

SUBMISSION

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To: Commerce Commission

Submission on: ACQUISITION OF NZ DAIRIES LTD BY FONTERRA

From: Federated Farmers of New Zealand

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SUBMISSION

ACQUISITION OF NZ DAIRIES LTD BY FONTERRA

1. FEDERATED FARMERS SUBMISSION

- 1.1. Federated Farmers welcomes the opportunity to submit to the Commerce Commission (the Commission) on the acquisition of NZ Dairies Limited (NZDL) by Fonterra.
- 1.2. We applaud Fonterra for its role in picking up milk from farmers who supply failed business ventures, as seen in 2010 with NZ Organic Dairy Co-operative. There is no obligation for it to do so, but it does so in the interests of farmers, cows, the environment and Fonterra itself.
- 1.3. The fact that on this occasion it has decided to buy NZDL is of little interest to Federated Farmers aside from the fact that the dairy industry needs a strong, single player to lead the whole dairy industry.
- 1.4. Federated Farmers supports the right of dairy farmers to supply a processor of their choice. While not every farm has this choice close at hand, modern transport options (rail, modern tankers, adequate standard of roads) make this option viable for many farmers.
- 1.5. The farmers who chose to supply NZDL did so for a variety of reasons and the close proximity of its factory was just one of the criteria.
- 1.6. The placing of NZDL into receivership has left its farmer suppliers facing what could easily have been a disaster, given that once the dairy season commences, cows need milking everyday and milk is a perishable good. They were also owed money for milk supplied last season.
- 1.7. Fonterra has handed these farmers a lifeline, but it comes at a price, and Federated Farmers believes that this price was achieved by giving the farmers no choice, or Hobson's choice.
- 1.8. Fonterra has agreed to buy the plant, subject to approval by the Commission, on the basis that:
 - All (100 percent) of NZDL suppliers sign up with Fonterra
 - For the current season (2012/13), suppliers will get 10c per kg milksolids (/kgMS) less than the Fonterra farm gate price (FFGP)
 - For the following three years, any unshared supply will be 5c/kgMS less than other Fonterra suppliers with unshared milk
 - Year five will be as per the normal growth contract for all shareholders
 - All farmers must be fully shared up by year six
 - Farmers can start sharing up from next season, but are not allowed to buy any shares this season

- All farmers are locked into a seven year contract
- 1.9. In return, Fonterra has undertaken to pay all the suppliers the money they are owed.
 - 1.10. This is a business decision and does offer farmers a good deal, given that they broke away from the co-operative or chose to supply NZDL from the start of their own business.
 - 1.11. However, the Federation would like to highlight three of these conditions: every farmer or none; inability to start sharing up now; and a seven year contract.
 - 1.12. **Every farmer or none.** The prospect of these farmers recouping all the money owed them has given Fonterra considerable leverage. While many did very well supplying NZDL (due to the milk price being within 10 cents of Fonterra's own milk price without the need to buy shares to supply NZDL), the thought that they could only get their money back if they brought every farmer to Fonterra has led to farmer being pitted against farmer.
 - 1.13. Federated Farmers is fully aware that not many creditors of failed ventures get their money back, so these farmers have been very fortunate that Fonterra is choosing to do this. However, this will not cost Fonterra or its shareholder base any money in the long run as they will recoup this outlay from these farmers even with a low milk payout.
 - 1.14. **Inability to buy shares now.** Many of these farmers are concerned that with the advent of Trading Among Farmers (TAF), the price of Fonterra shares will increase dramatically. They would like the option to start buying shares this season. Finding the money this season will be no more or less difficult than finding the money to buy the shares over the next six seasons. It also gives Fonterra access to this capital sooner rather than later.
 - 1.15. **Locking farmers in to supplying Fonterra for seven years.** This obligation is severe. It gives Fonterra security that the factory will be used to capacity but given there are a number of options to fill this factory up, as stated in Fonterra's own application (Notice seeking clearance 6 July, section 10.7, 10.8 and 10.9) this should not matter.
 - 1.16. Farmers will have no choice over who they can supply for this extensive period, unless they break the contract, which will not be easy.
 - 1.17. **DIRA.** Federated Farmers argues that farmer choice of whom to supply is what the Dairy Industry Restructuring Act (DIRA) is all about. There are a number of processors that farmers could choose to supply in this catchment: Synlait and Westland Co-operative Dairy Ltd are within 180km, or further afield lie OCD and Gardian, over 250km further south. Given that Westland's catchment on the West Coast extends over 200km, these choices should not be disregarded. Most of the farms affected by this acquisition lie close to the railway line, too, so use of rail transport should not be ignored.
 - 1.18. Some farmers in the area do already supply processors other than Fonterra.
 - 1.19. **Conclusion.** Federated Farmers does not want to use this submission to influence the Commission's decision, which must be based on the competitive effects of the proposed merger.

- 1.20. We feel, however, that it is important that the Commission understands the obligations that Fonterra is placing on these farmers. This example can be used as an endorsement for the continued existence of the DIRA.
- 1.21. On the whole, we think that this acquisition by Fonterra is very good for the industry as well as for Fonterra itself, and does show the strength of the co-operative model.

2. ABOUT FEDERATED FARMERS

- 2.1. Federated Farmers of New Zealand is a primary sector organisation that represents farming and other rural businesses. Federated Farmers has a long and proud history of representing the needs and interests of New Zealand farmers.
- 2.2. The Federation aims to add value to its members' farming business. Our key strategic outcomes include the need for New Zealand to provide an economic and social environment within which:
 - Our members may operate their business in a fair and flexible commercial environment;
 - Our members' families and their staff have access to services essential to the needs of the rural community; and
 - Our members adopt responsible management and environmental practices.