

Review of Fonterra's 2020/21 Milk Price Manual: Dairy Industry Restructuring Act 2001

Final report

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Executive Summary

What this report covers

- X1 This report sets out our conclusions on our review of Fonterra's 2020/21 Milk Price Manual (**the Manual**). The Manual contains the methodology that will be used to calculate Fonterra's base milk price for the 2020/21 season.

About this review

- X2 Our review of the Manual is required as part of the milk price monitoring regime (**monitoring regime**), which is contained in subpart 5A of the Dairy Industry Restructuring Act 2001 (**the Act**). An overview of our approach when reviewing the Manual can be found in our supporting paper "Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation" (**the Approach paper**).¹ This framework paper should be read together with, and as part of, this report. We did not make any changes to this framework paper for the purposes of this Manual review.
- X3 Our review considers the extent to which the Manual is consistent with the purpose of subpart 5A of the Act. In particular, our review considers the 'efficiency' and 'contestability' dimensions of the s 150A purpose as required by the Act. These focus on whether the methodology used in the Manual:
- X3.1 provides an incentive for Fonterra to operate efficiently (the 'efficiency dimension'); and
 - X3.2 adopts assumptions, inputs and processes that would be practically feasible for an efficient processor (the 'contestability dimension').²

¹ Commerce Commission "Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation" (15 August 2017). This paper provides an overview of the approach we have taken in reviewing the Manual. It outlines how we conduct our annual reviews of Fonterra's Milk Price Manual and each season's base milk price calculation. It includes our interpretation of key legislative provisions, our practical approach to the statutory reviews, an overview of how Fonterra sets its base milk price, assumptions of the notional processor, and internal and external controls surrounding the integrity of the milk price calculation.

² We consider the same 'efficiency' and 'contestability' dimensions when we carry out our milk price calculation review.

- X4 To satisfy the provisions in s 150A, our interpretation is that our statutory reviews must assess the extent to which the Manual is consistent with both dimensions. We attach equal weight to both dimensions in our reviews.
- X5 In reaching our conclusions we have focused on the amendments Fonterra has made to the Manual for the 2020/21 season.
- X6 Our Manual reviews also consider matters carried forward from previous reviews.
- X7 With the exception of FX rates, for those parts of the Manual that have remained unchanged we have continued to rely on our previous conclusions. We are not aware of any other new information which would warrant reconsideration of our conclusions in previous Manual reviews.

Our conclusions

- X8 In regard to Fonterra's amendments to the Manual since last year's review, our conclusions are that the following matters are not inconsistent with s 150A of the Act:
 - X8.1 replacing independent reviewer provisions with Milk Price Group (**MPG**) reviews is consistent with the contestability and efficiency dimensions of s 150A of the Act.
 - X8.2 the rule that requires the MPG, when determining the asset beta, to have regard to "any relevant requirements under DIRA" does not alter the requirements the Act places on Fonterra. We therefore do not consider that this change is relevant to our assessment of consistency with s 150A.
 - X8.3 the amendment to the receivables risk principle that actual bad or doubtful debts should generally not affect the Farmgate Milk Price is consistent with the efficiency and contestability dimension of the s 150A purpose. As the allowance is based on historical patterns, we consider it is practically feasible.
- X9 However, there are two aspects of the Manual that we consider inconsistent with the purpose in s 150A or we would like to see more disclosure in the Manual:
 - X9.1 Fonterra's amendments to Rule 23 that allow the ability to apply the outcome of a Within-Period Review in the year of a review; and
 - X9.2 capacity of standard plants.
- X10 Fonterra's amendments to Rule 23 is not consistent with the efficiency dimension of s 150A of the Act. Having the ability to apply the outcome of a Within-Period Review

to the year in which the review is undertaken could give rise to the use of actual rather than notional inputs, potentially reducing Fonterra's incentive to operate efficiently. We recommend that the rule be amended to make it clear that current year actual inputs cannot be used to replace notional inputs in the year of review, except where it is impracticable to obtain notional data.

- X11 We have also carried forward our conclusion from previous reviews that disclosure in the Manual of the capacity for both primary and secondary plants would better promote the purpose in s 150A.³
- X12 Based on the information we have before us, we do not consider that either matter is sufficiently material to render this season's Manual inconsistent with the s 150A purpose as a whole.
- X13 Accordingly, our overall conclusion is that this season's Manual is largely consistent with the statutory purpose set out in s 150A of the Act.

Matters carried forward from previous Manual reviews

- X14 We have updated our view on the disclosure of FX rates. We accept that the Manual is not the appropriate vehicle for disclosing assumed FX rates since they are assumptions that will change each season, whereas the Manual contains the overall rules that give effect to the milk price principles. We continue to consider there should be more transparency of information on the actual FX rates assumed to be achieved by the notional processor by disclosing the FX rates to four decimal points in quarterly milk price statements.
- X15 There is a recommendation from previous reviews that we considered would better promote the purpose in s 150A and provide greater confidence to interested parties through additional transparency. We consider that the disclosure of what constitutes a 'material change', when considering whether a change to the Manual should be made, will provide greater transparency.⁴
- X16 We have updated our recommendations on the following matters as we consider that further disclosure would better promote the purpose:

³ Commerce Commission "Review of Fonterra's 2019/20 milk price manual: Dairy Industry Restructuring Act 2001 Final report" (12 December 2019), paragraph X9.

⁴ Commerce Commission "Review of Fonterra's 2019/20 Milk Price Manual: Dairy Industry Restructuring Act 2001 Final report" (12 December 2019), paragraph 80.

- X16.1 the publication of the list of all products that constitute ‘Generic product specifications’ in the Manual would greatly assist clarity of what is a standard product offering;
- X16.2 the conditions that apply to sales that are not considered to be transacted on freely contestable markets should be specified in more detail in Principle 2 of the Manual to clarify how this principle is to be applied; and
- X16.3 the term ‘prevailing’ is used in a number of rules in the Manual. We consider that defining the term ‘prevailing’ would provide greater clarity in respect of the inputs required to be used by these rules.

Next steps

- X17 Based on Fonterra's 2020/21 Manual amendments and our conclusions on this review, we have not identified any new specific focus areas for our 2020/21 milk price calculation review.
- X18 In respect of the Manual’s approach to asset stranding, we intend to carry out a substantive review in our 2020/21 base milk price calculation review after Fonterra’s review of the specific risk premium.⁵

⁵ Commerce Commission “Review of Fonterra’s 2018/19 Milk Price Manual: Dairy Industry Restructuring Act 2001 Final report” (14 December 2018).

Chapter 1 Introduction and scope of review

1. This report sets out our review of the extent to which the Manual is consistent with the purpose of the base milk price monitoring regime, which is set out in s 150A of the Act.

How this report is structured

2. This chapter introduces our review and covers the scope of our review.
3. Our conclusions of our review are set out in Chapter 2.
4. Other submission points raised on our draft report have been summarised in **Attachment A**.
5. Outstanding amendments proposed earlier to Fonterra have been summarised in **Attachment B**.
6. A glossary of key terms is provided in **Attachment C**.
7. As noted above, this paper should be read with the paper "Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation" (15 August 2017) which we have applied in this Manual review and which forms part of this report.⁶

We are fulfilling our statutory requirements

8. We are required to review the Manual for each dairy season and make a report on the extent to which the Manual is consistent with the purpose of subpart 5A of the Act, as set out in s 150A of the Act.⁷
9. The Act requires Fonterra to provide us with the following information for consideration in our review:⁸

⁶ Commerce Commission "Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation" (15 August 2017).

⁷ As required under s 150H and s 150I of the Act.

⁸ Section 150L of the Act.

- 9.1 the Manual for the current season;
 - 9.2 any recommendations by the Milk Price Panel (**MPP**)⁹ in relation to the setting of the base milk price;¹⁰
 - 9.3 notification of any change in the economic and business environment that, in Fonterra's view, requires a change to the Manual;
 - 9.4 certification on the extent to which Fonterra considers that the Manual is consistent with the purpose of s 150A; and
 - 9.5 reasoning behind the views expressed in Fonterra's certification.
10. The above information, where relevant, has been provided by Fonterra in the 'Reasons' Paper in support of Fonterra's Manual for the 2020/21 season and has been considered as part of our review. Fonterra's Manual and the Reasons Paper can be found on our website.¹¹

Scope of this review

- 11. We have focused our review on Fonterra's amendments to the Manual made since the 2019/20 review. We published our draft report on 15 October and received submissions on the draft report from Fonterra, Miraka and Synlait.
- 12. There remain recommendations from previous reviews that we considered would better promote the purpose in s 150A and provide greater confidence to interested parties through additional transparency that have not been addressed in the current Manual. With the exception of FX rates, for those parts of the Manual that have remained unchanged from the 2019/20 Manual we have relied on our previous

⁹ The MPP is a committee that Fonterra is required to establish and maintain under s 150D of the Act. The MPP is required to, for each season, supervise the calculation of the base milk price; advise Fonterra on the application of the Manual; and recommend the base milk price to Fonterra. See also Fonterra "Farmgate milk price manual" (1 August 2020), page 26.

¹⁰ Fonterra provides the Commission a 'marked up' version of the Manual that shows the changes that have been made to the previous season's version of the Manual. Fonterra has stated in its Reasons Paper (page 1) that the 'marked up' version of the Milk Price Manual attached to its Reasons Paper identifies all amendments to the Manual. For the 2020/21 Manual, all the recommendations by the MPP were implemented by the Board.

¹¹ Fonterra "Fonterra's Reasons Paper in support of Milk Price Manual for the 2020/21 season" (2020) at <https://comcom.govt.nz/regulated-industries/dairy/milk-price-manual-and-calculation/milk-price-manual>

conclusions. We are not aware of any other new information which would warrant reconsideration of our previous conclusions.

13. We have previously signalled we would review the asset beta and specific risk premium in the 2020/21 season. This aligns with Fonterra's scheduled review of its asset beta and specific risk premium. We will review these matters as part of our base milk price calculation review in 2020/21 since:
 - 13.1 the 2020/21 Manual requires the MPG to determine an updated specific risk premium and asset beta in 2020/21. The MPG has not completed its review of the calculation of these inputs in time for this final report; and
 - 13.2 the asset beta and specific risk premium are inputs to the base milk price calculation, reflecting certain cost of capital assumptions.
14. In this report we have grouped issues in the following order:
 - 14.1 The areas of the Manual that are most likely to have an impact on the extent to which the Manual is consistent with s 150A taking account of new information and changes to the Manual (Chapter 2).
 - 14.2 A summary of the Manual amendments we have proposed to Fonterra over the course of our milk price reviews which have not been adopted and which we continue to consider should be provided for. Given the ongoing nature of our reviews we consider these issues to be of continuing relevance (Attachment B).

Chapter 2 Conclusions

15. This chapter summarises our conclusions on the extent to which the 2020/21 Manual is consistent with the s 150A purpose.

Our conclusions

16. Regarding Fonterra's amendments to the Manual since last year's review, our conclusions are that the following matters are not inconsistent with s 150A of the Act:
- 16.1 replacing independent reviewer provisions with MPG reviews is consistent with the contestability and efficiency dimensions of s 150A of the Act.
 - 16.2 the rule that requires the MPG, when determining the asset beta, to have regard to "any relevant requirements under DIRA" does not alter the requirements the Act places on Fonterra. We therefore do not consider that this change is relevant to our assessment of consistency with s 150A.
 - 16.3 the amendment to the receivables risk principle that actual bad or doubtful debts should generally not affect the Farmgate Milk Price is consistent with the efficiency and contestability dimension of the s 150A purpose. As the allowance is based on historical patterns we also consider it is practically feasible.
17. However, there are two aspects of the Manual that we consider inconsistent with the purpose in s 150A or we would like to see more disclosure in the Manual:
- 17.1 Fonterra's amendments to Rule 23 that allow the ability to apply the outcome of a Mid-Period Review in the year of a review; and
 - 17.2 capacity of standard plants.
18. Fonterra's amendments to Rule 23 is not consistent with the efficiency dimension of s 150A of the Act. Having the ability to apply the outcome of a Within-Period Review to the year in which the review is undertaken could give rise to the use of actual rather than notional inputs, potentially reducing Fonterra's incentive to operate efficiently.

19. We have also carried forward our conclusion from previous reviews that disclosure in the Manual of the capacity for both primary and secondary plants would better promote the purpose in s 150A.¹²
20. Fonterra does not consider the Manual is the appropriate vehicle for these disclosures. Fonterra states that they put this information into the public domain in its base milk price calculation reasons papers.¹³
21. We consider that the disclosure of plant capacity in the Milk Price Calculation reasons paper may be too late to enable interested parties to assess the practical feasibility of the assumed production volumes. We therefore maintain and adopt the conclusion in our previous Manual reviews on this matter.
22. Based on the information we have before us, we do not consider that either matter is sufficiently material to render this season's Manual inconsistent with the s 150A purpose as a whole.
23. Accordingly, our overall conclusion is that this season's Manual is not inconsistent with the statutory purpose set out in s 150A of the Act.

Matters carried forward from previous Manual reviews

24. Fonterra does not consider the Manual is the appropriate vehicle for the disclosure of FX rates. Fonterra states that they routinely disclose the information suggested by the Commission with respect to both the prior season average FX conversion rate and the forecast rate for the current season in the Milk Price Statement, released each September.¹⁴
25. We accept that the Manual is not the appropriate vehicle for disclosing assumed FX rates since they are assumptions that will change each season, whereas the Manual contains the overall rules that gives effect to the milk price principles. However, although not a matter that affects our conclusion that the Manual is largely consistent with the purpose in s 150A of the Act, we continue to consider there

¹² Commerce Commission "Review of Fonterra's 2019/21 milk price manual: Dairy Industry Restructuring Act 2001 Final report" (12 December 2020), paragraph X9.

¹³ Fonterra "Fonterra's Reasons Paper in support of Milk Price Manual for the 2020/21 season" (2020), page 4.

¹⁴ Fonterra "Fonterra's Reasons Paper in support of Milk Price Manual for the 2020/21 season" (2020), page 4.

should be more transparency of information on the actual FX rates assumed to be achieved by the notional processor by disclosing the FX rates to four decimal points in quarterly milk price statements, not just each September.

26. Although not a matter that affects our conclusion that the Manual is largely consistent with the purpose in s 150A of the Act, there is a recommendation from previous reviews that we considered would better promote the purpose in s 150A and provide greater confidence to interested parties through additional transparency.
27. We concluded in our 2016/17 Manual review, that disclosure of what constitutes a 'material change' in this context will provide greater transparency. Fonterra considers that a 'bright line' materiality threshold is likely to lead to less disclosure.¹⁵
28. As stated in last year's Manual review, we do not believe that a materiality threshold applied in respect of making changes need also be applied to the disclosure of changes, so as to reduce the level of disclosure. As with financial reporting, various matters might be disclosed at the discretion of the Board that do not constitute material matters.
29. We therefore continue to consider that the disclosure of what constitutes a 'material change', when considering whether a change to the Manual should be made, will provide greater transparency.¹⁶
30. In the base milk price calculation review 2019/20, we asked Fonterra to provide a detailed description of 'Standard Product Offering', 'tender and formulaic sales', 'freely contestable markets' and 'prevailing prices' as we made recommendations in regards to these matters in our 2019/20 Manual review.¹⁷ In our view, Fonterra's explanations of these terms provide greater transparency regarding how the relevant

¹⁵ Fonterra "Fonterra's Reasons Paper in support of Milk Price Manual for the 2020/21 season" (2020), page 4.

¹⁶ Commerce Commission "Review of Fonterra's 2019/20 Milk Price Manual: Dairy Industry Restructuring Act 2001 Final report" (12 December 2019), paragraph 80.

¹⁷ Commerce Commission "Review of Fonterra's 2019/20 Milk Price Manual: Dairy Industry Restructuring Act 2001 Final report" (12 December 2019), paragraph X10.

rules are applied.¹⁸ Although not matters affecting our conclusion that the Manual is largely consistent with the purpose in s 150A of the Act, we consider that further disclosure of the following matters would better promote the purpose:

- 30.1 the publication of the list of all products that constitute 'Generic product specifications' in the Manual would greatly assist clarity of what is a standard product offering;
 - 30.2 the conditions that apply to sales that are not considered to be transacted on freely contestable markets should be specified in more detail in Principle 2 of the Manual to clarify how this principle is to be applied; and
 - 30.3 the term 'prevailing' is used in a number of rules in the Manual. We consider that defining the term 'prevailing' would provide greater clarity in respect of the inputs required to be used by these rules.
31. Fonterra's submission on our draft report for this review noted that they will consider our recommendations in detail in the course of drafting amendments to the Manual for the 2021/22 season.¹⁹

Fonterra's amendments to the 2020/21 Manual

- 32. Fonterra has made amendments to the 2020/21 Manual to assign explicit responsibility for various independent reviews to the MPG. The specific rules affected are set out in Fonterra's Reasons Paper.²⁰
- 33. Rule 23 has been amended to provide that in exceptional circumstances when a Within-Period Review may be initiated, the outcomes of the Within-Period Review will apply, where warranted by circumstances, to the year in which the review is undertaken.

¹⁸ Commerce Commission "Review of Fonterra's 2019/20 base milk price calculation: Dairy Industry Restructuring Act 2001 Final report" (15 September 2020), paragraph 2.59.

¹⁹ Fonterra "Submission to the Commerce Commission on its Draft Report on Fonterra's 2020/21 Farmgate Milk Price Manual" (15 November 2020), page 3.

²⁰ Fonterra "'Reasons' Paper in Support of Fonterra's Milk Price Manual for the 2020/21 Season", found [here](#).

34. Rule 42 has been amended to require that, when calculating the Asset Beta, the MPG will also have regard to any requirements under the Act.

Assigning responsibility for reviews to the Milk Price Group

35. In our draft report we concluded that we consider the change to reassign responsibility for various reviews from the Independent Reviewer to the MPG does not detract from the consistency of the Manual with the s 150A purpose.

Submitter views & our response

36. In its submission, Miraka considered the removal of the explicit requirement for independent review “dangerous and at the very least risks a derogation from the application of independence”. Miraka considered that the explicit requirement for independent review should remain in the Manual so as to reinforce that any party providing input to the milk price calculations must remain independent of direct influence from Fonterra.²¹
37. Miraka also submitted that it is wrong to state the MPG and the MPP are “independent” in a manner that provides assurance their priorities are not in conflict with the Act’s purposes. Miraka referred to an independent assessment of WACC, in which the MPG and the MPP took a position consistent with the Fonterra constitution of favouring parameters which assured an unnaturally low WACC resulting in a higher milk price while prejudicing the interests of non-supplier equity investors in Fonterra. Miraka noted that it has taken an Act of Parliament to attempt to force a commercially feasible WACC to be recommended by the MPG and the MPP. Miraka stated that this is not a standard of behaviour that reflects or assures independence.²²
38. We note that the example given by Miraka of the MPP ‘favouring parameters’ was in respect of implementing recommendations made by Fonterra's independent reviewer, rather than as a consequence of any bias introduced by the milk price governance structure.

²¹ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 6.

²² Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 9.

39. In respect of Miraka’s assertion that it is wrong to state the MPG and the MPP are “independent”, Section 150E of the Act requires that Fonterra must ensure that at all times the chair and a majority of the members of the MPP (including the chair) are independent, as it is defined in section 5 of the Act. We note the recent amendments to DIRA now also provide for a ministerial nominee to the MPP.²³

Our conclusion on Assigning responsibility for reviews to the Milk Price Group

40. Our conclusion is that we consider the change to reassign responsibility for various reviews from the Independent Reviewer to the MPG does not detract from the consistency of the Manual with the s 150A purpose.
41. The definition of “independent reviewer” previously in the Manual was “a valuer or other expert appointed to perform a review or function with respect to the Manual.” The Manual does not contain any specific independence requirements.
42. Fonterra has explained that the introduction of an independent review was a temporary measure, designed to ensure that key inputs were provided by or reviewed by parties independent of Fonterra when the responsibilities initially carried out by the MPG were transferred to Fonterra management. Fonterra also explains that that transfer of responsibilities has not eventuated, so the additional layer of independence is not required.²⁴
43. The governance structure around the milk price is set out in Fonterra’s 2020 Farmgate Milk Price Statement.²⁵ The key features of the governance structure include a statutory committee known as the MPP whose terms of reference must include the following functions:
- 43.1 supervise the calculation of the base milk price;
- 43.2 advise Fonterra as necessary on the application of the milk price manual;

²³ Dairy Industry Restructuring Amendment Act 2020, s 150E(1)(A).

²⁴ Fonterra, ‘Reasons’ Paper in Support of Fonterra’s Milk Price Manual for the 2020/21 Season Public Version 1 August 2020, page 2.

²⁵ This can be downloaded from <https://www.fonterra.com/nz/en/investors/farmgate-milk-prices/milk-price-methodology.html>

- 43.3 recommend to Fonterra the base milk price; and
 - 43.4 make recommendations to Fonterra in respect of the milk price manual, including a recommendation that it should be amended and a recommendation that a proposed amendment should not be made.²⁶
44. Section 150E(2) of the Act requires that at all times the Chair and a majority of members (including the Chair) of the MPP must be independent.
 45. Fonterra’s Farmgate Milk Price Statement explains that the MPP oversees the governance of the Farmgate Milk Price and the Manual, including changes to the Manual and verification by independent external experts of key parameters (such as resource usage rates, product yields and fixed manufacturing costs).
 46. The governance structure also includes the MPG, which is a working group established by Fonterra. The Head of the MPG is independent of Fonterra’s management and reports directly to the Chair of the MPP. The role of the MPG includes:²⁷
 - 46.1 ensuring that the base milk price is calculated in accordance with the Manual and making recommendations in respect of the Farmgate Milk Price to the MPP;
 - 46.2 considering any proposed amendments to the Manual, including those the MPG itself considers are appropriate, and ensuring they are in accordance with the Milk Price Principles in Fonterra’s Constitution;
 - 46.3 providing assurance to the Fonterra Board over the calculation of the forecast of the base milk price; and
 - 46.4 managing engagement with external reviewers.
 47. The functions of the MPG are contracted out to EY and other technical experts who are not employees of Fonterra.
 48. The Manual requires that “In order to enhance the independence of the MPG, the MPG Head will report to the Panel in relation to all matters, including matters

²⁶ Sections 150D(3) and (4) of the Act

²⁷ Fonterra “Farmgate Milk Price Statement – for the season ended 31 May 2020”, page 11. Found [here](#).

relating to, or arising from, the administration, operation and application of the Manual and the performance of the MPG Head and the MPG, and to the MPG Head's appointment."

49. Fonterra also explained that the independence of the MPG is further assured by a requirement imposed by the MPP that the core members of the MPG team are prohibited from investing both in Fonterra (and other NZ dairy processors) and in dairy farms.²⁸
50. The relationship between the milk price governance structure and the Manual and base milk price is explained in Fonterra's Reasons Paper supporting the 2019/20 base milk price calculation:

As noted above, we interpret the term 'process' in section 150T to cover both the processes used by Fonterra to generate and aggregate the various inputs into the base milk price, and the processes and controls implemented by Fonterra to ensure individual inputs and the overall milk price accurately reflect the underlying data and rules. In addition, Fonterra has put in place a number of mechanisms to provide assurance that the Milk Price is consistent with the Milk Price Principles set out in both the Milk Price Manual and in Fonterra's constitution.²⁹
51. These assurance mechanisms comprise the Fonterra Board, the MPP, the MPG, external audit, internal audit and the Milk Price Steering Committee, which provides Fonterra management input to the work of the MPG.
52. Given the degree of independence that exists between Fonterra and the MPP and MPG, we do not consider that the absence of any additional independence provided by the independent reviews detracts from the s 150A purpose. The verification of the input of external reviewers will continue to be overseen by the MPP and reviewed by us in our base milk price calculation reviews.
53. Therefore, we do not consider the change significantly alters the quality of the independence of assurance processes associated with the inputs to the base milk price calculation and its consistency with the rules and principles set out in the Manual.

²⁸ 'Reasons' Paper in Support of Fonterra's Milk Price Manual for the 2020/21 Season Public Version 1 August 2020, page 2.

²⁹ Fonterra "'Reasons' Paper in Support of Fonterra's Base Milk Price for the 2019/20 Season – Public Version" (1 July 2020), page 5.

Within-Period Reviews

54. In our draft report we concluded that we do not consider the introduction of the requirement to apply the outcome of a Within-Period Review to the year in which the review is undertaken is consistent with the efficiency dimension of the s 150A purpose.

Submitter views & our response

55. Fonterra submitted that

Rule 23 provides that in “exceptional circumstances” Fonterra may undertake a ‘within-period review’ of inputs which are normally subject to a four-yearly reset. We have amended the provision to make it explicit that it applies to all inputs subject to a four-yearly review, and not just cost inputs, and to provide that “where warranted by circumstances” the outcome of a review will be implemented in the year in which the review is undertaken.³⁰

56. Fonterra also specified the circumstances in which it would apply the results of a within period review in a particular year in greater detail:

The amended provision does not impose a requirement that the outcome of a within-period review be applied in the year in which the review is undertaken. Rather, it allows this to occur only “where warranted by circumstances”. Our intent, as indicated in our reasons paper, is that we will only implement the outcome of a within-period review in the year of the review in circumstances where the relevant input would otherwise clearly not be practically feasible for an efficient processor (and not just for Fonterra), and where the difference between the previous and new input was sufficiently large such that the overall milk price could potentially otherwise not be practically feasible. The amended provision therefore clarifies and enhances Fonterra’s ability to apply the Manual in a method that complies with DIRA.³¹

57. Fonterra also noted:

As the Commission notes, the amended provision does not prohibit the potential replacement of benchmark notional inputs with actual current-year inputs, and we agree that if this were to occur it would weaken incentives on Fonterra to efficiently manage the relevant inputs. However, we are very cognisant of this risk, and advise that where practical we would continue to always seek notional inputs, rather than use the relevant actual current-year value to calculate the milk price. We also note

³⁰ Fonterra “Submission to the Commerce Commission on its Draft Report on Fonterra’s 2020/21 Farmgate Milk Price Manual” (15 November 2020), page 2.

³¹ Fonterra “Submission to the Commerce Commission on its Draft Report on Fonterra’s 2020/21 Farmgate Milk Price Manual” (15 November 2020), page 2.

that in a year in which the amended provision is used we will be required to explain in the base milk price reasons paper for that year why we consider the input is consistent with the s 150A principles, and the Commission will be able to assess the compliance of our reasons with DIRA.³²

58. We consider this issue would be better mitigated by amending the rule to require the replacement of existing notional inputs with alternative notional inputs that are considered to be practically feasible, making it clear that current year actual inputs cannot be used, except where it is impractical to obtain notional data.

Our conclusion on the Within-Period Reviews

59. Our conclusion is that we do not consider the introduction of the requirement to apply the outcome of a Within-Period Review to the year in which the review is undertaken is consistent with the efficiency dimension of the s 150A purpose.
60. The Within-Period Review is only able to be conducted under exceptional circumstances, which are set out in Rule 23.³³
61. In its reasons paper Fonterra explains that the intent of the amendments is threefold:³⁴
- 61.1 To assign to the MPG responsibility for undertaking Within Period Reviews, for the reasons discussed in the “Independent review provisions” section above.
- 61.2 To clarify, where necessary, the outcome of a review to be implemented in the year in which the review was undertaken, rather in the following year.³⁵

³² Fonterra “Submission to the Commerce Commission on its Draft Report on Fonterra’s 2020/21 Farmgate Milk Price Manual” (15 November 2020), page 2.

³³ Fonterra “Farmgate Milk Price Manual” (1 August 2020), page 46.

³⁴ Fonterra “Reasons’ Paper in Support of Fonterra’s Base Milk Price for the 2019/20 Season – Public Version” (1 July 2020).

³⁵ The necessity of this amendment became apparent in the context of the 2019 review of overhead costs, where it became evident that it was necessary to implement a portion of the review’s outcome immediately, in the 2018/19 season, rather than as scheduled in the 2019/20 season, to ensure the practical feasibility of the provision for overhead costs for the 2018/19 season.

- 61.3 To extend the ability to undertake a Within Period Review with respect to all inputs established on a four-yearly basis, rather than just cost inputs.³⁶
62. The first of these reasons is dealt with in our conclusion on assigning responsibility for independent reviews to the MPG above.
63. We consider the change in respect of the third reason reflects the fact that costs may only be one of a number of relevant inputs and is consistent with the “notional costs, revenues, or other assumptions” language of the s 150A purpose.
64. In respect of the second change, we consider that earlier revision of an input where the input is no longer considered to be practically feasible for an efficient notional processor is consistent with the contestability dimension of the s 150A purpose. In applying Rule 23 to initiate a Within-period review we would expect that Fonterra would compare the value of existing inputs with the value of inputs faced by an efficient notional processor.
65. However, we consider this change could give rise to the potential replacement of benchmark notional inputs, with current actual inputs in the year of review, thereby removing an incentive for Fonterra to beat those inputs in the year of review.
66. We therefore consider that this change is not consistent with the efficiency dimension of the s 150A purpose.
67. We observe, however, that the efficiency incentive impact of a review year change in an input or assumption may have less weight where the ‘exceptional circumstances’ trigger for the Within-period review is exercised in circumstances that are truly exceptional. As the term ‘exceptional circumstances’ is not defined, there may be a wide range of circumstances in which a Within-period Review can be triggered.
68. After a Within-period Review is triggered, the wording that prescribes when the outcomes of a Within-Period Review may be applied in the year in which the review is undertaken (“where warranted by circumstances”) is overly discretionary and vague, and Fonterra should consider amending the wording to provide greater certainty and objectivity. We note that Fonterra has specified the circumstances in which it would apply the results of a within-period review in a particular year in

³⁶ Other inputs established on a four yearly basis include, for example, resource usages and certain capital inputs.

greater detail in its submission. We encourage Fonterra to include this detail in the rule itself.

69. We also recommend that the rule be amended to make it clear that current year actual inputs cannot be used to replace notional inputs in the year of review, except where it is impracticable to obtain notional data, as described in the Approach paper.³⁷

Asset beta

70. Fonterra has made an amendment to Rule 42, that requires that in calculating the asset beta the MPG will have regard to any relevant requirements under the Act.
71. In our draft report we noted that Fonterra must comply with the requirements of the Act (including any amendments made to the Act, once they come into force) irrespective of the contents of the Manual. For this reason, we do not consider that this change is relevant to our assessment of consistency with s 150A. We did not receive any submissions on this matter, therefore we maintain our draft report view.
72. We will carry out a review of the asset beta calculation in our 2020/21 base milk price calculation review.

Table 2.1: Receivables risk

73. In our draft report we noted that the clarification of this rule better describes the assumptions and inputs used in calculating the base milk price. The general use of a notional ex ante allowance is consistent with the efficiency dimension of the s 150A purpose. As the allowance is based on historical patterns, we also consider it is practically feasible. We did not receive any submissions on receivables risk, therefore we maintain our draft report review.
74. We consider the clarification of this rule better describes the assumptions and inputs used in calculating the base milk price. The general use of a notional ex ante allowance is consistent with the efficiency dimension of the s 150A purpose. As the allowance is based on historical patterns, we also consider it is practically feasible.

Plant capacity

75. In our draft report we recommended Fonterra considers disclosing its plant capacity for both primary and secondary plants earlier in each season to provide certainty of

³⁷ Commerce Commission “Our approach to reviewing Fonterra’s Milk Price Manual and base milk price calculation”, 15 August 2017, paragraph 52.

the notional processors' assumed capacity for the related season. We consider this would improve the ability of interested parties to assess the practical feasibility of the assumed production volumes.

Submitter views & our response

76. Fonterra responded to our draft conclusion that the plant capacity disclosure should be made earlier in the season than in the base milk price calculation reasons paper.
77. Fonterra stated the disclosures in the base milk price reasons papers are not restricted to plant capacities for just the current season. Fonterra explained that since at least 2016 they have summarised the results of the most recent four-yearly review of standard plant capacity, explaining (for example) in the 2016/17 base milk price reasons paper that “the most recent [four-yearly] review of the fixed asset base was completed in 2016, and resulted in a decision to maintain the assumed processing capacities of incremental and replacement plants for the manufacture of each of the RCPs at the same levels assumed for the previous 2013-2016 Review Period.”³⁸
78. Fonterra noted that they will continue to make this information available, including on a forward looking basis (clearly reflecting that the current standard plant capacities will apply until the next review period), in the base milk price reasons paper, which is provided to the Commission a month before the Manual reasons paper. Fonterra noted that this would appear to address the Commission’s concerns regarding the timeliness of the disclosure.³⁹
79. Synlait submitted that they agree with the Commerce Commission that to be meaningful the timing of the plant capacity disclosure is critical:
- 79.1 This disclosure, when made after the season has finished carries little additional transparency value. Capacity requirements need to be made ahead of peak production, as occurs in the real world.⁴⁰

³⁸ Fonterra “Submission to the Commerce Commission on its Draft Report on Fonterra’s 2020/21 Farmgate Milk Price Manual” (15 November 2020), page 3.

³⁹ Fonterra “Submission to the Commerce Commission on its Draft Report on Fonterra’s 2020/21 Farmgate Milk Price Manual” (15 November 2020), page 3.

⁴⁰ Synlait “Submission on 2020-21 milk price manual draft report” (16 November 2020), paragraph 5.

80. Miraka submitted that they support the intention of the Commission recommendation to disclose its plant capacity early in each season. Miraka however considers that:

80.1 “the disclosure should be made prior to the start of each season i.e. well in advance of the usual timeframe for making the annual update of the Milk Price Manual publicly available (September). Miraka does not have a view on whether failure to make the disclosure invalidates the Manual itself. It is though notable and welcome that the Commission has now acknowledged that failure to make a recommended increase in disclosures for purposes of transparency can be judged to be a failure to meet the s 150A purposes.”

81. Miraka also considered “that Fonterra must at least demonstrate to the Commission it has established Notional Producer available capacity at a geographic level prior to the start of any Season and that failure to do so would render certain milk price calculations unable to be found practically feasible.”

82. Miraka stated that Fonterra’s reporting on standard plant capacity (at a much later date) in the Reasons Papers supporting the annual milk price calculations does not address the core issue at stake. Miraka submitted:⁴¹

Fonterra has in recent years been adjusting the number of Notional Producer plants and associated costs (e.g. mothballing of plants) on the basis of fluctuating milk volumes. Fonterra Reasons Papers have described adjusting plant numbers on an “after the event” basis (e.g. determining plants would have been mothballed from the start of the Season based on observed milk flows analysed at the end of the Season). Miraka has contended (and it is obvious) that a real world processor cannot adjust available processing capacity (e.g. assume a plant would have been mothballed) “after the event”. It is therefore not practically feasible for the Notional Producer to apply an “after the event” procedure to determine costs associated with shortfall or surplus capacity. A practically feasible procedure **requires** that planned and available capacity be set at least **before** the start of the season, and that costs be assessed against that predetermined available capacity.

83. Miraka also suggested in its submission that Fonterra disclose total capacity (planned and available) by geographic location prior to the start of the season.⁴²

⁴¹ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 14.

⁴² Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 15.

84. We agree that to the extent that plant numbers and associated costs are adjusted in response to annual milk volumes, the disclosure in the base milk price reasons paper is not early enough. We recommend that the disclosure is made in the Manual for the following season and incorporates mothballing or other assumptions for that season which may not be assumed in the 4-yearly review of plant capacity inputs.
85. We do not agree with Miraka's observation that failure to make a recommended increase in disclosures for purposes of transparency can be judged to be a failure to meet the s 150A purpose. Our s 150A concern with regard to this matter is that the practical feasibility of seasonal plant capacity and other inputs and assumptions in the milk price calculation cannot be assessed unless the planned and available capacity is set and disclosed in the Manual before the start of each season.

Attachment A Other submission points raised on our draft report

Table A1 Other submission points

Submitter	Key points	Our response
Synlait ⁴³	Synlait would support the additional level of disclosure a quarterly milk price statement would deliver. FX rate assumptions, captured four times a season in these statements, would greatly improve transparency.	We continue to consider there should be more transparency of information on the actual FX rates assumed to be achieved by the notional processor by disclosing the FX rates to four decimal points in quarterly milk price statements.
Miraka ⁴⁴	Miraka supports Commission's recommendation that Fonterra should provide quarterly updates of the Notional Producer USD conversion rate. Miraka requests that the Commission refine its recommendation regarding the conversion rate updates to state that all reports of conversion rates should be correct to four decimal places, and that the forecast provided in the Annual Milk Price statement should be updated and reported as at the end of October, January, March and June as soon as possible after those respective month ends.	We encourage Fonterra to consider disclosing the average conversion rate to four decimal points.

⁴³ Synlait "Submission on 2020-21 milk price manual draft report" (16 November 2020), paragraph 3.

⁴⁴ Miraka "Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra's 2020/21 Milk Price Manual", paragraph 19.

Submitter	Key points	Our response
Miraka ⁴⁵	In its submission on the Draft Report, Miraka explained that the new expression “sub Reference Commodity Products” adds no further meaning to the existing plethora of product descriptions and categories which have been made necessary by inclusion of off-GDT sales. The new expression in fact adds further complexity and ambiguity to the process. In Miraka view, there should either be a clear explanation of how the “sub Reference Commodity Product” concept adds clarity to the off-GDT sales issue, or the Commission should reject it as unhelpful.	We consider this is addressed by our recommendation in X16.1 to publish the list of all products that constitute ‘Generic product specifications’ in the Manual. ⁴⁶
Miraka ⁴⁷	The Commission appears (Paragraph 2.39, 2019/20 Milk Price Calculation) to conflate IWMP with ISMP, including a suggestion that ISMP is manufactured through a similar process to IWMP (by the addition of lecithin). This is incorrect. Unlike IWMP where the “Instantised” characteristic is achieved through the addition of lecithin ingredient, ISMP (or “agglomerated” SMP) requires a specialised manufacturing process. Miraka remains of the view that ISMP (the only off-GDT product Fonterra has actually disclosed as being included in Notional Producer revenue calculations) cannot be attributed to the Notional Producer.	This submission is more relevant for the base milk price calculation and we will consider whether to include this matter in our 2020/21 review of the base milk price calculation.

⁴⁵ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 3(i).

⁴⁶ Commerce Commission “Review of Fonterra’s 2020/21 Milk Price Manual: Dairy Industry Restructuring Act 2001” (15 October 2020), paragraph X16.1.

⁴⁷ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 3(ii).

Submitter	Key points	Our response
Miraka ⁴⁸	<p>Miraka questions the costing principles Fonterra is using to determine incremental product costs because an incremental product cost should not in and of itself materially erode the premium obtained from ISMP. The Fonterra costing system is outside the scope of the Manual and remains opaque. Costing system policies vary substantially depending on the purpose to which they are put. Fonterra has provided a high level description of the system. This is not sufficient evidence to confirm it is “fit for purpose” for the quite specific purpose of adjusting arms- length pricing of specific products to achieve an equivalence with a related but different set of products so as to determine a competitive milk price.</p>	<p>This submission is more relevant for the base milk price calculation and we will consider whether to include this matter in our 2020/21 review of the base milk price calculation.</p>
Miraka ⁴⁹	<p>Unfortunately, and repeating the manner of its conclusions in the Draft Report, the Commission does not actually address compliance with the requirement concerning Specialised Plant. Rather, it simply restates that “plant” would not require “significant modification” to produce the qualifying materials. Miraka had requested the Commission clarify its conclusions in the context of the rules in the Manual and in particular concerning Specialised Plant. It accordingly remains unclear if the Commission has in fact satisfied itself that qualifying material can be manufactured on Standard Plant without the use of Specialised Plant.</p>	<p>This is a matter concerning Fonterra’s application of the rule and is more relevant for the base milk price calculation. We will consider whether to include this matter in our 2020/21 review of the base milk price calculation.</p>

⁴⁸ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 3(ii).

⁴⁹ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 3(v).

Submitter	Key points	Our response
Miraka ⁵⁰	<p>Miraka has long submitted that Notional Producer yields based on theoretically long production runs of just five individual products would be materially and adversely impacted by the expansion of product range to include the “qualifying reference sales”. Miraka has previously raised the need for a materiality standard to assess whether a departure from or failure to comply with rules and procedures in the Manual causes the measurement of an outcome to be impaired. - The Commission has recommended that Fonterra include a definition of “material change” when considering changes to the Manual (which Fonterra has rejected). Miraka considers that recommendation should be expanded to include a standard of materiality from which to assess whether measured outcomes are impaired as a result of faulty measurement procedures (in this case, yields based on single product plants where the assumed sales programme requires the plant to produce multiple products).</p>	<p>We intend to conduct a review of the framework paper in the near future. The review will include a consideration of materiality.⁵¹</p>

⁵⁰ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 3(v).

⁵¹ Review of Fonterra's 2018/19 base milk price calculation (12 September 2019), footnote 49.

Submitter	Key points	Our response
Miraka ⁵²	<p>The Commission does not offer an alternative explanation of the Fonterra reference to a “target margin”. Miraka points out that it is Fonterra not Miraka that described an internal control procedure for approving prices for off-GDT sales that included the requirement that prices be referred to senior management where “prices ... do not achieve the target margin”. Miraka contends that the “prevailing price” benchmark remains a meaningless and unenforceable requirement for the selection of qualifying reference sales because “prevailing prices” remains an unexplained and undefined concept.</p>	<p>Fonterra explained (paragraph 2.59) that " The MPG therefore deems all sales which satisfy the relevant policies as having been undertaken at a ‘prevailing market price’ on the basis that if it were to exclude the small subset of sales which senior management agree to proceed with at prices that do not achieve the target margin, the resulting price series used in the Milk Price would arguably not be achievable for a real-world dairy processor (i.e., would not be practically feasible)." We consider this means that all sales allowed by policy are included regardless of whether they achieve any management target margin or benchmark, consistent with our conclusion at paragraph 2.61. While at paragraph 37.3 of our draft report in our 2020/21 Manual review we have recommended that defining the term "prevailing prices" would provide greater clarity, the lack of a definition does not derogate from our conclusion on the consistency of the Manual with the s 150A purpose.</p>

⁵² Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 3(vi).

Submitter	Key points	Our response
Miraka ⁵³	The Commission does not provide any alternative benchmark for the “relevant market spot price” (the Draft Report, 2020/21 Milk Price Manual). It is unclear why GDT prices would not be an appropriate benchmark simply because an off-GDT price is higher. The whole point of a benchmark is to provide a basis for comparison – and by definition actual achieved prices will vary from the benchmark; that does not render the benchmark ineffective but rather reflects the correct function of a benchmark.	Based on Fonterra’s explanation in paragraph 2.59, we consider this means that all sales allowed by policy are included regardless of whether they achieve any management target margin or benchmark, consistent with our conclusion at paragraph 2.61. ⁵⁴
Miraka ⁵⁵	It is not a coincidence that ALL the Standard Specification Products are sold on GDT. These products clearly provide benchmarks for the FGMP model. It is then difficult to understand why the prices achieved for these same products on the transparent and independent GDT auction site could be anything other than the appropriate benchmark of “prevailing prices” for assessment of off-GDT prices of New Zealand sourced product. If not that, then what? Notably when Fonterra introduced its policy for expanded use of off-GDT sales to inform the Notional Producer prices, it indicated that GDT prices would remain the benchmark for assessing selling price performance and this would be a benchmark for inclusion of off-GDT sales. Miraka questions why that intention has not been acted on.	In paragraph 2.65 of our 2019/20 milk price calculation review we stated that "we consider that the practical application of the exclusion rules, as explained by Fonterra and set out above, does give rise to pricing that could be achieved by the Notional Processor selling Reference Commodity Products at arms-length in freely contestable global markets. Therefore, they are practically feasible."

⁵³ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 3(vi).

⁵⁴ Commerce Commission “Review of Fonterra's 2019/20 base milk price calculation: Dairy Industry Restructuring Act 2001 Final report” (15 September 2020), paragraph 2.59.

⁵⁵ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 3(vi).

Submitter	Key points	Our response
Miraka ⁵⁶	<p>In our submission on the Draft Report, 2019/20 Milk Price Calculations, Miraka concluded (paragraph 23) and continues to conclude there is no demonstrated process or procedure which assures prices for qualifying reference sales are in fact selected on the basis they are transacted at “prevailing market prices”. Paragraph 29 of the Miraka submission on the Draft Report, 2019/20 Milk Price Calculations summarised our assessment of the impact of including off GDT sales in the milk price calculations. Miraka assessment remains unchanged.</p>	<p>Fonterra explained (paragraph 2.59) that " The MPG therefore deems all sales which satisfy the relevant policies as having been undertaken at a ‘prevailing market price’ on the basis that if it were to exclude the small subset of sales which senior management agree to proceed with at prices that do not achieve the target margin, the resulting price series used in the Milk Price would arguably not be achievable for a real-world dairy processor (i.e., would not be practically feasible)." We consider this means that all sales allowed by policy are included regardless of whether they achieve any management target margin or benchmark, consistent with our conclusion at paragraph 2.61. While at paragraph 37.3 of our draft report in our 2020/21 Manual review we have recommended that defining the term "prevailing prices" would provide greater clarity, the lack of a definition does not derogate from our conclusion on the consistency of the Manual with the s 150A purpose.</p>

⁵⁶ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 3(ii).

Submitter	Key points	Our response
Miraka ⁵⁷	<p>The policy change in 2016/17 to include off-GDT sales has had a profound effect on the FGMP process and calculations, and for example increasing the FGMP in 2019/20 by 11 c/kg MS. The Manual fails to provide a proper framework for assuring that increase in the FGMP is supported by proper process and evidence. The Commission is requested to review this issue again when considering adequacy of the 2020/21 Milk Price Manual for the measurement of the Notional Producer revenues prior to completing its Final Report. The Commission is further requested to consider the points raised in this Miraka submission and the Miraka submission on the Draft Report, 2019/20 milk price calculations, when planning its review for the 2020/21 milk price calculations.</p>	<p>This submission is more relevant for the base milk price calculation. We consider we have addressed the points raised by Miraka but will consider any new evidence presented in our 2020/21 milk price calculation review.</p>

⁵⁷ Miraka “Miraka submission to the Commerce Commission: Draft report (16 November 2020): Review of Fonterra’s 2020/21 Milk Price Manual”, paragraph 4.

Attachment B Outstanding amendments proposed earlier to Fonterra

- B1 This Attachment provides a summary of the amendments that we have proposed to Fonterra through both the Manual and calculation reviews, which have not been adopted. We note that Fonterra has undertaken to consider the matters raised in paragraph 29 above, which are also included in Table B1.
- B2 We have updated the recommendations relating to the Manual that were raised during the base milk price calculation review 2019/20. We consider this to be a valuable summary for all interested parties.
- B3 We consider that these outstanding amendments would:
- B3.1 better promote the purpose of the Act; and
 - B3.2 provide greater confidence to interested parties through additional transparency.

Table B1 outlines these outstanding Manual amendments, Fonterra's reasons and our brief comments.

Table B1 Summary of amendments proposed earlier to Fonterra

Manual reference	Detail	Category	First raised by the Commission	Previous Commission conclusion ⁵⁸	Conclusion in this review
Part A, Section 2.6	Fonterra considers that a 'bright line' materiality threshold is likely to lead to less disclosure. ⁵⁹	Materiality	2016/17 Manual review	The Manual does not define a 'material change' when considering a change to the Manual and the timeframe for making such a change. Disclosure if what constitutes a 'material change' will provide greater transparency.	No change to our previous position. We do not believe that a materiality threshold applied in respect of making changes need also be applied to the disclosure of changes, so as to reduce the level of disclosure. As with financial reporting, various matters might be disclosed at the discretion of the Board that do not constitute material matters.

⁵⁸ Previous conclusions in these areas from prior reviews. These reports can be found at <https://comcom.govt.nz/regulated-industries/dairy/milk-price-manual-and-calculation>

⁵⁹ Fonterra "Fonterra's Reasons Paper in support of Milk Price Manual for the 2020/21 season" (2020), page 4.

Manual reference	Detail	Category	First raised by the Commission	Previous Commission conclusion ⁵⁸	Conclusion in this review
Part B, Rule 26	Fonterra does not consider the Manual is the appropriate vehicle for these disclosures. Fonterra states that they put this information into the public domain in in our base milk price calculation reasons papers. ⁶⁰	Capacity of standard plants	2016/17 Manual review	We recommend Fonterra considers disclosing its plant capacity for both primary and secondary plants early in each season to provide certainty of the notional processors' assumed capacity for the related season. We consider this would improve the ability of interested parties to assess the practical feasibility of the assumed production volumes.	No change to our previous position. We consider that the plant capacity disclosure should be made earlier in the season than in the base milk price calculation reasons paper. We consider that the disclosure of plant capacity in the Milk Price Calculation reasons paper is too late to enable interested parties to assess the practical feasibility of the assumed production volumes.

⁶⁰ Fonterra "Fonterra's Reasons Paper in support of Milk Price Manual for the 2020/21 season" (2020), page 4.

Manual reference	Detail	Category	First raised by the Commission	Previous Commission conclusion ⁵⁸	Conclusion in this review
N/A	<p>Fonterra does not consider the Manual is the appropriate vehicle for these disclosures. Fonterra states that they routinely disclose the information suggested by the Commission with respect to both the prior season average FX conversion rate and the forecast rate for the current season in the Milk Price Statement, released each September.⁶¹</p>	Actual FX rates assumed	2016/17 Manual review	We suggest there should be more transparency of information on the actual FXD rates assumed to be achieved by the notional processor.	We accept that the Manual is not the appropriate vehicle for disclosing assumed FX rates since they are assumptions that will change each season, whereas the Manual contains the overall rules that gives effect to the milk price principles. However, we continue to encourage greater transparency by disclosing FX rates to four decimal points in the quarterly milk price statements, not just each September.
N/A	<p>The application of this rule forms part of the process that filters off-GDT sales. Not specifically addressed in 2019/2020 base milk price calculation.</p>	Standard Product Offering	2019/2020 Manual review	We suggest there should be a clearer specification in the Manual of what is a 'Standard Product Offering' (SPO).	We consider the publication of the list of all products that constitute 'Generic product specifications' in the Manual would greatly assist clarity of what is a standard product offering.

⁶¹ Fonterra "Fonterra's Reasons Paper in support of Milk Price Manual for the 2020/21 season" (2020), page 4.

Manual reference	Detail	Category	First raised by the Commission	Previous Commission conclusion ⁵⁸	Conclusion in this review
N/A	The application of this rule forms part of the process that filters off-GDT sales. Fonterra provided further explanation in the 2019/2020 base milk price calculation.	Tender and Formulaic sales	2019/2020 Manual review	Consistent with our 2016/17 review, we do not consider that there are strong arguments as to why tender sales should inform milk price revenues. We consider that tender sales do not meet the “globally contested markets” requirement in the Act, to be considered a commodity.	Given that the circumstances of tender sales may change, we consider the conditions that apply to sales that are not considered to be transacted on freely contestable markets should be specified in more detail in Principle 2 of the Manual to clarify how this principle is to be applied.
N/A	The application of this rule forms part of the process that filters off-GDT sales. Fonterra provided further explanation in the 2019/2020 base milk price calculation.	Sales not transacted on freely contestable markets	2019/2020 Manual review	We suggest further clarifications regarding conditions applying to sales not transacted on freely contestable markets.	We consider the conditions that apply to sales that are not considered to be transacted on freely contestable markets should be specified in more detail in Principle 2 of the Manual to clarify how this principle is to be applied.

Manual reference	Detail	Category	First raised by the Commission	Previous Commission conclusion ⁵⁸	Conclusion in this review
N/A	The application of this rule forms part of the process that filters off-GDT sales. Fonterra provided further explanation in the 2019/2020 base milk price calculation.	Prevailing prices	2019/2020 Manual review	We consider Fonterra's explanation of 'prevailing prices' is clear, that "prevailing prices" means the relevant market spot price for the product unless it is outside policy, is a formulaic sale or a long-term sale agreement. We do not read Fonterra's reference to a target margin to mean a margin above the market spot price. We do not agree that a prevailing price benchmark should be limited to GDT standard specification products. We consider there may be good reasons why higher prices may be achievable off-GDT.	The term 'prevailing' is used in a number of rules in the Manual. We consider that defining this term would provide greater clarity in respect of the inputs required to be used by these rules.

Attachment C Glossary

Term/Abbreviation	Definition
AMF	Anhydrous milk fat
The Act	Dairy Industry Restructuring Act 2001
Base milk price	Farm gate milk price expressed per kilogram of milk solids
Calculation review	Review of Fonterra's base milk price calculation for the prior season
Dairy season	1 June to 31 May annually
FX	Foreign exchange
GDT	GlobalDairyTrade, Fonterra's online auction platform used to sell commodity products
kgMS	Kilogram of milk solids
Manual review	Review of Fonterra's Milk Price Manual for the current season
MPG	Milk Price Group
Milk Price Manual or the Manual	Fonterra's Milk Price Manual
MPP	Milk Price Panel
Notional processor	The notional commodity business that is used to calculate the base milk price (in its Reasons paper Fonterra uses the term notional producer).
QRS	Qualifying Reference Sale
QOS	Qualifying Outlier Sale
RCP	Reference Commodity Product
R&M	Repairs and maintenance
Reasons paper	Fonterra's Reasons paper which is provided alongside the Manual for each dairy season (this is also provided when Fonterra discloses its base milk price calculation at the end of each dairy season)
SMP	Skim milk powder
WMP	Whole milk powder