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Ministry for Primary Industries
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By email to DIRA2022@mpi.govt.nz

FONTERRA CO-OPERATIVE GROUP LIMITED – RESPONSE TO FONTERRA CAPITAL RESTRUCTURING: PROPOSED GOVERNMENT RESPONSE (MPI DISCUSSION PAPER NO 2022/03)

Fonterra welcomes the opportunity to comment on the proposed Government response to Fonterra's Capital Restructuring.

We would like to acknowledge Minister O'Connor, MPI Director-General Ray Smith and MPI for the constructive process to date and their work to develop proposed amendments to DIRA, which support the Flexible Shareholding structure that our farmer shareholders voted overwhelmingly in favour of late last year.

We believe the Co-op's aspirations for the New Zealand dairy industry, rural communities and New Zealand are well aligned to the Government's.

Our Co-operative was created through a community of people working together to help each other. Working together to create goodness for generations continues to be at the heart of our purpose. The communities we are part of have always been important to us, and we remain committed to delivering economic opportunity by supporting local and rural communities and leveraging opportunities that enhance regional economic prosperity. We are also committed to working with the wider dairy industry and with iwi to help deliver a more sustainable future for New Zealand.

We all want a well performing and competitive dairy industry where farmers have a choice on who to supply their milk to at a fair and sustainable price; that provides consumers with a choice of new and innovative products; that supports Kiwi farmers through some challenging but necessary changes to their farming systems; and invests in research and innovation to grow value for New Zealand and help solve the significant challenges our country faces – such as climate change and freshwater.

A strong, efficient and value creating Fonterra is central to New Zealand achieving these aims.

Changes to our capital structure are critical to the future of our Co-op. Our strategy is focused on New Zealand milk. Our ability to meet our strategic targets depends on the Co-op maintaining access to a sustainable New Zealand milk supply in an environment where we see total milk supply in New Zealand as likely to decline, and flat at best, due to environmental pressures, new regulations and alternative land uses.

Flexible Shareholding will help our Co-op maintain a sustainable milk supply. It is intended to make it easier for new and young farmers to join our Co-op, and for existing farmers to remain in our Co-op.

Farmers leave the Co-op for different reasons, but one of the most influential ones is the high level of compulsory investment that's required to be part of our Co-op, in part driven by the different costs of capital between farmers and investors in a public market. A Flexible Shareholding structure will make it easier for farmers to join and stay with the Co-op by helping to level the playing field with other domestic processors, many of whom see milk as a cost to be minimised, rather than aiming to maximise the long-term sustainable value created by and for New Zealand farmers and therefore to the New Zealand economy as a whole.

Flexible Shareholding will increase the emphasis within the Co-op on performance and innovation. It gives our farmers more choice about where they put their capital, driving clear structural tension for the Co-op to deliver both a competitive return on invested capital and a sustainable milk price.

Most importantly, these changes to our capital structure enable Fonterra to remain farmer owned and controlled for generations to come. Maintaining a globally competitive Co-op of scale is in the best interests of all New Zealanders.

Fonterra's scale efficiencies improve our ability to invest in on-farm support services, innovation, and developing new markets and products - all of which creates value for New Zealand in terms of milk price and profits returned to rural communities, export performance, employment, environmental performance, and community development.

We have already shown a strong commitment to the future of the New Zealand dairy industry. Our strategy includes the following financial targets out to 2030 that we are aiming to achieve[1]:

- $1 billion invested in sustainability and protecting our natural environment
- $1 billion invested into moving New Zealand milk into higher value products
- $1 billion intended to be distributed to shareholders by FY24 after asset sales
- $2 billion available for investment in a mix of innovation for future growth – including opportunities for nutrition science – and providing a capital return to shareholders
- increasing current total annual R&D investment by over 50% to around $160 million per annum in 2030

These targets sit alongside, and assist with, our aim to be Net Zero by 2050. Our ability to achieve our strategic targets is dependent on a sustainable supply of New Zealand milk which is underpinned by Flexible Shareholding.

In Appendix A we have provided detailed comments on the additional regulatory measures proposed by MPI, including answers to the specific questions posted. The table below provides a short summary of our positions on those matters:

Proposal	Fonterra's position
Increase the number of Ministerial nominees to the Milk Price Panel from one to two and ensure that their proportional contribution to the Panel's recommendations to the Fonterra Board cannot be diluted by prescribing both the maximum (seven) and minimum (five) number of Panel members.	While we do not oppose increasing the number of Ministerial nominees to two, we believe that the independence of the Panel is already assured through its current composition. We have concerns about the proposal to prescribe a maximum of seven Panel members in the context of the proposal to make the Chair an additional independent member.

[1] These targets are subject to successfully completing a number of business initiatives, and a number of assumptions and risks, each of which could materially affect the actual outcomes. The details of these are set out in our strategy booklet titled *Our Path to 2030* released in September 2021.

Require that the Chair of the Milk Price Panel: • must be suitably independent of Fonterra • can only be appointed by the Fonterra Board with the Minister's approval • is additional to the two Ministerial nominees on the Panel.	We propose that any of the five independent members of the Panel should be eligible to be appointed as the Chair. The current definition of "independent" in DIRA is sufficient for the other independent members, and there is no clear rationale for adopting a different test of independence for the Chair. We also believe it is important that the Chair has strong corporate governance experience.
Require Fonterra to contract out the day-to-day administration of the base milk price calculation to an external party; and replace the contracted party every 4-6 years.	We do not oppose codifying in legislation the current arrangements that the day-to-day administration of the base milk price is contracted to an external party, provided there is sufficient flexibility to continue the current practice of contracting this function to several external parties. It is important the additional proposal to replace the contracted party every 4-6 years does not inadvertently undermine the efficient and effective administration of the calculation. Accordingly, the timeframe for replacing a contracted party should be up to 10 years, with sufficient flexibility to enable continuity of key personnel, knowledge and expertise.
Reduce Fonterra's discretion in setting the base milk price by giving the Commerce Commission the power to make its review findings binding on Fonterra's inputs, assumptions, and processes in the base milk price Manual and the calculation.	We do not agree that this additional measure is required at this time, as it would be duplicative of the intended impact of the three proposals set out above, and add significant additional annual cost for no clear benefit. Instead, we propose that consideration of additional measures as significant as this should be deferred to the next DIRA review.
Require a market maker to maintain a range of minimum bid/ask spreads in the market. This measure would also comprise: a scaled obligation on the market maker to participate as liquidity changes; an obligation to hold a minimum amount of inventory; and the ability to hold additional inventory for long periods of time to facilitate liquidity in the market.	We support the proposal to require a market-maker in the farmers-only market to deliver specified functions. We agree with MPI that it is important to set out broad expectations for the market-maker, as being prescriptive would reduce flexibility to respond to dynamic market conditions and could have unintended consequences of limiting the effectiveness of the market making arrangements.
Require Fonterra to ensure independent financial markets (e.g., broker or other) research and analysis of Fonterra's performance are easily accessible to farmers.	We support this proposal, noting that it is aligned with our goals and that it benefits all shareholders and unitholders.
Require Fonterra to maintain and publish a dividend and retentions policy.	Fonterra already publishes our dividend / retention policy on our website as a matter of good practice. We support this proposal to codify in legislation our current practice.

We look forward to working through the consultation process and with MPI to finalise the regulatory framework in a timely manner, with a view to taking the next steps on Flexible Shareholding which our farmers have strongly endorsed and which is needed to maintain a strong Co-op, and deliver on our strategy, for the benefit of all New Zealanders.

Yours sincerely

Peter McBride
Chairman

Miles Hurrell
Chief Executive Officer

APPENDIX A: DETAILED COMMENTS ON PROPOSED REGULATORY MEASURES

Proposal: Increase the number of Ministerial nominees to the Milk Price Panel from one to two and ensure that their proportional contribution to the Panel's recommendations to the Fonterra Board cannot be diluted by prescribing both the maximum (seven) and minimum (five) number of Panel members.

Question 1: *What impact do you consider this measure might have on your business?*

The current level of governance for the base milk price setting-regime is robust (as outlined in more detail in our response to Question 9 and works well, supporting an efficient and transparent milk price. This is evidenced by the growth in sustained competition for raw milk in the last 10 – 15 years and by the fact that independent processors are competing effectively and new independent processors are taking active steps to enter.

While we do not oppose increasing the number of Ministerial nominees to two, we consider that the independence of the Panel is already assured through its current composition, with only two out of the current six members being non-independent farmers. In addition, the Panel takes advice from the independent externally contracted Milk Price Group that undertakes the day-to-day administration of the base milk price calculation, the calculation is reviewed by an independent external auditor, and it is also subject to the robust statutory oversight from the Commerce Commission.

We have concerns about the proposal to prescribe a maximum of seven Panel members in the context of the proposal to make the Chair an additional independent member, as set out further in our response to Question 4.

The requirement to increase the number of Ministerial nominees to the Panel to two and prescribing the maximum and minimum number of Panel members will require amendments to our Constitution and the Fonterra Shareholders' Market Listing Rules (FSM Rules), both of which set out the composition and appointment processes for the Milk Price Panel.

Amending the Constitution requires the support of a majority of 50% or more of Councillors on Fonterra's Co-operative Council, and approval by a special resolution of shareholders (75% of those entitled to vote and voting on the question).

Changes to the FSM Rules would require approval of both NZXRegCo and the Financial Markets Authority.

It is therefore important that the legislation effectively overrides or is deemed to amend anything in Fonterra's Constitution or the FSM Rules to the contrary.

Question 2: *What criteria do you consider that the Minister should take into account when selecting his/her nominees?*

We consider the Minister should take into account the qualifications for the appointment to the Panel as set out in the Terms of Reference for the Milk Price Panel, i.e.:

> "Appropriate qualifications and experience for appointment to the Panel may include, but are not limited to:
>
> - Relevant commercial and financial expertise;
> - Appropriate standing in the farming and / or wider commercial community; and
> - Appropriate professional qualifications."

Expanding on this and given the Ministerial nominees must be independent, we consider the following types of experience would be relevant:

- Regulatory experience (either as a member or senior employee of a regulatory body or as a director or senior executive of a business in a regulated industry)
- Economic advisory experience (preferably with experience advising businesses in regulated industries)
- Financial advisory or valuation experience (preferably with experience advising businesses in regulated industries or as a senior financial executive within a business in a regulated industry)

- Experience as a director or senior executive of a dairy or other commodity exporter

We also believe the specific experience for an appointee should be considered in the context of the composition of the wider Panel at the time of the appointment to ensure there is appropriate breadth and depth of experience across all Panel members.

In addition to meeting the independence requirements under DIRA, it is critical that the nominee also meets the requirements to avoid conflicts of interest listed in the Terms of Reference for the Milk Price Panel, specifically:

> *"A member of the Milk Price Panel must not be a director, officer, employee, shareholder, or holder of a relevant interest (as defined in the DIRA) in any security of, supplier of milk to, or consultant or advisor to, any independent processor (as defined in the DIRA) either during the term of appointment or at any time during the two years prior to appointment. A person is a "supplier of milk" to an independent processor if they have a direct or indirect financial interest in a farm that supplies milk to an independent processor."*

Finally, as the Milk Price Panel addresses complex technical issues, and in accordance with good governance practice, consideration must be given to tenure and succession of Panel members. These considerations should apply to the Ministerial nominees in the same way as for other Panel members. For example, it is preferable that two new Ministerial nominees not join the Panel at the same time.

Question 3: *What criteria do you consider Fonterra should be required to take into account when selecting the external party to administer the base milk price calculation?*

We note that this question does not relate to the proposal to increase the number of Ministerial nominees on the Milk Price Panel, and is the same as Question 8. Our response is provided under Question 8.

Proposal: Require that the Chair of the Milk Price Panel:

- ***must be suitably independent of Fonterra***
- ***can only be appointed by the Fonterra Board with the Minister's approval***
- ***is additional to the two Ministerial nominees on the Panel***

Question 4 *What impact do you consider this measure might have on your business?*

The Milk Price Panel currently has four independent members (out of six members):

- 2 independent (non-farmer) Fonterra directors
- 1 independent (non-farmer) Fonterra Co-operative Council appointee
- 1 Ministerial nominee

There is also one elected (farmer) Fonterra director and one non-independent (farmer) Fonterra Co-operative Council appointee.

We understand that the intent of this proposal is that an additional person is appointed to the Panel as Chair, i.e. that none of the independent members of the Panel could be eligible to be appointed as the Chair of the Panel at the same time as fulfilling their independent appointment. However, if any of those independent members ceased to be in their existing role (e.g., if a Fonterra independent director on the Panel ceased to be on the Fonterra Board, if the Council independent appointee ceased to be the Council appointee or a Ministerial nominee ceased to be the Ministerial nominee) then that person could separately be appointed as the Chair of the Panel.

Given our understanding of the intent of this proposal outlined above, and the separate proposals to increase the number of Ministerial nominees from one to two and to set the maximum number of Panel members at seven, then the key impact of this for Fonterra is that either:

- the Fonterra Co-operative Council would need to agree to waive their right to appoint two members as set out in the Constitution and FSM Rules (and only appoint one member going forward); or
- one of the Fonterra directors would need to be removed from the Panel.

This proposal creates unnecessary uncertainty and change in the composition of the Panel. The value of the Fonterra directors on the Panel, with their real time understanding and insights of Fonterra's large processing business and the global markets in which it operates, should not be underestimated in the context of governing the setting of the base milk price. Further, it is important to remember that the base milk price is typically the price Fonterra pays its farmers for milk, with only two specific occasions where this has not been the case (as outlined in previous DIRA submissions). Creating a situation where a Fonterra director may need to be removed from the Panel creates a risk of the Panel becoming too removed from the reality of a large processing business to be effectively governing the milk price for a notional processing business.

The proposal is also unnecessary given the current high level of independence of the Panel, which will be further increased with the proposed additional independent Ministerial nominee.

The meaning of independence for Panel members has been regulated in DIRA since 2012 and there has never been any suggestion that members who meet this definition are not 'independent', including the independent directors of the Fonterra Board, who are highly experienced and respected governors in the business community.

We do not understand why a separate and greater standard of independence should now be overlaid onto this regime for the Chair, and we do not understand the benefits it would deliver, particularly in light of the potential costs and risks it raises.

We propose that any of the five independent members of the Panel should be eligible to be appointed as the Chair, while still holding their original independent appointment.

This proposed change would require amendments to the Constitution and the FSM Rules in the same manner as outlined above for Question 1.

***Question 5** What criteria do you consider that the Minister should take into account when approving the Chair?*

We think it is preferable that an independent Chair has been on the Milk Price Panel for at least one full milk price cycle prior to being appointed Chair. As a full milk price cycle spans two seasons, this would require the Chair to have at least two years of prior experience on the Panel. The changes Fonterra proposes under Question 4 (and further explained in our response Question 6) would enable any of the five independent members of the Panel to be eligible to become the Chair following at least two years of experience on the Panel.

In our experience it may be challenging to find an appointee at the level required that would be willing to chair the Panel without either some Fonterra or some milk price knowledge. This is a substantial role chairing a Panel that has a significant role in a significant decision for New Zealand's largest company and the New Zealand dairy industry. There is a relatively small pool of potential candidates in general, and even smaller with chair experience. MPI will be aware of this having recently identified the first Ministerial nominee to the Panel.

We also consider that the Chair should have substantial corporate governance experience, preferably including having chaired other boards for a listed company. This would ensure the Chair has experience ensuring the Panel has the right information in front of it to be able to make an informed assessment, balances different views and perspectives, and undertakes robust and collective decision making. Fonterra notes that independent directors of Fonterra typically have this background anyway.

The Chair should also meet the requirements for Panel members to avoid conflicts of interest, as listed under question 2, specifically:

> "A member of the Milk Price Panel must not be a director, officer, employee, shareholder, or holder of a relevant interest (as defined in the DIRA) in any security of, supplier of milk to, or consultant or advisor to, any independent processor (as defined in the DIRA) either during the term of appointment or at any time during the two year prior to appointment. A person is a "supplier of milk" to an independent processor if they have a direct or indirect financial interest in a farm that supplies milk to an independent processor."

Question 6 *How do you consider the Chair's 'independence' should be provided for in the DIRA?*
We note that the consultation document proposes that the Chair should be "suitably independent of Fonterra (for example, not connected to a shareholding farmer, or an employee, director, an agent or an associate of Fonterra or its Co-operative Council)." This description of independent is not fully consistent with the definition already in DIRA, which states: ***independent****, in relation to a person, means that the person is none of the following:* *(a) a shareholding farmer:* *(b) a relative of a shareholding farmer:* *(c) an employee of new co-op:* *(d) an employee of a shareholding farmer:* *(e) a person who has a direct or indirect financial interest in a farm that supplies milk to new co-op:* *(f) a person who has a relevant interest in new co-op fund securities* It is unclear what would be achieved by adopting a different test of "independence" for the Chair of the Panel. Neither the consultation document nor the Regulatory Impact Assessment provide an explanation for why the current definition of independence is considered inadequate for the Chair, or why it is appropriate to hold the Chair to a different standard of independence than the other independent Panel members. There is no evidence that the relationship of the chair with Fonterra has caused the milk price to be non-compliant with the legislative framework. The definition of independent in DIRA is more than just "financial" independence. It reflects an absence of disqualifying relationships, i.e. relationships that could affect, or be perceived to affect, the person's judgement. This is the same philosophy that underlies the independence test in the NZX Listing Rules and Corporate Governance Code. Under the proposed description of "suitably independent", independent (non-farmer) Fonterra directors would not be eligible to be the Chair. Independent directors of Fonterra already satisfy rigorous independence requirements analogous to those applied by any NZX listed company. The same test is used for the independent Panel member nominated by the Co-operative Council. Fonterra considers that the following Panel members should be eligible for the Chair: • 2 independent (non-farmer) Fonterra directors • 1 independent (non-farmer) Fonterra Co-operative Council appointee • Ministerial nominee(s). We propose that the current definition of "independent" in DIRA is sufficient for the Chair of the Milk Price Panel.
Proposal: Require Fonterra to contract out the day-to-day administration of the base milk price calculation to an external party; and replace the contracted party every 4-6 years.
Question 7 *What impact do you consider this measure might have on your business?*
The proposal to require Fonterra to contract out the day-to-day administration of the base milk price calculation to an external party reflects current practice and the existing requirements in the Milk Price Manual. We note that this is a highly technical function and requires the parties filling this role to have a high level of expertise in complex calculations, which is fundamentally different to the function of an auditor. We do not object to the current arrangements being codified in legislation, although it is important that the legislative provisions do not inadvertently undermine the efficient and effective administration of the base milk price calculation. For example, as a matter of practicality, this measure should not be interpreted as complete separation between Fonterra and the contracted party(ies), as there needs to be access to, and free and regular interaction between, Fonterra and those external parties undertaking the calculations, for example for forecasting and resolving interfaces of data.

There should also be sufficient flexibility to continue the current practice of contracting this function to several external parties (rather than a single external party). This enables access to an appropriate mix of expertise and capabilities, which may not be found in a single entity. Consideration also needs to be given to enabling sufficient continuity of personnel and resource to perform the day-to-day administration of the base milk price calculation. Given the complexity in the milk price calculation, insufficient continuity could lead to an increased risk of arbitrary outcomes which go against the intended objective of integrity of the base milk price. The proposal refers to replacing the contracted party every 4-6 years. While we support the intention of rotating administration of the calculation periodically, the specifics of how this can practically occur given multiple contracted parties needs further consideration. The 4-6 year timeframe may present a challenge from a succession perspective. The relatively narrow subset of Panel members that can become the Chair and the rotation requirements for the contracted administration parties could result in a situation where a new Chair of the Milk Price Panel, and a new head of the day-to-day administration party overlap. This would create issues with continuity of administration of the milk price calculation. Therefore, we consider there should be sufficient flexibility in the timeframes to ensure that right skill sets and right experience are coming onto and off the respective roles at the right times. Replacing the day-to-day administration parties every 4-6 years is more frequent than expectations for auditors, which are typically replaced every 10 years. Accordingly, we propose that the timeframe for replacing a contracted party should allow more flexibility, such as up to 10 years. The decision as to when that rotation occurs within the broader timeframe should be at Fonterra's discretion, to allow any issues with succession to be addressed. It should also be possible to rotate some of the contracted parties involved in day-to-day administration of the base milk price calculation without replacing all of them. The requirement to replace the contracted parties should apply from when the legislative changes come into force (not retrospectively to the current Milk Price Group parties) to enable planning for succession.
Question 8 *What criteria do you consider should be included in the DIRA for selecting and appointing the external party?*
We note that, considering the independence and conflict of interest requirements that will be applied and the expertise and experience clearly required given the significance of the role, there will be an extremely limited pool of potential parties. The criteria for selecting and appointing the external party should avoid being too prescriptive. Overly prescriptive criteria could be detrimental to intended outcomes and impair the robustness and perceptions around integrity of the process. Fonterra proposes the criteria should include a majority of the following: o Relevant economic, commercial and Capital Asset Pricing Model (CAPM) expertise o Management and financial accounting expertise o Familiarity with the Milk Price Manual or a similar regulated price setting mechanism o Dairy operational experience o Financial modelling expertise o An understanding of commodity markets There should also be criteria for independence (using the current DIRA definition for independence) and to avoid conflicts of interest (which could be based on the conflicts of interest provisions set out in the Terms of Reference for the Milk Price Panel).
Proposal: Reduce Fonterra's discretion in setting the base milk price by giving the Commerce Commission the power to make its review findings binding on Fonterra's inputs, assumptions, and processes in the base milk price Manual and the calculation.

Question 9 *What matters do you consider should be included in any powers of direction given to the Commerce Commission?*

The Regulatory Impact Assessment notes that this measure is intended to address a perception by some that Fonterra is able to manipulate the base milk price calculation. We strongly reject any suggestion that Fonterra manipulates the base milk price calculation. The current base milk price setting-regime is robust (as detailed further below) and works well, supporting an efficient and transparent milk price. We note that measures 1, 2 and 3 are intended to address this same perception through increasing the degree of independence of Fonterra's internal milk price-setting processes, and while we would like to see some changes in the details of how these measures are designed and implemented, we do not oppose their introduction. We do not agree that this additional measure is required, as it would be duplicative of the intended impact of measures 1, 2 and 3, and add significant additional cost for no clear benefit. Instead, we propose that consideration of any such additional measures should be deferred to the next DIRA review in a few years' time.

The setting of the base milk price is robust because it is already set within a tightly defined and controlled governance process, with multiple elements providing independence from Fonterra:

(a) a majority independent governance Panel (the Milk Price Panel) with recently enhanced (and proposed to be further enhanced) independence;
(b) an independent externally contracted working group (the Milk Price Group) that performs the day-to-day administration of the base milk price calculation and provides advice to the Milk Price Panel;
(c) additional external advisors and reviewers, on inputs and financial models;
(d) an external auditor; and
(e) Commerce Commission annual statutory reviews, of both the Milk Price Manual and the base milk price calculation.

More specifically:

(a) The calculation of the base milk price itself is not carried out by Fonterra, but by the independent Milk Price Group with the oversight of the independent Milk Price Panel (again noting this independence is to be further enhanced with proposals 1, 2 and 3).
(b) The base milk price is calculated with reference to the Milk Price Manual, which is prepared in accordance with the principles of subpart 5A of DIRA and the Milk Price Principles set out in Fonterra's constitution.
(c) Amendments to the Milk Price Manual are recommended by the independent Milk Price Group and the majority independent Milk Price Panel.
(d) As noted above, the calculation is subject to regulatory oversight through the Commission's review of both the Milk Price Manual and the base milk price calculation.

Fonterra and the Milk Price Panel recognise that stakeholders' perceptions of the integrity of the base milk price calculation requires consistency across years in the application of the rules, and for this reason the Manual was amended in 2014/15 to require the public disclosure in the Milk Price Statement and base milk price reasons paper of any material change in methodology and of the reasons for the change. We have subsequently provided public explanations of all non-incidental changes in methodology annually in the Milk Price Statement, and in most instances have implemented them prospectively.

We have reviewed the Commission's findings since 2012 on matters related to the inputs, assumptions and processes used to calculate the base milk price, and have identified that over that period the Commission has raised just two matters which Fonterra has not promptly addressed to the Commission's satisfaction, comprising the appropriate treatment of the funding costs associated with the farmer support payments implemented by Fonterra in 2015 and the appropriate approach to calculating asset beta. Our differences in view translated into approximate impacts on the base milk price of less than 1 cent (farmer support payments) and 2 cents (asset beta), with the Commission noting that these impacts were immaterial.

In respect of all other matters:

- The Commission last recommended that we amend the calculation methodology in 2018, to address an issue that had an impact on the Milk Price of less than 0.15 cents.

- Fonterra always responded promptly, either by amending the calculation in the following year or by providing further information which has addressed the matter to the Commission's satisfaction.

These facts are consistent with the maturity of the base milk price methodology and the rigour of the associated governance processes, and further demonstrate that this additional measure is not required.

We also note that the costs associated with this proposal are not insignificant. The Commission estimates its costs could increase from current $0.757m to $1.5m per annum, but this is an estimate only of the Commission's costs. There will also be additional non-Commission annual costs borne by the industry arising from the process. For example, Fonterra and the Panel will incur additional time and cost, directly and through the Milk Price Group to review and participate in any process where the Commission exercises its powers of direction (in addition to the already detailed and robust annual milk price setting process).

If this proposal is progressed, there are several issues that need further consideration:

- Before the Commission directs a particular input or assumption be employed, there should be a requirement the Commission first finds that the input or assumption the Panel has recommended is inconsistent with the purpose of Subpart 5A as set out in section 150A of DIRA; i.e. the input or assumption does not incentivise Fonterra to be efficient **or** is not practically feasible for an efficient processor.
- The Commission also needs to be able to specify with sufficient particularity how to determine the input or assumption it directs and the impact on the base milk price calculation. We suggest that there should be a materiality threshold that would apply before the Commission could exercise its powers of direction to ensure efficiency in the process, and to ensure attention and time are focused in the right places.
- We do not consider there is a case to have higher penalties for contravening any directions issued by the Commission. There is no history of non-compliance with the DIRA milk price oversight provisions or any evidence to suggest that Fonterra is more likely to breach the DIRA milk price provisions if the proposed changes are made.

We note that as an alternative, the Commission could instead specifically report where it disagrees with Fonterra's approach on the inputs, assumptions and processes used in the base milk price calculation **and** their view of what it should be instead as well as the overall impact on the base milk price. This would provide more transparency to the industry, without the same cost or risk of unintended consequences.

Question 10 *What changes to the statutory deadlines for the Commerce Commission's review processes and/or Fonterra's internal milk price setting processes would you consider necessary to ensure effective operation of the existing monitoring regime and the proposed powers? Please give reasons for your view.*

We note that timeliness will be a significant challenge.

Fonterra submits that any direction(s) should only take effect the following financial year. It is impractical to arrange timelines to allow for a Commission direction to apply in the current financial year, given the requirements for the Commission to consult on any proposed direction and the well-established timeframes for finalising the base milk price calculation.

Proposal: Require a market maker to maintain a range of minimum bid/ask spreads in the market. This measure would also comprise: a scaled obligation on the market maker to participate as liquidity changes; an obligation to hold a minimum amount of inventory; and the ability to hold additional inventory for long periods of time to facilitate liquidity in the market.

Question 11 *How do you consider the requirements regarding the functions of the market maker could best be set out, noting the intention to avoid highly prescriptive requirements?*

We support the proposal to require a market-maker in the farmers-only market to deliver specified functions. We agree with MPI that it is important to set out broad expectations for the market-maker, as prescriptive requirements would reduce flexibility to respond to dynamic market conditions and could have unintended consequences of limiting the effectiveness of the market making

arrangements. The market maker needs the ability to judge the situation and respond appropriately, within the overall parameters established through their engagement by Fonterra, having regard also to the specific rules and requirements of the relevant market operator (NZX Limited). Section 109L of DIRA already requires Fonterra to ensure there are one or more market makers operating when the market is operating. This section could be expanded to cover the proposed points in the same level of detail as the other subsections, specifically: • a scaled obligation on the market maker to participate as liquidity changes; • an obligation to hold a minimum amount of inventory; and • the ability to hold additional inventory for long periods of time to facilitate liquidity in the market.
Proposal: Require Fonterra to ensure independent financial markets (e.g. broker or other) research and analysis of Fonterra's performance are easily accessible to farmers.
Question 12 *Would this measure have an effect on you own business? If so, how?*
We support this proposal in principle, noting that it is aligned with our goals and that it benefits all shareholders and unitholders. This measure will require Fonterra to work more with the financial community to deliver easily accessible independent analysis to farmers, through channels that are familiar and frequented by farmers. We recommend that there is a requirement for this to be provided on not more than a quarterly basis to be consistent with reporting cycles and to mitigate risk of challenge that we are not meeting this obligation.
Proposal: Require Fonterra to maintain and publish a dividend and retentions policy
Question 13 *What effect, if any, do you consider this measure could have on your business and/or the dairy sector as a whole? Please provide reasons for your view.*
Fonterra already publishes our dividend / retention policy on our website as a matter of good practice. We support this proposal to codify our current practice. We agree with the note in the consultation document that there should not be any statutory requirement or direction on the scope of our dividend and retention policy. Publishing our dividends and retention policy provides transparency for shareholders and unitholders. It supports good governance and discipline as an explanation of any deviation from the policy, and any changes to the policy from time to time, would be required. It is critical that Fonterra's Board retains the same discretion as any other Board to assess from time to time whether the solvency and best interests of the company are consistent with adherence to the policy.
Additional proposal: Publication of milk prices by all dairy processors
We propose that DIRA should be amended to require all processors to publish prices paid for farmers' milk. Improved transparency of milk prices paid by other processors will address the current imbalance of information available to farmers and support contestability in milk supply.