150S; and
 - (c) give reasons for its conclusions.
- (3) In making the report, the Commission—
 - (a) is not required to calculate the costs of an independent processor; and
 - (b) is not required to, and must not, state the amount of the base milk price according to its own calculations.

[49] Fonterra must cooperate with the Commission's review and it must certify the extent to which the assumptions adopted and the inputs and process used by it in the calculation are consistent with the purpose of subpart 5A. It must also give reasons for its view.³⁰

[50] The Commission's draft report must be released to Fonterra no later than 15 August following the season to which the report relates.³¹ If Fonterra wishes, it may

²⁹ Dairy Industry Restructuring Act 2001, ss 150O and 150Q.

³⁰ Section 150T.

³¹ Section 150U(2).

make a submission on the draft report or notify the Commission if it does not wish to do so no later than 1 September.³²

[51] The draft report must then be finalised by the Commission and made publicly available by 15 September.³³

[52] The portfolio of commodities must be determined under s 150C(2) as follows:

- (2) ... the portfolio of commodities must be determined having regard to the following:
 - (a) in respect of the commodities included in the portfolio,—
 - (i) the commodities that are likely to be the most profitable over a period not exceeding 5 years from the time when the portfolio is determined; and
 - (ii) the need for commodities included in the portfolio to utilise all components of milk; and
 - (b) in respect of the relative proportions of the commodities included in the portfolio, the quantities of commodities likely to be produced by new co-op based on—
 - (i) the mix of commodities that are likely to be most profitable; and
 - (ii) new co-op's physical manufacturing capacity for the production of those commodities; and
 - (iii) the need to utilise all components of the milk processed.

[53] There is no dispute over the commodities selected by Fonterra for the portfolio.³⁴ The issue raised by OCD is the inclusion in the revenue of prices obtained from off-GDT sales made by Fonterra in confidential commercial contracts the terms of which cannot be verified directly by OCD.

[54] In summary the text of the legislation requires the Commission to report on the *extent* to which the assumptions adopted and inputs and process used by Fonterra in

³² Dairy Industry Restructuring Act, section 150U(2).

³³ Section 150Q.

³⁴ The commodities are whole milk power, skim milk powder, butter, buttermilk powder and anhydrous milk fat.

the calculation are consistent with the s 150A purpose.³⁵ The relevant statutory purpose to be borne in mind is to promote the setting of a price that provides an incentive to Fonterra to operate efficiently while providing contestability in the market for the purchase of milk from farmers.³⁶ Contestability is 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”.³⁷ The Commission is not required to calculate the costs of an independent processor and it must not state the amount of the base milk price according to its own calculations.³⁸ The Commission must give reasons for its conclusions.

The Commission’s approach

[55] The Commission published a document called *Our approach to reviewing Fonterra’s Milk Price Manual and base milk calculation* (Our Approach) which provides an overview of the Commission’s approach as a frame of reference for its annual reports. Each annual review and report builds on the previous.³⁹

[56] The Commission describes its approach as follows:⁴⁰

38. Our review roles under the Act are intended to support the setting of a base milk price by Fonterra that provides incentives for Fonterra to operate efficiently while also providing for contestability. ... we consider both of these interlinked dimensions when carrying out our reviews.
39. When reviewing the Manual our role is not to determine how the base milk price should be calculated ourselves. Similarly, when reviewing Fonterra’s calculation our role is not to determine the assumptions, inputs and processes of the calculation ourselves but to review those set by Fonterra.
40. In order to conclude on the extent to which the components of the calculation are consistent with the efficiency and contestability purposes of s 150A our review role may require us to consider what component values would meet those purposes. However, our role does not include developing an alternative approach to calculating the base milk price or suggesting alternative components of the calculation that we think would better promote the efficiency and

³⁵ Dairy Industry Restructuring Act 2001, s 150P.

³⁶ Section 150A.

³⁷ Section 150A(2).

³⁸ Section 150P.

³⁹ *Our Approach 2017/18*, above n 5, at [59].

⁴⁰ Above at [38]-[42] (footnotes omitted).

contestability purposes under s 150A. Further, in making our report on the calculation, we are not required to calculate the costs of an independent processor and must not state what we consider the base milk price should be.

41. Our reviews are also constrained by the safe harbours under s 150B, the mandatory principles under s 150C, and the test for contestability set by s 150A(1).
42. Our review roles under subpart 5A of the Act are therefore not the same as our roles under those regulatory regimes where we are the primary regulatory decision-maker (for example under Part 4 of the Commerce Act 1986 and under the Telecommunications Act 2001) and are specifically required (and have the express power) to make determinations that give effect to the objects of those enactments.

[57] The interlinked “contestability” and “efficiency” concepts are well known to economists. In economic terms a fully contestable market is one which can be entered without sunk costs and left without loss. There is virtually no market which meets that definition completely.⁴¹ The contestability dimension of a market will be measured by the degree to which a particular market is contestable.

[58] “Efficiency” describes obtaining the maximum output for the given input with minimum waste or effort.⁴² The efficiency dimension is also a relative concept.

[59] The requirement on the Commission to report on the “extent” to which the factors it is required to consider are consistent with the contestability and efficiency dimensions reflects the fact that neither concept is absolute.

[60] The approach the Commission took to its review of the contestability and efficiency purpose dimensions was set out in its *Our Approach* paper as follows:⁴³

Interpretation of the ‘efficiency’ dimension

14. Section 150A(1) refers to incentives [on] Fonterra to “operate efficiently”.
15. There are many factors which can, and do, incentivise Fonterra to operate efficiently. We have interpreted the primary focus of the efficiency dimension to be providing incentives for Fonterra to drive

⁴¹ N Hashimzade, G Myles and J Black *Oxford Dictionary of Economics* (5th ed), 2002, Oxford University Press).

⁴² Above.

⁴³ *Our Approach 2017/18*, above n 5, at [14]–[20].

cost efficiencies (ie, productive and dynamic efficiency) through setting the base milk price.

16. When assessing the efficiency dimension we focus on the following:
 - 16.1 our review of the Manual requires us to report whether the methodology for calculating the base milk price in the Manual incentivises Fonterra to operate efficiently; and
 - 16.2 our review of the calculation requires us to assess whether the assumptions adopted, inputs and process used by Fonterra in setting the base milk price incentivise Fonterra to operate efficiently.
17. Our view is that the methodology for calculating the base milk price in the Manual and the assumptions adopted, inputs and process used in the calculation 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 and the calculation uses these benchmarks for the revenue and costs inputs.
18. This is consistent with the Act, which envisages the use of notional values, and involves the assumption of a notional milk processing and collecting business (the ‘notional producer’).

Interpretation of the ‘contestability dimension’

19. Section 150A(2) outlines the ‘contestability dimension’ as a function of whether any notional costs, revenues, or other assumptions taken into account in the calculation are ‘practically feasible’ for an efficient processor.
20. Our interpretation is that the contestability dimension is satisfied if:
 - 20.1 The Manual provides for the assumptions used in setting the base milk price to be practically feasible for an efficient processor; and
 - 20.2 The assumptions adopted, inputs and processes used in the calculation are practically feasible for an efficient processor.

[61] This approach was open to the Commission and is consistent with its statutory obligations. As is apparent the Commission’s statutory function in this case differs from the regulatory role it performs in other sectors where it is required to calculate and impose a price (or revenue cap) on regulated suppliers. In this case the Commission is not required to calculate the costs of an independent processor and *must not* state the amount of the base milk price according to its own calculations. The Commission’s job is to review and report by offering its opinion on the extent to which the assumptions adopted and the inputs and process used in the base milk price calculation are consistent with the purpose described in s 150A.

The calculation of the base milk price

[62] The base milk price is an estimate of the average price that would be able to be paid to a supplying farmer by a notional efficient processor of the commodity products and still achieve a normal return on capital. This processor is known as the notional processor.

[63] Fonterra's Manual describes the process for calculating the base milk price. The process can be broken down to three stages:⁴⁴

- (a) Fonterra calculates the revenue that it would have received if it had collected all the milk that it purchased in the relevant year, processed it into a basket of the five most profitable commodity products and sold it on the international dairy markets. These commodity products are known as reference commodity products (RCPs). Since the beginning of the regime, this has consisted of the same five products: whole milk powder; skim milk powder; butter; buttermilk powder and anhydrous milk fat.
- (b) After converting revenue to New Zealand dollars, Fonterra deducts:
 - (i) The cash costs that would be incurred in producing the corresponding volume of RCPs including transport costs, administration and tax expenses plus costs of selling the finished product; and
 - (ii) The capital costs representing the return on capital that the notional milk price business would make on its hypothetical investment, depreciation of fixed assets and working capital. This takes into account the Weighted Average Cost of Capital (WACC) which incorporates the asset beta multiplier;

⁴⁴ *Our Approach 2017/18*, above n 5, at [104]-[108].

- (c) The difference between the total revenue and the total costs is the assumed cost of purchasing the milk. This is divided by the total volume of milk collected to determine the price per kilogram of milk solids. That is the notional base milk price.

[64] As well as the Commission's statutory oversight Fonterra is subject to a number of legislative provisions intended to provide external oversight of the base milk price setting process. This includes the requirement for Fonterra to maintain a Milk Price Panel which supervises Fonterra's calculation of the base milk price and advises Fonterra on the application and amendment of the Manual. The panel makes a recommendation to Fonterra as to the base milk price to be adopted for each season.⁴⁵ This panel operates independently of the Commission. Its composition is set out in the DIRA and the majority of members of the panel including the chair must be independent.⁴⁶

[65] Fonterra must also certify, with reasons, to the Commission on the extent to which it considers the Manual, and the assumptions adopted and the inputs and process used by Fonterra to calculate the base milk price, are consistent with the purpose of subpart 5A as stated in s 150A.⁴⁷

[66] As part of its review the Commission seeks input from a wide range of stakeholders including other independent processors on its draft annual reports and at earlier stages of its review process. The DIRA requires only a bilateral process involving the Commission and Fonterra and does not mandate engagement with stakeholders such as OCD or other processors.

[67] The Commission relies on earlier years' work to inform the scope and depth of its review in following years. The Commission also engages with Fonterra and independent processors to determine the particular areas of focus for each season's review. The Commission in addition to an in-depth review of targeted issues also conducts a fitness for purpose review of the whole calculation for the season.

⁴⁵ Dairy Industry Restructuring Act 2001, ss 150D and 150E.

⁴⁶ Section 150E(1) and (2). Fonterra must appoint the panel but the Chair and the majority of members must be independent.

⁴⁷ Sections 150L(d)-(e) and 150T(b)-(c).

Asset beta

[68] The asset beta is a figure used to reflect systematic risk to capital as a component of the WACC. The lower the asset beta figure the less risk the firm faces relative to movements in the stock market generally. OCD says that for 2017/18 Fonterra adopted an asset beta that was too low so the notional base milk price was too high. That higher base milk price raised farmers' expectations and so led to undue expense for other independent processors competing for milk supply in a price-sensitive market.

[69] In its final report on the base milk price calculation for the earlier year, 2016/17, the Commission had expressed concerns about Fonterra's asset beta calculation. It said at that stage the asset beta was a "material departure" from the sample mean submitted by Fonterra but did not conclude the asset beta was not practically feasible for that year. It determined that the asset beta and therefore the WACC calculation was consistent with the contestability dimension.⁴⁸

[70] The Commission undertook an in-depth review of the asset beta used by Fonterra in the 2017/18 review. Following that review the Commission concluded and reported that an efficient processor was unlikely to have an asset beta as low as that used in Fonterra's calculation. Therefore its report stated that Fonterra's asset beta figure was unlikely to be practically feasible.

[71] OCD agrees with the Commission's conclusion that "when all the available evidence is properly considered, an asset beta of 0.38 is unlikely to be practically feasible for purposes of the milk price calculation".⁴⁹ It agreed that given the weight of the expert evidence and the Commission's "own specialist knowledge in this area" that conclusion must be sound. However OCD says the Commission's report on the asset beta was misleading. It says the Commission failed to state that the milk base price was inconsistent with the s 150A purposes.

⁴⁸ Commerce Commission *Review of Fonterra's 2016/17 base milk price calculation: Dairy Industry Restructuring Act 2001* (Final report, project no. 16.03/15837, 15 September 2017) ("Review 2017/18") at [2.12]-[2.22].

⁴⁹ Above at [2.26].

[72] OCD says that the Commission needed to be “satisfied” on the contestability dimension. It says as the Fonterra asset beta was “significantly” lower than the range estimated in the Commission’s review it followed that the base milk price itself was materially affected by the Fonterra asset beta. OCD says the Commission did not act as a reasonable decision maker in that it failed to state that the base milk price itself was not consistent with the s 150A purposes.

[73] OCD said that the only regulatory machinery for monitoring Fonterra in the milk price setting was the Commission’s review and public report process. Therefore, unless the report clearly stated the base milk price was materially wrong, then the regulation was not working so the Commission needed to be held to its task.

[74] OCD acknowledged that the Commission was prohibited from calculating its own base milk price but says it was not prevented from stating that Fonterra’s setting of the price was inaccurate and inconsistent with the s 150A purpose. OCD says anything less than that would render the Commission’s role perfunctory.

Report by the Commission regarding asset beta for 2017/18

[75] The Commission’s report on its review of Fonterra’s 2017/18 base milk price calculation devoted 41 pages to a detailed review of the asset beta.⁵⁰ It had commissioned independent experts, Cambridge Economic Policy Associates (CEPA) and FreshAgenda, to look at the issue. The experts’ report was circulated to stakeholders for comment as was the Commission’s draft report. The Commission’s conclusion that the asset beta of 0.38 used by Fonterra for the 2017/18 base milk price was unlikely to be practically feasible for an efficient processor was reached by it after considering submissions from various stakeholders including OCD on the draft report and on the emerging views paper on asset beta which had been circulated by the Commission.⁵¹ The Commission’s detailed analysis is set out in an appendix to the report.

⁵⁰ *Review 2017/18*, above n 47.

⁵¹ *Review 2017/18*, above n 47, at [1.16] citing Commerce Commission *Review of Fonterra’s 2017/18 milk price calculation: Emerging views on asset beta* (Public version, project no. 16471, 14 June 2018).

[76] In summary, there were differences between CEPA/FreshAgenda and the Fonterra experts as to the level of risk borne by the notional processor. These differences led to a gap between the asset beta used by Fonterra of 0.38 and the higher figures within the range estimated as appropriate by the Commission of 0.48-0.58 (combining estimates).⁵²

[77] The depth of the analysis undertaken by the Commission in its review of the asset beta is apparent from the number of submissions and the advice it considered. It reported these as being:⁵³

- B88.1 Submissions to the draft report
- B88.2 Submissions to the emerging views paper;
- B88.3 the advice from CEPA/FreshAgenda of 28 March 2018 comparing the risks faced by the NP⁵⁴ and the listed dairy companies;
- B88.4 the empirical analysis of asset beta for listed comparator companies undertaken by CEPA and previously by Dr Marsden in his submission to the 2015/16 milk price calculation review and updated in 2017;
- B88.5 Fonterra's submission and the reports submitted by Fonterra from its expert advisers, Dr Marsden and NERA⁵⁵, on the CEPA/FreshAgenda report, as well as submissions received from independent processors on the CEPA/FreshAgenda report;
- B88.6 further analysis undertaken by CEPA in response to the submissions on its first report;
- B88.7 submissions and advice provided to us in previous years' reviews of the milk calculation, including the reports we commissioned from Dr Lally and the submission from TDB Advisory received during the review of the 2017 /18 Milk Price manual; and
- B88.8 reports and analysis from other commentators including NZ trading and investment banks.

[78] The Commission summarised its overall conclusions on the asset beta in its final report as follows (emphasis added):⁵⁶

2.3 *With the exception of the asset beta*, the assumptions adopted and the inputs and processes used by Fonterra to calculate the 2017/18 base

⁵² Above at [B95].

⁵³ Above at [B88] (footnotes omitted).

⁵⁴ Notional processor.

⁵⁵ NERA is an economic consultancy firm.

⁵⁶ *Review 2017/18*, above n 47, at [2.3]-[2.6].

milk price are *consistent* with the *contestability dimension* of the s 150A purpose.

2.4 The assumptions adopted and the inputs and processes used in calculating the 2017/18 base milk price are consistent with the *efficiency dimension* of the s 150A purpose.

2.5 An efficient processor with a similar risk exposure to the notional producer is *unlikely to have an asset beta as low as Fonterra's estimate* of 0.38, and on balance we consider that this *beta estimate* is therefore *unlikely to be practically feasible*.

...

[79] The Commission in its report set out the submissions it had received on its draft report. OCD and Miraka (another independent processor) commented on the wording of the Commission's conclusions set out above in their submissions on the draft report. Miraka criticised the wording in relation to the asset beta summary conclusion at [2.5] above, saying:⁵⁷

This doubly qualified decision ("on balance" and "unlikely") leaves the door open for Fonterra to continue its campaign to justify the low asset beta, or to simply ignore the Commission on this matter.

[80] OCD in its submission on the draft report also commented on the Commission's comments on the asset beta saying, "the Commission should take great care that the wording of its conclusions do not mislead".⁵⁸

[81] The Commission responded to both submissions as follows:

Estimated asset beta is inherently difficult, as shown by the stark differences between the views of the parties (including their experts). While we are confident that it is unlikely that the asset beta of 0.38 is practically feasible we do not consider that we are able to be more conclusive.

[82] The Commission was required by the DIRA to take into account Fonterra's submissions on the Commission's draft report. Fonterra and its experts maintained that the asset beta they had used was within the appropriate range and gave their reasons for this view. However the Commission in its final report maintained its position and did not agree with Fonterra's view on this point.

⁵⁷ Above at [2.17].

⁵⁸ Above at [2.17].

[83] The Commission disagreed with Fonterra's submission in a number of respects. For instance, it rejected Fonterra's submission that considerable weight should be attached to the fact there had been continued competitive entry by independent processors into the market. Fonterra said that fact should be definitive that an asset beta of 0.38 was practically feasible for an efficient provider and so met the contestability dimension. Fonterra also submitted that more weight should have been given by the Commission to the fact that there had been continuing investment in the sector by the independent processors. That point was also rejected by the Commission.

[84] The conclusions in the Commission's report were necessarily confined to the extent to which the assumptions adopted and the inputs and process used by Fonterra were consistent with the s 150A purpose. The conclusions were that the asset beta used by Fonterra was below the appropriate range and therefore the likelihood was that Fonterra's asset beta was not practically feasible.⁵⁹ The wording of the Commission's conclusion properly reflected its views following a detailed analysis on an issue on which the experts themselves disagreed. The wording in its report that "on balance" the asset beta was "unlikely" to be practically feasible did accurately report the extent to which the Commission considered the asset beta met the contestability dimension of the s 150A purpose.

[85] The Commission was not required to do anything other than report its conclusion on the "extent" to which the assumptions adopted and the inputs and process used by Fonterra was consistent with the efficiency dimension and providing for contestability in the purchase of milk. Section 150A specifically noted that the function of contestability is provided if any notional costs, revenues or other assumptions are practically feasible for an efficient provider. The Commission reported that the asset beta used by Fonterra was not practically feasible. In my view this was a proper approach to the Commission's task as set out in the legislation.

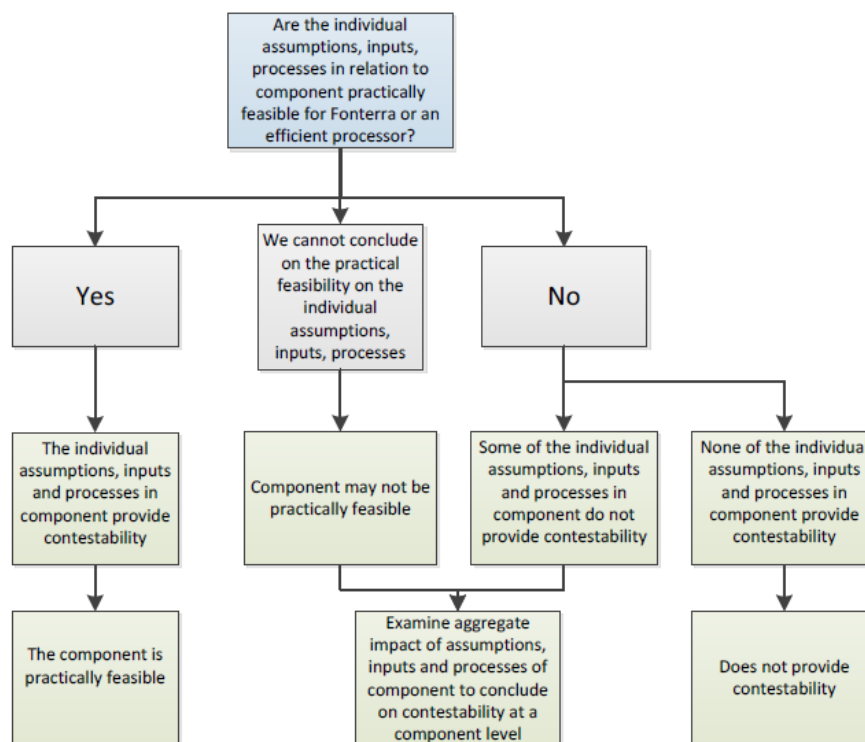
⁵⁹ *Review of Fonterra's 2017/18*, above n 47, at B[47]-B[48].

Contestability dimension

[86] OCD submitted that the Commission should have borne in mind the fact that the base milk price acted as a benchmark for the market price paid to farmers for milk by independent processors. OCD said that the price set by Fonterra effectively forced the other processors to match or to be close to the price paid by Fonterra.

[87] The Commission set out its process in diagrammatic form as follows:

Figure 3.4 Process for assessing the contestability dimension



[88] The Commission noted that there were numerous other factors and considerations which went into the mix when considering whether a component (in this case the asset beta) affected the contestability of the base milk price as a whole. It noted that if it found that one component might not be practically feasible it examined the aggregate impact of assumptions, inputs and processes to conclude on contestability at the component level. Therefore, while one assumption or component may not be practically feasible, it must consider each assumption, input and process before concluding none of the components provided contestability.

[89] In terms of both the contestability and efficiency dimensions of the purpose, the Commission's view was that with the exception of the asset beta multiplier used the assumptions adopted and the inputs and process used by Fonterra in the calculation were consistent with the contestability and the efficiency dimensions.

[90] OCD, apart from the asset beta and its effect on the calculation as a whole, did not assert that the Commission made any errors in relation to its assessment on the other components used in the calculation under this head of claim.⁶⁰ It is the asset beta which OCD says met neither the contestability nor the efficiency dimension and that affected the base milk price. Therefore, it is not necessary to consider any other assumptions adopted, inputs or the process used by Fonterra or the way in which the Commission reported on those.

[91] OCD pointed out that the Commission had suggested in its circulated draft report on the 2017/18 base milk calculation that the base milk price "may only need to be set marginally too high to undermine efficient entrants and erode contestability". However, this statement was not repeated in the Commission's final report which is the subject of this application. The Commission said that the statement was included in the draft due to an administrative error, that it was incorrect and did not reflect the view of the Commission. The Commission said that a sufficiently large change in the base milk price might erode contestability but it noted that other factors played a role.

[92] The Commission said that while the base milk price might be an important reference point for independent processors it did not dictate the price paid by independent processors. It pointed out that the market is more complex and dynamic than was suggested by OCD. The Commission said that the reasons why a farmer might supply to a particular processor were varied and complicated. For instance, a processor might offer different payment arrangements. These were attractive to some suppliers and in fact different arrangements were offered by some processors. Another element in the mix that the Commission pointed to was the ability of some processors to pay more for supply where they were able to produce higher value products. The

⁶⁰ The claim as that it relates to the off-GDT revenue is under a different head of claim. I consider that below.

competition between the processors for the supply of milk, the Commission says, is affected by many factors.

[93] In summary the Commission said the competitive dynamic is not as sensitive as OCD suggests. The Commission was not of the view that in this case the base milk price would be affected by the asset beta to the extent claimed by OCD.

[94] In any event the Commission's task is not to reach a determination on what the base milk price should be. It is charged only with determining "the extent" to which the assumptions adopted and the inputs and process used by Fonterra in calculating the base milk price are consistent with the legislative purpose expressed in efficiency and contestability dimensions. The review by the Commission involved a multifactorial analysis and the application of its judgement and expertise. The Commission is the expert in that area and that is why it has been entrusted with the task. A wide span of discretion must be allowed to the Commission in its review and the reporting of its conclusions.

[95] The Commission reported in terms of the statute and did so with the relevant legislative purpose firmly in mind. It made no errors of law in its review and report as it related to the asset beta.

Efficiency dimension

[96] The contestability dimension was the primary focus of the OCD's complaint about the report as it related to the asset beta. However submissions were also made on whether or not Fonterra's asset beta affected the efficiency dimension.

[97] The Commission in its report said that the efficiency dimension was not affected by its conclusion on the asset beta as the assessment of the efficiency dimension was based on the reviews over previous seasons. It said in its report:⁶¹

From our review of the milk price in previous seasons we are satisfied that the estimate of asset beta used by Fonterra provides it with an incentive to operate efficiently, satisfying that aspect of s 150A(1). As the asset beta has remained 0.38 as per the previous season, the outstanding issue is to review the extent

⁶¹ *Review 2017/18*, above n 47, at [B35].

to which the value of asset beta used by Fonterra is providing for contestability in the market for the purchase of milk from farmers.

[98] Therefore the Commission concluded that the asset beta did provide an appropriate incentive for Fonterra to operate efficiently based on the information it had reviewed over previous seasons. This was a conclusion available to the Commission.

[99] OCD invited the Court to go behind the Commission's conclusions on the contestability and efficiency dimensions to reweigh the factors considered by the Commission. However, that is not the function of the Court on judicial review. The conclusion of the Commission was based on the views of experts following a thorough analysis involving many factors. In the absence of an error of law the Commission's analysis and determination should not be revisited by this Court. The Commission is a specialist body making a technical assessment which this Court is not equipped to undertake.

[100] I conclude under this head, that the Commission's report met the legislative requirements in relation to its review and report on the setting of the base milk price by Fonterra. It reported in accordance with its statutory obligations. The Commission reported on the extent to which it considered the assumptions adopted and the inputs and process used by Fonterra for the relevant year in calculating the base milk price were consistent with the purpose set out in s 150A. The purpose was to incentivise Fonterra to operate efficiently while providing contestability for the purchase of milk. On balance, the Commission reported that it considered the asset beta was not practically feasible and to that extent the contestability dimension was not satisfied. It was not required to go any further. Its report was not misleading.

Off-global dairy trade (off-GDT) platform and revenue

[101] Fonterra must set its base milk price in a manner consistent with a number of principles. One of these is that the revenue and costs taken into account must be determined from the prices and costs of a portfolio of commodities at the times that those commodities are contracted to be sold by it.⁶² The portfolio of commodities is

⁶² Dairy Industry Restructuring Act 2001, s 150C(1).

determined by including the commodities that are likely to be the most profitable over the five years from the time the portfolio is determined. The source of the revenue information from the sale of those commodities is not otherwise prescribed.

[102] OCD says the Commission should not have accepted that Fonterra could include off-GDT sales revenue in the notional revenue calculation.

[103] OCD says that it does not dispute the fact that Fonterra provided sufficient information to satisfy the Commission about the soundness of the off-GDT transaction revenue and details. However it does say that the legislation contemplates the transparency of such information. It says it was not transparent because, in particular, OCD was not privy to it.

[104] OCD says that because the off-GDT transactions were not public OCD cannot check whether the prices obtained in those transactions might be for instance affected by terms included in private sales contracts. In addition it says the inclusion of the off-GDT sales means the independent processors cannot usefully contribute to the base milk calculation process because they are not privy to all the information.

[105] In summary it says its concern is that the sales might not meet the requirements of s 150C because OCD has no way to verify them. In light of that OCD says the use of off-GDT data undermines the transparency and ‘simplicity’ of the base milk price calculation to such an extent that the Commission should have intervened.

[106] The Commission says it was satisfied with the information supplied by Fonterra as to the off-GDT sales transactions and the appropriateness of using the revenue in the base milk price calculation.

Transparency

[107] The Commission in its Our Approach paper notes its view that Fonterra has a stronger incentive to operate efficiently when the base milk price is set independently of Fonterra’s actual performance. Therefore, the calculation uses notional data. The Commission says this provides Fonterra with a benchmark to beat. However where there is, for instance, insufficient information to know what an appropriate notional

value might be, it might be unreasonably costly to find out, or where Fonterra has very limited control over the actual costs, the Commission may use actual Fonterra data. The Commission assesses whether the use of the actual data may distort or weaken Fonterra's incentive to operate efficiently.

[108] The GDT information and prices are publicly available. Whereas the off-GDT transactions are not publicly available. Fonterra says that the information on those transactions is confidential and commercially sensitive. It does not want to share it with competitors such as OCD. Nevertheless, it was required to supply and did supply the confidential information regarding these transactions as requested to the Commission for its review of the calculation of the base milk price.

[109] OCD and Miraka both outlined their concerns about the lack of transparency of the off-GDT sales in their submissions in response to the Commission's draft report.

[110] Fonterra is required by the legislation to provide various information to the Commission. It says it adopts an open book policy which enables the Commission to obtain any information it requires. The statutory process contemplates a bilateral framework for supervision by the Commission of the setting by Fonterra of the base milk price. There is no statutory requirement to involve third parties. The Commission has chosen as part of its process to include other stakeholders including OCD and other independent processors in the submission process but that does not mean they are entitled to review all the confidential information that the Commission has available to it.

[111] Fonterra is not required to publicly disclose information which it considers to be commercially sensitive. The Commission is in a position to verify confidential information that is used in the base milk price calculation. This is the process which Parliament has chosen for supervision in the regulation of the milk price setting. Regulations could be made to require Fonterra to publish information but such regulations have never been made.

[112] The Commission in its review of the base milk price calculation (2017/18) said:

Inclusion of off-GDT sales as a reference for calculating WMP,⁶³ SMP⁶⁴ and AMF⁶⁵ prices

- 2.40 We concluded in our 2016/17 calculation review that the inclusion of off-GDT reference sales is consistent with the efficiency dimension. We consider inclusion by Fonterra of off-GDT sales as a reference for prices used for the notional producer is practically feasible for Fonterra and an efficient processor. Fonterra has included the necessary costs for the notional producer as a result of including off-GDT sales for WMP, SMP and AMF.
- 2.41 In reviewing the 2017/18 milk price calculation we have looked at the off-GDT prices and volumes against last seasons to obtain comfort in what is being included in this year's calculation. We have seen a similar proportion of the milk price revenues coming from the off-GDT sales, as well as a similar price differential with GDT sales prices in this year's calculation relative to last year. This is in line with what Fonterra describes in its reasons paper supporting the 2017/18 milk price.
- 2.42 In its reasons paper for the 2017/18 milk price calculation Fonterra has confirmed that it has not made any amendments to the product specifications used to determine which off-GDT sales are used in the milk price calculation.
- 2.43 For the purpose of this season's review we requested further information from Fonterra on this issue, focussed around the decision making process to include or exclude off-GDT sales. Fonterra supplied us with a 'decision tree' describing the process/decision points for filtering out non-milk price informing sales. Figure 2.2 is a simplified version of this decision tree.

[113] OCD submitted that in a newspaper article quoting Fonterra's chairperson that there was an indication that the proportion of off-GDT sales (compared with GDT sales) obtained by Fonterra for 2017/18 was inconsistent with the previous year which is contrary to the Commission's comments above at [2.41] of its report. The Commission in response said the comments in the article were misinterpreted by OCD. I see no reason to doubt the Commission's response on this issue. The information in the article is second-hand and does not contain the full transcript or the context of the interview. In my view the article does not take the matter any further.

[114] I am satisfied that the Commission carried out its review and reported appropriately on the inclusion of the off-GDT sales revenue. The Commission saw

⁶³ Whole milk powder.

⁶⁴ Skim milk powder.

⁶⁵ Anhydrous milk fat.

and verified the supporting information that it had requested from Fonterra on this point. That is part of its role. As a matter of common sense it seems the inclusion of both on and off-GDT sales prices will provide a more reliable notional revenue figure for the base milk price calculation.

[115] OCD also pointed to comments by the Commission in its report as follows:

2.44 We continue to consider that there should be more transparency around how Fonterra has determined the off-GDT sale prices used for the Notional Producer.

[116] While the Commission might be encouraging further transparency it is not a legislative requirement. The Commission is the body responsible for the review and it was entitled to and did review Fonterra's confidential information. It satisfied itself that the use of Fonterra's off-GDT transaction prices was appropriate for the 2017/18 calculation of the base milk price. That was all it was required to do.

[117] The Commission did not make an error of law nor did it act unreasonably or fail to take into account relevant considerations when it made the decision to report in the manner it did on the inclusion of Fonterra's revenue from off-GDT sales in the calculation of the base milk price.

Policy

[118] OCD suggested that in relation to contestability the Commission did not properly consider or recognise the fact that competitors were not entering the market particularly in some geographic areas. OCD says that Parliament intended to actively encourage further efficient entry by independent processors, where they could operate marginally more efficiently than Fonterra.

[119] However Mr Ruck an expert economist for the Commission noted that Parliament had adopted policy settings designed to give Fonterra an incentive to strive for greater efficiency. This, he said, would be encouraged by setting the price at a level that provided a credible threat of entry by independent processors, whether or not entry actually occurred. An alternative policy approach would have been to actively encourage entry by independent processors but this approach had been

deliberately rejected by Parliament. That was not the approach taken in the legislation and as summarised in the 2012 regulatory impact statement⁶⁶ which accompanied the introduction of subpart 5A. That statement summarised the present policy approach as follows:

In general, the DIRA is premised upon regulating to ensure that the dominant player has the right incentives to be efficient. It does this through ensuring a credible threat of entry by efficient competitors – i.e. the DIRA imposes a contestability standard. Contestability essentially means that outcomes should be efficient, whether or not there is an increase in the number of competitors in the farm gate milk market. That is, as long as Fonterra does not use the farm gate milk price as a barrier to entry for efficient competitors, then the price should allow an efficient processor to compete; and incentivise Fonterra to itself operate efficiently.

[120] The legislation includes a number of mechanisms for the regulation of the behaviour of Fonterra in the market⁶⁷ as well as for independent governance and oversight by the Milk Price Panel.⁶⁸ Other factors relevant to Fonterra’s behaviour in the market include its accountability to investors (who are not also suppliers) and the competition it faces as one of New Zealand’s largest exporters.

[121] There are a myriad of economic, regulatory and policy considerations which have been taken into account in the design of the legislative framework and statutory role of the Commission.

[122] OCD would prefer a policy that imposed more proactive or aggressive regulation by the Commission in the setting of Fonterra’s base milk price. That is a matter for parliament, not this court.

[123] Counsel noted in the course of argument that the Ministry for Primary Industries had recently conducted a further review of the DIRA following the setting of the base milk price for the 2017/18 year. As a result Cabinet has adopted proposals for legislative restrictions on how the asset beta is calculated.⁶⁹ Counsel said that the bill was yet to be drafted however, in part, the new legislation was intended to address

⁶⁶ Regulatory Impact Statement, above n 14, at [20].

⁶⁷ For instance the “open entry and exit” provisions. See [40].

⁶⁸ The Milk Price Panel is made up of a majority of independent members including the Chair. See [64].

⁶⁹ Cabinet Economic Development Committee Minute of Decision “Review of the Dairy Industry Restructuring Act 2001 and Impacts on the Dairy Industry” (29 May 2019) DEV-19-MIN-0142.

concerns raised by the Commission in the 2017/18 report related to the asset beta adopted by Fonterra. It may be that the proposals herald a change in policy however that is a matter that is not relevant to this application.

Conclusion

[124] OCD said that the Commission had failed to be as vigilant as it should have been in supervising Fonterra in the setting and calculation of the base milk price for 2017/18. It said that Fonterra had incentives to favour its competitive position against other independent processors.

[125] The Commission's role in the oversight of the setting and calculation of the base milk price was introduced by subpart 5A of the DIRA in 2012. Its role is to review and report on specific matters in relation to the Manual and the base milk price calculation in each season. The Commerce Commission was appointed as an expert body. The DIRA allows a wide discretion to the Commission as to the approach it takes and the manner it undertakes its reviews and reporting on the setting and calculation of the base milk price by Fonterra.

[126] The first ground of review related to the Commission's 2017/18 report concerning the asset beta used by Fonterra. The Commission was required to report on the extent to which the assumptions adopted and the inputs and process used by Fonterra in calculating the base milk price for the season were consistent with the purpose of subpart 5A of the DIRA. The Commission did report on the extent to which it considered the asset beta used was not consistent with the statutory purpose as it related to the contestability dimension. It concluded that the asset beta used by Fonterra for the 2017/18 season was unlikely to be practically feasible. Otherwise it reported that the assumptions adopted and the inputs and process used by Fonterra were consistent with the efficiency and contestability dimensions of the purpose. The Commission reported properly on the conclusions it had reached in its review.

[127] The second ground advanced by OCD was that for 2017/18 the Commission approved the use by Fonterra of revenue figures from off-GDT sales in the base milk price revenue calculation. The Commission reported it was satisfied that the inclusion of the off-GDT information was appropriate. The use of that revenue information was

not contrary legislative provisions. The Commission made no error of law in its review or report on the use of the revenue.

[128] The Commission has fulfilled its obligations under the legislation in respect of both the reviewing and reporting on the extent to which the assumptions adopted and the inputs and process used by Fonterra were consistent with the relevant statutory purpose and in its report on the inclusion of off-GDT revenue. It has made no errors of law nor has it acted unreasonably nor failed to take into account relevant considerations in making its decisions.

[129] The application for judicial review is dismissed.

Costs

[130] If counsel are unable to agree on costs, any application together with supporting submissions should be filed by memorandum on or before seven days of the date of delivery of this judgment. Any submissions in response should be by memorandum filed on or before a further seven days and any reply should be filed within a further three days.

Grice J

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