



Dear Leighton

Cross Submission on the Commerce Commission's Process and Issues Paper – Review of 2015/16 Base Milk Price Calculation

Open Country Dairy (Open Country) is pleased to make this cross submission on the Commerce Commission's (Commission) Process and Issues Paper (Process Paper) for the review of the 2015/16 base milk price calculation. Open Country reiterates the points it has made in its original submission. However, after reviewing Fonterra's submission, we felt compelled to add the following comments:

Fonterra still has not provided a robust basis for excluding the financing costs associated with its interest-free loans from the calculation of the milk price. Fonterra has now raised two distinct arguments for excluding interest-free loan costs in the milk price model—neither of which are convincing:

- Fonterra first argued that interest-free loan costs should be excluded because they were paid for out of cost reductions. As the Commission rightly pointed out, the way that cost is financed is irrelevant—if the notional processor would have borne the cost, it must be included.
- Fonterra's new argument appears to be that including the cost of interest-free loans in the milk price is self-defeating because it would mean that "Fonterra would not be providing any support to its suppliers", and that the part-payment of interest-free loan costs by shareholders who didn't accept the loans (or couldn't because they were financial investors in the Fonterra Shareholders' Fund) would be "counter to Fonterra's objectives of supporting its shareholders in the current low milk price environment". Fonterra (and the notional processor) have borne financing costs to provide the loans. Fonterra cannot then pretend that cost wasn't incurred for the purposes of the regulatory milk price calculation because this would be a clear breach of practical feasibility. The issue Fonterra raises comes back to Fonterra's nature as a co-operative where Fonterra's shareholders (for the most part) are its farmer suppliers. In response to difficult times, farmers could have directly obtained finance or obtained finance through their supply relationship with Fonterra. They chose to obtain finance through Fonterra. The fact that that finance was passed on without Fonterra charging the farmers a margin reflects a choice by the co-operative about how they share burdens. That does not change that either financing approach would have led farmers to bear the economic costs of the financing—and they should be included in the calculation to satisfy practical feasibility.

Fonterra is still avoiding the inclusion of winter milk costs in the milk price model and the Commission should definitively state its position on the (lack of) practical feasibility with this approach. Fonterra has stated that it will "consider how it can increase transparency around winter milk premiums". The inclusion of the costs of winter milk in the model is the matter of primary importance—although additional transparency would be welcomed and is overdue. Open Country has laid out in detail how we think the Commission should view the winter milk premiums and we look forward to the Commission stating its final position on this matter and Fonterra including the costs in the milk price calculation.



Fonterra should release the Terms of Reference for Dr Alastair Marsden's further work. Fonterra's submission states that it has provided the Commission with the Terms of Reference for Dr Marsden's further work. Given that this is part of an existing regulatory process and because the Commission will be engaging an expert to comment on Dr Marsden's work, we request the Terms of Reference be released at the earliest opportunity.

Open Country looks forward to reviewing the independent reviewer's report on the notional processor's asset beta and risk premium for asset stranding, and to continuing to engage in the review of the 2015/16 milk price calculation.

Best regards,

A handwritten signature in blue ink, appearing to read "S. Koekemoer", is written over a horizontal line.

Steve Koekemoer

Chief Executive Officer, Open Country Dairy Ltd