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**IDP Joint submission on the Commerce Commission paper:
“Our Approach to reviewing Fonterra’s Milk Price Manual and base milk price
calculation” (issued 30.3.23)**

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Subject: Submission on – Approach Paper – Milk Price Review

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(Independent Dairy Processors (IDPs))

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Abbreviations and other references

Approaches Paper – Commerce Commission reference paper: “Our approach to reviewing Fonterra’s milk price manual and base milk price calculation”. The current paper was issued in 2021

Draft Approaches Paper – draft update of the Approaches Paper on which the Commission is currently consulting and which is the subject of this submission.

BMP - Base Milk Price

DIRA - Dairy Industry Restructuring Act 2001

DIRA Amendment Act 2022 - Dairy Industry Restructuring (Fonterra Capital Restructuring) Amendment Act 2022

IDPs – Independent Dairy Processors: Miraka, Open Country Dairy, Synlait Milk, Westland Milk Products

Manual – Fonterra’s Farmgate Milk Price Manual

NP - Notional Processor

Summary

1. The Approaches Paper is being updated (the Draft Approaches Paper) to incorporate the recent amendments to DIRA subpart 5A (Base Milk Price). The amendments result in substantial changes to the reviews of the BMP. In this submission, the DPs request the Commission:
 - Reconsider its approach to the amended s 150B assumptions
 - Include guidelines on how it will approach the new BMP disclosure requirements
2. The submission also requests the Commission:
 - Consider the continued justification if any of embedding stretch targets in notional data used in the BMP
 - Revisit its explanation of the FGMP
 - Clarify the scope and measurement of the materiality standard for determining focus areas for review

DIRA Amendments

3. The latest update of the Commission’s “Approaches Paper” incorporates substantive amendments to sub-Part 5A of the DIRA (calculation of the BMP). These amendments were introduced by the DIRA Amendment Act 2022. The main purpose of that Amendment Act was to enable Fonterra to implement changes to its capital structure. The Government recognised those changes could have negative implications for competition in the wider dairy industry and was in that regard contrary to the purpose of the DIRA. To help mitigate the increased risk to competition, the Government made other changes to the DIRA, including changes to *“strengthen the Commerce Commission oversight of the base milk price-setting regime”*¹.

¹ Dairy Industry Restructuring (Fonterra Capital Restructuring) Amendment Bill, Explanatory Note

4. These changes to strengthen the Commission oversight were necessarily substantive to help counter the increase in market power and associated risks that arise from the new Fonterra capital structure. The relevant changes are:
 - Safe harbours: amendment to the s 150B “safe harbour” assumptions making them subject to the s 150A purpose of the DIRA (efficiency and contestability). This has the effect of removing the “safe harbour” status of the assumptions, bringing them within the full oversight of the Commission reviews.
 - Disclosure: requiring Fonterra to disclose non-sensitive information related to the Commission’s milk price reviews, and granting the Commission powers to overrule Fonterra decisions to withhold information.
 - Direction: powers to direct Fonterra on matters arising from the Commission’s reviews of the milk price manual and the BMP calculations (including the above noted power to overrule Fonterra decisions to withhold information).
5. The IDPs consider the first two areas of amendment (safe harbours, and disclosure) require substantial changes to the way the BMP is calculated and reviewed. The powers to “direct” Fonterra are expected to have a longer term impact on Fonterra responses to the Commission reviews.
6. The IDPs consider the changes in the Draft Approaches Paper (2023) do not sufficiently account for the significant amendments that have been made to strengthen regulation of the BMP.

DIRA Section 150B assumptions (“safe harbour” status)

7. Until now, the assumptions in s 150B have been treated as safe harbours: Fonterra was able to use these assumptions for the BMP calculations, but the assumptions were not subject to the s 150A (efficiency and contestability) purpose of the BMP. The assumptions have had a wide ranging effect on the BMP, both in the way it is calculated and in the outcome. To the extent Fonterra continues to use the assumptions, this will require a significant widening in the scope of the Commission reviews.
8. The “safe harbour” status of the S 150B assumptions has been expunged as a result of the following amendments:
 - *S 150B (2): Subsection (1)² does not extend to the way in which new co-op uses an assumption in setting the base milk price*
 - *S 150I (1A) – To avoid doubt [the Commission’s annual report on the milk price manual] may include the extent to which the way [Fonterra] uses an assumption described in section 150B(1) in relation to the milk price manual is consistent with the achievement of the purpose set out in section 150A*

² Subsection 1: “it does not detract from the achievements of the purpose set out in section 150A that [Fonterra] sets the base milk price using [the s 150B] assumptions”. This had been the source of the “safe harbour” status of the assumptions. While subsection (1) remains unchanged, new subsection (2) neutralizes that safe harbour status.

- S 150P (1A) is an exact mirror of s 150I (1A) but in relation to the Commission’s annual report of the BMP calculations
9. S 150B (2) is the key change that expunges the “safe harbour” status of the assumptions. While the s 150B assumptions can still be used, that is now subject to their use (*“the way in which [Fonterra] uses an assumption”*) being compliant with the s 150A purpose. This is because subsection 1 (the section which previously afforded the safe harbour status) no longer protects (*“does not extend to”*) the way the assumptions are used. This is then no different to any other BMP assumption: they are all required to meet the purpose of s 150A.
 10. The other two amendments do not add anything other than to reinforce (*“to avoid doubt”*) that the Commission can report on its findings as regards compliance of the s 150B assumptions with the s 150A purpose. This is no different to the Commission’s reporting of any other findings. But it carries increased significance because the latest amendments grant the Commission the power to direct Fonterra to take action where the Commission has concluded (and necessarily reported) that a matter does not comply with the s 150A purpose.
 11. As a result of the amendments affecting s 150B, it is now difficult to identify that the s 150B assumptions carry any weight at all. It is understood the assumptions were originally included in subpart 5A to ensure that certain perceived Fonterra advantages (such as economies of scale) were able to be preserved in the BMP calculations. The assumptions have been interpreted to mean actual characteristics of Fonterra are permitted (and sanctioned) assumptions of the NP.
 12. Considering each of the s 150B assumptions:
 - S 150B (1) (a): *“that [Fonterra]³ operates a national network of facilities for the collection and processing of milk”*

The purpose of the assumption seems to have been to preserve in the BMP the advantages that are available to Fonterra to optimise milk processing through its nation-wide network of facilities. It has been deemed to mean that the NP can be assumed to operate a “network of facilities” that mirrors the Fonterra “network of facilities”. Moving forward, Fonterra can continue to assume the NP operates the same network of facilities and there is no obvious reason that s 150B (1) (a) is required to make that assumption. The key change however is that the network of facilities assumption must now comply with the s 150A efficiency and contestability purposes.
 - S 150B (1) (b): *“that the size of [the Fonterra] assumed units of processing capacity approximates the size of [Fonterra’s] actual units of processing capacity”*.

The purpose of the assumption seems to have been to preserve in the BMP the advantages of processing scale that are available to Fonterra. As written it is difficult to extract meaning. It has however been deemed to mean that the size of the NP processing capacity can be assumed to be approximately the same size as the average of Fonterra’s actual units of processing capacity. Moving forward, Fonterra can continue to assume the NP operates factories which “approximate the size of Fonterra’s actual factories” and again there is no

³ “new co-op” is used throughout the DIRA to in effect refer to Fonterra (refer DIRA s 5 interpretation). For clarity, “Fonterra” is used in these quoted DIRA sections in place of “new co-op”

obvious reason that s 150B (1) (a) is necessary to permit that assumption to be made. The key change is that the assumption regarding the scale of the NP processing facilities must now comply with the s 150A efficiency and contestability purposes.

- S 150B (1) (c): *“that gains and losses experienced by [Fonterra] resulting from foreign currency fluctuations, including from [Fonterra’s] foreign currency risk-management strategies, are incorporated in the base milk price”*

The purpose of the assumption seems to have been to preserve in the BMP the commercial advantages from Fonterra’s currency risk management policies. Unlike assumptions (a) and (b) this intention is clear and explicit. In practice it has however been difficult to implement the assumption as written. It has then been interpreted to permit the NP to adopt the same monthly USD conversion rate that Fonterra actually achieves, but to apply that conversion rate to the different cashflows of the NP. Moving forward Fonterra can continue to make that assumption and does not need the sanction of s 150B to make the assumption provided it complies with the s 150A efficiency and contestability purposes.

- S 150B (1) (d): *“that all milk collected by [Fonterra] is processed into commodities at yields that are practically feasible”*

Uniquely of the four assumptions, assumption (d) is not related to any actual or perceived advantage of Fonterra. It has been used to assume economies of scale and production efficiency which are NOT available to Fonterra: it results in a scale of a limited range of commodity products that exceed Fonterra actual volume, and it is not commercially feasible by comparison with the selling prices assumed by the NP. While the assumption requires the yields to be “practically feasible”, that test has until now not applied because of the over-arching safe harbour status. The yields have instead been assessed on the basis of technical feasibility for the commercially unfeasible volumes assumed. To the extent that Fonterra chooses to continue to use this assumption they will need to demonstrate the consequences of the assumption are commercially feasible in the real world.

13. In summary, Fonterra can continue to use the s 150B assumptions but s 150B no longer gives those assumptions any special status. Like all other assumptions, they are now subject to the s 150A purpose of the BMP. With the possible exception outlined in paragraph 23 below, s 150B no longer carries any weight and all assumptions, processes and inputs for the BMP must now comply with the s 150A purpose (efficiency and contestability) of the BMP.

[S 150B Amendments: Draft Approaches Paper](#)

14. All references to the s 150B assumptions as “safe harbours” have been removed from the Draft Approaches Paper. However, other changes made in the Draft Approaches Paper suggest the Commission considers s 150B continues to infer special status to the s 150B assumptions.

[Draft Approaches Paper paragraph 56: review of s 150B assumptions](#)

15. At paragraph 56, the Commission summarises its approach to interpreting the amended s 150B assumptions:

“Section 150B lists certain assumptions that, if used in the Manual or the calculation, do not detract from the achievement of the purpose set out in s 150A. While Fonterra is able to use

these assumptions, we are able to review the way the assumptions have been used in setting the base milk price.

16. Paragraph 56 does not explain for what purpose or against what standards the Commission will “review” the s 150B assumptions. The Commission has for example previously reviewed the way the s 150B assumptions are used for consistency with the way the assumptions are described; that falls well short of a s 150A compliance review. It seems clear the Commission intention goes further, but the Commission does not clarify how it will change its review of the assumptions. The amendment to s 150B leaves no room for uncertainty. For purposes of the review of the way the s 150B assumptions are used s 150B (1) does not apply (“does not extend”). It must then follow that the Commission’s review of the s 150B assumptions can be no different to the Commission’s role in reviewing any assumption, processes and inputs – i.e. to confirm that they are adopted in the milk price manual or applied in the milk price calculations in a manner that is

“consistent with the purpose of this subpart (see section 150A)”⁴

17. **The IDPs request the Commission** change paragraph 56 to make it clear that to the extent Fonterra adopts the assumptions in s 150B, the Commission is required to review those assumptions and associated processes and inputs in the same way as it reviews all other assumptions, processes and inputs.

Draft Approaches Paper paragraph 50: commercial feasibility

18. At paragraph 50, the Commission notes that it interprets that the practical feasibility requirement of s 150A includes commercial feasibility:

“Our interpretation is that practical feasibility under s 150A goes further than theoretical feasibility and technical feasibility. Subject to the assumptions specified in s 150B and the mandatory principles in s 150C, practical feasibility includes commercial feasibility in the sense that it must be possible for an efficient processor operating in New Zealand to replicate or achieve the component being assessed”.

19. The IDPs agree that practical feasibility must include commercial feasibility. The Commission however implies that the s 150B assumptions do not need to be commercially feasible, inferring it is sufficient they be only theoretically or technically feasible.
20. The IDPs disagree with this interpretation. Again, s 150B (2) makes it clear that the s 150B assumptions have no preferential or unique status for determining compliance with s 150A. **The IDPs request the Commission** change paragraph 50 to remove reference to the s 150B assumptions.

Draft Approaches Paper paragraph 101: features unique to Fonterra

21. In general the Commission considers that if notional costs, revenues and other assumptions can be achieved by Fonterra, they would be practically feasible for an efficient processor (i.e. would

⁴ DIRA s 150I (1) and s 150P (1)

meet the practical feasibility requirement of s 150A (2)⁵. The Draft Approaches Paper qualifies this position in reference to “unique features” of Fonterra in paragraph 101:

“We also examine whether our assessment is affected by unique features of Fonterra which are not subject to s 150B or 150C provisions. If the Manual provides for assumptions that are only practically feasible for Fonterra due to features unique to Fonterra, then such assumptions may not be practically feasible for another efficient processor”

22. The Commission is again drawing an inference that the s 150B assumptions carry a special status that protects them in some way from the requirement to comply with s 150A. As discussed above that is not the case.
23. It might be interpreted that the remaining weight of s 150B does in fact relate to unique features of Fonterra to the extent that where there are alternative assumptions available, Fonterra can apply those (a) to (c) assumptions without further justification⁶. The way they are applied would still though need to comply with s 150A purpose.
24. **The IDPs request the Commission** to remove the reference to s 150B in paragraph 101 of the Draft Approaches Paper.

New Disclosure Requirements

25. Prior to the DIRA Amendment Act 2022, Fonterra was not required to disclose any information relating to its calculation of the DIRA regulated BMP. It was required to make the Milk Price Manual publicly available but there were no prescribed disclosures for the Manual. Public (redacted) versions of its annual reasons papers in support of the Manual and of the BMP calculations are also published on the Commission’s website. Fonterra has also published an annual Farmgate Milk Price Statement which disaggregates some outputs from the BMP calculations. Over the years and including with prompting from the Commission Fonterra has also voluntarily provided some further information – for example in the excel version of the milk price model which Fonterra issues with the annual FGMP Statement. The Commission has not been able to require Fonterra to disclose aspects of the BMP, and Fonterra often does not respond to the Commission recommendations to expand disclosures.
26. Disclosures nevertheless remain limited and the BMP remains largely opaque. This makes it difficult for the IDPs to have confidence that the BMP has been determined on a fair and equitable basis. It also places the IDPs at a disadvantage to Fonterra, with reduced information regarding the likely milk price increasing their risk in managing exposure to milk cost. The cost of milk is the single largest cost the IDPs face. The scope of that risk is not fully known until Fonterra finally discloses the annual BMP in late September each year⁷. That is almost four months after the season has finished and 16 months after milk cost liabilities first start accruing for the season (in June of the previous year). The IDPs use milk price forecasting systems to mitigate that milk cost risk. Forecasting error in these systems is however unavoidable due to

⁵ Draft Approaches Paper para 98.

⁶ This would not apply to s 150B (1) (d) since that assumption is not a unique feature of Fonterra.

⁷ By way of example, based on Synlait published results for the 2021/22 season a 10 cent movement in the cost of milk would have been equivalent to 13% of Synlait EBIT and 20% of Synlait NPBT. 10 cents is equivalent to just 1.1% of the 2021/22 BMP (\$9.30).

the opacity of the BMP model. By contrast Fonterra has full knowledge of the assumptions inputs and processes that determine the BMP. It has always been disconcerting that the DIRA, which is intended to mitigate Fonterra market power, has granted Fonterra the role of setting the BMP and to gain competitive advantage from the role by withholding key information concerning the BMP from the rest of the dairy processing industry.

27. The new DIRA disclosure requirements go some way to mitigating that Fonterra competitive advantage⁸. The IDPs need the disclosure requirements to be enforced to the fullest extent possible. The Commission is the body that has been allocated the regulatory power to ensure that is the case.
28. The new DIRA disclosure requirements are:
- S 150JA and 150QA require the disclosure of all information requested by or provided to the Commission for the BMP reviews and which Fonterra “reasonably considers” is not sensitive information⁹. That information is required to be made publicly available within 20 working days after the Commission issues its final reports on its reviews of the Manual and of the BMP Calculations respectively.
 - S 150UA (1) (a) (b) has the effect of granting the Commission power to overrule any decision by Fonterra to withhold information under the above two sections.
 - S 150UB (2) and (3) limits the Commission’s authority to require disclosures that are “consistent with the purpose set out in s 150A”, and which the Commission “is satisfied” is not sensitive information.
29. **The IDPs request the Commission** include guidance in the Approached Paper to explain how the Commission will approach the new disclosure requirements.

Guidance to New Disclosure Requirements

30. The Draft Approaches Paper includes an explanation of the new disclosure requirements. It does not however provide any guidance on how the Commission expects the new disclosure requirements will be implemented. Equally, while the Commission is empowered to require Fonterra to disclose information, the use of that power is at the Commission’s discretion – the Commission is for example not required to determine if a Fonterra decision to withhold information is reasonable. The IDPs consider the Approaches Paper would be strengthened if it includes guidance on how the Commission will approach implementing its power to require disclosure. The IDPs consider guidance could include that:
- any notional costs, revenues or assumptions used in calculating the BMP are presumed not commercially sensitive (and therefore unlikely to be sensitive information) because they

⁸ Unfortunately the new DIRA disclosure requirements relate to “after the event” disclosures (for example, disclosures related to the BMP calculations are not required until after Fonterra’s already delayed publication of the BMP. Full mitigation of the Fonterra competitive advantage granted to it by its role in setting the BMP would have required ongoing disclosures of key BMP assumptions and inputs as the season progresses.

⁹ Sensitive information is defined as information which is one or more of: commercially sensitive, subject to legal or professional privilege, or personal information.

are different to Fonterra actual costs, revenues, or business practices relevant to these assumptions

- where Fonterra withholds information on the grounds of commercial sensitivity but which remains of interest to other parties, the Commission would expect Fonterra to aggregate the information to the minimum extent to remove commercial sensitivity but which still provides relevant information to other parties
- Fonterra is expected to present information in a manner which is useful to other parties, or in any event which does not obscure interpretation or utility of the information
- At the time Fonterra provides information to the Commission in support of its reasons paper (Manual review and BMP calculations review), Fonterra will be expected to indicate if and why it considers the information is sensitive information. In the event the Commission holds a different view the Commission would then (if it so chooses) be in a position to take timely action that assures disclosures are consistent with the requirements of the DIRA.

Draft Approaches Paper: paragraph 75 and note 38

31. Paragraph 75 confirms the Commission’s power to direct Fonterra to publish information except where (note 38):

“the information is reasonably considered to be commercially sensitive, subject to legal privilege or personal information”

32. Note 38 uses the legal standard that applies to any Fonterra decision to withhold information – i.e. Fonterra is required to disclose information where it “reasonably considers” it is not sensitive (s 150JA and 150QA). The legal standard for the Commission to overrule Fonterra and to direct Fonterra to disclose information is different: the Commission must be “satisfied” the information is not sensitive information (s 150UB (3)).
33. The IDPs see no reason why the Approaches paper should mix the two standards for determining “sensitive information”. **The IDPs request Commission** change note 38 to align to the wording in the Act as it relates to the Commission power to direct.

Other Issues

Notional Data (stretch targets) incentivise Fonterra efficiency

34. Paragraph 87 of the Draft Approaches paper (unchanged from the Approaches Paper) states:

“Using notional data provides Fonterra with a benchmark to beat. This increases transparency to shareholders about the extent to which Fonterra is achieving efficiency gains relative to the alternative of using data on Fonterra’s actual performance to set the base milk price”

35. The notional data referred to here is the use of assumptions which represent stretch targets for Fonterra (“benchmark to beat”). The consequence of such notional data is to increase the BMP by comparison with what it would be using data based on “Fonterra’s actual performance”.

36. Draft Approaches Paper paragraph 87 is an assumption. It is not supported by evidence. Fonterra for example does not explain to shareholders how its performance compares to the notional benchmarks so there is no increase in transparency. If Fonterra were to restate the BMP using data based on its actual performance, then a comparison with the BMP based on notional data (benchmarks) might create that increased transparency and might incentivise Fonterra efficiency. Fonterra does not however provide a BMP calculated using “actual data”.
37. The IDPs consider the use of “stretch targets” has the opposite effect to that attributed in the Draft Approaches Paper paragraph 87. By setting the BMP at a level which exceeds Fonterra actual performance, it obscures that performance while at the same time inflating the key measure of Fonterra performance (the BMP aligned FGMP).
38. At paragraphs 85 and 86 the Commission alternatively suggests that the notional data (the “stretch targets”) incentivise Fonterra to operate efficiently because it must beat those targets to deliver a profit. While it might be important to Fonterra to deliver profits, the extent to which any profit objective might incentivise efficiency must be balanced against the much more important objective of Fonterra, so important it is sanctioned in its corporate constitution – i.e. to maximise the milk price.
39. Paragraphs 82 and 83 of the Approaches Paper explained that “*Fonterra has incentives to improve efficiency to maximise profits*”. That was attributed to “*an incentive to maximise overall payments to farmers and to shareholders, including unitholders in the publicly listed Fonterra Shareholders Fund*”. The incentive to maximise “overall payments to farmers and to shareholders” is irrelevant to the use of notional data in setting the BMP. This is because the “overall payments to shareholders” is unaffected by the level at which the BMP is set (i.e. if the BMP increases Fonterra profits reduce and vice versa).
40. The extent to which Fonterra might have had an incentive to maximise payments to unit holders in the Fonterra Shareholders Funds (FSF) was shown to lack substance by the way Fonterra proceeded with its latest capital restructure. The restructure was put in place for the benefit of supplier shareholders. At the same time, although it had the direct effect of undermining the value of FSF unit holder investments, Fonterra chose not to compensate those investors. In any event, the Fonterra capital restructure has largely eliminated any incentive for Fonterra to maximise payments to unit holders. This is one of the reasons the Government considered the Fonterra restructure increased risks to competition in the dairy processing industry, and why the Government further amended the DIRA to strengthen regulation of the milk price.
41. The Draft Approaches Paper has appropriately deleted what were paragraphs 82 to 83 in the Approaches Paper. This has also removed the Commission’s explanation that “Fonterra has incentives to improve efficiency to maximise profits”. This was a justification for using notional data in the BMP calculations. The Commission has not replaced that with any new justification.
42. Fonterra undoubtedly has objectives to improve efficiency to increase overall returns (FGMP plus profits) to shareholders. It should though be equally clear that the use of notional data in setting the BMP does not incentivise efficiency as it does not have any impact on Fonterra overall returns to shareholders. Furthermore, embedding “stretch targets” in notional data has the effect of Fonterra paying its FGMP at a level as though the efficiency implied in those stretch targets had in fact been achieved. Fonterra efficiency is thus disguised and overstated.

This should be especially concerning noting that Fonterra supplier shareholders consider the FGMP the primary objective and measure of performance of their co-operative.

43. It seems clear that the requirement of the BMP to promote Fonterra efficiency does not then justify the use of notional data that includes “stretch targets” for Fonterra.
44. The IDPs request the Commission give further consideration to any remaining justification for embedding stretch targets in notional data used in the BMP calculations.

Explanation of Farmgate Milk Price

45. In paragraphs 6 to 14 of the Draft Approaches Paper (unchanged from the Approaches Paper) the Commission lays out the relationship between the
 - BMP - the milk price calculated in accordance with the DIRA s 150A purpose and prescribed in the Manual
 - farm gate milk price – defined in the DIRA as the total amount Fonterra pays for milk less organic and winter milk premiums (expressed as a unit per kg MS)
 - Farmgate Milk Price (FGMP) – the FGMP is not a DIRA mandated measure; it is the milk price Fonterra pays in accordance with its standard terms and conditions and is the price it typically is referring to in public statements concerning the milk price. It is different to the farm gate milk price (the DIRA defined measure) because for example the latter includes milk purchased under the Fonterra fixed price contract scheme (where the milk price is typically different to the final FGMP).
46. At paragraph 8, the Commission states the FGMP

“is calculated in accordance with the Manual. Therefore, this price equates to the base milk price recommended by the Panel”.

This description might be consistent with the way Fonterra perceives the FGMP. However it has no legal standing in the DIRA. The FGMP is not regulated by the DIRA and is determined by the Fonterra Board independently of the DIRA. It is a fact that the Fonterra FGMP is informed by the BMP. That is no different to all raw milk prices in New Zealand. By policy, the Fonterra Board typically (but not always) approves an FGMP which is the same as the BMP, but has no obligation to do so. It is thus incorrect or at best ambiguous to say the FGMP “is calculated in accordance with the Manual ... and is the same as the BMP”.

47. At paragraph 9, the Approaches Paper alludes to the Fonterra Board adjusting the BMP in accordance with s 150N of the DIRA and that Fonterra refers to that adjusted price as the “final farmgate milk price”. Paragraph 9 illustrates this by reference to the Fonterra Farmgate Milk Price Statements for the 2013/14 seasons and the 2017/18 seasons. For the 2013/14 Season the Fonterra Board approved a BMP that was \$0.53 lower than the \$8.93 calculated in accordance with the Manual and recommended by the milk price panel. In the statutory declaration required under s 150N Fonterra explained¹⁰:

¹⁰ <https://www.fonterra.com/content/dam/fonterra-public-website/phase-2/new-zealand/pdfs-docs-infographics/pdfs-and-documents/milk-prices/pdf-statement-under-section-150n-of-the-dira.pdf>

“Fonterra is required to publish the following information if it sets a ... ‘base’ milk price other than in accordance with a recommendation of the Milk Price Panel:

- *The Panel’s recommendation, and*
- *A statement setting out the reasons why the Panel’s recommendation was not accepted.”*

The statutory declaration proceeded to provide the explanation, although it confusingly conflated the BMP (the statutory measure which was the subject of the statutory declaration) with the FGMP which has no standing in the DIRA. The declaration stated:

“The Fonterra Board decided that it was necessary to protect the Co-operative and maintain the confidence of key stakeholders by recognising that it would be prudent to maintain strength in Fonterra’s balance sheet by not setting a Farmgate Milk Price that would need to be paid in part out of borrowings. Accordingly, in early December 2013, Fonterra signalled its intention to pay a final Farmgate Milk Price below the price calculated under the Manual. The Fonterra Board subsequently confirmed this decision when approving the final Farmgate Milk Price for the 2014 season”

48. In summary, the Fonterra Board explained it had adjusted the BMP because it could not afford to pay the BMP calculated in accordance with the DIRA. In so doing, Fonterra confirmed it had altered the BMP without reference to the s 150A purpose of subpart 5A, and in a manner that frustrated that purpose. The DIRA having no sanctions, this was at the time of little consequence.
49. It is likely Fonterra felt compelled to adjust the BMP under s 150N because there was a view that the DIRA required Fonterra to set what it refers to as the FGMP to be the same as the BMP. Whether or not that was correct, Fonterra seems to have believed the only way it could set an FGMP that was different to the BMP was for the Board to adjust the BMP by s 150N.
50. Following the insertion into the DIRA of subpart 5A in 2012 there was uncertainty about whether (as written) it required Fonterra to pay a milk price that was the same as the BMP. However it seems unlikely this was ever the intention: given the DIRA purposes of the BMP included to provide for contestability in the market, the BMP would only set a maximum price for Fonterra to pay. Fonterra would be free to pay a lower price for example on the grounds of affordability. To make this clear, section 150CA was inserted on 1 June 2021 into the DIRA by the Dairy Industry Restructuring Amendment Act 2020¹¹. That amendment explicitly permits (where it might only have previously been implied) Fonterra to pay a farm gate milk price that is different from the BMP. Fonterra is required to provide a statutory declaration explaining why the farm gate milk price differs from the BMP. For the two seasons for which the final BMP has been determined since s 150CA was enacted, the Fonterra Board has approved an FGMP which is the same as the BMP. Accordingly the explanation for any difference between the farm gate milk price and the BMP has largely been attributed to the Fonterra fixed milk price scheme. In

¹¹ In its report back to Parliament on the DIRA Amendment Bill (No 3) regarding new section 150CA, the Primary Production Select Committee explained that “the terms base milk price and farm gate milk price are often used interchangeably. Some people were not aware that the base milk price is a notional benchmark and a reference point for farmers to assess Fonterra’s performance. We believe the distinction between the two prices needs to be made clearer”.

the future if Fonterra again chooses to pay an FGMP lower than the BMP its explanation for the difference between the BMP and the farm gate milk price would then also include that the Fonterra Board had approved an FGMP that was lower than the BMP.

51. The enactment of s 150CA thus removes the need (if a need ever existed) for Fonterra to resort to s 150N in order that it set the FGMP at a lower price to the BMP. It seems unlikely that Fonterra will ever again resort to s 150N, and in any event it would presumably remain illegal to use s 150N to change the regulated BMP calculated in accordance with the DIRA for no other reason than Fonterra chose to pay a different milk price.
52. In summary it is incorrect to state that the FGMP is the same as the BMP, and it is not appropriate to suggest that Fonterra can frustrate the s 150A purpose simply so that the BMP (the statutory regulated milk price) aligns to the milk price the Fonterra Board decides to pay. It is unhelpful that the Approaches Paper suggests a statutory link between Fonterra's FGMP and the BMP. That reinforces an incorrect view that the regulated BMP must necessarily be based on Fonterra performance or is predicated on Fonterra's framework for setting its own milk price.
53. The IDPs request the Commission review and update paragraphs 6 to 14 of the Draft Approaches Paper taking into account the above discussion.

[Draft Approaches Paper note 59: Materiality](#)

54. Note 59 of the Draft Approaches Paper is unchanged from the Approaches Paper. It states:
For the purposes of identifying changes which might become focus areas we apply an "indicative operational" materiality of an equivalent 0.5% of the WACC used in the milk price reporting model for the season under review"
55. In its submission on the review of the 2020/21 BMP Calculations Miraka sought clarification of the scope and interpretation of the above materiality measure¹². In its final report on the 2020/21 BMP calculations review, the Commission responded that it would consider the points raised in the Miraka submission at the next update of the Approach Paper¹³.
56. The IDPs request the Commission reconsider the Miraka submission on this matter.

¹² Miraka Submission (1 September 2021): Review of Fonterra's 2020/21 BMP calculations, Paras 40 to 45

¹³ Commerce Commission Review of Fonterra's 2020/21 BMP calculation (Final Report 15 September 2021), Appendix A

Authorisation

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