

Submission

Dairy Industry Restructuring Amendment Bill (No 3)

We welcome the opportunity to submit on the Dairy Industry Restructuring Amendment Bill (DIRA) (No 3).

A modernised DIRA will support our Co-operative's ability to deliver its new value strategy, which prioritises our increasingly precious New Zealand milk and seeks to maximise the value of the unique provenance story that sits behind our milk. Changes to DIRA will also help us to achieve our shared vision for the future of the industry, including our goals for: improving fresh water quality, maintaining our position as the world's most emissions efficient producers of dairy, ethical animal welfare standards, and protecting the dairy industry's significant contribution to the New Zealand economy.

DIRA has been critical to the performance of the dairy industry since its passage in 2001. The formation and evolution of Fonterra has created wealth for New Zealanders with dairy exports growing from \$7.4b in 2001 to \$18.1b for the year ended June 2019.

New Zealand farmers, who were once paid approximately half that of their European or US peers, are now consistently paid at parity or more due to the development of a strong and transparent milk price regime underpinned by this legislation. The majority of that income flows into regional New Zealand where it plays a strong role helping sustain local communities.

Fonterra is proudly owned by around 10,000 New Zealand farmers and their families. We set out every day to ensure New Zealand farmers, the New Zealand economy and every New Zealander gains the greatest benefit from the New Zealand dairy industry.

As a Co-operative, our farmer-owners are paid the maximum sustainable milk price. That price sets the benchmark for dairy in New Zealand, so every kiwi dairy farmer benefits from a strong Fonterra. At our manufacturing sites, our people are paid a fair wage for the highly skilled roles they undertake and they go home to their families safe every night because of our commitment to maintaining the highest health and safety levels. We continue to create opportunities for hardworking and innovative people in the regions.

The purpose of the initial DIRA legislation was to establish a major New Zealand owned dairy co-operative with the scale to compete in the global market. In doing so, it was recognised that some restrictions were required because of the associated domestic market dominance of that new co-operative. Farmers needed options and protections when deciding who to supply their milk to and domestic consumers needed options when deciding which products to buy.

Eighteen years after the passage of the original legislation, there are ten other competitors operating 15 manufacturing sites across the country. Our market share has reduced from 96% in 2001 to around 82% in 2018. In regions such as Canterbury, Waikato and Southland, farmers have multiple options about which processor they wish to supply.

As planned, DIRA has successfully helped competition thrive. From the 2002 to 2019 season, independent processors' collections increased by approximately 830%, compared to just a 37% increase in Fonterra's collections.

All of these milk processing companies, with the exception of co-operatives Fonterra and Tatua, are either fully or partly owned by off-shore interests.

The co-operative structure is the best operating model to provide farmers with the greatest control over their capital, processing assets, and channels to sell their product across the world. There is no benefit of a future without farmer-owned co-operatives in New Zealand.

Maintaining elements of this legislation for longer than required imposes unnecessary costs. While some market safeguards – such as protecting farmers in areas where there is no competition – remain critical, other provisions are tipping the playing field in favour of foreign-owned export-driven companies.

If DIRA continues to tilt the competitive playing field in favour of foreign-backed competitors with significant capital resources, the dairy industry runs the risk of over-capacity. In the context of future projections for a flat or slowly declining domestic milk production, this will lead to plant closures in regional New Zealand. If you look across the Tasman to Australia, where they've lost their co-operatives, you can see that playing out right now.

Back home, the level of competition and number of processors shows that the requirement on Fonterra to supply milk, effectively at cost, to new processors focused on exporting must end.

These processors are backed by significant offshore capital, and are typically producing simple dairy ingredients for export which are already manufactured across New Zealand. The proposed legislation continues to help them into the market by providing regulated milk supply, with no offsetting benefit to New Zealand.

We ask that you remove the requirement for our farmers to supply regulated raw milk to independent processors who have a capacity to process more than 30 million litres per year and who export more than 20% of their processed volume. If export-orientated companies wish to participate in the New Zealand dairy industry, they should seek their own milk supply. Our Co-operative members should not have to carry the risk for overseas processors.

We recognise that this proposed legislation enables our Co-operative to decline membership to farmers who are not likely to comply with our terms of supply. This is a positive step, however we ask that the bill go further. We request the end of open entry and would like the right to decline all applications to supply our Co-operative. We need greater control over where we invest our farmers' capital to ensure that we can return the greatest value to them.

If the Committee does not accept this change, then we request the ability to decline applications to supply our Co-operative in regions where significant competition exists. That is, where our market share has dropped below 75%.

With regard to collecting milk from new conversions, the proposed legislation implements a five-year rolling window. We ask that the Committee strengthens this provision and from the date of Royal Assent we should no longer be required to accept milk supply from new conversions. Strengthening this clause will send a very clear message to those who financially support and enable dairy conversions on environmentally sensitive land. Dairy farming must only operate within recognised environmental limits.

We recognise that the Government is seeking additional oversight by giving the Minister of Agriculture the ability to nominate an appointee to the Milk Price Panel. We believe this is unnecessary as the Commerce Commission provides adequate oversight today.

However, greater transparency of how all processors determine their milk price should be implemented. All milk processors should be required to publish the average price they pay farmers, the key parameters of their milk price, and examples showing the payout farmers would receive for different parameters.

There are no negative outcomes for farmers having clear and consistent information from which to compare processors.

Since the passage of the Act and subsequent amendments, the trigger for legislative review has changed. In line with the competition objective, review and expiry of some provisions were previously triggered when specified market share levels were met. This remains our preferred trigger, in addition to time bound reviews. Due to the fast-changing nature of the industry, we request that the time bound reviews are conducted every three years.

While DIRA continues to influence our financial performance, some of its now unnecessary constraints hinder our ability to efficiently and effectively utilise our assets.

Fonterra is a farmer-owned New Zealand co-operative here for generations, and taking the very best of Aotearoa to the world. New Zealand farmers are currently the most carbon efficient producers in the world and they produce the world's best milk. However, our industry must continue evolving to remain economically and environmentally sustainable.

The New Zealand dairy industry has been built on more than 150 years of hard work, adaptation and innovation. We ask that you consider the structure of the dairy industry you want for our children, and their children. New Zealand farmers are the best in the world and they deserve legislation that ensures that they have the best opportunity to remain this way.

Regards



John Monaghan
Chairman



Miles Hurrell
Chief Executive

**Our Co-operative, empowering people, to create goodness for generations,
You, me, us, together
Tātou, Tātou**

The principal Act

In 2001 DIRA established Fonterra to be a major player in the global dairy market.

In doing so, the Government acknowledged that there were broadly two possible negative outcomes which would need to be regulated if they were to allow a dominant player to be formed – Fonterra would have to have constraints placed on its monopoly power as the largest seller of dairy products to New Zealand consumers, and on its monopsony power as the largest buyer of milk from dairy farmers.

Over the 18 year life of DIRA, Parliament has continued to work with the dairy industry to refine the ways that DIRA constrains Fonterra.

Key to constraining Fonterra's influence are provisions designed to make it easier for competitor processors to establish themselves in New Zealand by way of guaranteed milk supply (Raw Milk Regulations) while these processors established their own supply from farmers.

In order to allow these processors to establish their own supply as easily as possible, farmers would always have a right to supply Fonterra (Open Entry), a right to leave Fonterra to supply another processor (Open Exit), and to return to Fonterra if they wish (Open Entry again). The risks to establishing independent (non-Fonterra) milk processing would therefore be lower, and over time a competitive market for farm-gate milk would emerge.

On the other key objective, New Zealand consumers would be protected from Fonterra's dominant position in the domestic consumer market by guaranteed supply of milk (Raw Milk Regulations) to Goodman Fielder, which lacked its own supply contracts with dairy farmers.

It was hoped that over time, competition to Fonterra at the dairy processor level would be enabled and domestic focused competitors would establish their own milk supply, thus lessening the risks of monopoly behaviour from Fonterra.

Parliament took the view that these provisions would be necessary until sufficient competition, measured by market share of milk collected from dairy farmers, existed. This was measured separately in each of the North and South Islands.

This was not a view predicated on constraining Fonterra until the risk of dominant behaviour disappeared completely. Rather, this was an acknowledgement of a balance being struck. On the one hand dairy farmers sought Parliament's permission to establish a co-operative which had the scale to operate successfully on the global milk market, on the other, it could not abuse that scale to the detriment of farmers and consumers. This is the tension at the heart of DIRA – ignore market dominance and you could create a monster. But constrain that dominance too much and you would destroy the thing you set out to create.

This tension has been lost. Over time, the goalposts have shifted, and along the way the major reason for DIRA has been lost. The need to create and maintain a major export focused global dairy co-operative has been forgotten and we run the serious risk of driving competition so hard that the original purpose of DIRA is undermined and lost.

One of the unforeseen consequences of the passage of DIRA was the incentivisation of converting land into dairy. With an automatic right to join Fonterra as a guaranteed buyer of milk in most parts of the country, and a relative lack of environmental regulation compared to today, there was a large increase in land utilised for dairy production.

DIRA was intended to ensure Fonterra couldn't use its position in the market to constrain land-use moving to its highest and best use. However, the degree to which the success of Fonterra, in ensuring strong returns to dairy farmers, incentivised land into dairy was an unforeseen outcome and in the absence of appropriate environmental regulation this has had an impact in parts of the country.

Parliament should also recognise the objectives of independent processors entering the market. Fonterra's non co-operative competitors have no incentive to pay their farmers more. Their entire business model is designed to lower their cost of goods and thus return maximum profit to their owners.

Continuing to encourage more processors to operate in New Zealand does not benefit farmers. It does not benefit workers, and it does not benefit the New Zealand economy.

This review is an opportunity for Parliament to tilt the balance back in favour of farmer owned co-operatives, or at the very least level the playing field. Instead of farmers' capital being used to help more export driven independent processors, this legislation should evolve to ensure the future success of the local industry.

Dairy Industry Restructuring Amendment Bill (No 3)

- **We support the introduction of this legislation**
- **We ask that Parliament implement further changes to better reflect the future facing the New Zealand dairy industry**

Overview of our proposed amendments to the legislation

Open entry and exit provisions

Open entry provisions (s73, 74) and non-discrimination rule (s106)

We seek the full repeal of open entry provisions and non-discrimination rules

If this is not accepted, our second preference is the repeal of open entry and exit in the regions where our market share drops below 75%

Our third preference is a strengthening of what this legislation proposes – that we are no longer required to collect milk from new conversions and those who are unlikely to meet our terms of supply

Non-discrimination (clause 23)

We seek clarification on the new provision regarding our terms of supply to remove potential ambiguity

Milk price regime

Asset beta (clause 29)

While we do not believe that change is necessary, we do not oppose the proposed changes

Ministerial appointee to the Milk Price Panel (clause 30)

While we do not believe that a Ministerial nominee is necessary, we do not strongly oppose the proposed change

Greater transparency obligations on the industry (new clause to be inserted)

We seek greater transparency across the industry so farmers can make an informed choice about which processor to supply

Review and expiry (sunset) provisions

Sunset provisions (clause 27)

We support expiry of open entry and exit based on market share provisions in addition to three yearly time bound review periods

Raw milk regulations

Large export-focused processors (regulation 4, 6, 18)

The bill should go further and exclude Fonterra from having to provide raw milk to processors that:

- have capacity to process more than 30 million litres per year and export more than 20% of their processed volume; and

- have their raw milk processed by other companies and export more than 20% of their processed volume

Goodman Fielder and domestic supply (regulation 4, 7, 17A)

We support a strong domestic market

We do not object to Goodman Fielder receiving 350 million litres but ask for the legislation to be amended to ensure that it must be used for sale in the domestic market

We also seek clarity that regulated raw milk is processed into finished consumer products for the domestic market

Raw milk price (regulation 20)

We seek a fee of \$0.12/kgMS rather than \$0.10/kgMS and this should apply to all independent processors not just Goodman Fielder

Other minor changes (regulations 6, 10, 21, 11, clause 5, and s134)

We seek greater certainty of estimates from independent processors

We seek more notice from independent processors seeking winter milk supply and to reduce the tolerance for winter milk supply quantity estimates from independent processors

We seek to be able to charge the winter milk premium for independent processors seeking winter milk supply who do not take that supply

We seek appropriate limits on the volumes of winter milk independent processors can purchase

We seek clarification of the proposed new definition of raw milk

The Commerce Commission levy should be allocated proportionately

Below we set out our substantive views on the bill by topic and where relevant, we have shown our specific drafting recommendations.

We do not make any comments on the bill's changes in relation to LIC and the core database (Part 2, Subpart 4 of DIRA).

Open entry and exit provisions

- **We seek the full repeal of the open entry provisions and non-discrimination rules**
- **Our second preference is the repeal of open entry and exit in the regions where our market share drops below 75%**
- **Our third preference is a strengthening of what this legislation proposes – that we are no longer required to collect milk from new conversions and those who are unlikely to meet our terms of supply**

We seek the full repeal of the open entry provisions. The intended benefits of open entry have been achieved and no longer outweigh open entry's significant downsides. We remain strongly of the view that the open entry provisions (the obligation to accept supply (s73, s74) and non-discrimination between suppliers (s106) should be repealed in full.

Open entry was designed to stop Fonterra using its market dominance to cut off a dairy farmer and ensure that a dairy farmer always had someone to sell their milk to.

It also ensures that Fonterra, and our farmer shareholders, underwrite the risk of farmers seeking to supply an independent processor. We are forced to maintain the reserve capacity to process milk if farmers choose to supply an independent processor and then choose to return to our Co-operative.

This makes choosing to leave our Co-operative and supply an independent processor less risky for the farmer and thus incentivises the entry and growth of independent processors. It is clear from the existence of at least ten competitors around New Zealand that these provisions have worked and created adequate competition in the industry.

However, these open entry provisions have also encouraged inefficient investment decisions by requiring our Co-operative to build and maintain excess capacity, due to uncertainty of milk volumes and to ensure we can process all milk that could come our way. This means that capital has been directed away from other, potentially higher-value uses and has constrained capital investments in R&D and innovation. With the level of competition now in the market, this is simply no longer warranted or sustainable.

In addition, to the extent that DIRA continues to incentivise new processor entry or expansion, it creates an ever-increasing risk of industry wide overcapacity and under-utilisation. Industry wide overcapacity is likely to lead to industry wide low returns as milk growth drops. This in turn could result in a long period of stagnation in the sector – as we have seen with the red meat processing industry. Eventually players may capitulate and close plants. While this would "fix" the over-capacity problem, it would have significant and serious consequences for the communities affected.

We do not need more processors in New Zealand. As you will see from the map in appendix A, a majority of Fonterra farmers are within range of an independent processor with the exception of those farming in Northland and Tasman.

It should also be recognised that the open entry provision has incentivised land conversion to dairy when this is not the best use of that land. Removing open entry will send a very clear message to those who financially support and enable dairy conversions on environmentally sensitive land. Our clear view is that dairy farming should only operate within recognised environment limits.

Finally, it is further worth noting that the importance of open entry as a protection for farmers has been less important since the introduction of the milk price regime. The milk price regime provides a clear signal to all farmers of the value of their milk and safeguards against Fonterra using its milk price for anti-competitive purposes.

We proposed the following changes:

Drafting for full repeal of open entry

Repeal Section 73 New co-op must accept application

Repeal Section 74 Commencement and terms of supply

Repeal Section 106 No discrimination between suppliers

By repealing section 73, consequential changes would be required to:

- Section 5 (definitions of "new entrant" and "price range")
- Section 71
- Section 81
- Sections 84 to 96
- Section 109M
- Sections 136 - 139

By repealing section 74, consequential changes would be required to:

- Section 82
- Section 97
- Sections 75 – 85

By repealing section 106, consequential changes would be required to:

- Section 71

If our first preference is not accepted, our second preference is the repeal of open entry and exit in the regions where our market share drops below 75%

If Parliament does not currently want to support the complete repeal of open entry, then we seek the repeal of open entry in regions where our market share has dropped below 75%. This would protect farmers in regions without that level of competition, and not overly incentivise competition in already well served regions.

In most dairying regions, farmers have a choice about which processor to supply. Dairy NZ data for 2017/18 shows that our market share is already below 75% in the Greater Auckland (60.2%) and Westland (0.9%), and is near that level in the Canterbury (75.3%), Horizons (Manawatu-Wanganui) (75.4%) and Southland (79.8%) regions.

For farmers in areas such as Northland and Tasman who do not have a viable alternative processor, we would continue to pick up the milk for so long as the farm chooses to remain a supplier to our Co-operative.

Drafting for repeal of open entry and exit in the regions where our market share drops below 75%

New sections 150AA to 150AC and cross-heading inserted

After section 150, insert:

Regional expiry of open entry and open exit

150AA Minister to certify that market share thresholds met

- (1) For the purposes of sections 150AA to 150AC:
 - (a) dairy farm means a farm in New Zealand that produces milk from dairy cows as a business or part of a business; and
 - (b) factory means a facility that has a capacity to store at least 50,000 litres of milk; and
 - (c) region—
 - (i) means the region of a regional council; and
 - (ii) includes the district of a territorial authority, if the territorial authority is a unitary authority.
- (2) Subsection (3) applies if the Minister is satisfied, on the basis of the information reported to the Minister under subsection (5), that independent processors have, directly or indirectly, collected 25% or more of milk solids on or from dairy farms in any region in a season.
- (3) If this subsection applies, the Minister must, as the case may be, sign a certificate that states that the market share threshold for the region has been met.
- (4) A certificate signed by the Minister stating that a market share threshold has been met for a region—
 - (a) is conclusive evidence of that fact; and
 - (b) must be published—
 - (i) in the Gazette; and
 - (ii) on the Ministry's Internet site.
- (5) For the purposes of subsection (2) and section 150AB(5), new co-op and each independent processor—
 - (a) must, in the form prescribed by the chief executive by notice in the Gazette and published on the Ministry's Internet site, but subject to any exemptions granted in the

notice, keep a record of the total amount in kilograms of milk solids collected, directly or indirectly, on or from dairy farms in each region of New Zealand, and keep a record of the location of each of their factories; and

- (b) must, if requested by the Minister, provide the information specified in paragraph (a) to the Minister—
 - (i) in the case of a season that has ended, within 30 days after the request; and
 - (ii) in the case of a season that is yet to end, within 30 days after the end of the season.

150AB Open entry and open exit cease to apply to region that meets its market share threshold

- (1) Subject to subsection (2), if the Minister has signed a certificate under section 150AA in respect of any region, the Governor-General must, by Order in Council, declare that sections 73, 74, 97, 106 and 107(3) cease to apply to that region.
- (2) An Order in Council made under subsection (1)—
 - (a) must specify the date on which sections 73, 74, 97, 106 and 107(3) cease to apply to the relevant region, which may be no later than the end of the season that begins after the date on which the Order in Council is made; and
 - (b) must come into force on or before the date specified in paragraph (a); and
 - (c) may not be amended or revoked (except under section 15 of the Legislation Act 2012).
- (3) Despite subsection (1), sections 73, 74, 97, 106 and 107(3) continue to apply to any existing supplier to new co-op located in a part of a region that is more than 160 kilometres from any independent processor's factory.
- (4) New co-op may give notice to the Minister in writing where it considers that subsection (3) has no further application in a region in which sections 82, 97 and 107(3) have ceased to apply.
- (5) Subsection (6) applies if the Minister is satisfied, on the basis of information notified to the Minister under subsection (4) and section 150AA(5) that subsection (3) has no further application in a region.
- (6) If this subsection applies, the Minister must, as the case may be, sign a certificate that states that subsection (3) has no further application in a region.
- (7) A certificate signed by the Minister stating that subsection (3) has no further application in a region —
 - (a) is conclusive evidence of that fact; and
 - (b) must be published—
 - (i) in the Gazette; and
 - (ii) on the Ministry's Internet site.
- (8) If the Minister has signed a certificate under subsection (6), the Governor-General must, by Order in Council, declare subsection (3) has no further application to that region.
- (9) An Order in Council made under subsection (8)—
 - (a) must specify the date on which subsection (3) ceases to apply to the relevant region, which may be no later than the end of the season that begins after the date on which the Order in Council is made; and
 - (b) must come into force on or before the date specified in paragraph (a); and
 - (c) may not be amended or revoked (except under section 15 of the Legislation Act 2012).

150AC Open entry and exit expire if all regions meet their market share thresholds

Sections 73, 74, 97, 106 and 107(3) expire on the date that those provisions cease to apply to all regions of New Zealand.

Note that consequential changes would likely be required to:

- Section 72 (new subsection 72(11) required in overview)
- Sections 98 – 105
- Section 109M

If our first and second preferences are not accepted, our third preference is a strengthening of what this legislation proposes – no longer required to collect milk from new conversions and those who are unlikely to meet our terms of supply

Our third preference supports the policy intent of the proposed bill, however we would like these provisions strengthened. Rather than a fixed date after which Fonterra would have discretion to decline new conversions, this proposed legislation creates a rolling five-year window for the exception to apply. In other words, a new dairy farm established at any time after the bill comes into force could become a Fonterra supplier provided it has been supplying another processor at some point in time in the five years prior to application.

We ask that you amend this provision, and from the date of Royal Assent, we should no longer be required to accept applications to supply from new conversions.

As this legislation is currently drafted it does not create a disincentive to convert land to dairying or put an end to new conversions. The inefficient incentives to invest will still exist. The incentives to convert land to dairying under the status quo are primarily the benefits received from the existence of a guaranteed buyer. These benefits will continue to be available, simply delayed by five years.

The risk of having no guaranteed buyer for the first five years of a farm's life may in practice be small compared to the benefits available over the profitable life of the farm.

The presence of these incentives gives rise to a real risk that the exception could and would be gamed, with new conversions supplying independent processors for five years until our Co-operative is required to accept their supply.

Separately, it is not clear how the definitions apply in respect of farm land that is used to grow crops to feed lactating cows. There are two general scenarios. In the first, land that is part of a dairy farm may be used to grow crops to feed lactating cows on the dairy farm. We agree that this is "production land". However, the second scenario relates to separate cropping farm businesses, where the whole farm is used to grow crops for sale, which may include sale to dairy farm owners to feed their lactating cows. If such a cropping business was to be converted to a dairy farm, it would generally be understood to be a new conversion. However, under the current wording and examples, there is a risk that it would not be a new conversion (that is, if 50% or more of the crop was sold to dairy farms to feed lactating cows). We ask that this is clarified in this legislation.

Altered drafting for the bill - third exception for new conversions

Amend clause 22 of the bill

96B Definitions relating to third exception

In sections 96A to 96G,—

collection point means a place containing a milk vat, or milk vats, from which milk can be collected by new co-op or an independent processor

dairy farm means a farm in New Zealand that produces milk from dairy cows as a business or part of a business

new collection point—

(a) means a collection point that ~~has not been used at any time in the preceding 5 years to supply milk from cows as part of a business;~~ **was not being used to supply milk from cows as part of a business from the date of Royal Assent;** but

(b) does not include—

- (i) a collection point that will replace another collection point under **section 96C**; or
- (ii) a collection point for milk produced on particular land if, since a collection point for milk produced on particular land if, ~~in the preceding 5 years~~ **since 1 December 2016**, milk has been produced from the land as part 10 of a business and is, on a regular basis, processed by the applicant themselves or sold to consumers as unprocessed milk; or
- (iii) a collection point where applications for all authorisations required under the Resource Management Act 1991 for the use of the associated production land have been made prior to date of Royal Assent.

new production land means land that, ~~in the preceding 5 years,~~ **since 1 December 2016** has not been used at any time as part of the production land of a business

~~**preceding 5 years**, in relation to an application, means the 5-year period immediately preceding the date of receipt of the application~~

production land means the land **on a dairy farm** that, in the ordinary course of business, is used for grazing or feeding lactating cows

Examples

Land that is **part of a dairy farm that is** used to produce crops that are used as feed for a dairy herd is production land.

Land that is used only to graze non-lactating dairy cows is not part of the production land.

Land that is used only on a single occasion to graze lactating dairy cows is not part of the production land because it is not used for grazing or feeding lactating dairy cows in the ordinary course of business.

Land that is not part of a dairy farm that is used to produce crops that are sold to dairy farms for feeding lactation cows is not production land.

Non-discrimination (clause 23)

- **We seek clarification on the new provision regarding our terms of supply to remove potential ambiguity**

The bill includes a new section 106(5) to clarify that Fonterra may differentially price milk based on any matters specified in the terms of supply, including, but not limited to; matters that relate to animal welfare, food safety, health and safety, employment conditions, the environment, climate change, and sustainability.

However, the cabinet paper states that the bill should clarify that Fonterra is entitled to provide in its terms and conditions for matters including animal welfare, food safety, health and safety, employment conditions, the environment, climate change, and sustainability, and that Fonterra may differentially price milk based on those matters, which is broader than s106(5).

To reduce the potential for ambiguity and to ensure that the legislation is in line with the cabinet determination, we request that the bill clarify that Fonterra is entitled to provide for these issues in our terms of supply and that we may differentially price milk based on those matters.

Altered drafting – no discrimination between suppliers

Amends clause 23 of the bill

Section 106 amended (No discrimination between suppliers)

After section 106(4), insert:

(5) **For the avoidance of doubt**, in its terms of supply, ~~but subject to subsections (1) to (4)~~, new co-op may provide for, ~~differential pricing for milk based on any~~ **and price differentiate on the basis of**, matters ~~specified in the terms of supply~~, including, but not limited to, matters that relate to animal welfare, food safety, health and safety, employment conditions, the environment, climate change, and sustainability.

Milk price regime

We support the current milk price regime. It is robust and works as intended. Given the level of competition in the market and that independent processors compete effectively and sustainably, there is no clear basis for a lack of confidence in the milk price regime.

The Commerce Commission is typically satisfied that the calculation of our milk price is largely consistent with both the efficiency and contestability purposes of DIRA, and that our assumptions, inputs and costs meet the “practically feasible” standard. In the limited areas where this has not been the case, such as in the case of the asset beta used in the weighted average cost of capital component of the milk price calculation, we work actively to resolve the Commission’s issues.

Milk price calculation: asset beta (clause 29)

- **While we do not believe that change is necessary, we do not oppose the proposed changes**

The bill’s proposal to increase regulation in relation to the asset beta used in the calculation of the weighted average cost of capital component is counterproductive and contrary to the desired policy direction towards less regulation. We do not consider statutory guidance is necessary. Nevertheless, Fonterra understands the role this prescription could play in providing additional reassurance about the robustness of the milk price.

We continue to consider that the analysis and expert advice underpinning the Commission’s position, that the current asset beta of 0.38 is unlikely to be practically feasible, is flawed. Among other things, it does not take into account the impact of Fonterra’s (and therefore the notional milk price business’) unique regulatory obligations set out in DIRA or the very significant differences between a commodity-focused New Zealand dairy processor and dairy businesses elsewhere, which are generally not commodity producers. However, we appreciate that our engagement with the Commission on this issue has been protracted and this has created uncertainty and challenge of the milk price model.

Ministerial appointee to the Milk Price Panel (clause 30)

- **While we do not believe that a Ministerial nominee is necessary, we do not strongly oppose the proposed change**

The new requirement for Fonterra to appoint a nominee recommended by the Minister to the Milk Price Panel is unnecessary. The milk price regime is robust and working as it was intended. There is already significant statutory oversight from the Commerce Commission and other effective checks and balances including the review of the milk price calculation by Fonterra's independent external auditor.

Greater transparency obligations on the industry (new clause to be inserted)

- **We seek greater transparency across the industry so farmers can make an informed choice about which processor to supply**

Transparency in the milk price regime is vitally important and should be applied in respect of all processors. As we have seen in the Australian dairy industry, farmers are greatly disadvantaged by information asymmetries with processors.

The bill should provide for all processors to publish the average price they pay to farmers, the key parameters of their milk price and examples showing the payout that would be received for different parameters, in a way that is consistent across processors to allow proper comparison. This would enable farmers to make informed choices about who to supply and what they are likely to receive for their milk.

This can be easily implemented by expanding s116(1)(a) of the principal Act, which allows the Governor-General to make regulations requiring our Co-op to publish information, to allow the inclusion of pricing information for independent processors.

New drafting for the principal Act – expanded transparency

Amends Section 116 of the principal Act

116 Obligations to publish information

(1) The Governor-General may, by Order in Council made on the recommendation of the Minister, make regulations that—

(a) impose obligations on new co-op **and independent processors** to publish information about their business, including the following information:

Review and expiry (sunset) provisions

Sunset provisions (clause 27)

- **We support expiry of open entry and exit based on market share provisions in addition to three yearly time bound review periods**

The bill confirms a departure from the prevailing position of the past 18 years that parts of the principal Act should expire once market share triggers have been reached. This presumption was briefly removed by Parliament at the end of 2017 to provide time and space for Government officials to conduct the review of the legislation following the change of Government after the last General Election.

Fonterra opposes any move away from the market share trigger, and believes it should be inserted into this legislation. The drafting is as provided above under our second preference – repeal of open entry and exit in regions where our market share drops below 75%.

Up until the 2017 amendment which removed the market share trigger, investment in the dairy industry was made in full awareness of the future regulatory environment. By removing this trigger and moving to a cyclical review model, greater uncertainty is being injected into the investment environment.

A review based on a time period such as between four and six years is unlikely to keep pace with the industry's development, and consequently risks regulation remaining in place much longer than is justified. There is danger in having legislative constraints when they are no longer required, including the potential for unnecessary and costly long-term dependence on regulation. The industry requires clarity to inform future investment decisions.

In addition to market share expiry provision, reviewing the Act every three years strikes a better balance and reflects industry changes without risking regulation remaining in place much longer than is justified.

Altered drafting for the bill – periodic review

Amends clause 27 of the bill

New sections 147 to 150 and cross-heading inserted

After section 146, insert:

Regular reports on operation of subparts 5 and 5A

147 Minister must require regular reports

(1) The Minister must require regular reports from the chief executive on whether this subpart and subpart 5A should be retained, repealed, or amended.

(2) The Minister must require the first report no earlier than 4 3 years after the commencement of the Dairy Industry Restructuring Amendment Act (No 3) 2019 and present the report to the House of Representatives no later than 6 5 years after commencement of that Act.

(3) The Minister must require any subsequent report no earlier than 4 3 years after presentation of the previous report to the House of Representatives, and present the report to the House of Representatives no later than 6 5 years after presentation of the previous report to the House of Representatives, unless subsection (4) or (5) applies.

(4) If a Bill is introduced into the House of Representatives to amend this Act in the 6 5 years before the Minister is required to present a report under subsection (3) and the Bill is passed, the Minister must instead—

(a) require a report no earlier than 4 3 years after the commencement of that enactment or (if different provisions come into force on different dates) the earliest date on which any provision of the enactment commences (the **commencement date**); and

(b) present the report to the House no later than 6 5 years after the commencement date.

(5) If the Bill is withdrawn, lapses with the dissolution or expiry of Parliament, or is defeated, the Minister must—

(a) request the report no earlier than 4 3 years after the withdrawal, lapse, or defeat of the Bill; and 10

(b) present the report to the House of Representatives no later than 6 5 years after the commencement date.

150 Limits on effect of report and response

(1) The Crown is not bound by a report under section 147.

(2) Sections 147 to 149 are not intended to—

(a) create any rights or protections in relation to any person or group of persons, **subject to the requirements of section 147(2) to (4)**;

or

(b) confer any rights or protections on any person or group of persons.

Raw milk regulations

Large export-focused processors (regulation 6, 18)

The bill should go further and exclude Fonterra from having to provide raw milk to processors that:

- **have capacity to process more than 30 million litres per year and export more than 20% of their processed volume**
- **have their raw milk toll processed* by other companies and export more than 20% of their processed volume**

As recognised in the bill, support for larger export-focused processors capable of sustaining their own supply is now unnecessary and risks creating long-term regulatory dependence. Removing raw milk entitlements for large export-focused processors will ensure regulatory support is targeted to those smaller independent processors who need assistance and ensures competition in domestic consumer markets.

However, the bill only excludes large, export-focused processors that source 30 million litres per year of their own raw milk. In our view, limiting the exclusion to these processors does not properly achieve the policy objectives outlined above.

The bill should also exclude:

- processors that have capacity to process more than 30 million litres per year, and export more than 20% of their processed volume; and
- processors that have their raw milk toll processed* by other companies and export more than 20% of their processed volume.

A processor may choose never to source its own supply (whether from farmers or another source), and instead operate primarily as a toll processor for other parties. Similarly (and related to the above) other processors may choose to just take an entitlement to raw milk, and have it toll processed as above. Under the current bill in both scenarios, the independent processors could take and export 50 million litres of raw milk per year from our Co-operative in perpetuity. It would be processing for export and not the domestic market. It is our view that this activity is not intended to be encouraged or supported by the raw milk regime and these processors should be treated in the same way as large export-focused processors that do secure their own milk supply.

This is a material cost to our Co-operative as we do not make any return on raw milk supplied under the Raw Milk Regulations.

*An arrangement in which a company processes raw materials (milk) for another company.

Amendment to the raw milk regulations

Replace regulation 6(3) with:

- (3) Despite subclauses (1) and (2), new co-op is not required to supply raw milk to an independent processor (other than Goodman Fielder New Zealand Limited) in a season beginning on and after 1 June 2016
- (a) if the independent processor's own supply of raw milk in each of the 3 consecutive previous seasons was 30 million litres or more as specified in returns provided to new co-op under regulation 18(2); or
- (b) in any season beginning on or after 1 June 2023—
- (i) the independent processor's own supply of raw milk is 30 million litres or more as specified in the returns; or
 - (ii) the independent processor has capacity to process 30 million litres or more, and more than 20% of the volume it processes is exported; or
 - (iii) the independent processor has had its raw milk toll processed and export more than 20% of its processed volume.

Regulation 18 (Returns by independent processor with own supply)

Replace regulation 18(2) with:

- (2) The independent processor must, no later than the 5th working day in June of the current season, provide a return to the new co-op specifying whether:
- (a) the quantity of raw milk sourced by the independent processor from its own supply in the previous season was-
 - (i) less than 30 million litres; or
 - (ii) 30 million litres or more; or
 - (b) the independent processor had capacity to process 30 million litres or more, and exported more than 20% of the volume it processed; or
 - (c) the independent processor had its raw milk toll processed, and exported more than 20% of its processed volume.

Goodman Fielder and domestic supply (regulation 4, 7, 17A)

- **We support a strong domestic market**
- **We do not object to Goodman Fielder receiving 350 million litres but ask for the legislation to be amended to ensure that it must be used for sale in the domestic market**
- **We also seek clarity that regulated raw milk is processed into finished consumer products for the domestic market**

We have always supported ensuring Goodman Fielder remains a viable, large-scale domestic competitor and as such we continue to support its regulated raw milk entitlement. We also support maintaining the regulated raw milk entitlement of smaller processors, as it is important that we protect and retain robust competition in domestic consumer markets.

While we do not object to increasing Goodman Fielder's regulated raw milk entitlement, it should be used for domestic supply. It would be counter to the policy objective of safeguarding domestic competition if Goodman Fielder was able to use that additional raw milk entitlement to support its export business.

More generally, the intent of the Raw Milk Regulations is to support domestic consumer markets, not to enable processors to broker milk components. Accordingly, raw milk supplied under the Raw Milk Regulations should be required to be processed into finished consumer or foodservice products for the domestic market, and not subject to “milk component harvesting” i.e. independent processors taking their entitlement to raw milk to obtain certain specific components and then on-selling the rest (e.g. taking the cream for ice-cream to be exported, and on-selling skim milk, or taking the skim milk for infant formula for export and selling the cream).

As a more minor point, there is currently no limit on the volume Goodman Fielder may take during the winter months and there does not appear to be any basis for this. The monthly limits should be extended to include the winter months.

Amendment to the regulations

Regulation 4 (New co-operative must supply raw milk to independent processors)

Replace regulation 4 with:

- (1) New co-op must supply raw milk to independent processors.
- (2) Raw milk supplied pursuant to subclause (1) may only be used by the independent processors for processing into finished consumer or foodservice products.
- (3) For the purposes of subclause (2), an independent processor must certify that raw milk supplied to the independent processor pursuant to subclause (1) has only been used by the independent processor for processing into finished consumer or foodservice products, as part of a return required under regulation 17A.
- (4) Subclause (1) is subject to the other provisions of this Part.

Regulation 7 (Maximum limit on supply of raw milk to Goodman Fielder New Zealand Limited)

Replace regulation 7(1)(b) with:

- 7(1)(b) must be used for products to be sold in New Zealand; and
- (c) for June, July, August, September, November, December, January, February, March, April, or May, is limited to 110% of the amount taken by Goodman Fielder New Zealand Limited in October.

Regulation 17 (Return by new co-op relating to actual supply of raw milk to independent processors)

Insert, after regulation 17:

17A Return by independent processors relating to use of raw milk

- (1) This regulation applies to an independent processor that requires new co-op to supply it with raw milk in a current season.
- (2) The independent processor must, no later than the first working day in July, provide a return to new co-op:
 - (a) certifying that all raw milk supplied by new co-op to the independent processor has been or is being used by the independent processor for processing into finished consumer or foodservice products; and
 - (b) signed by a director of the independent processor, or a person authorised by the board to sign on behalf of the board.

- (3) For the avoidance of doubt, subclause (1) applies to Goodman Fielder.
- (4) In addition to the requirements in subclause (2), Goodman Fielder must, no later than the first working day in July, provide a return to new co-op:
 - (c) certifying that all milk supplied by new co-op to Goodman Fielder was used for products that were sold in New Zealand; and
 - (b) signed by a director of the independent processor, or a person authorised by the board to sign on behalf of the board.

Raw milk price (regulation 20)

- **We seek a fee of \$0.12/kgMS rather than \$0.10/kgMS and this should apply to all independent processors not just Goodman Fielder**

When supplying raw milk an additional fee of \$0.12/kgMS rather than \$0.10 per kgMS should be charged and it should apply to all independent processors. All independent processors take a flat supply and benefit from our additional costs of running a milk sourcing operation and this is just a small contribution towards those costs.

Amendment to the bill

Regulation 20 (New co-op must supply raw milk at default milk price unless parties agree price for supply)

Replace Regulation 20(4) with:

- (4) In subclause (3), **default milk price** means the farm gate milk price for that season plus 12 cents per kilogram of milk solids plus—
 - (a) the reasonable cost of transporting the raw milk to the independent processor; and
 - (b) for winter milk, the additional cost of winter milk in the Island in which the milk is supplied; and
 - (c) for organic milk, the reasonable additional costs to new co-op of procuring and supplying the organic milk.

Other minor changes (regulations 6, 10, 21, 11, clause 5, and s134)

We are proposing a number of other improvements to the Raw Milk Regulations

- **We seek greater certainty of estimates from independent processors**

The tolerances in regulations 10(3), 21(1) and 21(2) in relation to independent processors' estimates of the quantity of raw milk they anticipate purchasing should be reduced as they have a significant combined effect.

While we are generally able to cope with these during "shoulder" months, we face significant costs and challenges dealing with the potential variability of demand during "peak" months. We agreed with MPI's proposals to address this in the previous DIRA review by limiting the variation of: (a) processors' one-week supply estimates to 20% more or less than the earlier three-month estimate; and (b) contracted volume to between 90% and 110% of the one-week supply estimates.

Amendment to regulations

Regulation 10 (Daily estimates)**Regulation 21 (other terms of supply)****Regulation 10**

(3) A quantity estimated under subclause (2)(b) must be within the range from ~~40~~ 20% more than a quantity estimated under subclause (2)(a) to ~~40~~ 20% less than that quantity.

Regulation 21

- (1) New co-op may require an independent processor to contract to buy a quantity of raw milk not exceeding ~~80~~ 90% of the quantity of raw milk estimated by the independent processor under regulation 10(2)(b) or 11(2)(b).
- (2) An independent processor may require new co-op to contract to sell a quantity of raw milk not exceeding ~~120~~ 110% of the quantity of raw milk estimated by the independent processor under regulation 10(2)(b) or 11(2)(b).

- **We seek more notice from independent processors seeking winter milk supply and to reduce the tolerance for winter milk supply quantity estimates from independent processors**

The notice period in Regulation 11(2)(a) which currently requires independent processors to give 18 months' notice of requiring winter milk supply above 20,000 litres per day, should be increased to 24 months. A period of 18 months can be insufficient for our Co-operative to source new winter milk supply and for successful applicant farmers to alter calving patterns in order to supply milk in June and July (changing calving patterns itself takes at least 18 months), although the amount of any winter milk premium can impact this.

The tolerance for winter milk supply quantity estimates in Regulation 11(3) should be reduced from 40% to 10%. We need to separately contract winter milk from our suppliers and pay them a winter milk premium. If independent processors do not purchase the winter milk they have forecast to purchase we still have to pay the premium to our suppliers. Although we are able to process the milk, we do not recover the winter milk premium.

Amendment to regulations**Regulation 11 (Daily estimates for winter milk quantities exceeding 20,000 litres)****Regulation 11**

(2) For a quantity of winter milk to which subclause (1) applies, the independent processor must provide new co-op with an estimate for supply—

- (a) at least ~~18~~ 24 months before the date on which the winter milk is to be supplied;
- and

(3) A quantity estimated under subclause (2)(b) must be within the range from ~~40~~ 10% more than the quantity estimated under subclause (2)(a) to ~~40~~ 10% less than that quantity.

- We seek to be able to charge the winter milk premium for independent processors seeking winter milk supply who do not take that supply
- We seek appropriate limits on the volumes of winter milk that independent processors can purchase

A take or pay obligation in respect of the winter milk premium component of the regulated price under Regulation 21(5) – should be permitted for the same reasons as above. While we can process the winter milk not purchased into other products, we would not be able to recover the winter milk premium when an independent processor does not take what they forecast to take on short notice.

We also note that winter months are currently excluded from the months that are subject to maximum monthly volume limits (the “October rule”) and there does not appear to be any basis for this. While we can obtain a winter milk premium, which reflects the cost to Fonterra of sourcing that milk, the premium does not justify independent processors purchasing unlimited volumes of winter milk under Regulation 6.

Amendment to regulations

Regulation 21 (Other terms of supply)

Regulation 21

(5) This regulation does not allow new co-op to require that a contract to supply raw milk to an independent processor includes a take or pay requirement **except in respect of a winter milk premium.**

Regulation 6 (Maximum limit on supply of raw milk to each independent processor other than Goodman Fielder New Zealand)

- (2) For the purposes of subclause (1)(b), the maximum monthly limits are—
- (a) for June, 1 million litres:
 - (b) for July, 1 million litres:
 - (c) for August, 3 million litres:
 - (d) for September, 6 million litres:
 - (e) for October, 7 million litres:
 - (f) for November, 7 million litres:
 - (g) for December, 6 million litres:
 - (h) for January, 6 million litres:
 - (i) for February, 5 million litres:
 - (j) for March, 4 million litres:
 - (k) for April, 4 million litres:
 - (l) for May, 2 million litres.

Definition of raw milk (amends clause 5 of the bill)

- We seek clarification of the proposed new definition of raw milk

The bill moves a number of definitions from the Raw Milk Regulations into the DIRA, which were not foreshadowed in the MPI consultation. The rationale for these changes has not been explained in the bill, so it is not clear to us why this change is necessary.

However, as these definitions are now in the bill, we make the following comments:

The definition of Raw Milk is internally inconsistent in that it includes organic milk in (b), but then excludes milk produced under special conditions in (d). We understand (b) relates to Regulation 8 of the Raw Milk Regulations which requires Fonterra to supply to each independent processor the quantity of organic milk supplied by Fonterra's predecessors in the 2000/01 season. However, this Regulation is not utilized in practice and accordingly (b) should be removed from the definition of raw milk and Regulation 8 should be repealed.

The definition of Raw Milk includes a new (c) which has the effect of shifting the onus to make raw milk an inclusive term (rather than untreated milk from a cow). It is not clear, and nor has it been explained, what other types of milk might be prescribed by regulation to constitute raw milk. This change is unnecessary as raw milk should not be anything other than untreated milk from a cow.

Amendment to the bill

Definition of raw milk

Amends clause 5 of the bill

Raw milk—

(a) means untreated milk from a cow; ~~and~~ but

~~(b) includes organic milk; and~~

~~(c) includes any other milk of a kind that is not excluded by paragraph (d) and is prescribed by regulations made under section 115; but~~

~~(d)~~ does not include—

(i) Milk or a component of milk from a cow if the milk or component is produced under special conditions by, for example, the use of specialised herd selection, specialised farming practice, specialised feeding practice, or new technology; or

(ii) colostrum

Amends schedule 2, part 2 of the bill

Regulation 8

Repeal regulation 8.

Other issues

- **The Commerce Commission levy should be allocated proportionately**

Clause 25 allows for a more flexible process to set the levy Fonterra pays to fund certain Commerce Commission activities in relation to DIRA. Given the decline in Fonterra's market share since DIRA was implemented, it is no longer reasonable for Fonterra to bear all of the costs of the DIRA regulation. The Commission should be able to impose a proportionate share of costs on those who benefit from relevant processes, rather than Fonterra single-handedly funding these functions.

Amendment to the bill – Levy regulations

Amends clause 25 of the bill

Section 134 replaced (Levy regulations)

Replace section 134 with:

134 New co-op and independent processors must pay levy

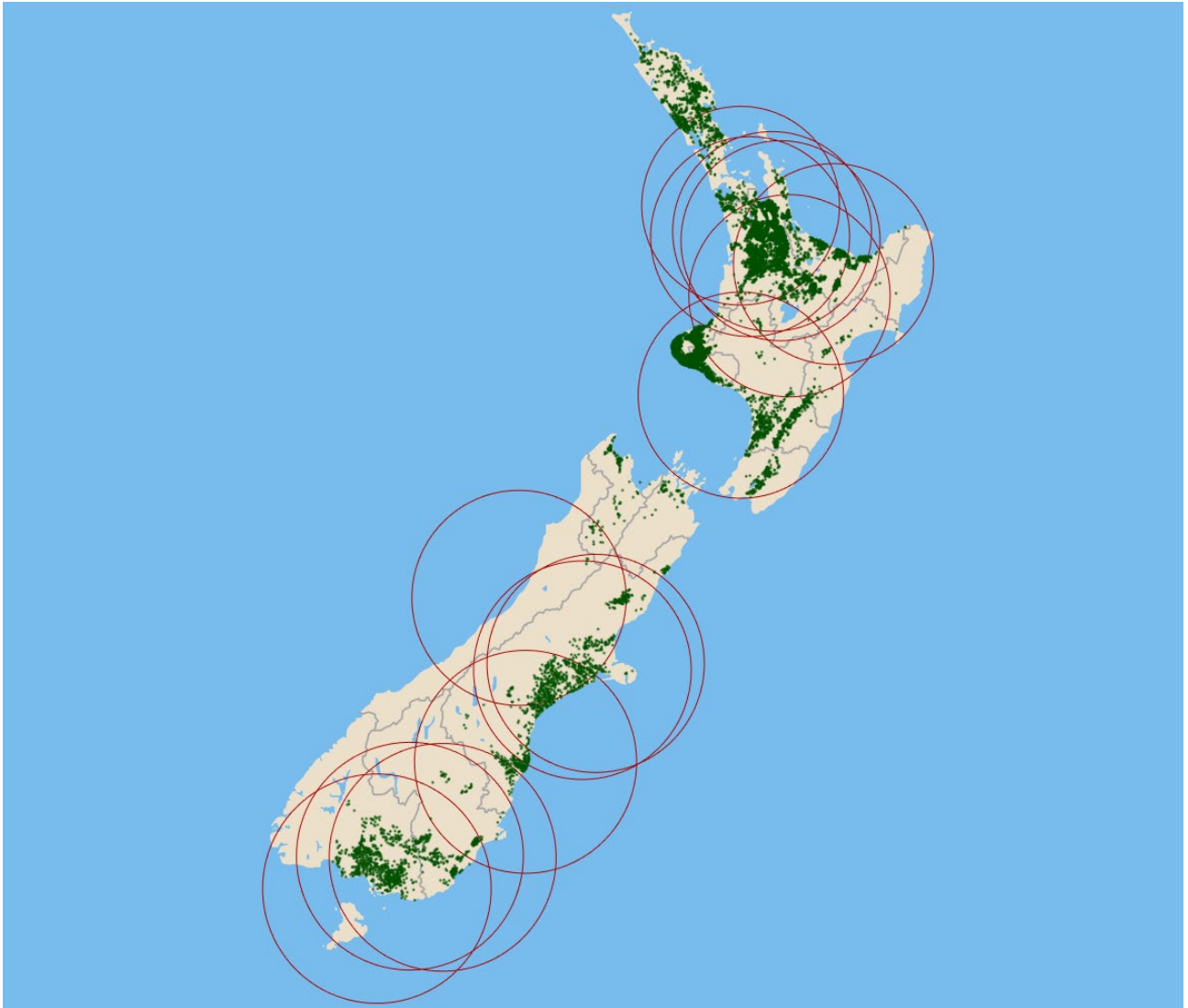
- (1) New co-op and independent processors must pay, in each financial year, a levy to the Minister that is determined in accordance with regulations made under **subsection (2)**.
- (2) The Governor-General may, by Order in Council made on the recommendation of the Minister, make regulations—
 - (a) specifying the amount of the levy, or method of calculating or ascertaining the amount of the levy, on the basis that the costs estimated under **subsection (4)** should be met fully out of the levy, with the proportion paid by new co-op and each independent processor commensurate with its national share of milk solids collections:
 - (b) including in the levy, or providing for the inclusion in the levy of, any shortfall in recovering those actual costs (including, without limitation, providing for a reconciliation of the levy against the levy that would have been payable had the calculation used the actual costs and invoicing new co-op and independent processors for the amount under-recovered from it as part of the levy):
 - (c) refunding, or providing for refunds of, any over-recovery of those actual costs:
 - (d) specifying 1 or more financial years or part financial years to which the levy applies:
 - (e) providing for the levy amount to be specified in the *Gazette* or some other publication (if the amount is not specified in the regulations):
 - (f) providing for the payment and collection of the levy:
 - (g) requiring payment of the levy for a financial year or part financial year, even though the regulations may be made after that financial year has commenced:
 - (h) exempting or providing for exemptions from, and providing for waivers of, the whole or any part of the levy.
- (3) The regulations may provide for the levy to apply, and be calculated in respect of, 1 or more financial years (with the levy being collected in each of those years from new co-op and independent processors).
- (4) In calculating estimated costs for the purposes of **subsection (2)(a)**, the Commission—
 - (a) may include—
 - (i) the cost of making determinations; and
 - (ii) the cost of enforcing this subpart or subpart 5A; and
 - (iii) the cost of enforcing determinations in the High Court; and
 - (iv) over-recoveries or under-recoveries of actual costs; and
 - (v) the cost of conducting reviews under subpart 5A; and
 - (b) must exclude—
 - (i) the cost of taking other proceedings in the High Court, or defending proceedings against the Commission in the High Court; and
 - (ii) the cost of investigations that are not related to complaints or determinations made under this subpart; and
 - (iii) the cost of providing input for the reports under **section 147** on the operation of subparts 5 and 5A; and

- (c) must calculate and deduct the total amount of application fees likely to be received.
- (5) The Minister must consult with new co-op, [independent processors](#) and the Commission before making a recommendation under **subsection (2)**.
- (6) The amount of unpaid levy is recoverable in a court of competent jurisdiction as a debt due to the Crown.

Note that consequential changes would likely be required to:

- Section 72 (overview).

Appendix A – Map showing competition



Under s107(3) of DIRA, if you are a farmer within 160kms of an independent processor we apply less restrictive supply contracts in order to enable milk supply to shift to independent processors.

ENDS