



Cabinet

Minute of Decision

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Review of the Dairy Industry Restructuring Act 2001 and Impacts on the Dairy Industry

Portfolio **Agriculture**

On 4 June 2019, following reference from the Cabinet Economic Development Committee, Cabinet:

Background

- 1 **noted** that the Dairy Industry Restructuring Act 2001 (the DIRA) regulates Fonterra to manage risks to the dairy industry, farmers and consumers arising from Fonterra's dominance in the market for farmers' milk;
- 2 **noted** that the key regulatory tools for managing Fonterra's dominance risk are the open entry and exit provisions that allow farmers to switch their milk supply between Fonterra and other dairy processors in response to price signals and Fonterra's performance;
- 3 **noted** that the Ministry for Primary Industries has carried out a review of the DIRA and its impact on the dairy industry, informed by extensive consultation with stakeholders and independent economic analysis;
- 4 **noted** that the overall conclusions arising from the review are that the DIRA:
 - 4.1 has been effective in achieving its core regulatory objective of managing Fonterra's dominance;
 - 4.2 is still required to manage ongoing risks arising from Fonterra's dominance and incentive to use its incumbency advantage to lock farmers in or out of the co-operative as a strategy to deter farmers from switching to other dairy processors;
 - 4.3 has resulted in some unintended consequences, in preventing Fonterra from effectively managing some aspects of its farmer-shareholders' on-farm performance and planning investment in capacity;
 - 4.4 requires some strengthening of requirements around the calculation of the base milk price to improve the certainty and reliability of the calculation;
 - 4.5 requires updating of terms of access to regulated milk for Goodman Fielder and large export-focussed processors;

Proposed amendments

5 **agreed** to the following amendments to the DIRA:

Open entry and exit

- 5.1 provide a limited exception to the open entry and exit requirements to allow Fonterra, subject to the existing non-discrimination provision, to either decline an application to become a shareholding farmer, or to increase supply from an existing shareholding farmer, where it is evident that the applicant could not meet Fonterra's terms of supply;
- 5.2 clarify that Fonterra's terms of supply can relate to, and price differentiate on the basis of, various on-farm performance matters that include, but are not limited to animal welfare, food safety, health and safety, employment conditions, environmental, climate change and other sustainability standards, subject to the existing non-discrimination provision;
- 5.3 provide a limited exception to the open entry and exit requirements to allow Fonterra, subject to the existing non-discrimination provision, to decline an application to become a shareholding farmer, or to increase supply from an existing shareholding farmer, when the application is in respect of a new dairy conversion;
- 5.4 provide a definition of 'new dairy conversion' that includes dairy farming established on land that had not been used for dairying in the five years prior to an application to Fonterra to become a shareholding farmer, or to increase supply from an existing shareholding farmer;
- 5.5 provide a transitional arrangement to disapply the exception referred to in paragraph 5.3 above to dairying conversions that are currently underway;

Base milk price calculation

- 5.6 limit Fonterra's discretion in setting its assumption on the estimate of risk (measured by asset beta) by requiring consistency with dairy and other commodity processors when estimating the cost of financing milk processing operations in its base milk price calculation;
- 5.7 provide that Fonterra be required to appoint one member of its Milk Price Panel on the nomination of the Minister;

Future review provisions

- 5.8 provide that the Minister of Agriculture should carry out reviews on whether the DIRA regulatory regime should be retained, repealed or amended, at intervals of no less than four years and no more than six years from presentation to the House of a report on the previous review;
- 5.9 provide that the Minister of Agriculture, in consultation with the Minister of Commerce and Consumer Affairs, can direct the Commerce Commission to provide input to a review, as provided under paragraph 5.8 above;

Minor and technical changes***Fonterra Levy***

- 5.10 amend the existing regulation-making power in the DIRA to enable future regulations to be made that simplify the process for setting a levy to recover the Commerce Commission's costs of administering the DIRA;

Capacity constraint notices

- 5.11 provide that Fonterra can issue a capacity constraint notice in a region for a period of three seasons, rather than one, as at present;

Monitoring

- 5.12 add a regulation-making power to require Fonterra and independent processors to provide information to the Ministry for Primary Industries to support the monitoring of dairy markets (such as the wholesale (processor-to-processor) market);

Base milk price

- 5.13 clarify that Fonterra can pay a farmgate milk price that differs from the base milk price calculated and monitored under Subpart 5A of Part 2 of the DIRA;

- 6 **agreed** to the following amendments to the Dairy Industry Restructuring (Raw Milk) Regulations 2012:

Access to regulated milk by dairy processors other than Goodman Fielder

- 6.1 provide that Fonterra will no longer be required to sell up to 50 million litres of raw milk per season to an independent processor once that independent processor has obtained 30 million litres of its own supply of raw milk in a season (whether from farmers or through a wholesale process);
- 6.2 provide transitional arrangements for independent processors who have not yet exhausted the three-year own-supply entitlement as set out in current regulations;

Access to regulated milk by Goodman Fielder

- 6.3 update the terms on which Goodman Fielder can purchase regulated milk from Fonterra to:
- 6.3.1 increase the total maximum volume that Goodman Fielder can purchase from Fonterra in a season from 250 to 350 million litres to recognise changing demand and growth in the domestic consumer market;
- 6.3.2 amend the regulated price from Fonterra's farmgate milk price per kgMS to Fonterra's farmgate milk price plus 10 cents per kgMS to compensate Fonterra for the economic cost of providing milk to Goodman Fielder;
- 6.3.3 allow Goodman Fielder to purchase raw milk from Fonterra at fixed quarterly prices in line with other processors supplying the domestic consumer market;

Monitoring

- 6.4 subject to paragraph 5.12 above, require processors to keep records and enable the Ministry for Primary Industries to collect information on the supply of raw milk other than that supplied by Fonterra or direct from farmers to processors, i.e. raw milk that is subject to wholesale (processor to processor) trade;

Legislative implications

- 7 **invited** the Minister of Agriculture to issue drafting instructions to the Parliamentary Counsel office to give effect to paragraphs 5 and 6 above;
- 8 **authorised** the Minister of Agriculture to make secondary design and policy decisions in relation to any minor and technical drafting matters required to ensure consistency with paragraphs 5 and 6 above.

Michael Webster
Secretary of the Cabinet

Secretary's Note: This minute replaces DEV-19-MIN-0142. Cabinet amended paragraph 5.7.

Hard-copy distribution:

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Minister of Agriculture