

Evaluation of Zespri's Prior Notice of its China Gold3 Commercial Trial

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Executive summary

Prior Notice and regulations

Zespri has provided Kiwifruit New Zealand (KNZ) Prior Notice of a commercial procurement model trial in the People's Republic of China (China) (Zespri, 2020). This trial would be undertaken over a period of up to three years and involve a maximum of 1.95 million trays of Gold3. The procurement and sale of Chinese-grown Gold3 fruit for commercial purposes does not fall within the scope of core business for Zespri.

We understand that Zespri is not permitted to engage in non-core business activities under the Kiwifruit Export Regulations (the Regulations) unless:

- KNZ is satisfied the activity would support core business; an activity is defined to support core business if it is likely to enhance the performance of the core business and poses no more than a low risk to the interests of producers (Regulation 10A); or
- Zespri obtains the approval of its producers to engage in the activity (Regulation 11).

Hence, we understand that KNZ's role is neither to itself manage the risks undertaken by Zespri, nor to decide whether the potential benefits justify the risks involved. Rather, its role is to ensure producer oversight is engaged when Zespri wishes to undertake an activity that is not likely to enhance the performance of core business or that is more than a low risk to the interests of producers (KNZ, 2020).

Approach to this evaluation

We have reviewed the Prior Notice and supporting information provided by Zespri. The documents we reviewed are listed in Appendix A. Zespri also facilitated video conference meetings for us with two of its consultants, Boston Consulting Group (BCG) and Vision Consulting, in which we were able to ask questions of clarification. We also benefited from a further discussion with Zespri staff on the assumptions and modelling underpinning its cost benefit assessment.

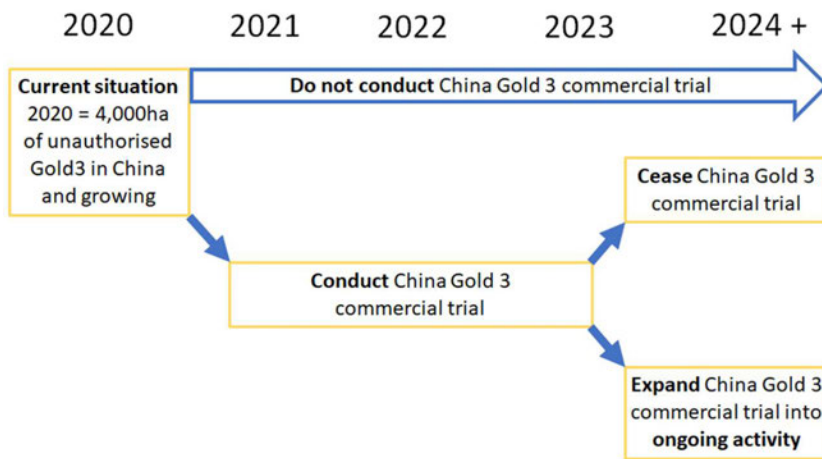
KNZ consulted with the New Zealand Kiwifruit Growers Incorporated (NZKGI) about its views of the Prior Notice and the interests of producers. In summary, NZKGI noted a range of interests which all link to the financial impacts on growers including grower returns, orchard capital values, brand reputation and customer perception of food safety and quality, market access and New Zealand/China relations, future industry stability and orchard practice intellectual property (NZKGI, 2020). It stated that growers believed the risk of trying to prevent the spread of Gold3 was a lower risk option than doing nothing, so they supported Zespri working with China on a small-scale trial in 2021. The NZKGI Forum view the proposed first year trial of 200,000 trays as low risk to the New Zealand grower. (Our assessment considers the three-year trial as specified by Zespri in its Prior Notice). The NZKGI Forum indicated it would seek further discussion with Zespri on the outcomes of the trial before providing support for additional trials. The Forum reiterated its view that Zespri must undertake a producer vote prior to progressing from a trial to commercial operation.

We assess the material provided by applying the analytical approaches set out in the KNZ document of 20 November 2020, "The prior notice and non-diversification rules" (KNZ, 2020).

The Prior Notice decision tree

As illustrated in the decision tree below, there are some key decision points inherent in the China Gold3 commercial trial. A decision to proceed with the trial would give rise to the potential to enhance the performance of the core business and to any risks arising during the trial. A decision to proceed with the trial would also necessarily lead to a decision, at the conclusion of the trial, to either cease the trial or expand it into an ongoing activity. There is no choice of returning to the pre-trial situation from 2023.

Timeline and decision tree of Zespri’s Prior Notice of its China trial



The Prior Notice identifies that a decision to commence commercial procurement of Chinese-grown kiwifruit as an ongoing activity would be the subject of a further prior notice to KNZ and/or a producer vote (Zespri, 2020, para. 9). This regulatory overlay means any enhancement of core business from expanding the trial into an ongoing activity, and any risks that might result from that ongoing activity, are not relevant factors when assessing this Prior Notice; any enhancement of core business, and any risks, from commencing commercial procurement would result from future decisions that will be the subject of a further prior notice or producer vote.

However, as the Prior Notice is for a time-limited trial, it embeds the possibility that Zespri will decide not to extend the activity at the end of the three-year period. A decision by Zespri to cease the trial, and any risks to the interests of producers from that decision, would not be the subject of a further prior notice or producer vote. Any consequences that might result from a decision to cease the trial should therefore be assessed as an element of the Prior Notice, unless it were a *fait accompli* that the trial would expand into commercial procurement.

Is the activity likely to enhance core business?

The trial would allow due diligence and risk assessment of potential commercial procurement options. It would expand the knowledge available to Zespri in assessing the competitive threat of unauthorised Gold3 in China and other markets for New Zealand kiwifruit, and support efforts by Zespri to influence the government and industry via working directly with local kiwifruit industry stakeholders. For these benefits, Zespri is likely to pay a relatively low cost depending on revenues from the sale of trial

Chinese Gold3 volumes. In our view, the trial is likely to enhance the performance of Zespri's core business by providing information that may:

- reduce current or future costs or risks of carrying out the core business; and
- increase current or future prices or demand for New Zealand-grown kiwifruit.

We consider that the objectives for the trial establish a clear nexus between the proposed non-core activity and Zespri's core business.

Does the activity pose no more than a low risk to the interests of producers?

Assessing whether the activity would pose no more than a low risk to the interests of producers is fraught with uncertainty. KNZ is required to take into account any measures that Zespri puts in place to mitigate the effects of the risk, and then consider the likelihood of the risk event occurring and the impact on the interests of producers if a risk event occurs (regulation 10A(3)).

In the body of the paper we consider in turn each of the risks identified by Zespri in its Prior Notice and those that emerge from our consideration of the material and in discussions with Zespri and its consultants.

We consider that an assessment of two risks may determine whether KNZ is satisfied that the China Gold3 commercial trial poses no more than a low risk to the interests of producers:

- The potential for the trial to impact on Zespri's relationship with provincial Chinese government stakeholders, should Zespri conclude at the end of the trial that it was not in its interests to continue.
- The potential for the trial to hasten the leakage in China of New Zealand on-orchard and post-harvest expertise.

Potential for the trial to impact on Zespri's relationship with provincial Chinese government stakeholders, should procurement end with the trial

The possibility that Zespri might not expand the trial into an ongoing activity cannot be ruled out. Zespri's consultants Vision Consulting, and KNZ adviser John McKinnon, suggested it would be possible that damaged relationships on exit could result in a worse outcome for New Zealand producers than not entering the trial. This worse outcome could occur if expectations were not well managed, including an exit being foreshadowed in advance as much as possible. This damage could occur if the Chinese authorities felt let down by such a decision. [REDACTED]

[REDACTED] This earlier project sought to investigate whether local kiwifruit varieties could be grown to Zespri standards in China.

John McKinnon and Vision Consulting were both of the view that expectations could be managed so a decision to exit the trial would not damage the interests of New Zealand producers. However, the Prior Notice and supporting papers do not set out how Zespri intends to manage the expectations of its provincial Chinese government stakeholders to mitigate this risk, other than a general comment about a stakeholder and communication strategy. KNZ cannot therefore account for any measures that Zespri might put in place to mitigate the risk of damaged relationships, were the trial not

expanded into an ongoing activity. Unmanaged, the risk of damaged relationships in this key market would pose more than a low risk to the interests of producers.

Risk of leakage of New Zealand on-orchard and post-harvest expertise

An important part of the proposed China Gold3 commercial trial is the planned on-orchard and post-harvest extension and quality assurance activities. Zespri explains that these activities risk specific skills and techniques used by New Zealand producers being copied or adopted more broadly by Chinese producers and post-harvest operators. We agree with Zespri that there is potential that such leakage of know-how could both inadvertently hasten the development of volumes and quality of unauthorised Gold3 production and reduce the competitive advantage of New Zealand kiwifruit producers. In the material we reviewed, and in our discussions with Zespri's advisers, improving orchard yield productivity and pack out rate to New Zealand levels was seen as a key potential improvement that could be made to Gold3 production in China.

Zespri discusses a number of measures it would implement to mitigate this risk of leakage. These measures include selecting the most able and trustworthy Chinese producers and post-harvest partners, contracts for confidentiality and intellectual property protection, and only providing the necessary information for the trial. These measures are all likely to mitigate the risk of leakage.

A range of views were aired on the potential for leakage in discussions with Zespri and its advisers. The advisers emphasised Zespri's competitive advantage in on-orchard and post-harvest expertise involved too many different factors and was too complex to be easily replicated. These factors include

[REDACTED]

[REDACTED] The extent to which leakage of on-orchard information and skills could see matching yield productivity on orchards not aligned to Zespri was also debated.

Zespri will make information and skills of value available to participants in the trial as it seeks to attract local growers and post-harvest operators and to ensure Zespri quality levels are met. These planned on-orchard extension and quality assurance activities are key parts of the activity of the China Gold3 commercial trial and it is assumed that by the end of the trial Zespri aligned growers could achieve

[REDACTED]

[REDACTED] The Prior Notice and supporting documents do not explain how its post-harvest strategy will work and what controls Zespri will have over the expertise it supplies.

We accept that the productive advantage of New Zealand producers is a result of a complex array of factors. However, given the rapid spread of information and skills among the unauthorised Gold3 growing sector in China, driven by good returns from unauthorised Gold3, extra leakage of New Zealand expertise seems to us likely when compared to the current situation. The numbers of Zespri aligned Chinese growers of Gold3 is expected to grow from [REDACTED] in 2021 to circa [REDACTED] by the conclusion of the trial in 2023. As a combination of grower and grower staff turnover and information sharing occurs among Zespri-aligned Chinese growers and post-harvest partners, there will be leakage of expertise to the Chinese sector generally.

Our assessment is that the impact of this leakage, despite Zespri's mitigation measures, could be material. The level of leakage would likely be initially low. However, by the end of the trial period the risk of a level of leakage materially higher than if the trial were not conducted—accidental and

deliberate—from circa [redacted] local growers and their key staff, and its long-term consequences, would, in our view, be more than low.

Conclusion

NZKGI has identified six producer interests listed in the left-hand column below. Our findings about the impact of the trial on those interests are set out in the right-hand column.

Table 1 : Trial effect on producer interests identified by NZKGI

Producer interest	Risk assessment
Grower returns	No more than low risk to grower returns, as volumes in trial are comparatively small and Zespri will bear financial cost of trial.
Asset values (i.e., orchard capital values)	Investors in Gold3 are likely to value the information from the trial; the risk that the trial itself would adversely affect the value of G3 licences is no more than low.
Brand reputation and customer perception especially with regards to food safety and quality	Risk to Zespri brand in consumer markets is no more than low given limited nature of trial.
[redacted] [redacted]	[redacted] [redacted] [redacted] [redacted] [redacted]
Future industry stability including ongoing support of the Single Point of Entry and financial sustainability	The limited nature of the trial means the risk of it impacting on the ongoing support and financial sustainability of the 'single desk' is no more than low.
Orchard practice intellectual property	The level of leakage would likely be initially low, but by the end of the trial period the risk of a materially higher level of leakage, than if the trial were not conducted, and its long-term consequences, would, in our view, be more than low.

We therefore conclude that the proposed China Gold3 commercial trial is likely to enhance the performance of the core business. However, it would pose risks to the interests of New Zealand producers that are more than low. Our assessment of whether the trial could enhance core business, and the risks involved, has been undertaken over a short period of time. As discussed in the body of our report, this assessment involves reviewing judgements made by Zespri on matters about which information is limited and which necessarily rely on important but untested assumptions. We attempt

to identify these judgements and assumptions so the Board can assess the significance of the technical and operational issues discussed.

1. Introduction

Zespri has provided KNZ Prior Notice of a commercial procurement model trial in China (Zespri, 2020). The trial would entail Zespri buying and selling under its brand up to 1.95 million trays of Chinese-grown Gold3 fruit over a period of up to three years. Buying and selling Chinese-grown kiwifruit would fall outside Zespri's core business of buying and exporting New Zealand-grown kiwifruit.

KNZ has asked us to assess whether the trial would support core business in terms of Regulation 10A; that is, whether the activity is likely to enhance the performance of the core business and pose no more than a low risk to the interests of producers

Our report unfolds in five sections:

- this first section introduces our report and sets out its structure
- the second section outlines the Zespri's proposal
- our third section sets out our understanding of the Regulations under which the Prior Notice is to be assessed
- the fourth section assess whether the China Gold3 commercial trial would enhance the performance of the core business
- the fifth section assesses whether China Gold3 commercial trial pose no more than a low risk to the interests of producers
- Our final section sets out our recommendations.

The documents we reviewed in this evaluation are listed in Appendix A. Zespri also facilitated video conference meetings for us with two of its consultants, Boston Consulting Group (BCG) and Vision Consulting. We also benefited from a further discussion with Zespri staff on the assumptions and modelling underpinning its cost benefit assessment.

2. Zespri proposal

2.1 The proposed activity

On 28 October 2020, Zespri provided KNZ Prior Notice of a commercial procurement model trial in China (China), also described as the China Gold3 commercial trial (Zespri, 2020). Zespri explains in its Prior Notice that this trial will involve it procuring and selling Gold3 grown in China over a three-year period. In the first year - 2021 - it proposes to procure and sell up to 200,000 trays. Subject to approval by its Board, Zespri plans to procure and sell around [REDACTED] trays in 2022, year 2, and up to 1 million trays in 2023, the third and last year of the trial.

2.2 Context of the trial

Zespri explains in its Prior Notice that the purpose of the China Gold3 commercial trial is to provide the information needed to assess whether expanding from a trial to an ongoing China procurement strategy would enhance the core business and be no more than low risk to the interests of New Zealand producers. It also states that monitoring of supply channels carried out to date, as well as anecdotal evidence from kiwifruit stakeholders and distributors in China, indicated that there were [REDACTED] It argued that the strongest evidence of this was [REDACTED]

Zespri advised in its Prior Notice that this counterfeit product leads to a considerable risk to the Zespri brand, consumer experience and potential to impact on New Zealand sales to China during the shoulder seasons when northern and southern hemisphere fruit are both available in that market. It explained further that beyond straight counterfeits, this unauthorised fruit could also impact Zespri sales through competing local brands at points of purchase.

Zespri described how around 35 per cent of New Zealand fruit sold in China – circa \$NZ 207.9 million in the 2019/20 season – was sold from October onwards, when China-grown fruit is also in the market. It elucidated that this volume of fruit is most directly exposed in the immediate term to the pressure from unauthorised Gold3. In the long term, a more significant risk could emerge as acceptable quality fruit sold under recognised local brands emerge at a lower price point. [REDACTED]

3. Relevant Regulations mitigate risks of single desk seller

3.1 Statutory context for our analysis

This section describes our understanding of the Regulations relevant to our assessment of the Prior Notice. The outline below draws heavily from KNZ's 2020 document setting out its approach to its monitoring and enforcement functions under the prior notice and non-diversification rules (KNZ, 2020), and from our briefings from KNZ.

3.2 Risk mitigation measures of Kiwifruit Export Regulations

The Regulations were promulgated pursuant to Part 2 of the Kiwifruit Industry Restructuring Act (1999). The Act set up a monopsony arrangement with Zespri as the single desk exporter of New Zealand-grown kiwifruit, other than to Australia. To offset and mitigate the risks and costs inherent in Zespri's monopsony position, the Act provided for the Regulations, including setting up KNZ as the regulatory body charged with monitoring and enforcing a range of mitigation measures.

The risks and costs of Zespri's monopsony position are broad and varied. Growers are tied to Zespri as the primary authorised exporter. The concern was Zespri might misuse its market position to adversely affect grower interests and make unwise or inefficient decisions in its exporting activities that damaged the global market or reduced the return to growers. Other risks included the impact of limited competition on innovation, investment and the incentives towards greater efficiency.

The risks and benefits of the regime are summarised in the Regulatory Impact Statement (RIS) for the 2017 amendments to the Regulations. The RIS stated that the regime (Ministry for Primary Industries, June 2017(a), para. 20):¹

- concentrates risk throughout the industry: kiwifruit growers are reliant on the price that Zespri pays for their produce; if Zespri's strategy is not successful, the industry as a whole does not perform well;
- captures kiwifruit growers: with captured supply, the incentives on Zespri to operate in a cost-effective way and to offer its suppliers a top price for their kiwifruit are reduced; and
- concentrates market power, which, unless safeguarded against, could be used for anti-competitive gains: domestically, the kiwifruit industry is competitive, and any firm can invest in on-shore post-harvest services, in kiwifruit-related business activities, and (with approval) can export kiwifruit in collaboration with Zespri. However, unless appropriately monitored, Zespri could leverage its privileged export right to compete against other firms in the kiwifruit industry.

¹ The 2017 amendments came into effect on 1 August 2017.

Part 3 of the Regulations contains the “mitigation measures” intended to address these risks. These are the non-discrimination rule, the non-diversification rule and the information disclosure requirements. Further mitigation is intended to be provided by Zespri’s corporate structure and shareholding and the general competition provisions of Part 2 of the Commerce Act (1986).

3.3 Interpretation of Regulation 10A

KNZ sees the primary function of Regulation 10A as to distinguish between non-core activities that must be approved by 75 per cent of producers under Regulation 11, and those that do not under Regulation 10A. The relevant regulatory impact statements made it clear that KNZ’s role was not to itself regulate and manage the risks undertaken by Zespri, but rather to ensure that producer oversight was engaged where it ought to be. This is because it is producer (‘captured grower’) oversight that is the key mitigating measure in the Regulations.

In KNZ’s view, Regulation 10A’s interpretation should be guided by its purpose and function. Its primary function is to distinguish between activities based on the level of risk to producers. This is designed to provide protection to ‘captured growers’ as a mitigation measure against Zespri’s monopsony.

If an activity falls outside the definition of ‘supports core business’, the activity can still proceed. However, Zespri would have to engage with producers and obtain their approval before proceeding. These factors point to a level of conservatism in assessing levels of risk but also that Zespri should not be put to the time and cost of seeking producer approval when the level of risk does not justify this.

KNZ believes that the “interests of producers” should be given a wide meaning aligned to the breadth of the risks to producers arising from the single desk framework as set out in Part 3 ‘Mitigation measures’, Regulation 8(a). This Regulation states:

“The purpose of this Part is to mitigate the potential costs and risks arising from the monopsony, by encouraging innovation in the kiwifruit industry while managing risks associated with activities that are not the core business.”

KNZ’s view is that this concept of risk is not limited to direct risks to the quantum of payments made to growers. The scope of interests relevant to Regulation 10A is the same as the scope of interests that would be relevant to a producer if they were free to make their own investment/business decisions. Therefore if a producer could legitimately say, “If I was allowed to make my own business decisions, I would not make that decision because of the risks it poses to this interest I have as a producer”, then those are the interests that would be within scope.²

KNZ notes that the decision by the legislature to exclude from the definition of core business Zespri’s ownership of proprietary cultivars (Ministry of Primary Industries, June 2017(b), para. 23):

“because these activities have the potential to pose a higher degree of risk to the interests of captured kiwifruit

² This is the concept of ‘captured growers’ as set out in the RIS, (Ministry for Primary Industries, June 2017(a)), paragraphs 19 and 20.

growers and therefore require continued regulatory oversight”.³

Accordingly, in KNZ’s view this indicated that the legislature held a very broad concept of risk and the interests of producers when drafting these provisions.

3.4 KNZ monitoring of whether an activity supports core business

KNZ’s function under Regulation 33 is to monitor whether an activity that Zespri notifies under Regulation 10A meets the criteria specified in regulation. Specifically, under regulation 10A(2) KNZ must monitor whether a proposed activity:

- a) is likely to enhance the performance of the core business; and
- b) the activity poses no more than a low risk (if any) to the interests of producers.

When considering whether an activity poses no more than a low risk, KNZ must (Regulation 10A(3)):

- a) first take into account any measures that Zespri has put in place to mitigate the effects of any risk event; and
- b) then consider—
 - i. the likelihood of a risk event occurring; and
 - ii. the impact on the interests of producers if a risk event occurred.

A risk event is defined to mean an event identified as a risk to the interests of producers that is posed by the activity (Regulation 10A(4)), and risk is limited to “foreseeable risk” (Regulation 10A(5)).

3.5 Buying and selling Chinese fruit is not core business

Zespri acknowledges that “the procurement and sale of Chinese-grown Gold3 fruit for commercial purposes does not fall within the scope of core business” (Zespri, 2020, para. 4). This view accords with KNZ’s interpretation of the prior notice and non-diversification Regulations that growing, purchasing or marketing kiwifruit that is not New Zealand grown falls outside the definition of ‘core business’ (KNZ, 2020).

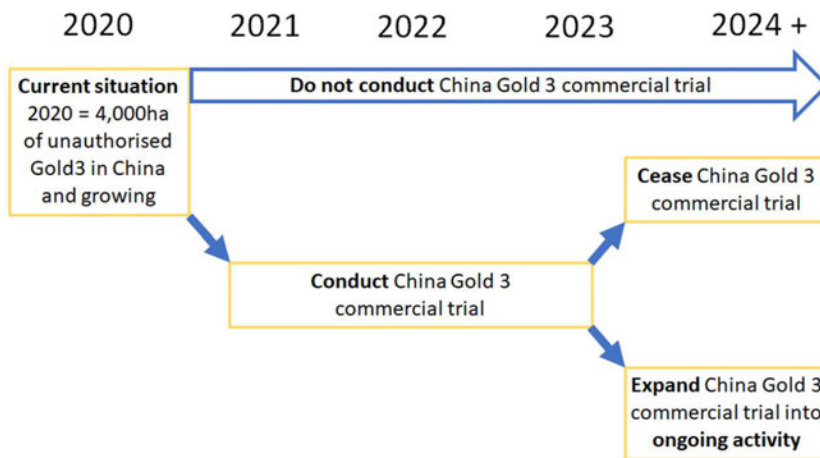
KNZ is therefore required by the Regulations to monitor whether the proposed activity would support core business, as outlined in section 3.4 above.

³ The second RIS was issued on 26 June 2017 to deal with a transition issue arising from the proposed changes to the non-diversification rule, being how the new rule would apply to Zespri’s sunk investments in its non-core business activities.

3.6 Prior notice decision tree

As illustrated in the decision tree below, there are some key decision points inherent in the China Gold3 commercial trial. A decision to proceed with the trial would give rise to the potential to enhance the performance of the core business and to any risks arising during the trial. A decision to proceed with the trial would also necessarily lead to a decision, at the conclusion of the trial, to either cease the trial or expand it into an ongoing activity. There is no choice of returning to the pre-trial situation from 2023. We discuss these timing aspects further in 6.Appendix C.

Timeline and decision tree of Zespri’s Prior Notice of its China trial



The Prior Notice identifies that a decision to commence commercial procurement of Chinese-grown kiwifruit as an ongoing activity would be the subject of a further prior notice to KNZ and/or a producer vote (Zespri, 2020, para. 9). This regulatory overlay means any enhancement of core business from expanding the trial into an ongoing activity, and any risks that might result from that ongoing activity, are not relevant factors when assessing the Prior Notice; any enhancement of core business, and any risks, from commencing commercial procurement would result from future decisions that will be the subject of a further prior notice or producer vote.

However, as the Prior Notice is for a time-limited trial, it embeds the possibility that Zespri will decide not to extend the activity at the end of the three-year period. A decision by Zespri to cease the trial, and any risks to the interests of producers from that decision, would not be the subject of a further prior notice or producer vote. Any consequences that might result from a decision to cease the trial should therefore be assessed as an element of the Prior Notice, unless it were a *fait accompli* that the trial would expand into commercial procurement.

3.7 Factors relevant to assessing the China Gold3 commercial trial

As discussed in its 2020 document, KNZ expects a Prior Notice to (KNZ, 2020):

- clearly describe the proposed activity; and

- describe how and in what manner the proposed activity is expected to enhance the performance of the core business activity.

The document also lists performance and risk factors KNZ believes would be relevant for Zespri to demonstrate that the proposed activity would be likely to enhance the performance of the core business (KNZ, 2020, p. 8).⁴ Some of these factors are relevant to Zespri's current Prior Notice of the China Gold3 commercial trial. These factors are discussed below.

3.7.1.1 Enhanced performance

KNZ explained that a clear nexus would need to be established between the non-core business activity and likely enhanced performance of the core business. Enhanced performance would include (KNZ, 2020):

- reducing current or future costs or risks of carrying out the core business; or
- increasing current or future prices or demand for New Zealand-grown kiwifruit.

Where the non-core business activity would involve horizontal integration (combining the supply of other goods or services with the export of New Zealand-grown kiwifruit) – as is the case for the China Gold3 commercial trial – the expectations of enhanced performance of the core business would be supported by the proposed activity and the core business:

- depending upon the same proprietary know-how base;
- using the same specialised asset as a common input.

Vertical integration is another relevant factor that could enhance performance of the core business. Vertical integration was defined as combining additional stages, or inputs, in the export of New Zealand-grown kiwifruit. The proposed China Gold3 commercial trial is more properly defined as a trial of a wider horizontal integration strategy, rather than vertical integration, so this factor is not directly relevant to this analysis.

3.7.1.2 No more than a low risk (if any) to the interests of producers

The KNZ document set out its view that the threshold for “no more than a low risk (if any)” should be defined conservatively in accordance with the purpose of regulation 10A.

KNZ considered that its assessment of a proposed activity would not require it to balance positive and negative risks; rather, under 10A(3), its focus is only on whether there is a low risk of a negative outcome. This means that any proposed activity that involved taking a modest or large risk of negative outcomes that could be offset by a risk of greater positive outcomes would not be relevant to regulation 10A but instead would fall under regulation 11 and require a vote of producers.

KNZ views the “interests of producers” as limited to their interests as producers engaged in the business of supplying fruit to Zespri. So, it does not include a producer's interests as a producer of

⁴ The document notes that this list of factors is not exhaustive, and that none of the factors would be determinative.

fruit grown for the Australian or New Zealand markets. However, the interests of producers are not limited to only the impact on orchard gate returns (OGRs). KNZ views the interests of producers as encompassing other factors such as the timing and variability of returns, and their long-term stability and growth. However, relevant producers could also have environmental or social interests, such as concerns about foreign labour laws, or activities negatively affecting the environment.

KNZ explained its view that gauging the interests of producers would require some form of direct engagement or surveying of producers. This direct engagement was viewed as necessary because each producer will have different perceptions of potential outcomes and likelihoods of proposed activities and what might be a risk to their interests.

However, KNZ emphasised that it must also look to ensure that the costs of compliance are proportionate to the risks being managed, and that another objective of the regulations is to enhance cost efficiency and reduce the administrative burden on both Zespri and KNZ (Ministry for Primary Industries, June 2017(a), p. 5).

To allow it to assess whether an activity would be no more than a low risk (if any), KNZ indicated that it would generally expect to see addressed in the Prior Notice and associated documentation information (KNZ, 2020):

- identifying the scope and range of interests of producers that may be affected by the proposed activity, and an explanation of the basis for Zespri's assessment that it has identified all relevant interests
- identifying the nature of the risk(s) arising from the activity
- providing an assessment of the likelihood of each risk event occurring
- provide an assessment of the impact on the interests of producers if each risk event occurred
- identifying the mitigation measures that Zespri proposes to address each risk, and the assessments of how each measure might mitigate the effects or might not work as intended
- showing the assumptions upon which each of the above assessments are based, and the grounds upon which those assumptions are considered to be reasonable
- distinguishing the relative size of the proposed activity and associated risk event—is it of small to moderate scale relative to existing activities?
- identifying whether the proposed activity is anticipated to generate low to moderate variance of returns relative to existing activities
- assessing whether the proposed activity is anticipated to generate returns that that are at least moderately independent of existing activities.

4. Does the China Gold3 commercial trial enhance the performance of the core business?

Zespri explained the nexus between the China Gold3 commercial trial and likely enhanced performance of the core business in its Prior Notice. Zespri's reasoning is summarised under the following headings:⁵

- due diligence and risk assessment of potential future commercial procurement options
- confirmation/expansion of existing knowledge to permit more robust assessment of potential competitive threat of unauthorised Gold3 in China and other core New Zealand kiwifruit markets
- supporting existing government and industry relations platforms through working directly with local kiwifruit industry stakeholders
- reduction of risk.

We summarise below Zespri's reasoning for each of these categories.

4.1 Due diligence and risk assessment

Zespri explained due diligence and risk assessment involved developing its understanding of local agronomic, supply chain and distribution channels and economics to underpin an analysis of whether a domestic global supply procurement strategy for Chinese-grown Gold3 would enhance the core business. In addition, the trial would obtain this information in a manner that would be low risk to New Zealand producers. Zespri added that this due diligence and risk assessment would also involve ensuring, as far as possible, the corporate integrity of selected Chinese growers and their ability to align their practices and procedures with Zespri's values and brand, as well as to provide adequate capital investment for post-harvest development.

Zespri stated that the strength of the relationships of Chinese growers with regulatory and political bodies was also an important factor. It described how engaging Chinese growers with local cooperatives would be vital to securing fruit supply, key orchard inputs and securing subsidies for these authorised growers. An additional key factor was the capability of these growers to work with, and learn from, Zespri orchard extension teams to improve their technical abilities and bring their orchard practices into line with the standards Zespri requires.

⁵ Prior Notice of China Gold3 commercial trial, 28 October 2020, Pages 4 to 7

4.2 Gathering knowledge for a more robust assessment of competitive threat of unauthorised Chinese Gold3

Zespri explained that the core business would be supported and enhanced by gaining a more substantial and robust understanding of the potential scale and implications for Zespri and New Zealand kiwifruit producers from existing and potential competitive sources of Gold3 kiwifruit in China. This information would include assessing the likelihood of unauthorised Gold3 becoming a viable competitive product within the New Zealand fruit sales season and potential impacts on the distribution relationships used by New Zealand kiwifruit.

Zespri noted there were around 4,000 hectares of unauthorised Chinese Gold3 now that could result in around 10 million trays of Class 1 fruit being available in China this season. Zespri explained that if the current growth in new grafting and unauthorised orchard developments continued, its modelling suggested that unauthorised Chinese vines could grow to around [REDACTED] within the next [REDACTED] or around [REDACTED].

In its Prior Notice, Zespri argued that the impact of such growth in unauthorised Gold3 on its market share, channels and value could be significant. But it recognised that it had insufficient data on the quality, volume and distribution of Chinese-grown Gold3 to be able to accurately assess the potential competitive threat. Zespri explained that the trial would enable it to collect accurate data to refine assumptions and help determine whether ongoing commercial procurement would materially reduce the competitive threat either via deterring the continued expansion of unauthorised plantings or the ability to defend supply relationships using locally procured Gold3.

4.3 Supporting government & industry relations by working with local kiwifruit industry stakeholders

Zespri suggested that the China Gold3 commercial trial would create a means of leveraging industry and political support in China to help mitigate the spread and impact of unauthorised Gold3 plantings, as well as more broadly promote the importance of food safety, quality and the Zespri brand as a critical differentiator for consumer protection and price. Zespri argued that such industry and government engagement would further signal Zespri's intent to work with local communities with a view to assisting poverty alleviation and improve grower outcomes. It would also reduce the risk of [REDACTED]. Finally, Zespri suggested that direct engagement with Chinese kiwifruit producers and stakeholders could potentially lead to opportunities for New Zealand producers to learn from their techniques or capabilities.

Discussions with Zespri and its advisors has underlined the benefit of focusing on the provincial Chinese authorities in its government engagement activities. The provincial authorities in Sichuan were of particular importance as this is where the majority, estimated at [REDACTED] of the unauthorised Gold3 is currently grown (Vision Management Consults Limited, Draft 12 November 2020).

4.4 Reduction of risk

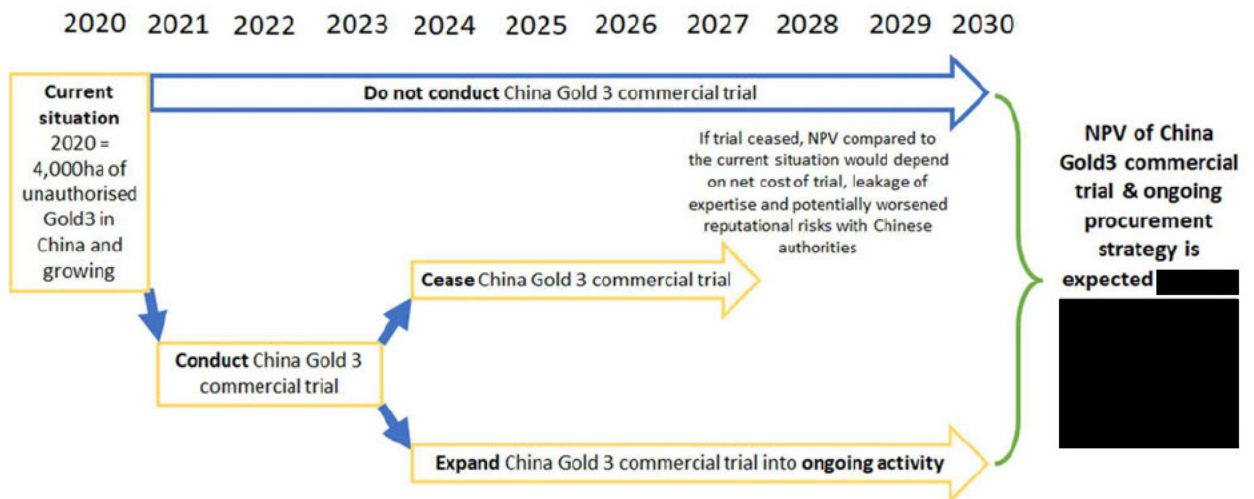
Zespri averred that the China Gold3 commercial trial would reduce the immediate and future financial and reputational risks to New Zealand producers by protecting the Chinese supply chain and distribution relationships. It concluded that this would benefit New Zealand kiwifruit producers, and potentially reduce the likelihood of unauthorised plantings continuing to grow.

In the Prior Notice, Zespri estimated that the trial and roll out of its China procurement strategy over 10 years would avoid lower October-to-March New Zealand-grown Gold3 sales volumes and price decreases in the Chinese market [REDACTED]. This is a core benefit of the commercial trial and nexus to supporting its core business and benefiting the interests of New Zealand producers.

[REDACTED]

These Prior Notice estimates dated from work undertaken in August 2020.

Figure 1: Estimated value of China Gold3 commercial trial



These estimated OGR losses to producers that are avoided by conducting the China Gold3 commercial trial are measured as net present value (NPV) compared to Zespri's 2019 long-term plan, which covers 10 years. The variance in value lost is based on differing assumptions about [REDACTED]

[REDACTED]

[REDACTED]. These scenarios

result in significantly reduced benefits to New Zealand producers from the trial and a full procurement strategy. These scenarios are explained in more detail in Appendix B.

Zespri's modelling of the financial impact on OGRs did not explicitly factor in additional risk elements such [REDACTED]

Zespri's Prior Notice states that the modelling suggests procuring Chinese-grown Gold3 is likely to be the best option for reducing the direct financial risk to New Zealand growers and preserving the OGR of New Zealand producers. It also notes that the information obtained through the China Gold3 commercial trial would test this proposition and allow more accurate assessments of the risks to New Zealand producer OGRs from competitive Chinese production.

Assessment

Zespri's assessment that the China Gold3 commercial trial would enhance the performance of the core business is based on net benefits that accrue not from the trial itself, but from the trial and a decision to be made at a later date to turn the trial into an ongoing activity. Zespri states in the Prior Notice (Zespri, 2020, p. 14):

"...no returns to producers are anticipated from the commercial procurement model trial."

Also, the relevant Board Paper states (Zespri Group Limited, October 2020, p. 13):

"As the budget indicates, while [REDACTED] of funding is requested for the first-year activity, revenue from direct fruit sales are expected to offset this by [REDACTED]"

This leaves a net cost of [REDACTED] which is to be borne by Zespri rather than the grower pool (Zespri, 2020, p. 10).

The benefits of the China Gold3 commercial trial separated from any roll out of the full China procurement strategy are probably better summarised as (Zespri, 2020, p. 1)

"The commercial procurement model trial will provide the information needed to assess whether an ongoing China procurement would enhance the core business and be no more than low risk to the interests of New Zealand producers."

In our view, these objectives for the trial establish a clear nexus between the proposed non-core activity and Zespri's core business.

Based on the information available to us, the trial appears likely to enhance the performance of Zespri's core business by providing information that may:

- reduce current or future costs or risks of carrying out the core business; or
- increase current or future prices or demand for New Zealand-grown kiwifruit.

We therefore consider that the activity proposed in the Prior Notice would satisfy the first limb of regulation 10A(2); that is, it is likely to enhance the performance of the core business.

5. Does the China Gold3 commercial trial pose no more than a low risk (if any) to the interests of producers?

Section 3.7.1.2 of this report sets out the points KNZ established that a Prior Notice from Zespri, and associated documentation, need to address. In this section, we discuss each of these points.

5.1 Identify the scope and range of interests of producers that may be affected by the proposed activity, and an explanation of the basis for Zespri's assessment that it has identified all relevant interests

Zespri states in the Prior Notice that the regulations do not define the term "interests of New Zealand producers", nor do they provide an indicative list of what interests need to be considered. However, it defines the scope of the interests of producers as limited to interests as producers engaged in the business of supplying it with fruit and not to their interests as its shareholders (Zespri, 2020, p. 7).

Zespri also notes that while individuals may have personal interests or opinions, it is reasonable to assume that for the purposes of the regulations, interests of producers should largely be interpreted collectively, although there may be scenarios where "an interest" may be of more interest to particular groups of growers, which should be taken into account (Zespri, 2020, para. 44). This differs from the view in the KNZ paper, which places more emphasis on individual's experience and knowledge affecting their perceptions of their interests.

Zespri considers that the interests of producers are generally likely to include (Zespri, 2020, para. 46):

- financial returns (OGR delivered by Zespri for fruit produced, and related factors such as timing and potential stability of returns)
- on-orchard operating costs and orchard values, which could include both the value of licences and/or land
- sustainability/environment/social responsibility issues
- reputational matters relating to the Zespri brand and, by extension, the "New Zealand producer" brand of being a producer of high-quality, premium kiwifruit.

Zespri states that the activities planned in the China Gold3 commercial trial will not impact on New Zealand on-orchard operating costs or orchard values, nor on sustainability/environmental matters in New Zealand. However, it believes that reputational matters relating to the Zespri brand and, by extension, the "New Zealand producer" brand of being a producer of high-quality, premium kiwifruit and financial returns OGR delivered by Zespri for fruit produced, and related factors such as timing and potential stability of returns, may be affected by the China Gold3 commercial trial (Zespri, 2020, paras. 48 - 49).

Zespri's explains that its assessment of the relevant interests of producers is based on commercial modelling of likely impacts of the activity, combined with its experience of engaging with producers internationally over more than 20 years, as well as direct engagement with New Zealand kiwifruit producers through industry forums, Zespri publications and direct grower engagement. It continues that it has undertaken a wide range of communications and engagement with New Zealand producers over the issue of unauthorised Gold3 in China, particularly since the scale of the unauthorised plantations was realised. It states that it has communicated and consulted widely among growers, and its statements about the interests of producers are based on, and supported by, this extensive and consistent grower interaction. Zespri also describes recent engagements with producers and attached a list of producer engagements as Appendix 1 of its Prior Notice. In addition, it attached a list of media coverage as Appendix 2 to the Prior Notice, while Appendix 3 provides examples of Zespri presentations to producers.

Zespri describes the questions typically raised by growers. It states that these have largely focused on topics such as impact on their returns, orchard prices and the prices paid for Gold3 licences, as well as impact on New Zealand fruit sales in China over time, impacts on fruit returns if China sales decline and what ability Zespri has to protect plant variety rights (PVRs) in China. Growers have also asked whether Zespri knows of unauthorised Gold3 in other countries, and what options it would have in other jurisdictions.

In the Prior Notice, Zespri undertakes to continue to engage with growers directly with respect to potential commercial procurement activities in China through the course of the China Gold3 commercial trial (Zespri, 2020, p. 9).

Assessment

Zespri has provided a lot of material about the number and content of its interactions with producers. It has also supplied information on the questions typically raised by growers about the China Gold3 commercial trial. However, there is not much specific information on the extent to which producers hold differing views or a breakdown of the proportions of producers holding different views. It would be reasonable to expect Zespri to keep statistics on grower interactions, concerns, the extent to which they held different views and the proportions holding those different views. This sort of information has not been made available for our assessment.

A letter from the New Zealand Kiwifruit Growers Incorporated (NZKGI) CEO Nikki Johnson of 11 December states (NZKGI, 2020):

“There are a range of interests which all ultimately link to the financial impacts on the growers. More specifically, the [NZKGI] Forum⁶ identified the following interests:

- **Grower returns**
- **Asset values (i.e. orchard capital values)**
- **Brand reputation and customer perception especially with regards to food safety and quality**

⁶ NZKGI is mandated to represent the interests of New Zealand's kiwifruit growers through its Forum members.

- **Market access with regards to the New Zealand China relationship**
- **Future industry stability including ongoing support of the Single Point of Entry and financial sustainability**
- **Orchard practice intellectual property”**

The material provided by Zespri on producer interests does not provide the assessment of supplier views that KNZ contemplated in its document. We are not aware of how many producers are concerned about which issues or the degree of that concern. Our assessment below considers the risks to the interests of producers identified by Zespri and listed above in Section 5.1, as well as those identified by NZKGI.

5.2 Identify the nature of the risk(s) arising from the China Gold3 commercial trial

Zespri believes the risks to the interests of producers from the China Gold3 commercial trial include reputational risk, financial risk, and the risk of leakage of New Zealand on-orchard production expertise in China. These risks are discussed further in Zespri’s risk framework, which is set out in Appendix 4 of its Prior Notice.

5.2.1 Reputational risk

Zespri describes the continued growth and strength of its brand as fundamental to the stability and growth of New Zealand producer returns, and any risk to the brand is considered to be directly aligned with risk to New Zealand producer interests. It sees food safety and quality as the key risk factors for its brand and provides the example that its [REDACTED]

Zespri states that the procurement of Chinese-grown kiwifruit and sale under the Zespri brand raises a risk of reputational damage in the event of any food safety or quality issues with the kiwifruit. But it argues that any such reputational damage is unlikely to accrue to New Zealand producers given that any such quality or food safety failures would be clearly linked to Chinese-grown fruit.

Zespri canvasses a second area of reputational risk as possibly arising from geo-political risk [REDACTED] or Zespri’s engagement with Chinese government stakeholders became difficult. It suggests that [REDACTED]

Assessment

The risk to the Zespri brand in consumer markets from the trial is likely to be low given the limited nature of the trial. We are not convinced that if a serious issue with fruit quality were to arise, consumers would distinguish between Chinese-grown and New Zealand-grown kiwifruit marketed under the Zespri band. However, given the limited nature of the trial, we agree with Zespri that this risk can be considered low.

The trial is unlikely to be a risk factor in China-New Zealand government relations deteriorating. However, an expanded relationship engendered by the trial would marginally expand the wide variety of issues which could spark some problem. This would be a low likelihood, though high impact risk event, that, although it cannot not be ruled out, would not be more than low risk.

There is potential for the trial to impact on Zespri's relationship with Chinese government stakeholders, should Zespri conclude at the end of the trial that it was not in its interests to continue. Zespri's consultants, Vision Consulting, and KNZ adviser John McKinnon, suggested it would be possible that damaged relationships on exit could result in a worse outcome for New Zealand producers than not entering into the trial. This worse outcome could occur if expectations were not well managed, including an exit being foreshadowed in advance as much as possible. This damage could occur if the Chinese authorities felt let down by such as decision. [REDACTED]

[REDACTED] This earlier project sought to investigate whether local kiwifruit varieties could be grown to Zespri standards in China.

Zespri faces reputational risks now but these arise from unauthorised growing of Gold3 and use of its brand. It is possible that the trial, and any decision to pursue an ongoing procurement strategy, could complicate measures to control unauthorised use of the brand if cooperation with the Chinese authorities is not effective in stopping these activities. In this case, the trial could set a precedent and encourage the growing of other illegally acquired plant variety rights from New Zealand. John McKinnon observed to us that the trial may signal that Zespri accepts the difficulty of prosecuting growers, though agreed that any signalling of this likely reflects reality and not an additional risk.

In summary, the primary reputation risk from the trial that appears to be more than low is the risk of damage to relationships should Zespri conclude that it was not in its interest to continue with commercial procurement. We consider below whether Zespri has provided KNZ with an analysis of how it will mitigate that risk.

5.2.2 Financial risk

Zespri explains in its Prior Notice that costs relating to on-orchard activities will be paid by Zespri (not the grower pool), and thus will not flow through to New Zealand producer OGRs (Zespri, 2020, p. 10). As it will control the distribution of Chinese-grown fruit procured during the trial, Zespri explains that the timing and channels for this fruit can be aligned to sales of New Zealand kiwifruit to avoid any impact on New Zealand producer OGRs.

Zespri argues that there would be no adverse impact on the value of New Zealand Gold3 licences arising from the China Gold3 commercial trial. It states that one of the purposes of the trial is to

consider potential impacts on New Zealand Gold3 licence value in the event of the continuation of unauthorised plantings and/or if Zespri were to grant licences pursuant to a commercial procurement strategy.

Assessment

Zespri has investigated the potential of the trial, and a wider roll out of an ongoing procurement strategy, to affect returns to New Zealand producers. This work relies on a number of important but untested assumptions and variance in these assumptions represent financial risks that could emerge from the trial. Some of these risks could occur during the trial, and some following it should it become an ongoing activity. These risks are discussed further in sections 4.4, 5.6 and Appendix B.

It is possible that the trial could affect the value of Gold3 licences by affecting producer and potential producer perceptions of the size of the on-going risk from unauthorised Chinese-grown Gold3. It could be that producers interested in acquiring Gold3 licences could see the trial as evidence of a strategy that could succeed in better managing the risks inherent in the growth of unauthorised Chinese-grown Gold3. This may give them more confidence in the future of New Zealand-grown Gold3 and therefore flow through to what they might be prepared to pay for licences. The reverse is also possible: demand for Gold3 licences could be depressed due to a perception of those interested that the China Gold3 commercial trial was not effective.

We consider the risk that the trial itself would adversely affect the value of G3 licences to be low. As Zespri identifies in its Prior Notice, the commercial procurement model trial will provide the information needed to assess whether an ongoing China procurement strategy would enhance the core business and be no more than a low risk to the interests of New Zealand producers. New Zealand investors in Gold3 are likely to value this information relative to not knowing the answers to these questions.

5.2.3 Risk of leakage of New Zealand on-orchard expertise in China

An important part of the proposed China Gold3 commercial trial is the planned on-orchard and post-harvest extension and quality assurance activities. Zespri explains that these activities risk specific skills and techniques used by New Zealand producers being copied or adopted more broadly by Chinese producers and post-harvest operators. It states that this could both inadvertently hasten the development of volumes and quality of the unauthorised Gold3 production and reduce the competitive advantage of New Zealand kiwifruit producers.

Assessment

We agree that the risk of leakage of New Zealand on-orchard expertise appears a valid concern as raised by both Zespri and NZKGI. We consider below the likelihood and impact of the risk arising once mitigation strategies are considered.

5.3 Provide an assessment of the likelihood of each risk event occurring

5.3.1 Likelihood of reputational risk

Zespri considers the likelihood of reputational risk to New Zealand producers to be low, arguing that any food safety or quality issues would clearly relate to Chinese-produced fruit, rather than New Zealand kiwifruit. It suggests that potential for confusion as to source of the fruit would be limited due to the counter-seasonal nature of Chinese and New Zealand production. Zespri also points out that quality assurance and oversight by Zespri will mitigate against this risk and reduce its likelihood. It finally notes that the limited volumes of fruit proposed to be sold as part of the trial also reduces this risk.

Assessment

The likelihood of reputational risks occurring are relatively high in China, as Zespri noted in paragraph 60 of the Prior Notice.

...**"The China market** [redacted]
[redacted]
[redacted] **Businesses**
operating in China must be able to flex and evolve to
respond to continually changing environments, as well as
maintaining awareness of geo-political and economic issues
which can drive significant government policy."

There is also a wider geo-political risk, as also canvassed in paragraph 69 of the Prior Notice:

"... [redacted]
[redacted]
[redacted]
[redacted]
[redacted]

The potential for this sort of reputational risk to affect the trial and any expansion of the trial into an ongoing activity will grow with the level of involvement in the Chinese market. As the level of Zespri's involvement in China grows, so does its exposure to these sorts of political risks. Some level of this risk to the interests of producers exists now under the status quo without the trial, but this is likely to be of a different form. The existing situation involves exports and sales of fruit grown outside China with no involvement in local production. This limits [redacted] that could affect Zespri authorised production activity. However, the Chinese local authorities, are according to Zespri and its advisors, [redacted]
[redacted]
[redacted] occurs now and is likely to continue unless the trial and any ongoing activity can [redacted] It also depends on the relative

importance [REDACTED] relative to other motivations such as relative fruit profitability.

The likelihood of food safety or quality risks is currently confined to the sale of non-Chinese grown Zespri fruit on the Chinese market and the illegal use of Zespri's brand on non-Zespri fruit. The likelihood of these risks would increase as Zespri procures and sells increasing amounts of local fruit at low volumes in the trial, but much greater volumes should a full China procurement strategy follow the trial.

5.3.2 Likelihood of financial risk

Zespri believes that the likelihood of financial risk to producers to be low given that the costs of the trial will be paid by Zespri, and the sales of Chinese-grown Gold3 will be largely at times when New Zealand kiwifruit is not in the market. Zespri also points to the disparity between its forecast distribution of [REDACTED] of Gold3 into China in the 2020/21 season compared to the [REDACTED] trays of kiwifruit (of all varieties) produced in China for the domestic market. Zespri argues that the trial volumes of 200,000 trays in 2021 with a maximum of 1 million trays in 2023 is immaterial compared to Zespri's supply of Gold3.

Assessment

We agree that the small size of the trial and its limited cost does reduce the likelihood of any impact on the interests of New Zealand producers.

5.3.3 Risk of leakage of New Zealand on-orchard expertise in China

Zespri avers the risk of leakage of New Zealand on-orchard expertise to be low. This is because it will be requiring contractual controls on information and will have the ability to limit the level of information provided to Chinese Gold3 growers. It also argues that at a practical level, many on-orchard techniques and expertise are common across kiwifruit growing regions, and that many participants in the Chinese kiwifruit industry have experience from the New Zealand industry on growing techniques and Gold3. It also states that growing techniques typically do not translate directly to other geographic regions with different climates, soil types and management practices.

Assessment

Contractual controls and limiting information could help manage this risk. However, to provide value to its Chinese grower and post-harvest partners, Zespri will have to provide information and training of value to them. Common on-orchard techniques and expertise and geographic differences between growing regions exist now and are the situation in which any trial will take place, rather than factors that will help Zespri manage the risk of leakage of New Zealand on-orchard expertise in China that could result from the trial. If the level of common on-orchard techniques and expertise in China is high, this is likely to limit the value that Zespri can bring to its Chinese partners, making it more difficult for the trial and its China procurement strategy to succeed.

Discussions with Zespri and its agribusiness advisors underlined the concentration of unauthorised Gold3 growing in Sichuan, particularly around Chengdu, and the speed with which information and skills can be shared between local growers. The difficulties in maintaining confidentiality were also acknowledged. The characteristics of unauthorised Gold3 sector in Sichuan suggest that the likelihood of leakage of information and skills will be materially higher because of the trial compared to not conducting the trial. The trial will involve Zespri attempting to attract local growers and post-harvest processors to its business model. This will necessitate providing information and skills of value to these partners. Zespri is planning on partnering with [REDACTED] Chinese Gold 3 growers in 2021. This will grow to circa [REDACTED] by the last year of the trial in 2023. These growers and post-harvest partners and their key staff will have access to information and skills sufficient for them to [REDACTED] [REDACTED] (Zespri Kiwifruit, Case studies on growing in China, BCG, Slide 12 for [REDACTED] and email from Matt Crawford, Zespri to Geoff Morgan, KNZ sent). Within the period of the trial there are factors that cannot be controlled for, such as staff churn, which are likely to cause leakage of on-orchard and post-harvest expertise. Even with controls in place, some level of leakage of information and skills appears likely to occur.

China is estimated to account for [REDACTED] per cent of global kiwifruit production, has over [REDACTED] hectares planted in kiwifruit, and is expected to have 4,000 hectares of unauthorised Gold3 in 2020 (Vision Management Consults Limited, NZKGI Presentation, Draft 12 November 2020, Slides 15, 18 and 29). The projected growth and size of the Chinese kiwifruit sector and Gold3 production suggests that even low levels of leakage of skills that lifted productivity by a few percentages points could have significant effects when the volumes are compared to New Zealand's projected exports of Gold3 to China. BCG has forecast that unauthorised Chinese production could surpass Zespri imports by 2023 (Zespri Kiwifruit, Case studies on growing in China, BCG, Slide 2). This needs to be seen in the existing political and commercial context of operating in China. The Economist magazine recently wrote:

Many foreign executives and diplomats have little time for the idea that there is real pro-market reform going on; they talk of promise fatigue. Repeated pledges to level the playing field on which Chinese and foreign firms meet have amounted to naught. State firms benefit from reams of subsidies and preferential rules, often opaque (Economist magazine, 15 August 2020, "The new state capitalism, Xi Jinping is trying to remake the Chinese economy, Party control is mixed ever more intimately with market mechanisms").

John McKinnon's advice was that risk of leakage of knowledge and technologies from foreign businesses to Chinese businesses was a very common feature of direct investments in China. So, its likelihood was probably medium to high.

5.4 Provide an assessment of the impact on the interests of producers if each risk event occurred

Zespri provides a risk framework as Appendix 4 of its Prior Notice in which it addresses the impacts of the risks it has identified. It has not addressed impacts separately from its risk framework.

Assessment

As set out in regulation 10A, Zespri uses likelihood and impact to assess the risks of the China Gold3 commercial trial and then explains actions it plans to mitigate those risks. We therefore analyse how Zespri draws together its views of the likelihood and impact of the identified risks after the next section on the actions it proposes to mitigate those.

5.5 The mitigation measures Zespri proposes to address each risk, and how each measure might mitigate the effects, or might not work as intended

5.5.1 Reputational risk mitigations

Zespri is planning processes governing on-orchard extension and quality assurance activities to mitigate risks of reputational damage from the China Gold3 commercial trial. These include:

- [REDACTED] to drive certainty as to what products have been employed and ensure compliance to legal requirements and New Zealand standards for quality assurance and brand protection. Its advisors will oversee the application of sprays.
- Compliance managed through central spray diary programme and residue testing through a lab partner in China.
- Due diligence on partners and growers and ongoing compliance audits.
- Strong governance of the commercial procurement model trial through direct reporting and oversight by the Zespri Executive, China Advisory Board and Board of Directors.

Zespri explains that it will have direct oversight of growers and post-harvest facilities and will apply what it has learned from previous work to determine if local kiwifruit varieties could be grown to its standards in China. It states that this will inform the direction and standards required during the production of the Chinese-grown Gold3 fruit in the trial.

Zespri states that it will continue to liaise closely with New Zealand Government officials on this issue, both in New Zealand and China, as well as engage directly with national, provincial and local government officials in China, with a clear stakeholder and communication strategy. It continues that this engagement will not only focus on activities relating to the production and procurement of fruit, but broader engagement to ensure that [REDACTED]

Assessment

Zespri's planned approach on-orchard extension and quality assurance activities should help it mitigate food safety and quality risks inherent in the trial and any expansion of the China procurement strategy into an ongoing activity.

Zespri's engagement activities will mitigate the risks of the China Gold3 commercial trial in so far as they are different from its current ongoing engagement efforts, which will also be seeking [REDACTED]

Zespri and its advisors explained that actions to protect PVRs needed to be pursued through the local Chinese government authorities rather than at a central government level. Local Chinese authorities were described as very important because they were seeking, through agencies with a focus on agricultural development, to improve the livelihood of farmers and improve the sector's incomes generally. [REDACTED]

[REDACTED]. It is also likely that poverty alleviation has also been a driver of their policies (Economist magazine, 19 September 2020 edition, "China's anti-poverty drive is not disinterested charity. It is about transforming people's thoughts"; 2 January 2021 edition, "The fruits of growth, extreme poverty is history in China, officials say.>"). [REDACTED]

[REDACTED] The trial plans to mitigate this current situation by building better engagement with local Chinese authorities. If Zespri could attract enough grower and post-harvest partners, [REDACTED]

[REDACTED] This could better protect the interests of New Zealand producers.

As explained in meetings with Zespri and its advisors, Zespri is seeking to strike the right balance and pace of engagement with local Chinese authorities. These authorities were described as potentially expecting a larger and deeper engagement with greater knowledge and skill transfer than Zespri or New Zealand producers might be comfortable with. However, getting the right balance and pace of engagement would be important to achieving Zespri's objectives to mitigate the unauthorised plantings of Gold3 and thereby better protect New Zealand fruit sales in the October to March Chinese marketplace in the first instance, but potentially in other markets too.

This effort to improve engagement, particularly with local Chinese authorities, could have significant benefits if it [REDACTED]

[REDACTED] However, the low volumes involved in the trial suggest it will be challenging to achieve the political and influencing of policy objectives that Zespri seeks. A full roll-out of the China procurement strategy would involve a much greater level of investment exposed to other reputational risks such as those of unpredictable government intervention and other geopolitical risks.

5.5.2 Financial risk mitigations

Zespri describes how it plans to mitigate any financial impact on New Zealand kiwifruit producers as:

- [REDACTED]
- [REDACTED]
- [REDACTED]

Assessment

Zespri is likely to [REDACTED] whether or not it proceeded with the China Gold3 commercial trial. So, this aspect appears to be an ongoing 'business as usual'

activity rather than a mitigation of risks involved in conducting the trial. However, the trial will allow Zespri to manage its sales channels for the Chinese-grown Gold3 to avoid financial impact on New Zealand kiwifruit still in that market. The quantities of fruit involved will be small so have little chance of cannibalising sales of New Zealand-grown fruit.

Paying the costs of the trial from Zespri, rather than the pool, will avoid any direct impact on the OGR that producers are paid. The indicative net costs of the first year of the trial are forecast to be [REDACTED] million, which consists of [REDACTED] million of funding offset by [REDACTED] million of direct sales of Chinese-grown Gold3 (Zespri Group Limited, Board Recommendation Paper, October 2020 1.8 - Unauthorised China SunGold – Commercial Model Trial, Page 13). It is probably reasonable to expect that years 2 and 3 of the trial would involve increased budgets as well as offsetting sales. These net costs are small relative to Zespri's overall budget but will marginally affect Zespri's total cash resources. There is a risk that efforts to establish a commercial advantage during the trial could fail. Undoing this could add to trial costs on any wind up. These could arise from any contracts or other arrangements needed to achieve a [REDACTED]

[REDACTED] (See Zespri Kiwifruit, Case studies on growing in China, BCG, Slide 12).

5.5.3 Mitigation of risk of leakage of New Zealand on-orchard expertise in China

Zespri expects to mitigate the potential for the leakage of New Zealand on-orchard expertise by:

- Carrying out due diligence on growers and post-harvest stakeholders chosen to participate in the China Gold3 commercial trial.
- Putting in place contractual requirements for confidentiality and intellectual property protection.
- Limiting access to information provided to solely information necessary for risk mitigation and successful trial objectives.

Assessment

Selecting the most able and trustworthy Chinese producers and post-harvest partners, contracts for confidentiality and IP protection and only providing the necessary information for the trial are all likely to reduce the risk of leakage. However, given the rapid spread of information and skills among the unauthorised Gold3 growing sector in China, extra leakage of New Zealand expertise seems likely when compared to the current situation. As staff turnover and information sharing occurs among Zespri-aligned Chinese growers and post-harvest partners, there will be leakage of expertise to the Chinese sector generally. Zespri will make information and skills of value available as it seeks to attract local growers and post-harvest operators and ensure Zespri quality levels are met. Zespri's planned on-orchard extension and quality assurance activities are critical parts of the activity of the China Gold3 commercial trial. The impact of this leakage, despite Zespri's mitigation measures, could be material. The level of that leakage would initially be low, but by the end of the trial period the level of leakage and its long-term consequences would likely be higher than if the trial were not conducted.

This point has been discussed with Zespri and its advisors. A range of views were aired including that Zespri's competitive advantage in on-orchard expertise involved too many different factors and was too complex to be easily replicated. These factors include [REDACTED]

[REDACTED] was seen as a key potential improvement that could be made to Gold3 production in China. The extent to which leakage of on-orchard information and skills could see [REDACTED] was also debated.

5.5.4 Risk Framework – Likelihood and impact of risks after proposed mitigation measures

Zespri's Appendix 4 risk framework crystallises its analysis of the likelihood and impact of the risks it identifies from the China Gold3 commercial trial after the impact of its proposed mitigation measures. Zespri's risk framework is repeated in Figure 2 below.



Source: Prior Notice of China Gold3 commercial trial, 28 October 2020, Page 37

Likelihood before and after trial

Zespri's risk framework shows that it considers the likelihood of two risks – 'Reputational' and 'Leakage of New Zealand on-orchard expertise in China' would be materially reduced by the China Gold3 commercial trial.

- 'Reputational' risk is reduced from [REDACTED]
- 'Leakage of New Zealand on-orchard expertise in China' is reduced from [REDACTED]

The likelihood of the 'Financial' risk is not thought to change between the status quo without the trial and conducting the trial. It remains at 'Rare'.

Impact before and after trial

Zespri's risk framework shows that it believes that the three-year China Gold3 commercial trial will materially reduce the impact of only 'Reputational' risk. Zespri believes that this will be reduced from [REDACTED]

The trial does not affect the impact of either the 'Financial' or 'Leakage of New Zealand on-orchard expertise in China' risks. These are both seen as 'Low' impact risks and don't change on the horizontal axis between the status quo without the trial and conducting the trial.

5.5.5 Assessment of risk framework

Zespri's analysis of whether the trial would pose no more than a low risk to the interests of producers appears to fuse the three-year trial period with what might follow. Given the low volumes of trial fruit being sold in the shoulder season, it appears questionable whether the trial can reduce 'Reputational' risk likelihood from [REDACTED] without the trial to [REDACTED] with the trial. Equally, it seems debatable whether the impact of 'Reputational' risk would be lowered from [REDACTED] without the trial to [REDACTED] with the trial. As Zespri argues, the volumes are low and the financial commitment by Zespri is relatively modest.

It is difficult to see how a small-scale trial could lower what is presumably a general market 'Reputational' risk in the way shown by Zespri in its risk matrix. This effect seems more reasonable if it is assumed that it refers to an outcome that assumes the trial is superseded by a full roll-out of a wider China procurement strategy. This is analogous to Zespri's analysis of whether the trial will enhance the performance of its core business. The estimated value of the trial captures benefits over 10 years when the trial covered in the Prior Notice is expected to last three years. Many of the benefits are assumed to be incurred within the three years of the trial but significant benefits also occur over the seven years of an assumed roll-out of a full China procurement strategy.

Similar reasoning could apply to the risk of 'Leakage of New Zealand on-orchard expertise in China' where the likelihood is assumed to reduce from [REDACTED]. However, the trial provides an opportunity for increased leakage rather than a reduction in leakage. In our view, the level of leakage would likely be initially low, but by the end of the trial period the level of leakage—accidental and deliberate—would likely be materially higher than if the trial were not conducted. The numbers of Zespri aligned Chinese growers of Gold3 is expected to grow from [REDACTED] in 2021 to circa [REDACTED] by the conclusion of the trial in 2023. As a combination of grower and grower staff turnover and information sharing occurs among Zespri-aligned Chinese growers and post-harvest partners, there will be leakage of expertise to the Chinese sector generally.

5.6 Supply the assumptions upon which each of the above assessments are based, and the grounds upon which those assumptions are considered to be reasonable

Zespri explains that it has assumed that controls implemented for the China Gold3 commercial trial will operate as effectively as the same controls for similar activities in other markets⁷ where it undertakes on-orchard extension activities and procures and sells kiwifruit, subject to adjustment for known issues and its experience in China.

Assessment

The risks inherent in the China Gold3 commercial trial are very likely to have features that differ from other markets in which Zespri carries out similar activities. This is clearly the case with the difficulties in enforcing protection of plant variety rights compared to Zespri's other markets. It is therefore in New Zealand producers' interests that Zespri has adjusted its expectations of those risks to take account of known issues with its experience in China and sought advice on how other businesses have fared following similar strategies in China.

The modelling of the extent to which the trial and wider roll out of Zespri's procurement strategy in China enhance the value of the core business necessarily involves making some very important assumptions. Key among these are:

- [REDACTED]
[REDACTED]
[REDACTED]. This assumed [REDACTED] is expected by Zespri to significantly slow the growth of unauthorised Gold3 from an estimated base of 4,000 hectares in 2020. Zespri expects that with the trial [REDACTED] hectares of unauthorised Gold3 would be planted in China by [REDACTED], whereas without the trial there would be [REDACTED] hectares. These results are arrived at by Zespri [REDACTED] per annum growth in hectares of unauthorised fruit from 2021 to 2024 with the trial and a 2 [REDACTED] [REDACTED] without the trial.
- [REDACTED]
[REDACTED] Zespri aligned growers to earn enough premium to attract and retain them (Zespri Kiwifruit, China G3 Production, CAB Scenario modelling 19 August 2020, Slide 10). Other factors may also assist in attracting and retaining Chinese growers including [REDACTED]
[REDACTED]
- By the last year of the trial in 2023, Zespri assumes [REDACTED]
[REDACTED]
[REDACTED] (see Zespri Kiwifruit,

⁷ Zespri added that this would be "subject to the allocation of appropriate resource, the governance layers overseeing the trial and that the similarity of activities that are already been completed by Zespri in other markets." See Prior Notice of China Gold3 commercial trial, 28 October 2020, Page 13, Paragraph 85.

Case studies on growing in China, BCG, Slide 12). This suggests a rapid transfer of technology and skills.

5.7 Distinguish the relative size of the proposed activity and associated risk event – is it of small to moderate scale relative to existing activities?

Zespri states that the proposed China Gold3 commercial trial is of a very small scale relative to existing New Zealand Zespri activities, but also relative to the commercial procurement of kiwifruit elsewhere. As discussed earlier, the Zespri trial plans to procure and distribute up to 1.95 million trays over three years. This quantity compares to Zespri’s plans to distribute 29 million trays of New Zealand Gold3 and 5 million trays of Non-New Zealand (Zespri Global Supply or ZGS) Gold3 in China this season alone. Zespri also argues that its estimates of unconstrained demand in China are well in excess of Zespri’s [REDACTED]

Zespri therefore believes that the trial would be immaterial in the Chinese market and points out that the trial fruit will largely be sold at times that are counter-seasonal to New Zealand kiwifruit. Furthermore, it states that without the trial this fruit would be sold anyway, either as counterfeit or under a local brand, so having it managed and distributed by Zespri would allow Zespri to mitigate against disruption to sales of New Zealand fruit.

Assessment

While the trial volumes are low relative to existing activities and therefore probably pose a low level of risk, the decision at the end of the trial period is much more likely to have larger risks attached. At that time, Zespri must either decide to cease the trial, and its procurement activities, or expand them at some level. The BCG advice to Zespri suggests that to pursue an effective procurement strategy in China, Zespri would have to ensure it could:

- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]

8 [REDACTED]

5.8 Identify whether the proposed activity is anticipated to generate low to moderate variance of returns relative to existing activities

Zespri argues that the trial would not result in any variance of returns to New Zealand producers, given its ability to manage the distribution of the Chinese-grown Gold3.

Assessment

The low volumes involved in the China Gold3 commercial trial also suggest that there would only be a low level of variance of any returns to New Zealand producers that may arise from the trial. However, the similarity in values estimated in the [REDACTED] could suggest that there is little direct value to New Zealand producers from [REDACTED]

5.9 Assess whether the proposed activity is anticipated to generate returns that that are at least moderately independent of existing activities

Zespri does not expect net returns from the China Gold3 commercial trial in the first year of the trial. It also believes that due to the unconstrained demand evident in China, returns generated from China Gold3 kiwifruit are likely to be more than moderately independent of Zespri's current portfolio of products, including those produced by New Zealand growers.

Assessment

The first year of the trial is expected to be a net cost to Zespri, and this could be the case in the following two years. Given the relatively low volumes involved in the trial and the shoulder season focus of the marketing of this fruit, it seems likely that any net returns in years 2 or 3 of the trial would be very modest and unlikely to affect returns to New Zealand producers.

5.10 How does the trial affect the producer interests identified by NZKGI

In this section the effect of the trial on each of the producer interests set out in NZKGI's letter of 11 December 2020 to KNZ is summarised (NZKGI, 2020). Each of the 6 headings below is one of the producer interests listed in section 5.1.

Table 2 : Trial effect on producer interests identified by NZKGI

Producer interest	Risk assessment
Grower returns	No more than low risk to grower returns, as volumes in trial are comparatively small and Zespri will bear financial cost of trial.

Asset values (i.e., orchard capital values)	Investors in Gold3 are likely to value the information from the trial; the risk that the trial itself would adversely affect the value of G3 licences is no more than low.
Brand reputation and customer perception especially with regards to food safety and quality	Risk to Zespri brand in consumer markets is no more than low given limited nature of trial.
<p>[REDACTED]</p> <p>[REDACTED]</p>	<p>[REDACTED]</p> <p>[REDACTED]</p> <p>[REDACTED]</p> <p>[REDACTED]</p> <p>[REDACTED]</p>
Future industry stability including ongoing support of the Single Point of Entry and financial sustainability	The limited nature of the trial means the risk of it impacting on the ongoing support and financial sustainability of the 'single desk' is no more than low.
Orchard practice intellectual property	The level of leakage would likely be initially low, but by the end of the trial period the risk of a materially higher level of leakage, than if the trial were not conducted, and its long-term consequences, would, in our view, be more than low.

5.11 Conclusion on risks

The benefits of the trial itself are focused on allowing Zespri to reduce the uncertainty it faces by gathering "...the information needed to assess whether an ongoing China procurement would enhance the core business and be no more than low risk to the interests of New Zealand producers." (See Prior Notice of China Gold3 commercial trial, 28 October 2020, Page 1, Paragraph 10.)

The costs of the trial itself are net [REDACTED] million in the first year (Zespri Group Limited, Board Recommendation Paper, October 2020 1.8 – Unauthorised China SunGold – Commercial Model Trial, Page 13) with some expansion in fruit sales revenues and costs likely in the following two years of the trial. The risks to producers from these financial costs are no more than low.

The benefits of the full roll-out of the China procurement strategy are estimated to be better orchard gate returns (OGR). A portion of these accrue during the trial period. Zespri has investigated many different scenarios of what these benefits might be under different assumptions. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] (Prior Notice of China Gold3 commercial trial, 28 October 2020, Page 6).

However, [REDACTED]

████████████████████ This lowered the estimated benefits of the proposed strategy significantly. The trial and further work may provide better estimates of these benefits and whether the strategy can be expected to significantly benefit New Zealand producers or not.

The risks of the full China procurement strategy, their likelihood, impact and mitigation are set out in Zespri's risk framework. These are 'Reputational', 'Financial' and the risk of 'Leakage of New Zealand on-orchard expertise in China'. Zespri has identified the 'Reputational' and 'Leakage of New Zealand on-orchard expertise in China' as the risks that would change as a result of the trial. The size of the changes in these risks as set out in Zespri's risk framework in Figure 2, appear to assume that the China procurement strategy is rolled out as an ongoing activity. It seems unlikely that these changes would be possible only from the trial.

Our assessment is focused on the three-year trial period. Any enhancement of core business from expanding the trial into an ongoing activity, and any risks that might result from that ongoing activity, are not relevant factors when assessing this Prior Notice. For completeness, we include a brief comment in 6.Appendix D of the scenarios as contained in Zespri's risk framework.

Zespri sees the likelihood of 'Reputational' risk reducing from ██████████ without the trial to '██████' with the trial. At the same time, it believes that the impact of 'Reputational' risk will be reduced from ██████████ to ██████████. Zespri states that the likelihood of the risk of 'Leakage of New Zealand on-orchard expertise in China' will be reduced from '██████' to '██████'. It does not see the impact of this risk changing. It stays at low.

John McKinnon's advice is that the political risks with the trial suggests that this aspect of 'Reputational' risk is likely to be low during the trial. Zespri's planned engagement strategy with the local Chinese authorities during the trial should be a positive feature of the trial. The food safety and quality aspect of 'Reputational' risk is also likely to be low during the trial given the proposed mitigation measures and the relatively low volumes of fruit involved.

On the other hand, the risk of accelerated leakage of New Zealand on-orchard expertise could be material, in spite of Zespri's mitigation measures. It seems unlikely that by rolling out a trial where none currently exists that the likelihood of this risk would fall from '██████' to ██████████ and its impact remain low. The level of that leakage would likely be initially low, but by the end of the trial period the level of leakage—accidental and deliberate—from circa ██████ local growers and their key staff and its long-term consequences would, in our view, likely be materially higher than if the trial were not conducted.

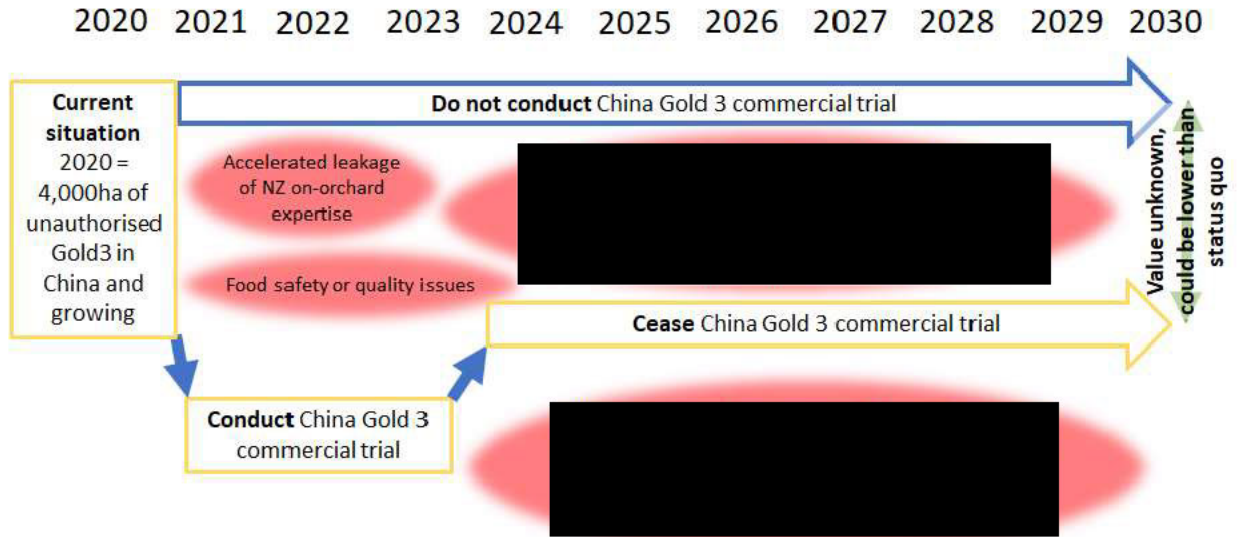
The Prior Notice is for a time-limited trial, and there is a chance that Zespri will decide not to extend the activity at the end of the three-year period. Zespri's analysis suggests that if the China Gold3 commercial trial were wound up without becoming an ongoing activity, Zespri would still have gathered information and reduced uncertainty about its options. It is likely Zespri would incur a relatively small net cost of running the three-year trial depending on the level of its revenue from on-selling Chinese-grown Gold3. If the trial ceased, the leakage that occurred during the trial, as discussed above, could still have ongoing consequences and could continue to spread.

Should the trial cease, the 'Reputational' risks would arise in a different context, one of returning to a situation without procurement of Chinese-grown Gold3 and the Chinese authorities' perception of

this. This situation is shown in Figure 3 below. These risks include [REDACTED]

[REDACTED] The risk of food safety or quality issues would also return to a state without any in-market procurement. That risk could be similar to that faced today but could potentially be worsened by any disappointment the Chinese authorities might feel about the China Gold3 commercial trial ceasing.

Figure 3: Risks should the China trial cease after three years



A key 'Reputational' risk could arise particularly if any discontent by the Chinese authorities were to [REDACTED]. This risk would be heightened by the extent to which the local Chinese authorities misunderstand Zespri's approach, believe that Zespri had committed to deliver economic development through a trial and wider China procurement strategy and believe there has been a breach of trust. Therefore, it is possible that damaged relationships on exit could result in a worse outcome for New Zealand producers than not entering the trial. This worse outcome could occur if expectations were not well managed, including an exit being foreshadowed in advance as much as possible.

The potential for this outcome from the trial was discussed with Zespri and its advisors and is recognised in the Zespri Board Paper:

[REDACTED]

⁹ Zespri canvasses this [REDACTED] in its Prior Notice of China Gold3 commercial trial, 28 October 2020, Page 10, paragraph 69

**Unauthorised China SunGold – Commercial Model Trial,
Page 12.)**

[Redacted text block]

**(Zespri Group
Limited, Board Recommendation Paper, October 2020 1.8 –
Unauthorised China SunGold – Commercial Model Trial,
Page 12.)**

[Redacted text block]

There could also be risks if this occurred, which could be material, should future varieties – for example, red kiwifruit or other cultivars – also end up being grown unauthorised in China and attempts were made to ameliorate this.

The Prior Notice and supporting papers do not set out how Zespri intends to manage the expectations of its provincial Chinese government stakeholders to mitigate these relationship risks. KNZ cannot therefore account for any measures that Zespri might put in place to mitigate the risk of damaged relationships, were the trial not expanded into an ongoing activity. Unmanaged, the risk of damaged relationships in this key market would pose more than a low risk to the interests of producers.

6. Recommendations

We recommend that the Kiwifruit New Zealand Board agree with Zespri that under regulation 10A of the Kiwifruit Export Regulations (1999) the activity which Zespri plans to conduct—the China Gold3 commercial trial—is not core business.

In our view, the activity proposed in the Prior Notice would satisfy the first limb of regulation 10A(2); that is, it is likely to enhance the performance of the core business. We consider that the objectives for the trial establish a clear nexus between the proposed non-core activity and Zespri's core business, and that the information obtained from the trial may reduce current or future costs or risks of carrying out core business or increase current or future prices or demand for New Zealand-grown kiwifruit.

However, we assess the trial as posing more than a low risk for the interests of New Zealand producers. Two risks appear more than low risk:

- The potential for the trial to impact negatively on Zespri's relationship with provincial Chinese government stakeholders, should Zespri conclude at the end of the trial that it was not in its interests to continue; we consider that Zespri has not shown how a risk of misaligned expectations would be managed by Zespri.
- The potential for the trial to hasten the leakage in China of New Zealand on-orchard and post-harvest expertise; our assessment is that the impact of this leakage, despite Zespri's mitigation measures, could be material. The level of that leakage would likely be initially low, but by the end of the trial period the risk that the level of leakage, and its long-term consequences, would, in our view, likely be more than low.

We therefore conclude that the proposed China Gold3 commercial trial would pose risks to the interests of New Zealand producers that are more than low. Hence, in our view the China Gold3 commercial trial does not support Zespri's core business because while the trial could enhance the performance of Zespri's core business, it is likely to pose more than a low risk to the interests of producers.

We offer no view on whether the potential benefits to New Zealand producers from incurring those risks would exceed the expected cost of those risks.

Our assessment of whether the trial could enhance core business and the risks involved has been undertaken over a short period of time. As discussed in the body of our report, this assessment involves reviewing judgements made by Zespri on matters about which information is limited and which necessarily rely on important but untested assumptions. We attempt to identify these judgements and assumptions so the Board can assess the significance of the technical and operational issues discussed.

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Letter from Rachel Lynch, Regulatory Affairs Manager, Zespri to Geoff Morgan CEO of KNZ of 1
December 2020, Re: Supplementary information to Prior Notice for China Gold3 trial submitted on 28
October 2020

Letter from Rachel Lynch, Regulatory Affairs Manager, Zespri to Geoff Morgan CEO of KNZ of 4
December 2020, Re: Prior Notice for China Gold3 trial

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Appendix C Timing

Zespri is keen to expedite the Prior Notice process as outlined in a letter of 4 December 2020 where Zespri stated:

"Our request for KNZ to expedite this process is to allow us to proceed with certainty in our dealings with the Sichuan SOE and the orchards." (Letter Re: Prior Notice for China Gold3 trial, 4 December 2020, Page 1.)

An important focus for Zespri's activities leading up to the trial is building stronger relationships with the Chinese authorities, in particular the Sichuan Provincial Government. In a letter of 1 December 2020 to KNZ, Zespri noted that:

"The situation continues to evolve as we work through the structure and timing of the supply agreement/s. As indicated in our email of 7 November, we signed a Memorandum of Understanding with the [REDACTED] on 16 November. Following discussion with [REDACTED] the recommended approach is that Zespri enters into a formal supply agreement with [REDACTED] which in turn will sign supply agreements with the individual growers/entities. This formally engages the provincial government which will [REDACTED] [REDACTED] (Letter Re: Supplementary information to Prior Notice for China Gold3 trial, 1 December 2020, Page 2 'Supply agreement'.)

However, the same Zespri letter also noted that:

"In discussions [REDACTED] has indicated that as a Sichuan SOE, its preference is to formally sign the agreement with the new Zespri entity that is being established to conduct the trial rather than Zespri's existing entity which is set up in another province. As the company set-up will take some time, given the process involved, this could defer the finalisation and execution of the supply agreement."

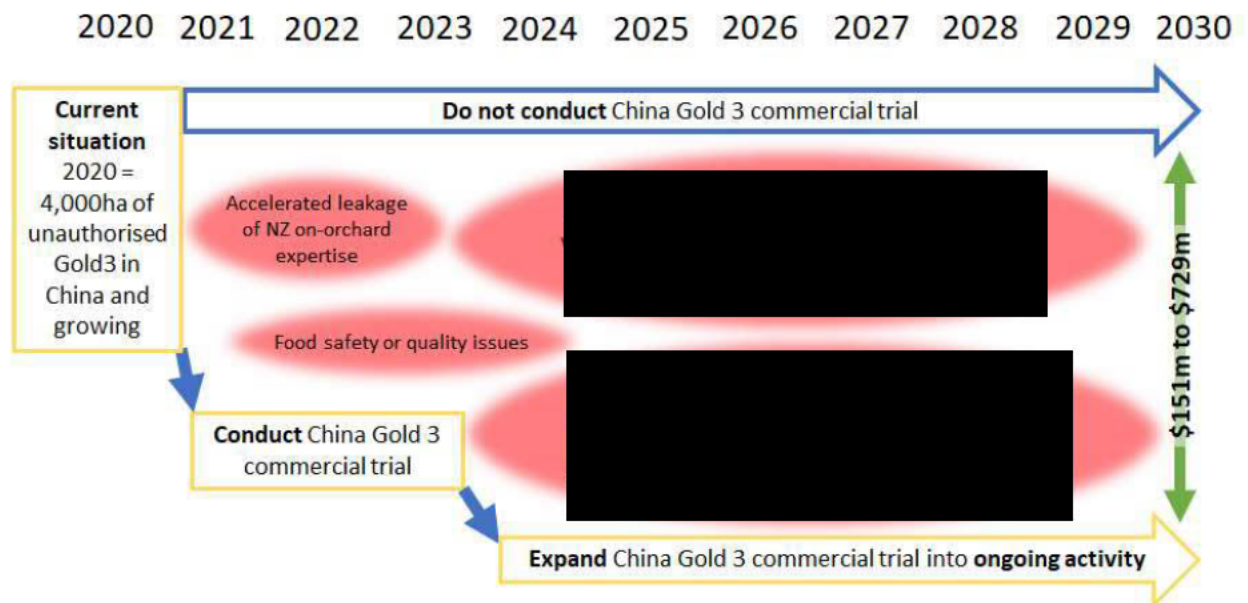
These letters and other correspondence attest to the importance of Zespri cementing its engagement strategy with Chinese government stakeholders very early in the trial in 2021 to attempt to [REDACTED] [REDACTED], increase enforcement of Zespri's PVRs and protect its brand and avoid restrictions on market access. This issue was discussed with Zespri and its advisors. One of those advisors suggested that the grafting window for Gold3 of January to March 2021 was already in train and the trial would aim to influence the 2022 grafting window. However, Zespri also suggested that it was still important to act as quickly as possible to make it apparent to the local Chinese authorities and growers that Zespri was concerned and active as this might deter some from expanding their unauthorised plantings.

Based on the information available, Zespri is therefore close to committing to a step change in its relationship with Chinese authorities, particularly with [REDACTED]

Appendix D Zespri risk scenario of trial becomes an ongoing activity

Zespri’s analysis suggests that the trial and full China procurement strategy might enhance Zespri’s core business by protecting producers’ OGRs relative to continuing with the status quo China market arrangements. Some risks that are may be low in the trial, may not be low in any roll-out of the China procurement strategy beyond the trial. These risks are shown in red in Figure 4 below. They include ‘Reputational’ risks of negative interventions by the Chinese authorities or geopolitical risks and risks of food safety or quality issues and risk of accelerated ‘Leakage of New Zealand on-orchard expertise in China’.

Figure 4: Risks should the China trial become an ongoing activity



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