## *Key Messages*

- Miraka welcomes the opportunity to engage with officials early in the review process.
- In terms of the review, Miraka's primary focus is on competition policy.
- In terms of competition policy, Miraka considers there are two key issues, namely:

    - *Preservation of the existing open entry and exit regime*: It is imperative that DIRA remains based on seamless farmer switching on a 'no arguments' basis.

      This is the 'do nothing' message.

    - *Reducing the worst excesses of using a hypothetical competitor as the basis for setting the Fonterra farm gate milk price.* Sensible amendments to subpart 5A of DIRA will go a long way to removing a series of distortions that inhibit contestability, artificially inflate land prices and places a marginal squeeze across the entire processing sector (including Fonterra).

      This is the 'do something' message.

- It is Miraka's view that a contestable dairy processing sector based on seamless farm gate switching and a workable milk price will result in workable levels of in-market competition; thereby laying the foundations to a transition to a post DIRA world.

## *Detailed Points*

- Whilst Miraka's primary focus for this review is on competition policy, it is useful to note:

    - Miraka takes the environmental impact of its operations extremely seriously, as illustrated by its use of sustainable geothermal energy (rather than fossil fuels) during the manufacturing process, the composing and re-use of biological factory wastes, and financially rewarding its farmer-suppliers for excellent on-farm environmental practices.
    - After only seven years in operation Miraka has expanded beyond solely producing commodity products (such as WMP) into consumer goods (such as supermarket-ready UHT) and branded consumer products (such as its *Whaiora* range of milk-based fruit smoothies).
    - Miraka is also investing in innovation – as evidenced by its three-year partnership with AgResearch investigating the properties of raw milk as a means of preventing allergies, hay fever and asthma in infants and young children.
    - Miraka has been profitable from day 1 – and consumer goods now comprise 20 percent of its total production and generates 40 percent of its profits.

- Miraka's focus on the open entry and exit regime is based on the following points:

    - Farmers are unlikely to leave Fonterra if they know by doing so they effectively 'burn their bridges' and cannot come back (a situation amply illustrated by Fonterra's treatment of former NZ Dairies suppliers).
    - With static milk supply growth and competition from new entrants Fonterra is increasingly facing a stranded asset risk, which gives its extremely strong commercial incentives to 'lock in' its farmer-suppliers (i.e. 'open entry/sticky exit').
    - With the severe restrictions on the entrance pathway previously afforded by the raw milk regulations 'open entry and exit' is effectively 'the only game left in town'. It is therefore imperative from a competition policy perspective that 'farmers choose Fonterra' rather than 'Fonterra chooses farmers'.

    ***It is Miraka's view that the current open entry and exit regime is working well and does not require any amendments or modifications.***

- Miraka's focus on the milk pricing regime is based on the following points:

    - The level of milk price manipulation is substantial – at around 50 cents per kgMS (or $900 million annually across the industry). The result is margin squeeze on processors via vertical foreclosure where the farm gate milk price is artificially increased (resulting in distortions around land prices and land use change decisions) and correspondingly, manufacturing profits are artificially lowered (thereby reducing returns and contestability).

      The mispricing bought about by the current regime represents upwards of $10 million per annum in lost profitability for Miraka.

      Miraka notes that this level of mis-pricing is now freely admitted by Fonterra.

    - Ironically, the largest victim of Fonterra's vertical foreclosure is Fonterra itself – indeed, this is reflected in the woeful performance of the Fonterra Shareholders' Fund and Fonterra's inability to maintain a credible retentions policy (so, as a consequence, is unable to fund a credible value add strategy).
    - Over the medium term, the result is a severe undervaluation of Fonterra – currently conservatively estimated to be in the order of $6 billion. This has the potential to cause considerable disruption in a post DIRA world – so represents a prospective 'time bomb' that is best defused early.

- Whilst Miraka has consistently argued that the Fonterra farmgate milk price should represent the *actual* performance of the *actual* Fonterra, the simple reality is a different regime has been in place now for a considerable period of time, making 'Fonterra actuals' arguably an unrealistic public policy objective. The following solutions (which are neither extensive nor complete) are suggested:

    - Creating a much tighter definition of what is meant by 'practicably feasible'
    - Adding a process for speedy redress (potentially with penalties and the imposition of an alternative) if ComCom declares part (or parts) of the milk price formula for a given year are not deemed 'practicably feasible'
    - Ensuring that part 5 and subpart 5A are consistent in their treatment of 'efficiency' and contestability, in that both are given equal weighting in both parts of the Act.
    - That 'efficiency' is also defined to extend beyond notions of static productive efficiency to also include dynamic efficiency and allocative efficiency.

- Miraka also recommends the following aspects of subpart 5A are retained, namely:

    - The requirement to have a milk price manual and that manual be publicly available
    - ComCom oversite of the milk price setting process
    - The use of a series of reference products based on gDT prices as a basis to set the Fonterra farmgate milk price.
    - The need for ComCom to do a competition assessment before DIRA is allowed to expire (though a focus on what represents workable competition in relevant dairy markets v. a situation existing of insufficient competition would be helpful).

## *Further Information*

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