

**JUDGMENT FOR PUBLIC RELEASE: SEE ADDENDUM TO JUDGMENT
DATED 22 AUGUST 2011.**

**IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY**

CIV 2009-404-004392

UNDER the Declaratory Judgments Act 1908
AND UNDER the Commerce Act 1986

BETWEEN TURNERS & GROWERS LIMITED
First Plaintiff

AND TURNERS & GROWERS
HORTICULTURE LIMITED
Second Plaintiff

AND ENZA LIMITED
Third Plaintiff

AND ZESPRI GROUP LIMITED
First Defendant

AND ZESPRI INTERNATIONAL LIMITED
Second Defendant

Hearing: 9-13, 23-26 and 30-31 May, 1-3 and 7-10 June 2011

Court: White J
K M Vautier CMG (Lay member)

Counsel: C M Walker and M C Smith for Plaintiffs
D J Goddard QC and L A O'Gorman for Defendants

Judgment: 12 August 2011

JUDGMENT OF THE COURT

*This judgment was delivered by me on 12 August 2011 at [] pm
pursuant to Rule 11.5 of the High Court Rules.
Registrar/Deputy Registrar*

Date:

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Introduction

[1] Since 1 June 2000 the export of kiwifruit from New Zealand, other than for consumption in Australia, has been restricted to Zespri Group Limited (Zespri) in accordance with its authorisation granted by the New Zealand Kiwifruit Board (KNZ) as required by the Kiwifruit Export Regulations 1999 (the Regulations). It is unlawful for anyone else to export kiwifruit from New Zealand, other than for consumption in Australia or under a collaborative marketing arrangement with Zespri as approved by KNZ.

[2] As a result of the export ban, Zespri is the sole purchaser of kiwifruit for export destinations other than Australia, giving it the status of a monopsonist. In accordance with the regulatory definition of Zespri's "core business" and the regulatory restrictions on its activities, Zespri purchases New Zealand-grown kiwifruit for export from other parties who grow or supply the kiwifruit. Since 2004 Zespri has entered into rolling three-year loyalty contracts with growers and annual supply agreements with its suppliers which also contain exclusivity provisions.

[3] In the 2009/10 season, as a result of an anticipated over-supply of Class 1 Green kiwifruit in the larger sizes for export by Zespri to markets other than Australia, Zespri took steps to arrange for this excess supply to be released for supply to Australia (or New Zealand) instead of the same sized Class 2 Green kiwifruit which, in accordance with a service level agreement, would be prohibited from export to Australia. Zespri would pay compensation to contractors for the Class 2 kiwifruit not packed, but this would be forfeited if any of the Class 2 fruit were exported to Australia.

[4] Zespri has also developed a policy for a mandatory evaluation process in relation to any new commercial kiwifruit cultivars for export from New Zealand. One of the stipulations in the policy is that, in most cases, a third party bringing a cultivar to Zespri must be able to grant (preferably) a world-wide exclusive licence to Zespri as well as an absolute assignment of the intellectual property rights associated with the cultivar.

[5] Turners & Growers Limited and the other plaintiffs (Turners & Growers) have in this proceeding:

- (a) challenged the validity of the Regulations imposing the export ban and requiring KNZ to authorise Zespri to export kiwifruit;
- (b) sought declarations that Zespri has engaged in “unjustifiable discrimination” and “non-core activities” in breach of the Regulations; and
- (c) sought declarations at common law and relief under the Commerce Act 1986 (the Commerce Act) in respect of Zespri’s loyalty contracts and the exclusivity provisions in the supply agreements, Zespri’s 2009 Australia service level agreements and Zespri’s cultivar policy.

Previous judgments

[6] For the reasons given in a previous judgment dated 5 May 2010 it was decided to determine first as preliminary issues Turners & Growers’ challenge to the validity of the Regulations and a challenge by Zespri to the Court’s jurisdiction to grant the declarations sought by Turners & Growers relating to the alleged breaches of the Regulations by Zespri: *Turners & Growers Ltd v Zespri Group Ltd*.¹ For the reasons given in judgment (No. 2) dated 13 August 2010 it was decided that the Regulations were valid and that the regulator KNZ had exclusive jurisdiction to determine in the first instance Turners & Growers’ complaints about Zespri’s engagement in “unjustifiable discrimination” and “non-core activities”: *Turners & Growers Ltd v Zespri Group Ltd (No. 2)*.² That decision is subject to appeal to the Court of Appeal, but the parties are in agreement that the remaining issues should be determined now in this Court on the basis of the High Court’s earlier decision.

¹ *Turners & Growers Ltd v Zespri Group Ltd* HC Auckland CIV 2009-404-004392, 5 May 2010.

² *Turners & Growers Ltd v Zespri Group Ltd (No 2)* HC Auckland CIV 2009-404-004392, 13 August 2010.

Commerce Act causes of action

[7] The remaining issues involve claims by Turners & Growers that Zespri has contravened the restrictive trade practices provisions of s 27 and s 36 in Part 2 of the Commerce Act. In essence Turners & Growers claim that:

- (a) in contravention of s 27, the loyalty contracts and the exclusivity provisions in the supply agreements have the purpose and/or the effect and/or are likely to have the effect of substantially lessening competition in one or more of the following markets:
 - (i) the grower/exporter (non-Australia) market whether that is defined as two markets sequential in time (pre-deregulation and post-deregulation) or as a single, continuous market which is liable to a future change in dynamic by reason of deregulation (a “deregulated” grower/exporter (non-Australia) market);
 - (ii) the grower/exporter (non-Australia) market for Hayward kiwifruit;
 - (iii) the grower/exporter (non-Australia) market for Hort 16A kiwifruit post November 2018;
 - (iv) the post-harvest services market;
- (b) in contravention of s 36, by entering into the loyalty contracts and the exclusivity provisions in the supply agreements, Zespri has taken advantage of its substantial degree of power in the current grower/exporter (non-Australia) market for the purposes of preventing or deterring exporters or potential exporters of kiwifruit from engaging in competitive conduct in one or both of the following markets:
 - (i) a “deregulated” grower/exporter (non-Australia) market;

- (ii) The post-harvest services market;
- (c) in contravention of s 27, provisions in the 2009 Australia service level agreements had the purpose, the effect and/or the likely effect of substantially lessening competition in the market for the acquisition and supply of kiwifruit for export to Australia;
- (d) in contravention of s 36, by entering into the 2009 Australia service level agreements, Zespri has taken advantage of its substantial degree of power in the current grower/exporter (non-Australia) market for the purpose of preventing or deterring exporters or potential exporters of kiwifruit from engaging in competitive conduct in the supplier/exporter (Australia) market; and
- (e) in contravention of s 36, by seeking to acquire and control the rights to new kiwifruit cultivars and restricting the ability of competitors or potential competitors to develop competing cultivars, Zespri has taken advantage of its substantial degree of power in the current grower/exporter (non-Australia) market for the purpose(s) of:
 - (i) preventing or deterring other exporters from engaging in competitive conduct in a “deregulated” grower/exporter (non-Australia) market; and
 - (ii) preventing or deterring other rights holders from engaging in competitive conduct in the (kiwifruit) cultivar licensing market.

[8] While the export ban and Zespri’s export authorisation are exempt from the operation of the restrictive trade practices provisions in Part 2 of the Commerce Act because they are “specifically authorised” by the Regulations, the provisions in the contracts or agreements and the other conduct of Zespri that is the subject of the claims by Turners & Growers, are not exempt because they have not been specifically authorised under s 43(1) of the Commerce Act: cf *New Zealand Apple*

*and Pear Marketing Board v Apple Fields Ltd.*³ It was therefore common ground that the restrictive trade practices provisions in Part 2 of the Commerce Act apply to Zespri's contracts, agreements and other conduct which are the subject of Turners & Growers' claims.

[9] It was also common ground that in considering whether Zespri has contravened s 27 and s 36 as claimed by Turners & Growers it needs to be recognised that Zespri's contracts, agreements and other conduct have occurred within the existing regulatory regime for the export of kiwifruit and that it is not for the Court to express any view on the merits or otherwise of the existing regulatory regime or on the question whether the regulatory regime should be retained and, if it is not to be retained, any view on the timing and form of any deregulation. Those are policy questions for the Government to consider and determine.⁴

[10] The separate question of the possibility or likelihood of deregulation has been raised by Turners & Growers in the context of the pleaded "markets" for their claims relating to the loyalty contracts and the exclusivity provisions in the supply agreements under both s 27 and s 36. As Mr Walker, counsel for Turners & Growers, recognised in his submissions, the question of whether and when deregulation might occur is uncertain and, as Mr Goddard QC, counsel for Zespri, pointed out in his submissions, the form of any deregulation is also uncertain. The impact of these uncertainties on the "market" analysis required under the Commerce Act raises a novel issue apparently not previously addressed in any New Zealand or Australian competition law case.

[11] A further unique feature of this case is that the ultimate "markets" for the kiwifruit acquired by Zespri for export and the "consumers" of that kiwifruit are overseas and therefore outside the reach of the New Zealand Commerce Act, the purpose of which is to promote competition in markets in New Zealand for the long-

³ *New Zealand Apple and Pear Marketing Board v Apple Fields Ltd* [1991] 1 NZLR 257 (PC).

⁴ cf *Crown Milling Co Ltd v The King* [1927] AC 394 (PC) at 402; *NZ Drivers' Association v NZ Road Carriers* [1982] 1 NZLR 374 (CA) at 388; *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 (PC) at 408; *Unison Networks v Commerce Commission* [2007] NZSC 74, [2008] 1 NZLR 42 at [54]; and *Kacem v Bashir* [2010] NZSC 112, [2011] 2 NZLR 1 at [36].

term benefit of consumers within those New Zealand markets.⁵ This case is therefore not concerned with the ability of Zespri, as a monopsonist, to obtain price premiums for its exported kiwifruit, or with the interests of overseas consumers. Those are issues that may arise in the context of international trade negotiations and any Government policy decision that may affect the current regulatory regime. In this case the focus is on the impact of Zespri's monopsony on the growers of kiwifruit and on other potential exporters such as Turners & Growers.

[12] As Turners & Growers' five claims relate to three separate factual matters, namely the loyalty contracts and the exclusivity provisions in the supply agreements, the 2009 Australia service level agreements and the new kiwifruit cultivar policy, it is convenient to consider Zespri's alleged contraventions of s 27(1) and s 36(2) in relation to these three matters separately. It is also convenient to set out first the general factual and regulatory background to the case and the legal framework under the Commerce Act before turning to consider the three matters and the specific issues, evidence and submissions relating to them.

Factual Background

[13] The evidence establishing the relevant factual background to this case was provided by way of an agreed bundle of documents (some 16 volumes), witnesses during the four week trial (five for Turners & Growers, with two briefs taken as read, and four for Zespri) and an agreed statement of facts. Each party also called an independent economic expert whose evidence was given and tested through the "hot tub" process at the conclusion of the evidence from the factual witnesses for the parties.

[14] The existence of the extensive documentary evidence and the agreed statement of facts meant that in the end the factual evidence was largely undisputed and we were not called on to make any findings of credibility. It is, therefore, only necessary for us to summarise the evidence that is relevant to our determination of the specific issues under the Commerce Act raised by Turners & Growers' claims.

⁵ Sections 1A, 3(1A) and 4. No contravention of s 36A was alleged in this case.

Zespri

[15] Zespri is the sole authorised exporter of kiwifruit from New Zealand, otherwise than for consumption in Australia. It is not a co-operative company. As at March 2011 Zespri had 2,188 shareholders of whom 1,816 were growers or entities economically aligned with current growers.

[16] As at March 2011 2,701 New Zealand growers supplied kiwifruit to Zespri.

[17] Zespri International Ltd is a wholly owned subsidiary of Zespri and acts as its international marketing arm.

Turners & Growers

[18] The first plaintiff is a New Zealand company that carries on business as a holder of companies growing and dealing in horticultural products. Both Turners & Growers Horticulture Ltd and ENZA Ltd are wholly owned subsidiaries of Turners & Growers Ltd.

[19] Turners & Growers Horticulture Ltd trades as “Kerifresh”. It is a kiwifruit grower and also operates packhouse and coolstore facilities in New Zealand. It is a shareholder in Zespri. It is also party to a three-year rolling grower loyalty contract with Zespri, which is the subject of the first claim.

[20] ENZA Ltd holds the rights in the plaintiffs’ new varieties of kiwifruit, ENZAGold™, ENZARed™ and Summerkiwi™. It also operates the plaintiffs’ business trading in the Hayward variety in Australia.

Kiwifruit

[21] The most common kiwifruit variety or “cultivar” is the green-fleshed “Hayward”. This variety currently comprises approximately 80% of the New Zealand kiwifruit crop. Hayward is not subject to any intellectual property protection. It is marketed by Zespri as “ZESPRI® GREEN” and by Turners & Growers as “ENZAGreen™”.

[22] The other major kiwifruit cultivar grown in New Zealand is Hort 16A, a gold-fleshed variety developed by HortResearch in the early 1990s. It comprises approximately 20% of the kiwifruit grown in New Zealand. The rights to Hort 16A are now owned by Zespri. Fruit from this variety is marketed by Zespri as “ZESPRI® GOLD”. In addition to Zespri’s grower licences, Zespri’s contracts with growers and suppliers require them to supply all fruit grown from this cultivar to Zespri.

[23] Zespri is in the process of commercialising three new varieties: an early season, gold-fleshed kiwifruit currently known as “Gold3”; a long-storing, gold-fleshed kiwifruit currently known as “Gold9”; and an early season, green-fleshed kiwifruit currently known as “Green14”. Zespri applied for plant variety rights for these cultivars in June 2009 in New Zealand and the USA and in 2010 in various other overseas jurisdictions. In each jurisdiction, applications in respect of each of the three cultivars were filed on the same date. The applications have not yet been determined. While the applications are determined, Zespri enjoys provisional protection for these varieties under s 9 of the Plant Variety Rights Act 1987 and similar provisions overseas.

[24] Turners & Growers is commercialising three new varieties: a gold-fleshed kiwifruit marketed as “ENZAGold™”; a red-fleshed kiwifruit marketed as “ENZARed™”; and an early season, green-fleshed kiwifruit marketed as “SUMMERKIWI™”. Turners & Growers (or the cultivar owner) has applied for plant variety rights for these varieties in New Zealand and overseas. Rights have been granted for ENZAGold™ in the USA and for ENZARed™ in Argentina, China, Hong Kong and Uruguay. Applications are pending in other countries, including Australia and New Zealand. Responsibility for obtaining rights for SUMMERKIWI™ remains with the cultivar owner.

[25] Turners & Growers’ licences with New Zealand and overseas growers require growers to supply all fruit grown from the ENZAGold™, ENZARed™ and SUMMERKIWI™ cultivars to Turners & Growers.

[26] The owners of rights to cultivars generally charge growers to plant their cultivars. Zespri sells the rights to grow its varieties by auction or tender, from time to time. Zespri has charged up to \$25,000/ha for Hort 16A licences; \$12,000/ha for Gold3 and Gold9 licences; and up to \$3,000/ha for Green14 licences. Turners & Growers charges up to \$5,000/ha for ENZAGold™; up to \$4,000/ha for ENZARed™; and up to \$4,500/ha for SUMMERKIWI™.

Season

[27] Kiwifruit is generally harvested in New Zealand between April and June. Fruit is available for release to market until November, and usually into December. The “2009 season” refers to the season where fruit is picked in 2009.

Grading and packing

[28] Kiwifruit is packed into either single-layer trays (3.3 kg for Gold and 3.6 kg for Green) or 10 kg boxes for export. Quantities of kiwifruit are commonly described in “tray equivalents” and pricing may be indicated in terms of either trays or boxes. Due to differences in fruit size the number of kiwifruit packed per tray or per box varies.

[29] Picked kiwifruit is graded into three standards based on shape, appearance and damage: Class 1; Class 2; and Class 3. 80% to 90% of the overall New Zealand crop is Class 1. The balance comprises roughly equal quantities of Class 2 and Class 3 fruit.

[30] Class 1 is the premium export fruit, almost all of which is exported to countries other than Australia. Class 2 is also an export grade, exported primarily to Australia. Zespri has also had a Class 2 export programme in place to other export markets for many years, but only a small proportion of Zespri's total exports are Class 2. “Class 3” is not a grade standard as such, but simply the by-product of grading Classes 1 and 2; it is also referred to as “reject fruit”. Class 3 is sold domestically or dumped. The New Zealand market absorbs about 2 million trays of

Hayward kiwifruit annually and a small volume of Gold kiwifruit. Most of the fruit is Class 3; some is Class 2; there is very little Class 1.

[31] Kiwifruit is sorted into sizes when packed, from 14 to 46, indicating the number of pieces of fruit which will fit into a standard tray. Fruit of sizes 42 and above is regarded as “small”; fruit of sizes 18 to 33 is “large”.

Quantity of kiwifruit produced in New Zealand

[32] Over the last decade New Zealand’s kiwifruit production has increased from about 65 million trays to well over 100 million trays per annum. In the 2009 season New Zealand produced about 102 million trays of Class 1 kiwifruit, comprising about 75 million trays of Class 1 Hayward; about 3.4 million trays of Class 1 Hayward Organic; and about 22.2 million trays of Class 1 Hort 16A. New Zealand typically produces about 5 million trays of Class 2 Hayward and roughly the same amount of Class 3 Hayward annually.

Participants in the supply chain

[33] There are a number of different parties in the supply chain for kiwifruit. These include registered suppliers; growers; supply entities; packhouses and coolstores; and exporters. We summarise the role of each of these in turn.

Registered suppliers

[34] A registered supplier is a person registered by Zespri to provide services to Zespri under a supply agreement. Under Schedule 5 of Zespri’s supply agreement growers supplying fruit to Zespri must do so via a registered supplier (“option A”) or agree to enter into the supply agreement themselves (“option B”). Therefore, supply entities either have to become registered as suppliers to Zespri or enter into a contract with a registered supplier. For example, Turners & Growers Horticulture Limited contracts with the registered supplier G6 Kiwi Supply Limited (“G6”). There are 15 registered suppliers.

[35] Registered suppliers operate as supply and logistics management companies, co-ordinating the supply activities of their member supply entities and representing them in dealings with Zespri. The registered supplier enters into agreements with the supply entities, packhouses and coolstore operators to coordinate the supply of fruit from the growers to Zespri. The registered supplier also contracts with a logistics operator to transport the fruit to the wharf and load it.

Growers

[36] The orchards of most New Zealand kiwifruit growers are less than 5 hectares in size.

[37] Each season, Zespri offers a “ZESPRI Loyalty Contract” or “Enhanced Three Year Rolling Grower Contract” to each grower. Under the loyalty contract, Zespri agrees to pay the grower a loyalty premium in exchange for contractual commitments by the grower over the term of the contract in relation to the supply of all Class 1 Hayward and Class 1 Hort 16A kiwifruit to Zespri for export to countries other than Australia. We consider the provisions of the loyalty contract in more detail when we deal with Turners & Growers’ first claim.

[38] As depicted in the tables below, most orchards in New Zealand are planted in Hayward. Table 1 sets out: the numbers of distinct Zespri-registered growers and orchards; the number of “Zespri growers” as defined in the supply agreement, including a break down by variety; and the number of “Zespri growers” who signed up for the loyalty premium in each season. In all cases, the information in Table 2 relates only to growers who supply fruit to Zespri. Because some growers have more than one variety planted, the total of the grower numbers by variety exceeds the total number of growers.

Table 1: Time series of grower numbers with orchards planted in whole or part in conventional Hayward, conventional Hort 16A and Zespri new varieties. Also showing grower numbers signed up for loyalty premium.

	Total Zespri-registered growers	Total Zespri-registered orchards	Grower numbers	Grower numbers signed up for loyalty rebate	Hayward grower numbers	Hort 16A grower numbers	Gold 3, Gold 9, Green 14 grower numbers
2006/07	2,748	3,077	3,187	3,180	2,647	777	Nil
2007/08	2,727	3,106	3,216	3,211	2,669	774	Nil
2008/09	2,710	3,110	3,236	3,234	2,699	778	Nil
2009/10	2,711	3,080	3,244	3,241	2,618	785	Nil
2010/11	2,721	3,025	3,261	3,260	2,659	798	Nil
2011/12	2,701	3,169	Unknown	Unknown	2,590	807	621

[39] Table 2 sets out the productive hectares of each of the varieties grown for supply to Zespri, by season.

Table 2: Producing hectares of Zespri varieties

	Hayward	Hayward Organic	Hort 16A	Other	Total
2006/07	9,479	456	2,032	-	11,967
2007/08	9,675	451	2,060	-	12,186
2008/09	9,766	480	2,091	-	12,337
2009/10	9,871	505	2,149	-	12,525
2010/11	9,937	558	2,330	-	12,825
2011/12	9,378	558	2,562	615	13,113

[40] It is possible to graft kiwifruit vines from one cultivar to another, eg from Hayward to Hort 16A. For example, 85% of the plantings of Zespri's new varieties in 2010 were grafted onto existing Hayward rootstock. The new budstock can be grafted in the same season that the final crop from the old variety is harvested. There will be no fruit in the following season and up to half yield in the season thereafter. Generally the vine then returns to full yield, depending on the cultivar. The 615 hectares referred to above as "other" are newly grafted varieties which are not expected to be productive before 2012.

Grower returns

[41] A common measure of grower returns is the “Orchard Gate Return” (“OGR”), which is the notional gross fruit return to growers at the “orchard gate”. The OGR is the fruit payment from Zespri, less off-orchard costs such as packing, coolstorage and transport costs. The OGR can be measured by tray or by hectare. The OGR per hectare reflects the yield of kiwifruit per hectare as well as the per tray return.

[42] The grower’s on-orchard costs must be deducted from the OGR to obtain a net return. On-orchard costs vary depending on the size of the orchard and the efficiency of the particular grower.

[43] Table 3 below shows historic OGRs and estimated net orchard returns per hectare for an average New Zealand orchard for each season from 2004 to 2010.

Table 3: Historic OGRs and estimated net orchard returns (NOR) per hectare for an average New Zealand orchard.

	Hayward OGR	Hayward estimated average NOR	Hayward Organic OGR	Hayward Organic estimated average NOR	Hort 16A OGR	Hort 16A estimated average NOR
2004/05	31,900	16,900	33,500	18,500	49,400	29,400
2005/06	25,600	10,600	30,000	15,000	42,500	22,500
2006/07	29,000	14,000	35,200	20,200	48,500	28,500
2007/08	24,100	4,223	34,700	12,700	46,100	25,663
2008/09	30,100	7,750	39,400	17,515	60,900	35,568
2009/10	29,600	8,061	39,400	19,019	83,100	54,894
2010/11	32,234	9,153	37,541	14,040	83,785	51,233

[44] Zespri pools grower returns based on the characteristics of the kiwifruit supplied. The characteristics are: variety Green (Hayward) or Gold (Hort 16A); growing method (conventional or organic); and class of fruit (Class 1 or 2). Within each pool, the returns are paid out to growers either via their supply entities (option A) or directly (option B).

[45] Most growers also receive the loyalty premium from Zespri, which is paid out of Zespri's corporate margin, rather than from the grower pools. Table 4 below contains a time series of the total fruit and service payments for each pool, showing the proportion of which is loyalty premium.

Table 4: Summary of fruit and service payments

	Zespri Green Fruit and Service Payment (\$/TE)	Loyalty %	Zespri Green Organic Fruit and Service Payment (\$/TE)	Loyalty %	Zespri Gold Fruit and Service Payment (\$/TE)	Loyalty %	Loyalty premium (\$/TE)
2006/07	\$7.67	3.39%	\$9.35	2.78%	\$9.68	2.87%	\$0.26
2007/08	\$6.40	1.56%	\$8.25	1.21%	\$8.91	1.12%	\$0.10
2008/09	\$7.14	2.38%	\$9.43	1.80%	\$9.86	1.72%	\$0.17
2009/10	\$7.15	2.10%	\$9.11	1.65%	\$12.28	1.22%	\$0.15
2010/11	\$7.56	3.31%	\$9.33	2.68%	\$12.90	1.94%	\$0.25

Supply entities

[46] Growers generally contract to supply their fruit to one or more of 42 "supply entities". Turners & Growers Horticulture Limited is a supply entity. Supply entities are a mechanism for aggregation, creating efficiencies and economies of scale. When growers contract with supply entities in relation to their Class 1 fruit, they usually also agree to the supply entity taking their Class 2 and Class 3 reject fruit. The supply entities arrange harvesting, packing and coolstorage contracts, on behalf of their growers. The packing and coolstorage contracts tend to be with operators economically associated with the supply entity.

[47] Title to the kiwifruit passes to Zespri at FOBS,⁶ either directly from the grower (ie the supplier acts as an agent authorised to pass title directly from the grower to Zespri), or through the registered supplier acting as principal (ie the supplier acquires title from the grower prior to FOBS, then passes title to Zespri at FOBS).

⁶ FOBS is defined in reg 2 of the Kiwifruit Export Regulations 1999 to mean "stowed on board the ship or aircraft on which the kiwifruit is exported".

[48] Most of Zespri's fruit payments are made on an individual grower basis but are paid by Zespri to the grower's supply entity (option A) rather than directly to the grower (option B). To spread the risk, in particular of fruit loss, growers commonly pool their returns at a supply entity level.

[49] Although contracting through a supply entity is the norm, some growers contract directly with Zespri for fruit supply. They have no contractual relationship with either a supply entity or a registered supplier. They have to make their own arrangements for picking, coolstorage and transport and do not pool risk with other growers.

[50] In most cases option B growers assign their payments from Zespri to their post-harvest operators so there is no difference in cash-flow from option A. For example, in the 2011 season, there are 77 option B growers, 72 of whom have assigned their payments to their post-harvest operators.

Packhouses

[51] There are currently 71 packhouses which pack kiwifruit. Usually supply entities are associated with a post-harvest facility, and often a supply entity will be a trust and/or company owned or controlled by a group of growers. Most kiwifruit packhouses can pack fruit other than kiwifruit. Many packhouses pack other fruit, typically avocados, during the offseason. However, most packhouses pack only kiwifruit during the kiwifruit season. Generally a packhouse in the main Bay of Plenty growing region could not survive if it were unable to pack kiwifruit. There is not enough alternative crop to satisfy the capacity. Growers tend to use packhouses in the same locality or at least the same region, to avoid additional transport costs and risk of fruit damage. There is competition between packhouses, particularly in the Bay of Plenty. Growers may switch between packhouses from season to season. Larger growers commonly split their crop between separate packhouses.

Coolstores

[52] From the packhouse, kiwifruit moves to the coolstore to be held before dispatch to market. There are currently 77 coolstores which store kiwifruit. Traditionally, most coolstores have been operated by entities which also run packhouses. There are some independent operators. Fruit is progressively released from the coolstore until the end of October, with the best lasting fruit being released until November and usually into December. It is impractical to store kiwifruit with certain other types of fruit, in particular apples, so coolstores tend to be dedicated to kiwifruit at least during the kiwifruit season.

World Production and Export

[53] Notwithstanding its name, “kiwifruit” is a fruit grown and consumed in many countries around the world. Indeed there are significant international markets for the export of kiwifruit produced in many countries, including New Zealand. Information published in the latest World Kiwifruit Review⁷ shows that:

- (a) The top five kiwifruit producing countries in the world, accounting for 87.3% of the world’s production in the period 2007 to 2010, were in descending order: China, Italy, New Zealand, Chile and Greece.
- (b) The major exporters of the world’s kiwifruit, as measured by their respective shares of world export trade in 2008, were: New Zealand (35.1%), Italy (28.6%) and Chile (14.9%), followed by Greece (3.5%) and France (2.4%). China, which consumes most of its own production, accounted for only 0.2% of the world’s exports.
- (c) In the period 2007 to 2010 New Zealand exported 90.3% of its kiwifruit production. Zespri’s export markets by volume and by value for the 2010/11 season are set out Tables 5, 6 and 7 below:

⁷ *Belrose Inc’s World Kiwifruit Review* (2010 ed, Belrose, Pullman (Washington, USA)).

Table 5: Volume and value by market of New Zealand-grown kiwifruit exported by Zespri in the 2010/11 season (all varieties)

	Volume Sold (million TE)	% of Zespri volume	Market Return (NZ\$m)	% of Zespri returns
Europe	46.42	47%	406.14	40%
Japan	17.62	18%	315.44	31%
China & Hong Kong	9.25	9%	93.33	9%
Korea	6.68	7%	60.75	6%
Taiwan	6.06	6%	60.65	6%
Southeast Asia	2.10	2%	18.69	2%
North Africa & Middle East	6.03	6%	35.62	4%
Australia	0.63	1%	5.91	1%
Collaborative Marketing	2.52	3%	17.11	2%
Other	0.80	1%	3.72	0%
TOTAL	98.12	100%	1,017.36	100%

Table 6: Volume and value by market of New Zealand-grown kiwifruit exported by Zespri in the 2010/11 season (Hayward Class 1 conventional only)

	Volume Sold (million TE)	% of Zespri volume	Market Return (NZ\$m)	% of Zespri returns
Europe	38.52	55%	322.59	51%
Japan	9.50	14%	147.64	23%
China & Hong Kong	5.66	8%	45.81	7%
Korea	3.04	4%	23.55	4%
Taiwan	3.99	6%	35.12	6%
Southeast Asia	1.30	2%	10.18	2%
North Africa & Middle East	4.89	7%	26.01	4%
Australia	0.25	0%	1.51	0%
Collaborative Marketing	1.96	3%	12.24	2%
Other	0.76	1%	3.70	1%
TOTAL	69.86	100%	628.34	100%

Table 7: Volume and value by market of New Zealand-grown kiwifruit exported by Zespri in the 2010/11 season (Hort 16A Class 1 conventional only)

	Volume Sold (million TE)	% of Zespri volume	Market Return (NZ\$m)	% of Zespri returns
Europe	4.95	24%	58.09	18%
Japan	7.25	35%	152.62	48%
China & Hong Kong	3.14	15%	43.04	14%
Korea	2.05	10%	24.57	8%
Taiwan	2.02	10%	24.95	8%
Southeast Asia	0.63	3%	7.08	2%
North Africa & Middle East	0.20	1%	2.01	1%
Australia	0.32	2%	3.81	1%
Collaborative Marketing	-	0%	-	0%
Other	0.05	0%	0.27	0%
TOTAL	20.62	100%	316.44	100%

- (d) Worldwide production of kiwifruit has increased by nearly 75% in the last decade. For the last two decades Chile has been a major competitor of New Zealand in respect of Hayward and the volume of production of Hayward in Chile and other countries has been increasing. The parties agree that, reflecting such world supply and market conditions, orchard gate returns for Hayward growers worldwide have been decreasing in real terms; and that New Zealand's distance from market and higher wage costs make it difficult for New Zealand growers to compete on a pure commodity basis. World production of kiwifruit is likely to continue to expand for the next few years with more areas of production, particularly in China, and new varieties of kiwifruit, particularly from New Zealand, Italy and China.

- (e) There is a general acceptance in the New Zealand kiwifruit industry, including on the part of Turners & Growers and Zespri, that the future of the industry lies in new cultivars. Zespri said in its proposal to FRST (Foundation for Research Science and Technology) in February 2009:

“The ‘Hayward’ cultivar (ZESPRI™ GREEN) is not controlled by plant variety protection or licensing and returns are dropping as this product becomes commoditised by competitors with cheaper production economics. In the 2008 season, 34% of the New Zealand ZESPRI™ GREEN growers were cash negative for the season (even greater when mortgage costs are taken into account), yet they [ie New Zealand’s ZESPRI GREEN growers] contribute 79% of New Zealand’s kiwifruit production by volume. Chile is New Zealand’s key Southern Hemisphere kiwifruit competitor with cheaper production economics than New Zealand and will double its ‘Hayward’ production in the next 5 years. This will place huge pressure on the viability of many ‘Hayward’ growers in New Zealand. While more efficient production will sustain New Zealand average profitability in the short term, this strategy is unlikely to be viable in the long-term.”

“If more proprietary new cultivars are not supplied to the industry, such as ‘Hort16A’, many New Zealand growers will struggle to compete globally against countries with cheaper production economics and that are closer to key markets. If new cultivars are not commercially released in the medium term it is likely many New Zealand ‘Hayward’ growers will have to exit kiwifruit production with the flow-on effects adversely impacting the 25,000 people currently employed by the New Zealand kiwifruit industry.

New cultivars therefore have huge market potential and are key to the sustainable future of the New Zealand kiwifruit industry. The New Zealand kiwifruit industry therefore needs to identify and protect premier new cultivars to replace ‘Hayward’ and use these to provide a new foundation for the New Zealand kiwifruit industry.”
(emphasis in original)

[54] In summary the position is that:

- (a) New Zealand and Chile are the main Southern Hemisphere exporters of kiwifruit. The principal competitor for New Zealand-grown Hayward fruit is Chilean-grown Hayward. This is in the market for

approximately the same time period, although New Zealand fruit is available further into October and November.

- (b) In recent years about 90% of kiwifruit produced in New Zealand has been exported. A grower would generally prefer to have fruit sold into international markets other than Australia, because this earns higher returns than sales to Australia or the domestic market.
- (c) Access for New Zealand-grown fruit to foreign markets other than Australia is dependent upon either: Zespri agreeing to export the fruit; or KNZ approving a collaborative marketing arrangement under Part 4 of the Regulations.

The Australia market

[55] The Australia market takes around 5% of the kiwifruit exported from New Zealand. Approximately 4.2 million trays are exported to Australia each year. Generally, around 90% is Hayward and the balance is Hort 16A.

[56] Australia is predominantly a Class 2 market. It is the primary market for New Zealand-grown Class 2 fruit. In a typical season (ie excluding 2009/2010), approximately 3.5 million trays of Class 2 Hayward go to Australia and between 1.6 million and 1.8 million trays to Zespri's other Class 2 export markets. Only a small proportion of the kiwifruit exported from New Zealand to Australia has been Class 1.

[57] Zespri has a small share of the Hayward market to Australia: in 2008 it was just under 8%. The volumes exported to Australia by Zespri and by the other exporters to Australia in the 2008/2009, 2009/2010 and 2010/2011 seasons are referred to in more detail when we deal with Turners & Growers' claim in relation to the Australia service level agreements.

[58] Export of kiwifruit to Australia is regulated under the New Zealand Horticulture Export Authority Act 1987 (the "HEA Act"). The HEA Act regime requires exporters of prescribed products to have licences and the relevant industry

“product group” to formulate an annual “export marketing strategy”.⁸ The export marketing strategy may not limit either the number of export licences available or the volume of product to be exported.

[59] Kiwifruit exported to Australia for consumption in Australia is a prescribed product. The “New Zealand Kiwifruit Product Group to Australia Incorporated” (NZKPGA) is a recognised product group for the purposes of the HEA Act. The kiwifruit export marketing strategy requires all licensed exporters to be members of “Kiwifruit Exporters to Australia” (KETA). It also imposes a minimum Class 2 grade standard.

[60] In the 2009/2010 season there were 18 licensees, including Turners & Growers and Zespri, entitled to export fruit to Australia. That is the relevant season for the claims regarding the Australia service level agreements.

[61] Most of the New Zealand exporters into the Australia market are supply entities. As already explained, when growers contract with a supply entity in relation to their Class 1 fruit, they usually also agree to the supply entity taking their Class 2 fruit. Most of the exporters to Australia only export Class 2 fruit acquired in this manner from their supplying growers. The market shares of New Zealand exporters in the Australia market accordingly tend to reflect the packhouses’ relative shares of supply from growers.

[62] Relatively few exporters seek to acquire fruit from other supply entities for export. Turners & Growers is an example of a company that does. If fruit is acquired by an exporter from another supply entity, an issue for negotiation between the parties is whether the fruit is to be packed and sold in the exporter's packaging or in the supplier's own boxes. Many exporters will want it packed in their own branded boxes, but some will take fruit in another party's branded packing and effectively spot trade during the selling season.

⁸ Parts 2 and 3, New Zealand Horticulture Export Authority Act 1987.

[63] Fruit sold into Australia is sold on a commission basis. The wholesale prices achieved have been between A\$12 and A\$25 per 10 kg box (about A\$4 to A\$8 per 3.6 kg tray).

Regulatory background

Current regulatory regime

[64] The regulatory background to the kiwifruit industry under the Kiwifruit Export Regulations 1999 (the Regulations) and Zespri's export authorisation is described in the earlier High Court judgment in *Turners & Growers Ltd v Zespri Group (No. 2)*, 13 August 2010, at [41]-[55].

[65] For present purposes the following features of the current regulatory regime are relevant:

- (a) The combined effect of the ban on the export of kiwifruit otherwise than for consumption in Australia and the obligation on KNZ to authorise Zespri as the sole exporter makes Zespri a monopsonist for the purchase of kiwifruit for export destinations other than Australia: regs 3 and 4. This means that only Zespri may acquire kiwifruit in New Zealand for export to countries other than Australia. No-one else is permitted to compete with Zespri for the acquisition of kiwifruit for that purpose.
- (b) As Zespri's export authorisation cannot, by law, have an expiry date and must not provide for any events on which the authorisation is to terminate, Zespri's status as a monopsonist will continue unless and until the regulatory regime is changed: regs 5(a) and 6(1)(h). In terms of the Regulations, Zespri's monopsonist status is indefinite.
- (c) As part of its authorisation, Zespri is generally free to decide what proportion of the kiwifruit crop it purchases and the basis on which it does so: reg 6(1)(b) and (c). At the same time, as was common

ground in this case, Zespri was not precluded by these regulations from entering into the loyalty contracts and supply agreements.

- (d) The potential costs and risks arising from Zespri's monopsony are mitigated by the non-discrimination and non-diversification rules and the information disclosure obligations in Part 3 of the Regulations which, by virtue of reg 8, have the purpose of:
- (a) Encouraging innovation in the kiwifruit industry while requiring that providers of capital agree to the ways in which their capital is used outside the core business; and
 - (b) Promoting efficient pricing signals to shareholders and suppliers; and
 - (c) Providing appropriate protections for [Zespri's] shareholders and suppliers; and
 - (d) Promoting sustained downward pressure on [Zespri's] costs.

Constraints of this nature are described as "light-handed" regulation.

- (e) Zespri's monopsonist powers are also constrained by the requirements that the point of acquisition of title to kiwifruit purchased for export by Zespri be at FOBS or later in the supply chain and that Zespri must generally not carry out activities, nor own or operate assets that are not necessary for its "core business", which is defined as the purchase of New Zealand grown kiwifruit for export other than for consumption in Australia: regs 5(c), 11(1) and 2 (definition of "core business"). The combined effect of these regulations is to prevent Zespri from becoming vertically integrated as a grower or supplier of kiwifruit itself.
- (f) The obligations on Zespri to disclose the terms and conditions for the purchase of kiwifruit grown in New Zealand, the period for which the terms and conditions are applicable, the methodology used to determine the payments for kiwifruit, the relationship between purchase prices and selling prices and the key costs, ensure

transparency in respect of Zespri's terms and conditions and pricing and are part of the "light-handed" regulatory regime: reg 14.

- (g) The collaborative marketing provisions in Part 4 of the Regulations, which enable KNZ to require Zespri to enter into such arrangements for the purpose of increasing the overall wealth of New Zealand kiwifruit suppliers and, no later than one month after the commencement of the season, to direct Zespri to make a certain volume of kiwifruit available for collaborative marketing arrangements, permit the only other exception to the export ban: regs 24, 26 and 29.
- (h) The enforcement regime, which must enable KNZ to ensure reasonable compliance by Zespri with the non-discrimination and the non-diversification rules, the information disclosure and the collaborative marketing requirements, and the point of acquisition requirement, reinforce the "light-handed" regulatory regime: regs 7(1)(a) and 33(1)(b). It was the existence of this enforcement regime that led to the decision in the judgment of 13 August 2010 that KNZ had exclusive jurisdiction to determine in the first instance Turners & Growers' complaints about Zespri's engagement in "unjustifiable discrimination" and "non-core activities".
- (i) The express recognition in reg 30 that, subject to any collaborative marketing allocation, nothing in Part 4 of the Regulations affects or limits the ability of Zespri to enter into "any contract or arrangement" for the purchase and marketing of kiwifruit. This confirms that it was anticipated that Zespri might well enter into such contracts or arrangements provided that they complied with the terms of its authorisation and did not contravene any relevant prohibitions under the Commerce Act.
- (j) In performing its functions and exercising its powers under its export authorisation Zespri must comply with any international obligation of

New Zealand specified by notice given to Zespri by the Minister of international trade: reg 45.

Application of Commerce Act

[66] As already noted, the export ban and Zespri's export authorisation are exempt from the operation of the restrictive trade practices provisions in Part 2 of the Commerce Act because they are "specifically authorised" by the Regulations: s 43(1) of the Commerce Act. It is common ground, however, that the provisions in the contracts or agreements and the other conduct of Zespri that is the subject of the claims by Turners & Growers have not been "specifically authorised" by the Regulations. The provisions and conduct are therefore not exempt under s 43(1) of the Commerce Act from the trade practices provisions in Part 2 of the Commerce Act.

[67] The issue in the present case, therefore, is whether, in respect of the rolling three-year loyalty contracts with growers and the exclusivity provisions in the annual supply agreements, the 2009 Australia service level agreements and the new kiwifruit cultivar policy, Zespri has acted inappropriately and contravened s 27(1) and/or s 36(2).

Collaborative marketing

[68] As noted, the collaborative marketing provisions in Part 4 of the Regulations are an important aspect of the regulatory background. It is therefore convenient to describe briefly how the provisions have been applied in practice.

[69] The criteria applied by KNZ for the grant of a collaborative marketing approval are described in KNZ's "Information Document" for the 2011 season. The primary criteria are: proof that the proposed programme will increase the overall wealth of New Zealand kiwifruit suppliers; and proof that collaboration has taken place with Zespri in preparing the application and will take place in the execution of the arrangement if the application is approved by KNZ. KNZ has explained:⁹

⁹ *Collaborative Marketing Committee Decisions*, Kiwifruit New Zealand, 24 March 2009.

KNZ is of the view that the spirit and intent of collaboration envisaged by the Regulations is generally of a continuous nature from the formulation of the arrangement through to its implementation and completion. Collaboration requires the parties involved, the applicant and Zespri, to work together on a project.

[70] The volume of kiwifruit exported under collaborative marketing approvals has historically been relatively low, generally with less than 2% of the New Zealand crop exported by this method. All of the fruit sold pursuant to collaborative marketing approvals prior to 2010/11 has been Hayward. The volumes over the last five seasons are set out in Table 8 below. The other fruit types exported under collaborative marketing approvals in 2010/11 were Hort 16A (10,767 tray equivalents) and Hayward OECD Class 1 (a different grading standard, falling between Zespri's Class 1 and 2) (134,835 tray equivalents).

Table 8: Time series of volumes of New Zealand-grown kiwifruit exported under collaborative marketing approvals

	Green Organic Class 1	Green Class 1	Green Class 2	Other	Total CM (TE)	Total New Zealand-grown exports sold (TE)	CM/Total
2006/07	91,867	1,258,492	77,716	-	1,428,075	80,060,000	1.8%
2007/08	290,180	1,292,195	74,492	-	1,656,867	92,436,000	1.8%
2008/09	372,405	1,449,271	85,931	-	1,907,607	99,969,000	1.9%
2009/10	345,999	1,306,419	62,328	-	1,714,748	98,550,000	1.7%
2010/11	457,814	1,882,171	45,452	145,602	2,531,039	98,117,000	2.6%

[71] A number of the collaborative marketing applications record Zespri International Limited as the applicant or exporter of record. The volumes by season since the 2006 season are set out in Table 9 below.

Table 9: Time series of volumes of New Zealand-grown kiwifruit exported by Zespri International Limited under collaborative marketing approvals

	Total CM (TE)	ZIL volume	ZIL %
2006/07	1,428,075	584,327	40.9%
2007/08	1,656,867	625,000	37.7%
2008/09	1,907,607	570,504	29.9%
2009/10	1,714,748	406,269	23.7%

[72] We now turn to consider the legal framework.

The legal framework

[73] Interpretation of the relevant provisions of the Commerce Act is governed by well-established principles of statutory interpretation and previous decisions of appellate courts. The meaning of a statutory provision must be ascertained from its text and in light of its purpose and in determining purpose the court must have regard to both the immediate and the general legislative context and its social, commercial or other objective: Interpretation Act 1999, s 5, and *Commerce Commission v Fonterra Co-operative Group Ltd.*¹⁰

[74] The purpose of the Commerce Act 1986, prescribed by s 1A, is:

to promote competition in markets for the long term benefit of consumers within New Zealand.

[75] The following elements of this purpose provision are to be noted:

- (a) The term “competition” is defined in s 3(1) as meaning “workable or effective competition”.
- (b) The term “market” is defined in s 3(1) as:
 - a reference to a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.
- (c) The focus is on “the *long* term benefit”.
- (d) The reference to “consumers” makes it clear that consumers are the intended beneficiaries of the promotion of competition: cf *Commerce Commission v Telecom Corporation of New Zealand Ltd.*¹¹ While the term “consumer” is defined in s 52C of the Act for the purposes of Part 4, which relates to regulated goods or services, there is no definition of the term in the Act applicable to Part 2.

¹⁰ *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [22].

¹¹ *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2009] NZCA 338, (2009) 12 TCLR 457 at [34]-[35].

- (e) The reference to “New Zealand”, consistent with the legislature’s territorial jurisdiction¹² and the definition of “market”, limits the “benefit” from the promotion of competition to consumers within this country.

[76] As appellate courts have recognised, the definitions of the terms “competition” and “market”, with their respective references to “workable or effective” and to substitutability as “a matter of fact and commercial common sense”, show that the Act is concerned with the economic role of competition and with promoting the competitive process rather than protecting individual competitors: *Port Nelson Ltd v Commerce Commission* and *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd (ANZCO v AFFCO)*.¹³ Vigorous legitimate competition by a powerful firm may damage competitors, but will not necessarily damage competition: *Commerce Commission v Telecom Corporation of New Zealand Ltd*.¹⁴

[77] The definitions of the terms “competition” and “market” also mean that the Act is concerned with the real world of commerce. Furthermore, as the Supreme Court has recognised in *Commerce Commission v Telecom Corporation of New Zealand Ltd*,¹⁵ the analytical approach to s 36 requires a reasonable basis for predictability of risk of contravention by firms and the exercise of commercial judgment by the courts.

[78] As the parties were largely in agreement as to the interpretation of many of the specific provisions of the Act relevant to the present case, we are able to summarise both the provisions and the authorities relatively briefly. We address later the principal disputes between the parties relating to aspects of the relevant markets and the application in the present case of the Supreme Court’s approach in *Commerce Commission v Telecom Corporation of New Zealand Ltd*.

¹² Section 4 and *Poynter v Commerce Commission* [2010] NZSC 38, [2010] 3 NZLR 300.

¹³ *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 (CA) at 564-565; and *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 (CA) at [242]-[243] and [248].

¹⁴ *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2010] NZSC 111, [2011] 1 NZLR 577 at [25].

¹⁵ *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2011] 1 NZLR 577 at [30], [31], [35] and [42].

[79] The relevant parts of s 27 provide:

27 Contracts, arrangements, or understandings substantially lessening competition prohibited

- (1) No person shall enter into a contract or arrangement, or arrive at an understanding, containing a provision that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.
- (2) No person shall give effect to a provision of a contract, arrangement, or understanding that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market.
- (3)
- (4) No provision of a contract, whether made before or after the commencement of this Act, that has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market is enforceable.

[80] For the purpose of interpreting s 27(1), the following definitions are also relevant:

2 Interpretation

(1) ...

provision, in relation to an understanding or arrangement, means any matter forming part of or relating to the understanding or arrangement ...

(1A) ...

substantial means real or of substance.

...

(3) Where any provision of this Act is expressed to render a provision of a contract unenforceable if the provision of the contract has or is likely to have a particular effect, that provision of this Act applies in relation to the provision of the contract at any time when the provision of the contract has or is likely to have that effect, notwithstanding that—

(a) at an earlier time the provision of the contract did not have that effect or was not regarded as likely to have that effect; or

(b) the provision of the contract will not or may not have that effect at a later time...

...

- (5) For the purposes of this Act—
- (a) a provision of a contract, arrangement or understanding, ... shall be deemed to have had, or to have, a particular purpose if—
 - (i) the provision was or is included in the contract, arrangement or understanding ... for that purpose or purposes that included or include that purpose; and
 - (ii) that purpose was or is a substantial purpose

...

3 Certain terms defined in relation to competition

- (1)
- (2) In this Act, unless the context otherwise requires, references to the **lessening of competition** include references to the hindering or preventing of competition...
- ...
- (5) For the purposes of section 27 of this Act, a provision of a contract, arrangement, or understanding shall be deemed to have or to be likely to have the effect of substantially lessening competition in a market if that provision and—
- (a) the other provisions of that contract, arrangement, or understanding; or
 - (b) the provisions of any other contract, arrangement, or understanding to which that person or any interconnected body corporate is a party—

taken together, have or are likely to have the effect of substantially lessening competition in that market.

[81] While the term “purpose” is not defined separately in the Act, its meaning may be discerned in part from:

- (a) s 27(1) itself which makes it clear that it is the “purpose” of the “provision” in the “contract or arrangement” and not the “purpose” or intentions or motives of the “person” that is relevant: *Port Nelson Ltd v Commerce Commission*, *Giltrap City Ltd v Commerce Commission* and *ANZCO v AFFCO*;¹⁶
- (b) s 2(5)(a) which deems a “provision” in a contract or arrangement to have had, or to have, a particular purpose if it was included for that purpose or purposes that included or include that purpose and the purpose was or is a substantial purpose. This means that one substantial anti-competitive purpose will suffice even if the provision also has legitimate business purposes and/or reflects a unilateral rather than a joint purpose: *Tui Foods Ltd v New Zealand Milk Corporation Ltd*, *Port Nelson Ltd v Commerce Commission* and *ANZCO v AFFCO*;¹⁷ and
- (c) s 2(1A) which, consistently with the real world definitions of “competition” and “market”, defines “substantial” as meaning real or of substance.

[82] The question whether “purpose” is to be ascertained or assessed subjectively or objectively has been considered in several cases: *Tui Foods Ltd v New Zealand Milk Corporation Ltd* (CA) at 409, *Port Nelson v Commerce Commission* (CA) at 564, *ANZCO v AFFCO* (CA) at [143]-[147] and [250]-[263], and *Commerce Commission v Bay of Plenty Electricity Ltd*.¹⁸ It is unnecessary to address this question further in the present case as the parties were in agreement that whether a provision has a s 27 purpose is to be determined objectively from the contracts themselves and the relevant surrounding circumstances.

¹⁶ *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 (CA) at 563; *Giltrap City Ltd v Commerce Commission* [2004] 1 NZLR 608 (CA) at [73]; and *ANZCO v AFFCO* (CA) at [258].

¹⁷ *Tui Foods Ltd v New Zealand Milk Corporation Ltd* (1993) 5 TCLR 406 (CA) at 410; *Port Nelson Ltd v Commerce Commission* (CA) at 563-564; and *ANZCO v AFFCO* (CA) at [259].

¹⁸ *Commerce Commission v Bay of Plenty Electricity Ltd* HC Wellington CIV-2001-485-917, 13 December 2007, at [333]-[340].

[83] The term “effect” is also not defined separately in the Act, but there is no dispute that whether a provision has an “effect” is essentially a question of fact: *ANZCO v AFFCO* at [135]. Actual results are relevant when considering the “effect” of a provision in a contract or arrangement: *Commerce Commission v Bay of Plenty Electricity Ltd* at [342]. As Turners & Growers accepted, if a provision has the “effect” of substantially lessening competition, necessarily that is “an immediate effect” in an existing market. In *Commerce Commission v Bay of Plenty Electricity Ltd* the Court explained at [343]:

That said, the reference to an “immediate” effect denotes an effect that follows directly from the provision without an intervening cause, rather than an effect which occurs immediately in time upon the promulgation or implementation of the provision.

[84] The meaning of the expression “likely effect” in the context of s 27(1) was explained by the Court of Appeal in *Port Nelson Ltd* at 562-3:

bearing in mind the purpose of the provision the appropriate level is that above mere possibility but not so high as more likely than not and is best expressed as a real and substantial risk that the stated consequence will happen.

[85] In considering whether a provision in a contract or arrangement is “likely” to have an anti-competitive effect, it is useful to compare the likely state of competition “with” the provision (“the factual”) against the likely state of competition “without” (“the counterfactual”). As the Court of Appeal put it in a business acquisition case, *Commerce Commission v Woolworths Ltd*:¹⁹

“This exercise requires a comparison of the likely state of competition if the acquisition proceeds (“the factual”) against the likely state of competition if it does not (“the counterfactual”). The expression “factual” is, in the context of a clearance application, a misnomer as it is just as hypothetical as the counterfactual. A substantial lessening of competition is “likely” if there is a “real and substantial risk” that it will occur, see *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 at 562-563 (CA). Another way of putting it is that there must be a “real chance” that there will be a substantial lessening of competition, see *Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees’ Union* (1979) 27 ALR 367 at 382 (FCA).”

[86] The issue of time in relation to whether a provision in a contract has or is likely to have a particular effect is addressed in s 2(3) of the Act which provides that

¹⁹ *Commerce Commission v Woolworths Ltd* [2008] NZCA 276, (2008) 12 TCLR 194 at [63].

s 27 applies “at any time” when the provision has or is likely to have that effect notwithstanding that it did not have or was not regarded as likely to have that effect at “an earlier time” or will not or may not have that effect at “a later time”.

[87] In the present case there is a dispute between the parties as to whether a provision may presently be regarded as likely to have the effect of substantially lessening competition in a future state of affairs in a current market or in a future market. We consider this dispute when we address the definition of the relevant markets in this case and in particular whether a “deregulated” market should be accepted.

[88] The meaning of the phrase “substantially lessening competition” is to be derived from the definitions of “substantial” in s 2(1A) as “real or of substance”, “the lessening of competition” in s 3(2) as including references to “the hindering or preventing” of competition and “competition” in s 3(1) as “workable or effective competition”. The phrase “substantially lessening competition” was considered in some detail in *ANZCO v AFFCO* by Glazebrook J at [239]-[249]. Among the points the Judge made were the following:

- (a) while a strict proportionality approach is likely not required, “substantially” is nevertheless used in a relative rather than absolute sense;
- (b) “workable and effective” competition encompasses a market framework which participants may enter and in which they may engage in rivalrous behaviour with the expectation of deriving advantage from greater efficiency;
- (c) whether firms compete is very much a matter of the structure of the markets in which they operate and the Court will need to look to structural features such as market concentration, barriers to entry, product differentiation and vertical integration;

- (d) a behavioural approach may also be useful in assessing effects on competition;
- (e) when assessing whether there has been a substantial lessening of competition in a market, the phrase must obviously be construed as a whole which essentially means that the competitive functioning of a relevant market must be assessed with and without the disputed practice: cf *Commerce Commission v Woolworths* at [63];
- (f) judicial intervention is justified only if there is a purpose, effect or likely effect on competition which is substantial in the sense of meaningful or relevant to the competitive process; and
- (g) short-term effects are unlikely to be substantial.

[89] We turn next to s 36, the relevant parts of which provide:

36 Taking advantage of market power

- (1) Nothing in this section applies to any practice or conduct to which this Part applies that has been authorised under Part 5.
- (2) A person that has a substantial degree of power in a market must not take advantage of that power for the purpose of—
 - (a) restricting the entry of a person into that or any other market; or
 - (b) preventing or deterring a person from engaging in competitive conduct in that or any other market; or
 - (c)
- (3) For the purposes of this section, a person does not take advantage of a substantial degree of power in a market by reason only that the person seeks to enforce a statutory intellectual property right, within the meaning of section 45(2), in New Zealand.
- (4)

[90] For the purpose of interpreting s 36(2), the following provisions are also relevant:

2 **Interpretation**

(2) In this Act,—

- (a) a reference to **engaging in conduct** shall be read as a reference to doing or refusing to do any act, including—
 - (i) the entering into, or the giving effect to a provision of, a contract or arrangement; or
 - (ii) the arriving at, or the giving effect to a provision of, an understanding; or
 - (iii) the requiring of the giving of, or the giving of, a covenant:

- (b) a reference to **conduct**, when that expression is used as a noun otherwise than as mentioned in paragraph (a) of this subsection, shall be read as a reference to the doing of, or the refusing to do, any act, including—
 - (i) the entering into, or the giving effect to a provision of, a contract or arrangement; or
 - (ii) the arriving at, or the giving effect to a provision of, an understanding; or
 - (iii) the requiring of the giving of, or the giving of, a covenant:

- (c) a reference to **refusing to do an act** includes a reference to—
 - (i) refraining (otherwise than inadvertently) from doing that act; or
 - (ii) making it known that that act will not be done:

- (d) a reference to a person **offering to do an act, or to do an act on a particular condition**, includes a reference to the person making it known that the person will accept applications, offers, or proposals for the person to do that act or to do that act on that condition, as the case may be.

...

(5) For the purposes of this Act—

...

- (b) a person shall be deemed to have engaged, or to engage, in conduct for a particular purpose or a particular reason if—

- (i) that person engaged or engages in that conduct for that purpose or reason or for purposes or reasons that included or include that purpose or reason; and
- (ii) that purpose or reason was or is a substantial purpose or reason.

...

36B Purposes may be inferred

The existence of any of the purposes specified in section 36 ... as the case may be, may be inferred from the conduct of any relevant person or from any other relevant circumstances.

[91] There is no dispute between the parties that a contravention of s 36(2) requires:

- (a) the existence of the relevant market;
- (b) a person who has “a substantial degree of power” in that market;
- (c) who has “taken advantage” of that power;
- (d) for one of the proscribed purposes either in the market in which the person has a substantial degree of power or in “any other market”.

[92] Nor is there any dispute between the parties that:

- (a) the current grower/exporter (non-Australia) market exists and that Zespri has “a substantial degree of power” in that market;
- (b) whether Zespri has “taken advantage” of its market power depends on the application of the analytical method adopted by the Supreme Court in *Commerce Commission v Telecom Corporation of New Zealand Ltd*;
- (c) in s 36(2) it is the “purpose” of the person with market power rather than the purpose of a provision as in s 27(1) which is in issue: cf *Commerce Commission v Bay of Plenty Electricity Ltd* at [330];

- (d) as long as it was or is “substantial”, a proscribed purpose may exist alongside a legitimate (benign) purpose: s 2(5)(b) : *Port Nelson Ltd v Commerce Commission* (CA) at 578 and *Commerce Commission v Bay of Plenty Electricity Ltd* at [323]-[324].

[93] In determining whether Zespri has “taken advantage” of its market power in contravention of s 36(2), the decision of the Supreme Court in *Commerce Commission v Telecom Corporation of New Zealand Ltd* at [42] requires the Court to decide whether Turners & Growers has shown, on the balance of probabilities, that in a “hypothetical workably competitive market”, constructed in accordance with the analytical method adopted by the Supreme Court, a company without Zespri’s market power would not, as a matter of practical business or commercial judgment, have acted as Zespri did in respect of its impugned conduct. The rationale for, and the construction of, a “hypothetical workably competitive market” is explained in full in the decision of the Supreme Court. We return to the application of the Supreme Court’s analytical method when we come to consider Turners & Growers’ claims under s 36(2) in relation to Zespri’s new kiwifruit cultivar policy, noting that the parties disagreed on the construction of a hypothetical market in this context.

[94] The issue of the relationship between a finding of anti-competitive purpose and reaching a conclusion about “taking advantage” of market power has been considered by both the Privy Council in *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd*²⁰ and the Supreme Court in its recent decision.²¹ In both cases it was said that it may be dangerous to proceed too quickly from a finding of anti-competitive purpose to a conclusion about “taking advantage” of market power.

[95] The converse situation, namely proceeding from a finding of “taking advantage” of market power (or “use of a dominant position” in terms of s 36 as it previously stood) to a conclusion of anti-competitive purpose, was considered by the Privy Council, but not by the Supreme Court because the issue did not arise.²² The Privy Council said at 402:

²⁰ *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd* [1995] 1 NZLR 385 at 402-403.

²¹ *Commerce Commission v Telecom Corporation of New Zealand Ltd* at [19].

²² At [50].

If a person has used his dominant position it is hard to imagine a case in which he would have done so otherwise than for the purpose of producing an anti-competitive effect; there will be no need to use the dominant position in the process of ordinary competition. Therefore, it will frequently be legitimate for a Court to infer from the defendant's use of his dominant position that his purpose was to produce the effect in fact produced. Therefore, as the Court of Appeal in the present case accepted, use and purpose, though separate requirements, will not be easily separated ...

Although it is legitimate to infer "purpose" from use of a dominant position producing an anti-competitive effect, it may be dangerous to argue the converse ie that because the anti-competitive purpose was present, therefore there was use of a dominant position.

(emphasis added)

[96] As the emphasised passages show, the Privy Council accepted that, when an anti-competitive "effect" is produced as a result of the use of a dominant position, it will frequently be legitimate to infer an anti-competitive "purpose" under s 36(2). This reflects the well-recognised relationship between "purpose" and "effect": a purpose is the effect which it is sought to achieve or the end in view: cf *Glenharrow Holdings Ltd v Commissioner of Inland Revenue*.²³ The concept of using dominance to enable "the conduct to be undertaken and the purpose to be achieved" or for the "achievement" of an anti-competitive purpose was also recognised by the Supreme Court in *Commerce Commission v Telecom*.²⁴ This reinforces the view that, when an anti-competitive "effect" is in fact produced or achieved by a person taking advantage of market power, an anti-competitive purpose may well be able to be inferred from the person's conduct.

[97] The ability of the court to infer anti-competitive purpose from a person's conduct in taking advantage of market power is now also reinforced by s 36B of the Act which expressly provides that the existence of an anti-competitive purpose may be inferred from the person's conduct or from any other relevant circumstances. An inference is to be drawn logically from proven facts and should not be mere speculation or guesswork: *R v Puttick* and *Commerce Commission v Visy Board (NZ) Ltd*.²⁵ This means, as the Privy Council recognised, it may be possible to draw the

²³ *Glenharrow Holdings Ltd v Commissioner of Inland Revenue* [2008] NZSC 116, [2009] 2 NZLR 359 at [37]-[38].

²⁴ At [14].

²⁵ *R v Puttick* (1985) 1 CRNZ 644 (CA) at 647; and *Commerce Commission v Visy Board (NZ) Ltd* HC Auckland CIV 2007-404-7237, 20 April 2011 at [63].

inference that a person's purpose is proscribed if on the proven facts it is established that the effect of the taking advantage of the person's market power was anti-competitive.

[98] Equally, however, if no anti-competitive effect is produced or achieved by the taking advantage of the person's market power, then it will not be possible to draw an inference of anti-competitive purpose from that particular conduct. Unless there is other evidence establishing an anti-competitive (proscribed) purpose, the absence of an anti-competitive effect may be determinative. The situation where no anti-competitive effect is in fact produced or achieved may need to be distinguished from the situations where the taking advantage of market power has not occurred, but remains prospective; and where there is an anti-competitive purpose, but no achievable anti-competitive effect. The former situation is recognised by the power of the court to grant an injunction under s 81 restraining a person from engaging in conduct that "would constitute" a contravention of any of the provisions of Part 2 and by the power to grant interim injunctions under s 88. In the latter situation it would be necessary in the High Court to follow the approach of the majority in *ANZCO v AFFCO* where it was held in the context of s 27 and s 28 that anti-competitive purpose might be established in the absence of proof of an achievable anti-competitive effect or likely effect: William Young P at [152]-[154] and Anderson P at [302], cf Glazebrook J at [256]-[262].

[99] Again it is not necessary in the present case to address the question whether in the context of s 36(2) the "purpose" of the person is to be ascertained subjectively or objectively because Turners & Growers accepted that it should be determined objectively. Support for the view that in the end there may not be much practical difference is provided by *Union Shipping NZ Ltd v Port Nelson Ltd*:²⁶

We must say we are reluctant to adopt an entirely subjective approach. As the development of the law of contract rather demonstrates, the commercial field is one in which objective ascertainment of states of mind has much to commend it. We would be sorry to see the objectives of s 36 inhibited by any undue subjectivity as to purpose, perhaps more natural to the criminal law. However, in the light of Tipping J's firmly expressed view [in *New Zealand Magic Millions Ltd v Wrightson Bloodstock Ltd* [1990] 1 NZLR 731 at 762] we will leave the question of principle open. In the end, a decision is

²⁶ *Union Shipping NZ Ltd v Port Nelson Ltd* [1990] 2 NZLR 662 (HC) at 709.

not strictly necessary within the context of this present case. In any event, often the difference will be more apparent than real. Proof of purpose, in the nature of these cases often will turn upon inferences drawn from actions and circumstances, with a sprinkling of internal memoranda and correspondence. Protestations of inner thoughts which do not reconcile with objective likelihoods are unlikely to carry much weight. In many cases, and this ultimately is one, both objective and subjective standards are met.

Similar views have been expressed subsequently in *Port Nelson Ltd v Commerce Commission* (CA) at 564 and *Telecom v Clear* (PC) at 403.

[100] As s 36(1) recognises, nothing in s 36 applies to any practice or conduct to which Part 2 of the Act applies that has been authorised by the Commerce Commission under Part 5 of the Act. As Zespri has not sought authorisation from the Commission for any of its practices that are the subject of Turners & Growers' claims, there is no suggestion that Zespri is currently able to avoid the application of either s 27 or s 36 on that ground. The possibility of Zespri seeking authorisations for its practices was, however, raised in the following contexts:

- (a) the need for the court to recognise that in the event of deregulation the Government might consider it appropriate to give Zespri the opportunity to apply to the Commission in advance for authorisation of its practices;
- (b) the need for the court to recognise that in the event of Turners & Growers succeeding in its claims and the court considering the grant of an injunction, consideration should be given to the terms of the injunction enabling Zespri:
 - (i) to seek an authorisation of its exclusivity contracts under ss 58 and 59B of the Act; and
 - (ii) for that purpose, to seek an order from the Commission under s 59A(3) that the contracts not be discontinued pending the Commission's decision on the authorisation application; and

- (c) the need to recognise that under s 61(6) of the Act the Commission, in determining whether to grant the authorisation, would need to be satisfied that in all the circumstances the contracts would result, or be likely to result, in a benefit to the public which would outweigh the lessening in competition that would result or would be likely to result or would be deemed to result from the contracts.

[101] As far as the relief sought by Turners & Growers is concerned, there is no dispute that the court has jurisdiction at common law to grant the declarations relating to the loyalty contracts and the exclusivity provisions of the supply agreements, the 2009 Australia service level agreements or the cultivar policy: *Commerce Commission v Fletcher Challenge Ltd.*²⁷

[102] There is also no dispute that the court has power to grant injunctions and damages under ss 81 and 82 of the Act. An injunction may be granted restraining a person from engaging in conduct that constitutes or would constitute a contravention of Part 2. Damages may be awarded if some loss or damage caused by the contravention is established.

[103] Finally, there is no dispute that the onus of proof in this civil proceeding under the Commerce Act is on Turners & Growers as the plaintiffs and that the standard of proof is the ordinary civil standard, namely the balance of probabilities: *Commerce Commission v Telecom* (SC) at [34] and [42]. As the Court of Appeal pointed out in *Commerce Commission v Woolworths*:²⁸

A hypothesis is established on the balance of probabilities if it is more likely than not to be true.

[104] We now turn to consider separately the three factual matters which give rise to the claims by Turners & Growers.

²⁷ *Commerce Commission v Fletcher Challenge Ltd* [1989] 2 NZLR 554 (HC) at 609-611.

²⁸ *Commerce Commission v Woolworths* at [97].

The loyalty contracts and the supply agreements

The provisions of the loyalty contracts

[105] As already noted in our section on the factual background, Zespri offers a “ZESPRI Loyalty Contract” or “Enhanced Three Year Rolling Contract” to each grower. Growers who enter into a loyalty contract with Zespri sign both a short form and long form of the contract.

[106] For present purposes it is convenient to summarise the long form of the 2010 contract. The preamble provides:

The Enhanced Three Year Rolling Grower Contract provides a strategic choice for growers and the post harvest sector to strengthen the single point of market entry which underlies the industry’s competitive advantage and ultimately the in market premiums paid by our customers for New Zealand Kiwifruit. Through the Enhanced Three Year Rolling Grower Contract, growers and the post harvest sector make an on-going commitment to supply 100% of their Class 1 fruit to ZESPRI and growers in return share directly in the tangible benefits of the integrated market channel through receiving the Loyalty Premium.

[107] As foreshadowed in the preamble, clause 1 of the contract contains a commitment to supply by the grower who agrees to:

- (a) supply to [Zespri] for the next three seasons commencing with the 2010 season, all Class 1 Kiwifruit to which the Grower has title while it is on the vine that is grown on any and all properties that, at any time during the duration of this contract, it owns or controls ...
- (b) obtain all post harvest services for all such Class 1 Kiwifruit (including all Services under a Supply Agreement) from the time it is packed only from post harvest operators and a Registered Supplier or Registered Suppliers who:
 - (i) have been appointed by ZESPRI and remain as exclusive suppliers; and
 - (ii) provide post harvest services (including Services under a Supply Agreement) for Class 1 Kiwifruit only if it is supplied to ZESPRI

[108] The effect of clause 3 is that at the beginning of each season, the grower commits to supply fruit to Zespri for three years, unless that grower opts out by 15 March. At the beginning of the following season the same process occurs. The

effect is to create a continuous three year contract which rolls over every year, unless the grower opts out in which case the contract terminates at the end of the current three year period. Clause 4 then provides that if notice is given:

- (a) the Grower's commitment under clause 1 continues for the two remaining seasons of its term;
- (b) ZESPRI's obligation under clause 8 to pay the Loyalty Premium applies only in respect of the season in which the notice was given, and only if the Grower meets its commitment under clause 1 for the two further full seasons after notice is given;
- (c) for the avoidance of doubt:
 - (i) ZESPRI is not required to pay the Loyalty Premium for the two remaining seasons after notice is given, even if the Grower meets its commitment under clause 1 for those seasons; and
 - (ii) ZESPRI may exercise its remedies under clause 10 to withhold or recover any Loyalty Premium paid for the season in which the notice was given, if the Grower does not meet its commitment under clause 1 for that season or for the two remaining seasons following the giving of the notice; and
- (d) this contract will terminate at the end of the second full season after notice is given.

[109] In return for the supply commitment under clause 1, clause 8 provides for the payment of the loyalty premium by Zespri in the sum at present of \$0.25 plus GST per tray of Class 1 Kiwifruit. Clause 9 provides that the loyalty payment will be paid in a first instalment of \$0.10 plus GST per tray in January with a second instalment subject to market conditions in June. If a grower breaches the supply commitment under clause 1, Zespri may, under clause 10, withhold or suspend payment of some or all of the loyalty premium. Under clause 14, Zespri may withhold the loyalty premium from growers who fail to supply all of their Class 1 fruit.

[110] Zespri's commitments are contained in clause 15 which provides that Zespri will, subject to compliance with the contract:

accept for supply at FOBS all Class 1 Kiwifruit from the Grower from all properties that the Grower owns or controls, in accordance with the Supply Agreement,.....

[111] The essential features of these provisions in the loyalty contracts are:

- (a) A commitment by the grower to supply 100% of Class 1 Hayward and Hort 16A kiwifruit grown in New Zealand to Zespri for export beyond Australia for a period of at least three years: clauses 1(a) and 3;
- (b) A commitment by the grower to use the exclusive services of Zespri's registered suppliers and post harvest operators providing services in respect of Class 1 Hayward and Hort 16A grown for a period of at least three years: clauses 1(b) and (c) and 3;
- (c) The payment by Zespri to the grower of a loyalty premium of \$0.25 plus GST per tray in two instalments;
- (d) The financial sanctions for breaching the commitments and terminating the contract (including by choosing to opt out of the automatic rollover of the contract) and continued grower obligation to supply without payment of the loyalty premium for two years: clauses 4 and 10-14.

The provisions of the supply agreements

[112] The parties are in agreement that the key terms of Zespri's supply agreement, which has been in materially identical form since the 2006 season, are as follows:

- (a) Zespri will acquire all Class 1 Hayward and Hort 16A kiwifruit from the contractor (ie the registered supplier or Option B grower);
- (b) the contractor must supply all Class 1 Kiwifruit to Zespri in accordance with the provisions of the supply agreement;
- (c) Zespri will pay the contractor for the supply of kiwifruit and services in accordance with the Pricing and Payment Manual;

- (d) the contractor will cause (either as principal or as agent on behalf of the titleholder) legal and beneficial title to the kiwifruit to pass to Zespri at FOBS free of all security interests;
- (e) the contractor will provide services to Zespri, including the delivery of kiwifruit from the growers listed in Schedules 3 and 4 from the coolstore to Zespri at FOBS; and
- (f) the contractor may apply for itself, and for any post-harvest operators who authorise the contractor to apply on their behalf, to be appointed as Zespri exclusive suppliers on the terms set out in Schedule 8.

[113] The supply agreement also includes a number of other elements, including:

- (a) the requirements applicable to kiwifruit to be purchased for export by Zespri;
- (b) the pricing and payment methodologies applicable to transactions for kiwifruit, including applicable incentive and penalty mechanisms for meeting demand;
- (c) operational planning and order management processes, including in the 2009 version of the agreement a provision relating to the possible development of an industry generic service level agreement for the purposes of crop management;
- (d) arrangements for insurance to be made on behalf of growers by Zespri;
- (e) definitions of costs that are attributable to the grower pools as opposed to those to be borne by Zespri; and
- (f) normal contractual provisions such as dispute resolution, intellectual property, termination, notices, confidentiality and governing law.

The background to the loyalty contracts and the supply agreements

[114] It is clear from Zespri's Board papers from 2003 onwards that the loyalty contracts and supply agreements were developed as part of Zespri's response to the prospect of deregulation. The Board had received an executive memorandum dated 29 April 2003 reporting on advice from officials of the Ministry of Foreign Affairs and Trade and the Ministry of Agriculture and Fisheries which indicated that the outcome of ongoing, but potentially protracted, World Trade Organisation negotiations might well require the New Zealand Government to take steps to deregulate the kiwifruit industry. At the Board meeting held on 29 April 2003 the then chairman, Mr Greenlees, spoke of the need to plan a progression for Zespri from the regulatory single channel to a commercial de facto single channel by convincing industry players of what the future held for Zespri.

[115] At the same time Zespri management was developing its proposals for closer involvement with the industry, including the sharing of knowledge and the strategy for Zespri as the integrated marketer to be known as "the Zespri system". The changes and philosophy behind these proposals were approved by the Board in July 2003.

[116] At the Board meeting on 26 August 2003 there was a presentation by Mr Lain Jager, then Zespri's General Manager Corporate Strategy, who said that, since the combination of the single point of entry and Zespri's expertise as an integrated marketer delivered premium returns to growers, it was fundamental to industry success to maintain regulation for as long as possible and to use that time to develop Zespri's competitive strength so that on deregulation Zespri could offer a value proposition to growers such that growers would choose to continue to supply Zespri in a deregulated market. After Board discussion on a proposed contractual relationship with growers and the proposed payment of what was then described as "a Margin Rebate", the Board unanimously approved the direction proposed, "but wished to see more detail on ownership structures". The Board also discussed the subject of managing transition to deregulation and the strategy that Zespri should develop a value proposition or integration model which ensured growers remained

committed to it and the value of integration even if the formal regulatory support for Zespri ceased.

[117] At the Board meeting held on 23 September 2003 Mr Jager presented a comprehensive paper covering the proposed integration strategy designed to develop Zespri's competitive strength through the development of Zespri as an integrated marketer, grower contracts and payments and the Zespri system, to maintain the regulations by winning the hearts and minds of growers, and to manage the transition to deregulation. In his paper Mr Jager proposed a new contractual relationship with growers and details of "a Margin Rebate". The paper emphasised that the proposed model was focused on "winning the hearts and minds of growers" and was not about "sticks", such as long term contracts, or overt barriers to entry, such as penalties or substantive costs for exit.

[118] The paper also indicated that the "Margin Rebate", which would probably be expressed as a percentage of profit and only paid in good years, would be on the following basis:

- An ever-green (ie rolling) contract (with no barriers to exit);
- The Grower committing 100% of Class 1 crop to Zespri; and
- The Grower undertaking to pack with a Post Harvest Organisation (Supplier/Packhouse/Coolstore) which would supply 100% of Class 1 crop to Zespri.

[119] The paper gave an overview of the World Trade Organisation debate about state trading enterprises and recommended that Zespri undertake:

a proactive and aggressive engagement of government and officials to defend and retain the "regulated single desk" for the New Zealand Kiwifruit Industry for as long as possible.

[120] It was pointed out that by undertaking a strategy of this nature Zespri might also be able to influence:

- (a) The length of time to deregulation;

(b) Incorporating any conditions Zespri might consider were in the interests of the business or the industry, for example:

- Making any transition market specific (if even only for a period of time), thereby protecting the premiums the industry enjoys from certain markets.

The paper then set out proposals for managing the transition to deregulation, including the development of an integrated structure, with a “stretch target” aim of retaining 100% supply.

[121] At the Board meeting on 23 September 2003 the Board discussed Mr Jager’s paper at length and resolved to approve Zespri entering into discussions with the industry to implement individual grower contracts. The Board also directed that more work was required on the proposed Margin Rebate.

[122] At the Board meeting on 21 October 2003 the Board approved the concept of a Margin Rebate being paid to growers who signed long term contracts on all Class 1 trays.

[123] For the Board meeting on 17 and 18 November 2003 management recommended a \$0.10 per tray margin rebate on the basis that this was considered to be the minimum amount to motivate growers to sign a long term contract. It was recorded that an arbitrary splitting of “excess profits” 50-50 had been used. The Board accepted the recommendation and resolved that a margin rebate of 10 cents per tray (on Class 1 trays) be paid to growers who signed long term contracts, subject to the achievement of a “normal” return to shareholders.

[124] The first three year rolling contracts with growers directly were introduced by Zespri in 2004. Zespri explained the new contracts in its February 2004 Kiwiflier:

Three Year Rolling Contract

When the Industry Advisory Council confirmed ZESPRI’s margin for the next three years, it was agreed by NZKGI [New Zealand Kiwifruit Growers Incorporated], suppliers, and ZESPRI that up to 10 cents per tray should be rebated back from ZESPRI profits to growers in good years. Accordingly, ZESPRI is offering up to 10 cents per tray supplied as a Loyalty Premium

for growers who commit to supply ZESPRI exclusively for three years. This establishes both a formal contractual interface between growers and ZESPRI and a commercial framework that could be developed over time to withstand any changes to our integrated structure.

Growers have the choice of receiving the up to 10 cents per tray Loyalty Premium directly, or assigning the monies to a third party such as an entity pool.

[125] At the Zespri Board meeting held on 17 August 2004 the Board considered a further paper from Mr Jager recommending the incorporation of a supplier exclusivity element into the loyalty contracts. It was suggested in the paper that this was the next step to be taken to support the single point of entry, especially in the event of deregulation.

[126] At the Board meeting the Chairman, Mr Greenlees noted:

ZESPRI's SPE [single point of entry] status gave it a critical strategic advantage – the foundation of guaranteed supply and export exclusivity was critical to success. The questions were therefore how to maintain this post-deregulation, and in particular what share of total supply was the “critical mass”, and what enduring structure could be put in place to secure that level of supply?

[127] At the next Zespri Board meeting held on 21 September 2004 the Board considered another paper from Mr Jager which recommended that the grower rebate and the supplier/post-harvest rebates be combined and positioned as a mechanism to enable growers to maintain the single point of entry commercially in the absence of the Regulations. The Board noted that it was “generally happy” with the outline of the proposal, but noted that to get post-harvest operators' acceptance it would need to be integrated into a broader package of reforms.

[128] In April 2005 Mr Jager prepared a discussion paper for the Industry Advisory Council (IAC) about the proposed enhanced grower/supplier rebate. The rationale for the rebate was explained as follows:

This design is intended to achieve a 3 year commitment to Supply [sic] Zespri and to act as a barrier to partial exit, i.e., it is designed to discourage a grower from splitting his/her crop between Zespri and another marketer. The forfeiture of rebate is unlikely to be commercially powerful enough to stop a grower from channelling all of his/her fruit through another marketer if the grower believes the other marketer can deliver higher fruit returns than Zespri. What the rebate does do is discourage the grower from

experimenting with other marketers and pushes up the risk of leaving the Zespri System, i.e., moving his/her whole crop to an alternative marketer is a bigger risk than “seeing how Freshco goes” with 20% of the crop “just to keep Zespri honest”.

[129] At the Zespri Board meeting on 23-24 November 2005 the Board resolved to accept the draft enhanced loyalty rebate contracts (for the sale of Class 1 fruit outside New Zealand and Australia), with the proviso that the IAC be asked to endorse the extension of the supply commitment to cover Class 2 fruit outside New Zealand and Australia.

[130] The new loyalty contracts with their exclusivity arrangements were introduced by Zespri in 2006 and have remained in place since then. As Mr Jager said in evidence, that was the first time that an enhanced loyalty rebate was linked to the obligation to use a “Zespri exclusive supplier”, being a post-harvest operator and supply entity that had made a contractual commitment to pack Class 1 exclusively for Zespri.

[131] In mid-2006 Zespri considered extending the loyalty rebate to Italian growers but decided against it. The May 2006 executive recommendation paper to the Board stated:

“The Loyalty Rebate was established in New Zealand to support the single desk. The Loyalty Rebate is paid to New Zealand Growers in respect of their commitment to sell Class 1 fruit only through ZESPRI and to pack only with ZESPRI Exclusive Suppliers. The Loyalty Rebate mechanism has been developed by ZESPRI specifically to support and strengthen the New Zealand single point of entry.

Summary

[132] In the end there is little doubt that the evidence relating to the development and adoption of the loyalty contracts and the exclusivity provisions in the supply agreements established that Zespri took these steps with the concurrence of the majority of the industry in order to:

- (a) reinforce its regulatory monopsony by replicating it with a commercial (ie contractual) monopsony in the event of deregulation;

- (b) achieve vertical integration on a contractual basis within the grower/supplier/post-harvest operator/exporter levels of the industry;
- (c) retain grower support through sharing, in the form of loyalty rebates, overseas price premiums in order to defer deregulation for as long as possible; and
- (d) prepare for the advent of deregulation through its commercial monopsony and vertical contracts.

[133] It was the continued threat of potential deregulation which influenced Zespri in its development of the contractual arrangements with growers and suppliers. Both Mr Jager, now Zespri's chief executive, and Dr Yeabsley, Zespri's independent economist, acknowledged that the loyalty contracts and the exclusivity obligations in the supply agreements would strengthen Zespri's position in the event of deregulation.

The issues

[134] There is no dispute between the parties that:

- (a) Zespri's loyalty contracts and supply agreements are "contracts" containing "provisions" within the meaning of those expressions in s 27(1);
- (b) There is a current regulated grower/exporter (non-Australia) market for the export of kiwifruit otherwise than for consumption in Australia;
- (c) Zespri's loyalty contracts and the exclusivity provisions of the supply agreements have no actual or likely anti-competitive "effects" in the current regulated grower/exporter (non-Australia) market in which actual and potential competition is excluded by the export ban and Zespri's authorisation;

- (d) Zespri has a substantial degree of power in the current regulated grower/exporter (non-Australia) market;
- (e) If the Court decides to grant the injunction(s) sought by Turners & Growers, the terms of the injunction should preserve Zespri's entitlement to apply to the Commerce Commission for an authorisation of the loyalty contracts and the exclusivity provisions of the supply agreements under s 59A of the Commerce Act.

[135] The issues therefore are whether:

- (a) The loyalty contracts and the exclusivity provisions in the supply agreements had the "purpose" of "substantially lessening competition" in the current regulated grower/exporter (non-Australia) market;
- (b) The loyalty contracts and the exclusivity provisions in the supply agreements had the "purpose" or "effect" or "likely effect" of "substantially lessening competition" in a "deregulated" grower/exporter (non-Australia) market;
- (c) Zespri by entering into the loyalty contracts and the supply agreements has "taken advantage" of its admitted market power in the current regulated grower/exporter (non-Australia) market for a proscribed purpose in that market or in a "deregulated" grower/exporter (non-Australia) market; and
- (d) The exclusivity provisions in the supply agreements have the "likely effect" of "substantially lessening competition" in a deregulated post-harvest services market.

[136] We consider each of these issues in turn after summarising the submissions for the parties.

Submissions for Turners & Growers

[137] For Turners & Growers, Mr Walker submitted that:

- (a) The objective of the loyalty contracts and the exclusivity provisions in the supply agreements was to retain all or most of the supply of Class 1 kiwifruit on deregulation.
- (b) Zespri carefully tailored the quantum of its loyalty premiums to be material and therefore attractive to growers.
- (c) Zespri specifically designed the contracts to be a barrier to “partial exit” or “crop splitting” in the event of deregulation.
- (d) To the extent that maintaining the regulatory monopsony for as long as possible was a purpose of the loyalty contracts, that was a purpose of substantially lessening competition, by deterring competition, in the grower/exporter (non-Australia) market.
- (e) A primary purpose of the exclusivity agreements was to secure 100% of the supply or close thereto, for a period of years, in the event of deregulation.
- (f) It was enough for the Court to conclude that deregulation was sufficiently possible at the time that the exclusivity agreements were entered into that their provisions could objectively be construed as having the purpose of substantially lessening competition in the event of deregulation, ie it would not be irrational for them to have that purpose: cf *ANZCO v AFFCO*.
- (g) It was permissible to ascertain the objective purpose of the exclusivity agreements having regard to the prospect of there being a deregulated market.

- (h) The loyalty contracts have the likely effect of substantially lessening competition in the grower/exporter (non-Australia) market, whether that is defined as two markets sequential in time (pre-deregulation and post-deregulation) or as a single, continuous market which is liable to a future change in dynamic by reason of deregulation.
- (i) The exclusivity obligations in the supply agreements have the likely effect of substantially lessening competition in the post-harvest services market.
- (j) In entering into the exclusivity agreements Zespri, which has a substantial degree of market power in the current grower/exporter (non-Australia) market, was taking advantage of its market power for the purpose of restricting the entry of other persons into a deregulated market or preventing or deterring other persons from engaging in competitive conduct in a deregulated market.

Submissions for Zespri

[138] For Zespri, Mr Goddard submitted that:

- (a) The exclusivity provisions have no effect on competition for so long as the current regulatory regime remains in force. The concerns raised by Turners & Growers may never eventuate.
- (b) The exclusivity provisions have no effect on the ability of growers to grow and supply kiwifruit of any variety for sale in New Zealand or export to Australia.
- (c) The exclusivity provisions have no effect on the ability of growers to grow and supply kiwifruit of varieties other than Hayward and Hort 16A for export because this is restricted by the regulatory regime not by the exclusivity provisions.

- (d) The exclusivity provisions have no effect for the foreseeable future on the ability of growers to supply Hort 16A fruit to persons other than Zespri because this is restricted by the supply agreement and the licence agreement, which are not challenged in this proceeding (and could not be challenged under the Commerce Act, by virtue of ss 36(3) and 45). The same applies to fruit from other new Zespri cultivars.
- (e) The exclusivity provisions have no effect on a wide range of entry strategies available to competing exporters in the event of deregulation, including purchase of existing kiwifruit orchards and new planting of kiwifruit, and/or contracting to purchase kiwifruit from suppliers over a number of years to encourage them to purchase existing orchards.
- (f) The non-application of the exclusivity provisions to core entry strategies for competing exporters in the event of deregulation illustrates that this is not the purpose or effect of the exclusivity provisions. Rather, they are designed to support Zespri's commercial strategy. That strategy depends on ensuring the delivery of kiwifruit in the quantities and with the premium quality attributes demanded by overseas customers, and on investing in the market and industry information, expertise and relationships that make this possible. Scale is also important for Zespri's business model.
- (g) The purposes of achieving scale economies and preserving market share, however aggressively pursued or expressed, are consistent with competition. The purposes of the provisions (exclusive supply commitments and corresponding loyalty rebates) are to support a more profitable co-ordinated structure for premium product exports to foreign markets. It is legitimate for an exporter to include supply commitments and loyalty rebates for the purpose of supporting and developing a structure that is most likely to succeed internationally and maximises grower returns. Such provisions were also used prior

to the introduction of the single desk when some seven exporters competed with each other. Accordingly, even if deregulation was reasonably foreseeable as a likely outcome (which is denied), using such terms for competitive reasons covering a three year period would not breach s 27 of the Commerce Act.

- (h) Taking into account objective considerations there cannot be an anti-competitive purpose or likely effect under s 27 if the provisions are in fact incapable of having an anti-competitive effect while the single desk regulatory regime is in force, and there is no reason to think that deregulation is likely during the relevant period for competition analysis.
- (i) More generally, the exclusivity provisions cannot have the likely effect or purpose of substantially lessening competition in the market in which Zespri acquires kiwifruit, if they have the likely effect and purpose of increasing prices to growers and increasing output.

Contraventions in current regulated market?

[139] We do not accept the submissions for Turners & Growers that the loyalty contracts and the exclusivity provisions of the supply agreements had an anti-competitive purpose under s 27(1) or that Zespri took advantage of its market power for a proscribed purpose under s 36(2) in respect of the current regulated grower/exporter (non-Australia) market. Competition in the current market is prohibited by the export ban and Zespri's monopsony under the Regulations. Neither the loyalty contracts nor the exclusivity provisions of the supply agreements are able to have an anti-competitive or proscribed purpose in a market in which by law no actual or potential competition is permitted. In the absence of any permitted competition there can be no purpose of "substantially lessening competition" in the regulated market. The decision to prevent or permit competition in that market rests with the Government and not with Zespri. In the meantime Zespri is lawfully entitled to enter into contracts with growers for the purpose of sharing any benefits

from its monopsony and export strategy with them, even if it is motivated to do so by its wish to retain grower support and defer deregulation for as long as possible.

[140] Turners & Growers have therefore not established any contravention by Zespri of s 27(1) or s 36(2) in respect of its loyalty contracts or supply agreements in the current regulated market.

A “deregulated” market?

[141] As already noted, there is no dispute between the parties in this case that:

- (a) There is a current “grower/exporter (non-Australia) market” which encompasses the supply of kiwifruit by growers to Zespri, the single authorised exporter, which acquires the kiwifruit for export from New Zealand to countries other than Australia.
- (b) This current market is a regulated market in that by virtue of Government regulation Zespri is the single acquirer and exporter. No other person is lawfully entitled to acquire kiwifruit for export from New Zealand to countries other than Australia.
- (c) Turners & Growers’ claims under both ss 27(1) and 36(2) relating to the loyalty contracts and the exclusivity provisions in the supply agreements depend on establishing that the “market” should be defined as either:
 - (i) a single, continuous market which is liable to a future change in dynamic by reason of deregulation; or
 - (ii) two markets sequential in time (pre-deregulation and post-deregulation).
- (d) The question whether the relevant market(s) can be defined as claimed by Turners & Growers to include a “deregulated” dimension

is a novel question not previously considered in any New Zealand or Australian competition law case.

[142] For Turners & Growers, Mr Walker submitted that it was appropriate to take into account the prospect of deregulation in assessing “purpose” under ss 27 and 36 and “likely effect” under s 27 because:

- (a) Under s 27 a provision in a contract or arrangement, and under s 36 a person, could have the present purpose of substantially lessening competition now or in the future.
- (b) There is nothing in the wording of either s 27(1) or s 36(2) which requires that the purpose be to substantially lessen competition in a market, or state of affairs in a market: (i) which already exists; (ii) which is certain to exist; or even (iii) which is “likely” to exist. The latter would elide “purpose” and “likely effect”.
- (c) Whether there is a 100% chance, a 50% chance, a 10% chance or even a 3% chance that a market or state of affairs will come about, a provision or a person could objectively have the purpose of substantially lessening competition in that market or state of affairs. A firm could objectively be taken to be entering into a contract in case a state of affairs comes about which has only a 3% probability. There is an analogy with a firm insuring against catastrophe.
- (d) The purpose of the provision or the person has to be assessed at the time that the contract or arrangement is entered into or the understanding is reached or the conduct which constitutes the taking advantage of the market power occurs: cf s 2(3) of the Act, which relates to “effect” and “likely effect”, and *ANZCO v AFFCO* at [262].
- (e) The court is entitled to have regard to possible changes in the law when applying ss 27 and 36. There is no constitutional objection to the court doing so. The decisions for the undoubtedly correct

proposition that courts determine the law as it currently exists, not as it may exist in future, may be distinguished: cf *Willow Wren Canal Carrying Co Ltd v British Transport Commission*, *Unitec Institute of Technology v Attorney-General* and *Genesis Power Ltd v Environment Court*.²⁹ It is not necessary for the changes to the law to have been enacted already: cf *New Zealand Milk Corporation v McDonald* and *New Zealand Bus Co Ltd v Commerce Commission*.³⁰ There is no express or implied prohibition in the Commerce Act against taking into account the possibility of future changes in the law in assessing “purpose” and “likely effect”. Competition laws in other jurisdictions accept that courts should take into account likely future law changes in their competition analysis: European Commission Notice “Guidelines on the Effect on Trade Concept contained in Articles 81 and 82 of the Treaty” and Areeda & Ors, *Antitrust Law*.³¹

- (f) As a matter of policy, it would be strange if ss 27 and 36 left parties free to enter into contracts or to take advantage of market power which had anti-competitive purposes upon deregulation right up until the point of deregulation. It would be equally strange to pick some earlier point in time such as the introduction of a Bill or drafting of regulations or some formal or informal announcement of policy by the Government. That would be an arbitrary constraint on abuse of market power.
- (g) The various steps taken by Zespri, especially the loyalty contracts, were designed to “buy” grower support for the purpose of delaying deregulation in order to retain Zespri’s monopsony and appear to-date to have been successful in maintaining grower support for the regulatory regime.

²⁹ *Willow Wren Canal Carrying Co Ltd v British Transport Commission* [1956] 1WLR 213 (EWHC); *Unitec Institute of Technology v Attorney-General* [2006] 1 NZLR 65 (HC); and *Genesis Power Ltd v Environment Court* [2003] NZAR 371 (HC).

³⁰ *New Zealand Milk Corporation v McDonald* [1993] 2 NZLR 543 (CA); and *New Zealand Bus Co Ltd v Commerce Commission* (2002) 10 TCLR 377 (HC).

³¹ European Commission Notice “Guidelines on the Effect on Trade Concept contained in Articles 81 and 82 of the Treaty” (2004/C 101/07) and Phillip E Areeda, Herbert Hovenkamp and John L Solow, *Antitrust Law* (3rd ed, Aspen Publishers, New York, 2006) at 103.

- (h) While there are uncertainties as to whether and when deregulation will occur and what form it will take, there is at the very least a real and substantial risk, or real chance, of deregulation. Zespri's own evidence is that deregulation is very likely: when rather than if. Logically, it can only be a matter of time before political or legal challenges in other jurisdictions bring an end to Zespri's unique position.
- (i) Deregulation could occur within a year or two or not for another 10 years. There is no presumption in the Act that anti-competitive effect can only be assessed within a two to three year timeframe: cf *Commerce Commission v Woolworths Ltd, Re Carter Holt Harvey – Elders Resources NZFP Ltd* and *Commerce Commission Decision No. 408 Re Shell Exploration Company BV Fletcher Challenge Energy*.³²
- (j) Uncertainties as to the form of deregulation, that is its substance, and the possibilities of a lead-in period and specific regulations addressing the loyalty contracts, do not prevent the court from taking into account the prospect of deregulation. There can be little doubt that deregulation will open Hayward exports to at least one other player, and more likely several: cf *New Zealand Bus Ltd v Commerce Commission*.³³ The exclusivity contracts would block any new exporters' supply of New Zealand-grown Hayward whether there was complete deregulation, the exercise of the power in s 26(1)(d) of the Kiwifruit Industry Restructuring Act 1999 to permit one or more persons to export kiwifruit, or the opening of exports to specific markets, either generally or by permit. There may or may not be a lead-in period and it would only make a difference if it were lengthy and a significant number of growers used the opportunity to give notice under clause 3 of the loyalty contracts which, on the expert

³² *Commerce Commission v Woolworths Ltd* (2008) NZBLC 102, 128 (HC) at [130]-[131]; *Re Carter Holt Harvey – Elders Resources NZFP Ltd* (1990), 2 NZBLC (Com) 104, 509 at [7.3.5]; and *Commerce Commission Decision No. 408 Re Shell Exploration Company BV Fletcher Challenge Energy*, 12 October 2000, at [50]-[54].

³³ *New Zealand Bus Ltd v Commerce Commission* at [51]-[53].

evidence of the economists, was unlikely. The argument that the exclusivity contracts may be addressed by the Government is an argument that Zespri must be free to enter into anti-competitive agreements.

[143] In considering the submissions for Turners & Growers, we recognise at the outset that the prohibitions on anti-competitive conduct contained in s 27(1) and s 36(2) depend on identification and description of “a market” in that context: cf *ANZCO v AFFCO*.³⁴ Unless anti-competitive conduct “in a market” is established, there will be no contravention of the provisions and no basis for granting the relief sought by Turners & Growers.

[144] As already noted, for the purposes of s 27(1) and s 36(2), the term “market” is defined in s 3(1A) as:

a reference to a market in New Zealand for goods or services as well as other goods or services that, as a matter of fact and commercial common sense, are substitutable for them.

[145] We note the following features of the text of this definition :

- (a) It is a reference to “a market in New Zealand”.
- (b) It has two limbs:
 - (i) “goods or services”, that is the principal goods or services; as well as
 - (ii) “other goods or services” that “are” substitutable for the principal goods or services.
- (c) At the same time the definition requires “substitutability” to be applied as “a matter of fact and commercial common sense”.

³⁴ *ANZCO v AFFCO* at [276].

[146] The definition has been considered and applied in numerous decisions under the Commerce Act. For present purposes we note the following well-established points:

- (a) The reference to “substitutability” was added by the Commerce Amendment Act 1990 to make “economic substitutability explicit”.³⁵
- (b) The reference to “fact and commercial common sense” was retained from the original definition to affirm.³⁶

the traditional New Zealand emphasis upon the need for a commercially realistic factual base.

- (c) The need for a factual and commercially realistic approach reflects the scheme of the Commerce Act, particularly the purpose provision with its reference to the promotion of “competition in markets”, the definition of “competition” as “workable or effective” and the provisions requiring a competition analysis in a “market”.³⁷
- (d) When adopting a factual and commercially realistic approach to the definition of a “market”, it is necessary to recognise the different dimensions of product, geography, functional level and time that exist and require analysis.³⁸ It is the temporal dimension which is of particular relevance in the present case.
- (e) In economic terms a market may be described as:³⁹

the field of actual and potential transactions between buyers and sellers amongst whom there can be strong substitution, at least in the long run, if given a sufficient price incentive.

³⁵ *Telecom Corporation of New Zealand Ltd v Commerce Commission* (1991) 4 TCLR 473 (HC) at 499; and *Brambles New Zealand Ltd v Commerce Commission* (2003) 10 TCLR 868 (HC) at [76]-[77].

³⁶ *Telecom Corporation of New Zealand Ltd v Commerce Commission* (HC) at 499; and *Brambles New Zealand Ltd v Commerce Commission* at [81]-[82].

³⁷ *Re Queensland Co-operative Milling Association Ltd* (QCMA) (1976) ATPR 40-012 at 17,246; *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352 (CA) at 358; *Port Nelson Ltd v Commerce Commission* at 560-561; and *ANZCO v AFFCO* at [243].

³⁸ *Tru Tone Ltd v Festival Records Retail Marketing Ltd* at 359; Thomas Gault (ed) *Gault on Commercial Law* (online looseleaf ed, Brookers) at [CA3.05]; and Matt Sumpter, *New Zealand Competition Law and Policy* (CCH New Zealand Ltd, Wellington, 2010) at [403].

³⁹ *Re Queensland Co-operative Milling Association Ltd* at 17,247.

The reference to “the long run” in this description was explained in *Telecom Corporation of New Zealand Ltd v Commerce Commission*.⁴⁰

We include within the market those sources of supply that come about from deploying *existing production and distribution capacity* but stop short of including supplies arising from entirely new entry. Thus “the long run” in market definition does not refer to any particular length of calendar time but to *the operational time* required for organising and implementing a redeployment of *existing capacity* in response to profit incentives.

(emphasis added)

The emphasised references to “existing capacity” reflect the requirement of the definition of “market” in s 3(1A) that the “other goods or services” in the second limb “are” substitutable for the principal goods or services in the first limb.

[147] The classic description⁴¹ of the interrelationship between the competitive process and market structure is found in *QCMA* at 17,246:

Competition is a process rather than a situation. Nevertheless, whether firms compete is very much a matter of the structure of the markets in which they operate. The elements of market structure which we would stress as needing to be scanned in any case are these:

- (1) the number and size distribution of independent sellers, especially the degree of market concentration;
- (2) the height of barriers to entry, that is the ease with which new firms may enter and secure a viable market;
- (3) the extent to which the products of the industry are characterized by extreme product differentiation and sales promotion;
- (4) the character of “vertical relationships” with customers and with suppliers and the extent of vertical integration; and
- (5) the nature of any formal, stable and fundamental arrangements between firms which restrict their ability to function as independent entities.

Of all these elements of market structure, no doubt the most important is (2), the condition of entry. For it is the ease with which firms may enter which establishes the possibilities of market concentration over time, and it is the

⁴⁰ *Telecom Corporation of New Zealand Ltd v Commerce Commission* at 503.

⁴¹ *Port Nelson Ltd v Commerce Commission* at 564-565; and *ANZCO v AFFCO* at [243].

threat of the entry of a new firm or a new plant into a market which operates as the ultimate regulator of competitive conduct.

[148] In the present case there is no dispute that the principal “goods” are kiwifruit; different varieties and classes of kiwifruit are “substitutable” for one another; the geographic dimension is New Zealand; and the functional level is wholesale, being the acquisition of kiwifruit by Zespri for export to countries other than Australia. No question of identifying other “substitutable” goods arose.

[149] There is also no dispute that regulation of the grower/exporter (non-Australia) market has created an insurmountable legal barrier to entry by other persons wishing to acquire kiwifruit for export to countries other than Australia. In this regulated market there is no substitute for Zespri’s functional activity and therefore no actual competition between Zespri and any other acquirers of kiwifruit for export to countries other than Australia. Nor is there any scope for new entry and therefore no scope for potential competition.

[150] Consequently, there is no dispute as to either the definition of the current regulated market or the competitive circumstances within it.

[151] The crucial issue is therefore the temporal dimension of the market. Does this dimension require the Court in this case to consider and accept a possible “deregulated” market?

[152] The temporal dimension of a market recognises that, when adopting the requisite factual and commercially realistic approach to the definition question, the focus should be on “a moving picture of continuing commercial activity” rather than on a snapshot of “short run phenomena”: *Tru Tone Ltd v Festival Records Retail Marketing Ltd*.⁴² This may require the Court to take into account the potential for substitutable goods or services or changes in market structure such as:

⁴² At 360; *Gault on Commercial Law* at [CA3.09]; and Sumpter *New Zealand Competition Law and Policy* at 76-77.

- (a) Technological changes: cf *Telecom Corporation of New Zealand v Commerce Commission*;⁴³
- (b) The predictable depletion of a source of raw materials: cf *Commerce Commission Decision No. 408 Re Shell Exploration Company BV – Fletcher Challenge Energy*;
- (c) The expiry of a patent or a significant supply contract or licence: cf *Sumpter New Zealand Competition Law and Policy* at 76;
- (d) A new, potentially significant, source of competition: cf *Commerce Commission v Woolworths*;⁴⁴
- (e) The advent of deregulation: cf *Re Dunlop New Zealand Ltd*⁴⁵ and *New Zealand Milk Corporation Ltd v McDonald*.

[153] In this case we are being asked to consider the advent of deregulation and consequential changes in market structure and competitive activity.

[154] Our starting point is to note that under the current Regulations Zespri's monopsonist status is to continue indefinitely as its export authorisation has no expiry date or termination events: regs 5(a) and (6)(1)(h). Unless and until the market is deregulated, there is therefore no possibility of actual or potential competition in the current grower/exporter (non-Australia) market. Consequently, as already noted, no conduct of Zespri's:

- (a) has the purpose, or has or is likely to have the effect, of substantially lessening competition in that market in contravention of s 27(1); or
- (b) has the purpose of restricting the entry of a person or preventing or deterring a person from engaging in competitive conduct in that market in contravention of s 36(2)(a) or (b).

⁴³ *Telecom Corporation of New Zealand v Commerce Commission* at 503-504.

⁴⁴ *Commerce Commission v Woolworths* (2008) 12 TCR 194 (CA).

⁴⁵ *Re Dunlop New Zealand Ltd* (1987) 1 NZBLC (Com) 104,190.

[155] The stark issue is whether for the purpose of establishing a contravention by Zespri of s 27(1) and/or s 36(2) Turners & Growers have adduced evidence to prove on the balance of probabilities that Zespri's alleged anti-competitive conduct occurred in a "deregulated" market in which, with the removal of the existing legal barrier to entry, there would be scope for potential competition from other acquirers of kiwifruit for export to countries other than Australia.

[156] Deregulation of the market in some form or other is of course possible. The Kiwifruit Industry Restructuring Act 1999 itself empowers the making of regulations providing for KNZ to permit "other persons" to export kiwifruit: s 26(1)(d). The Regulations also recognise the possibility of revocation of the ban (reg 6(1)(i)) and, in terms of s 26(1) of the Restructuring Act, they may be amended "from time to time", or repealed along with the Restructuring Act itself on whatever basis the Government of the day decides is appropriate. As recognised in the submissions for Turners & Growers, the legislative or regulatory changes implementing a Government policy decision to deregulate the market might simply revoke the export ban and Zespri's authorisation without more or might introduce deregulation over time or only in part. The form of any deregulation might or might not address the existing loyalty contracts and their exclusivity provisions and might or might not give Zespri time to apply to the Commission for authorisation of the contracts under s 59A of the Commerce Act. In that event the Government might or might not wish to transmit a statement of its economic policy to the Commission under s 26 of the Commerce Act. The timing, nature and extent of any deregulation would be for the Government to determine.

[157] Mr Walker was able to point to evidence that showed that over the last 10 years Zespri anticipated and planned for the advent of deregulation. Zespri's internal documents, including Board papers and minutes, referred frequently to the threat or risks of deregulation faced by the kiwifruit industry. [

] From Zespri's perspective, there was some relief from the threat of an adverse WTO agreement when at a Geneva Ministerial meeting in 2008 a *de minimis* exemption to

the elimination of export monopoly powers by single trading enterprises was included to cover Zespri's situation (though Zespri was not specifically named). Zespri Board papers, however, continued to address the prospect of deregulation which was still seen as a matter of "when" not "if". [

] Both Mr Greenlees and Mr Jager accepted that deregulation was probably inevitable, but also believed that, with grower support, the current regulation could be retained for another 10 years.

[158] Mr Walker also pointed out that Zespri sought to maintain grower support for the single point of entry by spending some \$25 million a year in loyalty premiums and incurring the costs of entering into and administering 3,260 loyalty contracts with growers.

[159] Turners & Growers have, however, adduced no evidence to establish that the Government has made a decision to deregulate the market now or at any particular time in the future. Nor has Turners & Growers adduced any evidence to show the form any deregulation that might occur would take. While some form of deregulation is undoubtedly a policy option for the Government, particularly as an outcome of trade negotiations, there was no evidence that the Government was contemplating the removal of Zespri's monopsonist status, which is currently to continue indefinitely, either now or in the foreseeable future.

[160] On the other hand, Zespri has pointed to:

- (a) The fact that the market has remained regulated since 2000;
- (b) The absence of any evidence of any immediate international pressures for deregulation; and
- (c) Indications from the Government that as long as grower support for the Zespri's monopsony remains strong the market will remain regulated.

[161] In these circumstances Turners & Growers have invited the Court to accept that, notwithstanding uncertainties as to whether, when and how deregulation may occur, there is at the very least a real and substantial risk, or real chance, of deregulation sometime in the foreseeable future. It was urged upon us that even a 3% chance of deregulation in the next 10 to 20 years should be sufficient for the Court to accept and consider a deregulated market.

[162] For the following reasons we do not accept the submission for Turners & Growers.

[163] First, it is not for the Court to assume the existence of a theoretical “deregulated” market at some indeterminate future time. We are required to take a factual and commercially realistic approach to market definition which does not involve making theoretical assumptions about changes in market conditions and market participation which cannot occur without Government intervention.

[164] Actual and potential competition for the acquisition of kiwifruit can only be initiated by a change in Government policy and the removal of the legal barrier to competition. The task of identifying and defining markets in which to assess “workable or effective” competition under s 27(1) and s 36(2) is unrealistic without any evidence of actual or potential competition. In the absence of such evidence the task of analysing the purpose and effect of contracts and arrangements with and without the alleged anti-competitive provisions would be difficult if not impossible.

[165] A theoretical deregulated market is to be distinguished from the requirement to define an appropriate “workably competitive hypothetical market” for the purpose of determining whether a person has taken advantage of a substantial degree of market power under s 36(2) in accordance with the analytical approach the Supreme Court in *Commerce Commission v Telecom Corporation of New Zealand Ltd*. While the latter may involve unrealistic scenarios, which are permissible in that context, the former should not, especially as this may lead to a finding of contravention, and remedies in the form of an injunction and damages. There is no basis for the Court to grant the injunction sought by Turners & Growers when there is no evidence that a deregulated market, which is a prerequisite for the alleged contraventions of s 27(1)

and s 36(2), will come into being at any determinable point or in any determinable form.

[166] Second, it is not for the Court to express a view or to speculate on whether the market will be deregulated and, if so, when. Nor is it for the Court to express a view or to speculate on the form a deregulated market might take. These are policy questions for the Government of the day. It was the Government which decided to regulate the export of kiwifruit by imposing a legal barrier to entry to the market which prevents any competition on the acquisition side of that market. It is for the Government to decide whether for any reason, including its view of the consequences of its decision to regulate the market, steps should be taken to deregulate the market and permit competition. As already noted, it is not for the Court to express any views on these policy questions.⁴⁶

[167] Third, the uncertainties as to whether, when and how the market might be deregulated distinguish this case from cases where the prospect of deregulation has been able to be taken into account:

- (a) *Re Dunlop New Zealand*⁴⁷ where the Commerce Commission took into account the fact that the existing regulated import regime was already in the process of deregulation.
- (b) *New Zealand Milk Corporation Ltd v McDonald*⁴⁸ where the Court of Appeal was prepared to consider that proscribed conduct by the New Zealand Milk Corporation Ltd before 31 March 1993 - when the statutory monopoly held by the Corporation under the Milk Act 1988 expired and any exclusive zones for the delivery of milk previously granted by the Corporation to its contractors were also deemed to have been cancelled - was in breach of s 36 of the Commerce Act.

⁴⁶ See [9] above.

⁴⁷ *Re Dunlop New Zealand Ltd* (1987) 1 NZBLC (Com) 104,191 at [18] and [32](a) and (b).

⁴⁸ *New Zealand Milk Corporation Ltd v McDonald* [1993] 2 NZLR 543 (CA).

- (c) *New Zealand Bus Co Ltd v Commerce Commission*⁴⁹ where the High Court held that the Commerce Commission had incorrectly formulated the test under s 68(2) of the Commerce Act for determining whether a business acquisition was “unlikely to be proceeded with” and consequently had erred in failing to take into account as a relevant consideration the views of the relevant Ministers and their senior advisors as to the Government’s willingness to promote legislative change to enable the proposed acquisition to proceed. Although Mr Goddard submitted that the High Court’s reference at [51]-[53] to possible legislative change was inconsistent with the principle based on the decisions in *Willow Wren Canal Carrying Co Ltd v British Transport Commission*, *Unitec Institute of Technology v Attorney-General* and *Genesis Power Ltd v Environment Court* that courts apply the law as it currently exists, not as it may exist in future, we agree with Mr Walker that, in the context of assessing whether a legal barrier to entry into a market may be removed so as to permit competition, a court would be entitled to accept evidence as to the Government’s intentions as was held in the *New Zealand Bus Co Ltd* case. In the present case, however, there is no evidence of that nature.

[168] Fourth, the absence of any evidence as to if and when the current regulated market might be deregulated means that this case may also be distinguished from cases where it has been possible to predict a future break point or influencing event that will significantly alter the nature of competition one way or the other at that time:

- (a) *Commerce Commission Decision 408: Re Shell Exploration Company BV – Fletcher Challenge Energy*⁵⁰ where, because it was anticipated that the Maui gas field would be depleted by 2009, the competition

⁴⁹ *New Zealand Bus Co Ltd v Commerce Commission* (2002) 10 TCLR 377.

⁵⁰ *Commerce Commission Decision 408: Re Shell Exploration Company BV – Fletcher Challenge Energy* at [50]-[54].

analysis was separated into two distinct time periods, pre-2009 and post-2009 discrete gas production markets.

- (b) *Commerce Commission v Woolworths Ltd*⁵¹ where, because on the evidence it was found that there was a real and substantial prospect or chance of The Warehouse rolling out more Extra stores, in competition with the incumbent supermarkets, the Court of Appeal held that the Commission was right to reach the view that it was not satisfied that the acquisition of The Warehouse by Woolworths or Foodstuffs was unlikely to substantially lessen competition.

[169] Fifth, the competition law materials from other jurisdictions referred to by Mr Walker do not suggest that it is appropriate for a court to express a view or to speculate about a theoretical market in the absence of evidence about the possibility of a Government decision to deregulate a regulated market in the foreseeable future:

- (a) The European Commission Notice “Guidelines on the Effect on Trade Concept contained in Articles 81 and 82 of the Treaty” state:

In this respect, it is relevant to consider the impact of liberalisation matters adopted by the Community or by the Member State in question and other foreseeable matters aiming at eliminating legal barriers to trade.

- (b) The leading US text, Areeda & Ors, *Antitrust Law*, states:

..... laws or regulations obstructing independent entry may be changed. In the absence of good reason to believe that change is probable, however, it cannot be said that independent entry is probable.

[170] Consequently, in the absence of any evidence to establish that the Government has made or is likely to make a decision to deregulate the market now or at any particular time in the future, Turners & Growers have not established on the balance of probabilities a “deregulated” grower/exporter (non-Australia) market. There is not sufficient evidence to establish that their hypothesis as to the prospect of

⁵¹ *Commerce Commission v Woolworths Ltd* (CA) at [142], [193] and [206].

deregulation is more likely than not to be true: cf *Commerce Commission v Woolworths* at [97].

[171] Once we conclude that a “deregulated market” has not been established in this case, the submission for Turners & Growers - based on the judgments in *ANZCO v AFFCO* of William Young J (at [152]-[154] and Anderson P (at [302])), that a provision can have a purpose of substantially lessening competition in a market even if it does not have that effect or is not likely to have that effect - ceases to have any relevance. As the judgments of the majority in *ANZCO v AFFCO* make clear (Glazebrook J at [276]-[286] and Anderson P at [296] and [301]-[307]), the issue whether a provision has the purpose of “substantially lessening competition in a market” depends on the identification of the relevant market. In *ANZCO* there was no dispute that the relevant market was the procurement market for beef in the North Island and not a market geographically restricted to the locality of the particular meat works. On the basis of the identified agreed relevant market, the majority found on the evidence in that case that, notwithstanding AFFCO’s intentions in respect of the locality of the particular meat works, AFFCO had no purpose of “substantially lessening competition” in the procurement market for beef in the North Island. In the present case where the relevant market is a regulated market, with actual and potential competition excluded, Zespri could have no purpose of substantially lessening competition in that market as claimed by Turners & Growers. Nor, for the reasons we have given, are Turners & Growers able to establish anti-competitive purpose in relation to a theoretical “deregulated” market.

[172] The conclusion we have reached also provides the answer to the submission for Turners & Growers that the loyalty contracts were anti-competitive because they were designed to maintain grower support and delay deregulation. The contracts simply cannot have an anti-competitive purpose or effect, actual or likely, in the current grower/exporter (non-Australia) market because with Zespri’s monopsony there is no actual or potential competition on the acquisition side of that market. Nor can the contracts have an anti-competitive purpose or effect in a future deregulated market when Turners & Growers have not established such a market. A future “deregulated” market constructed on a theoretical basis does not provide a proper framework for the competition analysis required by s 27(1) and s 36(2). As set out in

QCMA, that analysis requires evidence about the number and size distribution of independent kiwifruit exporters, the degree of market concentration, the existence and height of any barriers to entry at the relevant time, the character of vertical relationships and the extent of vertical integration and the nature of any arrangements between firms at the relevant time. If there are any concerns that Zespri has acted inappropriately in strengthening its power in the current regulated market, then those concerns may be addressed by KNZ or the Government, if it wishes to do so, in the event of a decision to deregulate.

[173] Our conclusion means that the claims by Turners & Growers which depended on establishing a separate “deregulated” market or “deregulation dimension” to a market must fail. The claims in this category are:

- (a) the claim alleging contravention of s 27(1) in respect of the loyalty contracts and the exclusivity provisions in the supply agreements to the extent that they are based on a substantial lessening of competition in a “deregulated”
 - (i) grower/exporter (non-Australia) market;
 - (ii) grower/exporter (non-Australia) Hayward market; or
 - (iii) a grower/exporter (non-Australia) Hort 16A market, for the period after the New Zealand plant variety rights come to an end in 2018; and
- (b) the claim alleging contravention of s 36(2) in respect of the loyalty contracts and the exclusivity provisions in the supply agreements to the extent that they are based on establishing a proscribed purpose in a “deregulated” grower/exporter (non-Australia) market; and
- (c) the claim alleging contravention of s 36(2) in respect of the new kiwifruit cultivar policy to the extent it is based on establishing a

proscribed purpose in a “deregulated” grower/exporter (non-Australia) market.

[174] On this basis we now turn to consider the remaining claims:

- (a) the claim alleging contravention of s 27(1) in respect of the exclusivity provisions in the supply agreements based on a post-harvest services market;
- (b) the claim alleging contravention of s 36(2) in respect of the loyalty contracts and the exclusivity provisions in the supply agreements based on a post-harvest services market;
- (c) the claim alleging contravention of s 27(1) and s 36(2) in respect of the 2009 Australia service level agreements based on a market for the acquisition and supply of kiwifruit for export to Australia;
- (d) the claim alleging contravention of s 36(2) in respect of the new kiwifruit cultivar policy based on a kiwifruit cultivar licensing market.

A relevant post-harvest services market?

[175] Turners & Growers pleaded the existence of a market between kiwifruit growers and post-harvest operators for the provision of post-harvest services, including picking, processing, packing and cool storage, in respect of kiwifruit, but did not plead any alleged contravention of s 27(1) or s 36(2) in respect of that market.

[176] Zespri in its pleadings denied the existence of this market and claimed that the market in which post-harvest services were supplied was not confined to kiwifruit and extended to the provision of the alleged services and other services to customers including, but not limited to, kiwifruit growers and suppliers.

[177] While reference was made in passing to the “post-harvest services market” in the opening and closing submissions for Turners & Growers, no detailed

submissions were advanced. Following the hearing, counsel for Turners & Growers confirmed by memorandum dated 21 June 2011 that reliance was still placed on this market in the context of the alleged contraventions of s 27(1) and s 36(2) in respect of the exclusivity provisions in the supply agreements.

[178] In the absence of adequate pleadings or detailed submissions from the parties relating to the “post-harvest services market”, we sought further clarification from the parties as to why we should address this aspect of the case. By joint memorandum dated 1 July 2011, counsel requested us to approach the issue on the basis that:

- (a) Turners & Growers’ position was that the exclusivity obligations in the supply agreements, considered together with the grower loyalty contracts have the purpose and likely effect of lessening competition in the “post-harvest services market”;
- (b) Zespri’s position was that it was necessary for the Court to identify the specific provision(s) (if any) in the supply agreements, when considered with the grower loyalty contracts, that gave rise to a competition concern and confine any relief to those provisions.

[179] Reference was made in the joint memorandum to the relevant economic evidence given by the independent experts relating to the “post-harvest services market”. No mention was made in the joint memorandum of Turners & Growers’ claim under s 36(2).

[180] We have considered the evidence of the economists to which we were referred, particularly the evidence of Mr Mellsop for Turners & Growers. His evidence related to a “post-deregulation” post-harvest services market and not to the current regulated post-harvest services market. For the reasons which we have given in the previous section of our judgment for concluding that Turners & Growers did not establish on the balance of probabilities a “deregulated” grower/exporter (non-Australia) market, we reach the same conclusion in respect of the post-harvest

services market. Turners & Growers' claims which depended on establishing a "deregulated" post-harvest services market must therefore also fail.

The 2009 Australia service level agreements

Factual background

[181] The factual background leading to the 2009 Australia service level agreements is largely undisputed. The parties provided the Court with an agreed chronology of relevant events which is the basis for the following summary.

[182] By the last quarter of 2008 it was apparent to the kiwifruit industry worldwide that as a result of the global recession, with anticipated reduced demand and lower fruit prices, coupled with a dramatic increase in Zespri Green production, a significant surplus of kiwifruit, particularly in the larger sizes was expected for the 2009/2010 season. The surplus was initially projected to be an excess of 4 to 7 million tray equivalents.

[183] To address this expected excess supply problem and to avoid flooding the Australia market with Class 2 kiwifruit with consequent reduced returns, Zespri initially recommended a change of grade standards for exports to Australia from Class 2 to Class 1. The recommendation, which was made to the Horticulture Export Authority, involved changing the grade standards in the Authority's export marketing strategy, which required the approval of the New Zealand Kiwifruit Product Group to Australia Inc (KPG), a recognised product group under the HEA Act covering export of kiwifruit to Australia.

[184] KPG comprises two grower representatives from New Zealand Kiwifruit Growers Inc (NZKGI), two representatives from the post-harvest sector and three exporter representatives from Kiwifruit Exporters to Australia (KETA).

[185] Zespri believed that the Australia market would support Class 1 returns, which could sell for A\$20 or more a 10 kg box whereas it was estimated Class 2 on average sold for A\$15 a box.

[186] In the period from December 2008 until 24 February 2009 the surplus supply issue and Zespri's recommendation were referred to and considered by the Industry Advisory Council (the IAC) and other industry groups, including supplier and post-harvest operator representatives, growers and NZKGI, which also made submissions to the KPG. Zespri also wrote formally to KPG on 12 January 2009 requesting a change in the Horticulture Export Authority's grade standard for Australia from Class 2 to Class 1.

[187] After a period of consultation with industry stakeholders, the projected excess supply situation and Zespri's proposal were discussed at an IAC meeting on 20 February 2009. Then on 24 February 2009 KETA members voted by a majority against the proposal to change grade standards. That vote effectively killed the proposed change as KETA representatives on the KPG have the ability to veto such proposals. Once that occurred, it was clear to the industry that there was no question of there being any prohibition on the export of Class 2 kiwifruit to Australia in the 2009 season.

[188] Also on 24 February 2009 Mr Tony Hawken, the Chief Executive Officer of Eastpack Ltd, a post-harvest operator, raised with Mr Jager the idea of a commercial solution to achieve a shift to Class 1 kiwifruit in the Australia market for the 2009/2010 season, rather than achieving that result through the HEA. The commercial solution, as it was developed, ultimately involved the following key points which Zespri conveyed to suppliers by way of an email dated 5 March 2009:

- Suppliers would agree to not pack any Class 2 fruit
- This means that a comparable volume of Class 1 would be sold in Australia, which negates the need to crop manage fruit at this point
- Agreement of 90% of suppliers by volume is required to implement
- ZESPRI would pay suppliers 30c/tray for Class 2 not packed (calculated at 3.5 million trays pro-rated by supplier across the Class 1 crop estimate)
- ZESPRI would make Class 1 available from the Zespri pool to post harvest/exporters for sale in Australia. The volume available would not be prorated across suppliers, ie, it would be available to all exporters based upon a programme, and would include a volume of small fruit (say 500k). Obviously each exporter would have a preferred supplier partner. These Class 1 sales would be made via the

current Australian exporter structure and would be with their existing brands and labels.

- The price would be set at between \$12-\$15NZ FOB (targeting \$17AU-\$20AU/10kg at wholesale). This gives an OGR of \$0.55-\$1.70 per tray based on a sales programme from w25-w44 after time costs.
- Each supplier would pay a significant bond as an undertaking that they would dump their Class 2. The fruit would be audited as well to ensure that the Class 2 fruit was not available for sale.
- The fruit sold to Australia may be pre-cleared.
- There would be an extra crop estimate by supplier by KPIN [ie by orchard plot] next week. This would be the basis for Period 1 orders, Period 2 movement and Class 2 compensation.
- ZESPRI would not invoke any crop management processes at this point in time, unless the crop estimate showed a significant increase.

[189] Zespri advised suppliers in the email that financial analysis had been conducted which showed that selling Class 1 to Australia was financially better to growers than crop managing the fruit, even with the reduction in returns from Class 2. Zespri also advised suppliers that, if the proposal were not accepted, it would continue with its crop management plans (of Class 1) and Class 2 would be sold, as normal, to Australia.

[190] The question of “crop management” was addressed in Zespri’s 2009 supply agreement (Schedule 6) in the following terms:

An industry generic SLA [service level agreement] for the purposes of crop management may be developed and recommended by the ISG [the Industry Supply Group] for approval. If the ISG adopts such an SLA, it will be applicable to the Contractor from the time of adoption by the ISG for the remainder of the Season or such shorter time as may be stipulated by the ISG, whether or not the Contractor executes the SLA.

The contractor named in the supply agreement would be either the supply entity (for option A growers) or the grower (option B). In any instance crop management procedures might affect both the supply entity - in that fruit delivered was not packed for export for Australia - and the growers, in that fruit on the vine was not harvested. We do not see any need to distinguish between these different types of crop management and so refer to both growers and suppliers interchangeably for the purposes of the service level agreements.

[191] In the period 6 to 10 March 2009 Zespri received feedback on the commercial proposal. Many of the initial responses from suppliers and post-harvest operators were positive, while others were cautious and raised a number of issues and queries for Zespri. Suppliers representing 6% of 2008 volumes were against the proposal at this stage.

[192] By 13 March 2009 suppliers representing 91% of 2008 volumes to Australia had indicated their support, although the support from two was conditional.

[193] Following the responses from suppliers and post-harvest operators, Zespri circulated a revised proposal which took into account some of the issues that had been raised. Ms Gardiner said that the main changes were:

- (a) To restrict the commercial agreement to the larger sized kiwifruit (sizes 18 to 33), so the smaller sizes 36 to 42 Class 2 could still be exported. Very small fruit (size 46) of both classes could also be exported to Australia;
- (b) A change in the formula for determining compensation for Class 2 trays not packed for export to Australia; and
- (c) The price at which Zespri released Class 1 fruit.

[194] The Zespri Board met on 17 March 2009. After receiving and considering management reports on the commercial proposal and crop management, the Board resolved:

- That the ZESPRI executive is authorised to proceed with a commercial arrangement that enables Australia to be a predominantly Class 1 market for ZESPRI GREEN.
- That a volume of 3 million ZESPRI GREEN Class 1 trays are crop managed, 1 million on the vine and 2 million at packing, subject to Australia remaining a Class 2 market and an updated crop estimate.
- That a volume of 150,000 ZESPRI GREEN ORGANIC Class 1 trays are crop managed at packing.
- Additional costs of crop management, being the assessment, coordination and audit programme are authorised.

[195] Following the Zespri Board meeting, Zespri circulated to members of the Industry Supply Group (ISG), a subcommittee of the IAC, a discussion paper relating to the crop management of Class 1 Green kiwifruit and the draft service level agreement.

[196] On 19 March 2009 the ISG met to discuss the crop management proposals and draft service level agreements. The ISG agreed on most points, but reached an impasse on the issues of grower compensation and post-harvest margins on packing and coolstorage, which were then referred for discussion at the next IAC meeting.

[197] On 20 March 2009 there was an IAC meeting, attended by representatives of Zespri, NZKGI and suppliers, about the commercial proposal for the export of Class 1 to Australia. As the minutes of the meeting record and the evidence of Ms Sally Gardiner, Zespri's General Manager – Supply Chain confirmed, in the course of discussing the Australia supply proposal, Ms Gardiner presented Zespri's proposal and confirmed that:

- (a) Zespri would sell approximately 100,000 tray equivalents into its Australia programme, and this was not part of the deal for the Australia agreement proposal;
- (b) there would be no volume restrictions for supply of Class 1 into Australia; and
- (c) size 46s would be treated the same as Class 2.

[198] After further discussion, a resolution relating to Zespri's "Australia Recommendation" was passed with all present in favour, conditional on the terms being recorded in an Australia service level agreement which all suppliers except some 6 to 8% [], would be expected to sign. The resolution, recorded in the minutes of the IAC meeting in short form was, as explained by Ms Gardiner in her evidence, to the effect that:

- (a) Class 2 small fruit (sizes 36, 39 and 42) and 46s would be packed for Australia and exported in the usual way.
- (b) The Class 2 large fruit could be sold to a New Zealand handler who had agreed not to export it to Australia (eg for processing for stock food). Otherwise it would be dumped.
- (c) In compensation for not packing the Class 2 fruit, Zespri would pay suppliers 30c per tray in accordance with a specified formula.
- (d) Zespri would release Class 1 larger fruit (sizes 18 to 33) from its allocation at a price of \$16 per 10 kg box (this price would be paid by suppliers to Zespri for that Class 1 fruit instead of Zespri exporting it to other non-Australia markets where it was likely to be unwanted or sold at an uncertain or negligible return because of the supply surplus situation).
- (e) The suppliers would then be able to sell that Class 1 larger fruit through their normal export channels to Australia, with an anticipated sale price to Australia of approximately A\$19.22 per 10 kg box at wholesale.
- (f) A pack differential of \$0.35 per tray recognising the additional costs incurred in packing for Australia would be paid.

[199] Mr Lain Jager, the Chief Executive of Zespri, accepted under cross-examination that one effect of selling Class 1 into Australia instead of crop managing it was that the Zespri pool received a gross revenue contribution of \$16 per 10 kg box (plus a margin if one had been agreed) and that Zespri's overall grower returns would have been increased in an absolute sense only because, as Zespri was compensating growers or suppliers for crop managing fruit, the revenue from those trays, which were being counted, would not be counted and so per tray revenue would come down.

[200] Mr Jager also acknowledged in cross-examination that suppliers would have been picking and packing fruit on the assumption that the service level agreement approved at the 20 March 2009 IAC meeting would be implemented:

- Q. Would you have been surprised if post harvest operators when they started the harvest, operated on the assumption that this was going to be the arrangement?
- A. No, I wouldn't be surprised. I think, though, from memory that some post harvest operators harvested their Class 2 anyway, and sat on it, hoping that the demand would eventuate for the fruit.
- Q. That's fine. Is one way that a post harvest operator might have operated on that assumption, would one way be to destroy Class 2 fruit on the vine, or -
- A. They might - some operators may have chosen not to harvest it. In the end I guess they could leave that decision for some time because harvest doesn't finish until 15 June. Of course, too, I imagine some of them may have harvested it for sale in New Zealand.

[201] After the IAC meeting on 20 March 2009 a draft outline of the service level agreement was distributed internally within Zespri and Zespri also sought feedback by way of email from the ISG Contact Group and industry participants about the draft.

[202] On 25 March 2009 Zespri formally advised that it had withdrawn its proposal to have a Class 1 grade standard in the export marketing strategy. On 27 March 2009 the Horticulture Export Authority approved the 2009 export marketing strategy with a Class 2 grade standard.

[203] In the meantime on 25 March 2009 Turners & Growers had received a copy of Zespri's email to the ISG Contact Group and industry participants seeking feedback on the proposed service level agreement and had the opportunity to record its potential Australia programme in an internal email as follows:

- 1) We have full intention to go there again with our ENZA branded kiwifruit, so this is now daily work in progress to set this up
- 2) Apart from the brand recognition, we shall not forget the commission earning to the group and we do not want to [lose] that
- 3) It is an excellent platform to get [our] systems and processes in place for when some volume of our own fruit comes available, not to mention,

should there be a change in ability to market kiwifruit in general sense out of NZ

4) Up till today it has been close to impossible to put any plans together with all the uncertainties, however it is now clear from the points below that we can take 4 sizes to Australia without in any form disturbing the industry and without affecting the 30 cents on offer to the supply entities (not to the grower). We have to work out if it is worth to [lose] the 30 cents and gain it back through packhouse and coolstore through put for the sizes that earn the 30 cents.

So in all, we are planning for some ENZA branded kiwifruit to go to Australia, volume now likely to be less [than] last year, however still a presence

[204] Mr Hans Krabo, ENZA's Kiwifruit Operations Manager, confirmed under cross-examination that ENZA had a definite plan then to export small Class 2 fruit to Australia and that it had a commercial decision to make about whether to export large Class 2. The option of exporting Class 1 was considered later. Mr Krabo also confirmed that he had told Zespri at that time that ENZA was happy to comply with the service level agreement.

[205] During April 2009 Zespri circulated various drafts of the service level agreement both internally and to industry participants. This led to further discussions and a change to the payment terms.

[206] On 27 April 2009 Mr Krabo of Turners & Growers sent the following email to Ms Gardiner of Zespri:

Can I please ask a couple of questions for clarification;

1) Sizes 18-33 can be packed and distributed in New Zealand only without affecting the \$0.30 on offer? There is a few that have interpreted that these sizes can not be packed at all, while I am reading the SLA [service level agreement] as you can as long it stay in NZ only.

2. Where are we at with the SLA – is it due to be signed off shortly so we can act upon it.

3) Once the SLA is in place do I place an order for fruit with you guys directly or how does that side work? (I have several different views presented to me?)

[207] Ms Gardiner replied to Mr Krabo by email on the same day:

1. You are correct. Sizes 18-33 can be packed and sold in NZ. The packhouse still gets the 30 cents.
2. I will forward you the final SLA which we are sending out this afternoon.

The SLA is between Zespri and a supplier or supply entity, eg, Mainland Kiwi. They will pack the fruit to your specification and you order, ship and pay for the fruit through them. We need to have notice of a shipment (preferably a few days before it goes) so that our inventory and data is correct.

[208] Later that day she also emailed the latest version of the service level agreement to Mr Krabo, along with a copy of another email from Zespri to the industry seeking an indication about which facilities would be participating, which exporters would be shipping the Class 1 volume to Australia, and projected volumes by size.

[209] The Australia service level agreement was discussed at a meeting of KETA held on 30 April 2009. Concerns expressed by KETA members related primarily to pricing and whether suppliers could reduce the volume of Class 1 kiwifruit that they had agreed to obtain from Zespri under that agreement. Ms Gardiner pointed out at the meeting that the success or otherwise of the commercial proposal was in the hands of the suppliers and exporters rather than Zespri.

[210] As at 30 April 2009, based on estimates provided by suppliers of the volumes of Class 1 kiwifruit of sizes 18 to 33 that they would want to take from Zespri for their Australia export programmes, the total estimated volumes across those sizes were 2,225,356 tray equivalents.

[211] The evidence for Turners & Growers was that April was too late to do almost anything in terms of an export programme to Australia, regardless of what happened from there on in (except to the extent that they did eventually export Hayward to Australia).

[212] On 5 May 2009 Mr Krabo of Turners & Growers advised Ms Gardiner of Zespri by email that they were targeting 40,000 10 kg cartons from Nelson. Mr Krabo confirmed under cross-examination that Turners & Growers' plan then

was just to export Class 1 kiwifruit to Australia and that they had taken steps to organise a sales programme for that kiwifruit.

[213] The first finalised version of the service level agreement was circulated to suppliers on 7 May 2009. Clause 1 of the service level agreement was entitled Background and read as follows:

ZGL [Zespri Group Limited] has advised the industry that there is an excess of supply over demand for ZESPRI^(TM) GREEN Conventional Class 1 Kiwifruit in the larger sizes (sizes 18-33). An opportunity has been offered to contractors to supply this large size Class 1 fruit to Australia via their existing export channels. To ensure that the Australian market is not oversupplied with large GREEN fruit, contractors participating in this agreement will not pack Class 2 GREEN Kiwifruit in sizes 18 – 33, and ZGL will make a compensation payment to participating contractors in return. This agreement does not purport to alter any requirements imposed by the New Zealand Horticulture Export Authority Act 1987 with respect to export of Kiwifruit to Australia.

[214] Ms Gardiner of Zespri summarised the key provisions of the service level agreement as follows:

- (a) The supplier could contract to purchase Class 1 fruit from Zespri for sale via its exporter channels in Australia for \$16 per 10 kg box. Each supplier participating provided Zespri with the volumes of Class 1 kiwifruit of each size in the 18 to 33 range that the supplier committed to purchase from Zespri for its export programme to Australia. The contracted volume could be increased or reduced with the agreement of Zespri, with requests for decreases or increases being dealt with pragmatically by Zespri taking into account the realities of the industry.
- (b) The supplier agreed that the Class 1 fruit purchased from Zespri could only be sold into Australia and agreed to a penalty payment for breach of the obligation. These provisions were designed to prevent the re-export of Class 1 fruit from Australia to other markets, which would undermine price for Zespri fruit in those markets.

- (c) The supplier also agreed not to supply Class 2 kiwifruit in sizes 18 to 33 to Australia and to ensure any New Zealand sales were made on terms preventing export to Australia. The service level agreement did not cover the smaller sized fruit (sizes 36 to 46) that could, therefore, continue to be exported as Class 2.
- (d) The first payment, \$0.35 per tray (\$1 per 10 kg box), was a pack differential paid to suppliers. This was to recognise the added cost of packing different pack types other than the Euro pallet base, normal stacking height, “modular bulk pack”.
- (e) The second payment was to those parties who were no longer exporting larger Class 2 fruit and this meant that their Class 2 packing process was inefficient and more costly. The payment and compensation for this was \$0.30 per large Class 2 tray that they would have otherwise packed.
- (f) The payment for Class 2 fruit not packed was contingent on the supplier meeting its obligations not to supply Class 2 fruit to Australia.

[215] Ms Gardiner also explained that:

- (a) Zespri did not get any margin on the Class 1 kiwifruit sold to exporters for export to Australia under the service level agreement in 2009;
- (b) The service level agreement did not give Zespri the power to determine the quantity of Class 1 kiwifruit any supplier chose to take for export to Australia. That was a decision for each supplier, in collaboration with their exporter(s).

[216] Suppliers had three options under the service level agreement:

- (a) To enter into the service level agreement and take Class 1 fruit for supply to Australia, while not packing larger size Class 2 for supply to Australia and receiving compensation for not packing larger Class 2;
- (b) To enter into the service level agreement and not pack larger size Class 2 for supply to Australia, while receiving compensation for not packing Class 2, but without taking any Class 1 for supply to Australia; or
- (c) Not to enter into the service level agreement and continue to supply larger sized Class 2 kiwifruit to Australia.

[217] Suppliers continued to have the option to supply smaller sized Class 2 kiwifruit to Australia under each of these options and to supply larger sized Class 2 kiwifruit to buyers within New Zealand. It was Ms Gardiner's expectation that over 90% of suppliers by volume would participate in this service level agreement as they had agreed, despite not all the paperwork being completed; and suppliers were packing according to the service level arrangements.

[218] On 7 May 2009 Turners & Growers revisited their decision about Class 1, because they were concerned about rumours that the industry would not ultimately sign up to the Australia service level agreement in sufficient numbers, in which case the Australia market would be oversupplied, thereby depressing prices. Despite Zespri confirming that Zespri was not aware of any reason for such concerns, Turners & Growers changed their mind about purchasing Class 1 fruit and advised Zespri of this decision by email dated 8 May 2009.

[219] Mr Krabo agreed under cross-examination that at that time (7 to 8 May) Turners & Growers did not regard themselves as having any firm commitments under the Australia service level agreement. It was still a commercial decision for them whether to enter into it to obtain compensation for not packing Class 2, and whether to take Class 1. Their decision would be based on what they assessed to be more likely to result in a better outcome commercially for them in the circumstances. Turners & Growers withdrew from taking Class 1 because they believed the rest of

the industry was not committed to the Australia service level agreement proposal by this date, and were concerned that larger players were likely not to support that proposal and instead would export their Class 2 fruit to Australia.

[220] On 11 May 2009, right around harvest time for many orchards, a severe hailstorm struck the Bay of Plenty causing significant crop damage. The damage caused by the hailstorm had immediate implications for the projected difference between supply and demand, and the commercial reasons for implementing the Australia service level agreement.

[221] There was an Industry Supply Group conference call on 12 May 2009 to discuss the hail event and damage. Some suppliers suggested that the level of damage was such that large sized Class 2 fruit should be allowed back into Australia. Crop management was put on hold to allow time for the implications of the hail event to be considered. Ms Gardiner sent out an e-mail to the Zespri Board on 12 May 2009 providing an initial update on damage and setting out a number of decisions that would have to be made in the following days, including whether the hail event would impact on crop management and the Australia service level agreements.

[222] The Industry Supply Group met on 14 May 2009 and agreed that optimisation of total grower returns was the key consideration for whether or not the Class 1 to Australia proposal should proceed as planned. The Industry Supply Group also agreed that the crop management programme should be halted, with no new growers being allowed to sign up. Growers should be encouraged to harvest.

[223] The implications of the damage caused by the hailstorm were also discussed by the Zespri Board at its meeting on 14 May 2009. Management's assessment of overall eventual loss was in the region of 2 to 4 million tray equivalents. After discussion of the issues, the Board decided, in principle, to encourage growers to harvest their fruit rather than continue as part of the crop management programme, but to leave the option with each individual grower in the programme. The Board noted that, with hindsight, Class 1 fruit would not have been allocated to Australia if the hailstorm had been anticipated. It was unclear whether Zespri could make more

money by redirecting the Class 1 fruit to other markets that late in the year. It was agreed that these matters would have to be addressed at an IAC meeting scheduled for 18 May 2009.

[224] After the Zespri Board meeting on 14 May 2009 Ms Gardiner sent an email to industry participants recording that the Board had confirmed the Industry Supply Group decision that the crop management programme would cease.

[225] The Zespri Board met again on 17 May 2009 to discuss the implications of the damage caused by the hailstorm. The Board discussed whether suppliers could walk away from the service level agreement and decided that the executive should seek legal advice prior to the special IAC meeting scheduled for the next day in respect of the enforceability of the service level agreements and whether if a service level agreement was not signed the supplier could step away from it. The Board also decided that a proposal for discussion would be put to the IAC meeting. This proposal would see Australia remain a Class 1 market for large sized fruit for 2009 with Zespri selling the remaining volumes of large sized Class 2 fruit in international markets.

[226] Zespri received legal advice to the effect that there was a risk in trying to enforce the terms of the service level agreement against those suppliers who had not actually signed it (despite agreeing to the terms in principle) and equally there would be a risk for Zespri in attempting to cancel the service level agreement unless it was prepared to compensate suppliers. On the basis of this advice Zespri decided not to cancel the service level agreements.

[227] Based on the fact that by 15 May 2009 there had been 526 notifications of possible hail claims on orchards, Zespri's discussion paper for the IAC meeting on 18 May 2009 estimated that there would be a reduction of 2.4 million trays of Class 1 Green kiwifruit available. It was noted that the damage estimation was likely to be lower than the real figure. The paper also recorded that overall volumes had reduced further since the crop management decision had been made. At the time of crop management, Zespri had been looking to reduce Class 1 volume by approximately 5.7 million tray equivalents ("through crop management, Australia and Class 2").

With the hailstorm event (at between 2 million to 4 million tray equivalent loss) and a reduction in the crop estimate of 1.3 million tray equivalents the total reduction of supply was projected to be between 8.2 million tray equivalents and 10.2 million tray equivalents. As this range was far greater than the intended reduction to address the originally predicted surplus problems, a decision on the Australia programme in light of this reduction in crop was urgently required in order to provide certainty for suppliers and exporters. Zespri put the following proposal to IAC for discussion:

Given the uncertainty on market returns, the risks that remain in market and on supply and the inconclusive economic arguments **THAT:** Australia remains a Class 1 market for large sized fruit for 2009. ZESPRI can sell the remaining volumes of large sized Class 2 fruit as Family brand in international markets and estimates a return (Total Fruit & Service payments) of \$4.50 per TE [tray equivalent] for this fruit.

[228] At the IAC meeting on 18 May 2009 the ISG proposal to cease crop management, which the Zespri Board had confirmed, and the Zespri discussion paper were considered and debated with a range of views being expressed. As by that date only two suppliers had signed the first Australia service level agreement, Mr Jager said that without support from the suppliers and exporters Zespri could not enforce the current arrangements into Australia. Whether the agreements were signed or not, suppliers would export Class 2 to Australia if they wished to do so. Zespri's proposal was not accepted at the meeting. Instead Zespri agreed at the end of the meeting to circulate an amended Australia service level agreement with a revised compensation mechanism and an allowance for the larger sized Class 2 to go into Australia based on an estimated volume of 500,000 tray equivalents.

[229] The outcome of the IAC meeting on 18 May 2009 was reported to the Zespri Board at its meeting on 20 May 2009. On the same day Zespri sent an email to the ISG setting out the position relating to the revised volume to Australia.

[230] On 29 May 2009 Zespri circulated a paper to the Industry Supply Council setting out a recommended compensation model for the revised service level agreement and seeking feedback from the Industry Supply Council.

[231] The revised second version of the Australia service level agreement was circulated to industry participants on 8 June 2009. Ms Gardiner explained that the primary differences between the two agreements were:

- (a) The supplier could enter into the agreement and still export Class 2 fruit to Australia. If the supplier chose to export Class 2 fruit then the compensation for fruit not packed would be reduced on a pro rata basis. This change meant that the obligation not to sell Class 2 fruit in New Zealand without contractual terms preventing its export to Australia was removed from the 8 June 2009 agreement.
- (b) In order to facilitate the operation of the agreement, the supplier agreed to provide a range of information to Zespri and agreed that if false data was supplied wilfully the supplier would forego any compensation.

[232] Ms Gardiner also explained that under the second version of the service level agreement the supplier had four options:

- (a) Enter into the service level agreement, take Class 1 kiwifruit from Zespri for export to Australia, and elect not to export any large size Class 2 kiwifruit to Australia, thereby receiving the full amount of compensation for Class 2 kiwifruit not packed;
- (b) Enter into the service level agreement, elect not to take Class 1 kiwifruit from Zespri for export to Australia, and elect not to export any large size Class 2 kiwifruit to Australia, thereby receiving the full amount of compensation for Class 2 kiwifruit not packed;
- (c) Enter into the service level agreement, take Class 1 kiwifruit from Zespri for export to Australia, and elect to export Class 2 kiwifruit to Australia, thereby receiving reduced compensation for Class 2 not packed on a pro rata basis; or

- (d) Elect not to enter into the service level agreement and export Class 2 kiwifruit to Australia in accordance with the supplier's normal course of business.

The supplier retained the ability to export small sized Class 2 kiwifruit to Australia under any of the four options.

[233] The result was that each supplier that chose not to pack large sized Class 2 kiwifruit received a payment under the service level agreement. The calculations of the appropriate amount took into account the volume of Class 2 that each supplier exported to Australia, or provided to Zespri for export to other markets.

[234] A table providing a breakdown of the exports of kiwifruit in 10 kg boxes to Australia over the three years 2008, 2009 and 2010 was produced by Zespri. Taking into account Ms Gardiner's explanation of the acronyms in the table, it showed:

Fruit Group	2008	2009	2010
Class 1 Hayward (Green)			
Zespri	21,837	56,340	84,382
KETA Total (including Zespri)	36,843	379,558	84,382
Zespri % share	59.3%	14.8%	100.0%
Gold Class 1			
Zespri	146,084	167,795	136,605
KETA Total (including Zespri)	146,084	168,697	138,805
Zespri % share	100.0%	99.5%	98.4%
Hayward Class 2			
Zespri	60,886		
KETA Total (including Zespri)	1,053,508	812,527	1,068,684
Zespri % share	5.8%	0.0%	0.0%
Hayward Class 1 & Hayward Class 2			
Zespri	82,723	56,340	84,382
KETA Total (including Zespri)	1,090,351	1,192,085	1,153,066
Zespri % share	7.6%	4.7%	7.3%

[235] As Ms Gardiner pointed out, the table showed that:

- (a) There was a significant increase in the volume of Hayward Class 1 that was sold to Australia by exporters other than Zespri.
- (b) Over the three years Zespri was the only exporter of Gold Class 1 kiwifruit to Australia.
- (c) In the years 2009 and 2010 Zespri sold no Class 2 fruit into Australia, but the members of KETA (Kiwifruit Exporters to Australia Incorporated) sold significant volumes.
- (d) There was a drop in Class 2 fruit in 2009 because there was a conversion to Class 1 in that year.
- (e) In 2009 exports to Australia of Green Class 1 and 2 were about one-third Class 1 and two-thirds Class 2.

[236] Zespri also produced a table which showed that in 2009 there was a total of 1.774 million trays of Class 2 fruit that Zespri calculated was not packed and supplied to Australia and not supplied to Zespri, which received the \$0.30 compensation payment from Zespri. The table showed that the compensation payments to suppliers for not packing Class 2 totalled \$532,000.

Summary

[237] The evidence relating to the development and adoption of the Australia service level agreements in 2009 established that it was an industry response to a one-off situation arising from the likelihood of a significant surplus of Class 1 kiwifruit in New Zealand for the 2009 year, initially projected to be 4 to 7 million tray equivalents. Once Zespri's unilateral proposal to amend the Horticulture Export Authority's export marketing strategy was rejected, it was necessary for Zespri to work with the industry to find a solution to the anticipated problem. In essence the solution involved an industry agreement to export part of the surplus Class 1 kiwifruit to Australia and "crop manage" the surplus Class 2 kiwifruit, with Zespri paying compensation to growers.

[238] By joint memorandum of counsel dated 22 July 2011, the parties have confirmed that in accordance with the provisions of Schedule 6 of the 2009 supply agreement, which we have set out above and which is the only reference to “crop management” in any of the challenged agreements, Zespri can compel crop management only with the approval of the IAC on the recommendation of the Industry Supply Group.

[239] With the damage caused by the hailstorm of 11 May 2009, further crop management of the surplus Class 2 kiwifruit became unnecessary and, while there was a significant increase in the volume of Class 1 sold to Australia and a decrease in the volume of Class 2 sold, it was not as significant as it might otherwise have been.

Expert economic evidence

[240] Both Mr Mellsop for Turners & Growers and Dr Yeabsley for Zespri agreed that there was a close correlation between the acquisition of Class 2 kiwifruit for export to Australia and between the acquisition of Class 1 kiwifruit for export to premium markets. The subject matter of the service level agreements showed that Class 1 was substitutable for Class 2 on both the supply and demand side. Their aim was to change the mix of New Zealand’s kiwifruit exports to Australia.

[241] Mr Mellsop’s primary concern was that in order to achieve the proposed substitution of Class 1 for Class 2 fruit in the Australia market, Zespri had to bring about a reduction in the quantity of potential Class 2 exports to Australia, the purpose being to prevent or deter competitive conduct and raise the Class 2 price (to New Zealand exporters). Mr Mellsop indicated that it did not matter to his analysis whether or not Class 1 fruit was included in the relevant market. In the “without” scenario under s 27 (ie absent any service level agreements for 2009) the Class 2 volume available for export to Australia would have been reduced only by a fraction of the reduction with the service level agreements. Therefore, he concluded, the service level agreements had the effect of substantially lessening competition. In relation to s 36, he considered that only a firm with market power (or firms

colluding) would be able to appropriate sufficient net benefits to make rational the strategy of paying suppliers not to pack Class 2 fruit.

[242] Dr Yeabsley said that it was common ground that the pre-11 May 2009 goal of decreasing the volume of Class 2 kiwifruit exported to Australia was to decrease the overall quantity and increase the overall price achievable in Australia. This did not constitute harm to New Zealand markets. Had the purpose been to substantially lessen competition in the relevant market, then the expected outcome would have been lower prices for New Zealand growers. The evidence suggested that the service level agreements were intended to achieve precisely the opposite result. Neither had he seen any evidence that Zespri had any particular incentive to inhibit the ability of non-vertically integrated exporters to compete. Hindering such a small class of firms would hardly be a sensible commercial goal for Zespri.

[243] Dr Yeabsley's overall argument was that the service level agreement proposal was a one-off scheme and while there may have been transitory harm to an individual competitor, this was insignificant in the overall market context, especially as there was no separate market for vertically integrated firms.

[244] In the "without" scenario, Zespri would have implemented compulsory on-orchard crop management of surplus Class 1 volumes, thereby reducing the supply of kiwifruit from growers to suppliers. Post hail-storm, the "without" scenario changed in that further crop management would not have been necessary. Throughout the relevant timeframe the relevant market remained highly competitive. There was no change to the number of growers, suppliers or exporters; and suppliers had the choice not to sign up to the commercial solution offered by the service level agreement.

[245] Mr Mellsop was concerned about this focus on the number of participants in the market as distinct from the quantity of fruit available. And Dr Yeabsley was concerned that Mr Mellsop's analysis addressed only the quantity decrease of Class 2 and failed to include the increase in the quantity of Class 1 made available.

Turners & Growers' claims

[246] Turners & Growers claimed in its second amended statement of claim that by entering into the Australia service level agreement Zespri had contravened both s 27(1) and s 36(2).

The s 27(1) claim

[247] In respect of its claim under s 27(1), Turners & Growers pleaded that Zespri had entered into or proposed to enter into the Australia service level agreements, namely the drafts of 14 and 20 April 2009 and the agreements of 7 May 2009 and subsequent dates, which, at least until 11 May 2009, included terms that had the purpose and effect, and/or were likely to have the effect, of substantially lessening competition in a number of markets, now agreed to be the market for the acquisition and supply of kiwifruit for export to Australia.

[248] The terms of the service level agreements relied on by Turners & Growers in its pleading were that:

- (a) the supply entity would not export Class 2 Green fruit of sizes 18 to 33 to Australia and would not supply such fruit to anyone who would export it to Australia;
- (b) the supply entity would only sell such fruit in New Zealand to a party who had agreed that the fruit would not be exported to Australia;
- (c) Zespri would pay the supply entity \$0.30 for each tray of Class 2 Green fruit of sizes 18 to 33 not packed;
- (d) if the supply entity exported any Class 2 Green fruit of sizes 18 to 33 to Australia or supplied it to any party who exported it to Australia, the \$0.30 would not be paid in respect of any of that entity's fruit; and
- (e) the supply entity would purchase Class 1 Green fruit from Zespri for export to Australia for the price of \$16 per 10 kg box.

[249] Turners & Growers pleaded the following particulars in support of its claim that the service level agreements had the purpose or effect, or likely effect, of substantially lessening competition in the market for the acquisition and supply of kiwifruit for export to Australia:

- (a) Suppliers agreed in the Australia service level agreements not to supply Class 2 Green fruit of sizes 18 to 33 to any exporter who would export it to Australia.
- (b) The Australia service level agreements raised the cost of acquisition of Class 2 Green fruit of sizes 18 to 33 in each of the supplier/exporter markets because exporters acquiring such fruit would be required to compensate suppliers (and/or post-harvest operators to whom the suppliers would have passed on the payment) for the \$0.30 per tray payment foregone under the Australia service level agreements.
- (c) The Australia service level agreements raised the relative cost of acquisition of Class 1 Green fruit from Zespri for exporters not vertically integrated to the supplier level, in that vertically integrated exporters received an effective rebate of about \$1 on each 10 kg box of Class 1 fruit purchased from Zespri under the Australia service level agreement which rebate was not received by exporters not vertically integrated to the supplier level.
- (d) By reason of the effects pleaded in (b) and (c), the Australia service level agreements lowered the return which exporters, and in particular non-vertically integrated exporters, were able to offer growers and thereby substantially lessened competition in the market.

[250] Turners & Growers then pleaded that by promulgating and/or entering into the Australia service level agreements, Zespri had caused loss and damage estimated at \$94,000 to Turners & Growers, which had been able to procure only about 65,000 tray equivalents of Class 2 Green kiwifruit for export to Australia in the 2009/2010 season, compared to the up to 350,000 tray equivalents of Class 2 Green kiwifruit in

sizes 18 to 46 they would otherwise have expected to procure. Turners & Growers pleaded the following particulars in support of its claim for damages:

- (a) Based on their historical experience, Turners & Growers expected to procure between 250,000 and 350,000 tray equivalents of Class 2 Green kiwifruit from three or four post-harvest operators in the Nelson and Kerikeri regions.
- (b) Turners & Growers expected to procure the fruit on a consignment basis and to account to the post-harvest operators, through their suppliers, for the return net of costs and a commission to Turners & Growers.
- (c) Based on their historical experience, Turners & Growers expected to earn commission of about \$2,000 per container on Class 2 Green kiwifruit exported to Australia.
- (d) There are about 6,000 tray equivalents of kiwifruit in a container.
- (e) Turners & Growers therefore expected to earn commission of between about \$85,000 and \$116,000 on exports of Class 2 Green kiwifruit to Australia in the 2009/2010 season.
- (f) Because of the effect of the Australia service level agreements on supply of Class 2 Green kiwifruit for export to Australia, Turners & Growers were able to procure only about 65,000 tray equivalents of Class 2 Green kiwifruit of sizes 18 to 46 for export to Australia in the 2009/2010 season.
- (g) Turners & Growers in fact earned commission of about \$22,000 on exports of Class 2 Green kiwifruit to Australia in the 2009/2010 season.

[251] In its second amended statement of claim Turners & Growers sought:

- (a) a declaration at common law that the Australia service level agreements were unenforceable; and
- (b) damages pursuant to s 82, in the amount of \$94,000.

Amendments to pleadings

[252] In the course of the opening submissions for Turners & Growers, however, Mr Walker amended the form of the declaration sought to read:

a declaration at common law that the contract, arrangement or understanding reached at the 20 March 2009 meeting of the Industry Advisory Council, the terms of which are embodied in the 7 May 2009 Australia service level agreement, was entered into in breach of s 27 and, to the extent it was a contract, was unenforceable.

[253] Mr Goddard QC for Zespri accepted that Turners & Growers was entitled to modify the relief sought in this way, but flagged that there was no pleading that an arrangement or understanding was reached at the 20 March 2009 meeting of the IAC and that it was not referred to in the particulars of the Australia service level agreements as pleaded.

[254] Mr Walker's immediate reaction was that it might be less of a problem than was thought because the pleading related to the 7 May 2009 Australia service level agreements which embodied the arrangement. During the closing submissions for Turners & Growers, Mr Walker submitted that there was no need to amend the pleadings further, but that if the Court disagreed he sought leave to amend the pleading relating to the Australia service level agreements by adding the following new particular and by making the following addition to the existing first particular so that they read:

- (a) At a meeting on 20 March 2009, the Industry Advisory Council including the first defendant agreed an Australia service level agreement in principle, subject to entry into written agreements, with all suppliers except for around 6% who were opposed.

- (b) A draft Australia service level agreement in relation to “2009 Season Large Class 1 Green Supply to Australia” was provided to entities supplying kiwifruit in a memorandum dated 14 April 2009 reflecting and implementing the agreement at the 20 March 2009 IAC meeting.

[255] Mr Goddard opposed the granting of leave for these amendments on the grounds that:

- (a) The whole focus of the original pleading was on the contracts in the form of the Australia service level agreements between Zespri and the suppliers and the specific clauses in those contracts identified in the pleading.
- (b) There was no pleading of a meeting on 20 March 2009, who the parties to any arrangement arrived at then were, or what any oral understanding provided for.
- (c) Zespri would be prejudiced by the amendments because the trial had proceeded without sharp focus on the 20 March 2009 meeting, without relevant cross-examination of Mr Krabo and without evidence from other participants at the meeting.

[256] In reply Mr Walker submitted that:

- (a) The original pleadings identified the parties to the agreements and their terms which were agreed at the meeting on 20 March 2009.
- (b) There was no prejudice to Zespri because the amendments to the relief sought were made during the opening submissions for Turners & Growers and specifically referred to the 20 March 2009 meeting.

[257] Under rule 1.9(2) of the High Court Rules the court may, at any stage of a proceeding, make any amendments to the pleadings that are “necessary for determining the real controversy between the parties”. It is well-established that a court should exercise the discretion conferred by this rule on an application made

during closing submissions at the end of a relatively lengthy trial only if satisfied that they are necessary for determining the real controversy between the parties and will not result in an injustice or significantly prejudice other parties or cause significant delay: *Elders Pastoral Ltd v Marr*.⁵²

[258] In the present case we are satisfied for the following reasons that leave should be granted to Turners & Growers to make the amendments sought:

- (a) Zespri did not oppose the amendment to the form of the declaration at common law sought by Turners & Growers at the opening of the trial in respect of the contravention of s 27(1) and the inclusion in the declaration of the reference to the arrangements agreed at the IAC meeting on 20 March 2009. Mr Goddard recognised, correctly, that while rules 5.27 and 5.31 of the High Court Rules require the relief or remedy sought to be stated specifically in the statement of claim, under rule 5.31(2) the court may, if it thinks just, grant any other relief to which the plaintiff is entitled, even though that relief has not been specifically claimed.
- (b) The amendments sought by Turners & Growers, effectively out of an abundance of caution, do not add a new cause of action to their pleadings, but provide further particulars in support of the cause of action based on their claim that Zespri contravened s 27(1) when it:

entered into or proposed to enter into service level agreements with entities supplying kiwifruit, either directly or through [Zespri], in relation to the export of kiwifruit to Australia.

The further particulars refer to the agreement reached at the IAC meeting on 20 March 2009, which was subsequently implemented by the Australia service level agreement of 14 April 2009. As such, the further particulars provide further detail of the steps taken by Zespri which resulted in the Australia service level agreement and may be viewed as necessary for the purpose of determining the real

⁵² *Elders Pastoral Ltd v Marr* (1987) 2 PRNZ 383 (CA).

controversy between the parties. The further particulars do not amend the substantive allegation that Zespri contravened s 27(1) when it “entered into or proposed to enter into” the service level agreements. It remains necessary for Turners & Growers to establish the substantive allegation in order to succeed in this claim.

- (c) The question whether, if Turners & Growers succeed in this claim, the amended form of the declaration they now seek should be granted is a separate question which will require separate consideration if it arises and will depend on the nature of the contravention of s 27(1) that is established and not on the addition of the further particulars.
- (d) In these circumstances there is no injustice or prejudice to Zespri in granting leave to Turners & Growers to amend their statement by the addition of the further particulars. Zespri did not dispute that the IAC meeting took place on 20 March 2009 and that the matters discussed at that meeting led to the Australia service level agreement. The minutes of the meeting were in evidence and speak for themselves. In the absence of the addition of a new or further cause of action, no further evidence would have assisted Zespri in responding to the addition of these further particulars.

The s 27(1) issues

[259] There is no dispute between the parties that:

- (a) Zespri entered into or proposed to enter into the Australia service level agreements; and
- (b) the relevant market is the market for the acquisition and supply of kiwifruit for export to Australia.

[260] The issues therefore are whether the provisions in the Australia service level agreements that restricted the export of Class 2 Green kiwifruit of sizes 18 to 33 to

Australia, provided for the payment of compensation for not packing such fruit and the opportunity to purchase Class 1 Green kiwifruit from Zespri for export to Australia:

- (a) had the purpose of substantially lessening competition in the relevant market; or
- (b) had the effect of substantially lessening competition in the relevant market; or
- (c) were likely to have the effect of substantially lessening competition in the relevant market.

[261] The issue whether, if Zespri did contravene s 27(1), Turners & Growers suffered any loss or damage is considered separately after dealing with Turners & Growers' claim under s 36.

Submissions for Turners & Growers

[262] For Turners & Growers, Mr Walker submitted in relation to the "purpose" issue that:

- (a) It was clear from the evidence that the purpose of the relevant provisions of the service level agreement was to restrict supply and replace large Class 2 with Class 1 for export to Australia.
- (b) The fact that Zespri might have regarded itself as acting out of a good motive of helping the industry was beside the point. Achieving its motive required severe restriction of the supply.
- (c) Turners & Growers' case was supported by the economic evidence from Mr Mellsoop that a restriction of quantity in a market was anti-competitive.

- (d) Zespri's purpose was not short-term because there was evidence that Zespri was motivated not only by the short-term over-supply of Class 1 in the 2009 season but also by a broader goal of converting Australia into a Class 1 market.
- (e) Closing out all large Class 2 supply in the relevant market for a whole year was not fairly described as transitory.
- (f) While Zespri charged no margin, the result of the arrangement would have been that Zespri growers would have received higher overall pool returns from Zespri because the \$16 per 10 kg box would form part of the pool revenue.
- (g) The agreement of the suppliers to the service level agreement arrangement cannot be taken as evidence that it was the preferred choice of suppliers and growers when the arrangement was proposed under the threat of crop management. Suppliers had also previously rejected an attempt to change the grade standard.
- (h) The "revealed preferences" argument would not apply to the three exporters, including Turners & Growers, which acquired fruit from parties to the agreement.

[263] In relation to the "effect" and "likely effect" issues, Mr Walker submitted that:

- (a) Although the hailstorm intervened so that the provisions of the service level agreement did not have their full effect, they still had significant effect: Turners & Growers was unable to obtain Class 2 fruit for export to Australia because its potential suppliers had destroyed it in reliance on the pre-hailstorm agreement.
- (b) One significant effect of the pre-hailstorm agreement was that any exporter, such as Turners & Growers, who wished to acquire Class 2

fruit for export to Australia would have to compensate the supplier for the loss of the \$0.30 per tray payment on all other Class 2 fruit.

- (c) The provisions of the pre-hailstorm agreement were calculated to restrict supply substantially and, therefore, were likely to have that effect if implemented.

Submissions for Zespri

[264] For Zespri, Mr Goddard submitted in relation to the “purpose” issue that:

- (a) The overall purpose of Zespri and the industry throughout this time was to achieve the best return to growers for that season's fruit, given the forecast supply and demand position in overseas markets, including Australia.
- (b) The Australia service level agreements were short term and transitory arrangements, designed to increase options for suppliers and benefit growers and suppliers in the unusual circumstances affecting supply and demand in the 2009 season. On an objective approach, these provisions were not designed to have any enduring effect on competition in the market, or to affect the competitive process in any New Zealand market. Nor were Zespri's reasons for offering the Australia service level agreements linked in any way to harm to competition in a New Zealand market.
- (c) The evidence showed that Mr Tony Hawken of Eastpack Ltd put forward the commercial proposal ultimately leading to the Australia service level agreement.
- (d) People whose interests are at stake generally have the best incentive to understand where their interests lie, and the choices they make in those circumstances reveal their preferences.

- (e) There is no suggestion that possible commercial disadvantage to the small number of non-vertically integrated exporters operating in New Zealand was a subjective purpose of Zespri, in so far as that is relevant. Zespri had no commercial reason to seek such an outcome. Nor, moreover, would seeking to achieve a short term disadvantage to a few firms amount to a purpose of substantially lessening of competition, for the reasons discussed above, even if that had been Zespri's goal (which it was not).

[265] In relation to the "effect" and "likely effect" issues, Mr Goddard submitted:

- (a) The Commerce Act is not concerned with transitory effects. Increased prices for a short period (eg one year) would not raise Commerce Act concerns if there is no material harm to the competitive process, and prices would return to original levels within that time frame. Accordingly, even if the arrangements did affect price or output for one season, it would be inappropriate to treat effects lasting six months or thereabouts as substantial in Commerce Act terms.
- (b) Both before and after the Australia service level agreements, the market for the acquisition and supply of kiwifruit for consumption in New Zealand or export to Australia remained highly competitive. Even in the 2009 season, there was no evidence of any harm to competition – in the sense of increased prices to exporters, and reduced output.
- (c) The main factor determining the volume of kiwifruit supplied in New Zealand for export to Australia is the price likely to be achieved in Australia compared with alternatives (this expected price is a function of the likely volumes of kiwifruit supplied in Australia that season compared with expected consumer demand).
- (d) Mr Mellsop agreed that the only reason Zespri was seeking agreement for suppliers not to pack Class 2 fruit, was that this was the basis of

Zespri making the offer of Class 1 fruit. There was never going to be Class 1 fruit sold into Australia without Class 2 fruit quantities being reduced: growers/suppliers would not rationally have chosen to do this, as they would have been worse off.

- (e) A further difficulty with the plaintiffs' claim was that there was no evidence that any industry participant in New Zealand was worse off as a result of the service level agreements. The effect of the Australia service level agreements was to make New Zealand industry participants better off or, at least, no worse off, as they were given more options.

Competition analysis under s 27(1)

[266] The separate market for the acquisition and supply of kiwifruit for export to Australia has the following features:

- (a) It is not a regulated market. The export ban and Zespri's monopsony under the Regulations do not apply to the export of kiwifruit to Australia. Consequently, there is no legal "barrier to entry" to the market. Any person is lawfully entitled to acquire kiwifruit for export to Australia.
- (b) There was no suggestion that there were any other barriers to entry to the market which prevented firms from competing for the acquisition of kiwifruit from suppliers in New Zealand and in exporting that kiwifruit to Australia.
- (c) Some 10 or more firms, including Zespri, acquire kiwifruit for export to Australia. There was no suggestion that any one firm had any especially significant market share. The figures for the export of kiwifruit to Australia show that Zespri's market share for the three year period 2008 to 2010 was less than 10%.

- (d) There was no suggestion that the firms in the market did not compete with each other in respect of the amounts of kiwifruit acquired from, and the prices paid to, New Zealand suppliers.
- (e) Most of the firms that export to Australia are vertically integrated.
- (f) The market for the export of New Zealand kiwifruit to Australia is comparatively small at approximately 4 million tray equivalents or 5% of total exports.
- (g) As shown in the following figures for 2008, Class 2 Hayward Green kiwifruit is the predominant type of kiwifruit exported to Australia:

Fruit Type	10 kg boxes	%
Hayward Class 1 Green	36,843	2.98%
Zespri Gold Class 1	146,084	11.81%
Hayward Class 2 Green	1,053,508	85.21%

- (h) Firms other than Zespri are also able to acquire Class 1 Hayward Green kiwifruit for export to Australia because Zespri's regulatory monopsony and loyalty contracts do not apply to kiwifruit acquired for export to Australia. In 2008 just over 40% of the Class 1 Hayward Green kiwifruit exported to Australia was exported by firms other than Zespri.

[267] There is no dispute that in this market:

- (a) demand for kiwifruit (volume acquired) will depend on the price likely to be achieved in Australia;
- (b) the price in Australia for Class 1, the premium quality kiwifruit, will be likely to exceed the price for Class 2; and

- (c) notwithstanding these quantity and price differentials, Class 1 and Class 2 kiwifruit are in fact and commercial common sense substitutable products.

[268] When the industry was faced with the likelihood of a significant surplus of Class 1 kiwifruit in New Zealand for the 2009 year, originally projected to be 4 to 7 million tray equivalents, the consequences were that:

- (a) Zespri, by virtue of its loyalty contracts, was committed to acquiring 100% of Class 1 kiwifruit for export to countries other than Australia, on the basis of the FOBS price and the loyalty payments (fixed in part) and, as acknowledged by counsel for the parties in their joint memorandum of 22 July 2011, a failure by Zespri to accept 100% of Class 1 kiwifruit submitted by grower signatories to the contracts would have amounted to a breach of the contracts and the ordinary legal remedies would have been available;
- (b) exporting most of the Class 1 surplus supply to countries other than Australia would result in significantly lower prices off-shore, lower returns for Zespri (and its shareholders) and for growers (because the price risk arising out of any over-supply is ultimately borne by the growers/suppliers through the pool returns) and an adverse impact on Zespri's premium product in which it had invested significantly; and
- (c) exporting part of the Class 1 surplus supply to Australia would result in significantly lower prices there and lower returns for exporters and growers.

[269] In this situation the options on the supply side for Zespri and the industry were:

- (a) to reach agreement on the "crop management" of the surplus Class 1 kiwifruit with Zespri making substantial payments of compensation to growers; or

- (b) to export part of the surplus Class 1 kiwifruit to Australia and accept lower prices there for both Class 1 and Class 2 kiwifruit with resulting lower returns for exporters and growers; or
- (c) to export part of the surplus Class 1 kiwifruit to Australia and restrict the export of Class 2 kiwifruit to Australia by way of amendment to the Horticulture Export Authority's export marketing strategy with no compensation payments by Zespri to growers; or
- (d) to export part of the surplus Class 1 kiwifruit to Australia and reach agreement on the "crop management of" the surplus Class 2 kiwifruit with less substantial payments of compensation by Zespri to growers.

[270] The third option was the best for Zespri, but it was rejected by the industry.

[271] The fourth option, which required the agreement of the industry, was then the best commercial option for Zespri and the industry because it was likely to support export returns from all overseas markets, including Australia, while reducing the level of the compensation payments. As the parties accepted, the fact that this outcome was likely to result in increased prices for New Zealand kiwifruit in Australia would not affect Commerce Act claims relating to competition in markets in New Zealand. The end consumers were not participants in the New Zealand market.

[272] The commercial option initially proposed by Mr Hawken of Eastpack Ltd ultimately led to the Australia service level agreement which was accepted by the majority of the industry. It was an industry managed response to the surplus supply problem.

[273] As already noted, the implementation of the commercial proposal by the service level agreement of 7 May 2009 was of course affected by the unexpected hailstorm and damage caused to the kiwifruit crop in the Bay of Plenty on 11 May 2009. Instead of "crop management" by agreement there was "crop management" by "act of God".

[274] As the figures in the table at [234] for exports to Australia for 2009 show, however, the commercial proposal did alter the make up of kiwifruit exported that year:

Fruit Type	10 kg boxes	%
Hayward Class 1 Green	379,558	28
Zespri Gold Class 1	168,697	12
Hayward Class 2 Green	812,527	60
	<hr/>	<hr/>
	1,360,782	100%
	<hr/>	<hr/>

Exports of Hayward Class 1 Green increased by 342,715 boxes over the previous year, a tenfold increase, while exports of Hayward Class 2 Green decreased by 240,981 boxes, a decrease of 25%.

[275] This outcome was achieved by Zespri:

- (a) providing at no margin about 85% of the Hayward Class 1 Green kiwifruit that was exported to Australia, to other exporters;
- (b) compensating suppliers for Class 2 kiwifruit not packed (1,774,405 trays), a total of \$532,321.

[276] The outcome for the majority of the industry in 2009 was positive. As submitted for Zespri, there was no evidence of any harm to competition in the sense of increased prices to exporters or reduced output.

[277] There were also in fact no established adverse consequences for Turners & Growers because, as Mr Goddard submitted:

- (a) Turners & Growers' usual supply programme to Australia had been disrupted before the 20 March 2009 IAC meeting and any service level agreement had been signed;

- (b) any problems Turners & Growers encountered in obtaining Class 2 fruit resulted from uncertainty while the industry considered what to do in late 2008 to April/May 2009 about excess Class 1 supply;
- (c) after that point, the effect was a result of commercial decisions taken by suppliers to make the best they could of the unusual circumstances in which they found themselves (including the unanticipated effect of the hailstorm);
- (d) []

[278] Even if there had been adverse consequences for Turners & Growers that would not necessarily have meant that there had been any substantial lessening of competition in the market as a whole. And even if the claim of damage had been established, it would have been *de minimis* in the context of that market.

[279] The 2009 Australia service level agreements did not apply beyond the 2009 season. The figures for 2010 in the Table at [234] above show that exports of Class 1 and Class 2 kiwifruit together reverted to their 2008 levels.

[280] Mr Mellsop was correct in saying that a restriction of quantity in a market will normally raise competition concerns because of the likely impact on consumers. But, as he acknowledged, in the unusual circumstances of this case:

- (a) this concern about Class 2 output and prices to exporters would dissipate if Class 1 and Class 2 were in fact treated as substitutes in the same market;
- (b) it was in the interests of growers to reduce the quantity of Class 2 kiwifruit exported to Australia in order to export Class 1 and maintain grower returns;
- (c) Turners & Growers' claims are not concerned with kiwifruit volumes or prices in that overseas market;

- (d) as matters eventuated, the overall quantity of kiwifruit exported to Australia in 2009 was more than the volumes supplied in 2008 and 2010.

[281] On the basis of this analysis we do not consider that, objectively determined, the provisions of the service level agreements, had the “purpose” of “substantially lessening competition” in the market for the acquisition and supply of kiwifruit for export to Australia because:

- (a) The real and substantial purpose of the service level agreements was to provide a commercial solution in the best interests of the industry in response to the anticipated surplus of Class 1 kiwifruit in the 2009 season;
- (b) The real and substantial purpose of the provisions of the service level agreements, which enabled Zespri and other licensed exporters to export Class 1 kiwifruit to Australia, restricted the export of Class 2 kiwifruit to Australia, and provided for the payment by Zespri of compensation for “crop managed” kiwifruit, was to support export returns from all overseas markets, including Australia, for the benefit of the whole industry;
- (c) While the provisions of the service level agreements were designed to manage an industry agreed process of product substitution in the market, their purpose was not to hinder competition for the acquisition of Class 1 kiwifruit once Zespri made this product available for export to Australia;
- (d) The purpose of the provisions was therefore not to “substantially lessen competition” in that there was no substantial or enduring interference with the competitive process in the defined market.

[282] On the basis of our analysis we do not consider that the provisions of the service level agreements had the “effect” of “substantially lessening competition” in the defined market because:

- (a) As the figures for the export of kiwifruit to Australia in 2009 show, the significant drop in the export of Class 2 Hayward kiwifruit (nearly 25%) was more than outweighed by the almost ten-fold increase in export of Class 1 Hayward, of which only 15% was exported by Zespri.
- (b) There was no evidence that competition between exporters of kiwifruit to Australia for the acquisition of kiwifruit was hindered at all, let alone “substantially”, by the service level agreements. There was no evidence of harm to competition either in terms of quality – adjusted prices or in terms of increased prices/lower returns to exporters.
- (c) While the hailstorm had an impact on the supply of kiwifruit in the market, it did not alter the effect of the service level agreements as far as competition between exporters was concerned.

[283] On the basis of our analysis we do not consider that the provisions of the service level agreements were “likely” to have the “effect” of “substantially lessening competition” in the defined market because:

- (a) Without the service level agreements, the only option for Zespri was to continue to accept 100% of Class 1 kiwifruit acquired for export to countries other than Australia and to continue to export that kiwifruit, including the surplus, to those overseas markets and to Australia with the adverse consequences for Zespri and the industry to which we have referred.
- (b) “Crop management” with industry agreement of Zespri’s surplus Class 1 kiwifruit would not have had any effect on competition between exporters to Australia.

- (c) Export by Zespri of part of its surplus Class 1 kiwifruit to Australia would have significantly increased the supply of New Zealand kiwifruit to that market with resulting lower market returns.
- (d) Comparing the likely state of competition “without” the service level agreement with the likely state of competition “with” the service level agreement, it is apparent that the service level agreement was an industry managed process of product substitution within the market and that there was no attempt to restrict overall supply. Zespri had no power to determine the quantity of Class 1 kiwifruit acquired for export to Australia once the service level agreement took effect. Once the substitution strategy was facilitated through the service level agreements, individual exporters, including Zespri, determined how much Class 1 went there.
- (e) In the absence of any evidence of harm to participants in the defined market, ie growers, suppliers and exporters, the state of competition with the service level agreements was unlikely to be hindered, let alone substantially hindered.

[284] For these reasons Turners & Growers have not established on the balance of probabilities that by entering into the 2009 Australia service level agreements Zespri contravened s 27(1).

The s 36(2) claim

[285] In respect of its claim under s 36(2), Turners & Growers pleaded in its second amended statement of claim that, by entering into the Australia service level agreements, Zespri had taken advantage of its substantial degree of power, in the admitted grower/exporter (non-Australia) market for the purposes of preventing or deterring exporters or potential exporters of kiwifruit from engaging in competitive conduct in the admitted market for the acquisition and supply of kiwifruit for export to Australia.

[286] In support of this claim, Turners & Growers repeated the same particulars as for its claim under s 27(1) and added that an exporter which did not have a substantial degree of market power in the said markets would not be able to require suppliers to agree not to supply Class 2 Green fruit of sizes 18 to 33 to other exporters as a condition of being able to purchase Class 1 fruit from the exporter.

[287] In support of their claim that Zespri's contravention of s 36(2) had caused loss and damage to them, Turners & Growers repeated their pleading in respect of their claim for loss and damage from Zespri's contravention of s 27(1).

[288] Turners & Growers in its amended statement of claim also sought a declaration at common law in the same form as the declaration for contravention of s 27(1) and damages in the same amount. Again, in the course of the opening submissions for Turners & Growers, Mr Walker amended the form of the declaration sought to read:

a declaration at common law that Zespri breached s 36 by its conduct in respect of the arrangements for exports to Australia in the 2009 season agreed at the 20 March 2009 meeting of the Industry Advisory Council and embodied in the 7 May 2009 Australia service level agreement.

[289] Again Mr Goddard accepted that Turners & Growers was entitled to modify the relief sought in this way.

[290] Turners & Growers did not seek to amend their pleading in respect of their claim under s 36(2) in any other way.

The s 36(2) issues

[291] As there is no dispute that Zespri has a substantial degree of market power in the grower/exporter (non-Australia) market, the issues under s 36(2) are:

- (a) whether Zespri took advantage of that power when it entered into the Australia service level agreements; and, if so,
- (b) whether it did so for the purpose(s) of preventing or deterring exporters or potential exporters of kiwifruit from engaging in

competitive conduct in the market for the acquisition and supply of kiwifruit for export to Australia.

[292] The parties were in agreement that the proscribed “purpose” analysis in respect of the Australia service level agreements under s 36(2) was essentially the same as the “purpose” analysis under s 27(1). This means that our conclusion that the provisions of the service level agreements did not have an anti-competitive purpose under s 27(1) applies equally to the claim under s 36(2) with the result that Turners & Growers have also not established a proscribed anti-competitive purpose under this latter provision.

[293] For completeness we do not overlook that under s 27(1) the focus is on the “purpose” of the provisions in the service level agreements while under s 36(2) it is the “purpose” of Zespri that is relevant. We agree with the parties that this distinction does not alter either the analysis or the outcome in this case. Zespri’s real and substantial purpose in entering into the service level agreements was the same as the real and substantial purpose of the provisions of the service level agreements, namely to provide a commercial solution in the best interests of the industry in response to the anticipated surplus of Class 1 kiwifruit in the 2009 season. Zespri’s purpose was not to hinder competition for the acquisition of Class 1 kiwifruit once it made this product available for export to Australia. Even assuming that Zespri had taken advantage of its power in the current grower/exporter (non-Australia) market, there was no evidence that it had done so for the purpose of gaining market share at the expense of other exporters in the market for the acquisition of kiwifruit for export to Australia.

[294] Nor, as permitted by s 36B, is there any basis in this case for drawing an inference from Zespri’s conduct that it had a proscribed purpose under s 36(2). Once Zespri’s proposal to amend the Horticultural Export Authority’s export marketing strategy failed, Zespri had no option but to work in collaboration with the industry to achieve the commercial solution to the supply surplus situation ultimately contained in the service level agreements.

[295] Our conclusion that the provisions of the service level agreements did not in fact have the “effect” of “substantially lessening competition” in the defined market is consistent with our conclusion that Zespri did not contravene s 36(2). In this case, as no anti-competitive effect was in fact produced or achieved by Zespri’s alleged taking advantage of its market power, no anti-competitive purpose may be inferred: cf *Telecom Corporation of New Zealand Ltd v Clear Communications Ltd*.⁵³ This is a case where the absence of any anti-competitive effect from the provisions of the service level agreements in the defined period is determinative because there was no other evidence establishing that Zespri’s purpose in entering into the service level agreements in 2009 was proscribed by s 36(2).

[296] Our conclusion that in entering into the service level agreement Zespri did not have a proscribed purpose under s 36(2) means that it is unnecessary for us to consider whether Zespri took advantage of its market power.

[297] For these reasons Turners & Growers have not established on the balance of probabilities that by entering into the 2009 Australia service level agreement Zespri contravened s 36(2).

Loss or damage?

[298] As Turners & Growers have not established a contravention of either s 27(1) or s 36(2) by Zespri in respect of the 2009 Australia service level agreement, there is no need for us to consider whether Turners & Growers established any loss or damage. If it had been necessary to do so, it is unlikely that we would have found that any loss or damage was established by Turners & Growers for the reasons referred to in [277] above.

⁵³ *Telecom Corporation of New Zealand v Clear Communications Ltd* at 402-403.

Zespri's new kiwifruit cultivar policy

The claim

[299] Turners & Growers claim that Zespri has contravened s 36(2) by seeking to acquire and control the rights to new kiwifruit cultivars and by restricting the ability of competitors or potential competitors to develop competing cultivars. In particular, Turners & Growers claim that Zespri has taken advantage of its substantial degree of power in the current regulated grower/exporter (non-Australia) market for the purpose of:

- (a) preventing or deterring other exporters from engaging in competitive conduct in a “deregulated” grower/exporter (non-Australia) market; and
- (b) preventing or deterring other rights holders from engaging in competitive conduct in the (kiwifruit) cultivar licensing market.

[300] In view of:

- (a) the admission by Zespri that it has a substantial degree of power in the current regulated grower/exporter (non-Australia) market; and
- (b) our decision that Turners & Growers have not established a “deregulated” grower/exporter (non-Australia) market;

Turners & Growers, to succeed in its claim here, must establish a kiwifruit cultivar licensing market and that Zespri took advantage of its power in the current regulated market for a proscribed purpose in respect of the cultivar licensing market.

Factual background

[301] As already noted in our section on the factual background, both Zespri and Turners & Growers are in the process of commercialising various new varieties of kiwifruit. Both have applied for plant variety rights in respect of their new varieties

in New Zealand and overseas and enjoy provisional protection of their intellectual property while applications are determined. Rights have been granted to Turners & Growers in a number of overseas countries.

[302] It is common ground that the sustainable future of the New Zealand kiwifruit industry depends on the commercial release of new varieties of kiwifruit, ie new cultivars. The Hayward cultivar, from which Zespri Green and ENZA Green are grown in New Zealand, currently accounts for around 80 per cent of New Zealand's kiwifruit production. Not only is Hayward a non-proprietary cultivar, without plant variety protection or licensing, but also growers face increasing competition from Hayward growers in other countries, notably Chile. Hort 16A, the other major kiwifruit cultivar grown in New Zealand and marketed as Zespri Gold, accounts for the balance of approximately 20 per cent of New Zealand production. Zespri holds plant variety rights for Hort 16A in New Zealand and some 12 overseas countries. The New Zealand rights are due to expire in 2018 and in overseas markets between 2018 and 2035 (Japan).

[303] While the export ban and Zespri's regulatory monopsony remain, Turners & Growers are unable to export any fruit from their new cultivars grown in New Zealand to countries other than Australia. Turners & Growers are dependent on Zespri for such exports. In January 2009 the Managing Director of Turners & Growers (Mr Wesley) met with the Chief Executive Officer of Zespri (Mr Jager) to discuss proposals for the export of kiwifruit from cultivars in which Turners & Growers had an interest. This meeting led to a letter dated 27 March 2009 from Mr Jager to Mr Wesley which attached a document described as Zespri's "New Cultivar Evaluation Policy". As the letter and the policy document are the basis for Turners & Growers' claim that Zespri has contravened s 36(2), it is necessary to refer to them in some detail.

The letter

[304] The letter was headed: "A strategic approach to assessing new varieties of kiwifruit for commercialisation in New Zealand". Mr Jager then set out Zespri's thoughts on how it "might respond to the development for export of new cultivars in

the best interests of New Zealand kiwifruit growers”. The letter made the following observations in respect of the potential commercialisation for export of new varieties grown in New Zealand:

1. The objective of launching new varieties must be to grow or enrich the kiwifruit category and/or to grow market share relative to competitors;
2. We agree with your view that each new cultivar should be considered separately. There are many hundreds of Kiwifruit cultivars in the world and only a few will have all of the consumer, supply chain, and growing characteristics to support successful commercialisation. It is critical that investment is targeted at winners, not simply supporting the commercialisation of every new cultivar that comes along regardless of likely commercial potential. In ZESPRI’s view the mere existence of a proprietary cultivar and desire by the owner to commercialise it out of New Zealand is not sufficient for ZESPRI to support its export to international markets.
3. ZESPRI’s view is that new cultivars should be supported for commercialisation in New Zealand only if they are sufficiently different or better than existing commercialised varieties in New Zealand. There is a significant risk that, unless new varieties are significantly different or better than Hort 16A or Hayward, they will simply result in reduced sales of existing varieties and this will not be in the best interests of New Zealand growers because of the associated cultivar transition cost and heightened cultivar selection risk.
4. The kiwifruit category represents a small share (circa 1.5%) of global fruit sales and this:
 - (a) Limits the shelf space (numbers of facings) that is available for kiwifruit in retail; and
 - (b) Limits the number of new varieties which will be able to be commercialised at sufficient scale to underwrite the investment in promotion, distribution, growing techniques and packing and cool chain management. While we do not preclude the potential of smaller niche products in the Kiwifruit category it would be important to be clear both about what they bring to the category from a wealth creation and category portfolio perspective, and what potential adverse impacts may result from introducing new varieties into the already crowded market space. ZESPRI Organic is one example of such a niche offering which has been carefully managed to ensure commercial success alongside traditional varieties.
5. New varieties/products are one of the primary ways that the Kiwifruit category will be grown, through the introduction of attractive new offerings that will excite consumers and extend the category. ZESPRI supports the development of new kiwifruit

cultivars/products itself directly and potentially, in an environment of genuine collaboration, by 3rd parties.

6. Obviously in its role as SPE [single point of entry] Marketer for New Zealand Kiwifruit Growers, ZESPRI will need to be in a position to take a well informed view of the characteristics of new varieties that 3rd parties are promoting for commercialisation in New Zealand.

[305] Zespri then set out three ways in which it might respond when considering the potential of a new kiwifruit cultivar for export:

1. Support it for commercialisation and seek to enter into commercial arrangements with the owner of the PVR [plant variety rights] for the rights to exclusively market the new variety on the international market;
2. Support it for commercialisation in principle but either choose not to seek to market the new variety itself or be unable to reach mutually acceptable commercial terms with the owner of the PVR for exclusive marketing rights of the new variety. In this case we envisage that Collaborative Marketing mechanism may be used by the 3rd party PVR owner or their chosen exporter. We note that in this case the normal collaborative marketing processes and assessments would apply such that Kiwifruit New Zealand would determine whether the application would increase the overall wealth of the New Kiwifruit industry; or
3. Not support for commercialisation out of New Zealand and object to its export from New Zealand under ... the collaborative marketing mechanism on the grounds that:
 1. It is not sufficiently different or better than existing commercialised varieties;
 2. ZESPRI has not had the opportunity to assess the merits of the cultivar; and/or
 3. That the collaborative marketing application has not been made in genuine collaboration with ZESPRI.

[306] Mr Jager then noted that, in response to approaches by third parties with potentially interesting cultivars, Zespri had developed a process for objectively assessing such cultivars in comparison with other known candidates. Mr Jager said that:

..... it would be irresponsible for ZESPRI to agree to support for export a new product which was unproven through the ZESPRI system

[307] Mr Jager attached Zespri's "New Cultivar Evaluation Policy" for Turners & Growers' reference. (While this means a "new cultivar" policy rather than a "new" Cultivar Policy, in fact the policy was also "new".) Turners & Growers were invited to consider submitting the potential ENZA cultivars for consideration. While Zespri anticipated that its approach might appear to be "commercially restrictive", Turners & Growers were asked to have regard to Zespri's overall roles and obligations in the New Zealand kiwifruit industry. In any event, what was being proposed for third party cultivars was "much the same as for cultivars originating from the Plant & Food breeding program". (Plant & Food Research are part of a partnership (including Zespri) in New Zealand's kiwifruit breeding programme.)

The Policy

[308] Zespri in its New Cultivar Evaluation Policy stated that its policy objective was:

to define the process that ZESPRI employs for evaluation and consideration of potential new commercial cultivars, regardless of source.

[309] The Policy stated that its scope was to define the assessment procedures applying to a new fruiting cultivar or fruit offered to Zespri for evaluation and commercialisation. Reference was made to Zespri's "cost-efficient" screening process (pre-commercial release) involving three stages of evaluation: preliminary screening/assessment; clonal trials over 3 to 5 years; and pre-commercial block trials over 2 to 4 years. After describing the three stages in some detail, the Policy emphasised that:

As a general principle ZESPRI will only commercialise a cultivar or fruit from a new cultivar that has been robustly tested (Stage 3) and for which a business plan (including marketing plan) has been developed and accepted by the [Zespri] Board. When approved by the [Zespri] Board ZESPRI would look to use the new cultivar in its marketing portfolio for the strategic commercial life of the cultivar.

[310] On the subject of intellectual property rights and royalties the Policy stated:

ZESPRI will only commercialise a cultivar, or fruit from a new cultivar, which ZESPRI is able to protect through some form of ownership or marketing rights in key countries. In most cases, this will mean that the party bringing the cultivar to ZESPRI must be able to grant:

- Preferably a world-wide exclusive license for evaluation of the cultivar (or at a minimum exclusivity in ZESPRI's key markets and growing regions); **and**
- An absolute assignment of the intellectual property rights associated with the cultivar to ZESPRI at the conclusion of Stage 4 if ZESPRI elects to take ownership of the cultivar;

OR

- An absolute assignment of the marketing rights associated with the cultivar to ZESPRI at the conclusion of Stage 4 if ZESPRI elects to proceed with marketing of the cultivar; and
- Assurance that the cultivar has been fully protected and will continue to be protected to preserve the agreed exclusive marketing rights;

[311] The Policy also specified a maximum royalty rate. Where the rights are assigned to Zespri, it would pay a royalty based on the sales of fruit from the assigned cultivar. The royalty percentage would not exceed 1.5% of the gross sales price for all royalty fruit, less promotional rebates, claims and discounts, subject to negotiation where the party could demonstrate a significant historic development cost.

[312] Essentially, Turners & Growers' claim in this proceeding in respect of the New Cultivar Policy arises from:

- (a) the mandatory evaluation and selection process in relation to new commercial cultivars;
- (b) the requirement, in most cases, that the party bringing a cultivar to Zespri must be able to grant an exclusive licence and an absolute assignment of intellectual property rights or marketing rights and an assurance of cultivar protection; and
- (c) the prospect (detailed in the letter) of Zespri's opposition to export through the collaborative marketing mechanism.

Policy implementation

[313] There is no dispute that Turners & Growers have not to date submitted the potential ENZA cultivars for consideration under the terms of Zespri's New Cultivar Evaluation Policy.

[314] Early in 2009, in the context of a discussion about a collaborative marketing application for Korea (which Turners & Growers later withdrew), Zespri told Turners & Growers that it would consider accepting the ENZA Gold (Skelton 19) variety directly into Stage 3 of its new cultivar evaluation programme for evaluation under controlled and objective test conditions against other cultivars including Zespri Gold and other gold varieties. Zespri also suggested that the ENZA Gold variety could be included in the consumer and sensory testing it conducted during 2009.

[315] According to Mr Bryan Parkes, Zespri's Innovation Manager, Turners & Growers declined these opportunities. He also gave evidence that

For the remaining varieties of kiwifruit referred to in the amended statement of claim ... the rights holders have not approached Zespri with any commercial proposal for Zespri marketing and exporting those kiwifruit varieties, nor have they submitted any kiwifruit and supporting test data for including in the evaluation programme (which would be at whatever stage is appropriate on a comparative basis given the quality of any such test data submitted).

[316] Mr Parkes was not cross-examined on this evidence and added that "the plaintiffs have objected to the Policy purely on principle".

[317] The Policy had, however, been applied to [] as noted in a Zespri Board report dated November 2009 which contemplated the option of acquiring this cultivar in the context of a possible early decision by Zespri to commercialise a new variety. Discussions reached the point where, should Zespri have decided to commercialise [], a royalty had been set, the percentage of licence fees to be received by the owners would be further discussed, and Zespri would gain the exclusive rights to the plant variety rights for the [] variety. The Zespri Board was told that while the primary risk lay in misinterpretation of the data,

[] was potentially no different from other cultivars in Zespri's own breeding programme which yielded similarly imperfect data.

[318] Mr Walker pointed out that Zespri had decided not to proceed with the [] variety.

Expert economic evidence

[319] Mr Mellsop, Turners & Growers' economic expert, maintained that not only did Zespri have the ability to deter competitive behaviour by rival cultivar licensors, through control of the export channel, but it also had the commercial incentive to do so. The issue was whether Zespri was using its gateway role (to export markets) to deter competition. He would expect Zespri in a hypothetically competitive market to export a rival's cultivar (noting that a rival cultivar licensor would have more bargaining power in that market) provided Zespri was compensated for the opportunity costs of doing so. Zespri's Policy, requiring an absolute assignment of the intellectual property rights, in exchange for a maximum royalty percentage, appeared to provide for a blanket pricing mechanism regardless of specific opportunity costs. The absolute assignment of intellectual property rights seemed "more rigid" than in a competitive market.

[320] Dr Yeabsley, Zespri's economic expert, pointed out that Zespri did not export cultivars as such. It exported kiwifruit. Dr Yeabsley supported the view that the content of the Policy, based on objective and scientifically controlled testing, provided information about an entirely orthodox business approach towards making assessments of a wide range of issues and managing the relevant risks involved, having regard to the greatest value for the entire New Zealand kiwifruit industry over time. The requirement to assign rights simply reflected the need to secure the benefit of the proprietary new cultivar over the long term. The purpose of the Policy, rather than deterring competitive conduct, reflected a rational business case approach to any commercialisation investment. As the only authorised exporter, Zespri has every incentive to maximise the profitability of that business for Zespri and growers. This would be served by commercialising and exporting kiwifruit from the best cultivars, regardless of source, following appropriate business strategies to maximise the net

returns of the product portfolio. At the same time, Zespri was aware that it faced extensive global competition for the development of new cultivars.

The pleading and particulars

[321] Turners & Growers claim that Zespri has contravened s 36(2) by taking advantage of its substantial degree of power in the grower/exporter (non-Australia) market in seeking to acquire and control the rights to new kiwifruit cultivars (including through its subsidiaries) and restricting the ability of competitors or potential competitors to develop competing cultivars, for the purpose of preventing or deterring competitive conduct in the kiwifruit cultivar licensing market.

[322] Turners & Growers claim that Zespri, as an integrated exporter and rights holder has sought to restrict the ability of Turners & Growers (or other competitors or potential competitors) to develop and exploit new kiwifruit cultivars by adopting the Policy (described above) of:

- (a) declining to market the fruit of cultivars other than those owned by the “Zespri Group” unless the party which developed the cultivar grants all rights, or at least the marketing rights, in respect of the cultivar to the “Zespri Group”; and
- (b) opposing any collaborative marketing arrangement involving a new kiwifruit cultivar, the rights to which are owned by another party, unless the cultivar has been approved in trials mandated by Zespri and taking up to or in excess of nine years to complete.

[323] The following further particulars are also pleaded:

- (a) The effect of Zespri’s Policy is that where cultivar rights are not held by Zespri, the fruit cannot be exported beyond Australia – at least without undergoing lengthy testing – and even then only through a collaborative marketing approval (where the rights are not assigned).

- (b) The volume of New Zealand-grown kiwifruit for consumption in Australia and New Zealand is relatively small and prices are substantially lower than obtainable elsewhere.
- (c) The ability of rights holders other than Zespri to compete in the cultivar licensing market is therefore restricted. Their plantings in New Zealand are effectively restricted by the limited volume of kiwifruit which can be sold for consumption in New Zealand and Australia.
- (d) Hence such rights holders are restricted in the returns they can offer growers planting their cultivars.
- (e) As a consequence, integrated exporters and rights holders are restricted in their ability to compete with Zespri in the grower/exporter (non-Australia) market, including post-deregulation.
- (f) In these circumstances, Turners & Growers is restricted in its ability:
 - (i) to have its new kiwifruit cultivars licensed for planting in New Zealand; and
 - (ii) to export kiwifruit grown from such new cultivars as ENZA Gold, ENZA Red and Summerkiwi

which has caused and will continue to cause them loss in the form of foregone net licensing fees (\$330,000 to date for ENZA Gold) and foregone profits/commission (\$1.8 million net present value) from not being able to export fruit from the ENZA Gold cultivar in the 2014 season.

[324] Turners & Growers seek a declaration at common law that Zespri's Cultivar Policy is in breach of s 36 and unlawful, as well as damages under s 82.

The submissions

[325] For Turners & Growers, Mr Walker submitted:

- (a) There was confirmation by two Zespri witnesses, namely Mr Jager and Mr Parkes, that the policy objective was to target three to four “product types”, noting that one product type might have more than one cultivar. As Zespri’s Innovation Manager, Mr Parkes, explained under cross-examination, the Hort 16A product for example could be made up of three different cultivars reflecting different maturities and storage capability.
- (b) To the extent there was any flexibility in the Policy, it was in exceptional cases and related only to the extent of the ownership of marketing rights and not to Zespri’s key markets. The flexibility certainly did not extend to Zespri exporting fruit from a third party cultivar without taking rights to the cultivar. To the best of Mr Jager’s knowledge, Zespri had never done this other than through a collaborative marketing arrangement.
- (c) Where Zespri was the monopsonist, the mere publication of the terms on which Zespri would commercialise third party cultivars and their fruit is conduct that can fall within s 36 as a taking advantage of power. The mere publication of the Policy was calculated and likely to affect third party behaviour. The Policy was prepared and published specifically in response to Turners & Growers’ efforts to commercialise fruit from third party cultivars beyond Australia and the company had been affected by the Policy in that it had refused to submit its ENZA Gold for evaluation according to the Policy.
- (d) The relevant point for s 36 was that the Policy entailed Zespri acquiring the rights to the cultivar and refusing to commercialise where it did not acquire those rights. In addition, the limited number of product types coupled with Zespri’s preference for Plant & Food

Research cultivars meant that the prospects of a third party even having its cultivar considered for acquisition were small.

- (e) The evidence was that the purpose underlying the New Cultivar Policy was to restrict the licensing and commercialisation of cultivars owned by third parties and thereby entrench Zespri's position as the single point of entry for New Zealand kiwifruit and deter competitor entry in the event of deregulation.
- (f) Also, Zespri had opposed Turners & Growers' applications for collaborative marketing approvals for its new varieties. Although Zespri's Policy might appear to allow for export through the collaborative marketing approval mechanism, Zespri would not support a cultivar for export via a collaborative marketing approval unless the cultivar had been tested through the "Zespri system". The starting point for the Zespri Board was that if Zespri's New Cultivar Policy did not support commercialisation, KNZ should not grant a collaborative marketing approval to export the fruit.
- (g) In a hypothetically competitive market, Zespri would no longer be able to prevent third party cultivars from being planted or their fruit from being exported from New Zealand. The opportunity costs would not include the risk of cannibalisation of its own branded products because Zespri could no longer prevent that happening.
- (h) All other things being equal, it was preferable to license and plant in New Zealand rather than in Chile.

[326] For Zespri, Mr Goddard submitted:

- (a) The allegation that publishing a policy could breach s 36 was a surprising one when Turners & Growers did not identify any actual decision under the Policy and the only complaint was that the Policy was more rigid than might be expected.

- (b) There was no evidence that mere publication of the Policy had prevented or deterred competition. The Policy's in-built flexibility and the ability and willingness of Zespri to depart from the Policy addressed Mr Mellsop's concerns.
- (c) Zespri's commercial decision to act as an exporter of high quality and highly differentiated kiwifruit product, rather than as a broker/commodity trader, explained its substantial investment in research and development, including the world's largest and most successful kiwifruit breeding programme, and the adoption of the New Cultivar Evaluation Policy.
- (d) Zespri had no market power in the global market for intellectual property rights in respect of new cultivars.
- (e) Under Part 4 of the Regulations it was KNZ, not Zespri, which controlled collaborative marketing approvals. Zespri had no market power in respect of collaborative marketing approvals. Making submissions to KNZ did not, without more, constitute a misuse of market power: *Electricity Corporation Ltd v Geotherm Energy Ltd*.⁵⁴
- (f) Turners & Growers, who have acquired new cultivar licence rights from others, wanted to export or market kiwifruit themselves either on deregulation or under a collaborative marketing approval. Their expectation that they would achieve better prices, based on the reputation for quality already established for New Zealand-grown kiwifruit sold overseas by Zespri, raised an obvious free riding issue.
- (g) In adopting its New Cultivar Policy, Zespri had not taken advantage of its market power in the grower/exporter (non-Australia) market. As a matter of general competition law, Zespri as an exporter did not have any duty to assist its competitors to develop competing cultivars,

⁵⁴ *Electricity Corporation Ltd v Geotherm Energy Ltd* [1992] 2 NZLR 641 (CA) at 655.

or to promote competing cultivars to growers or in foreign export markets as alternatives to Zespri's own products.

- (h) Zespri had not acted with any anti-competitive purpose in relation to new cultivars. It had applied the same policy towards investment and development in respect of new cultivars offered by third parties as it applied to its own new cultivars.

The principal issue

[327] The principal issue is whether Turners & Growers have established that Zespri's response to the development for export of new cultivars (by Turners & Growers or anyone else) has contravened s 36(2) of the Act by taking advantage of its admitted monopsony power in the current regulated grower/exporter (non-Australia) market for a proscribed purpose in the kiwifruit cultivar licensing market. The matters in dispute are:

- (a) whether there is a kiwifruit cultivar licensing market;
- (b) whether making submissions to KNZ in opposition to a collaborative marketing application can constitute conduct that is capable of being prohibited by s 36;
- (c) whether publication of Zespri's New Cultivar Evaluation Policy can constitute "conduct" that is capable of being prohibited by s 36;
- (d) whether, in adopting the Policy, Zespri has taken advantage of its market power in the current regulated grower/exporter (non-Australia) market; and
- (e) whether Zespri did so for a proscribed purpose in a defined market.

Market definition and relevant markets

[328] In addition to their grower/exporter (non-Australia) market, Turners & Growers pleaded a cultivar licensing market in New Zealand, between growers and the holders of the rights to grow particular kiwifruit cultivars in New Zealand, for the licensing of such rights. It was submitted for Turners & Growers that the evidence supported a cultivar licensing market limited to kiwifruit.

[329] Zespri, supported by Dr Yeabsley, submitted that from a grower perspective a cultivar licensing market would be much broader than kiwifruit cultivars alone, having regard to land use alternatives. It would therefore encompass the acquisition of rights to grow kiwifruit cultivars as well as other horticultural crops for cultivation. On the basis of its economic evidence, Zespri submitted that there were two relevant markets in addition to the grower/exporter (non-Australia) market, namely:

- (a) grower use of land, being the retail market for providing goods or services to owners of land in New Zealand relating to their potential commercial use of that land (including but not limited to the commercial licensing of kiwifruit cultivars and other horticultural crops to growers); and
- (b) a new cultivar intellectual property market, being the wholesale market for the supply and acquisition of new cultivar intellectual property and materials for the purpose of testing, development and possible commercialisation. (The other party could be located in other countries, and any resulting testing and production of kiwifruit could occur in other countries.)

[330] For the following reasons we do not accept that either of these markets was established or shown to be relevant to the analysis required for this claim:

- (a) Dr Yeabsley's view on the "grower use of land market" was not supported by any specific evidence on the degree of substitutability

between alternative land uses. Nor was his view developed in submissions for Zespri. The relevant participants in this market were not identified.

- (b) In respect of a “new cultivar intellectual property market”, Zespri provided explanatory material on plant variety rights and related intellectual property obligations, but this “market” was not supported by any specific evidence on the degree of substitutability between alternative new cultivar intellectual property rights within New Zealand. Again Zespri did not develop further this market definition which related to a different activity from licensing new cultivars to New Zealand growers for which plant variety rights have already been obtained.

[331] The kiwifruit cultivar licensing market therefore remains for consideration. While neither Turners & Growers nor their economic expert explained the process whereby the definition of this market was reached, there was evidence on the practice and process of licensing New Zealand kiwifruit growers and the relative level of licence fees depending on supply and demand for the hectares to be planted. The market participants are: the companies (notably Zespri and Turners & Growers and any other cultivar rights holders, ie non-exporters (beyond Australia) who grant grower licences, ie sell the growing rights; and the growers in New Zealand who purchase the licences to plant or graft new varieties.

[332] Of 2701 Zespri-registered growers in New Zealand, only 621 are licensed to grow 615 hectares of Zespri’s three new varieties (see [40]). These will not produce until 2012. [

] Such indications suggest that the competition dynamic in the claimed cultivar licensing market is already changing.

[333] The functional boundary of the claimed cultivar licensing market is around this licensing and growing function, being the sale and acquisition of grower licences for planting proprietary kiwifruit. The relevant product is the kiwifruit grower licence and the relevant price is the licence fee.

[334] As the claim relates solely to licensing activity in respect of New Zealand grown kiwifruit, we are prepared to adopt for present purposes Turners & Growers' definition.

Section 36 – initial observations

[335] Turning to s 36, we make some initial observations:

- (a) It was not disputed that Australia and New Zealand together are unlikely to have the capacity to absorb significant volumes of kiwifruit from new cultivars. Turners & Growers, having recently acquired licence rights from new cultivar developers overseas, wish to export (beyond Australia) the fruit from these proprietary cultivars that it has licensed, or seeks to license, to New Zealand growers. Further, the company wishes to export new cultivar fruit without assigning its commercial rights to Zespri. It cannot export beyond Australia under the existing law. As Mr Goddard submitted, Turners & Growers' main complaint about new cultivars is in substance a complaint about the single point of entry regime.
- (b) Zespri's legal monopsony also impacts upon competition in the kiwifruit cultivar licensing market. As a result, the demand for and prices of third party cultivar licences are lower than for Zespri licences. This regulatory circumstance helps explain why third party rights holders are presently restricted in the returns they can offer growers planting their cultivars.
- (c) Zespri's export authorisation places no purchase obligations on Zespri; nor can Zespri be obliged to purchase a particular proportion of the kiwifruit crop.
- (d) Equally, as submitted for Zespri, Zespri, even with its substantial degree of market power, does not have any duty to assist its

competitors to develop competing cultivars, but this is not necessarily conclusive.

- (e) On its face, the New Cultivar Policy is non-discriminatory amongst holders of cultivar rights in that it applies to new commercial cultivars regardless of source.
- (f) The Regulations enable any person to apply to KNZ for a collaborative marketing approval, pursuant to which a person may export New Zealand-grown kiwifruit in collaboration with Zespri. To date, as noted in the regulatory background section of our judgment, these have had a small (but permissible) impact on Zespri's monopsony. If Turners & Growers consider that Zespri is being unduly obstructive in its submissions on collaborative marketing applications, or that the collaborative marketing approval process is failing applicants in some way, the remedy lies in the first instance with KNZ not the Court in this proceeding. As Mr Goddard submitted, in the absence of evidence of other prohibited conduct, Zespri is entitled to make submissions to KNZ opposing collaborative marketing applications without contravening s 36: *Electricity Corporation Ltd v Geotherm Energy Ltd*. And further, he submitted, the ease or difficulty of entering collaborative marketing agreements is not a Commerce Act issue. We agree.
- (g) At the same time we note that the process does seem somewhat fraught as shown in KNZ's 19 May 2011 decision on a Turners & Growers' application for exporting kiwifruit to multiple countries in collaboration with Zespri. For example, while Zespri cannot stop New Zealand companies from competing in overseas markets by licensing growers overseas, Turners & Growers' trade in Chilean grown (Hayward) kiwifruit – in competition with Zespri – was cited by Zespri as a barrier to successful collaboration in the context of the recent application.

- (h) Zespri has formulated a market strategy whereby it has committed itself to developing a small number of product types, given limited shelf space for and consumption of kiwifruit internationally. A new cultivar which extends the attributes of an existing “product type” is therefore seen by Zespri as more desirable and likely to succeed under the Policy, than a totally new “product type” cultivar.

Has Zespri taken advantage of its market power?

[336] We turn now to the question whether Zespri, in promulgating its New Cultivar Policy following its letter to Turners & Growers, and through that Policy seeking to acquire and control the rights to new kiwifruit cultivars and allegedly restricting the ability of competitors or potential competitors to develop competing cultivars, has taken advantage of its market power.

[337] At the outset we address the issue whether the mere publication of Zespri’s New Cultivar Policy can constitute “conduct” that might be prohibited by s 36(2).

[338] For the following reasons, we proceed on the basis that it can:

- (a) The definitions of the expressions “engaging in conduct” and “conduct” in s 2(2) of the Commerce Act are comprehensive and far-reaching. Both expressions are to be read as references to “doing” or “refusing to do” any “act”; and “refusing to do an act” includes a reference to “making it known that that act will not be done”.
- (b) When these comprehensive definitions are read with the references to “engaging in competitive conduct” in s 36(2)(b) and “conduct” in s 36B, it is clear that they should be construed broadly to encompass all types of “conduct” by the person with the substantial degree of market power which might constitute taking advantage of that power for a purpose proscribed by s 36(2).

- (c) This approach to the interpretation of the expression “conduct” is consistent with the purpose and scheme of the Commerce Act which does not exclude any particular form of “conduct” from the application of s 36(2), other than that specified in s 36(1) and (3), s 43(1), and s 44(1) and (2).
- (d) The publication of a policy by a person with a substantial degree of market power which states what “act” the person will do or will refuse to do in certain circumstances may therefore constitute “conduct” that amounts to taking advantage of that power. A policy that makes it known that that “act” will not be done would be within the extended definition of “conduct” under s 2(2)(c)(ii) of the Commerce Act.
- (e) As the Court of Appeal said in *Electricity Corporation Ltd v Geotherm Energy Ltd*⁵⁵ at 650:

We are not satisfied that statements [of policy] made on behalf of a company in a dominant position as to intended exercise of market power to deter potential competitors, made in circumstances that make them in fact likely to deter competition, could not fall within s 36. Such statements may be said to “use” a dominant position if it is the dominant position that gives the statements the force amounting to deterrence.

- (f) It is the making it known in the policy statement of the acts that will or will not be done that constitutes the “conduct”, rather than the publication of the policy itself: cf *Re ACCC by Pathology Practices*.⁵⁶
- (g) Consequently, the statements by Zespri in its New Cultivar Policy, including those that indicate that it will decline to market the fruit of new cultivars unless they have been evaluated by, and rights granted to, Zespri are within the extended definitions of “engaging in conduct” and “conduct” under the Commerce Act.

⁵⁵ *Electricity Corporation Ltd v Geotherm Energy Ltd* [1992] 2 NZLR 641.

⁵⁶ *Re ACCC by Pathology Practices* [2004] ACCMPT 4, (2004) 206 ALR 271 at [64]-[70] and [85]-[88].

- (h) If Zespri, as is claimed, was indeed attempting through its Policy to dissuade third parties from licensing and commercialising fruit from new cultivars, when there is no legal barrier to doing so, such “conduct” is properly addressed under s 36(2).

[339] In view of the substance, language, reach and the potential rigidity of Zespri’s Policy and its terms, together with the circumstances in which it was introduced, we cannot rule out that Zespri’s release of this Policy would significantly influence the expectation of a cultivar rights holder as to likely outcomes from applications of the Policy, ie in the event that, post-evaluation, Zespri supported a new third party’s cultivar for commercialisation; supported it in principle; or did not support it. Given that expectation, licensors or potential licensors could well be disincentivised from opting in to Zespri’s new cultivar evaluation process and from pursuing new cultivar investment.

[340] On this basis we now turn to apply the “take advantage” test as formulated by the Supreme Court in *Commerce Commission v Telecom Corporation of New Zealand Ltd*.⁵⁷ This requires Turners & Growers to show, on the balance of probabilities, that in a hypothetical workably competitive market, constructed in accordance with the Supreme Court’s analytical framework, the firm without a substantial degree of market power (Zespri) would not as a matter of commercial judgment have introduced the New Cultivar Policy (or at least the main elements of the Policy that have been challenged by Turners & Growers) as Zespri did. The commercial judgment is to be made by the Court objectively and informed by all those factors that would influence rational business people in the hypothetical circumstances which the inquiry envisages.⁵⁸

[341] Before applying the “take advantage” test in this case, it is convenient to set out the requisite steps and cross-checks that constitute the Supreme Court’s method for constructing a hypothetical market and for exercising the required commercial judgment.

⁵⁷ *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2011] 1 NZLR 577 at [42].

⁵⁸ At [35].

[342] First, in constructing a hypothetical market it is necessary to replicate the actual or existing market,⁵⁹ save for eliminating the dominance or substantial degree of market power by:

- (a) stripping out or neutralising the features or matters that give, or give rise to, the substantial degree of market power ;⁶⁰
- (b) denying all aspects of the firm's substantial market power by having constraints in the hypothetical market which neutralise that level of market power;⁶¹
- (c) ensuring that the firm, now denied all aspects of its substantial market power, does not gain (or rather retain) any advantage from its monopoly or monopsony in its dealings with its hypothetical competitors;⁶²
- (d) retaining any special or essential features in the actual market, ie those that do not give rise to the substantial degree of market power;⁶³ and
- (e) checking that the hypothetical firm without its substantial degree of market power is in the same position and circumstances as the actual powerful firm in the real world, but for the removal of its substantial degree of market power.⁶⁴

[343] Second, in constructing a hypothetical market it is necessary to include at least two participants, ie the firm without a substantial degree of market power (Zespri in this case) and at least one other firm in effective competition;⁶⁵ and to recognise that:

⁵⁹ At [36].

⁶⁰ At [38].

⁶¹ At [36].

⁶² At [39].

⁶³ At [40].

⁶⁴ At [12], [13] and [33].

⁶⁵ At [36].

- (a) the hypothetical market structure must be workably competitive;⁶⁶ and
- (b) the hypothetical market construct, being an analytical tool for comparative purposes, need not depend either on realistic or practical assumptions (or predictions); unrealistic scenarios are permissible.⁶⁷

[344] Third, in conducting the comparative exercise and in exercising the requisite rational commercial judgment, the following five questions are likely to guide the inquiry:

- (a) What are the factors that would influence commercially rational business people⁶⁸ in the hypothetical workably competitive market?
- (b) How would the firm, denied its substantial market power, act in the hypothetical circumstances of a workably competitive market?⁶⁹
- (c) Would competition in the hypothetical market have restrained the firm without substantial market power from acting as it did in the actual market?⁷⁰
- (d) Would the powerful firm, once denied its substantial market power, have acted in the same way in the hypothetical market as it is alleged to have acted in the actual market?⁷¹
- (e) As a cross-check: was the alleged conduct in the actual market caused by or materially enabled or facilitated by the firm's substantial degree of market power?⁷²

[345] While the hypothetical market construct is not required to conform with the factual and commercially realistic approach required by the statutory "market"

⁶⁶ At [42].

⁶⁷ At [29] and [39], footnote 56.

⁶⁸ At [35].

⁶⁹ At [12] and [33].

⁷⁰ At [32].

⁷¹ At [31] and [34].

⁷² At [14] and [31].

definition, it is nevertheless required to replicate the actual market, defined in accordance with that definition, but for removing the source(s) of the substantial market power that exists. In resolving the nature of the hypothetical market test, the Supreme Court emphasised the need to give firms and their advisers a reasonable basis for predicting in advance whether their proposed conduct falls foul of s 36.⁷³ We infer from this that the hypothetical market construct itself should be as straightforward and realistic as possible, notwithstanding that in some cases a key assumption may be neither realistic nor practical.

[346] In the Supreme Court's case, Telecom's dominance was attributed to its ownership of the PSTN network, a prohibitive physical and economic entry barrier to the market.⁷⁴ This had to be neutralised by the "unrealistic scenario" of having two firms each with a PSTN network. The Supreme Court did not suggest, however, that such an unrealistic scenario would be necessary in all cases.

[347] Zespri's "substantial degree" of power in the grower/exporter (non-Australia) market arises from the Regulations which create a legal barrier preventing any competitor from entering that market and acquiring kiwifruit for export to countries other than Australia. In addition, Zespri has been able to replicate the substantial degree of power conferred by its legal monopsony through creating a "commercial monopsony" with its loyalty contracts and the exclusivity provisions in the supply agreements.

[348] The parties suggested the following ways of stripping out or neutralising Zespri's substantial degree of power in the market:

- (a) the revocation of the Regulations thereby enabling other firms to compete in a completely deregulated market for the acquisition of kiwifruit in New Zealand for export to countries other than Australia (a "fragmented market" as proposed by Mr Mellisop and Turners & Growers);

⁷³ At [30].

⁷⁴ At [39].

- (b) the introduction of new regulations under s 26(1)(d) of the Kiwifruit Industry Restructuring Act 1999 providing for KNZ to permit other persons to export kiwifruit and the grant of a permit by KNZ to at least one other firm enabling that firm to compete in the modified regulated market for the acquisition of kiwifruit in New Zealand for export to countries other than Australia (a “modified regulated market”, recognised as a possibility by Turners & Growers); and
- (c) the adoption of new regulations creating a “duopsony” with two firms entitled to acquire between them all kiwifruit for export to countries other than Australia with each firm having a monopoly in respect of different export markets (a “regulated duopsony market” as proposed by Dr Yeabsley and Zespri).

[349] Adopting the most straightforward approach to the construction of the hypothetical workably competitive market in the present case, we consider that both the “fragmented market” and the “modified regulated market” proposed by Turners & Growers would serve to strip out or neutralise the substantial degree of power conferred on Zespri by its legal monopsony. For reasons given earlier in this judgment, we are not in a position to predict, assume or suggest the most realistic way for the Government to remove this source of Zespri’s market power.

[350] We agree with Turners & Growers that, in the hypothetical grower/exporter (non-Australia) market, Zespri also needs to be denied the substantial power that would result from the operation of its loyalty contracts and supply agreements in such a “deregulated” market. Being the sole acquirer of 100% of Class 1 Hayward Green fruit, for at least three years, in addition to acquiring 100% of the Class 1 Hort 16A crop at least up to the end of 2018 when the plant variety rights in New Zealand expire, would give Zespri an advantage in dealing with its hypothetical competitors. In our view, retaining these contracts would not meet from the outset the Supreme Court’s requirement that the hypothetical market be workably competitive.

[351] The presence of one or more new entrants to the hypothetical market would constrain Zespri and deny any one firm from having a substantial degree of power. This market would therefore replicate the actual market, but for the elimination of the two sources of Zespri's substantial power, and ensure that Zespri could not in its dealings with actual or potential competitors gain or retain any advantage from its regulatory or commercial power. We do not consider that it is necessary to adopt the less straightforward assumptions associated with a "regulated duopsony market" as proposed by Zespri.

[352] For the purpose of its proposed "regulated duopsony market", the only special features of the grower/exporter (non-Australia) market which Zespri submitted should be retained, because they did not give rise to its market power, were the provisions of the regulatory regime, such as reg 5(c) (which prevents Zespri from taking title to kiwifruit earlier than FOBS) and reg 11 (the non-diversification rule which limits Zespri's ability to integrate backwards into the industry in New Zealand). We agree that the same argument might apply in a "modified regulated market", but it would not be the position in a "fragmented market" where all exporters, including Zespri, would be entitled to be vertically integrated.

[353] This leaves for consideration the question whether the hypothetical workably competitive grower/exporter (non-Australia) market in New Zealand would enable Zespri and the new firm(s) to take steps to continue to receive premium prices or "rents" from the overseas export markets. Mr Walker submitted for Turners & Growers that with the removal of the sources of Zespri's substantial power, Zespri's present ability to earn such rents from having an export monopoly in respect of New Zealand-grown kiwifruit, should also go. Mr Goddard for Zespri submitted however that, notwithstanding competition in the hypothetical New Zealand market, Zespri and the new firm(s) should be assumed to have the opportunity to take steps to continue to receive rents from the sale of Class 1 kiwifruit in overseas export markets. He pointed out that Zespri and the new firm(s) would be able to avoid the application of the Commerce Act by entering into a contract or arrangement or arriving at an understanding, insofar as it contains a provision relating exclusively to the export of kiwifruit from New Zealand, if full and accurate disclosure (including particulars of any method of fixing, controlling or

maintaining prices) were furnished to the Commission within 15 working days under s 44(1)(g) of the Commerce Act.

[354] In our view there is no good reason why, in constructing the hypothetical workably competitive market, it is necessary to assume away the “opportunity”, as described by Mr Goddard, for New Zealand exporters not to compete with one another in premium overseas markets. The existence of these overseas markets for New Zealand grown kiwifruit, beyond the reach of the Commerce Act, and the financial incentives for “commercially rational” hypothetical exporters to take steps to endeavour to retain the rents from these markets, should therefore not be disregarded in considering economic activity within the hypothetical market in New Zealand.

[355] Having said that, it would equally be open to acquirers/exporters in a hypothetical workably competitive market not to agree with one another on export marketing strategies, as appears to be the case in respect of the actual grower/exporter (Australia) market. It cannot simply be assumed therefore that in “a fragmented” or “modified regulated market”, the conduct of hypothetical acquirers/exporters would be as predictable as it might be in the “regulated duopsony” market preferred by Zespri.

[356] We now turn to answer the five questions we identified above in [342].

[357] First, the main influencing factor on Zespri’s conduct in the hypothetical market would be competition from third party cultivar rights holders who would no longer be dependent on Zespri for exporting the fruit from their cultivars. Neither would they be dependent on Zespri for a decision on whether or not to commercialise their new cultivars. And nor would they be faced with the prospect of having to grant Zespri their commercial rights should the decision be made to commercialise their new cultivars.

[358] Second, in these circumstances, Zespri would at least consider exporting the fruit offered from rival cultivars, subject to being compensated for its opportunity costs, on the assumption that such fruit would otherwise be exported independently

and, as Turners & Growers submitted, Zespri could lose market share in both the grower/exporter and cultivar licensing markets. We agree with Mr Mellsop that Zespri could no longer prevent loss of market share, as a result of cannibalisation of its own branded products, and hence the opportunity costs would not include this risk. A commercially rational Zespri would, as Mr Walker submitted, blend the promotion of select, proprietary (higher value) cultivars with the export of other fruit if a commercial opportunity arose.

[359] While Turners & Growers submitted that Zespri would “no longer be able to prevent third party cultivars from being planted”, we note that Zespri does not in the current cultivar licensing market have such power. Indeed, the minutes of the Zespri Board (21 October 2009) record that in the event of Zespri not electing to pursue a new variety ([] in that instance) owners were free to commercialise for themselves. Any economic disincentive to do so derives from the current export ban. Turners & Growers’ complaint is more accurately described later in its submission as Zespri’s attempts to prevent third parties from licensing and commercialising fruit from those cultivars.

[360] In the hypothetical market, Zespri need not modify its cultivar evaluation procedures for determining which of its cultivars will be released commercially. However, it could no longer require Turners & Growers (or other exporters of new cultivar fruit in competition with Zespri) to subject their new cultivars to that process as a prerequisite for commercial release. And a policy requiring an assignment of rights to Zespri as a condition of it agreeing to export would likely meet with such resistance that the policy would serve no practical purpose. As Turners & Growers submitted, a commercially rational Zespri could no longer afford to insist on acquisition of the rights to a cultivar as the price of export. Furthermore, in our view in the hypothetical market royalty rates, if any, would be negotiated on a commercial basis rather than being expressed as a unilateral fixed maximum.

[361] In light of these conclusions on the first two questions our answers to the remaining three questions are:

- (a) Competition in the hypothetical market would have restrained the firm without substantial market power from acting as it did in the actual market.
- (b) The firm denied its market power would not have acted in the same way in the hypothetical market as it is alleged to have acted in the actual market.
- (c) The alleged conduct in the actual market was caused by or materially enabled or facilitated by Zespri's substantial degree of market power.

[362] Accordingly, we find that Turners & Growers have shown, on the balance of probabilities, that in a hypothetical workably competitive market, so constructed, Zespri stripped of its substantial degree of market power, would not as a matter of commercial judgment have introduced the New Cultivar Policy (or at least the main elements of the Policy that have been challenged by Turners & Growers) as it did. We find therefore, that Zespri has taken advantage of its power in the grower/exporter (non-Australia) market in respect of this Policy.

Proscribed purpose?

[363] The next question is whether Zespri has taken advantage of its market power for a proscribed purpose in respect of the new kiwifruit cultivar licensing market; or, in the more specific terms of the pleading, has Zespri the purpose of preventing or deterring competitive conduct in that market?

[364] As already noted in the legal framework section of our judgment, a purpose proscribed by s 36(2) may be inferred when the effect produced by or achieved from the taking advantage of market power is anti-competitive. Equally, however, if no anti-competitive effect is produced or achieved by the taking advantage of the person's market power, then it will not be possible to draw an inference of anti-competitive or proscribed purpose from that particular conduct.

[365] Turners & Growers in their pleadings and submissions suggested a number of effects arising from the New Cultivar Policy, giving rise to the issue of whether a proscribed purpose could be inferred from the conduct (or from any relevant circumstances) under s 36B. While incentives for developing new cultivars in New Zealand, independent of Zespri, are undoubtedly dampened by the regulatory regime, it is important to distinguish between an effect arising from Zespri's legal control of the export channel (beyond Australia) and an effect from the conduct in question. Here, any restrictions or deterrents in the kiwifruit cultivar licensing market flow from the ban on exports and cannot be attributed to Zespri's conduct in adopting the Policy. In our view, therefore, Turners & Growers have not established that an anti-competitive effect has in fact been produced or achieved from the conduct. A proscribed purpose cannot be inferred from that conduct. This leaves the question whether any other evidence established a proscribed purpose.

[366] We accept that Zespri's New Cultivar Policy is something more than flexible guidance and that it reflects Zespri's desire to maintain tight control over the fruit exported from New Zealand. It also reinforces "the Zespri way" which extends to product branding and promotion and marketing overseas. In Zespri's view, "it would be irresponsible for [it] to agree to support for export a new product which was unproven through the Zespri system".

[367] But we also agree with Dr Yeabsley that the Policy reflects a rational business case approach by Zespri to any commercialisation investment. Growers' interests will be served by commercialising and exporting kiwifruit from the best cultivars, regardless of source, and maximizing the net returns of the product portfolio. All of this is in the face of global competition for new cultivar development.

[368] Objectively, then, Zespri has a real and substantial commercial purpose for the present policy. And the fact that competition for new cultivar development is international is likely to act as a discipline on Zespri's policy for evaluating and selecting and commercialising new cultivars in New Zealand. The sale or licensing of potentially successful new cultivars for commercialisation overseas and in competition with New Zealand growers would not be in Zespri's interest.

Furthermore, Zespri's references to "the best interests of New Zealand kiwifruit growers" and "adding value to the New Zealand kiwifruit industry and Zespri shareholders" are consistent with the mandate entrusted by the Government to Zespri. Zespri is mandated to represent the economic interests of all kiwifruit growers in New Zealand. In our view Turners & Growers did not establish that Zespri's purpose in issuing its New Cultivar Policy was other than a substantial purpose consistent with that mandate.

[369] Nor did Turners & Growers establish any other substantial proscribed purpose.

Conclusion

[370] In our view, therefore, the s 36 claim in relation to the New Cultivar Policy fails. While Turners & Growers established on the balance of probabilities that Zespri, in setting the policy terms that it did, has taken advantage of its market power in the relevant grower/exporter market, they have not established on the balance of probabilities that Zespri had a substantial purpose of preventing or deterring competitive conduct in the kiwifruit cultivar licensing market.

Relief

[371] As no s 36(2) contravention has been found, it is unnecessary for us to consider the relief sought by Turners & Growers.

Result

[372] For the reasons given in our judgment, we have decided that:

- (a) Zespri has not contravened s 27(1) or s 36(2) of the Commerce Act in respect of the loyalty contracts and the exclusivity provisions in the supply agreements in the current regulated grower/exporter (non-Australia) market, and no "deregulated" market was established;

- (b) Zespri has not contravened s 27(1) in respect of the 2009 Australia service level agreements because the provisions of the agreements did not have the purpose or effect or likely effect of substantially lessening competition in the current regulated market;
- (c) Zespri has not contravened s 36(2) in respect of the 2009 Australia service level agreements because, even assuming that Zespri had taken advantage of its market power, it did not do so for a proscribed purpose;
- (d) Zespri has not contravened s 36(2) in respect of the new kiwifruit cultivar policy because, while it did take advantage of its market power, it did not do so for a proscribed purpose.

[373] As Turners & Growers' claims under Part 2 of the Commerce Act have therefore been unsuccessful, the relief sought by Turners & Growers in the fourth and fifth causes of action in their second amended statement of claim is formally declined.

[374] We see no reason why Zespri should not be entitled to its costs on a category 3 basis as determined in judgment (No. 3) dated 29 October 2010,⁷⁵ with disbursements to be fixed by the Registrar, but if the parties are unable to agree Zespri may submit a memorandum within 14 days and Turners & Growers may respond within a further 14 days.



D J White J



K M Vautier

⁷⁵ *Turners & Growers Ltd v Zespri Group Ltd (No. 3)* HC Auckland CIV 2009-404-004392, 29 October 2010.

Addendum dated 22 August 2011

[375] The complete version of this judgment was released only to counsel for the parties on 12 August 2011 to enable them to advise whether there were any parts of the judgment which they sought to have redacted from the public version of the judgment on grounds of confidentiality: minute (No 6) of the Court dated 12 August 2011.

[376] By joint memorandum of counsel for the parties dated 18 August 2011, redactions for reasons of confidentiality and commercial sensitivity were sought to aspects of the following paragraphs of the judgment: [157], [198], [277](d), [317], [318], [332] and [359].

[377] The Court accepts that these redactions should be made to the judgment for reasons of confidentiality and commercial sensitivity.

[378] The judgment with these redactions may now be released and published.


D J White J