

Process Paper – Review of base milk price calculation

3 May 2013

Purpose

1. This paper provides information on the scope and the timeline for our review of Fonterra's base milk price calculation for the 2012/13 season as required by the Dairy Industry Restructuring Act 2001 (as amended July 2012)(The Act). It also seeks comment from interested parties on how we should approach some likely areas of particular interest.

The review of the base milk price

2. We are beginning the process of reviewing the calculation Fonterra uses to determine the price they pay to farmers for milk, known as the 'base milk price'. This is the second of two reviews we are required to undertake on the base milk price each season. The first review, on Fonterra's Milk Price Manual (Review of the Manual), was completed in December 2012.¹
3. Submissions to this paper are due by 17 May 2013. They should be sent to: regulation.branch@comcom.govt.nz, for the attention of Paolo Ryan.

Scope and timeline of the review

Scope of the review

4. The scope of this review is confined to Fonterra's base milk price calculation. Specifically it will consider how the base milk price calculation provides an incentive to Fonterra to operate efficiently, while providing for contestability in the market for the purchase of milk from farmers.²

Timeline for the review

5. A summary of the process and our indicative timing is set out in Table 1 below.

¹ Commerce Commission, *Review of Fonterra's 2012/13 Milk Price Manual: Final Report*, 14 December 2013.

² These are the statutory tests in s 150A of the Act.

Table 1: Timeline for the review

Process step	Indicative timing
Process Paper issued	Friday 3 May 2013
Submissions on Process Paper due	Friday 17 May 2013
Fonterra provides Commission with information under section 150T of the Act	Monday 1 July 2013
Key issues paper released for public consultation	Friday 5 July
Submissions on key issues paper due	Friday 19 July
Draft Report for public consultation	Thursday 15 August 2013
Submissions on Draft Report due	Thursday 29 August 2013
Final Report	Monday 16 September 2013

6. We have provided for the public release of a key issues paper, based on advance analytical work we will have completed at that time. This is so any important matters which have the potential to impact our report can be dealt with as early as practicable.
7. We have provided for a further round of public consultation. The Act only requires us to consult with Fonterra on our draft report. However we have decided that for this first statutory review of the base milk price calculation we will also provide an opportunity for interested parties to comment on our draft report.
8. We will communicate to interested parties any other process matters as they arise.

Comment sought from interested parties on best approach to analysing areas of particular interest

9. We are seeking submissions from interested parties on information sources and best approaches to analysing the areas of particular interest we have identified as listed below, but broadly categorised as:
 - 9.1 outstanding issues from our Review of the Manual; and
 - 9.2 other topics for further consideration.
10. Table 2 below covers the four areas we indicated in our Review of the Manual that we would be following up in this review of the base milk price calculation. The table also references other documents in which these topics have been previously raised.

Table 2: Outstanding issues from our Review of the Manual

Topic	Reference to topic
Asset stranding	Review of the Manual, pp19-20 <i>Fonterra, Submission to the Commerce Commission on its Draft Report on Fonterra's 2012/13 Farmgate Milk Price Manual, 15 November 2012, pp4-5</i>
Milk collection costs	Review of the Manual, p18
Operating costs – Use of actual resource usage and unit rates	Review of the Manual, pp18-19
Over-optimisation of notional assets	Review of the Manual, pp20-21 <i>Fonterra, Submission to the Commerce Commission on its Draft Report on Fonterra's 2012/13 Farmgate Milk Price Manual, 15 November 2012, pp5-6</i>

11. Table 3 contains a number of other topics on which we would like your input. We assessed these topics in our Review of the Manual, but we consider that the detailed implementation of these topics in the base milk price calculation may give rise to issues not already considered.

Table 3: Other topics for further consideration

Topic	Reference to topic
Yields	Review of the Manual, p22 <i>Synlait, Submission to the Commerce Commission Regarding the Milk Price Manual, 15 November 2012, p20</i>
Practical feasibility of the notional producer	Review of the Manual, pp12-13 <i>Synlait, Submission to the Commerce Commission Regarding the Milk Price Manual, 15 November 2012, pp19-20</i>
Pricing	Review of the Manual, p22
<ul style="list-style-type: none"> • Impact on GDT prices of using notional yields • Discretion to use off GDT prices 	<p><i>Synlait, Submission to the Commerce Commission Regarding the Milk Price Manual, 15 November 2012, p20</i></p> <p><i>Fonterra, Submission to the Commerce Commission on its Draft Report on Fonterra's 2012/13 Farmgate Milk Price Manual, 15 November 2012, pp6-7</i></p>
Asset beta	Review of the Manual, Attachment C (Rule 40).

12. We are seeking submissions on this Process Paper regarding the best approach the Commission could take in assessing the topics outlined in tables 1 and 2 against the statutory purpose. That includes:

- 12.1 Methods of conducting the assessment of the base milk price calculation, including the best ways to analyse any information relating to those topics;
- 12.2 Where use of industry data and experts may be of assistance.
- 13. We also invite submitters to identify other issues which they consider to be important, along with views on the best approach to assessment.
- 14. Please note that we are not seeking substantive submissions on these issues at this point. Any substantive submissions on the above areas will not be considered in this round of the consultation.

Requests for confidentiality

- 15. While we discourage requests for non-disclosure of your comments, we recognise that there may be cases where parties wish to provide information in confidence. We offer the following guidance.³
 - 15.1 If it is necessary to include confidential material in your comments, the information should be clearly marked.
 - 15.2 Both confidential and public versions of your comments should be provided.
 - 15.3 The responsibility for ensuring that confidential information is not included in a public version rests entirely with the party providing the comments.

³ Parties can also request that we make orders under s 100 of the Act in respect of information that should not be made public. Any request for a s 100 order must be made when the relevant information is supplied to us, and must identify the reasons why the relevant information should not be made public. We will provide further information on s 100 orders if requested by parties. A key benefit of such orders is to enable confidential information to be shared with specified parties on a restricted basis for the purpose of making submissions. Any s 100 order will apply for a limited time only as specified in the order. Once an order expires, we will follow our usual process in response to any request for information under the Official Information Act 1982.