

DETERMINATION

In the Matter of a Complaint by

[REDACTED] t

Pursuant to the Provisions of the
Kiwifruit Export Regulations 1999

Background

1. By letter dated 23 August 2006 [REDACTED] (the Complainant), a kiwifruit grower, complained that Zespri Group Limited (Zespri) discriminated against him and other kiwifruit growers, "by removing suppliers (growers) and their elected representatives direct negotiating rights with Zespri on financial and monetary decisions which affect growers incomes. By handing these rights to decision making bodies, with a predominance of post harvest representatives and Zespri representatives, growers are severely disenfranchised."

2. Kiwifruit New Zealand Board (KNZ) accepted the complaint for consideration as falling within the provisions of Regulation 9 of the Kiwifruit Export Regulations 1999 (the Regulations) which imposes on Zespri a duty not to unjustifiably discriminate. Regulation 9 provides:

"ZGL, and its directors and managers, must not unjustifiably discriminate among suppliers and potential suppliers in respect of—

(a) ...

(b) The terms of the purchase contract."

A "supplier" for the purposes of the Regulations includes a grower; see Regulation 2 and Aotearoa Kiwifruit Export Limited and others v. Southlink Limited and Zespri Group Limited [CIV2003, 470-478], paragraphs 57-61.

3. KNZ approached the complaint on the basis that the complainant was alleging that the purchase contract (2006 Supply Agreement) for the 2006/2007 season entered into by him with Zespri included provisions which effectively removed growers and their elected representatives direct negotiating rights with Zespri on financial and monetary decisions which as a consequence adversely affected growers' incomes. The Complainant alleged that Zespri had set up two decision making bodies:

- (a) The Industry Advisory Council (IAC) to which he said Zespri had given negotiation and recommendation rights on financial and monetary decisions which could have a major effect on growers' incomes; and
- (b) The Industry Supply Group (ISG) which he said had as one of its main functions responsibility to negotiate the supply contract with Zespri, including financial and monetary considerations in the form of the pricing and payment manual.

The Complainant alleged that the membership of the IAC and the ISG was so structured that grower representatives were outnumbered by representatives of post harvest operator, supply and logistic groups. The Complainant put it succinctly as follows: "It is incomprehensible to growers that a third of the IAC and half of the ISG representation making grower financial and monetary decisions are supply and logistic people elected by Post Harvest Facilities."

The Complainant said that: "By establishing a much stronger numerical representation for Post Harvest Facilities and their leased and managed orchard interests on the IAC and the ISG, Zespri have given disproportionate power to post harvest and their interests on the financial and monetary decisions affecting all growers. By continuing to allow Post Harvest Facilities and their interests dominant control of financial and monetary decisions which affect all growers Zespri are unjustifiably discriminating against all other growers by treating post harvest fruit suppliers (leased and managed orchards) differently."

4. The material supplied to KNZ by the complainant was made available to Zespri and it was given the opportunity to comment thereon. The responses received by KNZ from Zespri were made available to the complainant and he was given an opportunity to comment thereon. KNZ gave careful consideration to the terms of the 2006 Supply Agreement.

Consideration of the Issues Raised by the Complaint

5. The primary focus of the complaint centred on the establishment by Zespri of the IAC and the ISG and their respective memberships, and the role each was given by the 2006 Supply Agreement and the negotiations establishing its contents.

The question for determination therefore was whether Zespri's creation of the IAC and the ISG, their membership, powers and voting rights resulted in the 2006 Supply Agreement unjustifiably discriminating among suppliers of kiwifruit to Zespri.

6. In summary, the IAC was established by Zespri after consultation with the kiwifruit industry to "provide recommendations to the Zespri Board."

The objectives of the IAC are identified in its terms of reference as follows:

"The primary objective of the IAC is the enhancement of commercial representation of the NZ kiwifruit industry and the improvement of grower wealth through:

- (a) Establishing a commercial supply interface with Zespri that encourages innovation and accountability for both Zespri, grower and supplier performance and that maximises growers' wealth.
- (b) Encouraging contestability of supply.
- (c) The ability to influence Zespri policy for the benefit of growers.
- (d) The ability to determine industry issues."

The terms of reference identified relevantly that one of the 'functions' of the IAC is "Issues relating to the Supply Contract."

Membership of the IAC consists of two Zespri Board members, three Zespri executives, five representatives appointed by suppliers and five representatives appointed by New Zealand Kiwifruit Growers Incorporated. Each member will have one vote.

The terms of reference specify:

- Recommendations will be made by clear consensus.
- The ISG is a standing committee of the IAC.
- Suppliers are representing interests that include but are not limited to supply entities, packhouse, cool store and logistic service providers.
- Grower representatives represent interests that include but are not limited to growers and product groups.

- Zespri represents the interests of the marketer and its grower/shareholders.

7. The terms of reference of the ISG (as a sub-committee of the IAC) are stated to be as follows:

“Working within the objectives of the IAC, the objectives of the ISG are to:

- Identify and achieve supply chain efficiencies.
- Continuous improvement of the quality systems.
- Enhancing the transactional partnership within the industry.

The scope of the ISG as identified within the terms of reference is as follows:

- Zespri EDI manual.
- Zespri Quality manual.
- Development of the services contract (i.e. Schedule 2 of the Supplier Agreement and sections of the pricing and payments manual that relate to service payments).
- Sections of the pricing and payments manual relating to onshore supply aspects.

The terms of reference include the following exclusions:

“The ISG will not consider the following matters:

- Any discussion or consideration of costing or pricing relating to fruit payment.
- Any internal procedures of Zespri, growers, or suppliers.

Membership of the ISG is as follows:

Zespri:

- Zespri Global Manager Global Supply Chain & Systems.
- Three Zespri staff appointed by the General Manager Global Supply Chain & Systems.

Supplier representatives:

- Four representatives appointed by suppliers

Grower representatives:

- Two representatives appointed by New Zealand Kiwifruit Growers Incorporated.

The terms of reference record that the decision making process is as follows:

“General consensus is to be reached on all matters to achieve the group objectives. Individual matters may be resolved on a case by case basis. If general consensus cannot be achieved a recommendation will be reached and objections reported.”

Basically the ISG is to make recommendations to the Zespri Board or to the IAC.

8. Clause A15 of the 2006 Supply Agreement provides for variations to that agreement and relevantly identifies a role for the IAC and the ISG as follows:

“A15.1 ZGL may, from time to time, either at the request of the contractor or otherwise, vary provisions of:

- (a) This agreement (excluding the supply specifications and the schedules) and the pricing and payment manual; and
- (b) The ZIL quality manual and the EDI manual; and
- (c) Schedule 2 or Schedule 6 of this agreement or Section F of the pricing and payment manual, or any of them, as long as it first complies with the provisions of clause A15.2 or clause A15.3 applies.

A15.2 Before any variation under clause A15.1 is made, ZGL must:

- (a) In the case of a variation to this agreement (excluding the supply specifications and the schedules) and the pricing and payment manual (excluding Section F):
 - (i) Give written notice of the proposed changes to the IAC; and then
 - (ii) Obtain the agreement of the IAC to the proposed variation and the appropriate compensation, if any, that reflects the financial impact on contractors (under supply agreement) and ZGL of those changes;

- (b) In the case of a variation to the ZIL quality manual or the EDI manual or Schedule 2 or Section F of the pricing and payment manual:
 - (i) Give written notice of the proposed change to the ISG; and then
 - (ii) Obtain the agreement of the ISG to the proposed variation and the appropriate compensation, if any, that reflects the financial impact on contractors (under supply agreement) and ZGL of those changes;

- (c) In the case of a variation of Schedule 6:
 - (i) Give written notice of the variation to the contractor; and then
 - (ii) Negotiate with the contractor appropriate compensation that reflects the financial impact on the contractor of those changes.”

9. The complainant expresses the view that as growers own the fruit to the point at which Zespri takes title, that is when the fruit is stowed on board the ship or aircraft on which the fruit is exported (FOBS), “both Zespri and Post Harvest Facilities must give recognition to this fact and negotiate directly with the grower only.” The complainant identifies what is at the core of this complaint in the following words:

“It may well be timely for Zespri to reconsider the point of purchase. Before corporatisation Zespri made the decisions and the regulations covered this. Now they have passed the bulk of the deliberation and recommendations on grower

payments to committees not contemplated by the regulations, the result is that the protection for the growers under the regulations is now diminished.”

In the complainant's view this creates a breach of the provisions of Regulation 9(b).

10. Zespri acknowledges that the 2006 Supply Agreement does confer certain roles on the IAC and ISG which may impact on payments made under the Agreement, including:
- The ability under clause A15 to approve certain amendments to the Agreement; and ISG decides taste bands for Taste Zespri product, under clause 8.2 (a) of Schedule 2; and
 - Zespri must consult IAC before smoothing fruit prices within a pool, under clause A1.3 of the pricing and payment manual.

However Zespri say: “None of those roles have resulted in payments being made which discriminate among suppliers. For example, suppliers of services who receive Taste Zespri payments receive the same payment, whether or not they are also grower suppliers or suppliers of kiwifruit, as well as suppliers of services.” The Zespri submission is that, “There is no discrimination in the annual supply agreement between the suppliers. All receive payments on the same basis for each fruit or service component, whether or not they are suppliers in more than one capacity.”

11. The complainant appears to be concerned that post harvest operators, through orchard leasing activities, have the same status as growers and are able to influence grower participation on the IAC and ISG and other grower bodies. All have input into negotiations with Zespri when it formulates the annual purchase contract, in this case the 2006 Supply Agreement. The complainant suggests that this allows post harvest

suppliers a dominant role in purchase contract negotiations and limits growers to a lesser role, thereby unjustifiably discriminating among suppliers.

12. The Zespri submission is that Regulation 9 does not apply to pre contract negotiations and "It applies only to the decision to purchase kiwifruit or the terms of the purchase contract."
13. Central to the complaint is the composition of the IAC and the ISG and the inclusion on those two bodies of post harvest 'suppliers', who are seen to be in a dominant role and grower 'suppliers' in a lesser role with the effect of "Removing suppliers (growers) and their elected representatives direct negotiating rights with Zespri on financial and monetary decisions which affect growers' incomes."
14. For the purposes of applying the relevant provisions of the Regulations, the following meanings have been applied:
 - 'Discriminate' means to single out a particular person or group for special favour or disfavour, and
 - 'Unjustifiably' means not in accordance with accepted standards of fairness or justice; discrimination not based on commercial grounds.
15. Growers are not identified in the Regulations as a separate component of the kiwifruit industry. Regulation 9 imposes on Zespri a duty not to discriminate unjustifiably among "suppliers and potential suppliers". Regulation 2 defines the word "supplier" as meaning "a person from whom ZGL acquires the property in kiwifruit grown in New Zealand". If a grower passes title to the grower's kiwifruit to Zespri then the grower clearly is within the meaning of the word "supplier" for the purpose of the

Regulations. However there are other different ways by which the title to kiwifruit is passed to Zespri, namely through the intermediary of post harvest operators or supply entities. Growers generally are however considered to be suppliers for the purposes of Regulation 9 as observed in the decision of the High Court in *Aotearoa Kiwifruit Export Limited and others V Southlink Limited and Zespri Group Limited* [CIV2003, 470-478] paragraphs 57-61. The Court observed "The industry structures its dealings in kiwifruit in a pyramid structure with Zespri at the apex of the pyramid. Zespri deals with a limited number of suppliers [described as post harvest operators].... Those suppliers in turn deal with another group of suppliers [described as supply entities] who in turn deal with another group of suppliers [growers]."

Different combinations within the pyramid can occur, but basically the title to kiwifruit passes from the supplier growers to Zespri direct or through an intermediary or series of intermediaries. For the purposes of this complaint Zespri must not by its actions discriminate unjustifiably in terms of the 2006 Supply Agreement entered into with the complainant directly or through the complainant's intermediary.

16. The KNZ Board is satisfied that the 2006 Supply Agreement was made available to the complainant and all other suppliers within the industry in similar terms. The question is does the Agreement in either its construction or terms unjustifiably discriminate between the various suppliers with which Zespri has a relationship and if so, whether that discrimination is justifiable on commercial grounds.

17. Before Zespri acquires title to the kiwifruit crop after it is picked from the vines, the fruit passes through a number of processes provided by post harvest operators and supply entities before it is ready to be placed on board ship or aircraft for export. The

exportable fruit is prepared as a result of a complex supply chain with growers, post harvest operators and supply entities all contributing to a series of interrelated activities. In negotiating the terms of its purchase contract for the supply of kiwifruit, Zespri confers with industry representatives through the IAC with a view to rationalising and coordinating each step in the process. The purchase contract, the 2006 Supply Agreement in this instance, brings together a series of transactions and activities designed to have available high quality fruit for export with the aim of obtaining premium prices. This collaboration and involvement is an essential component of the kiwifruit industry structure and provides a sound commercial basis from which Zespri is able to market New Zealand grown kiwifruit.

18. The IAC and the ISG have been established by Zespri after industry consultation. The purpose of the IAC is to 'provide recommendations to the Zespri Board.' The objectives of the IAC set out in paragraph 6.

The scope of the IAC's activities within those objectives are necessarily wide and include "issues relating to the supply contract".

The IAC's recommendation process specifies that each committee member will have one vote and that recommendations will be made by clear consensus.

19. The KNZ Board is satisfied that the establishment of the IAC is a practical way of enhancing the commercial representation of the various components of the New Zealand kiwifruit industry to provide for a commercial supply interface with Zespri. Although there could be different voting rights given to the membership groupings

comprising the IAC the members are enjoined to make their recommendations by clear consensus. Given the objectives of the IAC that does not seem unreasonable.

20. The ISG was established by Zespri as a sub-committee of the IAC. Its objectives are set out in paragraph 7.

General consensus is to be reached on all matters to achieve the group objectives. If general consensus cannot be achieved a recommendation will be reached and objections recorded. Decisions are to be "recommended to the Zespri Board or the delegated authority manual, and reported to the IAC."

21. The ISG as a sub-committee of the IAC can be seen as a practical way to address common industry supply and quality issues in a co-operative manner leading to a general consensus on recommendations to be made to the Zespri Board. All sections of the industry are represented by membership entitlement.

22. All industry stakeholders are represented on both the IAC and ISG. Whilst some stakeholders have dual interests, all suppliers are represented. Clearly the complainant sees that some suppliers with dual interests potentially have greater influence than solely grower suppliers by reason of some service suppliers also being grower suppliers. That does not necessarily follow. It is in the hands of the grower suppliers who are to represent them on the IAC and the ISG. Grower suppliers have a voice on both groups which in turn basically make recommendations based on consensus between the various stakeholders. Whilst the outcome of deliberations and recommendations of the IAC may have an impact on grower returns by amendments made to the supply contract, the primary objective is the enhancement of commercial representation of the kiwifruit

industry suppliers and improvement of grower wealth. This does not amount to discrimination against grower suppliers.

23. It is for each supplier to determine whether or not he/she/it was willing to enter into the 2006 Supply Agreement offered by Zespri. As the same agreement was offered to each supplier the KNZ Board is satisfied that it does not discriminate between suppliers. If the membership and voting provisions applicable to the IAC and ISG are seen as discriminating against grower suppliers then to the extent that there is discrimination it is reasonably justifiable on commercial grounds. The membership and voting provisions applicable to the IAC and ISG were set following industry consultation, balancing the interests of the various stakeholders in the kiwifruit industry. If the objective is to provide Zespri with high quality good tasting fruit in order to obtain premium prices, then the stakeholders must co-operate in coordinating their separate activities. The industry generally seems reasonably satisfied with the arrangements made through the establishment and operation of the IAC and the ISG to achieve this end. That said it may be possible that other membership and voting provisions could be agreed through industry consultation that could remove or limit the complainants perception of unjustifiable discrimination.
24. The complaint is not upheld.

General Observations

25. Notwithstanding the view reached, that there has been no discrimination by Zespri in terms of the Regulations and if there was discrimination it was justifiable on commercial grounds, some reservations are recorded about the ISG and IAC. It is the

way these committees are constituted that can be seen to underpin the concerns raised by the complainant.

26. Clause A15 of the 2006 Supply Agreement, entered in to by Zespri and Suppliers, provides for variations to that agreement and identifies a role for the IAC and the ISG, to agree to those variations. In that regard, those committees act as delegates on behalf of all suppliers to make recommendations which may ultimately amount to variations to the 2006 Supply Agreement. Significantly such decisions can also include matters of financial consequence.
27. While there are restrictions in the 2006 Supply Agreement as to the matters that can be considered by the IAC and ISG, there are no such restrictions on the way those committees are constituted or governed, as they are committees of Zespri. In short, the balance that exists in negotiating leverage between Zespri and suppliers in the process of arriving at the terms and conditions of the 2006 Supply Agreement can be substantially altered in perception or reality by the terms of reference of the IAC and ISG. The composition and voting rights of those committees particularly may result in a substantially different balance of power to that which existed at the time of concluding the Supply Agreement. Grower suppliers concerns as to the potential consequences of the existing arrangement are therefore understandable.
28. While Grower suppliers may be concerned, the remedy is in their own hands. The 2006 Supply Agreement is a negotiated document. If there are concerns as to the way that IAC and ISG may act on their behalf, the remedy is for Grower suppliers to negotiate more appropriate arrangements into the Supply Agreement. Refinement of that

document could substantially remove the cause of the concern raised by the complainant.

29. It is also clear that some Grower suppliers feel alienated from Supply Agreement issues that directly affect them; in particular from the negotiation and administration of the Supply Agreement. Nor does it appear that the communication systems are in place for them to understand when and how supply agreement negotiations take place so they keep abreast of the issues, have an opportunity for input into them, and ensure accountability to them. This appears to be an area warranting detailed consideration by all industry participants.

30. KNZ acknowledges the relevance of the complaint within the context of the kiwifruit industry's unique structure. That structure has evolved over time and continues to do so. In that situation it is important that growers and other stakeholders are heard and are able to contribute to the form of that evolution. The changing nature of the very competitive international marketplace for kiwifruit requires the industry to achieve the greatest possible degree of unity on shore in order to compete profitably and remain viable.

For and on behalf of the Kiwifruit New Zealand Board

[Original signed by Sir Brian Elwood]

Chairman

Dated: 20th day of February 2007