

### **Synlait submission on the Kotahi proposal**

1. Synlait Limited welcomes this opportunity to submit on Fonterra Co-operative Group Limited's (**Fonterra**) application seeking authorisation (**Application**)<sup>1</sup> for its Kotahi proposal (**Proposal**).
2. Having reviewed the Application, it would seem that the Proposal involves Fonterra (New Zealand's largest exporter), and Silver Fern Farms Limited (**Silver Fern Farms**) establishing a limited partnership called Kotahi Logistics LP (**Kotahi Logistics**).
3. According to the Application, Kotahi Logistics would initially coordinate the partners' acquisition of international shipping services (including related landside services). But at some future stage it is expected to expand and will involve Kotahi Logistics also coordinating the acquisition of intermodal transport services (ie domestic road, rail and costal shipping services). Under the Kotahi arrangements, Kotahi Logistics partners would be obliged to acquire the relevant services from Kotahi Logistics on an exclusive basis.
4. Given the enormity of such a proposal to an island nation, where virtually all exporters/importers (big and small), are dependent on shipping and intermodal transport services, we consider that it is important to comment on the following matters:
  - (a) While it is proposed that third parties may become additional partners (or acquire services from) Kotahi Logistics, it is our view that these opportunities must be explicitly **offered on a non-discriminatory, open access basis** to minimise potential detrimental impacts. "Standing together as one" must not allow Kotahi Logistics partners to exclude their competitors. These obligations should be clear and specified as a condition attached to any authorisation;
  - (b) Given the unprecedented nature of the Proposal careful consideration should be given to the **Proposal's impact on third parties and other markets**;
  - (c) Other than international shipping and intermodal transport services, Fonterra makes no attempt to set out an exhaustive list of the "other" services Kotahi Logistics may provide. We consider that **the scope of any authorisation must be clearly defined**; and
  - (d) Given the number of domestic and international factors at play, we query **the timing and quantum of the claimed public benefits and detriments**.

***Kotahi arrangements must be open to all exporters and importers on non-discriminatory terms***

<sup>1</sup> See, Fonterra's application for a more detailed description of what Fonterra envisages the Kotahi arrangements covering: <http://www.comcom.govt.nz/anti-competitive-practices-authorisations-register/detail/725>

5. The Application describes the Proposal as intended to be *"to the benefit of all users of the relevant services"*.<sup>2</sup> In order to achieve that intent, Kotahi's services must be open to all users on non-discriminatory terms.
6. We consider that Kotahi Logistics must be subject to an obligation not to discriminate between all persons who seek access to its services (ie all current and potential customers, whether limited partners or not). The obligation should apply to matters such as the entry of new limited partners, including the capital contribution required (which could itself constitute a barrier to entry and exit), the acceptance of customers, pricing, and terms of service.
7. We are not suggesting that Kotahi Logistics must offer common pricing for all. However, the Proposal must not result in other exporters and importers subsidising better freight prices and a negotiating vehicle for Fonterra, with the effect of entrenching or strengthening Fonterra's dominance across various markets.
8. Any discounts provided to Fonterra or any other entity must be objectively justifiable and based on principles which should be disclosed to both the Commission and interested parties prior to any authorisation being granted.<sup>3</sup>
9. Even then, non-discrimination obligations can confer benefits on larger players not available to others and we further submit that (if the Commission were minded to grant authorisation) standard access principles from the Telecommunications Act context should be adapted and imposed eg Kotahi Logistics must if requested, provide all customers and limited partners with information about its services at the same level of detail and within the same time frame, Kotahi Logistics' services must be provided in a timely manner and to a standard consistent with international best practice.<sup>4</sup>
10. We note that during consultation on non-discrimination obligations in the telecommunications industry, Telecom acknowledged that:<sup>5</sup>

*"It is possible that volume discounts could be designed in a way that could harm competition. For example, if only one customer could achieve the maximum volume discount, it is possible that it could create a de facto downstream monopoly. On this basis, we think that the maximum volume should be achievable by 2 or more customers within similar timeframes (e.g. within 6 months of each other)."*

11. The scope for denying potential additional partners entry to the Kotahi club also seems broad. This includes allowing a limited partner to veto the application on the basis of a "bona fide commercial objection".<sup>6</sup> Where a bona fide commercial objection begins and ends is unclear. The capital contribution required to join the limited partnership is also unclear. In our view, the Proposal risks being exclusionary (regarding entry) if it is not subject to a non-discrimination obligation.

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<sup>2</sup> Para 16.1 of the Application.

<sup>3</sup> We note that principles relating to pricing in clause 4.8 of the Limited Partnership Agreement are currently redacted from the public version of the Application.

<sup>4</sup> Clause 5, Schedule 1, Telecommunications Act 2001.

<sup>5</sup> Telecom, *Submission on the Commerce Commission's Draft Guidance on Telecom's non-discrimination obligations under the Telecom Separation Undertakings*, 22 February 2010 (paragraphs 76-78).

<sup>6</sup> Para., 5.25 of the Application.

12. On that note, it is interesting that Fonterra does not seem to consider rival dairy exporters as a "useful fit" for the Kotahi arrangements. Rather, Fonterra seems to view "[m]eat, forestry, fishing and horticultural producers...[as] a useful fit".<sup>7</sup> It is unclear whether Fonterra could make a "bona fide commercial objection" on the basis that a potential limited partner is not a "useful fit" or is seen as not offering sufficient volumes of exports.
13. We also note that there are no express restrictions on when Kotahi Logistics can refuse to contract with a potential customer. The Application suggests that firms denied entry into the limited partnership or refused access to Kotahi's services can resort to s 36 of the Commerce Act.<sup>8</sup> A dominant entity such as Fonterra must be aware of the difficulties and delays associated with the enforcement of s 36 in New Zealand, and that in most cases, it is not a viable option for seeking redress. If the Commission is minded to authorise the Proposal, s 36 is an ineffective solution for a problem Kotahi Logistics would create, and an ex ante enforcement mechanism should be put into place.
14. We consider that specific grounds must be set out for denying entry to a potential limited partner or refusing to provide services to a potential customer, eg failure to prove credit worthiness.
15. The Application also notes that the Proposal intends to focus on the export of Fonterra's and Silver Fern Farms' products in the first instance.<sup>9</sup> We consider that assurances need to be provided that Fonterra, Silver Fern Farms, and any other early limited partners will not benefit from material first mover advantages (eg by securing and locking in significant capacity on any particular routes) while later customers and limited partners are forced to pay premium rates for scarce remaining capacity.
16. Compliance with the non-discrimination obligations could be monitored by requiring the appointment of an independent auditor to monitor and enforce compliance. This is a well accepted remedy overseas when there are vertical access concerns.

***The detrimental impacts of the Proposal may be wide ranging***

17. Given the crucial role that ocean freight plays in New Zealand's economy it is imperative that the Commission robustly considers every potential consequential impact resulting from the Proposal. The Proposal could impact every current and future exporter/importer and numerous downstream markets for better or worse.
18. What seems clear is that if the Proposal is successful, Kotahi Logistics would be able to exploit its resulting countervailing buyer power and drive down the prices of the services it acquires. But what impact could this conduct have on other exporters/importers which have "failed" Kotahi Logistics' selection criteria (or otherwise wish to continue acquiring the relevant services independently)?
19. We query whether shipping lines and intermodal transport providers, which have suffered from Kotahi Logistics countervailing buyer power, may seek to recover decreasing revenues from exporters/importers outside of the Kotahi arrangements. Fonterra had little choice but to acknowledge that "foreign

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<sup>7</sup> Para., 17.7 of the Application.

<sup>8</sup> Paras., 5.22-5.30 of the Application.

<sup>9</sup> Para., 3.6 of the Application.

*shipping lines...exert a substantial degree of influence,...when negotiating with freight owners...”,<sup>10</sup> to substantiate its arguments in favour of the Proposal. But the Application fails adequately to explain how parties outside of the Kotahi arrangements will counter an arguably greater substantial degree of influence.*

20. Even if the Proposal provides shipping lines and intermodal transport providers with opportunities to release efficiencies, there is no guarantee that those providers would not seek to exploit exporters/importers outside of the Kotahi arrangements. As Fonterra rightly points out, the shipping lines are not subject to the Commerce Act in most instances.
21. Further, if prices were to rise above competitive levels for parties outside of the Kotahi arrangements this has the potential to impact every market that is, to some extent, reliant on the relevant services. Whether that impact manifests in reducing dynamic efficiencies, higher prices or reduced quality will depend on the characteristics of each relevant market.
22. We also query whether the Proposal could result in exporters/importers outside of the Kotahi arrangements having diminished choice as to service providers (including ports) and/or a reduction in the quality of those providers/services. For example, a reduction in the number of shipping lines servicing New Zealand and those which do, do so with marginal vessels. The latter arguably illustrated with the recent grounding of the container ship *Rena*, off the coast of Tauranga, on 5 October.
23. It is also possible that the Proposal could simply drive shipping lines offshore. The authorisation could empower Kotahi Logistics to cause this effect so significant safeguards would be needed, assuming that the net public benefits are made out. The risk is considerable.

***Fonterra fails to define exactly what it is asking the Commission to authorise***

24. Fonterra freely admits that the scope of the Proposal is a work in progress. Following an attempt to set out the scope of Kotahi Logistics’ coordination Fonterra explains:

*“That list is not exhaustive. It is intended that the operations of Kotahi Logistics will expand and modify in accordance with customers’ changing requirements and developments to New Zealand’s transport infrastructure”.<sup>11</sup>*

25. We consider that for the Commission to conduct a proper analysis it must be clearly defined what exactly Fonterra is asking the Commission to authorise. Any ambiguity and “unknown unknowns” may lead to misplaced conclusions based on incomplete information. Any expansion of the services that Kotahi Logistics’ coordinates is likely not only to have impacts on the relevant direct markets, but may also have indirect flow-on impacts in other markets.
26. We consider it vital that the Commission has complete information regarding the Proposal, especially given that Fonterra has acknowledged the difficulty in analysing the Proposal.
27. On that basis alone, there is no basis to conclude that net public benefits are made out.

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<sup>10</sup> Para., 31.1 of the Application.

<sup>11</sup> Para., 19.4 of the Application.

### **The public benefits may be far off**

28. On the basis of the Application it seems unclear exactly when the claimed benefits and potential detriments would accrue. Fonterra acknowledges that:
- (a) to achieve the claimed public benefits, Kotahi Logistics' would need to attract a "...critical mass of freight users...";<sup>12</sup> and
  - (b) in relation to section 27 of the Commerce Act, "[w]hether or not the substantially lessening competition line is crossed [ie detriments] in relation to a particular service at a particular time **will depend on various factors**...".<sup>13</sup> (emphasis added)
29. There seems to be ambiguities and a number of contingencies in relation to the timing of such outcomes. Further, we query whether under the factual there could be a sustained period of time where the detriments have accrued but Kotahi Logistics has failed to attract/accept a *critical mass* of freight users and thus achieve the claimed public benefits? Under such a scenario parties outside of the Kotahi arrangements (and other markets), could be suffering the detriments while the claimed public benefits have failed to materialise.
30. At this stage we have no settled views in relation to counterfactuals hypothesised by Fonterra, but no doubt the Commission will be vigorously testing those which have been proposed.

### **In conclusion - if authorised, it must be on an open access basis and this should be a condition of authorisation**

31. The application is vague in detail which is highly unsatisfactory given the potential adverse impacts in a number of domestic and offshore markets.
32. We assume that the Commission will require much greater specificity on the factual and counterfactuals, as well as a far more detailed review of all potential impacts. It is not enough to protect the interests of one or two major exporters. More consideration needs to be given to potential harms.
33. Assuming the Commission is minded to grant authorisation, at a minimum, we consider that if the Proposal is to achieve the greatest benefits for the public of New Zealand it must do so in a way that is likely to minimise harm to exporters/importers outside of the arrangements and other markets. Operating Kotahi Logistics on a non-discriminatory, open access basis, is the most efficient way of achieving that outcome.
34. Ocean freight and domestic logistics play too critical a role in the New Zealand supply chain to authorise such arrangements unless the Commission is truly satisfied in relation to the claimed public benefits and potential detriments.
35. We would like the opportunity to provide further input and take part in Commission's conference.

### **Authorisation should be subject to the following conditions**

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<sup>12</sup> Para., 32.2 of the Application.

<sup>13</sup> Para., 33.13 of the Application.

36. For the Commission's convenience, authorisation of the Proposal should, at the very least, be subject to the following conditions:
- (a) Kotahi Logistics is subject to an obligation not to discriminate between all persons who seek access to its services (ie all current and potential customers, whether limited partners or not), including specific objectively justifiable rules in relation to:
    - (i) entry to Kotahi Logistics;
    - (ii) the capital contribution for additional partners;
    - (iii) the acceptance of customers;
    - (iv) pricing (including volume discounts);
    - (v) terms of service; and
    - (vi) the provision of information to additional partners and customers (including scope and timeframe).
  - (b) Fonterra, Silver Fern Farms, and any other early limited partners will not benefit from material first mover advantages by securing and locking in significant capacity on any particular routes to the disadvantage of later customers and limited partners.
  - (c) Compliance with the non-discrimination and first mover obligations will be monitored by an independent auditor.

Yours sincerely,



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