

Review of Fonterra's 2021/22 Milk Price Manual: Dairy Industry Restructuring Act 2001

Final report

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Date of publication: 15 December 2021



Associated documents

Publication date	Reference	Title
15 October 2021	ISBN 978-1-869459-38-3	Review of Fonterra's 2021/22 Milk Price Manual: Dairy Industry Restructuring Act 2001 – Draft report
15 September 2021	ISSN 1178-2560	Review of Fonterra's 2020/21 base milk price calculation: Dairy Industry Restructuring Act 2001 – Final report
5 July 2021	ISBN 978-1-869459-10-9	Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation – 2021
15 December 2020	ISBN 978-1-869458-60-7	Review of Fonterra's 2020/21 Milk Price Manual: Dairy Industry Restructuring Act 2001 – Final report

Commerce Commission

Wellington, New Zealand

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Chapter 1 Purpose and scope

Purpose of this report

1. This report sets out our conclusions from our statutory review of the extent to which Fonterra's 2021/22 Milk Price Manual (**the 2021/22 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 2021/22 Manual contains the methodology that will be used to calculate Fonterra's base milk price for the 2021/22 season.

How this report is structured

3. This chapter outlines the purpose and scope of the 2021/22 Manual review.
4. Chapter 2 explains our review framework for our 2021/22 Manual review.
5. Chapter 3 sets out our conclusions from the review and responds to submissions from stakeholders on our draft report.
6. Attachment A summarises points raised in submissions that we consider to be out of scope for the 2021/22 Manual review. Where relevant, we have indicated whether the submission argument could be addressed as part of our base milk price calculation review and/or whether we have considered the argument in a previous Manual or calculation review.
7. Attachment B provides a glossary of the key terms and abbreviations used in this report.

Scope of this review

8. DIRA requires Fonterra to provide us with the following information for consideration in our Manual review:²
 - 8.1 the Manual for the current season;

¹ DIRA, s 150A. Unless otherwise stated all references to sections are to sections of the Dairy Industry Restructuring Act 2001.

² Section 150L.

- 8.2 any recommendations by the Milk Price Panel (**MPP**)³ in relation to the setting of the base milk price;⁴
 - 8.3 notification of any change in the economic and business environment that, in Fonterra's view, requires a change to the Manual;
 - 8.4 certification on the extent to which Fonterra considers that the Manual is consistent with the s 150A purpose; and
 - 8.5 the reasoning behind the views expressed in Fonterra's certification.
9. 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:
- 9.1 the Base Milk Price Manual for the 2021/22 season (marked-up version);⁵
 - 9.2 a Reasons paper in support of Fonterra's Milk Price Manual for the 2021/22 season (**Fonterra's Reasons paper**);⁶ and
 - 9.3 the MPP recommendations to Fonterra's Board with respect to amendments to the 2021/22 Manual.
10. The 'marked up' version of the 2021/22 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 2021/22 Manual identifies all amendments to the Manual.⁷ In addition, we have reviewed the MPP recommendations to Fonterra's Board and confirmed that all recommended amendments are reflected in the 2021/22 Manual.

³ 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 "[Attachment 1 – Base Milk Price Manual for the 2021-22 season \(marked up version\) – 30 July 2021](#)" (18 August 2021), page 26.

⁴ Fonterra has "interpreted this provision as in fact relating to recommendations by the Milk Price Panel in relation to amendments to the Milk Price Manual." (See Fonterra "[Reasons paper in support of Fonterra's Base Milk Price Manual for the 2021-22 season – 30 July 2021](#)" (18 August 2021), footnote 1). We agree with this interpretation.

⁵ Fonterra "[Attachment 1 – Base Milk Price Manual for the 2021-22 season \(marked up version\) – 30 July 2021](#)" (18 August 2021).

⁶ Fonterra "[Reasons paper in support of Fonterra's Base Milk Price Manual for the 2021-22 season – 30 July 2021](#)" (18 August 2021).

⁷ Fonterra "[Reasons paper in support of Fonterra's Base Milk Price Manual for the 2021-22 season – 30 July 2021](#)" (18 August 2021), page 1.

11. In reaching our conclusions we have applied DIRA as amended by the Dairy Industry Restructuring Amendment Act 2020 (**2020 Amendment Act**). We have focused on the amendments Fonterra has made to the Manual for the 2021/22 season and matters carried forward from previous reviews. We have also considered whether the amendments to DIRA under the 2020 Amendment Act should give rise to any other changes in the Manual.
12. For those parts of the Manual that have remained unchanged, we have continued to rely on our previous conclusions. We are not aware of any other new information which would warrant reconsideration of our conclusions in previous Manual reviews.
13. We published our draft report on our review of the 2021/22 Manual on 15 October 2021 (**draft report**).⁸ We received submissions on our draft report from the following stakeholders:
 - 13.1 Fonterra;⁹
 - 13.2 Miraka;¹⁰ and
 - 13.3 Open Country Dairy.¹¹
14. We have responded to stakeholder submissions that are within the scope of our 2021/22 Manual review in Chapter 3.

⁸ Commerce Commission "[Review of Fonterra's 2021-22 Milk Price Manual: Dairy Industry Restructuring Act 2001 – Draft report](#)" (15 October 2021).

⁹ Fonterra "[Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021](#)" (17 November 2021) (**Fonterra submission**).

¹⁰ Miraka "[Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021](#)" (17 November 2021) (**Miraka submission**).

¹¹ Open Country Dairy "[Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021](#)" (17 November 2021) (**Open Country Dairy submission**).

Chapter 2 Our framework for the Manual review

15. This report should be read with the framework paper "Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation - 2021" (**Approach paper**) which reflects the amendments made to DIRA in 2020.¹² The Approach paper applied in this review forms part of this report.¹³
16. The Approach paper provides an overview of the approach which we take in our reviews of Fonterra's Manual and base milk price calculation, and includes:
 - 16.1 an overview of how the base milk price is set;
 - 16.2 our interpretation of the key legislative provisions guiding our statutory reviews; and
 - 16.3 our practical approach to our statutory reviews.
17. The base milk price 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.¹⁴ The regime also promotes greater transparency of Fonterra's base milk price setting processes.¹⁵
18. 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 process to be followed in calculating the base milk price.
19. We consider the extent to which the Manual is consistent with the purpose of subpart 5A of DIRA, at s 150A. In particular, our review considers the 'efficiency' and 'contestability' dimensions of the s 150A purpose as required by DIRA. Our review thus focuses on whether the methodology used in the Manual:¹⁶
 - 19.1 provides an incentive for Fonterra to operate efficiently (the 'efficiency dimension'); and

¹² See Dairy Industry Restructuring Amendment Act 2020.

¹³ Commerce Commission "[Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation – 2021](#)" (5 July 2021).

¹⁴ Section 150A(1).

¹⁵ Dairy Industry Restructuring Amendment Bill (2012 11-1), page 2.

¹⁶ We consider the same 'efficiency' and 'contestability' dimensions when we carry out our base milk price calculation review.

- 19.2 adopts assumptions, inputs and processes that would be practically feasible for an efficient processor (the 'contestability dimension').
20. As set out in the Approach paper, the efficiency dimension is met if Fonterra uses notional inputs in calculating the base milk price (ie, inputs that are independent from Fonterra's actual data).
21. 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.¹⁷
22. To satisfy the provisions in s 150A, our interpretation is that our statutory reviews 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.¹⁸
23. In practice, we focus our review each year on changes to the Manual from the previous year's Manual and on any unresolved issues we carried over from our previous reviews.

¹⁷ Section 150A(2).

¹⁸ Commerce Commission "[Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation – 2021](#)" (5 July 2021).

Chapter 3 Conclusions

24. This chapter summarises our conclusions on the extent to which the 2021/22 Manual is consistent with the s 150A purpose.

Our conclusions

25. Our final conclusions remain unchanged from the conclusions in our draft report.
26. Regarding Fonterra's amendments to the Manual since last year's review, our conclusions are that the amendments made are consistent with s 150A of DIRA.
27. Our overall conclusion is that:
- 27.1 Rule 42 of the 2021/22 Manual is inconsistent with the new requirements set out in s 150C, and thus inconsistent with the statutory purpose set out in s 150A; and
- 27.2 based on the information we have before us, with the exception of Rule 42, the 2021/22 Manual is consistent with the s 150A purpose of DIRA.¹⁹

Amendments to DIRA

28. The relevant amendments to DIRA enacted by the 2020 Amendment Act came into force on 1 June 2021. We considered whether the DIRA amendments have been appropriately reflected in the 2021/22 Manual, where relevant. Our conclusion is that the only rule affected by the DIRA amendments is Rule 42 of the Manual on the asset beta.

Asset beta

29. We reviewed Rule 42 (asset beta) in light of the amendments to the asset beta calculation requirements in s 150C. We also considered all submissions from stakeholders on Rule 42 and our overall conclusion on this rule remains the same as our draft conclusion.
30. Our conclusion is that Rule 42, as currently worded, is in two respects inconsistent with section 150C(4) and is therefore inconsistent with the statutory purpose set out in s 150A of DIRA.

¹⁹ See paragraph 74 for a discussion on the review of the definition of 'commodity' in the context of how the Manual gives effect to the DIRA definition.

31. Miraka and Open Country supported our draft conclusion that Rule 42 is inconsistent with the statutory purpose set out in s 150A.²⁰

32. Rule 42 in the 2021/22 Manual states that:²¹

The MPG will determine an updated Asset Beta in a Review Year. In calculating the Asset Beta, the MPG will have regard to:

- Fonterra’s exposure to systematic earnings risk with respect to the portion of its business corresponding to the Farmgate Milk Price Business, as implied by the allocation of risks between Fonterra and suppliers under the Farmgate Milk Price Methodology.
- Any relevant requirements under DIRA.

Limb one of Rule 42

33. We consider that the first limb of Rule 42 is inconsistent with the s 150C(4) requirement for calculation of the asset beta and is therefore inconsistent with the s 150A purpose.²²

34. Section 150C(4) requires the use of an asset beta that is consistent with the comparator set asset betas. In our view, the use of an average from a set of comparators that meet the requirements of s 150(C)(4) would likely meet the legislative requirement, assuming the asset betas for the comparators have been appropriately estimated.

35. The first limb of Rule 42 enables the Milk Price Group (**MPG**) to have regard to Fonterra-specific systematic risk in calculating the asset beta. Our view is that any asset beta that has been adjusted away from the comparator set on the basis of Fonterra-specific systematic risk would not be consistent with the estimated asset betas of other processors of dairy and other food products and, therefore, would be inconsistent with s 150C(4).

²⁰ Miraka [“Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021”](#) (17 November 2021), paragraph 5; Open Country Dairy [“Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021”](#) (17 November 2021), page 1.

²¹ Fonterra [“Attachment 1 – Base Milk Price Manual for the 2021-22 season \(marked up version\) – 30 July 2021”](#) (18 August 2021), page 55.

²² Section 150C provides that “[f]or the achievement of the purpose set out in section 150A, the base milk price must be set in a way that is consistent with” the principles listed in s 150C(1). Section 150C(3) and (4) set out requirements relating to calculating an estimate of the return on capital as part of the application of the principles in s 150C(1).

36. In forming this view, we have considered Fonterra’s submissions on Parliamentary intent and statutory interpretation.²³ However, interpreting the text of s 150C(4) in light of the purpose of subpart 5A,²⁴ it is clear that Fonterra is not permitted to calculate an asset beta that is adjusted away from the comparator set on the basis of Fonterra-specific risk.
37. The efficiency and contestability purposes of subpart 5A are promoted by setting the asset beta based on a comparator set that reflects the level of systematic risk for an efficient processor. Using these comparators is consistent with a base milk price that allows for contestability (ie, an asset beta that would not impose higher than efficient costs that prevent entry into the market).²⁵ This is also consistent with the overall scheme of DIRA, which contemplates the use of notional values and the assumption of the ‘notional producer’ as an incentive to Fonterra to set a contestable price.²⁶
38. Against that purpose and statutory scheme, Parliament cannot have intended to allow Fonterra to adjust the asset beta by reference to its specific risks and therefore to the potential detriment of market contestability. This is supported by the explanatory note to the DIRA Amendment Bill, which explains that the purpose of the new s 150C(4) “is to reduce the risk of Fonterra using its discretion in a way that may impose *higher than efficient costs on new and existing dairy processors, including Fonterra itself*” (emphasis added).²⁷
39. Fonterra submitted that the Commission’s view in the draft report is inconsistent with Parliament’s intention in enacting s 150C(4) because s 150C(4) was designed to embed the Commission’s approach and specifically, the Commission’s six step framework, for setting the asset beta.²⁸ Fonterra references our fibre input methodologies decisions for that framework, which includes a step to apply

²³ Fonterra “[Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021](#)” (17 November 2021), pages 3-5.

²⁴ Section 150A(1) “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.” And s 150A(2) “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.”

²⁵ Including the base milk price, which is a cost to dairy processors.

²⁶ For example, s 150A(2) provides that the contestability aim is provided for where notional costs, revenues, or other assumptions used in the setting of a base milk price are practically feasible for an efficient processor.

²⁷ [Dairy Industry Restructuring Amendment Bill \(No 3\) 2019 166-1, explanatory note.](#)

²⁸ Fonterra “[Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021](#)” (17 November 2021), page 4.

adjustments for regulatory differences or systematic risk to the average asset beta for the sample.²⁹

40. However, both the text and the legislative history of the 2020 Amendment Act show only that Parliament intended to constrain Fonterra’s discretion in how it calculates the base milk price, by requiring that it use an asset beta that is consistent with other dairy and food processor asset betas.³⁰ To the extent the legislative history materials refer to embedding the Commission’s approach to asset beta, it is only to the Commission’s previously stated view that other dairy and food processors are better comparators.³¹
41. Parliament did not, as Fonterra submits, mandate the six-step framework for setting asset beta. Instead, it used clear language in s 150C(4) to require that Fonterra apply an asset beta that is consistent with the specified comparators.

Limb two of Rule 42

42. The statement in limb two “...the MPG will have regard to...” does not accurately reflect the legal obligation to comply with the DIRA requirements in setting the base milk price. In particular, s 150C(4) sets out requirements in relation to the calculation of an asset beta:

For the purposes of subsection (3), the asset beta used in the application of the capital asset pricing model must be consistent with the estimated asset betas of other processors of dairy and other food products that are—

- (a) traded in significant quantities in globally contested markets; and
 - (b) characterised by uniform technical specifications.
43. The requirements for the calculation of asset beta in s 150C(4) must be applied, and not merely be had regard to.

²⁹ We also note that the framework cited in the fibre input methodologies was applied in a different legislative setting, with different purposes to DIRA.

³⁰ [Dairy Industry Restructuring Amendment Bill \(No 3\) 2019 166-1](#); [Dairy Industry Restructuring Amendment Bill \(No 3\) 2019 166-2](#); and [Supplementary Order Paper 2020 \(547\) Dairy Industry Restructuring Amendment Bill \(No 3\) 2019 166-2](#).

³¹ Ministry for Primary Industries Cabinet Paper “[Review of the Dairy Industry Restructuring Act 2001 and its Impact on The Dairy Industry – Policy Recommendations](#)” (Sub19-0043).

Review of asset beta

44. In its submission on our draft report, Miraka objected to the provision in Rule 42 that the asset beta will be updated “in a Review Year”. Miraka argued that s 150C does not include any provisos limiting compliance to a review year and that, given the new DIRA requirements came into effect for the 2021/22 season, Fonterra should review and reset the asset beta for this season.³²
45. We agree with Miraka that the calculation of the asset beta needs to comply with the s 150C requirements from the 2021/22 season. We note that the amendments to Rule 23 (within-period reviews) in the 2021/22 Manual provide that an input to the base milk price calculation may be subject to a within-period review in response to “a material change in relevant legislation”.³³ In our view the revised Rule 23 allows Fonterra to update the asset beta value outside of review years. We recommend that Fonterra reviews the asset beta value in its base milk price calculation ahead of the next review year specified in the Manual (2024/25).³⁴

Fonterra's amendments to the 2021/22 Manual

46. Fonterra has made the following amendments to the 2021/22 Manual.³⁵
- 46.1 Rule 23 (within-period reviews) has been amended to make it explicit that “where feasible, the amended value should be calculated in a manner that does not result in an actual outcome to Fonterra being passed in full through into the Farmgate Milk Price” in any instance where a within-period review determines an input should be revised outside of a four-yearly ‘reset’ cycle.

³² Miraka [“Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021”](#) (17 November 2021), paragraphs 11-13.

³³ Fonterra [“Attachment 1 – Base Milk Price Manual for the 2021-22 season \(marked up version\) – 30 July 2021”](#) (18 August 2021), page 46.

³⁴ Fonterra [“Attachment 1 – Base Milk Price Manual for the 2021-22 season \(marked up version\) – 30 July 2021”](#) (18 August 2021), page 89.

³⁵ Fonterra [“Reasons paper in support of Fonterra’s Base Milk Price Manual for the 2021-22 season – 30 July 2021”](#) (18 August 2021), pages 3-4; and Fonterra [“Attachment 1 – Base Milk Price Manual for the 2021-22 season \(marked up version\) – 30 July 2021”](#) (18 August 2021), page 89.

- 46.2 Rule 8 (benchmark selling prices) has been amended to include a reference to ‘freely-contested global markets’ (consistent with Principle 2 of the Manual) and a definition of ‘freely-contested global market’ has been added to the Glossary in Part C of the 2021/22 Manual.³⁶
- 46.3 Fonterra has reviewed the use of the term ‘prevailing’ in the references to commercial or contract terms made in the Manual. As a result of this review, Fonterra has replaced ‘prevailing market conventions’ with ‘normal market conventions’ in the Manual and changed ‘prevailing prices’ to ‘prevailing market prices’. Fonterra’s Reasons paper contains an explanation on how the changes in the use of the term ‘prevailing’ modify the context of other terms in the Manual.³⁷
- 46.4 A review year for the post-tax market risk premium has been added for the 2021/22 and the 2024/25 seasons into the Glossary in Part C of the 2021/22 Manual.
47. Our conclusion on the amendments to the 2021/22 Manual remains unchanged from our draft conclusion. We consider these changes provide greater transparency and are consistent with the efficiency and contestability dimensions of the s 150A purpose. In particular, we consider that:
- 47.1 the amendment to the within-period reviews is consistent with the efficiency dimension;
- 47.2 the amendment to the benchmark selling price and the clarification of the term ‘prevailing’ are consistent with the contestability dimension of the s 150A purpose; and
- 47.3 the inclusion of a review year for the post-tax market risk premium is consistent with both the efficiency and contestability dimensions of the s 150A purpose.
48. In its submission Miraka argued that the changes in the 2021/22 Manual in the use of the term ‘prevailing’, eg, ‘prevailing prices’, are not meaningful and that the

³⁶ Principle 2 states that the base milk price “should be the maximum amount which Fonterra, reflecting its status as a properly-managed and efficiently-run, sustainable co-operative, could pay for the Milk supplied to it in a Season”. See Fonterra “[Attachment 1 – Base Milk Price Manual for the 2021-22 season \(marked up version\) – 30 July 2021](#)” (18 August 2021), page 9.

³⁷ Fonterra “[Reasons paper in support of Fonterra’s Base Milk Price Manual for the 2021-22 season – 30 July 2021](#)” (18 August 2021), pages 3-4.

reference to ‘market’ prices adds no new information and thus no additional transparency. Miraka sought the Commission’s view on any further understanding we have taken from these amendments.³⁸

49. In response we note that Fonterra has provided explanations in its Reasons paper as well as in the notes in the marked-up version of the 2021/22 Manual on how the changes in the use of the term ‘prevailing’ modify the context of other terms in the Manual. Specifically, Fonterra considers that the reference to ‘prevailing market prices’ makes more explicit its reliance on arm’s length prices, while replacing ‘prevailing’ with ‘normal’ in the references to ‘normal market conventions’ and ‘normal commercial terms’ better reflects the Manual’s intent.³⁹ Fonterra further acknowledges that in a number of cases it considers that the wording is generally clear without the changes.⁴⁰
50. We consider that the changes in the Manual rules and definitions where the term ‘prevailing’ was previously used either provide some further context or clarity of language. We acknowledge the changes are not substantive, but we are satisfied that these changes are consistent with the contestability dimension of the s 150A purpose.
51. We did not receive any submissions regarding the amendment of the Rule 23 and the addition of the review year for the post-tax market risk premium to the Manual.

Issues carried forward from previous reviews

52. We also considered the following issues carried forward from previous reviews:
- 52.1 materiality;
 - 52.2 capacity for primary and secondary plants; and
 - 52.3 how the Manual gives effect to the definition of commodity.

³⁸ Miraka [“Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021”](#) (17 November 2021), paragraphs 23-25.

³⁹ Fonterra [“Attachment 1 – Base Milk Price Manual for the 2021-22 season \(marked up version\) – 30 July 2021”](#) (18 August 2021), page 63.

⁴⁰ Fonterra [“Reasons paper in support of Fonterra’s Base Milk Price Manual for the 2021-22 season – 30 July 2021”](#) (18 August 2021), pages 3-4.

Materiality

53. In the final report on our review of the 2019/20 Manual, we suggested Fonterra should disclose what constitutes a ‘material change’, when considering whether a change to the Manual should be made.⁴¹
54. In response, Fonterra explained they do not consider it possible to codify in the Manual the full range of circumstances where they would consider it appropriate to amend the Manual. Fonterra noted that most changes to the Milk Price methodology, including changes which result in a material change to the base milk price (which would be publicly disclosed) do not require an amendment to the Manual.⁴²
55. We still consider that the disclosure of a material change threshold, whether stated as a number or key qualitative considerations that are relevant to change decisions other than simple clarifications or corrections, will provide greater transparency.
56. In our draft report, we concluded that while improved transparency might be helpful for interested parties to assess whether the changes to the Manual meet the purpose at s 150A of DIRA, we do not consider that the absence of this information renders the Manual inconsistent with the s 150A purpose.
57. In its submission, Miraka supported our ongoing recommendation that Fonterra include standards of materiality in the Manual.⁴³ However, Miraka argued that Fonterra’s refusal to include these standards in the Manual render Fonterra’s certifications to the Commission under s 150L(d) and s 150T(b) that the Manual and the Calculation are consistent with the purpose at s 150A of DIRA meaningless, because the certifications note that the consistency is only “in all material respects”.⁴⁴ For this reason, Miraka urged us to reconsider our conclusion on the materiality standards in the Manual.
58. We note Miraka’s support of our previous conclusion recommending that a materiality standard for changes to the Manual be included.

⁴¹ Commerce Commission [“Review of Fonterra’s 2019/20 Milk Price Manual: Dairy Industry Restructuring Act 2001 – Final report”](#) (12 December 2019), paragraph 80.

⁴² Fonterra [“Reasons paper in support of Fonterra’s Base Milk Price Manual for the 2021-22 season – 30 July 2021”](#) (18 August 2021), page 5.

⁴³ Miraka [“Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021”](#) (17 November 2021), paragraph 17.

⁴⁴ Miraka [“Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021”](#) (17 November 2021), paragraphs 17-19.

59. In respect of Miraka’s submission that the lack of a materiality threshold makes Fonterra’s certification meaningless, we must form our own view on the extent to which the Manual is consistent with the s 150A purpose. Fonterra’s materiality threshold, whether stated or not, is not relevant to this assessment.
60. Our final conclusion remains the same as our draft conclusion for the reasons explained above.

Capacity for primary and secondary plants

61. In the final report on our review of the 2020/21 Manual, we stated that the disclosure of the capacity for both primary and secondary plants in the Manual would better promote the purpose in s 150A.⁴⁵
62. Fonterra responded that the Manual is not the appropriate vehicle for disclosures about the specific values of inputs into the base milk price, and that they will continue to disclose this information for the following season in the 1 July Reasons paper supporting the base milk price calculation each year.⁴⁶
63. In our draft report we accepted that the plant capacity disclosures in Fonterra’s Reasons paper for the 2020/21 base milk price calculation included both the primary and secondary plant capacity along with a statement that the secondary plant capacity will be maintained for the next four years.⁴⁷ Fonterra’s Reasons paper therefore provided the plant capacity assumptions for both primary and secondary plant on an ex ante basis so as to enable interested parties to assess the practical feasibility of the assumed production volumes. Our final conclusion on this issue remains unchanged from the draft report’s conclusion.
64. In its submission, Miraka requested that we reconsider our conclusion with regard to ex ante disclosures of processing capacity. Miraka argued that:⁴⁸
- 64.1 Fonterra’s ex ante disclosure for individual plants is only provided for the capacity of the secondary plants;

⁴⁵ Commerce Commission “[Review of Fonterra’s 2020/21 Milk Price Manual: Dairy Industry Restructuring Act 2001 – Final report](#)” (15 December 2020), paragraph X11. This conclusion has been carried forward from previous Manual reviews, having first been raised in our 2016/17 Manual review.

⁴⁶ Fonterra “[Reasons paper in support of Fonterra’s Base Milk Price Manual for the 2021-22 season – 30 July 2021](#)” (18 August 2021), page 5.

⁴⁷ Fonterra “[Reasons paper in support of Fonterra’s Base Milk Price for the 2020/21 season – 1 July 2021](#)” (8 July 2021), page 9.

⁴⁸ Miraka “[Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021](#)” (17 November 2021), paragraphs 30-39.

- 64.2 the geographical detail for plant processing capacity disclosures should be improved because the current aggregation of plant numbers by North and South Island is not consistent with practically feasible management of milk; and
- 64.3 Appendix 3 of Fonterra’s Reasons paper does not disclose the mothballed plants, which presumably remain in the notional processor’s capital base and thus should remain transparent in disclosures of plant capacity.
65. We considered all arguments on this issue raised by Miraka. We note that Fonterra stated in the Reasons paper in support of the 2020/21 Manual:⁴⁹
- In the F20 Base Milk Price Reasons Paper we explained that “the most recent review of the fixed asset base was completed this year, and resulted in a decision to maintain the assumed processing capacities of incremental and replacement plants for the manufacture of each of the RCPs at the same levels assumed for the previous 2017-2020 Review Period.”
66. In light of this statement in Fonterra’s 2020/21 Reasons paper we consider the disclosures by Fonterra for primary plant to be effectively ex ante.
67. We have previously considered the level of geographical detail for plant capacity disclosures suggested by Miraka. For the reasons stated in our report on the 2019/20 Manual review we do not consider it necessary for the disclosures to be made at the level of geographical detail suggested by Miraka.⁵⁰
68. We note that Fonterra last disclosed the number of mothballed plants in its 2018/19 Calculation Reasons paper.⁵¹ However, this disclosure is not included in Attachment 3 of Fonterra’s Reasons paper in support of its 2020/21 base milk price calculation. We recommend that Fonterra includes this disclosure in future base milk price calculation Reasons papers to provide greater clarity about the total processing capacity. Since this disclosure is related to the value of an assumption and is made outside of the Manual, we do not consider this omission detracts from the consistency of the Manual with the s 150A purpose.

⁴⁹ Fonterra [“Reasons paper in support of the Milk Price Manual for the 2020/21 season – 1 August 2020”](#) (18 September 2020), page 4.

⁵⁰ Commerce Commission [“Review of Fonterra’s 2019/20 Milk Price Manual: Dairy Industry Restructuring Act 2001 – Final report”](#) (12 December 2019), paragraphs 83-95.

⁵¹ Fonterra [“Reasons paper on review of 2018-19 base milk price calculation – 1 July 2019”](#) (5 July 2019), footnote 21.

69. For the reasons outlined above, our conclusion on capacity for primary and secondary plants remains unchanged from our draft report conclusion.

How the Manual gives effect to the definition of commodity

70. In our 2019/20 base milk price calculation review, we asked Fonterra to provide a detailed description of 'Standard Product Offering' as we made recommendations regarding these matters in our 2019/20 Manual review.⁵²
71. In our 2020/21 base milk price calculation review, we further recommended that Fonterra clarifies the definition of standard packaging and clarifies its application of the "cascadable product" rule in the Manual.⁵³
72. Fonterra does not consider it appropriate as a matter of general principle to include in the Manual the outcomes from the application of the Manual's rules and processes, but they indicated they will continue to look for other means of providing additional information about the range of product specifications included in the base milk price calculation.⁵⁴
73. We consider that the publication of the list of all products that meet the criteria for 'Generic product specifications' in the Manual, or the accompanying Reasons paper, would greatly assist transparency of what is a standard product offering.
74. We also noted in our 2020/21 base milk price calculation review that given the submissions related to the inclusion of Instantised Skim Milk Powder as a 'Qualifying Material',⁵⁵ we intend to examine how the Manual gives effect to the DIRA definition of 'commodity' more closely in a future Manual review.⁵⁶ This process is likely to involve reviewing the list of 'Qualifying Materials' and incremental product cost adjustments made to account for differences in product specifications and manufacturing processes. We will consider undertaking this review in advance of the 2022/23 Manual review.

⁵² Commerce Commission "[Review of Fonterra's 2019/20 Milk Price Manual: Dairy Industry Restructuring Act 2001 – Final report](#)" (12 December 2019), paragraph X10.

⁵³ Commerce Commission "[Review of Fonterra's 2020/21 base milk price calculation: Dairy Industry Restructuring Act 2001 – Final report](#)" (15 September 2021), paragraph 3.140.

⁵⁴ Fonterra "[Reasons paper in support of Fonterra's Base Milk Price Manual for the 2021-22 season – 30 July 2021](#)" (18 August 2021), page 5.

⁵⁵ See definition of 'Qualifying Material' at Fonterra "[Attachment 1 – Base Milk Price Manual for the 2021-22 season \(marked up version\) – 30 July 2021](#)" (18 August 2021), page 64.

⁵⁶ Commerce Commission "[Review of Fonterra's 2020/21 base milk price calculation: Dairy Industry Restructuring Act 2001 – Final report](#)" (15 September 2021), paragraph 3.7.4.

75. All stakeholders supported the intention for an in-depth review of the list of 'Qualifying Materials' and the implications of how the Manual gives effect of the definition of 'commodity'.⁵⁷
76. Based on the information we have before us, we do not consider that these matters render this season's Manual inconsistent with the s 150A purpose as a whole. Once we have conducted our review of how the Manual gives effect to the DIRA definition of 'commodity' and have more information available to us, we will revisit this conclusion in a future Manual review.

⁵⁷ Fonterra "[Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021](#)" (17 November 2021), page 6; Miraka "[Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021](#)" (17 November 2021), paragraphs 28-29; and Open Country Dairy "[Submission on Draft Report of the Milk Price Manual 2021-22 – 15 November 2021](#)" (17 November 2021), page 3.

Attachment A Submissions that we consider to be out of scope for the 2021/22 Manual review

Topic	Submission reference	Summary of key points	Our response
Materiality	Miraka submission, pages 4-5	<p>Miraka submitted that:</p> <ul style="list-style-type: none"> The Commission should establish an objective measure of materiality used in the statutory reviews of the milk price. The Commission's materiality benchmark equivalent to 2.3 c/kgMS is close to 7.5% of the notional processor's EBIT for the 2020/21 season. Miraka argues that is well in excess of typical measures of materiality used for example in financial reporting. 	<p>We consider the submissions in respect of the Commission's approach to materiality to be more relevant for our Approach paper review and Calculation reviews.</p> <p>The materiality benchmark we apply is used for the purpose of identifying focus areas for review and may be different from benchmarks of materiality applied for financial reporting purposes.</p> <p>We will consider clarifying the application of materiality to our review processes when we next update our Approach paper but note that our indicative operational materiality of 2.3c for the 2020/2021 season multiplied by the season's 1.54b kgMS purchased by Fonterra gives a threshold of around \$35m. This is smaller than the \$50m materiality (determined with reference to a benchmark of the cost of New Zealand-sourced milk) used by KPMG in its audit of the 2021 Fonterra Group Financial Statements.</p>
Off-GDT sales	Open Country Dairy submission, page 2	<p>Open Country Dairy submitted that:</p> <ul style="list-style-type: none"> Any plain interpretation of a 'freely contested global market' would not include Fonterra's off-GDT sales which remain opaque and unable to be properly tested. Further, the Commission should: 	<p>The submissions on off-GDT sales go to matters relevant to our Calculation reviews.</p> <p>In our 2019/20 Milk price calculation review we stated that we consider that the practical application of the off-GDT exclusion rules does give rise to pricing that could be achieved by the notional</p>

Topic	Submission reference	Summary of key points	Our response
		<ul style="list-style-type: none"> ▪ require more transparency around the off-GDT prices (on-GDT prices should be the benchmark for prevailing prices) and its impact on sales revenues; ▪ request monthly updates of the impact of off-GDT sales on the prices of Reference Commodity Products; ▪ request a set of compulsory disclosures such as Generic Product Specifications; and ▪ request less lag between period under review in Fonterra’s “Global Dairy Update” publications and publication date. 	<p>processor selling Reference Commodity Products at arms-length in freely contestable global markets. Therefore, they are practically feasible.⁵⁸ As stated at paragraph 74 of this report, we plan to review the generic product specifications list in advance of our 2022/23 Manual review.</p> <p>We invite Fonterra to consider the disclosure requests made by Open Country Dairy. Making these disclosures compulsory is not within our statutory powers under DIRA.</p>
	Miraka submission, pages 5-7	<p>Miraka submitted that:</p> <ul style="list-style-type: none"> • The obvious price benchmark for including specific off-GDT sales is the comparable price achieved on GDT. • Fonterra committed to using GDT prices as the price benchmark in calculating the base milk price and has failed to honour that commitment. 	

⁵⁸ Commerce Commission “[Review of Fonterra’s 2019/20 base milk price calculation: Dairy Industry Restructuring Act 2001 – Final report](#)” (15 September 2020), page 30.

Attachment B Glossary

Term/Abbreviation	Definition
DIRA	Dairy Industry Restructuring Act 2001
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	Commission's review of Fonterra's base milk price calculation for the prior season
EBIT	Earnings before interest and taxes
GDT	Global Dairy Trade, Fonterra's online auction platform used to sell commodities
Manual review	Commission's review of Fonterra's Milk Price Manual for the current season
Dairy season	1 June to 31 May annually
kgMS	Kilogram of milk solids
MPG	Milk Price Group
Milk Price Manual or the Manual	Fonterra's Milk Price Manual
MPP	Milk Price Panel
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).
RCP	Reference Commodity Product. These products, manufactured and sold by the Notional Producer, are in the Reference Basket.
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)