

In Confidence

Office of the Minister of Agriculture
Chair, Cabinet Legislation Committee

DAIRY INDUSTRY RESTRUCTURING AMENDMENT BILL (NO 3) 2019: APPROVAL FOR INTRODUCTION

Proposal

1. The Minister of Agriculture seeks agreement to introduce the Dairy Industry Restructuring Amendment Bill (No 3) 2019 (attached in Appendix Two).

Policy

2. The Bill implements Cabinet decisions in respect of:
 - Part 2, Subpart 4 of the Dairy Industry Restructuring Act 2001 (the DIRA), which regulates aspects of the herd improvement industry and management of the New Zealand dairy Core Database (core database); and
 - Part 2, Subparts 5 and 5A of the DIRA and the associated Dairy Industry Restructuring (Raw Milk) Regulations 2012, which regulate the activities of Fonterra, to promote the efficient operation of New Zealand dairy markets.

Policy and amendments to Part 2, Subpart 4

3. Part 2, Subpart 4 provides, among other things, for the management and maintenance of the core database, an industry-good repository of New Zealand herd improvement data that supports genetic gain across the New Zealand dairy herd. The Bill implements decisions of the Cabinet Economic Development Committee taken on 8 May 2019 [DEV-19-MIN-0111 refers]. It recognises in law that management of the core database was transferred from Livestock Improvement Corporation (LIC) to DairyNZ in 2014.
4. The Bill also revokes the Herd Testing Regulations 1958, which are now redundant.
5. Part 2, Subpart 4 of the DIRA also imposes some statutory obligations on LIC, which the company considers should be removed. Policy decisions on whether these obligations should be removed have not yet been taken and remain under consideration. Free and frank advice

Policy and amendments to Part 2, Subparts 5 and 5A and the associated regulations

6. Part 2, Subparts 5 and 5A of the DIRA regulate Fonterra to manage risks to the dairy industry, farmers and consumers arising from Fonterra's dominance in New Zealand dairy markets.

7. The Ministry for Primary Industries has carried out a review of the DIRA and its impact on the dairy industry from May 2018 to May 2019, informed by extensive consultation with stakeholders and independent economic analysis. The purpose of the review was to ensure that the DIRA is effective at achieving its regulatory purpose and remains fit-for-purpose; does not create unintended consequences; and does not stay in place for longer than necessary.
8. The review has found that, despite Fonterra's reduced market share, it retains significant market power in terms of its national scale, large market share and incumbency advantage. It is therefore necessary to continue regulating the activities of Fonterra to promote the efficient operation of dairy markets in New Zealand.
9. However, changes to how Fonterra is regulated are needed to remove some regulatory requirements that are no longer necessary; support and encourage better environmental performance of the dairy industry; provide Fonterra with more flexibility to manage some aspects of its operations; and provide increased clarity on aspects of the regulatory regime for both Fonterra and other dairy industry stakeholders.
10. The Bill therefore provides a package of measures to maintain regulatory disciplines on Fonterra's performance and enhance aspects of the dairy industry's performance as above. It gives effect to policy decisions taken by Cabinet on 4 June 2019 [CAB-19-MIN-0264.01 refers].
11. The Bill amends Subparts 5 and 5A of Part 2 of the Dairy Industry Restructuring Act 2001 to:
 - Allow Fonterra to decline applications from dairy farmers to become shareholders in, and supply milk to, Fonterra when it is unlikely that the applicant would comply with Fonterra's terms of supply. This is intended to support Fonterra's ability to manage aspects of farmers' on-farm performance more effectively and address reputational risks to Fonterra, and the dairy industry in general, which may arise from poor environmental, or other, on-farm performance.
 - Clarify that Fonterra's terms of supply can include, and Fonterra may pay different prices, on the basis of, for example, environmental, animal welfare, employment matters, and health and safety requirements. This will ensure that Fonterra is fully able to reward excellent on-farm performance of its farmer-shareholders as part of its business and strategic direction. Fonterra and its farmer-shareholders are expected to fully utilise the flexibility afforded by these amendments, including better management of discharges and greenhouse gas emissions.
 - Provide Fonterra with discretion to refuse applications for applications to become shareholders in, and supply milk to, Fonterra if milk is supplied from newly converted dairy farms. This is to enable Fonterra to better manage uncertainty of future milk supply that may arise from dairy conversions, and the associated impacts on Fonterra's processing capacity and investment decisions.

- Allow Fonterra to issue capacity constraint notices for a period of three dairy seasons, rather than one, as now. This would provide Fonterra more flexible and realistic timeframes to plan and manage its future capacity investment.
 - Limit Fonterra's discretion with regard to setting a key assumption (the asset beta) in its base milk price calculation. This is to reduce the risk of Fonterra using its discretion in a way that may impose higher than efficient costs on new and existing dairy processors, including Fonterra itself, while retaining the essence of the existing light-handed milk price monitoring regime administered by the Commerce Commission.
 - Require Fonterra to appoint one member of its Milk Price Panel on the nomination of the Minister of Agriculture. This is intended to further support the independence of Fonterra's Milk Price Panel.
 - Require the Minister of Agriculture to carry out periodic time-bound reviews of whether the provisions of Subpart 5 and 5A of Part 2 of the Dairy Industry Restructuring Act 2001 should be retained, repealed or amended. This would provide regulatory certainty and a clear timeframe within which the dairy industry can plan and operate.
12. The Bill also amends the Dairy Industry Restructuring (Raw Milk) Regulations 2012 to:
- Lift the obligation on Fonterra to supply up to 50 million litres of raw milk to independent processors at regulated prices once an independent processor has its own raw milk supply of 30 million litres or more in a single season (reduced from the three consecutive seasons currently provided for), sourced from dairy farmers or the wholesale raw milk market. This recognises that access to regulated milk from Fonterra is no longer essential to support investment in new large scale dairy processing facilities in New Zealand. At the same time, it maintains access to regulated milk for smaller processors that predominantly service the New Zealand domestic consumer market.
 - Update the regulated terms on which Goodman Fielder – the only other large scale supplier of fresh milk to the New Zealand domestic consumer market – can purchase raw milk from Fonterra. This is to ensure that New Zealand consumers continue to have choice and access to basic dairy staples supplied by more than one processor at scale.
13. The Bill also provides for a number of minor and technical changes to Part 2, Subparts 5 and 5A of the Dairy Industry Restructuring Act 2001.
14. Free and frank advice
- Free and frank advice

- Free and frank advice

- Free and frank advice

Impact Analysis

15. Regulatory impact assessments were prepared in accordance with the necessary requirements and submitted to the Cabinet Economic Development Committee when policy approvals were sought. _

Compliance

16. The Bill complies with:
- the principles of the Treaty of Waitangi
 - the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993
 - the disclosure statement requirements: a disclosure statement has been prepared and is attached to the paper
 - the principles and guidelines set out in the Privacy Act 1993
 - relevant international standards and obligations
 - the [Legislation Guidelines](#).

Consultation

17. The following departments were consulted: the Treasury, Ministry of Business, Innovation and Employment, Ministry of Foreign Affairs and Trade, Te Puni Kokiri, Te Arawhiti, Ministry for the Environment, Ministry of Justice, the Commerce Commission, Inland Revenue, and State Services Commission. The Department of the Prime Minister and Cabinet has been informed. Apart from the Ministry of Justice's comment (see below) no issues were raised.

18. Free and frank advice

19. MPI notes that the offences and penalties in these clauses are not new. They are existing provisions in the Act. The amendments update the existing provisions consequent on other amendments implemented in the Bill, as follows:

- Clause 16 – the existing penalties and offences are applied to a new manager of the New Zealand dairy core database, consistent with the general updating of this subpart,

- Clause 30 – the existing penalties and offences are applied to a new requirement on Fonterra to appoint one member of its Milk Price Panel on the nomination of the Minister.
20. MPI published a discussion paper that invited public submissions, and undertook an extensive public consultation process including 13 public meetings, and 22 one-to-one meetings, with dairy processors and other key stakeholders, such as farmer representatives, Māori landowners and environmental NGOs.
21. The Minister of Agriculture consulted relevant Ministers and Coalition partners.

Binding on the Crown

22. The Dairy Industry Restructuring Act 2001 binds the Crown.

Allocation of decision making powers

23. The draft legislation does not involve the allocation of decision-making powers between the executive, the courts, and tribunals. The draft legislation does not affect the role of the Commerce Commission in resolving disputes under the DIRA.

Associated regulations

24. The Bill would amend some existing regulations and amend a regulation-making power. No new regulations are proposed at this time.

Other instruments

25. No other legislative instruments are envisaged.

Commencement of legislation

26. The Bill will come into force on 1 June 2020.

Parliamentary stages

27. The Bill will be introduced in late August 2019, and must be passed by March 2020 so that it can commence prior to the beginning of the new dairy season on 1 June 2020.

Proactive Release

28. Following Cabinet consideration the Minister of Agriculture intends to consider the release of this paper with certain redactions in line with the Official Information Act 1982. Documents that provide context to the decisions reached in this paper have already been released on the Ministry for Primary Industries' website.

Recommendations

The Minister of Agriculture recommends that the Committee:

1. **note** that the Dairy Industry Restructuring Bill (No 3) 2019 holds a category 2 priority on the year 2019 Legislation Programme;
2. **note** that the Bill updates Part 2, Subpart 4 of the Dairy Industry Restructuring Act 2001 to recognise a change in responsibility for management of the New Zealand Dairy Core Database and amends Part 2, Subparts 5 and 5A of the Dairy Industry Restructuring Act 2001 and associated regulations to provide a package of measures to maintain efficiency disciplines on Fonterra and enhance aspects of the dairy industry's performance;
3. **agree** to approve the Dairy Industry Restructuring Amendment Bill (No 3) 2019 for introduction, subject to the final approval of the government caucus and sufficient support in the House of Representatives;
4. **agree** that the Bill be introduced on 29 August 2019;
5. **agree** that the Government proposes that the Bill be:
 - 5.1 referred to the Primary Production Select Committee for consideration;
 - 5.2 enacted by March 2020.

Authorised for lodgement

Hon Damien O'Connor
Minister of Agriculture