



## Process Paper - Review of 2013/14 base milk price calculation

9 June 2014

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### Purpose

1. This paper provides information on the proposed scope and timeline for our review of Fonterra's base milk price calculation for the 2013/14 season as required by the Dairy Industry Restructuring Act 2001 (The Act). It also provides an opportunity for interested parties to comment on any matter set out in this process paper.
2. Any comments on this process paper are due to us by 20 June 2014. They should be sent by email to: [regulation.branch@comcom.govt.nz](mailto:regulation.branch@comcom.govt.nz), for the attention of Patricia Jennings.

### Our 2013/14 review of the base milk price calculation

3. We are beginning our process of reviewing the calculation Fonterra uses to determine the price it pays to farmers for milk, known as the 'base milk price', for the 2013/14 season.
4. This is the second of two reviews we are required to undertake on the base milk price each season. The first review, of Fonterra's 2013/14 Milk Price Manual, was completed in December 2013.<sup>1</sup>

### Scope and timeline of our review

#### *Scope of our review*

5. The scope of our review is confined to Fonterra's base milk price calculation. It will consider the extent to which the assumptions adopted, and the inputs and processes used, provide an incentive to Fonterra to operate efficiently, while providing for contestability in the market for the purchase of milk from farmers.<sup>2</sup>

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<sup>1</sup> Commerce Commission "Review of Fonterra's 2013/14 Milk Price Manual: Final Report" (16 December 2013).

<sup>2</sup> These are the statutory tests in s 150A of the *Dairy Industry Act 2001* (as amended on 26 July 2012).

*Timeline for our review*

6. A summary of our review process and indicative timings for stages in our review is set out in Table 1.
7. The Act only requires us to consult with Fonterra on our Draft Report. However, we have decided that we will also provide an opportunity for other interested parties to comment throughout our review process, as outlined in Table 1.

**Table 1: Indicative timeline**

<b>Process step</b>	<b>Indicative timing</b>
This Process Paper released	Monday 9 June 2014
Comments on Process Paper due	Friday 20 June 2014
Fonterra provides Commission with information required under section 150T of the Act	Tuesday 1 July 2014
Invitation for submissions on Fonterra's section 150T reasons in relation to the expected adjustment to the base milk price derived from the 2013/14 Milk Price Manual	Wednesday 2 July 2014
Submissions on Fonterra's section 150T reasons	Tuesday 15 July 2014
Draft Report on base milk price calculation released	Friday 15 August 2014
Submissions on Draft Report due	Friday 29 August 2014
Final Report on base milk price calculation released	Monday 15 September 2014

8. We will communicate any updates to this process as they arise.

**Our proposed approach in reviewing the 2013/14 base milk price calculation**

9. We propose to focus our analysis for the 2013/14 base milk price calculation review on the issues listed in Table 2 below and any areas where Fonterra changes its approach since 2012/13. For other components of the base milk price calculation, we do not consider it will be necessary to undertake the same depth of analysis as in 2012/13 to reach a conclusion on the extent to which that component is consistent with the purpose in s 150A of the Act.
10. Fonterra is proposing to pay less than the milk price calculated under the Milk Price Manual (see Table 2). The approach above may therefore change based on the outcome of our assessment of Fonterra's assumptions adopted, inputs and process in determining a milk price that is expected to be less than the milk price derived under the Manual.

**Table 2: Possible topics for consideration**

Topic	Reference to topic
Fonterra has forecast paying less than the milk price calculated in accordance with the 2013/14 Milk Price Manual	<ul style="list-style-type: none"> <li>• Fonterra media release “Fonterra announces forecast Farmgate Milk Price for 2014/15 season and revised forecast for 2013/14 season” (28 May 2014)</li> </ul>
Energy usage	<ul style="list-style-type: none"> <li>• Review of the 2012/13 base milk price calculation, pp 98-101</li> <li>• Fonterra “Submission to the Commerce Commission on its Draft Report on its review of the F13 base milk price”, pp 4-6</li> </ul>
Capital charge on fixed assets	<ul style="list-style-type: none"> <li>• Review of the 2012/13 base milk price calculation, pp 133-139</li> <li>• Fonterra “Submission to the Commerce Commission on its Draft Report on its review of the F13 base milk price”, pp 7-9</li> </ul>
Asset beta assumption in the weighted average cost of capital (WACC) calculation	<ul style="list-style-type: none"> <li>• Review of the 2012/13 calculation, pp 140-143</li> </ul>
Asset stranding risk provided for in the calculation of the asset beta (Rules 31 and 32)	<ul style="list-style-type: none"> <li>• Review of the 2013/14 Milk Price Manual, pp 12-14</li> <li>• Fonterra “Submission to the Commerce Commission on its Draft Report on Fonterra’s 2013/14 Farmgate Milk Price Manual”, pp 8-10</li> </ul>
Basis of derivation of other costs, including site overheads, general overhead costs and R&D costs (Rule 19)	<ul style="list-style-type: none"> <li>• Review of the 2013/14 Milk Price Manual, pp 19-20</li> <li>• Fonterra “Submission to the Commerce Commission on its Draft Report on Fonterra’s 2013/14 Farmgate Milk Price Manual”, pp 10-11</li> </ul>
Change in basis of repairs and maintenance costs (Rule 16)	<ul style="list-style-type: none"> <li>• Review of the 2013/14 Milk Price Manual, pp 14-17</li> <li>• Fonterra “Submission to the Commerce Commission on its Draft Report on Fonterra’s 2013/14 Farmgate Milk Price Manual”, pp 10</li> </ul>