



The Tatua Co-operative Dairy Company Limited  
Submission on

REVIEW OF THE STATE OF COMPETITION IN THE  
NEW ZEALAND DAIRY INDUSTRY -  
DRAFT REPORT

4 December 2015

## **SUBMITTER**

Formed in 1914, The Tatua Co-operative Dairy Company Ltd (Tatua) is one of the few dairy companies in New Zealand that has remained unchanged by merger or take-over. The Company operates as a co-operative, with 114 supplying shareholders and concentrates its business activities in the added value and higher technology sectors. The Tatua business model can be considered as being part dairy processor and part food company.

Having had a long history of trading dairy materials, including raw milk, with other New Zealand based dairy companies as part of its normal business activities, Tatua continues to take a keen interest in all milk markets. We are grateful for the opportunity to provide our unique view of market development over an extended period.

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# SUBMISSION

## 1. State of Competition

1.1 The New Zealand dairy industry competitive environment has steadily evolved over the past decade, and further development can be expected in future in response to the anticipated reduction in milk growth. But for now, there is clear evidence that the industry continues to be strongly dominated by Fonterra. We therefore agree with the Commission's conclusion that there is insufficient competition to remove DIRA Regulation at this time.

1.2 Like many other independent processors, Tatua faces competition from Fonterra in international markets. Based on our experiences in these markets, we consider that the Commission is incorrect in its assertion that the export markets into which Fonterra sells are competitive and Fonterra has little market power or incentive to foreclose competing independent processors. In our view, it is difficult to envisage a situation where removal of competition by independent processors in the areas of milk supply and export product placement would not be welcomed by Fonterra.

To better understand this, the international market needs to be segmented into Consumer, Foodservice, Bulk Ingredients (commodities) and Specialised Ingredients. In Consumer and Foodservice markets globally we would agree Fonterra's market power is limited but, in Bulk Ingredients and Specialised Ingredients Fonterra has significant market power. For example, Fonterra is the largest single producer of wholemilk powder in the world. It is also a major player in specialised proteins. Fonterra is the biggest single exporter of dairy commodities. In these segments, we contend Fonterra has both the market power and incentive to work to foreclose New Zealand competitors.

## 2. Farm Gate Market

2.1 The Commission has concluded that Fonterra does not have the ability or incentive to exercise market power in the farm gate market, or the ability to engage in conduct to prevent or hinder rival processors from accessing raw milk at the farm gate. This view is, in part, based on the internal controls that would be applied through Fonterra's co-operative structure, DIRA Regulation, and constraints from competitors.

2.2 While we agree that internal shareholder/investor pressure may constrain Fonterra's ability to preferentially price milk in areas of strong competition, we do not consider that this would in any way diminish its desire to maintain and grow its overall share of New Zealand's milk supply. We consider it likely that Fonterra would continue to actively implement non-pricing initiatives aimed at limiting future loss of supply.

2.3 The open entry/exit provisions therefore remain an essential element of the Regulations for both limiting hurdles, and managing the risk, for farmers contemplating switching milk supply to a new and untested independent processor, and must be retained.

## 3. Factory Gate Market

3.1 The relatively small scale and wide geographical distribution of independent processors results in there being limited competition for factory gate milk, and makes it unlikely that a viable factory-gate milk market could be sustained without participation by Fonterra.

3.2 We share the Commission's expectation that the price of factory gate DIRA milk currently supplied to independent processors would increase in the absence of the DIRA Regulation. We remain concerned that this would deter independent processors with a

desire to establish in New Zealand, as well as severely disadvantage many small domestic market producers.

3.3 We support the Commission's view that there is insufficient competition at the factory gate to conclude that the markets would be more efficient without the DIRA Regulation, and maintain our position that the requirement for Fonterra to supply milk under the Raw Milk Regulations be retained in full.

#### **4. Milk Price**

4.1 We are disappointed that the Commission failed to identify any information that would alter the conclusions reached in its 2011 milk price inquiry. As extensively discussed in Tatua's August 2015 submission on this matter, we continue to have concerns with the current pricing model both in terms of how incentives to price high or low are balanced, and how revenue is accounted for. We request that the Commission review the considerable evidence provided by Tatua and others, and reconsider our call for the establishment of a new milk pricing panel that operates with complete independence from Fonterra.

#### **5. Opportunity to Deregulate**

5.1 Economic indices demonstrate that the New Zealand milk market remains highly concentrated, and that Fonterra is the dominant participant. We do not see this situation changing in the near future, and support the Commission's conclusion there is insufficient competition to consider full deregulation at this time.

#### **6. Pathway to Deregulation**

6.1 The Commission has proposed that the share thresholds be reset from 20% to 30% and the time limit provision be reset to the 2021/22 season. Tatua generally supports this proposal, but would have preferred to see the implementation of a longer term review mechanism.

6.2 We also support the Commission's draft recommendations that reaching a threshold simply triggers a review of competition, rather than immediate removal of controlling legislation, and that simple North and South Island market share thresholds are sufficient for this purpose.

6.3 We note the Commission's view that the DIRA is a temporary measure designed to achieve sufficient competition. While we agree that this is one of its purposes, we also consider that it has an important role in limiting Fonterra's ability to use its dominant position to exert undue competitive pressure on other industry participants. Should Fonterra perform well and maintain or grow its market share over the long term, then we see strong justification for maintaining the protections afforded by the DIRA in parallel.

Tatua is grateful for the opportunity to comment on the above issues. We would welcome the opportunity to meet with the Commerce Commission to further discuss any aspect of our submission.



Stephen B Allen  
Chairman of Directors



Paul D McGilvary  
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