# Submission by Open Country Dairy Limited

## Review of Fonterra’s 2025/26 Base Milk Price Calculation

### Introduction

Open Country Dairy Limited welcomes the opportunity to provide this submission on the Commerce Commission’s draft report on its review of Fonterra’s 2025/26 base milk price calculation.

Open Country supports the Commission’s role in monitoring Fonterra’s base milk price under the Dairy Industry Restructuring Act 2001. The base milk price remains a critical benchmark for competition in the market for the purchase of farmer milk. It therefore needs to be transparent, rule-based, replicable and capable of being tested by market participants.

Open Country has previously participated in submissions on the base milk price regime, including through joint Independent Dairy Processor submissions. The Commission’s draft report refers to concerns previously raised by IDPs, including Open Country, regarding lactose ingredient costs and transparency.

### Overall position

Open Country acknowledges the Commission’s draft conclusion on the 2025/26 base milk price calculation, but does not consider it appropriate to conclude that the calculation is consistent with the efficiency and contestability dimensions of section 150A of DIRA.

Open Country’s concern is that the issues identified in the draft report go directly to whether the regime is sufficiently transparent, replicable and capable of constraining Fonterra’s discretion over material inputs.

The Commission’s draft report identifies several areas where the current approach relies on complexity, judgement, confidential data or methodology that is not fully reflected in the Milk Price Manual. Those issues matter because the milk price is not just an internal Fonterra calculation. It is the benchmark against which other processors must compete for farmer milk.

A calculation may be technically acceptable in a given year, but still leave wider concerns about transparency, replicability and the scope for selective treatment of inputs. Where Fonterra has discretion over material inputs that can move the milk price, that creates a significant and unacceptable manipulation risk.

### Lactose pricing and freight methodology

Open Country welcomes the Commission’s more detailed review of lactose import prices and associated costs. The draft report provides greater visibility over the calculation methodology, including transaction filtering assumptions, freight treatment, foreign exchange treatment, storage costs and working capital.

This additional disclosure is useful. However, Open Country remains concerned that Fonterra appears to retain too much discretion over both FOB lactose prices and related freight costs.

Under the Commission's Review Framework, the efficiency dimension includes the use of independent notional benchmarks for revenue and cost inputs. Open Country considers that principle is directly relevant here. Where there are clear independent references for lactose prices and related shipping costs, those independent references should be used as the input references.

Fonterra should not have discretion to select between lactose price inputs or freight cost approaches where independent benchmark references are available. Allowing that discretion weakens confidence that the milk price is being calculated on a neutral notional basis, rather than on inputs selected or adjusted by Fonterra.

Open Country's concern is not simply that the lactose calculation is detailed. The concern is that key parts of the methodology are not clearly and completely described in the Manual. The Commission acknowledges that the calculation of lactose freight costs does not appear to be fully consistent with the Manual, although it treats this as a Manual drafting concern rather than a calculation issue.

Open Country supports the Commission's recommendation that the Manual be amended to accurately reflect how lactose costs are calculated. This should be treated as a substantive transparency issue, not a minor drafting point.

The Manual is the primary governance document for the milk price framework. If the Manual does not accurately describe the calculation that is actually applied, market participants cannot reliably test whether the methodology is being applied consistently over time.

## Optionality in the milk price calculation creates a significant and unacceptable manipulation risk

Open Country is concerned that several aspects of the 2025/26 calculation appear to give Fonterra discretion over whether certain assumptions, gains or sales are included in the milk price calculation.

Even if each item can be explained individually, the combined effect is a regime where Fonterra appears to retain optionality over inputs that can move the base milk price. That creates a significant and unacceptable manipulation risk.

Open Country considers this issue arises in three areas.

### 1. Lactose assumptions

Rule 16 allows Fonterra to choose before the season whether to use its own lactose price series or competitor import prices. For 2025/26, Fonterra has used the competitor price series.

However, the freight component appears to use a different approach. The Commission records that Fonterra freight rates are used by default where available, with competitor rates used where Fonterra rates are not available.

Open Country is concerned that the Manual does not clearly describe this combined approach. That creates practical optionality.

Open Country's position is that lactose FOB pricing and freight cost inputs should be based on clear independent benchmark references where those references are available. Fonterra should not have discretion to select or blend approaches in a way that is not fully described in the Manual and capable of being externally tested.

The lactose methodology should be locked down in the Manual with enough precision that Fonterra cannot choose between alternative approaches without clear disclosure, consultation and Commission scrutiny.

## 2. Gains from milk received from other processors

The draft report notes that Fonterra has included a one-off benefit in the milk price arising from accepting additional milk from a third-party processor on non-standard terms. The Commission notes that the impact is less than 1 cent per kgMS and concludes that the treatment is consistent with section 150A.

Open Country is concerned with the principle.

Fonterra benefited from this arrangement because of its market position, scale and processing footprint. If Fonterra then includes that gain in the benchmark milk price, the regime risks converting a transaction-specific benefit into a sector-wide milk price input.

That may lift the benchmark milk price against which other processors must compete, even though the opportunity may not be equally available to them.

Open Country also considers this treatment appears inconsistent with DIRA s150C(1)(c). That section requires the base milk price to be set on the basis that Fonterra collects all milk that it processes from the farms on which the milk is produced.

Including a benefit from milk received from another processor appears to depart from that statutory principle. The gain did not arise from Fonterra collecting milk from the farms on which that milk was produced. It arose from Fonterra receiving milk from another processor under non-standard commercial circumstances.

Open Country considers that distinction matters. Section 150C(1)(c) helps define the notional basis on which the base milk price is to be calculated. It should not be open to Fonterra to include a gain that depends on a real-world transaction outside that notional construct, particularly where that gain is available because of Fonterra's scale, footprint or market position.

Open Country considers that one-off or non-standard gains should be subject to a higher threshold before being included in the milk price. At a minimum, the Commission should require clear evidence that:

- the benefit is consistent with the statutory principle in s150C(1)(c);
- the benefit is genuinely available to an efficient processor, not merely available to Fonterra;

- the benefit does not arise from Fonterra's market position or unique processing footprint; and
- including the benefit does not increase the benchmark milk price in a way that competitors cannot reasonably replicate.

On that basis, Open Country considers the inclusion of this item creates a significant and unacceptable manipulation risk. It allows a benefit from a non-standard transaction, outside the ordinary notional collection model contemplated by s150C(1)(c), to be included in the price competitors must then compete against.

### 3. Optionality around large tenders and off-GDT pricing

The draft report notes that Fonterra has included certain key tenders as qualifying sales going forward. It also notes that such tender sales had historically been treated as non-price-informing because they involved large volumes and, in many cases, Fonterra was the only processor able to fulfil the order.

Open Country is concerned that this creates another area of optionality.

The treatment of large tenders appears able to shift over time, with sales previously excluded now included on the basis of a changed assessment. That may be appropriate if the criteria are clear, objective and consistently applied. It is problematic if Fonterra has discretion to include or exclude large tenders depending on whether their inclusion improves the milk price outcome.

Open Country is also concerned that recent changes to off-GDT pricing, including the inclusion of large government tenders and SGX daily referencing, add volatility to the calculation of the forecast farmgate milk price. This makes it more difficult for market participants to estimate, review and test the calculation.

The use of public futures references may assist pricing responsiveness, but it does not remove the need for transparency over which sales are included, which are excluded, and why.

Open Country considers that Fonterra should release regular information, preferably monthly, on the key inputs going into the farmgate milk price calculation. This should include, at a minimum:

- average pricing assumptions;
- average NZD/USD conversion rate assumptions;
- forecast farmgate milk price contracting rates; and
- phasing of relevant sales and pricing inputs.

Regular disclosure of these inputs would materially improve transparency and help market participants understand whether changes in the milk price are being driven by genuine market movements or by changes in methodology, inclusion criteria or timing.

## Wider DIRA review context

These concerns should also be considered in the context of the current DIRA review.

Open Country has recently raised concerns that DIRA remains necessary because Fonterra was created through exceptional legislative authorisation and continues to hold a dominant position in New

Zealand's dairy industry. General competition law does not, by itself, adequately address the risks created by Fonterra's scale, market position and price-setting role.

The base milk price monitoring regime is one of the few practical checks on that price-setting role. Its value depends on more than the Commission satisfying itself that a calculation appears reasonable after the event. It depends on the rules being clear, the methodology being accurately recorded in the Manual, and market participants being able to understand and test the benchmark they are required to compete against.

Open Country therefore considers that the milk price monitoring regime should be strengthened, not diluted.

## Recommendations

Open Country recommends that the Commission's final report:

- Confirm that transparency is central to the section 150A assessment, not merely a desirable feature of the regime.
- Require the Milk Price Manual to accurately describe the methodology actually applied, including the lactose FOB price and freight cost methodology.
- Confirm that where clear independent references are available for lactose prices and related shipping costs, those references should be used as the relevant notional benchmark inputs.
- Treat the current mismatch between Rule 16 and the lactose freight calculation as a substantive transparency issue that should be resolved before the next season.
- Recognise that Fonterra discretion over material inputs creates a significant and unacceptable manipulation risk, particularly where those inputs can affect the benchmark milk price.
- Apply greater scrutiny where Fonterra has discretion over material inputs, including assumptions, filters, qualifying sales, off-GDT pricing references and one-off gains.
- Require any gain from milk received from another processor to be excluded from the base milk price unless the Commission is satisfied that its inclusion is consistent with DIRA s150C(1)(c), which requires the base milk price to be set on the basis that Fonterra collects all milk that it processes from the farms on which that milk is produced.
- Require any one-off benefit included in the milk price to be supported by clear evidence that the benefit is genuinely available to an efficient processor, not merely available to Fonterra because of its scale, footprint or market position.
- Require any change in treatment of large tenders or off-GDT sales to be fully explained, consistently applied and capable of being tested by stakeholders.
- Recognise that the inclusion of large government tenders and SGX daily referencing adds volatility and makes the forecast farmgate milk price more difficult to estimate and review.
- Require regular disclosure, preferably monthly, of key farmgate milk price inputs, including average pricing, NZD/USD conversion rate assumptions, contracting rates and relevant sales phasing.
- Continue to prioritise transparency and replicability in future reviews, particularly where inputs rely on confidential data, judgement-based methodology or complex modelling.

## Conclusion

Open Country appreciates the Commission's detailed review and the additional transparency provided through this year's draft report. However, Open Country does not consider it appropriate to conclude that Fonterra's 2025/26 base milk price calculation is consistent with the efficiency and contestability dimensions of section 150A of DIRA.

The draft report highlights why the regime still requires improvement. The milk price calculation remains too dependent on complex methodology, confidential inputs and areas of Fonterra discretion that are difficult for external parties to test.

Open Country's central point is straightforward: a milk price regime that permits optionality over material inputs creates a significant and unacceptable manipulation risk. That risk exists even if the Commission ultimately concludes that the 2025/26 calculation is acceptable.

The base milk price should be calculated under clear, stable and transparent rules. Where Fonterra has discretion, that discretion should be narrow, disclosed, justified and reviewable. Where a material input depends on judgement, confidential data or a change in treatment from prior seasons, the Commission should apply a higher level of scrutiny.

Transparency, replicability and consistency between the Manual and the calculation actually applied are not optional process matters. They are essential to confidence in the milk price, effective competition for farmer milk, and the long-term performance of New Zealand's dairy industry.

Open Country's position is that if DIRA is to continue doing its job, the base milk price regime must be transparent, testable and capable of constraining the market power it was designed to address.

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**Open Country Dairy Limited**