Q&A

What is DIRA?

The Dairy Industry Restructuring Act 2001 (DIRA) enabled the creation of the Fonterra Co-operative Group Limited. The Act has provisions to promote the efficient operation of dairy markets in New Zealand by regulating the activities of Fonterra to ensure New Zealand markets for dairy goods and services are contestable.

What was the purpose of the review?

The purpose of the review was to ensure that the dairy industry operates in a way that protects the long term interests of farmers, New Zealand consumers and the wider economy.

The review considered the effectiveness and impact of DIRA across a range of areas, including incentives and/or disincentives it creates for the dairy industry to transition to:

- higher value dairy production and dairy processing that global consumers seek out for a premium;
- more sustainable environmental practices on and off farm.

Who did the review?

The review was led by the Ministry for Primary Industries in consultation with other agencies, including the Ministry of Business, Innovation and Employment, the Ministry for the Environment, the Treasury, the Ministry of Foreign Affairs and Trade, Te Puni Kōkiri and Te Arawhiti.

Officials were supported by a team of external experts, and consulted with key industry stakeholders.

How did the review work?

The Minister of Agriculture released the terms of reference for the review of DIRA in May 2018. The terms of reference recognised that DIRA is only one element in influencing dairy industry performance. The terms of reference focused on:

- whether the DIRA regulatory regime is operating in the long term interests of New Zealand dairy farmers, consumers, and the wider economy;
- whether, and if so to what extent, the DIRA regulatory regime gives rise to any unintended consequences; and
- whether the purpose and form of the DIRA regulatory regime remains relevant and fit-for-purpose.

MPI began by engaging with stakeholders and commissioning independent expert advice. This informed the development of a discussion document that MPI released for public consultation in November 2018.

During the public consultation we held 13 public meetings, and meetings with dairy processors and other key stakeholders, such as farmer representatives, representatives of Māori interests, and environmental NGOs. We received 188 written submissions on the discussion document.

Did the review include sheep, goat etc. dairy activities, or was it confined to bovine milk?

The review only focussed on cow dairy, as DIRA only covers cows' milk.

What did the review find?

The review found that DIRA has been effective in managing the risks associated with Fonterra's dominance and is still needed, despite Fonterra's reduced overall market share (i.e. Fonterra still collects 80% of all milk produced in New Zealand). However, changes are needed to ensure better management of on-farm performance (including matters such as environmental performance and animal welfare), and planning for processing capacity, increased certainty around milk price calculation, removal of unnecessary regulation, protection of consumer interests, and certainty of future regulatory review.

What changes have been proposed?

See attached table.

Will Fonterra have to continue to collect milk from all farmers?

Under DIRA, Fonterra has to accept any application to become a shareholder and collect milk from anyone who is a shareholder in Fonterra subject to Fonterra's terms of supply. Equally, Fonterra has to allow farmers to sell their shares in Fonterra, and stop supplying milk to Fonterra, without delay. If a farmer does not wish to purchase shares in Fonterra, in accordance with Fonterra's share standard, then Fonterra have no obligation to collect their milk.

These requirements (open entry and exit) will remain in place. However, there will be two exceptions to the open entry and exit provisions:

- Fonterra will be able to refuse milk supply from farmers who are unlikely to comply with Fonterra's terms and standards of supply, including Fonterra's environmental and animal welfare standards (Fonterra already has the ability to suspend supply from existing shareholders that do not meet the terms and standards of supply).
- Fonterra will be able to refuse supply from newly converted dairy farms. This will not apply to dairy conversions that are currently underway.

These exceptions will be subject to the existing non-discrimination rule. The non-discrimination rule prevents Fonterra treating farmer-shareholders (or applicants) who are in like situations differently.

Why does Fonterra have to supply milk to other processors?

Regulations made under DIRA allow independent processors to buy up to 50 million litres of raw milk per season from Fonterra for a regulated or negotiated price.

Goodman Fielder (which manufactures brands such as Meadow Fresh and Puhoi Valley) has a separate entitlement to purchase up to 250 million litres per year. The 250 million litre allocation supports competition in the domestic dairy markets.

The allocation for Goodman Fielder is to ensure that there is at least one large scale competitor to Fonterra, in the domestic milk consumer market, producing basic dairy products such as fresh milk, butter and cheese.

The total amount of raw milk that Fonterra is required to supply in a season is capped and is reviewed regularly (currently the total quantity is 600 million litres per season) and must not exceed 5 percent of the milk Fonterra collects from farmers in New Zealand.

Under the proposed changes to DIRA, Fonterra will no longer be required to supply regulated milk to independent processors with their own supply of 30 million litres or more in a single season. Previously, Fonterra was required to supply regulated milk to independent processors until they had established their own supply of 30 million litres or more for three consecutive seasons.

In effect, this means that (with the exception of Goodman Fielder) Fonterra will no longer be required to supply “start-up” milk to large processors on regulated terms. Fonterra may choose to supply large processors on commercial terms if it wishes to do so.

To support those processors who are currently eligible and have started, or are about to start, purchasing regulated milk from Fonterra, transitional arrangements will be included.

Why doesn’t DIRA explicitly address environmental concerns?

The purpose of DIRA is to manage Fonterra’s dominance.

Water, and other resource uses in New Zealand are regulated through the Resource Management Act 1991 (the RMA). The RMA empowers local communities to make decisions on how their environment is managed through regional and district plans. Accordingly, regional and local authorities play a critical role in determining what land use and economic activity, including dairying, can be established and under what conditions, to ensure that they are environmentally sustainable.

The government is progressing work in a number of environmental areas including essential freshwater work, and reducing climate change and greenhouse gases.

The changes to DIRA will allow Fonterra to refuse milk supply from farmers whose milk is not compliant with Fonterra’s terms and standards of supply, which include environmental and animal welfare standards.

Why do consumers in New Zealand have to pay so much for milk?

DIRA does not set prices for consumer milk. MPI commissioned independent analysis, which has indicated that, in general, consumer dairy prices (including fresh milk) have moved in line with prices for other grocery products. There have been fluctuations from time to time (e.g. butter) but the general trend suggests that there is no significant disparity in the movement of dairy goods compared with other grocery items.

Retail milk prices are more stable than international dairy prices and do not necessarily fall or rise in line with movements in international commodity prices. While retail milk prices have not fallen by as much as global dairy prices, they also tend not to increase as much when the global price rises. This stability is due to the fact that raw milk makes up only a portion of the cost of processed retail milk.

The price paid by consumers includes a wide range of costs incurred by processors and supermarkets, such as the costs of processing, packaging, labour, transport and retail storage, handling and overheads.

What happens next?

The changes to DIRA legislation will soon be introduced to Parliament so that they can be passed into law. They will be subject to scrutiny through the select committee process, allowing stakeholders (including farmers and the wider New Zealand public) the opportunity to make submissions on the changes before they are passed into law.

The changes to the Raw Milk regulations will be made through the Order in Council process.

When will the next DIRA review take place?

The next DIRA review will take place four years after the changes from the current review are implemented. This means the next review will take place in the 2024/2025 season, subject to the changes proposed in this review being implemented in the 2020/2021 season.

Appendix 1: Detailed information on proposed DIRA changes

Proposed change	How?	Why?
Retain the 'open entry and exit' provisions (including the non-discrimination requirement), but… …allow Fonterra to refuse milk supply from farmers whose milk is not compliant with Fonterra's terms and standards of supply or is supplied from newly converted dairy farms.	1) Introduce an exception to open entry by allowing Fonterra to decline applications from 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 (subject to the non-discrimination requirement*). In addition, clarify in law: • what Fonterra can include in its terms of supply, for example, environmental, animal welfare, employment matters, and health and safety requirements. This would clarify Fonterra's ability to manage such matters through terms of supply; and • that Fonterra's terms of supply can price differentiate on matters that include but are not limited to, environmental, animal welfare, employment matters, and health and safety requirements. 2) Introduce another exception to open entry requirements by allowing Fonterra to refuse applications from new and existing suppliers to become shareholders in, and supply milk to, Fonterra if their milk is supplied from newly converted dairy farms (subject to the non-discrimination requirement*). A newly converted dairy farm would include dairy farming established on land that had not	The two exceptions to open entry would enable Fonterra to: • manage aspects of farmers' on-farm performance more effectively and address reputational risks to Fonterra, and the dairy industry in general, that may arise from poor environmental, or other, on-farm performance; and • better manage uncertainty of future milk supply that may arise from dairy conversions, and the associated impacts on capacity and investment decisions.

	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. ** the non-discrimination requirement requires Fonterra to treat existing and entering farmers in like circumstances the same way. It is an **absolutely essential part of the open entry and exit regime**, which ensures that Fonterra does not game the open entry and exit regime by offering more or less favourable terms to new suppliers, thus dissuading new ones from entering Fonterra and existing ones from exiting Fonterra in the first place. Without the non-discrimination requirement the open entry and exit provisions would be completely ineffective.*	
Limit Fonterra's discretion in regard to setting a key assumption in calculating the base milk price, the asset beta.	Amend the DIRA to require Fonterra's assumption of the estimate of risk (measured by asset beta) to be consistent with dairy and other commodity processors when estimating the cost of financing milk processing operations in its base milk price calculation.	This would 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), thereby discouraging competition.
Require Fonterra to appoint two members of its Milk Price Panel on the nomination of the Minister of Agriculture	Amend the DIRA to require Fonterra to appoint two members of its Milk Price Panel on the nomination of the Minister of Agriculture	This change was taken in the course of Cabinet's deliberations on other policy recommendations submitted by the Minister of Agriculture. The intent is to further support the independence of Fonterra's Milk Price Panel.
Clarify in law that Fonterra can pay a farm gate milk price that differs from the calculated base milk price.	Amend the DIRA to clarify the original policy intent that Fonterra can pay a farm gate milk price that is	This would clarify Fonterra's legal obligations and avoid any unintended consequences

	different from the calculated and monitored benchmark price.	arising from Fonterra's current interpretation of the Act.
DIRA to be reviewed periodically, with a review to be initiated every four years following implementation of a previous review.	There is currently no expiry or review provisions in the DIRA (these were removed in February 2018). To effect this change, a statutory provision for periodic reviews will be introduced to the DIRA. Given the time involved in consultation and implementation of any changes associated with a review, future reviews will generally take place within a six year period.	This will provide regulatory certainty and a clear timeframe within which the dairy industry can plan and operate.
Amend the eligibility provisions for access to regulated milk once a processor has established its own supply of 30 million litres or more in a single season.	Amendments to the Raw Milk Regulations would provide that: • A dairy processor would cease to be eligible to purchase raw milk from Fonterra at regulated prices once the processor has obtained its own supply of 30 million litres or more in a season. • A transitional arrangement would be included to "grandparent" the current eligibility provisions for dairy processors who are currently eligible and have started, or are about to start, purchasing regulated milk from Fonterra. • Processors who source less than 30 million litres of own supply in a season would continue to have access (as now) of up to 50 million litres of regulated milk from Fonterra per season, on agreed or regulated terms. In effect, this means that current supply to small domestically-focused dairy processors will continue unchanged.	To ensure that any future regulated milk is directly targeted at those who require it in the very early start-up stage of for the purpose of servicing the domestic consumer market.

Update terms on which Fonterra supplies regulated milk to Goodman Fielder for the benefit of domestic consumers.	The terms that Fonterra supplies regulated milk to Goodman Fielder will be updated to: • increase the amount of regulated milk that Goodman Fielder could buy from Fonterra from 250 to 350 million litres per season to reflect growth in the domestic consumer market; • increase the regulated price Fonterra can charge Goodman Fielder by 10 cents per kgMS above Fonterra's farmgate milk price to compensate Fonterra for the economic cost of providing milk on the flatter supply basis required by Goodman Fielder; and • allow Goodman Fielder to purchase raw milk from Fonterra at fixed quarterly prices, in line with terms permitted to other processors supplying the New Zealand domestic consumer market.	This will ensure that domestic consumers continue to benefit from competition in the wholesale supply of dairy products in New Zealand.