COMMERCE ACT 1986: BUSINESS ACQUISITION

SECTION 66: NOTICE SEEKING CLEARANCE

5 July 2012

The Registrar
Business Acquisitions and Authorisations
Commerce Commission
PO Box 2351
Wellington

Pursuant to section 66(1) of the Commerce Act 1986 notice is hereby given seeking **clearance** of a proposed business acquisition.

SUMMARY OF NOTICE

This notice seeks clearance for Fonterra (as defined) to acquire the dairy processing assets of New Zealand Dairies Limited (in receivership) (*NZDL*).

A. The parties

A supplier owned co-operative, Fonterra is a vertically integrated milk processor and dairy products manufacturer and marketer. Fonterra operates mostly globally in its output markets.

NZDL is a vertically integrated milk processor, manufacturing whole milk powder. Its output too is almost exclusively exported. NZDL is a wholly owned subsidiary of the Nutritek Group (also in receivership).

B. Commercial rationale

Acquisition of NZDL was not pursued by Fonterra, but it provides the best option for the long-term interests and integrity of the New Zealand dairy industry and for NZDL's creditors, suppliers and employees. It is vital for the industry to retain the involvement of farmers and skilled dairy workers whose livelihood would be threatened were Fonterra's offer not to include a mechanism for ensuring the Studholme plant will open for the 2012-2013 dairy season and suppliers be paid for milk previously supplied.

Close examination shows that the Studholme plant offers Fonterra excellent opportunity for the rapid expansion of its Advanced Nutrition strategy as it looks to grow its share of the international paediatric nutrition market. That strategy will shift production for exports to smarter, higher value products for increasingly contested global markets. The plant is capable of manufacturing standard whole milk powder (*WMP*) in the interim and delivering a sound commercial return while Fonterra is growing its paediatric nutrition business.

The plant's location also offers transport efficiencies, especially while Fonterra expands its South Island asset base. Those transport efficiencies provide for reduced carbon emissions and other environmental benefits.

To become the world's most efficient dairy producer, Fonterra must be able to respond quickly to business opportunities – including whether to buy or build new processing capacity. Continuing rational expansion of milk processing capacity in areas of increasing milk supply is vital.

C. The markets

The only markets within New Zealand affected by the proposed acquisition are:

(i) the South Island market for the supply and collection of raw milk; and

(ii) the South Island market for raw milk processing assets.

The 100-150 kilometre radius for milk supply previously adopted by the Commission is now too restrictive for determining the geographic dimension of those markets. There are now plenty of examples of raw milk regularly being transported much longer distances. Both farms and processing plants have become much larger, allowing for increased efficiency in transport costs.

The geographic dimension of those markets encompasses all the South Island.

D. The Counterfactual

NZDL was placed in receivership on 17 May 2012 after its owner, Nutritek Group, was declared bankrupt in Russia earlier this year.

The Receiver sought offers from a number of parties but preferred Fonterra's offer because of;

i. [ ];

ii. [ ]; and

iii. [ ].

[ ].

Assured continued milk supply is vital to any purchaser of the Studholme plant. The Applicant believes that there is no certainty that NZDL suppliers would commit supply to any alternative purchaser that offered a price for the assets so low that suppliers would lose some or all of the money owed to them. [ ]. Thus, the alternative purchaser counterfactual is unlikely and speculative.

Notwithstanding, the Competition Analysis assumes that unlikely counterfactual.

E. Competition analysis

Milk supply has increased by about 50% over the last decade, but Fonterra's share of that increased volume has steadily reduced. Fonterra now collects and processes approximately 82% of the raw milk in the South Island. Fonterra's plants there account for approximately 82% of the available processing capacity.

NZDL collects and processes approximately 2% of the raw milk in the South Island. The Studholme plant represents approximately 2% of the presently available processing capacity there.

The substantial lessening of competition test is not about market shares. Post-acquisition Fonterra will continue to be constrained by:

- established and expanding competitors;
- real threat of new entry;
- large and sophisticated suppliers; and
- the Dairy Industry Restructuring Act 2001 (DIRA) regime, which has been effective in ensuring new entry to date and is now being extended and enhanced.

Most suppliers in the South Island now have a choice of processor and will continue to do so post-acquisition. There is plenty of evidence of suppliers exiting Fonterra to independent processors (and the reverse).

F. Efficiencies

Any notional lessening of competition resulting from the disappearance of one small processor must be offset against the substantial efficiencies that the acquisition will result in and expected benefits it will accelerate. Given that 95% of New Zealand's milk production is exported, increased returns from those efficiencies and more rapid expansion of Fonterra's advanced nutrition strategy will stimulate competition among other New Zealand processors. That will mean increased competition for raw milk.

It will also mean more competition amongst processors to have the best mix of raw milk processing assets. Buying rather than building a plant may mean avoiding 1-2 years' delay. Fonterra must be allowed to make commercially rational acquisitions of existing processing capacity to enable that competition.

Disqualifying Fonterra as a potential purchaser of NZDL would create a very real deterrent to future entry as new processors – and their suppliers and employees – would face increased risks if they fail. The Commission must avoid creating regulatory barriers to efficient exit.

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Appendices

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PART 1: TRANSACTION DETAILS

1 The person giving notice

1.1 This notice is given by **Fonterra Co-operative Group Limited**

Registered Office:	9 Princes Street Auckland New Zealand
Postal Address:	Private Bag 92032 Victoria Street West Auckland 1142
Telephone:	(09) 374 9000
Fax:	(09) 379 8281
Website:	http://www.fonterra.com/
Contact Person:	David Matthews General Counsel
Telephone:	(09) 374 9000
E-mail Address:	David.Matthews@Fonterra.com

1.2 All correspondence and notices in respect of the application should be directed in the first instance to:

Grant David, Consultant, Chapman Tripp
Email: Grant.David@chapmantripp.com
Telephone: (04) 498 4908

Tom Lane, Solicitor, Chapman Tripp
Email: Tom.Lane@chapmantripp.com
Telephone: (09) 358 9830

2 The business acquisition

2.1 The business acquisition for which clearance is sought is the acquisition by Fonterra Limited, being a wholly-owned subsidiary of Fonterra Co-operative Group Limited. or any of its interconnected bodies corporate (together “Fonterra” or the “Applicant”) of the specified assets of NZDL.

2.2 NZDL is currently wholly owned by Nutritek Overseas Pte Limited, a Singapore-based company ultimately owned by a Russian parent Nutritek Group (*Nutritek*). Nutritek was declared bankrupt after missing repayments on a 403 million ruble loan to Russian lender UniCredit. The Moscow Commercial Court had declared Nutrinvestholding, the head company of Nutritek, bankrupt in March this year.

2.3 Colin Gower, Stephen Tubbs and Brian Mayo-Smith (all of BDO) (together, the *Receiver*) were appointed as joint and severable receivers and managers of NZDL on 17 May 2012 under general security deeds granted by NZDL to VTB Capital PLC.

2.4 Fonterra has entered into a Sale and Purchase Agreement (*Agreement*) with NZDL and the Receiver to acquire the dairy processing assets of NZDL. A copy of the Agreement is attached as **Appendix A**.

2.5 The Agreement is subject to a number of conditions, all of which have now been met with the exception of obtaining clearance for the acquisition from the Commerce Commission.

2.6 The Applicant submits that, for the reasons referred to in the Summary above and outlined in detail below, the proposed business acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in any relevant market.

3 Other merger party

3.1 The other merger party, being the person whose assets are proposed to be acquired is NZDL.

3.2 NZDL's temporary webpage gives its address and contact details as follows:

Registered Address:	30 Sir William Pickering Drive, Burnside, Christchurch, 8053, New Zealand
Postal Address:	PO Box 31 Waimate
Telephone:	03 690 9000
Facsimile:	03 689 9841

3.3 NZDL was placed in receivership under the terms of a general security deed dated 2 March 2010 giving the holder a secured charge over the whole of the assets of the Company. Details of the Receiver are:

Receiver:	Brian Mayo-Smith
	Colin Gower
	John Tubbs
Organisation:	BDO Christchurch Limited
Postal Address:	30 Sir William Pickering Drive, Burnside, Christchurch, 8053, NZ
Telephone:	09 379 2950 or 09 379 5155
Email Address:	richard.hudson@bdo.co.nz

4 Persons interconnected to or associated with the merger parties

Acquirer

4.1 Fonterra Limited, being the purchaser in terms of the Agreement, is the wholly-owned subsidiary of Fonterra. Fonterra is a co-operative dairy company incorporated under the Companies Act 1993 and registered under the Co-operative Companies Act 1996. Shares in Fonterra are held by approximately 10,500 supplier shareholders.

4.2 Fonterra operates within New Zealand, and extensively throughout the world through subsidiaries and associated companies. A corporate structure chart is attached as **Appendix B**.

Other merger party

4.3 NZDL engages in milk processing, standard and specialty milk powder production and global distribution of those products. As of 5 June 2008 it has operated as a wholly owned subsidiary of Nutritek Group.

4.4 Nutritek Group was one of the leading producers of paediatric and specialist foods in Russia. Founded in 1990, Nutritek Group comprises production and agricultural facilities in Russia, Ukraine, Estonia and New Zealand. Further details of Nutritek Group may be found on: nutritekoverseas.com. Nutritek was declared bankrupt earlier this year.

5 **Beneficial interests of participants**

5.1 The only interests which each party (or any of its interconnected bodies corporate) has in the other party are the interests and entitlements as set out in (a) the Agreement and (b) the Operational Agreement entered into by Fonterra, NZDL and the Receiver contemporaneously with the Agreement (*Operational Agreement*) A copy of the Agreement is attached as **Appendix C**.

(a) The Agreement sets out the terms on which Fonterra will acquire the dairy processing business and assets of NZDL.

(b) The Operational Agreement provides that Fonterra will provide operational and other support to NZDL [

].

5.2 More generally, last season NZDL acquired around [ ] litres of raw milk from Fonterra pursuant to DIRA. The forecast requirement for the present season was [ ] litres. There are no other formal or informal arrangements between the parties.

6 **Links, formal or informal, between any participants**

6.1 There are currently no links between Fonterra and its existing competitors other than arms-length commercial arrangements.

6.2 [

].

7 **Cross-directorships**

7.1 No director of Fonterra holds directorships in any other companies which are involved in the relevant markets in which NZDL operates.

7.2 The Applicant is not aware of what (if any) other directorships directors of NZDL or Nutritek may hold. Certainly, they hold no directorships in Fonterra or its interconnected bodies corporate.

8 The business activities of each participant (and interconnected or associated parties)

Fonterra

8.1 The Commission will be familiar with Fonterra's activities due to its regulatory role under DIRA, and previously its consideration of Fonterra's clearance applications to acquire NZDF's branded butter and spreads business: *Decision 562 Fonterra/Rank*; and to acquire Kapiti Fine Foods: *Decision 574 Fonterra/Kapiti Fine Foods*.

8.2 In summary, Fonterra is a vertically integrated milk processor and dairy products manufacturer and marketer, operating in all dairy product markets in New Zealand and numerous other countries.

NZDL

8.3 NZDL was incorporated in 2006 by a group of investors to build a WMP plant at Studholme in South Canterbury. The plant was commissioned in September 2007 at a total cost of $108 million.[1]

8.4 In the 2011/12 season NZDL processed raw milk from 34 farms, [ ], as well as milk sourced from Fonterra under DIRA. Prior to the receivership, 32 farms were contracted to supply NZDL in the 2012/13 season.

8.5 NZDL sells almost exclusively into overseas markets.[2] [ ].

8.6 NZDL was placed into receivership on 17 May 2012. [ ]:

(a) [ ].

(b) [ ].

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[1] Fonterra considers this sum is unlikely to include working capital.

[2] Based on 2010 information, only 'downgrade product' (from broken bags) was sold into the domestic market. This amounted to approximately 6 tonnes of WMP that was sold to local farmers (ex-works) for use as stock feed.

(c) [ ].

(d) [ ].

8.7 The Applicant believes that global financial and dairy markets' volatility, and the loss of milk supply that resulted from Synlait's acquisition of Oceania Dairy Limited (described more fully in paragraph 25.3 below), also contributed to NZDL's plight.

8.8 Prior to NZDL being placed into receivership, the Nutritek Group had made determined efforts to sell NZDL. A description of that earlier sales process, (as well as the dairy processing business and assets of NZDL) is set out in the Information Memorandum prepared by Morgan Stanley dated December 2010, which is attached as **Appendix D**. Fonterra did not participate directly in this process.

9 What will be acquired

9.1 A copy of the Agreement between NZDL, the Receiver and Fonterra is attached as **Appendix A**.

9.2 The Agreement is subject to the conditions specified in clause 4.1 thereof, including obtaining clearance for the acquisition from the Commerce Commission. The other condition - namely that existing suppliers to the Studholme plant enter into milk supply agreements for continuing supply of milk to NZDL and Fonterra up to and following completion – now has been satisfied.

10 Commercial rationale for the transaction

10.1 Acquisition of NZDL's processing plant by Fonterra is the best option on the table for the long-term interests and integrity of the New Zealand dairy industry and for NZDL's creditors, suppliers and employees.

Fonterra's Advanced Nutrition Strategy

10.2 The Studholme plant offers Fonterra immediate opportunity to develop and expand its infant and specialty food business, especially for the growing Asian market. More specifically, the plant provides the option to manufacture base powders for use in dry blend paediatrics powders; and with some small capital upgrades, would be capable of manufacturing GUMP.

10.3 Paediatric products are a key focus of Fonterra's newly refreshed Advanced Nutrition strategy. The Studholme plant is excellent for supporting a rapid expansion of this strategy, as its small size means that it is well suited for use in short specialised product manufacturing campaigns. This will allow Fonterra to free up larger dryers at its other sites for use in longer commodity manufacturing campaigns, which minimises the cost from shutdown, clean out and changeover between product types and maximises its ability to produce large volumes of commodity product at low cost in its largest and most efficient plants. In the words of NZ Herald's business editor:[3]

> "Now, when the commodity business is good, is the time to put the foot down on the shift towards smarter, higher value food production and processing".

[3] Liam Dann "Mini-boom chance to diversify economy", NZ Herald of 23 June 2012.

10.4 The Studholme plant is capable of being expanded within its existing resource consents to allow for the development of a second 5 tonne per hour dryer, and a lot of the site infrastructure required is already in place to allow for such an expansion. A plant of this size would be ideal for an IF/FO capable plant, which could complement the use of the existing plant in GUMP applications and further support Fonterra's paediatric strategy.

10.5 The small size of the dryer also means that Fonterra could use the plant to align output with high specification requirements of specific customers.

Fonterra's New Zealand Milk Strategy

10.6 In the interim, as Fonterra is expanding its Advanced Nutrition strategy, the Studholme plant also presents an excellent investment to support its New Zealand Milk strategy. The plant has been built to a high standard, and is capable of producing a range of standard powder products in addition to its specialty milk capabilities. [

]. The investment supports Fonterra's New Zealand Milk strategy in several ways:

(a) The investment supports Fonterra's strategy of investing in and optimising the New Zealand milk supply base. A key advantage in this regard, which is discussed below, is that the asset will allow Fonterra to generate significant savings in its transport network.

(b) [

]. By contrast, with a newly built dryer, there is usually two years plus of capital spend involved during the planning, consenting, construction and commissioning period, in addition to which it may then take a further year to fill the asset to the point that returns become cash positive; and

(c) The earnings under a basic operating model are projected to be low volatility as the revenues from WMP sales are linked very closely to the price paid for milk. [

].

Transport efficiencies

10.7 The plant's location also offers significant transport efficiencies during rapid expansion of South Island milk supply. The existing milk supply of NZDL is located closer to the factory than Fonterra's average supplier. As such, Fonterra's average transport costs will be lowered.

10.8 Further, it will be necessary for Fonterra to continue to transport milk between Canterbury and Southland during the peak of the season for the foreseeable future. This results from the large scale plant developments that Fonterra is planning, which will result in excess capacity in one region with excess supply in the other (oscillating between regions as milk supply grows). Milk will need to be transferred via road or rail between regions in the South Island for the foreseeable future as a result. Given that Studholme is located roughly half way between Fonterra's Darfield and Edendale sites there are substantial opportunities to reduce the need to rail milk between regions, both due to the additional capacity the plant provides during the shoulders of the season, and to a lesser extent due to extra capacity during the peak.

10.9 As well as reduced transport costs, this will mean reduced carbon emissions and other environmental benefits.

Supplier and employee security

10.10 It is also important for continuing milk supply that, where milk processing firms do fail, they do not take their farmer suppliers and skilled employees down with them. Without the consideration provided for in the Agreement, NZDL's suppliers would face the potential loss of substantial amounts owed to them by NZDL for milk supplied prior to the receivership. Without the plant operating this season, many of NZDL's employees may well be lost to the industry.

10.11 NZDL and its associated companies were placed in receivership on 17 May 2012 under general security deeds granted by NZDL to VTB Capital PLC. The Receiver is appointed for the interest of the secured creditors and has no obligation to the unsecured suppliers or to keep the Studholme plant operating at all.

10.12 The importance of the dairy industry to New Zealand's prosperity cannot be over stated. The industry's success in global markets provides a significant boost to the economy and a bulwark against continuing global economic uncertainty.

10.13 But there is a human element to this success. To sustain growth in the face of increasing challenge from global competitors, the dairy industry needs to continue to attract both farmers who are willing to commit as suppliers and skilled workers who are prepared to commit their industry and expertise. Retaining their involvement and employment is vital to the industry that is a major contributor to New Zealand's GDP.

11 No other competition agency notified

11.1 While Fonterra operates mostly globally in its output markets, and NZDL's current owners are overseas persons, no competition agency in any other jurisdiction has been notified. This acquisition primarily involves the collection and processing of raw milk in New Zealand.

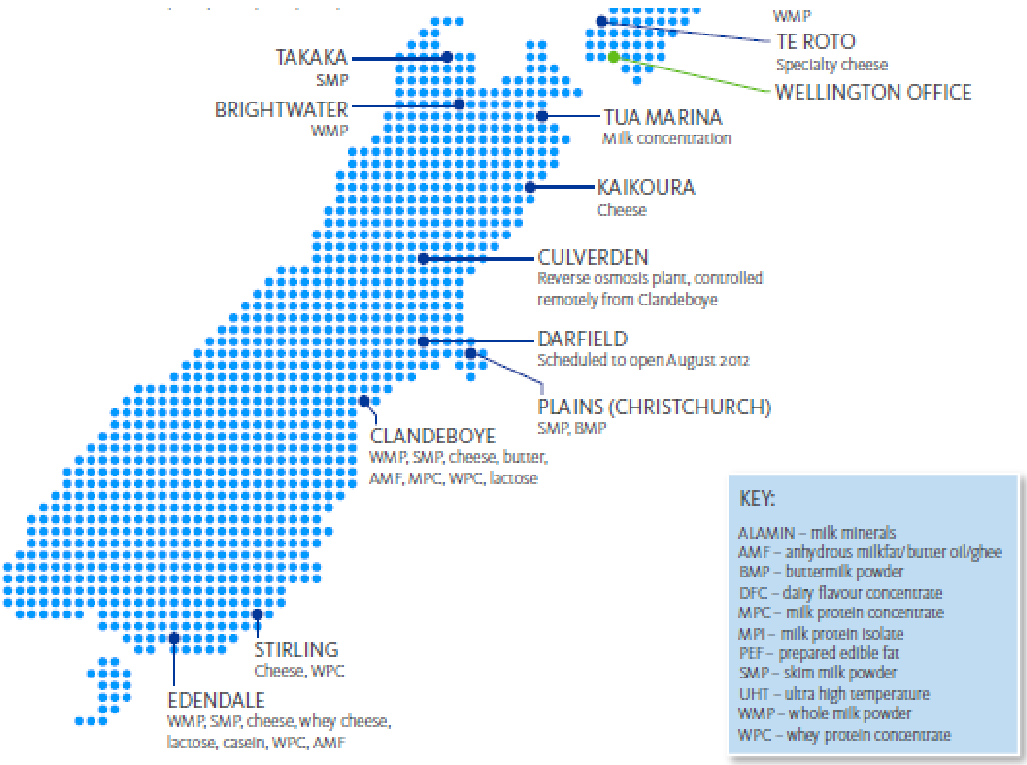
PART 2: THE INDUSTRY

12 Goods and services supplied by the merger parties

Fonterra

12.1 In the 2010/11 season[4] Fonterra collected and processed 88.9% of raw milk in New Zealand. Most relevant for this application are Fonterra's raw milk collection and processing operations in the South Island. Those operations are summarised in **Figure 1** below.

Figure 1: Fonterra's South Island operations



NZDL

12.2 NZDL's milk processing plant is located on a 55 hectare property at Studholme in South Canterbury. The plant has the capacity to process approximately 800,000 litres per day, or 30,000 metric tonnes of WMP per annum on a seasonal curve. NZDL's output was wholly export focussed.

12.3 The plant is currently able to produce standard WMP, nutritional base specification WMP for use in dry blend paediatric products, and skim milk powder. As noted above, the addition of oil injection equipment, at a minimal investment, would allow the plant to produce wet blend GUMP.

[4] The most recent season for which independent figures are available.

12.4 The site was designed to accommodate a second dyer, with excess capacity built into certain processes and a configuration which facilitates easy incorporation of additional equipment. With a commissioned cost of approximately $70 million, a second dryer would allow the site to more than double its powder production.

12.5 NZDL had 34 farms] supplying it [ ] in the 2011/12 season. [ ]. 32 farms were contracted to supply the company for the 2012/13 season.

12.6 In addition to milk from its own suppliers, NZDL sourced milk from Fonterra under DIRA. [ ].

12.7 In the 2011/12 season the majority of NZDL suppliers were paid on contract terms guaranteeing a minimum price of [ ]. In addition there were small bonuses [ ] for volume of milk supplied and milk quality.

13 Describe the industries affected by the proposed acquisition

13.1 The industry affected by the acquisition is New Zealand dairy industry. The Commission is familiar with the milk supply chain in New Zealand from its recent dry run review of Fonterra's Farm Gate Milk Price; the Commission's draft report (*FGMP report*) refers. The acquisition primarily affects the farm gate raw milk collection and processing markets of that industry.

14 Industry trends

14.1 The New Zealand dairy industry is predominantly an export business, with less than five per cent of raw milk production consumed domestically

14.2 Dairy exports account for around 27% of all of New Zealand's exports, making the industry critically important to the success and stability of the New Zealand economy. Products range from high quality basics such as milk powders, butter and cheese, and specialty foods such as ice cream, to highly specialised ingredients like spray-dried milk proteins, protein hydro lysates and freeze-dried biologically active proteins.

14.3 The greatest growth in international demand for dairy products is from Asia, due to population growth, a rapidly expanding middle class and dietary changes to include western-style foods. New Zealand has good trading relationships in these markets, including a free trade agreement with China, which has substantially benefitted the dairy industry.

14.4 Price volatility in commodity markets (both farm inputs and dairy products) and foreign exchange rates is resulting in higher uncertainty in farm returns. Marked increases in input costs for fuel, fertiliser and off-farm feed are commonplace.

Increasing environmental concerns relating to water quality and carbon emissions present a further challenge.

14.5 In contrast to New Zealand, most of the world's dairy production is consumed in the country where it is produced. This means that for some countries, relatively small increases in their production are amplified into significant changes in the volumes they trade. This in turn drives market volatility, with greater fluctuations in milk price than previously experienced. With so much of New Zealand's production being exported, those fluctuations can have quite a dramatic effect on this country's GDP.

14.6 The OECD-FAO publication "Agricultural Outlook 2009-2018" confirms that New Zealand will face more competition in dairy markets. The Outlook states:

Dairy demand over the medium term is expected to expand particularly in developing countries where increased consumption is not only governed by income and population growth, but also driven by factors such as changing preferences, changing diets and dietary diversification, all of which will be encouraged by further urbanisation with economic growth and development. These drivers are likely to be reinforced by growth in dairy marketing, increased product availability and retailing channels. Over the outlook, dairy products are expected to remain among the agricultural commodities for which consumption exhibits the highest growth rates.

In tandem to these broader changes, the outlook foresees the dairy sector as more competitive and more responsive to market signals. Rising supply potential in developing countries stimulated by investment and restructuring, will enable future production growth and improved domestic marketing linkages, placing these countries in a stronger competitive position in regional and global markets. As a result, milk production gains over the outlook period will be overwhelmingly driven by output growth in non-OECD countries, which could capture as much as 81% of the anticipated total increase. Much of the expansion is set to originate in Asia, including India, the largest producing country in the world, and also China and Pakistan. Milk production growth will allow such gains to be transformed to higher butter output in South Asia (India and Pakistan) and greater WMP production in South East Asia (China) – the two products and the two sub regions set to drive the global dairy expansion. Brazil is also foreseen to fuel world dairy output through higher WMP production.

14.7 Historically New Zealand dairy farming has held a position as the lowest cost producer at the farm gate. Recently this position has been eroded as costs in New Zealand have increased and other countries have adopted lower cost systems.

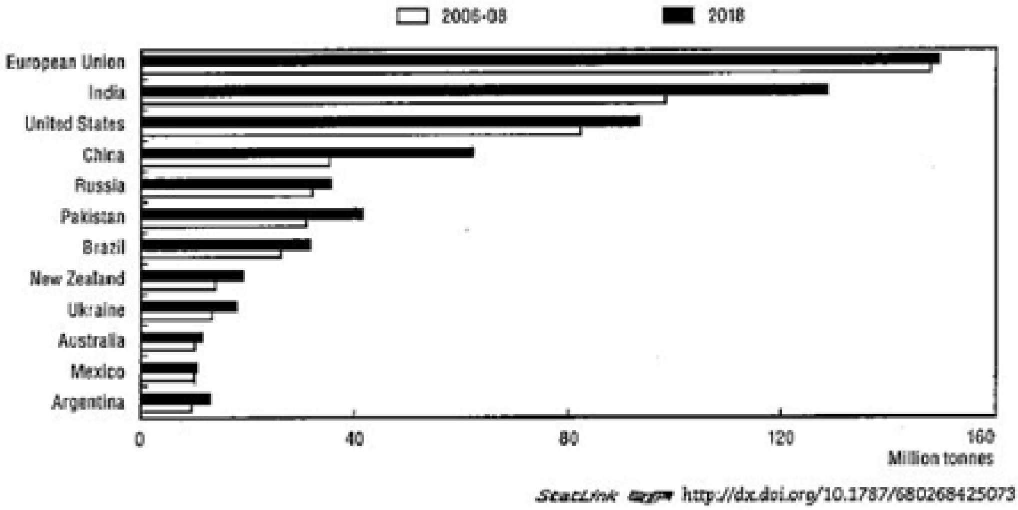
14.8 Meanwhile higher international milk prices have encouraged increased use of supplementary feeds in New Zealand; and conversions have lead to increased land prices. This has resulted in an increased on farm cost structure which, while supported by current dairy prices, underscores the importance of driving efficiency across all other areas of the industry.

Becoming the most efficient competitor

14.9 New Zealand has not been alone in recognising global demand for dairy products. It has driven increased investment globally, especially in areas where land, labour and compliance costs are significantly lower than in New Zealand. This is producing a new tier of lower cost producers.

14.10 **Figure 2** below, from the OECD-FAO publication "Agricultural Outlook 2009-2018", illustrates the increasing competition from India, China, Pakistan and Brazil, as production growth in those countries significantly outstrips that in New Zealand.

Figure 2: Comparative growth in global agricultural production



14.11 With the erosion of its historic low cost advantage, the challenge for New Zealand's dairy industry is to become the most efficient, integrated and sustainable producer of high quality food solutions in the world. Fonterra, as New Zealand's largest milk processor, must lead that drive to efficiency, with a focus on being the highest margin producer.

14.12 To do this, Fonterra must be able to respond quickly to business opportunities and expand in the most efficient manner to maintain sufficient scale to compete effectively abroad. That means Fonterra – like other industry participants - being able to make rational investment decisions about whether to build or buy new plant.

14.13 Greenfields plants typically take one to two years to bring into production. Acquisition of NZDL's plant at Studholme represents an immediate opportunity for Fonterra to support its Advanced Nutrition strategy, to secure a plant that can be profitably used in the interim to manufacture standard milk powders and support its New Zealand Milk strategy; and to achieve substantial transport savings.

14.14 It also means unsuccessful participants being able to quit the industry efficiently.

Milk supply is growing

14.15 Milk supply has been growing steadily over the last decade. Total raw milk output has increased; new farmers have entered the market; productivity has improved; and dairy land values have risen. All these observations are consistent with the existence of a competitive market for raw milk.

14.16 As is described in more detail below, the DIRA regime introduced to facilitate entry by new processors has performed well in enhancing competition in milk supply.

14.17 Not only is there now much more milk needing to be processed; but an increasing volume and percentage of that milk now is being processed by other dairy companies. In the South Island alone, four new processors have entered the market looking to secure raw milk from farmers since Fonterra's formation, seven new processing plants have been installed, and further expansion has been announced.

14.18 **Figure 3** below shows that national milk supply has increased by about 50% since Fonterra's formation in the 2000/01 season. However, Fonterra's share of that increased volume of milk has steadily reduced as competitors' shares have increased.

Figure 3: Share of national milk supply

	National milk supply (mil kgMS)	Fonterra milk supply (mil kgMS)	Fonterra market share (%)	Competitor market share (%)
2000/01	1,096,844,459	1,054,610,910	96.1%	3.9%
2001/02	1,152,000,000	1,111,406,916	96.5%	3.5%
2002/03	1,191,000,000	1,148,228,680	96.4%	3.6%
2003/04	1,254,000,000	1,201,800,127	95.8%	4.2%
2004/05	1,213,000,000	1,160,365,800	95.7%	4.3%
2005/06	1,267,000,000	1,210,030,163	95.5%	4.5%
2006/07	1,316,000,000	1,245,705,940	94.7%	5.3%
2007/08	1,270,000,000	1,192,051,451	93.9%	6.1%
2008/09	1,393,000,000	1,281,036,835	92.0%	8.0%
2009/10	1,438,000,000	1,286,010,316	89.4%	10.6%
2010/11	1,513,000,000	1,345,740,706	88.9%	11.1%

Source: NZ Dairy Stats 2010

14.19 It must be stressed that these figures relate to national milk supply. The increase in total milk supply, and decrease in Fonterra's share of that increased supply, has been much more profound in the South Island where most conversions have occurred.

15 Other mergers in the industry in the past 3 years

15.1 There have been no mergers affecting the dairy industry notified to the Commission in the past 3 years.

15.2 However, the Applicant is aware that:

(a) in April 2009, Kaimai Cheese Company took over Te Mata Cheese Company; and

(b) In February 2011, Synlait bought the assets of Oceania Dairy Limited.

15.3 The Commission's most recent consideration of a merger affecting this industry was the acquisition of Kapiti Fine Foods Limited and United Milk Limited by Fonterra in 2005 (*Decision No. 574*).

15.4 The Commission has considered non-dairying aspects of Fonterra's operations recently in the context of its consideration of Fonterra's application for authorisation of the establishment and operations of Kotahi Limited, a supply chain management company focussed on the efficient transport of goods.

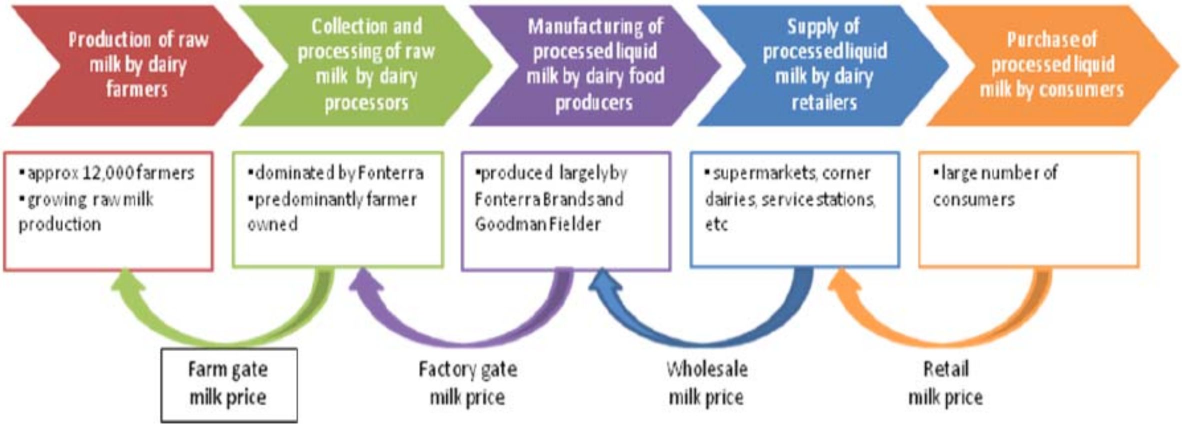
15.5 As outlined above, the Commission has considered Fonterra's dairying operations in its dry run review of Fonterra's Farm Gate Milk Price.

PART 3: MARKET DEFINITION

16 Relevant markets

16.1 **Figure 4** below, sourced from the FGMP report, usefully sets out the structure of the milk supply chain in New Zealand. Using the markets identified in that document, the only markets in which there would be horizontal aggregation would be the collection and processing of raw milk, more particularly within the South Island.

Figure 4: New Zealand milk supply chain



16.2 As to the product/geographic dimensions of those markets, in Decision No. 574 the Commission determined the input market relevant to that acquisition to be the supply and acquisition of raw milk in the Manawatu and Wairarapa wards. The market definition adopted there is noteworthy because the Commission:

(a) rejected narrower product differentiation (e.g. specialty milk for particular use);

(b) rejected temporal differentiation (e.g. winter milk); and

(c) adopted a conservative geographic dimension being the area within 100-150 kilometres of the Kapiti Fine Foods plant (equating roughly to the Manawatu and Wairarapa wards) rather than the whole of the North Island.

17 Geographic dimension

17.1 That geographic dimension requires close re-examination in the context of current South Island milk supply and the geography of the regions providing that milk supply. The Commission's rationale for adopting that more narrow geographic dimension of the raw milk market in Decision No. 574 (with which the Applicant does not agree) was that in that case it would enable the Commission to assess the ability of relatively small suppliers to switch from one milk processor to another in the event that the merged entity made a significant reduction in payout. The Commission repeated its previous findings in earlier milk processer mergers that transport costs "generally restrict catchment areas to within 100 kilometres or less (although in long thin catchment areas an outer limit of 250 kilometres may be possible).

17.2 That said, the Commission did recognise that "it is difficult to define a precise geographic dimension for the collection of raw milk". The Commission observed that although Kapiti Fine Foods was then acquiring milk from within 100 kilometre radius of its processing plant, it had initially acquired milk from Gisborne, 280 kilometres away, until it secured independent supply. "Taking a conservative approach", the Commission therefore adopted a market definition of within 100-150 kilometres of the target company's plant.

17.3 Turning to the present application, it will be readily apparent from the maps attached as **Appendix E**, that adopting the same radius here would encompass the area 100-150 kilometres north, west and south of NZDL's plant at Studholme. The resulting catchment would almost extend to Synlait's plant at Dunsandel, 162 kilometres by road to the north; and Westland Co-operative Dairy Limited's (*Westland's*) Rolleston site, 179 kilometres by road to the north, where their milk concentration plant is currently located and where they plan to install powder plants capable of processing up to 2.4 million litres per day. Both of these processors are now collecting milk in the South Canterbury region.

17.4 But, applying that 100-150 kilometre radius would not include any of: Westland's plant at Hokitika, 392 kilometres by road to the west; or OCD and Gardian's plants, 374 and 261 kilometres by road respectively to the south.

17.5 Of course, the straight line distances to those plants are much shorter.

Transport considerations

17.6 Seven years on from Decision 574, that 100-150 kilometre radius adopted for the lower North Island is much too restrictive for the present case, having regard to the size of farms, rapid expansion of dairying and transport considerations in the South Island.

17.7 There is also the practicality that the scale of the much larger processing plants now being built allows for greater efficiencies to be achieved, which can then more than offset higher transport costs.

17.8 As a consequence, both Synlait and Westland compete with Fonterra for suppliers; and OCD could feasibly transport milk to its plant in Southland. The farms in this area are typically large, producing approximately 300-400,000 kgMS, with relatively flat production curves. Further, the NZDL suppliers are mostly located on straight roads and are clustered close to State Highway 1.

17.9 Evidence of effective competition for raw milk at the farm gate illustrates that a significantly larger geographic definition of the market is now appropriate. Evidence includes;

(a) Synlait collects milk from an estimated [ ] former NZDL suppliers whose farms are located close to Studholme, following its acquisition of Oceania Dairy Limited;

(b) Westland currently collects milk from [ ].

The Applicant also understands that Westland has been actively making offers to NZDL suppliers during the period of the receivership;

(c) The Applicant understands that OCD has agreed to pick up milk from Hawea Flat farms that were seeking to supply NZDL;

17.10 Further examples of transport distances now covered include:

(a) [Westland regularly transports milk over 200 kilometres from their northern most suppliers in Karamea to Hokitika];

(b) [OCD regularly transports milk up to 180 kilometres from their furthest Southland supplier to the Awarua factory]; and

(c) Westland collects approximately [ ] annually from 12 Canterbury farms. The milk [ ] is transported by rail approximately 230 kilometres from the concentration plant in Rolleston to Westland's manufacturing plant in Hokitika. [ ].

17.11 There is also a rail alternative, with many farms in South Canterbury being close to the main trunk line. Fonterra regularly uses rail to transport milk from the Oamaru transfer station to its plant at Edendale as well as across the North Island. Westland already uses rail to transport raw milk collected in Canterbury to its processing facility in Hokitika, including farmer supply and 4 million kgMS of DIRA milk.

17.12 Suppliers in the South Canterbury and North Otago have therefore already been presented with substantial choice regarding processors to supply, and evidence suggests there are reasonable grounds to expect this would continue and expand. Synlait and Westland are already present, and it is also possible for OCD to establish a supply chain for milk to Southland.

17.13 In any event, transport charges are used by Fonterra and other processors as an effective way of maintaining the commercial viability of their more remote suppliers. [ ].

17.14 Finally, it is important to note that market definition is a tool to assist competition analysis that needs to be calibrated to the circumstances of the particular case. In Decision No. 574 the Commission was concerned at the potential impact of that acquisition on a number of small suppliers in the lower North Island who post-merger would have *no* alternative acquirer for their milk. That is demonstrably not the case here.

17.15 As a matter of current industry practice and commercial commonsense, the geographic dimension of the milk collection and processing assets markets relevant to this application encompass all the South Island.

18 Differentiated product markets

18.1 The Commission in Decision No. 574 rejected arguments by parties opposing that merger that the raw milk market should be differentiated based on pricing and quality considerations. That argument is not relevant here given that the NZDL plant uses standard raw milk to process standard specification WMP exclusively for export markets.

19 Vertical integration

19.1 The question is, will the proposed acquisition result in vertical integration between firms involved at different functional levels?

19.2 In essence, the New Zealand dairy industry processes raw milk to manufacture 4 major product groups: whole milk products; cream products such as butter and anhydrous milkfat; cheese; and protein products such as casein and caseinates. Fonterra is involved in the production of the full range of those products.

19.3 NZDL is not operating in any vertical layer of the market in which Fonterra is not already present. In 2011/12 its Studholme plant produced standard specification WMP, most of which was sold via a third party trader into Asia.

19.4 Post-acquisition NZDL will exit the market as an independent acquirer and processor of raw milk. Previously it has 'acquired' [ ] litres of that raw milk from Fonterra under DIRA. That DIRA milk now will become available to another independent processor.

19.5 Thus, there will be no increase in vertical integration.

PART 4: COUNTERFACTUAL

20 **NZDL is a failed firm**

20.1 The High Court in *Woolworths* held that there must be a 'real chance' of a counterfactual scenario occurring for it to be taken into account and postulated that it should have at least a 30% chance. Anything more remote or speculative must be dismissed.

20.2 Here, NZDL is a failed firm. The Receiver was appointed on 17 May 2012 and, as outlined in their letter of 15 June to the Commission Chair (see **Appendix F**), sought offers from a number of parties who had been able to conduct full due diligence on NZDL. As a result of that competitive process, the Receiver entered into the Agreement and Operational Agreement with Fonterra.

20.3 Fonterra was selected as preferred bidder by the Receiver because [ ]:

(a) [ ];

(b) [ ];

(c) [ ]; and

(d) [ ].

20.4 [ ].

21 **[ ]**

21.1 [ ]:

(a) [ ];

(b) [ ];

(c) [ ];

(d) [ ]; and

(e) [ ].

21.2 The Receiver has undertaken to 2011/2012 NZDL suppliers who sign Fonterra contracts that they will receive 100% of the amounts outstanding to them for the 2011/2012 season as soon as the sale to Fonterra is completed. [ ].

21.3 The Receiver has determined that this course is the only practical way of ensuring that the Studholme plant could resume processing milk for the 2012/13 dairy season. The Receiver is not in a position to operate the plant itself; and the Receiver's objective was to maintain the business of NZDL as a going concern until sold to Fonterra if the conditions in clause 4.1 of the Agreement can be satisfied; or to another purchaser if they cannot. As a consequence, the Operational Agreement ensures that the Studholme plant will remain operational to process its existing 32 suppliers' milk at least for the coming season.

21.4 That provides for an extraordinary counterfactual – namely, the prospective acquirer ensuring that the relevant business assets of the failed firm not exit the market pending satisfaction of the conditions in its own purchase agreement. Each of the former suppliers of NZDL now has entered into an agreement for continued milk supply to NZDL and Fonterra.

22 Other purchasers are unlikely and speculative

22.1 Where there are a number of bidders for a failed firm – as here – the question is whether there is a real chance of an alternative acquisition by a party that would not give rise to a substantial lessening of competition.

22.2 The Applicant is not privy to the other offers received by the Receiver, or even the identity of those other bidders. However, both the quantum of their offers and the identities of those bidders are relevant to the assessment of "at least a 30% chance" of occurring that a counterfactual requires to be valid. The Applicant understands that none of the other offers satisfied all of the essential characteristics described above.

22.3 Dealing first with quantum, any offer received by the Receiver that was sufficient only to repay secured creditors of NZDL would not allow payment to the 34 farms the substantial amounts owed to them for milk supplied to NZDL prior to the receivership. While the purchase price agreed in terms of the Agreement ensures all those suppliers will be fully paid for previous supply, any less consideration would not. Suppliers who have not been fully paid for the previous season are unlikely to show any loyalty to a new owner who has paid so low a purchase price for the plant that they have lost some or all of the money owed to them for their previous supply to that plant.

22.4 The reported words of NZDL suppliers committee chairman, Robert Borst, in relation to Fonterra's current offer to acquire the Studholme plant and service its suppliers, are relevant here:

"*It was a market for their milk which would otherwise go to waste in the rapidly approaching season and full repayment of what they were owed – a fantastic result, he said.*

Many of the farmers had previously supplied Fonterra and had moved, for various reasons, to an independent processor, he said.

For some, having to sign up to the co-operative for a considerable amount of time would be a bitter pill, he said.

But that's just business and life.

A combination of fiscal pressure from two missed milk payments and an imminent milking season meant farmers were compelled to jump to Fonterra for the six years, he said.

I think we haven't got a lot of other options at this stage."

22.5 So, while the Receiver may have received other bids, and the Operational Agreement will ensure operation of the Studholme plant for the 2012-2013 season in any event, there is no certainty that former NZDL suppliers would commit supply to that alternative purchaser for future seasons (i.e. beyond 2012-2013). Those suppliers themselves do not believe that they have "*a lot of other options at this stage*."

22.6 Turning to the identity of other bidders, this raises the spectre of overseas ownership of those other bidders. Miller J's ruling in relation to the Crafar Farms now has made it much more difficult for any purchaser requiring OIO consent. The Court held that in assessing the economic benefits relative to the consent, the OIO must adopt a forward-looking counterfactual assessment – i.e. similar to the Commission's own approach to section 47. Those benefits must be identifiable and substantial. For example, investment capital – or other benefit – brought by the prospective overseas buyer must be such that a New Zealand purchaser is unlikely to match.

22.7 The Applicant understands that at least some of the other potential bidders spoken to by the Receiver were overseas persons. Further, sale of the business and assets of NZDL as a going concern to an overseas person would require OIO consent. Thus, at least there is a 'clash of the counterfactuals' – with the Commission looking for acquisition by a party that would not give rise to competitive concerns, and the OIO ignoring competitive concerns but looking at the (other) *relative* attributes of a New Zealand purchaser. That is not to say that an overseas buyer, or an overseas person like Synlait, might not eventually have satisfied OIO requirements. But, any such offer could not have provided either certainty or speed of completion.

22.8 In relation to domestic buyers such as Westland or OCD, it may be that;

(a) They were not willing to pay an amount that would see suppliers paid all amounts owing;

(b) That they could not provide certainty of funding;

(c) They may not have been able to move quickly enough to put together a credible bid; or

(d) They may not have been able to operate the plant from 1 August 2012.

22.9 In summary, the Applicant regards it as speculative that an alternative purchaser will materialise without substantial OIO issues to resolve but with a purchase price sufficient to preserve the loyalty of NZDL's existing suppliers beyond the 2012-2013 season.

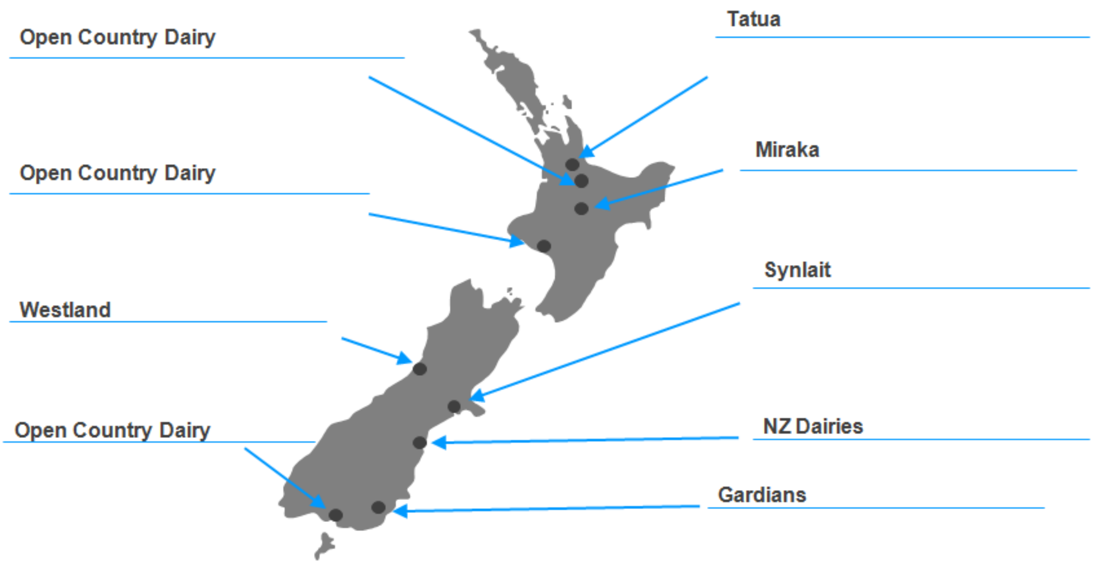
22.10 Notwithstanding, the following Competition Analysis assumes the unlikely counterfactual of an alternative purchaser who is able to complete a swift and certain purchase of the Studholme plant and preserve the loyalty of those suppliers. However, the small probability of such a scenario in fact coming to pass must weight the Commission's assessment of the competition consequences of the acquisition.

PART 5: COMPETITION ANALYSIS

23 Existing Competitors

23.1 The New Zealand processing landscape features a number of competing operators that collect and process raw milk.

Figure 5: Location of competing operators that collect and process raw milk



23.2 In addition to the NZDL plant at Studholme, Canterbury is host to:

(a) Fonterra's Clandeboye site and the soon to be commissioned Darfield site;

(b) Synlait's processing facilities in Dunsandel; and

(c) Westland's milk concentration plant in Rolleston.

23.3 In the Southland region, Fonterra's Edendale and Stirling sites are accompanied by the OCD site in Awarua and the new Gardians' Limited (*Gardians*) facility in Balclutha (to be commissioned in the 2012/13 season).

23.4 Details of the ownership of those competing plants are as follows:

24 Westland

24.1 A 100% farmer owned cooperative based in Hokitika, Westland commenced production in 1937. Westland has entered the Canterbury region in the past season, contracting suppliers and establishing a milk concentration operation connected to rail facilities in Rolleston.

24.2 In addition to its DIRA take ([ ] litres in the 2011/12 season) Westland has signed-up a small number of farmers in Canterbury and transports this milk back to Hokitika via rail (from the Rolleston site). [

]. It is estimated that Westland has at least 12 farms based in Canterbury supplying [ ].

24.3 Westland is seeking resource consent to establish a nutritional dairy plant at its Rolleston site. The proposed plant, once fully operational, will process up to 2.4 million litres of milk per day.

24.4 More information on Westland is available from www.westland.co.nz.

25 **Synlait**

25.1 Synlait was originally set up by a group of large ex-Fonterra suppliers as an integrated cow-to-customer business. The company is now 51% owned by Bright Dairy, a Chinese investment company, with Mitsui (a Japanese investment house) holding another 11%.

25.2 Synlait started as a commodity powder processor that commenced production in 2008 with a single powder dryer based at Dunsandel. It has begun expanding into nutritionals/IF production. It has expanded production at its Dunsandel site, assisted by significant overseas investment, building a small specialty milk dryer (2008/09) as well as a large scale infant nutritionals dryer (which commenced processing in the 2011/12 season). Synlait's production is sold exclusively to overseas markets.

25.3 In February 2011 Synlait purchased the assets of Oceania Dairy (a start-up processor located near NZDL). The main asset of the company was milk supply agreement from an estimated [ ] farms that had been contracted to supply Oceania with an estimated [ ]. Synlait collected milk from these farms during the 2011/12 season.

25.4 More information on Synlait is available from www.synlaitmilk.com.

26 **Open Country Dairy**

26.1 OCD was formed by the merger of Open Country Cheese and Dairy Trust in 2008. Currently Fonterra's largest competitor nationally, it is supplied by over 500 contracted farmers. A corporate competitor (suppliers don't need to hold shares), Talley's is the majority shareholder (52% held either directly or through its ownership of AFFCO). A further 25% is owned by Olam International (Singapore).

26.2 OCD is a commodity processor with approximately 75% of plants geared towards powder production and 25% cheese and whey production. Products include milk powders, milk proteins, milk fats and cheeses that are used in a variety of applications including food, beverage and nutritional applications.

26.3 The combined capacity of OCD's three sites (Waharoa, Awarua and Wanganui) is over 800 million litres of milk per annum making OCD the second largest dairy processor in New Zealand, exporting to around 45 countries world-wide.

26.4 More information on OCD is available from www.opencountry.com.

27 **Gardians**

27.1 Gardians intends to collect and process raw milk from a small number of farms in the lower South Island. [

].

27.2 The company's 4 hectare site near Balclutha will be capable of producing 20,000 metric tonnes of nutritional products annually.

27.3 More information on Gardians is available from http://www.gardians.co.nz/index.html.

27.4 For completeness, details of the ownership of competing plants in the North Island are as follows:

28 **Miraka**

28.1 Miraka Limited is backed by a group of Maori trusts and incorporations. These organisations include Wairarapa Moana, Tuaropaki Trust, Waipapa 9 Trust, Hauhangaroa Partnership, Tauhara Moana Trust and Huiarau Farms. Vinamilk (a leading enterprise in Vietnam in manufacturing milk and dairy products) owns 20% of the company.

28.2 Miraka processes milk collected from around the central North Island at its sole site near Mokai, 30 kilometres North West of Taupo. Another commodity processor, Miraka produces milk powder only.

28.3 More information on Miraka is available from http://www.miraka.co.nz/Home.aspx.

29 **Tatua Co-operative Dairy Company Limited**

29.1 Founded in 1914, Tatua is the oldest independent dairy company in New Zealand. Like Fonterra and Westland, Tatua operates under a co-operative structure and is supplied by its approximately 112 farmer shareholders.

29.2 Tatua exports 94% of its products to more than 60 countries worldwide each year. The business focuses on six key areas: Dairy Ingredients, Specialty Nutritionals, Flavour Ingredients, Bionutrients, Foodservice, and Consumer Products.

29.3 Tatua's head office and manufacturing facility is based in Tatuanui, 35 kilometres east of Hamilton.

29.4 More information on Tatua is available from http://www.tatua.com/.

30 **Competing Payouts**

30.1 The Applicant understands that the competing processors in the South Island have been paying their suppliers on the following terms;

(a) [

].

(b) [

].

(c) [

].

(d) [

].

31 **Market share estimates**

Market for the acquisition of raw milk

31.1 Fonterra is the largest participant in the market for the acquisition of raw milk. However, as competitors, especially new entrants, have built operational scale plants and attracted suppliers, Fonterra's market share has steadily reduced. **Figure 6** illustrates this downward trend across the national market since 2001.

31.2 **Figure 7** below illustrates the allocation of milk supply amongst the South Island market participants in the 2011-2012 season.

Figure 7: Acquisition of South Island milk supply – 2011/12 season

31.3 More detailed market share estimates relating to the acquisition of raw milk are set out in confidential **Appendix G**.

Market for raw milk processing assets

Figure 8 below sets out current South Island milk processing asset capacity for Fonterra and competing independent processors. The market shares shown in **Figure 8** [are conservative, including expected capacity from Fonterra's Darfield plant (not scheduled to reach full capacity until the 2013/14 season), while excluding announced expansions at other processor's plants].

Figure 8: South Island milk processing asset capacity

31.4 More detailed market share estimates relating to processing asset capacity are set out in confidential **Appendix H**.

32 Constraint from existing competitors

32.1 Both Fonterra and NZDL operated throughout the 2011-2012 season as South Island processors of raw milk. Fonterra manufactures a wide range of dairy products that are primarily for export, while NZDL manufactured standard specification WMP primarily sold by a third party into Asian markets.

32.2 As such, Fonterra and NZDL do not compete within New Zealand in any output markets for processed dairy products. A small amount of downgraded milk powder may have been sold by NZDL as stock food into the New Zealand market. The predominant use of such product is as feed for calves. The volumes would be considered immaterial, and there are many substitute sources of calf feed, including raw milk produced on farm.

32.3 Obviously, however, Fonterra and NZDL did compete in the South Island input market for raw milk supply. Strictly speaking, they only competed for that volume of its raw milk requirement that NZDL obtained from its suppliers, rather than through its DIRA entitlement. This contested supply represented approximately [ ] litres in the 2011-2012 season, or less than 2% of the total volume of raw milk acquired in the South Island.

32.4 NZDL's unusual feature was the Studholme plant's proximity to its supplier base. As is outlined in more detail below, the average collection cost for NZDL has been estimated at $[ ]/kg MS. By contrast, Fonterra's average cost of collection is $[ ]/kg MS, meaning NZDL had a cost advantage of around $[ ]/kg MS.

32.5 The Applicant understands that NZDL had secured sufficient milk supply to fill its plant for the 2009-2010 and 2010-2011 seasons. Last season, however, around one quarter of that farmer supply was lost to Synlait as a result of the Synlait purchase of the Oceania Dairies Limited project, with which a number of NZDL suppliers had already signed supply contracts. By then NZDL had well publicised funding problems that dated from the time of construction right through the period of Nutritek ownership, and the milk price NZDL paid to farmers reflected the perceived risk associated with supplying the company.

32.6 The following table details NZDL's peak day milk supply and processing capacity for the 201/12 season:

Figure 9: NZDL Peak Day Milk Supply and Collection Volumes

(000 litres/day)	*F12 Actual*	*Nominal Capacity*
Farmer Milk Supply	[ ]	[ ]
DIRA Milk	[ ]	

32.7 By contrast, the table below outlines Fonterra's approximate projections for 2012/13 peak supply, 2011/12 peak supply and Fonterra's peak day processing capacity by site.

Figure 10: Fonterra South Island Peak Day Milk Supply and Collection Volumes

(000 litres/day)			*F12 Actual*	*F13 Budget*	*Nominal Capacity*
Upper South Island	*Milk from*	Collection within region	[ ]	[ ]	
	Milk to	Liquid sales	[ ]	[ ]	
		Takaka	[ ]	[ ]	[ ]
		Brightwater	[ ]	[ ]	[ ]
		Kaikoura	[ ]	[ ]	[ ]
		Transport to Central SI	[ ]	[ ]	
Central South Island	*Milk from*	Transport from Upper SI	[ ]	[ ]	
		Collection within region	[ ]	[ ]	
	Milk to	Liquid sales	[ ]	[ ]	
		Darfield	[ ]	[ ]	[ ]
		Clandeboye	[ ]	[ ]	[ ]
		Transport to Lower SI	[ ]	[ ]	
Lower South Island	*Milk from*	Transport from Central SI	[ ]	[ ]	
		Collection within region	[ ]	[ ]	
	Milk to	Liquid sales	[ ]	[ ]	
		Stirling	[ ]	[ ]	[ ]
		Edendale	[ ]	[ ]	[ ]
Total		Milk Collected	[ ]	[ ]	[ ]
		Milk Processed	[ ]	[ ]	

32.8 Fonterra transports milk between regions to balance its growth in milk supply with its growth in processing assets. As such, Fonterra's sites in the Upper and Central South Island are projected to be full in 2012/13, but with spare capacity in the Lower South Island. Once the Darfield 2 plant is commissioned in 2013/14, it is projected that there will be surplus processing capacity in the Central South Island, and surplus supply in the Lower South Island. Fonterra's sales to third parties under DIRA and under separate contracts is also reported here, and reflects the difference between the volume of milk that Fonterra collects, and the volume that it processes.

32.9 It is apparent that Fonterra's supply is spread widely throughout the South Island, but with concentrations in South Canterbury and Otago/Southland. By way of illustration, the maps attached as **Appendix E** show the relative integration of the Synlait and NZDL supplier bases with Fonterra's supplier base for Clandeboye.

32.10 Unlike Synlait and NZDL - which have each received up to [ ] litres of milk from Fonterra under DIRA in past seasons – Fonterra must compete for not only its own milk supply but also sufficient milk to meet its total DIRA obligation. As **Figure 11** below shows, Fonterra last season supplied 157 million litres of raw milk to its competitors in the South Island and was projected to be supplying more for the coming season.

Figure 11: DIRA milk acquisition

(000 litres/day)	*F10*	*F11*	*F12*	*F13 (f)*
NZDL	[ ]	[ ]	[ ]	[ ]
Westland	[ ]	[ ]	[ ]	[ ]
Synlait	[ ]	[ ]	[ ]	[ ]
OCD Awarua	[ ]	[ ]	[ ]	[ ]
Total	[ ]	[ ]	[ ]	[ ]

32.11 In summary, the acquisition will result in Fonterra increasing its share of the raw milk collection and processing markets by less than 2%. However, the substantial lessening of competition test is not about market shares. The test measures movement along the market power continuum. An acquisition will not substantially increase that market power where – as in the present case – there are low barriers to entry, and proven, recent and significant entry, into the affected markets.

Suppliers will continue to have a choice of processor

32.12 This acquisition will have little impact on competition in the raw milk market (other than to maintain a viable processor for NZDL suppliers). It will be readily apparent that most South Island dairy farmers now have a choice of milk processor to which they can supply; and will continue to do so post-acquisition, ensuring a competitive market for raw milk remains. Even without NZDL as an independent processor, there will be other processors from which suppliers can choose.

32.13 Of the approximately [ ] South Island farms that supplied Fonterra in the 2011/12 season, Fonterra estimates:

(a) 70% had 3 options of processor within 150kilometres (as the crow flies); and

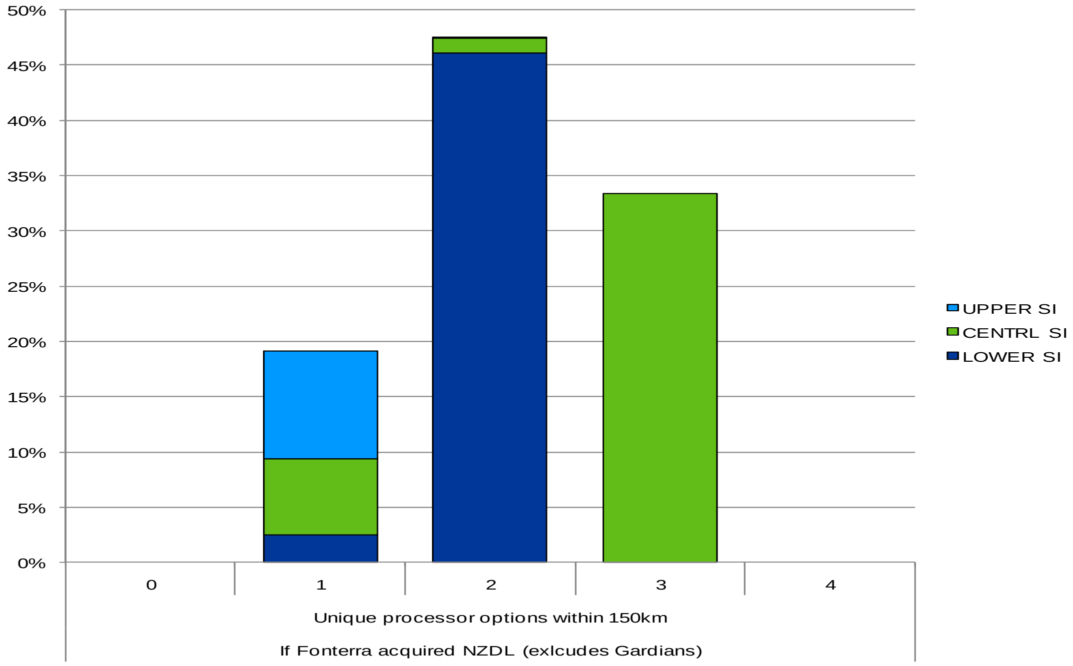
(b) 10% had 4 options within 150kilometres ;

(c) 10% had 2 options within 150kilometres ; and

(d) the remaining 10% are located in the Upper South Island where no competitors have yet established.

32.14 **Figure 12** below illustrates the situation post acquisition.

Figure 12: Post-acquisition supplier options



33 **Extent to which competitors could expand**

33.1 Increasing dairy production within New Zealand and sustained global demand for dairy products is driving that expansion. Key factors of production that a firm would need to access in order to expand include:

(a) *Capital*: Access to capital presents little constraint in the current high growth environment. Further, as is described below, the Commission's approval of this application will improve access to capital by providing investors with confidence that they will be able to exit their investment;

(b) *Land and Resource Consents*: There are many sites suitable for establishing a dairy factory on in the Canterbury region;

(c) *Plant and Equipment*: This acquisition would have no impact on companies ability to secure plant or equipment, all of which is provided by independent third parties;

(d) *Labour*: Shortage of skilled labour may limit expansion so unless workers can continue to be attracted to the dairy industry by the prospect of secure employment;

(e) *Raw Milk*: As discussed above, raw milk is readily accessed directly from farmers and under the Raw Milk Regulations. There is substantial evidence of this working in practice; and

(f) *Product Markets*: Markets for dairy products are growing rapidly, and there are many paths to market either directly or via third party traders for companies looking to expand.

33.2 The acquisition will not affect any of those conditions of expansion, except to relieve employee uncertainty and strengthen investor confidence in their ability to exit their investment.

33.3 Various media statements identifying commissioned or planned expansion by competitors from the past 6 year are attached as **Appendix I**. These statements report:

(a) Tatua is close to completing a $30 million expansion to its plant;

(b) Westland plans to build a $100 million ‘value-add’ product factory at its Rolleston site in 2012;

(c) Westland has begun modifying its Hokitika site to produce paediatric specification products;

(d) Synlait has installed a second powder dryer at its site in Dunsandel allowing it to produce specialty paediatric powder products;

(e) Miraka’s recently commissioned $90 million plant near Taupo is capable of handling 210 million litres of milk a year; and

(f) Gardians has installed a powder plant at Balclutha and intends to start processing paediatric nutritional products in 2012/13.

33.4 The output of competing processors is aimed mostly at export markets. Thus, those existing competitors operate primarily as a constraint on Fonterra within New Zealand as an acquirer of raw milk. Of course, they also compete with Fonterra in relevant export markets.

33.5 Even a cursory examination of these media reports reveals a substantial degree of foreign involvement with, or interest, in those competing processors. Similarly, with new entrants. For example, the media report of 6 July reports that Chinese-owned Natural Dairy, which is seeking to acquire the 16 Crafar farms in receivership, has also applied for milk under DIRA.

34 Potential Competition

34.1 Unquestionably, the New Zealand milk processing industry is dynamic. Thirteen years ago the Commission noted that Fonterra’s precursor would have virtually 100 percent of raw milk and perceived no threat of new entry. DIRA has facilitated substantial new entry to change all that. New entrants competing at scale in the raw milk market since Fonterra’s creation in 2001 include:

(a) *Open Country Cheese*: commenced production in 2004 with a cheese plant at Waharoa, Waikato. The site was subsequently expanded to include a whey plant and a powder dryer. In 2008 Open Country Cheese was acquired by Dairy Trust, and OCD was formed;

(b) *Dairy Trust*: commenced production in 2008 with a powder dryer at Awarua, Southland. In 2008 Dairy Trust completed the takeover of Open Country Cheese, forming OCD. OCD has subsequently built a further powder plant at Imlay, Wanganui;

(c) *NZDL*: commenced production in 2007 and had a single dryer based at Studholme in South Canterbury;

(d) *Synlait*: commenced production in 2008 and has three dryers based at Dunsandel, Canterbury;

(e) *Miraka:* commenced production in 2011 and has one dryer based at Mokai, South Waikato; and

(f) *Gardians:* to commence production in 2012 with one dryer based at Balclutha, Southland.

34.2 These new entrants together now have a processing capability of around 1.7 billion litres. On a volume weighted basis, over 50% of this new entry has been in the South Island, with each of the three new entrants there developing at least 200 million litres of capacity.

34.3 That recent history shows that there are in fact no barriers to entry or expansion as an independent milk processor.

34.4 The Applicant is not aware of any material issues that limit the ability of competitors to enter the New Zealand dairy market. Every processor that has been able to raise capital from investors has managed to subsequently to enter the New Zealand market, including Open Country Cheese Company Limited and Dairy Trust Limited (now OCD), Synlait Milk Limited, New Zealand Dairies Limited, New Zealand Organic Dairy Farmers Co-Operative Limited, Natural Dairy (NZ) Ltd, Miraka Limited, Gardians Dairy Limited and New Image Food Limited.

34.5 Miraka, Gardians and New Image all have entered the New Zealand market in the last year.

34.6 In addition, there are other businesses currently seeking funding for dairy plants including Arapuni Milk, Dairyland Products Limited and Mataura Valley Milk Limited. Expansions are also being undertaken or planned by existing processors, including Synlait's new IF dryer, Tatua's new investment in value add processing and Westland's investment in EasiYo and planned investment in IF processing at Rolleston noted above.

34.7 The potential for and fact of new entry is more fully set out in submissions by Compass Lexecon on the MAF Review of Raw Milk Regulations commissioned by Fonterra, a copy of which is attached as **Appendix J**.

34.8 All this suggests that the potential for further new entry and expansion is both real and imminent.

34.9 That threat of entry or expansion by competitors operates as a real constraint on Fonterra and will continue to do so post-acquisition. None of the conditions of entry or expansion are adversely affected by an acquisition.

34.10 In practice, there are few barriers to entry into the market, provided the new entrant has sufficient backing and a credible business case that will attract suppliers, customers and investors. Open Country Cheese, Dairy Trust, Synlait, NZDL and others all have overcome the obstacles perceived to confront new entrants – including Fonterra itself – when seeking to establish or expand a processing plant.

35 **Constraint on exit can be a barrier to future entry**

35.1 There are no significant barriers to entry to the milk processing assets market. Fonterra does not have significant ability to deter suppliers from switching to a new entrant. Fonterra also has no ability to manipulate the Milk Price by bundling the return on Fonterra shareholding.

35.2 That said, establishing or expanding a processing plant does involve major investment and time. Building the plant can take 1-2 years depending on whether a site with existing resource consent is available. The resource consent process can take 6-9 months, but other activities such as capital raising and site design can be run in tandem with the consent process. Typically plants cost between $50-$150 million when being built on a greenfields site. This cost is usually met through a mix of equity and debt.

35.3 What is vitally important with major investments in such plants however is that *all* such investment be rational. For new entrants that means a business case that does not depend on future access to cheap regulated milk. For Fonterra it means being able to make rational decisions about where to locate new plants and especially whether to build or buy capacity to meet increasing milk supply in the South Island.

35.4 Enabling Fonterra to bid for such plants, if they become available, must have a pro-competitive effect on the market for those assets. Lowering the impact of potential failure reduces the total risk to a new entrant.

35.5 Entry is no assurance of continued success, as NZDL's demise has shown. Many factors can give rise to failure. But when such failure does occur, excluding Fonterra from bidding can only depress the likely sale price of the relevant plant – which has the effect of inflating the exit cost of the present owner. Inflated exit costs (i.e. because Fonterra cannot bid) can only deter future entry.

35.6 Farmer suppliers face a heightened risk in this regard. As creditors of their processor for milk supplied to it they need certainty that their interests will be protected. That requires assurance of a strong competitive bidding process for the assets of the processor if it fails. Without this, farmers may become unwilling to supply independent processors.

36 **Impact of DIRA**

36.1 While entitlement to raw milk under DIRA undoubtedly facilitates entry by independent processors, it does not ensure their success. All processors face a range of commercial challenges. In particular, any new entrant processor still needs to convince sufficient farmers to commit supply to it in the face of considerable uncertainty about how the new processor will perform both technically and financially. Those farmers will need to be attracted by the promise of better payout than continued supply to Fonterra or another incumbent processor will provide them.

36.2 But, as with any commercial undertaking, greater reward may involve greater risk. Survival as a milk processor in any form requires minimum scale to support the management and marketing overheads. NZDL's business model proved vulnerable, for the reasons detailed above. Nutritek had been endeavouring to sell NZDL for 2 years when it went into receivership.

36.3 Further, the "pro-competition regulatory regime" provided by DIRA does not ensure that New Zealand's milk processing sector operates at peak efficiency. Indeed, that is not its purpose. The policy rationale for the Raw Milk Regulations, as recently explained by the Minister for Primary Industries to his Cabinet colleagues, clearly prefers ensuring New Zealand markets for dairy goods and services are contestable, to promoting the efficiency of the largest player in those markets. The Cabinet Committee paper is attached as **Appendix K**.

36.4 That continued preference – of contestability over efficiency – has resulted in further policy changes to prevent the triggering of DIRA's sunset clauses, that otherwise would soon occur.

36.5 The presently preferred suite of amendments to Raw Milk Regulations favoured by officials are as follows:

(a) for those independent processors who are in the business of sourcing milk directly from farmers, access to regulated milk would be limited to three seasons;

(b) the total volume of milk available under the Raw Milk Regulations would be increased to five percent of Fonterra's total milk supply;

(c) there would be a series of maximum quantity limits set, restricting how much milk an independent processor can take under the Raw Milk Regulations in different months of the season, to reflect the seasonal dairy supply curve;

(d) the $0.10 margin would be removed from the regulated milk price, as processors taking significant quantities of regulated milk will no longer have the ability to flatten the supply curve;

(e) the "October Rule" would be removed, as the quantity of regulated milk taken throughout the season will be controlled by monthly maximum limits, rather than by comparison to the quantity taken in October; and

(f) Goodman Fielder would continue to be able to access up to 250 million litres of regulated milk per season, on a flat supply basis.

36.6 While Fonterra opposes the proposed extension of the Raw Milk Regulations, it must be recognised that the DIRA regime not only will remain but will be potentially enhanced to continue to facilitate further new entry.

36.7 So saying, Fonterra does not oppose such new entry. On the contrary, other processors provide a local benchmark against which shareholders can measure Fonterra's own performance. Other processors may bring innovations which can be imitated. Other processors also provide the opportunity for greater industry cooperation on generic industry good issues, product development and promotion and allow processing capacity risk to be spread in times of over or under supply of raw milk.

Commission needs to look at dairy industry afresh

36.8 It is now 13 years since the Commission's last comprehensive look at the dairy industry, that being its consideration of the proposed merger of all the dairy co-operatives and the New Zealand Dairy Board into a single, vertically integrated entity encompassing New Zealand's then entire milk production. The Commission's draft determination of 27 August 1999 in relation to the application for authorisation of that merger refers.

36.9 Much has changed since then. In particular:

(a) Westland and Tatua did not participate in the merger, and continue to be robust and growing competiton;

(b) deregulation means dairy processors now determine their own product mix and markets;

(c) A suite of pro-competitive measures in DIRA, including open entry and exit, the 20% rule and access to Regulated Raw Milk facilitate contestability in the New Zealand dairy market and provide a proven "entrance pathway" for new processors;

(d) significant new entry in fact has occurred;

(e) suppliers of raw milk have become fewer but much larger – Fonterra has reduced from its initial 15,000 suppliers to 10,500;

(f) higher international milk prices have driven higher relative returns from dairying (compared with other land uses), which have driven substantial conversions, especially in the South Island;

(g) milk supply patterns have changed because of those conversions, recurrent drought in some areas, irrigation and other factors;

(h) the industry now has a higher cost structure;

(i) international markets for dairy products have become much more volatile around a higher mean; and

(j) markets have also changed, with developing country markets driving the need for innovation.

36.10 The fact that 95% of total raw milk produced in New Zealand is exported has a profound effect on that input market. In particular, the raw milk price that can be paid by processors to New Zealand farmers is substantially influenced by the supply and demand characteristics of international dairy markets. This acquisition is all about maintaining the integrity of the New Zealand dairy industry, and ensuring its continued efficiency in those markets, in the face of increasing off-shore competition.

36.11 The reality is that global competitors are gaining ground. On-going investment in processing capability R&D, education, sustainability and employment opportunities is therefore vital. In particular, there must be continued investment in plants that will shift dairy production up the value chain towards smarter, higher value food production and an efficient market for commodity processing assets. The Studholme plant represents such an investment. Fonterra can utilise that investment to swiftly change the product mix going into those developing country markets.

36.12 The Commission's historical approach to dairy industry mergers concentrated on the raw milk market and the desires of some suppliers to that market to have an alternative processor. That approach focused simply on any increase in the market power of the largest acquirer of raw milk.

36.13 The Commerce Act now allows for greater flexibility. The new test in section 47 requires measurement of change relative to the counterfactual. Importantly, the Commission and New Zealand courts recognise that the new test is concerned with the *net* effect on competition and thus requires a balancing of pro-competitive effects (including efficiencies). Here, the markets for globally traded dairy products and the on-shore markets for raw milk collection and milk processing assets are inextricably linked. Increased efficiencies in milk processing will flow through to raw milk suppliers, in terms of increased returns; and that will drive competition among processors for raw milk supply.

36.14 It will also drive competition among processors to have the best mix of milk processing assets. Being able to make commercially rational decisions about whether to build or buy plant is crucial in this regard.

36.15 The relativity inherent in the new test also means that any perceived change must be weighted by the likelihood of the counterfactual scenario in fact occurring. The law everywhere is that theoretical harm can be rebutted by demonstrating low barriers to entry and off-setting efficiencies. DIRA clearly establishes the conditions of low barriers to entry.

37 **Review of Fonterra's Farm Gate Milk Price**

37.1 That leads conveniently to the other major change impacting on the dairy industry – namely, the requirement in the Dairy Industry Restructuring Amendment Bill 2012 for the Commission to monitor and report on the extent to which Fonterra methodology for setting its Farm Gate Milk Price are consistent with the contestability principles set out in that Bill. Put bluntly, that requires the setting of a milk price to suppliers that;

(a) provides an incentive for Fonterra to operate more efficiently; but

(b) provides for contestability in the market for the purchase of milk from farmers.

37.2 The fear was that, without such regulatory oversight, Fonterra might be incentivised to set a milk price so high as to preclude –or even imperil – competing processors.

37.3 At the Minister for Primary Industries' request, the Commission has just carried out its own "dry run" review of Fonterra's 2011/12 methodology and application of that methodology. Importantly, the Commission's initial conclusion, as set out in the FGMP report, is that Fonterra's setting of the Farm Gate Milk Price does not appear to be inconsistent with the purposes and principles in the Bill.

37.4 In other words, one previous risk raised by those concerned by Fonterra's position – namely, that Fonterra (or its precursor), would distort the milk price it paid to suppliers to deter new entry – has been so shown to be unfounded. Further, the Commission's new monitoring role will ensure that such behaviour absolutely does not subsequently occur. In short, another perceived barrier to entry has been shown not to exist.

38 **Constraining power of suppliers**

38.1 Fonterra is a co-operative company and nearly all suppliers are also shareholders of the company. The co-operative structure of Fonterra means that farmers have control over the business through which to ensure the company maintains its performance.

38.2 The Commission has recognised previously that "there are significant elements of difference between co-operative and corporate structures"; and that a co-operative might face some degree of internal constraint from its co-operative ownership.

38.3 In the dairy industry context, however, concerns have been expressed historically about the perceived potential for Fonterra to:

(a) impose restrictions on farmers' ability to enter and exit the co-operative;

(b) pay a higher than efficient price for farmers' milk; and

(c) impede mobility on farmers' capital investment in a co-operative.

38.4 The DIRA regulatory regime, FGMP review and Trading Among Farmers system just endorsed by Fonterra's shareholders together now should remove those previous concerns.

38.5 Section 107(3) of DIRA requires Fonterra to ensure that, at all times, 33% or a greater percentage of the milksolids produced within a 160 kilometre radius of any point in New Zealand:

(a) is supplied under contracts with independent processors; or

(b) is supplied under contracts with Fonterra that:

(i) expire or may be terminated by the supplier at the end of the current season without penalty to the supplier; and

(ii) on expiry or termination, end all the supplier's obligations to supply milk to Fonterra.

38.6 Fonterra has tested this requirement both before and after the acquisition of NZDL, and can confirm that under both scenarios it would comply with this section of the Act in the 2012/13 dairy season.

38.7 In reality, Fonterra is also subject to considerable internal constraint by its shareholder suppliers. Many Fonterra shareholders now operate large and sophisticated farming businesses. Some have come to the industry with considerable commercial experience gained elsewhere. All have access to professional advisors. And Fonterra itself – through its Shareholders Council – operates an independent oversight of management decisions.

38.8 More generally, all Fonterra suppliers – like the suppliers to other processors – maintain a very keen awareness of both their terms of supply and the relative performance of the processor that they have chosen to supply for the time being. That choice of processor is their most vital business decision, as unlike most suppliers of other goods or services, the dairy farmer only supplies one product – being raw milk – and supplies only one customer - being the processor that has been chosen.

38.9 As NZDL suppliers have discovered, a wrong choice of processor may potentially be disastrous.

38.10 That choice of processor is not exercised on a "once and forever basis". As indicated above, most suppliers in the South Island have a choice of processors – and will continue to do so post acquisition.

39 Supplier switching

39.1 **Figure 13** below shows the number and size of suppliers exiting Fonterra to independent processors, and also the numbers and size of suppliers moving to Fonterra from independent processors. The latter figures for the 2012/13 season includes the 32 NZDL suppliers who have now entered into agreements to supply NZDL and Fonterra for that season.

Figure 13: Supplier switching figures

		2004/05	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Shareholders leaving Fonterra to supply an independent supplier	m/kgMS	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
	Number of suppliers	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
	Average size of suppliers	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
Shareholders joining Fonterra from an independent supplier	m/kgMS	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	]
	Number of suppliers	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]
	Average size of	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]	[ ]

	supplie rs

39.2 It should be noted that suppliers switching between independent processors also occurs. The Applicant understands that [ ] switched from OCD to Miraka for the 2011/12 season. Approximately [ ] moved from supplying NZDL to Synlait when Synlait purchased Oceania Dairy. Fonterra understands that a large proportion of the milk for the Gardians plant [ ].

40 **Efficiencies**

40.1 The overarching driver for the acquisition is the continued transformation of New Zealand's dairy industry into the world's most efficient and sustainable producer. However, that transformation will be limited if Fonterra is not able to make commercially rational acquisitions of existing processing capacity as plants become available from rival processers wanting to exit the New Zealand market.

40.2 For Fonterra, buying rather than building a plant may mean avoiding the 1-2 years' delay that building would involve. Global dairy markets are much too volatile not to avoid such delay wherever possible.

40.3 Allowing Fonterra to bid in competition with other, probably foreign owned bidders, for the plant will ensure that the successful purchaser's costs of entry (or expansion) are efficient. It will also ensure that the vendor's costs of exit are minimised, together with the impact on suppliers to, and employees and customers of, the exiting firm.

40.4 In this case, the proposed acquisition will accelerate Fonterra's capacity to produce high value GUMP products in the South Island where milk supply is expanding rapidly. Fonterra will be able to make a sound commercial return on the asset using it to manufacture standard specification WMP. In addition, the asset will allow for significant transport efficiencies in relation to Fonterra's endeavours to deal with that expanding milk supply. Those efficiencies will immediately translate into significant export benefits. Given that 95% of raw milk production is exported, these efficiencies will provide increased return to Fonterra suppliers. Those increased returns in turn will stimulate competition among other processors.

40.5 In short, Fonterra's continued success abroad will stimulate increased local competition. Certainly, that has been the discernable pattern to date. The raw milk price payable to New Zealand farmers is substantially influenced by what can be achieved by Fonterra in global markets. This acquisition is about achieving continued efficiency in those markets in the face of increasing off-shore competition.

41 **Co-ordinated Market Power**

41.1 The post-acquisition market structure will not support tacit or explicit co-ordination effects.

41.2 The market is dynamic, with significant new entry having occurred since Fonterra's creation in 2001. As has been outlined above DIRA continues to facilitate new entry.

41.3 Fonterra's setting of its Farm Gate Milk Price is transparent and now is subject to regulatory oversight. Again, as outlined above, the Commission's own "dry run" review has just approved Fonterra's methodology and application of that methodology.

41.4 Suppliers of raw milk maintain a keen awareness of both their own terms of supply and those offered by other processors, as well as the relative performances of rival processors.

41.5 There is clear evidence of suppliers exercising choice of processor and switching between processors. Their ability and willingness to switch stimulates competition among processors, not co-ordination.

41.6 Milk processing is shifting to smarter, higher value products for increasingly contested global markets. Fonterra's Advanced Nutrition strategy is an example of this. Collusion is difficult in markets where production is driven by innovation.

41.7 The New Zealand dairy industry is predominantly an export business, with less than 5 percent of raw milk production consumed locally. Global markets determine prices, not raw milk processors.

PART 6: FURTHER INFORMATION AND SUPPORTING DOCUMENTATION

42 Contact details of relevant competitors, buyers and suppliers and other relevant market participants are set out at in **Appendix L**.

43 **Supporting documentation:**

43.1 A copy of Fonterra's 2011 Annual Report is contained in **Appendix M**.

43.2 A copy of NZDL's draft 2011 Annual Report is contained in **Appendix N**.

PART 7: CONFIDENTIALITY

44 Confidentiality is sought for specific information contained in or attached to the Notice. This information has been removed from the Public Version of this Notice, as indicated by square brackets.

45 Confidentiality is sought indefinitely or until Fonterra advises the Commission that it can make public disclosure of particular details. Confidentiality is sought under section 9(2)(b) of the Official Information Act on the grounds that:

45.1 the information is commercially sensitive and valuable information which is confidential to the parties; and

45.2 disclosure of the information is likely to give unfair advantage to competitors of the parties and unreasonably prejudice the commercial position of the parties.

46 Fonterra also requests that it is notified of any request made under the Official Information Act for the confidential information, and that the Commission seeks Fonterra's views as to whether the information remains confidential and commercially sensitive at the time those requests are being considered.

47 The above applies equally in respect of any additional information provided to the Commission that is expressed to be confidential.

DECLARATION

This Notice is given by Fonterra Co-operative Group Limited.

David Matthews, General Counsel, Fonterra Co-operative Group Limited hereby confirms that:

- all information specified by the Commission has been supplied;
- if information has not been supplied, reasons have been included as to why the information has not been supplied;
- all information known to Fonterra which is relevant to the consideration of this Notice has been supplied; and
- all information supplied is correct as at the date of this Notice.

David Matthews undertakes to advise the Commission immediately of any material change in circumstances relating to the Notice.

Dated 5 July 2012

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I am General Counsel of Fonterra Co-operative Group Limited and am duly authorised by Fonterra Co-operative Group Limited to make this application/notice.

APPENDIX A

CONFIDENTIAL
Sale & Purchase Agreement

APPENDIX B

CONFIDENTIAL
Fonterra Corporate Structure Diagram

APPENDIX C

CONFIDENTIAL
Term Sheet Relating to Operation of NZDL Processing Facility

APPENDIX D

CONFIDENTIAL
Information Memorandum

APPENDIX E

Map of South Island processing facilities

APPENDIX F

CONFIDENTIAL
Letter To Commerce Commission

APPENDIX G

CONFIDENIAL
Market share estimates for acquisition of raw milk

APPENDIX H

CONFIDENTIAL
Market share estimates for acquisition of processing asset capacity

APPENDIX I

Media Articles

APPENDIX J

CONFIDENTIAL
Compass Lexecon Paper

APPENDIX K

Cabinet Paper

APPENDIX L

CONFIDENTIAL
Part 6 Table with Contact Details

APPENDIX M

Fonterra Annual Report

APPENDIX N

CONFIDENTIAL
Draft 2011 NZDL Annual Report & Auditor’s Letter