

Review of Fonterra's 2019/20 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 final conclusions on our review of Fonterra's 2019/20 Milk Price Manual (**the Manual**). The Manual contains the methodology that will be used to calculate Fonterra's base milk price for the 2019/20 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" (15 August 2017).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 '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
- 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 each dimension in our reviews.

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 NP, 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.

- X5 In reaching our final conclusions we have focused on:
- X5.1 Fonterra's amendments to the Manual; and
 - X5.2 matters carried forward from previous reviews.
- X6 For those parts of the Manual that have remained unchanged we have relied on our previous conclusions.

Our conclusions

- X7 Our overall final conclusion is that the Manual is largely consistent with the purpose of s 150A.
- X8 In regard to the specific matters we have reviewed, our final conclusions are:
- X8.1 the amendments to the Manual from last season's Manual are of low materiality or improve clarity, however we consider that some of these matters can be further clarified as discussed at paragraph X10.1;
 - X8.2 the definition of 'Qualifying Outlier Sales' (**QOS**) is consistent with the contestability and efficiency dimensions set out in s 150A of the Act; and
 - X8.3 we continue to consider that disclosure of what constitutes a 'material change', when considering whether a change to the Manual should be made, will provide greater transparency.
- X9 There remain recommendations from previous reviews that we consider 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. These recommendations relate to:
- X9.1 actual FX rates assumed; and
 - X9.2 capacity of standard plants (**SP**).
- X10 Although not matters affecting our conclusion that the Manual is largely consistent with the purpose in s 150A of the Act, we also consider that further disclosure of the following matters would better promote the purpose:
- X10.1 a clearer specification in the Manual of what is a 'Standard Product Offering' (**SPO**), and in particular the range of products that constitute 'Generic product specifications';
 - X10.2 clarification of what constitutes 'tender and formulaic sales';

X10.3 clarification regarding what conditions apply to sales that are not considered to be transacted on freely contestable markets; and

X10.4 clarification of what 'prevailing prices' means.

Next steps

X11 Our next step is to review Fonterra's 2019/20 base milk price calculation. We will provide our draft report by 15 August 2020 and final report by 15 September 2020.³ Our review will assess the extent to which the the assumptions, inputs and processes of the 2019/20 base milk price calculation are consistent with the s 150A purpose.⁴

X12 Based on Fonterra's 2019/20 Manual amendments, submitters' views and our final conclusions on this review, we have identified some areas that we will review during our 2019/20 milk price calculation review. These areas include the following matters identified by Miraka that we are unable to assess until we have looked at the practical interpretation of the rules in our review of the assumptions, inputs and processes in the milk price calculation:

X12.1 whether it is feasible for the Notional Processor (**NP**) plant, as configured, to manufacture the specified product range included in Fonterra's Qualifying Materials (**QM**);

X12.2 whether production efficiencies assumed for the NP are consistent with the range and scheduling of production for the full sales portfolio of QM;

X12.3 whether it is practically feasible to attribute selling prices to the NP using the 'Incremental Product Cost' (**IPC**) adjustments for products the NP cannot manufacture, if any; and

X12.4 whether the selling costs for all of the QM have been appropriately provided for.

X13 We do not consider that these matters detract from our ability to conclude on the 2019/20 Manual since they relate to the detailed practical interpretation of the rules that we assess as part of our review of the assumptions, inputs and processes used in the milk price calculation.

³ Sections 150U and 150Q of the Act.

⁴ Section 150P of the Act.

- X14 We have also previously signalled that we consider that it is appropriate to conduct a focused review of administrative and other overhead costs and also more generally of the allocation methodologies for deriving Notional Milk Price Business costs from Fonterra costs, where applicable, in our 2019/20 calculation review.⁵
- X15 In respect of the Manual's approach to asset stranding, we continue to consider that the best course of action is to monitor the asset stranding rules against real world behaviours for the time being, with a more substantive review to be included in the 2020/21 season after Fonterra's review of the specific risk premium.⁶

⁵ Commerce Commission "Review of Fonterra's 2018/19 base milk price calculation" (12 August 2019), paragraph 2.39.

⁶ 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 final conclusions of our review are set out in Chapter 2.
4. Minor technical and drafting amendments to the Manual, and our views on these, are set out in **Attachment A**.
5. Manual amendments that we proposed to Fonterra in prior reviews, and which we consider still outstanding, have been summarised in **Attachment B**.
6. A glossary of key terms is provided in **Attachment C**.
7. 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.⁷

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 statement of subpart 5A of the Act, as set out in s 150A of the Act.⁸
9. The Act requires Fonterra to provide us with the following information for consideration in our review:⁹
 - 9.1 the Manual for the current season;

⁷ Commerce Commission "Our approach to reviewing Fonterra's Milk Price Manual and base milk price calculation" (15 August 2017).

⁸ As required under s 150H and s 150I of the Act.

⁹ Section 150L of the Act.

- 9.2 any recommendations by the Milk Price Panel (**MPP**)¹⁰ in relation to the setting of the base milk price;¹¹
 - 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 2019/20 season (**Reasons Paper**) and has been considered as part of our review. Fonterra's Manual and the Reasons Paper can be found on our website.¹²
11. In addition to the information listed in paragraph 9, we considered the submissions we received on our draft report in reaching our final views.¹³

Scope of this review

12. We have focused our review on:
- 12.1 Fonterra's amendments to the Manual made since the 2018/19 review; and
 - 12.2 matters carried forward from previous reviews. These are:
 - 12.2.1 QOS; and

¹⁰ The MPP is a committee that Fonterra is required to establish and maintain under section 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 2019), page 26.

¹¹ 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 2019/20 Manual, all the recommendations by the MMP were implemented by the Board.

¹² Fonterra "Fonterra's Reasons Paper in support of Milk Price Manual for the 2019/20 season" (2019) at <https://comcom.govt.nz/regulated-industries/dairy/milk-price-manual-and-calculation/milk-price-manual>

¹³ These submissions can be found here: <https://comcom.govt.nz/regulated-industries/dairy/milk-price-manual-and-calculation/milk-price-manual/milk-price-manual-201920-season>.

12.2.2 materiality.

13. For those parts of the Manual that have remained unchanged from the 2018/19 Manual we have relied on our previous conclusions.
14. This review has been carried out following Fonterra's four-yearly review of the Manual to determine whether the Manual is satisfying (or could better satisfy) the Milk Price Principles (**Principles**).¹⁴ We have reviewed all of the changes to the Manual for the 2019/20 season, irrespective of the reasons why they have been made.
15. For the sake of clarity, this Principles four-yearly review is distinct from the periodic reviews of specific matters that are required by the Manual.¹⁵ For example, an independent reviewer is required to recommend an updated specific risk premium for the Weighted Average Cost of Capital (**WACC**), with the next update occurring for the 2020/21 season.¹⁶ As explained further at paragraph 19 below, we intend to undertake a more substantive review of the asset stranding rules in the 2020/21 season after Fonterra's review of the specific risk premium in that season.
16. In this report we have grouped issues in the following order:
 - 16.1 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).
 - 16.2 Minor amendments to the Manual of a technical or drafting nature (Attachment A).
 - 16.3 A summary of the Manual amendments we have proposed to Fonterra over the course of our milk price reviews which have not been adopted. Given the ongoing nature of our reviews we consider these issues to be of continuing relevance (Attachment B).

¹⁴ This review is required by Rule 5.4(d) of the Manual. The Milk Price Principles are contained in Fonterra's constitution, which requires the Manual to reflect the Milk Price Principles (see page 5 of the Manual).

¹⁵ These specific four-yearly reviews are set out in the definition of "Review Year" on page 89 of the Manual.

¹⁶ See Rule 42 of the Manual and the definition of "Review Year".

We will consider asset stranding in our 2020/21 Manual review

17. Asset stranding occurs when the reduction of milk supply results in the permanent removal of assets. Our focus has been how the Manual accounts for the capital costs of milk collection and processing in the event that the volumes of milk collected and processed by Fonterra were to remain static or permanently decline over time.
18. In our final report on the 2017/18 milk price calculation, we stated that we intended to monitor volume of milk collected by Fonterra for the purpose of determining whether a sufficiently large and consistent decline in milk volume might give rise to the permanent mothballing of plants and associated issues about the treatment of sunk costs in the calculation.¹⁷
19. In our final report on the 2018/19 Manual we concluded that the rules relating to asset stranding are consistent with the efficiency dimension and that the contestability dimension was satisfied due to the ‘safe harbour’ provisions in s 150B of the Act.¹⁸ In respect of whether asset stranding had occurred in light of lower than expected milk volumes for the previous two seasons, we concluded that the best course of action would be to monitor the asset stranding rules against real world behaviours for the time being with a more substantive review to be included in the 2020/21 season alongside Fonterra’s review of the specific risk premium.¹⁹
20. As part of our review of the 2018/19 milk price calculation, we reviewed changes that Fonterra made to the calculation assumptions to deal with the higher than expected milk volumes for the 2018/19 season. We confirmed in our report on the 2018/19 calculation that Fonterra had made appropriate adjustments to the milk price calculation to reflect the plant and site costs required to process the additional milk volumes.²⁰
21. We had previously stated in our approach paper setting out our proposed focus areas for our review of Fonterra’s 2018/19 calculation that we would look to include the

¹⁷ Commerce Commission “Review of Fonterra’s 2017/18 Milk Price Calculation – Final report” (14 September 2018), pages 14 & 15. At page 14 we made the distinction between Mothballing, which occurs when the reduction of milk supply results in the temporary removal of assets to reduce variable costs.

¹⁸ Commerce Commission “Review of Fonterra’s 2018/19 Milk Price Manual - Final report” (14 December 2018), paragraphs 56-70.

¹⁹ Commerce Commission “Review of Fonterra’s 2016/17 Milk Price Manual – Final report” (14 December 2016), paragraph 47.

²⁰ Commerce Commission “Review of Fonterra’s 2018/19 base milk price calculation” (12 August 2019), paragraph 2.106.

long-term issue of asset stranding in our review of the 2019/20 Manual, after Fonterra's four-yearly review of the Manual to determine whether it is satisfying (or could better satisfy) the Milk Price Principles. Our intention was to review any changes to the asset stranding rules that might have come out of this review. As there have been no changes to the rules that deal with asset stranding in the 2019/20 Manual, we continue to consider that the best course of action is to conduct a more substantive review in the 2020/21 season, alongside Fonterra's scheduled review of the specific risk premium.²¹

²¹ Commerce Commission "Proposed approach and focus areas for our review of Fonterra's 2018-19 base milk price calculation" (7 June 2019).

Chapter 2 Final conclusions

22. This chapter summarises our final conclusions on the extent to which the 2019/20 Manual is consistent with the s 150A purpose. Our overall final conclusion is that the 2019/20 Manual is largely consistent with the s 150A purpose.
23. There remain recommendations from previous reviews that we considered would better promote the purpose of the Act and provide greater confidence to interested parties through additional transparency that have not been addressed in the current Manual. These recommendations relate to:
- 23.1 actual FX rates assumed; and
 - 23.2 capacity of SPs.
24. These matters are discussed in Table B1.

Fonterra's amendments

Amended definitions of 'Standard Plant' and 'Standard Product Offering'

25. In the 2019/20 Manual, Fonterra amended the definitions of SP and SPO. The definition of SP has been amended to provide that these plants are suitable for the manufacture of a SPO. The definition of SPO has also been amended to delete the reference to "Can be manufactured in Standard Plants" from the list of required generic product specifications if the product is not sold on the Global Dairy Trade (GDT).
26. Fonterra commented that the amendment to SP was in response to Miraka's proposal, endorsed by the Commission,²² that Fonterra define a SP as "the [notional processor] plant which is designed to produce the GDT product range". Fonterra further stated that the amended definition effectively defines a SP as one which can be used to manufacture a SPO. Fonterra commented that the amendment to the definition of SPO was consequential on the amendment to the definition of SP, to avoid what would otherwise be a circular reference.²³

²² Commerce Commission "Review of Fonterra's 2018/19 Milk Price Manual - Final report" (14 December 2018), paragraph 15.

²³ Fonterra "Fonterra's reasons paper in support of the milk price manual for the 2019/20 season" (1 August 2019), page 2.

Our draft conclusion on the amended definitions of ‘Standard Plant’ and ‘Standard Product Offering’

27. In our draft report we concluded that these amendments improve clarity and are consistent with the s 150A purpose.

Submitter views & our response

28. Miraka submitted that Fonterra’s change to the definition of SP has resolved the circularity of the definition but this has not addressed Miraka’s key concern, which is that the definition of SPO that is able to be processed on SP remains open ended. Miraka asserts that while broad criteria for generic product specifications are provided these are wide or are based on self-referencing definitions, and do not establish a clear link between the definition of SP and ‘Standard Product’, such that the former defines and limits the latter (ie ‘Standard Product’ should be limited to what can be produced by a SP).²⁴
29. Miraka argues that Rule 25,²⁵ regarding the installation cost and specification of SP, limits manufacture to an ‘initial Reference Commodity Product’ which seems to refer to a singular product specification rather than the broad product range included in off-GDT sales. Therefore, the capital costs and characteristics of the SP may not provide for the additional plant and equipment and associated capital expenditure to manufacture the expanded range.²⁶
30. Instead, Miraka claims that Fonterra uses the IPC concept included in the Part C definitions of Milk Price Revenues in the Manual to adjust the selling price of products that the SP cannot manufacture to allow for the IPC the NP might incur if it did manufacture those products.²⁷
31. Miraka also questions whether the yields achieved by long production runs of single products can be achieved in real circumstances where the manufacture of a larger

²⁴ Miraka “Miraka submission to the Commerce Commission: Draft report (15 October 2019): Review of Fonterra 2019/20 Milk Price Manual” (15 November 2019), paragraphs 4 to 6.

²⁵ Fonterra “Farmgate milk price manual – Part A: overview” (1 August 2019), page 48.

²⁶ Miraka “Miraka submission to the Commerce Commission: Draft report (15 October 2019): Review of Fonterra 2019/20 Milk Price Manual” (15 November 2019), paragraphs 7 to 8.

²⁷ Miraka “Miraka submission to the Commerce Commission: Draft report (15 October 2019): Review of Fonterra 2019/20 Milk Price Manual” (15 November 2019), paragraphs 7 to 9.

range of products is disruptive and production is discontinuous across a seasonal milk curve.²⁸

32. In Miraka's view these issues raise the following general questions regarding the practical feasibility of Fonterra's product range and the inclusion of off-GDT reference prices for these products in the milk price calculation:
 - 32.1 Is it practically feasible for the NP plant as configured to manufacture the product range of QM?
 - 32.2 Are the production efficiencies assumed for the NP consistent with the range and scheduling of production for the full sales portfolio?
 - 32.3 Is it practically feasible to attribute selling prices to the NP using the IPC adjustments for products the NP cannot manufacture?
33. We agree that the absence of a clear limitation of what constitutes SPO may potentially give rise to the risk of new Reference Commodity Product (**RCP**) products being added without appropriate corresponding adjustments to plant and operating costs and yields where the products cannot be manufactured on a SP without modification.
34. The definition of QMs includes a product that is a SPO if its packaging format is 'Standard Packaging' and its manufacture does not require the use of 'Specialised Plant' (unhelpfully defined as plant which has material modifications from plant that manufactures SPO). A clear definition of SPO would therefore help to set the limits of the wider range of product that falls to be considered under the QMs definition and that can be manufactured on SP.
35. The narrower definition of QMs used to determine off-GDT 'Qualifying Reference Sales' (**QRS**) is provided by a schedule of QMs for each RCP, which the Milk Price Group (**MPG**)²⁹ is required to maintain.
36. This schedule therefore sets the limits of what product may be included in the milk price calculation. This schedule is the basis for considering whether plant cost, yield or other adjustments might be necessary to provide consistency between the product specification assumptions and other assumptions in the milk price calculation, including the costs of the plant as configured.

²⁸ Miraka "Miraka submission to the Commerce Commission: Draft report (15 October 2019): Review of Fonterra 2019/20 Milk Price Manual" (15 November 2019), paragraph 11.

²⁹ The Milk Price Group carries out the day-to-day administration of the Manual. Fonterra "Farmgate milk price manual – Part A: overview" (1 August 2019), page 27.

37. Testing the practical feasibility of the specified product range would therefore require a detailed review of this schedule and would need to be done at the level of our review of the base milk price calculation.
38. We note the existence of a formal process around the addition of new stock-keeping-units (**SKUs**) (albeit not set out in the Manual). This process addresses whether such SKUs should be considered QMs, with the addition or deletion of QMs then being audited by Fonterra's auditor.³⁰ We consider that the existence of this process helps to mitigate the risk that QMs are added without due consideration of other milk price calculation assumptions and inputs.
39. Given this formal process, and our analysis of product descriptions and off-GDT pricing in previous milk price calculation reviews, we do not have any reason to believe that the lack of clarity regarding the SPO definition has allowed material additions to the schedule of QMs of products which cannot be manufactured by the SP or which would introduce the need for yield (in relation to production efficiencies) or other adjustments including ICA.

Our final conclusion on the amended definitions of 'Standard Plant' and 'Standard Product Offering'

40. The existence of a formal process for making additions to QMs and our previous analysis of product descriptions and off-GDT pricing lead us to conclude that the rules regarding the definition of SP and SPO are not inconsistent with s 150A of the Act. Nonetheless, we encourage Fonterra to amend the definition of SPO so it is clear what range of standard specification can be manufactured using SP. We also consider that the removal of the circular reference in the definitions of SP and SPO improve clarity.
41. Given the importance of internal consistency to the assumptions, inputs and processes used in the milk price calculation, we will further examine in our 2019/20 review of the milk price calculation the process around adding products to the QMs schedule to confirm that only qualifying products are being added and appropriate adjustments are being made to other assumptions or inputs.
42. We may also examine in more detail the practical feasibility of the product range included in Fonterra's list of QMs.

³⁰ Commerce Commission "Review of Fonterra's 2018/19 base milk price calculation" (12 August 2019), paragraphs 2.91 to 2.92

Matters carried forward from previous reviews

Inclusion of ‘Qualifying Outlier Sales’

43. In our review of the 2018/19 Manual we undertook to seek clarification in our 2018/19 calculation review of what QOS comprise or are likely to comprise, and to identify whether they have had an impact on the selling prices of the NP.³¹
44. The definition of QOS allows for the re-inclusion in the milk price calculation of a sale of an RCP that had been excluded by the MPG under the definition of QRS on the basis that the price at which the contract for the sale was entered into did not reflect prevailing market prices.
45. Fonterra informed us that as a practical matter, the exclusion of sales is given effect in the milk price calculation by the application of non-automated review processes, such as contract pricing reviews by the MPG or internal/external audit. This non-automated process is adopted because the automated selection criteria applied to sales data does not incorporate any pricing threshold. If sales are excluded by this process the definition of QOS provides that the MPP may reverse an exclusion if, “on the balance of probabilities, the net impact of Fonterra undertaking the sale will be to result in a higher Farmgate Milk Price than would otherwise have been the case”. This will involve the exercise of commercial judgement.
46. Fonterra confirmed for the 2018/19 calculation review that the calculation solely reflected the application of automated criteria, thus there were no RCP sales excluded on the basis of any review of prevailing prices and hence no need for the MPP to decide whether to re-include sales under the definition of QOS.³² Therefore, for the 2018/19 milk price calculation, there was no impact of QOS on the sales prices of the NP.
47. As part of this year’s Manual review, we sought clarification regarding what QOS might comprise. We did this by requesting clarification on:
 - 47.1 how Fonterra would apply its discretion around including QOS; and

³¹ This was in response to Miraka’s submission. See Commerce Commission “Review of Fonterra’s 2018/19 Milk Price Manual - Final report” (14 December 2019), paragraph 16. Miraka “Miraka submission to the Commerce Commission: Draft report (15 October 2018): Review of Fonterra’s 2018/19 milk price manual” (16 November 2018), paragraph 1.7.

³² Commerce Commission “Review of Fonterra’s 2018/19 base milk price calculation” (12 August 2019), paragraph 2.95.

- 47.2 what level of pricing would not reflect 'prevailing prices' for the purpose of excluding a sale under the definition of QRS.
48. Fonterra has confirmed that it always includes a sale in the milk price calculation where it satisfies the inclusion criteria in the definition of QRS, as required by the definition of QRS.
49. Fonterra has further explained that when the QOS definition was introduced, it was envisaged that certain sales that would otherwise satisfy the QRS definition criteria might be rejected where the MPG considered the price was too far 'below market' to be included in the milk price calculation. In those circumstances the QOS definition would allow the MPP to form a different view and re-include these sales, using information that may not have been considered relevant by the MPG, including wider market considerations.³³
50. Fonterra has provided the following explanation for why sales at 'below market prices' might be included because they would have a net impact of increasing the milk price. Fonterra explained that the QOS definition was designed to deal with market dynamics and attitudes that existed in 2008/09, when demand and prices were spiralling downwards, which are unlikely to be present today. In these circumstances, it might be possible to accept sales that are below prevailing market prices that nonetheless result in a higher milk price than would otherwise the case. This is because the market is not aware of the terms and conditions of the sale and therefore the sale will not send pricing signals that will encourage the downward spiral.
51. Fonterra has stated that the rules were drafted specifically with below market prices in mind, but has acknowledged that the exclusion of non-prevailing price sales under the definition of QRS is agnostic between high and low prices.
52. Fonterra notes that the QOS definition has not been exercised since 2009/10 and, given the Manual's definition of QRS and the interplay with the QOS definition, situations where the QOS definition would apply would be highly unusual and infrequent.
53. Fonterra has also confirmed that sales are deemed to be at prevailing prices as long as internal approval processes and delegated authorities have been complied with.

³³ Fonterra explained that, at the time this provision was introduced, GDT was a newly developed platform which only sold WMP on a monthly basis, which meant that Fonterra did not have GDT-based references for market prices for other RCPs.

Our draft conclusion on the 'Qualifying Outlier Sale' rule

54. Our draft decision was that we were comfortable in light of Fonterra's explanation of the purpose and context to be applied to the interpretation and application of this rule that it does not provide Fonterra any effective discretion to increase the milk price in other than the rare situation where a sale at below prevailing prices would have the effect of increasing the milk price, thereby justifying its re-inclusion. In practice, the QRS rule and automated selection criteria operate to include all arms-length RCP sales where the contract complies with the relevant Fonterra Risk Management Policy. Therefore, our draft conclusion was that the QOS definition, in conjunction with the QRS definition, is consistent with the contestability and efficiency dimensions set out in s 150A of the Act.

Submitter views & our response

55. Miraka questioned the purpose of the QOS rule as explained by Fonterra. Miraka also submitted that Fonterra did not apply any 'prevailing prices' filter to QRS in 2018/19. Consequently, there were no sales rejected on the basis of price and no reason to consider any sales as QOS.³⁴
56. Miraka has requested that we consider:³⁵
- 56.1 the wider implications of the failure to apply the QOS rule;
 - 56.2 whether the treatment of individual sales that are 'tender and formulaic sales', is consistent in the milk price calculation; and
 - 56.3 whether 'tender and formulaic sales' as a group, are appropriately excluded from QOS.
57. 'Tender and formulaic sales' are sales that are excluded from off-GDT pricing as demonstrated by Fonterra's decision tree as set out at Figure 1 below. The decision tree describes the process/decision points for determining product to be included in the milk price calculation.³⁶ Miraka submitted that 'tender and formulaic sales' are

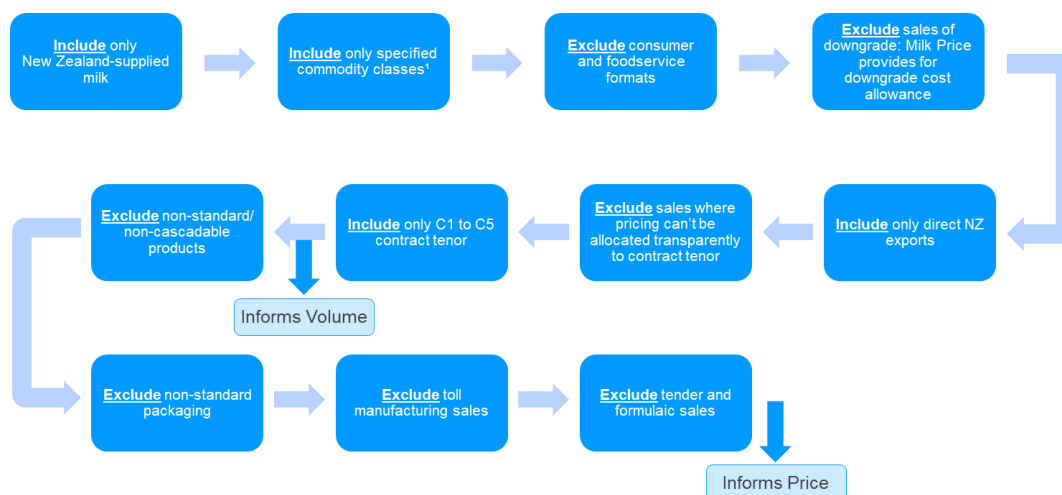
³⁴ Miraka "Submission to the Commerce Commission: Draft Report (15 October 2019): Review of Fonterra 2019/20 Manual" (15 November, 2019), paragraph 19.

³⁵ Miraka "Submission to the Commerce Commission: Draft Report (15 October 2019): Review of Fonterra 2019/20 Manual" (15 November, 2019), page 5.

³⁶ Commerce Commission "Review of Fonterra's 2018/19 Milk Price Calculation – Final report" (12 August 2019), Figure 2.1.

those that would most likely be reinstated into pricing under the QOS rule, but are excluded before they can be considered for re-inclusion.

Figure 1 Off-GDT milk price decision tree – Product to be determined in milk price calculation



58. With reference to materiality, Miraka further submitted that the failure to provide clear criteria for ‘prevailing prices’ means that “the door remains wide open for including any and every sale which Fonterra wishes as an off-GDT sale.”³⁷ This would have the effect of inflating the milk price.
59. We have previously expressed our view that the use of off-GDT pricing for RCPs is consistent with pricing outcomes that could be achieved by an efficient NP in arms-length transactions in international markets. We have also stated that given this position, the key question regarding practical feasibility of off-GDT pricing is whether the inclusion criteria for RCP sales are appropriate and have been applied consistently from season to season.³⁸
60. In respect of Miraka’s concern regarding whether ‘tender and formulaic sales’ are appropriately excluded from QOS, our understanding is that tender sales, including (for example) government tender sales, are excluded on the basis that they are not transacted in freely contestable markets. This is in accordance with Principle 2 of the Manual which outlines that the Farmgate Milk Price should be the maximum amount Fonterra could pay if Fonterra processed that milk into commodity products which

³⁷ Miraka “Submission to the Commerce Commission: Draft Report (15 October 2019): Review of Fonterra 2019/20 Manual” (15 November, 2019), paragraph 27.1.7.

³⁸ Commerce Commission “Review of Fonterra’s 2018/19 Milk Price Calculation - Final report” (12 August 2019), paragraphs 2.99-2.100.

were sold on freely contested global markets.³⁹ We also understand that formulaic sales are excluded on the basis that they are subject to formulaic pricing rather than spot pricing mechanisms.

61. Nonetheless, we agree with Miraka’s concerns about the lack of clarity regarding ‘tender and formulaic sales’. We agree that a clarification of what sales constitute ‘tender and formulaic sales’ and also what conditions apply to sales that are not considered to be transacted on freely contestable markets would both assist to explain why specific transactions of this type are excluded from the milk price calculation.
62. While we note Fonterra’s assertion that sales are deemed to be at ‘prevailing prices’ as long as internal approval processes and delegated authorities have been complied with, we consider that Fonterra should provide an explanation of what ‘prevailing prices’ means, so that it is clear when sales are not considered to be at ‘prevailing prices’ and can therefore be excluded under the QRS definition. We consider that this clarification will address Miraka’s concern regarding the wider implications of the failure to apply the QOS rule as the QOS rule will not be applied if sales are at ‘prevailing prices’.

Our final conclusion on the ‘Qualifying Outlier Sale’ rule

63. We consider that the QOS rule is consistent with s 150A of the Act given that the rule does not provide Fonterra any effective discretion to increase pricing in a way that would undermine the contestability dimension of s 150A.
64. Although we consider the QOS rule is consistent with s 150 of the Act, we encourage Fonterra to provide clarification of what constitutes ‘tender and formulaic sales’ and an explanation of the circumstances applying to transactions that are not considered to be conducted in freely contestable markets. We will review how these rules have been interpreted in practice for the purpose of our 2019/20 review of the milk price calculation, including whether the treatment of individual sales that are ‘tender and formulaic sales’, is consistent in the milk price calculation. We also encourage Fonterra to provide an explanation of what ‘prevailing prices’ means as a basis for potential exclusions to be considered under the QOS rule.

³⁹ Fonterra “Farmgate milk price manual – Part A: Overview” (1 August 2019), page 9.

Materiality

65. In our review of the base milk price calculation for 2016/17, we expressed concern that the Manual does not define:⁴⁰
- 65.1 what is considered a ‘material change’ when considering a change to the Manual; and
 - 65.2 the timeframe for making such a change.
66. Fonterra has previously stated that it will disclose any change in approach that results in a materially different value of an input used to calculate the Farmgate Milk Price.⁴¹ Fonterra has also previously advised that not setting a materiality measure is intentional and that this enables additional discretion to disclose changes irrespective of whether there is a material impact on the calculation.⁴² Fonterra maintains that a ‘bright line’ materiality threshold is likely to lead to less disclosure.⁴³
67. We do not believe that a materiality threshold applied in respect of making changes need then 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.
68. In our review of the base milk price calculation for 2018/19 we signalled that we intend to address materiality considerations as they apply to Manual changes in this Manual review.⁴⁴

Materiality for considering changes to the Manual

69. As part of this year’s Manual review, we asked Fonterra to explain its materiality threshold/decision making criteria applied when considering changes to the Manual. Fonterra has explained that because of the nature of the changes it has made to the

⁴⁰ Commerce Commission “Review of Fonterra’s 2016/17 Milk Price Manual – Final report” (14 December 2016), paragraph 59.

⁴¹ Fonterra “Fonterra’s reasons paper in support of the milk price manual for the 2016/17 season” (1 August 2016), page 6.

⁴² Commerce Commission “Review of Fonterra’s 2016/17 Milk Price Manual – Final report” (14 December 2016), paragraph 60.

⁴³ Fonterra “Fonterra’s reasons paper in support of the milk price manual for the 2019/20 season” (1 August 2019), page 4.

⁴⁴ Commerce Commission “Review of Fonterra’s 2018/19 Milk Price Manual - Final report” (14 December 2018), paragraph 2.56.3.

Manual, it has not needed to formally consider the nature of any materiality threshold.

70. Fonterra has advised that since 2014, changes to the Manual were intended to address matters raised by the Commission and have arisen in order to:
- 70.1 improve transparency by:
 - 70.1.1 making a rule more explicit, for example, the 2016/17 amendment to the then Rule 14 relating to the calculation of repairs and maintenance costs;
 - 70.1.2 codifying Fonterra's position regarding disclosure, for example, the 2014/15 inclusion of undertaking to disclose in the Milk Price Statement material changes in the calculation methodology; or
 - 70.1.3 making a rule more prescriptive, for example, the 2014/15 amendment to the definition of "Benchmark Selling Price", to make it explicit that only sales contracted up to and including five months before shipment would be included in milk price revenue.
 - 70.2 amend process requirements. For example, the 2015/16 amendment to Rule 6 brought sales costs into the scope of the four-yearly overheads reset review;
 - 70.3 address matters where the Manual was incomplete. For example:
 - 70.3.1 a rule was added to the Manual for 2015/16 relating to non-recurring costs, noting that this rule codified existing practice; and
 - 70.3.2 a specific risk premium was added to the WACC, in 2014/15 to address the Commission's position that the WACC did not adequately compensate for all forms of risk.
 - 70.4 better align a rule to provisions under the Act. For example, the 2015/16 amendment to Rule 3 provided that amendments to the basket of RCPs should occur only when this can be expected to result in a higher milk price, consistent with s 150C(2)(b)(i);
 - 70.5 better align the Manual with the Milk Price Principles and Fonterra's Constitution. The only amendment to the Manual under this key driver was the 2016/17 re-inclusion of off-GDT sales of WMP, SMP and AMF in the milk price; and
 - 70.6 correct errors, such as incorrect cross references.

71. In respect of the re-inclusion of off-GDT sales of WMP, SMP and AMF in the Milk Price, Fonterra has informed us that the primary purpose of this change was to better align the calculation of the milk price to the Milk Price Principles.⁴⁵

Our draft conclusion on materiality

72. Fonterra's explanation suggests that there are many situations whereby changes can be made to the Manual that do not give rise to costs through the milk price. It is not clear, however, what materiality considerations would apply to a decision that may have a cost or revenue impact or to a decision that no change is needed.
73. Our draft view was that it would improve transparency if the Manual defined a threshold or set of criteria that would be used by Fonterra to categorise amendments to the Manual (for example, improvements in transparency, addressing matters where the Manual was incomplete and correction of errors), but Fonterra otherwise retained the discretion to make any changes to the Manual.
74. Therefore, our draft conclusion was that disclosure of what constitutes a 'material change' in this context will provide greater transparency.⁴⁶

Submitter's views & our responses

75. Miraka submitted that the Manual amendment made in 2016/17 to re-include off-GDT sales in the milk price was a major policy change and that the absence of any materiality standards meant that Fonterra was not and still is not accountable for this major policy change without explanation or meaningful justification.⁴⁷
76. Miraka agrees that disclosure of what constitutes a material change will provide greater transparency. However, in Miraka's view the damage incurred as a result of this change must be addressed by way of a full review of the way in which off-GDT

⁴⁵ This was noted in Fonterra's NZX release at the time. The media release stated the change was required to meet "Fonterra's Constitutional requirement to pay the maximum sustainable Milk Price and regulatory requirements to pay an efficient, competitive Milk Price." This media release can be found here: <https://www.nzx.com/announcements/286479>

⁴⁶ Commerce Commission "Review of Fonterra's 2018/19 Milk Price Manual – Final Report" (14 December 2018), page 24. We note that Fonterra has provided comments on their view of materiality in terms of subpart 5A of the Act. These comments can be found here: https://comcom.govt.nz/_data/assets/pdf_file/0024/173823/Fonterra-Submission-on-review-of-Fonterra-base-milk-price-calculation-draft-report-2-September-2019.pdf

⁴⁷ Miraka "Miraka submission to the Commerce Commission: Draft report (15 October 2019): Review of Fonterra 2019/20 Milk Price Manual" (15 November 2019), page 11.

sales and associated changes in the NP business model have been included in the Milk Price Calculations.⁴⁸

77. We note that in our 2016/17 Manual review report we acknowledged that the amendment to re-include off-GDT sales in the milk price had a material impact on the industry.⁴⁹ We reviewed this amendment in our 2016/17 Manual and milk price reviews and concluded that the inclusions of off-GDT prices for WMP, SMP and AMF in the Manual were consistent with s 150A of the Act.⁵⁰
78. Fonterra submitted that in recent years it has not made any amendments with a primary (or sole) purpose of changing the quantum of costs or revenue provided for in the milk price. Consequently, it has not had cause to consider the relevant materiality considerations, and do not consider it desirable to attempt to codify potential materiality considerations in the abstract. Fonterra considers that it is likely that all future changes to the Manual will be for one of the purposes listed in paragraphs 70 to 71 and since the factors underpinning the decisions to make the changes are qualitative, it does not believe it would be feasible (or helpful) to articulate the associated materiality principles.⁵¹
79. We do not consider that Fonterra is likely to make changes to the Manual simply for the purpose of changing the quantum of costs or revenue provided for in the milk price. Rather, we consider that materiality is a cost-benefit assessment that assists with decisions about whether changes should be made. We also consider that it may include both qualitative and quantitative factors.

Our final conclusion on materiality

80. Our final conclusion is that disclosure of what constitutes a ‘material change’ in this context will provide greater transparency.

Other Manual matters raised by submissions

81. In our draft report, we stated that we have relied on our previous conclusions for those parts of the Manual that had not changed since previous reviews. We

⁴⁸ Miraka “Miraka submission to the Commerce Commission: Draft report (15 October 2019): Review of Fonterra 2019/20 Milk Price Manual” (15 November 2019), page 12.

⁴⁹ Commerce Commission “Review of Fonterra’s 2016/17 Milk Price Manual - Final report” (14 December 2016), paragraph 45.

⁵⁰ Commerce Commission “Review of Fonterra’s 2016/17 Milk Price Calculation - Final report” (15 September 2017), paragraph 2.104.

⁵¹ Fonterra “Submission on the Commission’s draft report on its review on Fonterra’s 2019/20 milk price manual” (November 2019), page 3.

welcomed submitters views on our previous conclusions and signalled that we are particularly interested in material relating to any new information that would warrant further consideration of previous conclusions.

82. We have addressed submitter’s views on substantive matters below. Overall, we do not consider there is sufficient reason to warrant changing our previous conclusions, however we have noted some areas that we will consider in determining the scope of our 2019/20 milk price review.

Granularity of NP capacity planning assumptions and collection costs

83. In the 2018/19 milk price calculation review report we confirmed that plant capacity is matched on a North Island/South Island basis to peak supply.⁵² Miraka submitted that this confirmed its suspicion that the NP treats installed manufacturing capacity as geographically unanchored, so it is therefore assumed that an infinitely flexible resource is available to process any milk supplied in each relevant island. Miraka submits that this cannot be practically feasible.⁵³ We concluded on this matter in our 2012 dry run review and 2012/13 milk price reviews.⁵⁴ We do not consider that there is any new information that requires us to revisit our previous conclusions, however for completeness we have summarised our previous conclusions below.
84. In Miraka’s view, a real world processor of the scale of the NP would retain more redundant capacity than for the ‘unanchored’ plants assumed for the NP and that the

⁵² Commerce Commission “Review of Fonterra’s 2018/19 Milk Price Calculation - Final report” (12 August 2019) , page 34.

⁵³ Miraka “Miraka submission to the Commerce Commission: Draft report (15 October 2019): Review of Fonterra 2019/20 Milk Price Manual” (15 November 2019), page 6.

⁵⁴ Prior to the Act being passed into law, the Minister for Primary Industries requested we conduct a non-statutory dry run review of Fonterra’s 2011/12 methodology for setting the FGMP and Fonterra’s application of that methodology. The purpose of the dry run review was to provide increased investor certainty ahead of Fonterra potentially launching Trading Among Farmers, In particular, this report was to show how the monitoring regime would work in practice. Commerce Commission “Report on the dry run review of Fonterra’s farm gate milk price – Final report,” (27 August 2012), paragraph A12.49. This document can be found here: https://comcom.govt.nz/_data/assets/pdf_file/0027/60939/Final-Report-on-the-Dry-Run-Review-of-Fonerras-Farm-Gate-Milk-Price-27-August-2012.pdf

Commerce Commission “Review of Fonterra’s 2012/13 Milk Price Calculation - Final report” (16 September 2013), paragraph J16.

NP would only mothball plants in the event Fonterra itself has actually mothballed a plant of equivalent scale and location.⁵⁵

85. In our 2012 dry run review draft report we noted that there could be a potential inconsistency between Fonterra’s approach for setting the number and location of SPs, and the relevant operating costs (for example collection costs). This is because Fonterra adds SPs into the milk price model to meet peak milk supply requirements at the level of the North and South Islands, rather than at the regional, manufacturing site specific level, and the incremental number of SPs is implicitly optimised for each island.
86. Fonterra submitted that the inference that the incremental number of SPs is implicitly optimised was incorrect. Fonterra explained that it makes its incremental capacity decisions by reference to a comparison of forecast peak supply to existing capacity across the entire North Island and South Island, respectively, so the approach employed in the model is consistent with the approach employed in practice.⁵⁶
87. We concluded that the fixed asset base costs were practically feasible and reflected assumptions that can be achieved by an efficient processor, including Fonterra.⁵⁷
88. As it was not in scope, we carried forward to our 2012/13 milk price calculation review the question of whether Fonterra’s actual operating costs, in particular collection costs (which are reflective of the regional, manufacturing site specific plant locations) should be adjusted upward to reflect this potential optimisation.⁵⁸
89. Fonterra’s subsequent response was that the NP’s allowance for site overhead costs and site capital reflected an assumption that the number and location of manufacturing sites are the same as those Fonterra actually maintains. Fonterra also

⁵⁵ Miraka “Miraka submission to the Commerce Commission: Draft report (15 October 2019): Review of Fonterra 2019/20 Milk Price Manual” (15 November 2019), page 7.

⁵⁶ Commerce Commission “Report on the dry run review of Fonterra’s farm gate milk price – Final report,” (27 August 2012), paragraph A12.13.

⁵⁷ Commerce Commission “Report on the dry run review of Fonterra’s farm gate milk price – Final report,” (27 August 2012), paragraph A12.55.

⁵⁸ Commerce Commission “Report on the dry run review of Fonterra’s farm gate milk price – Final report,” (27 August 2012), paragraph A12.49.

submitted that the annual volumes of milk processed on each site by the NP are materially aligned to the volumes actually processed by Fonterra.⁵⁹

90. Fonterra accepted, however, that a level of over-optimisation of collection costs might occur if Fonterra's actual incremental plants had a materially smaller processing capacity than the NP's assumed incremental plant's capacity. If this were the case, Fonterra could, for example, add two plants each on a separate site, while the NP might be assumed to have added only one plant. In this case, the assumed incremental collection costs of the NP would be lower than those achieved by Fonterra in terms of its actual incremental collection costs.
91. However, Fonterra stated that the opposite situation had occurred in practice. Since 2009, the NP had at that time been assumed to have added four incremental plants, each with a daily capacity of 1.95m litres, whereas Fonterra had actually added two incremental plants, with approximate capacity of 4.5m litres and 2.4m litres, respectively. Fonterra therefore submitted that there was an immaterial degree of under-optimisation in the collection costs calculation.⁶⁰
92. We accepted Fonterra's explanation and considered that the assumed collection costs in the base milk price calculation were not over-optimised.⁶¹
93. Also with respect to collection costs, Miraka submitted that the NP production programme is fundamentally different to that of Fonterra, and that in order to confirm the NP practical feasibility of milk collection and transport costs, there needs to be a comparison of Fonterra's actual milk processing by factory location and across the season, with the assumed NP milk processing at the same level of granularity. Miraka submitted that this would confirm whether it is feasible to rely on Fonterra's actual milk transport costs.⁶²
94. We note that there is a practical constraint in completing a review of this nature since the lack of specification of plant site locations means the geographical profile of

⁵⁹ Commerce Commission "Review of Fonterra's 2012/13 Milk Price Calculation - Final report" (16 September 2013), paragraph J16.

⁶⁰ Commerce Commission "Review of Fonterra's 2012/13 Milk Price Calculation - Final report" (16 September 2013), paragraph J17.

⁶¹ Commerce Commission "Review of Fonterra's 2012/13 Milk Price Calculation - Final report" (16 September 2013), paragraph J18.

⁶² Miraka "Miraka submission to the Commerce Commission: Draft report (15 October 2019): Review of Fonterra 2019/20 Milk Price Manual" (15 November 2019), page 8.

the assumed asset base is unable to be checked for consistency with, for example, collection costs.⁶³

95. We have also previously accepted the use of Fonterra's actual collection costs on the basis that it would be unreasonably costly to independently model the 'volume' drivers of Fonterra's collection costs (primarily kms travelled & average kms travelled per hour) and (in respect of the actual Fonterra costs) we had no reason to believe the use of Fonterra's sophisticated fleet management software produced sub-optimal results.⁶⁴

Disclosure of actual FX rates

96. Dairy Analytics submitted that Fonterra has taken active steps to reduce transparency around its foreign exchange hedging practices. Dairy Analytics stated that details regarding foreign exchange hedging practices were removed from the 2019 Farmgate Milk Price Statement compared to previous Farmgate Milk Price Statements.⁶⁵
97. Fonterra has provided the equivalent disclosure to previous years in Appendix 9.⁶⁶

Review of asset stranding

98. Miraka has sought clarification of when the signalled review of asset stranding will occur.⁶⁷
99. As stated in our draft report and in paragraphs 17 to 21 above, we will conduct a more substantive review of asset stranding in the 2020/21 season after Fonterra's review of the specific risk premium.

⁶³ Commerce Commission "Report on the dry run review of Fonterra's farm gate milk price – Final report," (27 August 2012), paragraph A12.57

⁶⁴ Commerce Commission "Review of Fonterra's 2012/13 Milk Price Calculation - Final report" (16 September 2013), paragraphs J11 to j13.

⁶⁵ Dairy Analytics "Submission on draft review of Fonterra's 2019/20 Milk Price Manual" (8 November 2019), page 1.

⁶⁶ Fonterra "Fonterra Farmgate Milk Price Statement" page 17.

⁶⁷ Miraka "Miraka submission to the Commerce Commission: Draft report (15 October 2019): Review of Fonterra 2019/20 Milk Price Manual" (15 November 2019), paragraph 24.5.

Submissions on milk price calculation matters

Mothballed plants

100. Miraka submitted that it could detect no discernible material effect of the assumption that lactose standardising had been reduced to cope with the shortfall of peak production processing capacity in 2018/19 and asserts that we did not address the issue of the costs of mothballed plants being properly accounted for in our final report on the 2018/19 milk price calculation.
101. Our review of the yields calculation for 2018/19 confirmed that the milk collected reconciled with the tonnes of RCP product processed after allowing for the reduction in lactose standardising during the peak capacity shortfall.
102. We also confirmed that the fixed site costs for mothballed plant were appropriately taken into account in the milk price calculation.

Notional producer selling costs

103. Miraka submitted that the higher selling costs attributed to Fonterra's Global Ingredients and Operations businesses by comparison with those of the NP in our 2015/16 review of the milk price calculation, means that with the subsequent expansion of the global off-GDT selling platform, it could be reasonably expected that the NP selling costs would have increased towards the \$0.16/KgMS achieved by Fonterra's actual business. Instead they have fallen to \$0.07/KgMS. Miraka requests that we revisit our previous conclusion about the feasibility of NP selling costs.
104. We reviewed off-GDT selling costs during our 2016/17 review of the milk price calculation, after the Milk Price Manual change to include off-GDT pricing for WMF, SMP and AMF and concluded the costs were practically feasible.⁶⁸
105. Given concerns about internal consistency with respect to product specification that Miraka has expressed above, we will re-examine the selling costs for off-GDT QMs during our review of the 2019/20 milk price calculation.

Excluding gains and losses from the foreign exchange hedging

106. Dairy Analytics invited us to consider excluding the gains and losses from foreign exchange hedging from the calculation of the milk price.⁶⁹

⁶⁸ Commerce Commission "Review of Fonterra's 2016/17 Milk Price Calculation - Final report" (15 September 2019), paragraph 2.104.

⁶⁹ Dairy Analytics "Submission on draft review of Fonterra's 2019/20 Milk Price Manual" (8 November 2019, page 1.

107. We continue to suggest there should be more transparency of information on the actual FX rates assumed to be achieved by the NP. However, s 150B(c) of the Act states that gains and losses experienced by Fonterra resulting from foreign currency fluctuations do not detract from the achievement of the purpose set out in s 150A.

Attachment A Final conclusions on minor amendments

108. This attachment highlights minor technical and drafting changes made by Fonterra.

Table A1 Summary of minor technical and drafting changes

Manual reference	Amendment	Fonterra comment in Reasons Paper	Submitter's views	Commission comment
Various pages	Cross references update	Amendments were made to correct cross references.	We received no submissions on this change.	We consider that these are the correction of errors.
p.61	The definition of sales cost has changed from "for a <i>month</i> , the amount calculated under Rule 17" to "for a <i>Season</i> , the amount calculated under Rule 17".	No comment in the Reasons Paper.	We received no submissions on this change.	We consider that this is the correction of an error.

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. For the continuity of our reviews and consideration of future submission points, we consider this to be a valuable summary for all interested parties.
- B2 We consider that these outstanding amendments would provide greater confidence to interested parties through additional transparency.
- B3 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	Category	First raised by the Commission	Previous Commission conclusion ⁷⁰	Description of issue	Fonterra reasoning ⁷¹	Submitter's views	Final conclusion
N/A	Farmer support	2015/16 calculation review	We conclude that Fonterra should include the costs of providing shareholder support to ensure continued supply to be consistent with the contestability dimension.	Financing and associated administration costs of providing farmer support loans and costs of providing other mechanisms of farmer support.	Fonterra has not changed its previous position that it is not appropriate to fund these costs from the Milk Price.	Fonterra submitted that the loans provided under the farmer support programme have all been repaid and the scheme is no longer operational.	We no longer consider that this is an open issue.

⁷⁰ Our previous conclusions in these areas from prior reviews. These reports can be found at <http://www.comcom.govt.nz/regulated-industries/dairy-industry/review-of-fonterra-s-farm-gate-milk-price-and-manual/>.

⁷¹ Fonterra "Fonterra's Reasons Paper in support of Milk Price Manual for the 2019/20 season" (2019) at <https://comcom.govt.nz/regulated-industries/dairy/milk-price-manual-and-calculation/milk-price-manual>

Manual reference	Category	First raised by the Commission	Previous Commission conclusion ⁷⁰	Description of issue	Fonterra reasoning ⁷¹	Submitter's views	Final conclusion
Part A, Section 2.6	Consistency over time - disclosure requirement	2016/17 Manual review	No consistency issue; however, we consider such disclosure would provide greater transparency.	We consider the Manual should outline what is considered a 'material change' when considering a change to the Manual and specify the timeliness of making such a change in order to set a minimum level for disclosure of changes.	Fonterra has not changed its previous position for reasons explained on page 5 of their submission on our F17 Draft Manual Report (a 'bright line' materiality threshold is likely to lead to less disclosure).	See chapter 2 discussion on materiality.	No s 150A consistency issue; however, we continue to consider such disclosure would provide greater transparency.

Manual reference	Category	First raised by the Commission	Previous Commission conclusion ⁷⁰	Description of issue	Fonterra reasoning ⁷¹	Submitter's views	Final conclusion
Part B, Rule 26	Capacity of SPs	2016/17 Manual review	We recommend Fonterra considers disclosing its plant capacity for both primary and secondary plants in the Manual early in each season to provide certainty of the NP' 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.	We recommend that Fonterra considers disclosing its plant capacity for both primary and secondary plants in the Manual. This earlier disclosure should provide increased transparency of the assumed capacity of the NP for the season. We consider Fonterra's latest amendment still allows a significant level of discretion.	Fonterra has not changed its previous position that it does not consider the Manual is the appropriate vehicle for these disclosures. Fonterra outlines that it has previously put this information into the public domain, including in the F19 Base Milk Price Reasons Paper, and the relevant assumptions will not be revisited until F20, with any changes not taking effect until F21.	N/A	See previous Commission conclusion.

Manual reference	Category	First raised by the Commission	Previous Commission conclusion ⁷⁰	Description of issue	Fonterra reasoning ⁷¹	Submitter's views	Final conclusion
N/A	Actual FX rates assumed	2016/17 Manual review	We suggest there should be more transparency of information on the actual FX rates assumed to be achieved by the NP.	We consider there should be more transparency of information on the actual foreign exchange rates assumed to be achieved by the NP. We suggest providing an average FX conversion rate assumed to be achieved by the NP throughout the season.	Fonterra considers that this matter is outside scope of Manual. ⁷²	Dairy Analytics submits that Fonterra has taken active steps to reduce transparency around their foreign exchange hedging practices. Dairy Analytics also invites the Commission to consider excluding gains and losses from foreign exchange hedging from the calculation of the milk price.	We continue to suggest there should be more transparency of information on the actual FX rates assumed to be achieved by the NP. However, s 150B(c) of the Act states that gains and losses experienced by Fonterra resulting from foreign currency fluctuations do not detract from the achievement of the purpose set out in s 150A.

⁷² Although outside of the scope of the Manual and a safe harbour under the Act, we consider the disclosure of the assumed rates would promote the purpose of the Act. We note this does not affect our ability to conclude on the Manual.

Attachment C Glossary

Term/Abbreviation	Definition
AMF	Anhydrous milk fat
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	Global Dairy Trade, Fonterra's online auction platform used to sell commodity products
IPC	Incremental Product Cost
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
NP	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
SP	Standard Plant
SPO	Standard Product Offering
The Act	Dairy Industry Restructuring Act 2001
WMP	Whole milk powder