



Dairy for life

1 August 2023

**‘Reasons’ paper in support of
Fonterra’s Milk Price Manual for the
2023/24 Season**

1 August 2023

To: The Commerce Commission

1. Fonterra Co-operative Group Limited (Fonterra), certifies that:
 - a. in terms of section 150L(d) of the Dairy Industry Restructuring Act 2001 (the Act), Fonterra considers that its milk price manual to be applied in calculating Fonterra's Farmgate milk price for the 2023/24 financial year is, in all material respects, consistent with the purpose of subpart 5A of the Act; and
 - b. none of the circumstances set out in section 150G(1) of the Act have occurred with respect to the milk price manual to be applied in calculating Fonterra's Farmgate milk price for the 2023/24 financial year.
2. This certification is based on our interpretation of subpart 5A, and the other relevant assumptions, views and qualifications set out in the accompanying reasons provided pursuant to s 150L(e).

Signed by

Andrew Cordner
Director, Legal

Introduction

This paper provides the reasons in support of Fonterra's certification in respect of the Milk Price Manual to be applied in the calculation of Fonterra's Farmgate milk price in respect of Fonterra's 2023/24 Season (the F24 Manual), as required under section 150L of the Dairy Industry Restructuring Act 2001 (DIRA). The paper has been prepared under the oversight of the Milk Price Panel, and where relevant reflects the Panel's views.

Section 150L provides that Fonterra must:

- Provide the Commission with the milk price manual for the current season (i.e., the season commencing on 1 June 2023) (section 150L(a));
- Provide the Commission with any recommendations by the Milk Price Panel "in relation to the milk price manual" (section 150L(b));
- Notify the Commission of any change in the economic and business environment that, in Fonterra's view, requires a change to the milk price manual (section 150L(c));
- Certify to the Commission the extent to which Fonterra considers that the milk price manual is consistent with the purpose of subpart 5A of DIRA (section 150L(d)); and
- Provide the Commission with reasons for the view expressed in its certificate (section 150L(e)).

In addition, section 150G sets out the steps that Fonterra is required to take if it does not amend the Manual in accordance with a recommendation by the Panel, if it amends the Manual contrary to a recommendation by the Panel, or if it amends the Manual without having received a relevant recommendation from the Panel. We advise that none of these circumstances has occurred with respect to the Manual applied by Fonterra in respect of the 2023/24 season (the F24 Manual).

On 21 June 2023 the board of Fonterra approved a number of amendments to the Milk Price Manual, all of which were recommended by the Milk Price Panel. These amendments are set out in 'mark up' form in the Milk Price Manual attached to this paper and, where not obvious given their context, we explain their rationale below. In all other respects, the F24 Manual is identical to the F23 Manual, in respect of which Fonterra submitted a certification and reasons paper on 1 August 2022. Consistent with that paper, we have confined our comments in this paper to areas where our views have changed subsequent to preparing previous reasons papers, or where we wish to provide additional information. In all other respects, we request that this paper be read in conjunction with our reasons papers submitted in respect of the 2012 – 2023 seasons.

We have also recently provided (in our 'reasons paper' in respect of the 2022/23 base milk price) the Commission with our views on the appropriate interpretation of section 150A of DIRA (the purpose provision), and have not repeated these views in this paper.

The paper is intended to satisfy the section 150L(e) requirement to provide the Commission with the reasons for the view expressed in our certificate. The paper is organised as follows:

- In section 2, we set out, and explain the rationale for, the amendments to the F24 Manual.
- In section 3, we summarise changes in the economic and business environment that are potentially of relevance to the calculation of the base milk price, and explain why we have not amended the Manual in response to these changes for the 2023/24 season.

The attachment to this paper comprises a 'marked up' version of the Milk Price Manual, identifying all amendments, and which satisfies the section 150L(a) requirement to provide the Commission with the manual for the current season.

We have separately provided to the Commission a paper to Fonterra's board of directors dated 21 June 2023, setting out the Milk Price Panel's recommendations with respect to amendments to the Milk Price Manual.

Amendments to the Manual for F24

The one substantive change to the Manual for F24 addresses the only potential amendment proposed by the Commission in its Final Report on the F23 Manual, where the Commission explained that:

... as we noted in the 2021/22 Calculation Review, we suggest, from a transparency perspective, that Fonterra considers whether the definition of Standard Product Offering in the Manual can be clarified, particularly with respect to the cascading product rule, or the application of the definition explained more clearly in the calculation Reasons paper.¹

In response, we have amended the definition of Standard Product Offering to now read:

A Reference Commodity Product specification which:

1. Is a Standard Specification Product, or
2. Is sold on GDT, or
3. Is otherwise a product which:
 - Is traded in significant quantities in globally contested markets, and
 - Is characterised by uniform technical specifications.

When determining whether a specific product specification satisfies the conditions specified in paragraph (3), the MPG will disregard any element of the product specification which it can reasonably be expected would not give rise to a requirement for consultation with a customer if that product was used to fulfil an order for a similar product.

When determining whether a product is traded in significant quantities in globally contested markets, the MPG will have regard to the quantity of functionally-equivalent products traded in globally contested markets, and not to the quantity of an individual product specification.

The previous definition defined a Standard Product Offering as:

Reference Commodity Product specifications that are:

1. Sold on GDT, or
2. Generic product specifications which:
 - Are sold in multiple regions
 - Are sold to multiple customers
 - Are sold through Fonterra's standard sales channels, and
 - Can be substituted for other Standard Product Offerings.

The intent of this amendment is to:

- Explicitly provide that the separately-defined Standard Specification Products (Premium AMF, Regular WMP, UHT BMP, MH SMP and unsalted butter) are Standard Product Offerings. These products are all sold on GDT, so this amendment will not have any substantive impact. However, it addresses a source of apparent confusion on the part of submitters in previous years, who have argued that only Standard Specification Products should be used in the Farmgate Milk Price calculation, by making it explicit that Standard Specification Products comprise a subset of the products included in the revenue calculation.
- Substitute the DIRA definition of a commodity product for the similar, but not identical, previous Manual definition. This will also not have any substantive impact on the selection of products, but is intended to make explicit our objective of applying a DIRA-consistent approach.
- Codify in the Manual the definition of 'cascadability' which we provided in our 2021/22 base milk price reasons paper, to the effect that we consider an individual stockkeeping unit, or SKU, to be

¹ Commerce Commission, Review of Fonterra's 2022/23 Milk Price Manual: Final Report, 15 December 2022, paragraph 48 on page 13; https://comcom.govt.nz/_data/assets/pdf_file/0022/301819/Final-report-Review-of-Fonterra27s-2022_23-Milk-Price-Manual-15-December-2022.pdf The Commission also noted that it considered the other matters carried forward from its previous reports were now closed.

cascadable if it can be used to satisfy an order for a functionally equivalent product (which also satisfies the Standard Product Offering definition) without any expectation that prior consultation with the customer would be required.

- Make explicit that when determining whether a product is traded in 'significant quantities', we focus on the overall sales volume of the generally recognised product (eg regular WMP) rather than the traded volume of individual SKUs of that product.²

We also made several minor amendments to Part A of the Manual, principally to align the Manual to amendments to subpart 5A of DIRA in the Dairy Industry Restructuring (Fonterra Capital Restructuring) Amendment Act 2022. None of these amendments, all of which are set out in mark-up form in the attached 2023/24 Manual, has any impact on the calculation methodology or the quantum of the base milk price.

Changes in the Economic and Business Environment

We confirm we are not aware of any changes in the economic or business environment that would in our view necessitate a change to the Milk Price Manual for the F24 Season. In arriving at this view, we have had regard to the following:

- None of the amendments to the Milk Price Manual were prompted by changes in the economic or business environment.
- As a general matter, our view is that changes in the economic or business environment will in most circumstances not necessitate changes to the Manual, though they may result in changes in the approach taken to applying existing provisions of the Manual. Among other things, the existing provisions of the Manual could accommodate the changes in approach required to reflect the impact of changes in relative demand for (and profitability of) different product streams that affect industry-wide patterns of new investment, of assets becoming 'stranded' due to a significant reduction in milk supply, or abnormal costs attributable to COVID-19.

² For example, Fonterra maintains a number of regular WMP SKUs, including several SKUs used to satisfy sales on GDT of regular WMP, all with identical composition and packaged in Fonterra bags, with the requirement for different SKUs arising from the need to ensure product shipped to a particular country satisfies country-specific testing and labelling requirements.