

## **Grower Complaint – 16 June 2016**

### **Complaint Process**

On 4 December 2015, the KNZ Board received a complaint that Zespri had failed to comply with the non-discrimination and non-diversification standards set out in the Kiwifruit Export Regulations 1999 (“Regulations”).

The Board, having responsibility for monitoring and enforcing compliance by Zespri with those standards, established a Complaint Committee (“Committee”) to conduct an inquiry into the complaint in January 2016.

The Committee consisted of Kristy McDonald QC (Chair), Dr Andrew Butler (Partner, Russell McVeagh), and Kieran Murray (Economist).

Below is a summary of the complaint and the Committee’s discussions and findings. The full decision is available below.

### **The Complaint**

In summary, the complaint made two allegations:

- 1) **Breach of the non-discrimination rule** - That Zespri was discriminating unjustifiably (regulations 9 and 10) against Hayward growers by paying them significantly less than growers of Zespri PVR varieties (effectively a form of discrimination/cross subsidisation linked to a complaint of monopsony abuse) and the information disclosures did not justify the pricing difference between the Hayward and Zespri PVR varieties (regulations 13 and 14).
- 2) **Breach of the non-diversification rule** - That Zespri’s practice of holding the proceeds of sale in its grower pool funds rather than holding the funds in a separate trust is contrary to the non-diversification rule at regulation 11.

### ***Non-Discrimination rule***

#### **Discussion**

Regulation 9(b) provides that Zespri must not unjustifiably discriminate among suppliers and potential suppliers in respect of the terms of the purchase contract.

Before dealing with the content of the complaint, the Committee commented that:

- The word “discriminate” in its ordinary legal usage means to treat someone differently from someone else when those people are in comparable circumstances.
- The phrase “unjustifiably discriminate” is not defined. Rather regulation 10 sets out what is to be regarded as “justifiable discrimination”. Regulation 10 is exhaustive. If discrimination does not fit within the terms of regulation 10 it is not justifiable and will therefore be unjustified discrimination.

### **Findings**

While all kiwifruit suppliers are subject to the same terms of purchase (as contained in the Supply Agreement), the complaint was concerned that Zespri was overcharging costs, or under allocating revenue, to suppliers of Hayward varieties compared to suppliers of gold kiwifruit. The amount paid

to suppliers of each variety is determined by Zespri's pricing methodology as set out in the Pricing and Payments Manual (a schedule to the Supply Agreement).

The Pricing and Payment Manual stipulates that kiwifruit supplied under its Supply Agreement are allocated to a "pool" of which there are seven as specified in the Pricing and Payment Manual, including the "Zespri Green Kiwifruit" pool and the "Zespri Gold Kiwifruit" pool. The Committee found that the Pricing and Payment Manual applies the same pricing methodology to all pools.

The Committee found that Zespri's pricing methodology, does not discriminate between suppliers of Hayward and Zespri PVR varieties. Further the Committee noted that if it was wrong in that conclusion the discrimination (which passes differences in revenue and cost back to suppliers) is justified on commercial grounds and therefore not contrary to regulation 9(b).

Further, the Committee noted that the non-discrimination rule in regulation 9(b) does not guarantee equality of outcome, it guards against unequal treatment of suppliers in terms of the purchase contract.

### ***Non-Diversification rule***

#### **Discussion**

Regulation 11(1) prohibits Zespri from carrying out activities, or owning or operating assets, that are not necessary for the core business, unless exceptions apply.

The Committee was of the view that something is to be considered "necessary" for a purpose if that thing is "essential" for that purpose.

It was the view of the Committee that Zespri is not confined to undertaking the bare logistics of the physical purchase of New Zealand-grown kiwifruit and its export. Other activities that support the core business can be classified as essential within that context.

The Committee also provided its view on other matters contained in regulation 11 as follows:

- The term "providers of capital" is wide enough to embrace both shareholders and suppliers.
- What constitutes minimal risk in any given case will depend on the particular circumstances.

#### **Findings**

The Committee concluded that Zespri's practice of itself holding "grower pool funds" rather than holding them in a separate trust did not breach regulation 11.

The Committee found that funds held by Zespri are not properly characterised as "grower pool funds". Neither growers nor suppliers are entitled to the gross returns from export sales held by Zespri. Instead they are entitled to receive payments of the amount, and at the time, specified in the Supply Agreement.

It was also noted that Zespri's practice of holding gross returns from export sales, meeting costs and liabilities in accordance with the Supply Agreement and making fruit payments, as specified in the Supply Agreement, is necessary for Zespri's core business because doing so is essential to the purchase and export of New Zealand-grown kiwifruit.

## ***Information disclosure***

### **Discussion**

While the Committee held that Zespri had not contravened regulation 13(e) (as that obligation was not on Zespri but rather a matter to be published in the Handbook by the Chief Executive of the Ministry of Primary Industries), the Committee noted that the complaint could be read as an allegation that Zespri had contravened disclosure requirements contained in the Handbook relating to transfer payments.

### **Findings**

The Committee found that Zespri were correct to identify that the purchase and export of both Hayward and Zespri PVR varieties falls squarely within the definition of “core business” and therefore the Handbook does not require Zespri to disclose transfer payments, if any, between Hayward and Zespri PVR varieties. As such Zespri had not breached the information disclosure requirements.

**Decision of** the New Zealand Kiwifruit Board  
**In the matter of** a complaint received on 4 December 2015  
**Under** the Kiwifruit Export Regulations 1999  
**Dated** 16 June 2016

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## 1. INTRODUCTION

- 1.1 The parties to this decision are Zespri Group Limited ("**Zespri**") and an individual kiwifruit producer (who will be referred to throughout as the complainant).
- 1.2 Zespri is a limited liability company, created as a consequence of the restructuring of the kiwifruit industry in 1999.<sup>1</sup> By virtue of the Kiwifruit Export Regulations 1999 ("**Regulations**"), Zespri is the only entity permitted to export New Zealand-grown kiwifruit for consumption in markets other than Australia.<sup>2</sup> Accordingly, Zespri is a monopsony (a monopoly purchaser).
- 1.3 The complaint received by the New Zealand Kiwifruit Board ("**Board**") alleges that Zespri has failed to comply with certain standards set out in the Regulations ("**the complaint**").<sup>3</sup>
- 1.4 Those standards are contained in Part 3 of the Regulations. At issue is Zespri's compliance with:
- (a) the duty not to discriminate unjustifiably (regulations 9 and 10);
  - (b) certain information disclosure requirements (regulations 13 and 14 specifically); and
  - (c) the non-diversification rule (regulation 11).
- 1.5 The Board is charged with monitoring and enforcing compliance by Zespri with those standards.
- 1.6 The Board received the complaint on 4 December 2015. The Board delegated to a Complaint Committee ("**Committee**") all powers and functions necessary to undertake a full inquiry into all aspects of the complaint. The Committee consists of Kristy McDonald QC, Dr Andrew Butler and Kieran Murray.
- 1.7 The Committee has been assisted in the preparation of its decision by the material provided by both the complainant and Zespri.
- 1.8 In this decision, the Committee sets out:
- (a) the procedural history (Part 2);
  - (b) the complaint and the submissions before us (Part 3);
  - (c) the legislative framework (Part 4);
  - (d) discussion (Part 5);
  - (e) general observations (Part 6);
  - (f) conclusions on merits of complaint (Part 7); and
  - (g) relief (Part 8).

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<sup>1</sup> Kiwifruit Industry Restructuring Act 1999.

<sup>2</sup> Kiwifruit Export Regulations 1999, reg 3.

<sup>3</sup> We note at the outset that the complaint also appears to raise issues that extend beyond the purview of the Board as empowered by the Regulations.

1.9 Throughout this decision, reference will be made to kiwifruit of the Hayward variety, and kiwifruit of Zespri PVR varieties. At the outset, we define these terms as follows:

- (a) "Hayward" means kiwifruit grown from the Hayward kiwifruit cultivar (otherwise referred to as HW or Green); and
- (b) "Zespri PVR varieties" means Kiwifruit of the GA (Gold3), GL (Gold9), GK (Hort16A), or HE (Green14) varieties. Zespri grants to contactors the right to grow plant material of these varieties and to sell the resulting fruit to Zespri.

## 2. PROCEDURAL HISTORY

2.1 The procedural history is set out chronologically in the following table.

Date	Event
4 December 2015	The Board received the complaint.
14 December 2015	The Board delegated to a committee of the Board comprising of Kristy McDonald QC and Andrew Fenton the power to conduct a preliminary inquiry into the complaint and to report to the Board as to whether there was sufficient evidence to require further consideration of the complaint by the Board. <sup>4</sup>
13 January 2015	Kristy McDonald QC and Andrew Fenton reached the view that there was sufficient evidence to require further consideration of the complaint by the Board.
29 January 2016	The Board informed Zespri of the complaint received, provided a copy to Zespri, and advised Zespri that a committee would be established to conduct an inquiry into the complaint.
29 January 2016	The Board advised the complainant that a committee would be established to conduct an inquiry into the complaint.
29 January 2016	The Board resolved to establish the Committee. The Committee consists of Kristy McDonald QC, Dr Andrew Butler, and Kieran Murray.
29 January 2016	The Board delegated to the Committee all powers and functions necessary and desirable for the Committee to undertake an inquiry into the complaint dated 4 December 2015 of discrimination contrary to regulations 9 and 10 of the Regulations. <sup>5</sup>
19 February 2016	The Committee advised Zespri of its members, provided a distillation of the complaint, and invited a response to the complaint on or before 4 March 2016.
19 February 2016	The Committee advised the complainant of its members, told the complainant that Zespri's comment had been requested, and that a copy of any provisional determination would be provided for comment.
24 February 2016	In response to a request by Zespri dated 22 February 2016, the Committee extended the date by which Zespri was to respond to the complaint to 11 March 2016.

<sup>4</sup> Delegation of authority pursuant to clause 11 of Schedule 2 of the Kiwifruit Export Regulations 1999.

<sup>5</sup> Delegation of authority pursuant to clause 11 of Schedule 2 of the Kiwifruit Export Regulations 1999.

Date	Event
2 March 2016	The Committee responded to an email from the complainant dated 21 February 2016, drawing attention to matters of process, costs, composition and disclosure.
2 March 2016	The Board delegated to the Committee all powers and functions necessary and desirable to undertake a full inquiry into all aspects of the complaint. <sup>6</sup>
11 March 2016	The Committee received Zespri's response to the complaint.
23 March 2016	The Committee provided a copy of Zespri's response, and accompanying materials, to the complainant. The Committee asked for any response by the complainant on or before 6 April 2016.
30 March 2016	The Committee responded to a letter received from the complainant, recalled its request for any comment on Zespri's response on or before 6 April 2016, noted the process it would follow in its investigation, and declined the complainant's request that other growers be permitted to join the complaint.
30 March 2016	The Committee requested Zespri to provide information within its control relating to its pricing methodology.
4 April 2016	The Committee received Zespri's response to its information request of 30 March 2016.
6 April 2016	The Committee received the complainant's response to Zespri's comment on the complaint.
7 April 2016	The Committee received further information from the complainant relating to the Supply Agreement.
11 April 2016	The Committee provided Zespri's letter of 4 April 2016 to the complainant for comment, and informed the complainant that the Committee had access to the 2015 Supply Agreement.
13 April 2016	The Committee received the complainant's response to Zespri's letter of 4 April 2016.
10 May 2016	The Committee provided to Zespri relevant correspondence it had received from the complainant (redacted for relevance and personal information).
20 May 2016	The Committee made a preliminary copy of its decision available to the parties for their comment.
3 June 2016	The Committee received the parties' comments on the preliminary decision.

### 3. THE COMPLAINT AND THE SUBMISSIONS BEFORE US

#### Material before the Committee

- 3.1 The complaint was received on 4 December 2015. It was made available to Zespri. Zespri responded by way of letter setting out its position, and enclosed a number of documents, being the 2016 Grower Payments pamphlet, Zespri's 5 Year Outlook (published February 2016), Zespri's Annual Report 2014/2015, Zespri's Annual Review 2014/2015, Kiwiflier issue 343 and Kiwiflier issue 344.
- 3.2 Zespri's response, and additional information sought and received by the Committee from the Board and Zespri, was made available to the complainant.<sup>7</sup> Comments were

<sup>6</sup> Delegation of authority pursuant to clause 11 of Schedule 2 of the Kiwifruit Export Regulations 1999.



received. Relevant correspondence received from the complainant was provided to Zespri.<sup>8</sup> The Committee also received comment from both parties on a copy of the preliminary decision, which was made available for their review.

- 3.3 The material before us addresses a wide range of issues, some of which are not issues upon which the Committee is empowered by the Regulations to pass judgment on. However, to ensure that both parties are aware their positions have been heard and considered, we set out the substance of the complaint, Zespri's position and further observations by the complainant on Zespri's position.

#### **Substance of the complaint**

- 3.4 The complaint expressed two fundamental concerns. These relate to allegations that:
- (a) The return for Hayward growers is unfair and discriminatory compared to the return for growers of Zespri PVR varieties. This allegation crystallises in the specific allegations that:
    - (i) Zespri discriminates between Hayward growers and growers of Zespri PVR varieties contrary to regulation 9; and
    - (ii) Zespri has failed to meet its disclosure obligations contrary to regulations 13 and 14.
  - (b) Zespri's decision not to separate its proceeds of sale from its own funds is contrary to the non-diversification rule (regulation 11).

#### ***Lack of a fair return for Hayward growers***

- 3.5 The complaint alleged that Zespri is not paying Hayward growers a fair return because Zespri is paying returns to the benefit of growers of Zespri PVR varieties at the expense of Hayward growers. This is said to result in an absence of efficient pricing signals for growers (contrary to regulation 8(b)) and a lack of appropriate protections for growers (contrary to regulation 8(c)). The complaint alleged that Zespri is discriminating against Hayward growers in favour of growers of Zespri PVR varieties, and that Zespri's information disclosures do not justify the pricing difference between Hayward and Zespri PVR varieties.
- 3.6 The complainant therefore requested the Board (and therefore this Committee) to enforce Zespri's compliance with:
- (a) the non-discrimination rule (regulations 9 and 10); and
  - (b) the information disclosure requirements (specifically regulations 13(e) and 14(4) and (5)).

#### ***The non-discrimination rule***

- 3.7 The complaint alleged that Zespri is discriminating against Hayward growers in favour of growers of Zespri PVR varieties and/or cross-subsidising in favour of the growers of

<sup>7</sup> With the exceptions of the Zespri Pool Policy Manual, which was not disclosed to the complainant for reasons of commercial sensitivity, and the 2015 Supply Agreement, which the complainant indicated he had access to. Zespri also stated by email of 22 April 2016 that the entire 2015 Supply Agreement (other than sections redacted as authorised by the Board) was published on the Canopy website ([www.zespricanopy.com](http://www.zespricanopy.com)) from 26 June 2015 until mid February 2016.

<sup>8</sup> To accord with principles of natural justice, the Committee ensured that each party was provided with all relevant information to which the Committee may have regard when making its decision, and afforded each an opportunity to be heard on all relevant matters: *Splice Fruit Ltd v The New Zealand Kiwifruit Board* [2016] NZHC 864 at [41].

Zespri PVR varieties. The central concern is that Hayward growers are paid significantly less than growers of Zespri PVR varieties. By way of example, the complaint stated that this year Zespri forecast that Hayward growers will get \$4.87 per tray of kiwifruit supplied, Green14 growers \$6.69, and Gold3 growers \$8.19.

- 3.8 The complaint alleged that this was a form of discrimination/cross subsidisation and linked to a complaint of monopsony abuse. It referred to various "market discrimination techniques and abuse of [Zespri's] monopsony powers" by which Zespri is said to achieve a higher price for its own varieties. The techniques alleged, and the evidence provided in support, are summarised in the following table:

Technique	Evidence provided in support
Zespri manipulates the market by allowing distributors/retailers to make higher margins on Hayward.	In Japan and the EU, Zespri sells Zespri PVR varieties at a significant premium, yet fruit sells in market at the same price. Photos from France (May 2015) and Japan (2013 and 2015) of Hayward and Zespri PVR varieties selling at the same price.
Zespri manipulates markets by under supply of Zespri PVR varieties, leading to Hayward being oversupplied.	Gold3 licenses sell for over \$100,000 per hectare. The value of Gold3 orchards is correspondingly higher per hectare by around \$100,000 compared to Hayward orchards. It is said that Zespri has an "optimisation strategy".
Zespri sends a higher proportion of Zespri PVR varieties to countries that pay higher prices.	More than half of the Zespri variety Green14 goes to Japan. Japan is the highest returning market. Further, a greater proportion of Zespri PVR varieties are allocated to Asia, China, Japan and Europe as compared to Hayward.
Zespri releases higher volumes of Zespri PVR varieties at a time when prices are higher.	This is evident in the shipping records.
Zespri raises the price and limits the volumes of Hayward at the start of the season so that Zespri PVR varieties get moved and do not incur storage costs or storage losses.	This is evident in the shipping records.
Hayward has significantly longer natural storage than Zespri PVR varieties. This enables the industry to keep supermarket shelf space but Hayward growers bear the costs in cool storage and higher fruit losses but reap none of the rewards.	None.
Zespri runs marketing trials for Zespri PVR varieties, but opposes collaborative marketing applications for third party varieties. Their policy dis-incentivises third party cultivar investment in New Zealand.	This is evident in Board records.
Zespri spends vast amounts on promotions, and they refuse to differentiate between promotion of Hayward and Zespri PVR varieties and the Zespri brand. Zespri sources this money from the grower pool rather than out of their commission income. A disproportionate amount of this spending is spent on Zespri promoting Zespri PVR varieties and not Hayward.	None.

Technique	Evidence provided in support
Zespri has an "optimisation strategy" for marketing the New Zealand kiwifruit crop, and uses Hayward as part of the PSA recovery pathway for Zespri PVR varieties by sending Hayward to lower paying markets to keep them open for growing volumes of Zespri PVR varieties.	This is often discussed by Zespri in terms of product and category optimisation.

*The information disclosure requirements*

3.9 In respect of Zespri's compliance with the information disclosure requirements, the complaint alleged a lack of proper disclosure of:

- (a) transfer payments (regulation 13(e)); and
- (b) pricing methodology and other costs and factors to justify the pricing difference between Hayward and Zespri PVR varieties (regulation 14(4) and 14(5)).

***Non-diversification of Zespri's core business***

3.10 The complaint alleged that Zespri's practice of itself holding grower pool funds rather than holding those funds in a separate trust is contrary to the non-diversification rule in regulation 11, because it is not necessary for core business, and has never been approved by growers (as opposed to shareholders).

3.11 The complaint also raised the related concerns that:

- (a) Zespri has resisted any attempts to place grower pool funds into a trust that is separate from Zespri corporate funds even where that would keep them secure from claims against Zespri, provide greater transparency, and require independent verification and audit.
- (b) Zespri's practice of seeking shareholder approval for diversified activities does not comply with regulation 11, and that it is growers (not shareholders) who must consent to any diversified activities under the Regulations.
- (c) The Board may rely on a strained interpretation of "core business" in order to allow continued diversification by Zespri.

***Remedies sought***

3.12 The complainant requested the Board to:

- (a) Appoint independent investigators to independently audit Zespri's promotions spending both onshore and offshore, and the grower pool, to determine if Hayward growers receive a fair return relative to growers of Zespri PVR varieties.
- (b) Require Zespri to disclose, under regulation 14(5) the relationship between the proceeds of sale of Hayward kiwifruit and the price paid by Zespri to Hayward growers across individual markets (starting with Japan and Europe).
- (c) Require Zespri to provide full disclosure of all onshore and offshore books showing returns and promotions expenditure, and all grower pool financial information to the independent investigators.
- (d) Require Zespri to fund the investigation, if necessary.

- (e) Direct Zespri to allow willing Hayward growers to choose a separate pool that allows equal draw down with non-Hayward varieties, and separate promotions funding pro-rata to volume with Zespri varieties.
- (f) Commission (if possible) an independent organisation to construct a financial model that compensates Hayward growers for storage losses, storage costs and lost market premiums for the delayed sale of their fruit, and for promotions subsidies paid by Hayward growers for the promotions of Zespri PVR varieties.
- (g) Revise the Kiwifruit Information Disclosure Handbook ("**Handbook**") to enable clear disclosure of any transfer payments between Hayward and Zespri PVR varieties.
- (h) Require Zespri to hold a grower referendum to approve its practice of not putting grower funds in a grower trust that is separate to Zespri corporate funds.

### **Zespri's response to the complaint**

3.13 We set out below Zespri's response in respect of each of the elements of the complaint identified above.

#### ***Lack of a fair return for Hayward growers***

##### *Non-discrimination rule*

- 3.14 Zespri submitted that the complaint does not raise any issues relating to regulation 9(a). Zespri submitted that regulation 9(a) is not breached, because the Supply Agreement governing Zespri's purchase of kiwifruit is negotiated with registered suppliers each year and, once agreed, is offered to *all* suppliers.
- 3.15 In respect of regulation 9(b), Zespri accepted that it could be said that the terms of the Supply Agreement contemplate discrimination amongst suppliers and potential suppliers, in that the sum paid per tray of kiwifruit by Zespri differs depending on the variety of kiwifruit in issue. Zespri submitted that the different prices are a result of the pricing methodology that Zespri uses.
- 3.16 The terms of the Supply Agreement contain Zespri's pricing methodology, which Zespri has described in the following way:
  - (a) The Supply Agreement sets out the terms and conditions for the purchase of kiwifruit.
  - (b) The Price and Payment Manual (a schedule to the Supply Agreement) sets out the manner in which the price paid to kiwifruit suppliers will be determined.
  - (c) For pricing purposes, a separate pool is established for each variety of kiwifruit. The fruit return for any given pool (at its simplest level) is the net sales from the variety, less Zespri's margin, less defined direct costs associated with distribution of the kiwifruit to reach an orchard gate per grower.
  - (d) Direct costs deducted from the net sales value are referred to as "pool costs" and include, among other things, promotion costs for fruit in the pool, freight, duty and other costs set out in the Price and Payment Manual.
  - (e) Revenues and costs that relate to more than one pool are generally allocated in accordance with the proportion by which those revenues or costs are incurred by the relevant pools. The details of these allocations are set out in

the Pool Policy Manual. That manual is agreed on by the Industry Advisory Council annually.

- (f) Service and incentive costs are calculated and charged at a pool level and may vary by pool based on the separate commercial drivers for each pool.
- (g) There are also specific payments for different pack types, delivery at different times in the season, and fruit incentives for early supply and fruit that meets taste specifications.

3.17 Zespri accepted that the application of this pricing methodology results in different fruit and service payments for different varieties, and for different attributes relating to fruit within each variety, such as size, taste and time of supply.

3.18 However, Zespri submitted that to the extent that different price outcomes arise under the terms of the Supply Agreement and therefore amount to discrimination, the terms of the Supply Agreement that produce that different price outcome were commercial in nature; the complainant had not been able to identify any term that was discriminatory on non-commercial grounds.

3.19 Zespri noted that the complaint appeared to raise concerns that extend beyond the scope of regulation 9 and submitted that the non-discrimination rule does not govern how Zespri markets and distributes kiwifruit once purchased. Notwithstanding that, Zespri sought to address the underlying perception of unfairness. To do so, Zespri noted that:

- (a) Marketing and allocations are to be understood in the context in which Zespri operates: complex and dynamic market conditions and production dynamics, the vast majority of which are outside Zespri's control.
- (b) Zespri makes decisions on marketing and allocation of kiwifruit with the purpose of advancing its global optimisation strategy. It seeks to obtain the best possible outcomes from all markets given the market conditions.
- (c) It does this by allocating each variety so as to achieve the highest returns for each variety and the crop as a whole.
- (d) Zespri continually reviews market allocations during the season to ensure the optimisation principles are being met.

3.20 Zespri also responded to the assertions in the complaint that Zespri does not provide efficient pricing signals for growers (contrary to regulation 8(b)) and that there are inappropriate protections for growers (contrary to regulation 8(c)), by saying:

- (a) Regulation 8 does not create a separate standalone obligation that Zespri must comply with. Rather, regulation 8 sets out the purpose of the mitigation measures contained in Part 3 of the Regulations. It is those measures that the Board is empowered under the Regulations to monitor and enforce.
- (b) Zespri does provide strong pricing signals to growers:
  - (i) by complying with the information disclosure requirements in Part 3 of the Regulations; and
  - (ii) by way of additional documents such as the 5 Year Outlook, Kiwiflier, the Annual Report and Review, grower road show slides, and emails from the Zespri Chairman following every board meeting. These documents are made available on the Unlisted platform announcement webpage.

- (c) The obvious difference in the market value of licences for Zespri's fruit and orchard land demonstrates that clear pricing signals are provided to growers.

*The information disclosure requirements*

3.21 In response to the complaint that Zespri is not complying with regulation 13(e), Zespri submitted that:

- (a) Regulation 13(e) states one standard that may be included within the Handbook that is published by the Chief Executive of the Ministry of Primary Industries. Zespri does not have an obligation to comply with regulation 13(e), except to the extent that the standard set out in that regulation is contained within the Handbook.
- (b) Zespri reports to the Board annually on the basis set out in the Handbook.
- (c) Those reports include reports on transfer payments between core and non-core business.
- (d) There are no transfer payments between the export of Hayward and Zespri PVR varieties as both are core business.

3.22 In response to the concern that Zespri is not complying with regulation 14(4) and 14(5), Zespri submitted that:

- (a) The pricing methodology is clearly stated in the Supply Agreement in combination with the Pricing and Payment Manual, and the annual Grower Payments brochure.
- (b) These documents are available to the complainant through the Zespri Canopy website or on request at any time.

***Non-diversification of Zespri's core business***

3.23 In response to the alleged breach of regulation 11, Zespri submitted that:

- (a) The premise of the allegation is incorrect. Growers do not have any proprietary right or interest in the cash proceeds of sales received and held by Zespri. Instead, they have a contractual right to returns on the terms and conditions of the Supply Agreement.
- (b) The receipt of proceeds from the export of kiwifruit, and the use of those funds in accordance with the terms and conditions of the Supply Agreement, is an integral aspect of the export of kiwifruit. Holding funds for that purpose is therefore not a diversified activity.
- (c) The Regulations anticipate that Zespri will hold the receipt of proceeds from the export of fruit for the purpose of its core business (citing the definition of "use of capital" in regulation 11(4)).

3.24 Zespri also suggested that the formation of a grower trust charged with holding proprietary varieties and/or funds for the benefit of the industry as a whole would be an extreme structural change and fundamentally impact the current operation of the industry.

**The response of the complainant to Zespri's comments on the complaint**

3.25 On 6 April 2016 the Committee received the complainant's response to Zespri's comments on the complaint. This response made the following points.

### ***Lack of a fair return for Hayward growers***

#### *Non-discrimination rule*

- 3.26 It may be the case that Zespri does not breach regulation 9(a), but Zespri is incorrect to say it negotiates the Supply Agreement with registered suppliers, because that process, properly understood, is a "consent manufacturing exercise".
- 3.27 It may be the case that there is no discrimination in the terms of the Supply Agreement that is not commercially justifiable if those terms are considered on their face. However, the essence of the complaint concerns Zespri's implementation of the terms in the Supply Agreement in practice.

#### *The information disclosure requirements*

- 3.28 The complainant inquired as to how Zespri's disclosures under regulation 14(5) operate so as to give a true picture of the relationship between selling prices and purchase prices. The complainant also noted that the Board may be limited in its response in this respect by the text of regulation 14(5), which only relates to Zespri's disclosures about pricing methodology.

#### *General*

- 3.29 Zespri's response did not include detailed information or data (which could be analysed) and avoided the question of an audit.

### ***Non-diversification of Zespri's core business***

- 3.30 None of the objections raised by Zespri in respect of the protection of grower funds are insurmountable or even difficult:
- (a) Zespri does not need to hold grower funds in one account;
  - (b) Zespri could easily operate a separate trust account for all export receipts; and
  - (c) these funds are grower money and they are at risk in the corporate fund.

### **Further comments of Zespri and the complainant**

- 3.31 On 30 March 2016, the Committee sought information from Zespri in respect of its pricing methodology. Zespri's response was received on 4 April 2016. The questions posed, and answers given, were:
- (a) **Question:** Clause A2.2 of the Pricing and Payment Manual for Kiwifruit and Services describes how the aggregate service costs and fruit incentives are deducted from the total fruit and service payments within a pool to arrive at the fruit return for that pool. Please clarify whether the amounts deducted for service costs and fruit incentives are contained within a pool. By way of example, fruit incentives would be contained within a pool if fruit incentives deducted in, say, the Zespri Green Kiwifruit pool were equal to the amount of fruit incentives paid to suppliers of Zespri Green Kiwifruit.
  - (b) **Answer:** "all service and incentive costs are calculated and charged at an individual pool level, such that the costs that relate to an individual pool remain within that pool. As noted in paragraph 11 of our response to the complaint, a Pool Policy Manual is annually approved by the IAC and identifies the service and incentive costs, their methodology, time of payment and pool allocation." "An explanation of the fruit return structure at a higher level is contained in the Grower Payments Manual enclosed with our prior correspondence, and shows

that these costs may vary by Pool based on the separate commercial drivers for each Pool."

- (c) **Question:** Please explain the processes, if any, that Zespri follows to verify:
- (i) its calculations of the fruit return under clause A2.2 of the Pricing and Payment Manual for Kiwifruit and Services; and
  - (ii) the accuracy of the inputs into those calculations.
- (d) **Answer:** Zespri's answer is set out at paragraph 5.29 below.

3.32 On 13 April 2016 the Committee received further comments from the complainant on Zespri's answers provided to the Committee on 4 April 2016. That further comment recorded:

- (a) that only schedule 5 of Supply Agreement is available on the Zespri's canopy website;
- (b) the concern that the Industry Advisory Council does not have competence to review the pricing methodology and its members have conflicting and vested interests;
- (c) a desire to learn how the Pool Policy Manual apportions promotion costs between each pool; and
- (d) that the only way to ensure Zespri's internal processes were impeachable would be to conduct an unrestricted external probity audit.

3.33 The Committee put the comment set out in paragraph 3.32(a) to Zespri, and by email dated 22 April 2016 Zespri commented that the entire 2015 Supply Agreement (other than sections redacted as authorised by the Board) was published on the Canopy website ([www.zespricanopy.com](http://www.zespricanopy.com)) from 26 June 2015 until mid February 2016.

3.34 Having recorded the parties' positions, and before turning to their merits, we set out the relevant legislative framework and the applicable legal principles.

#### 4. LEGISLATIVE FRAMEWORK

4.1 This Committee is governed in its response to the complaint by the Kiwifruit Industry Restructuring Act 1999 ("**Act**") and the Regulations. Throughout, the Act and Regulations are interpreted in light of their text and purpose.<sup>9</sup>

##### **The restructuring of the kiwifruit industry**

4.2 The Act and the Regulations came into force on 1 April 2000. In combination they restructured the kiwifruit industry.<sup>10</sup> As noted by Winkelmann J in *Aotearoa Kiwifruit Export Limited v McNaughton*, the principal features of this restructure were:<sup>11</sup>

- (a) the replacement of the New Zealand Kiwifruit Marketing Board by:
  - (i) Zespri; and

<sup>9</sup> Interpretation Act 1999, s 5(1); *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [22]; and *Splice Fruit Ltd v The New Zealand Kiwifruit Board* [2016] NZHC 864 at [35]-[38].

<sup>10</sup> We note that the Ministry of Primary Industries has been engaged in a process of reviewing the Regulations.

<sup>11</sup> *Aotearoa Kiwifruit Export Ltd v Southlink Ltd* HC Auckland CIV 2003-470-478, 3 February 2006 at [9].



- (ii) the Board (which was established to authorise exporting, to monitor compliance with, and to undertake enforcement of, the Regulations);
- (b) the retention of a single desk export regime; and
- (c) the substitution of the non-discrimination rule in place of the duty on the single exporter to acquire all kiwifruit.

#### Regulation-making powers under the Act

4.3 Section 26 of the Act empowers the Governor-General on the recommendation of the Minister to make regulations, among other things:

- (a) "providing for the establishment, functions, powers, membership, funding, and other matters relating to the new Board" (section 26(1)(a));
- (b) "providing for the new Board to grant to Zespri an authorisation to export kiwifruit" (section 26(1)(c));
- (c) "providing for the terms and conditions or other requirements that may or may not be part of the authorisation, permit, or collaborative marketing approval" (section 26(1)(f));
- (d) "restricting discrimination among suppliers of kiwifruit for export to commercial grounds" (section 26(1)(g));
- (e) "restricting certain diversification of business" (section 26(1)(h)); and
- (f) "requiring Zespri Group to publish in the prescribed manner information which may include (without limitation)—
  - (i) prices, terms and conditions;
  - (ii) pricing policies and methodologies;
  - (iii) costs;
  - (iv) cost allocation policies and methodologies; and
  - (v) performance measures, or information from which performance measures may be derived, or both" (section 26(1)(k)).

4.4 Among other things, the Regulations as promulgated set out the relevant standards with which Zespri must comply, and the relevant functions and powers of the Board in monitoring and enforcing that compliance.

#### The functions of the Board

4.5 The Board is established by regulation 32(1). Under the Regulations, it has all powers necessary to carry out its functions.<sup>12</sup> The Board's functions are set out in regulation 33(1), and are:<sup>13</sup>

- (a) to authorise the export of kiwifruit, and to set the terms of the authorisation in accordance with Parts 1 and 2 of the Regulations;
- (b) **to monitor and enforce—**

<sup>12</sup> Kiwifruit Export Regulations 1999, reg 38.

<sup>13</sup> Kiwifruit Export Regulations 1999, reg 33(1).

- (i) **the non-discrimination rule, the non-diversification rule, the information disclosure requirements**, and the collaborative marketing requirements;
  - (ii) the requirement that the point of acquisition of title to kiwifruit purchased for export be in accordance with regulation 5(c);
  - (iii) any other terms and conditions of the authorisation: and
- (c) to determine collaborative marketing applications in accordance with Part 4.

[Emphasis added]

4.6 In accordance with regulation 33(2), "the Board must carry out its functions under regulation 33(1)(b) to best achieve the purpose in regulation 8".

4.7 Regulation 8 states the purpose of Part 3 of the Regulations is to mitigate the potential costs and risks arising from Zespri's monopsony in the kiwifruit industry. In full, regulation 8 reads:

#### **8 Purpose of Part**

The purpose of this Part is to mitigate the potential costs and risks arising from the monopsony, by—

- (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 ZGL's shareholders and suppliers; and
- (d) promoting sustained downward pressure on ZGL's costs.

4.8 A number of the features of regulation 8 are noteworthy:

- (a) The purpose of Part 3 is to "mitigate" costs and risks arising from the monopsony. To mitigate these costs and risks means to make them less severe; it does not mean to eliminate them.
- (b) Paragraphs (a)–(d) set out the four means by which the purposes of Part 3 are to be achieved by the Part 3 mitigation measures.
- (c) The focus of the Part 3 mitigation measures is on "the potential costs and risks arising from the monopsony". The monopsony referred to is Zespri's position as the sole authorised purchaser of kiwifruit, where the kiwifruit is intended for export to anywhere in the world except Australia. As a monopsony, Zespri has market power when purchasing fruit from New Zealand suppliers. The potential costs and risks to which an entity with market power typically gives rise is the ability to "give less and charge more".<sup>14</sup>
- (d) The mitigation measures are:
  - (i) the non-discrimination rule (regulations 9 and 10);

<sup>14</sup> *Re Queensland Co-operative Milling Association Ltd; Re Definance Holding Ltd* (1976) ALR 481, citing Attorney General for the USA *Report of the US Attorney General's National Committee to Study the Antitrust Laws* (31 March 1955), 320.

- (ii) the non-diversification rule (regulation 11);
- (iii) information disclosure requirements (regulations 12 to 21);
- (iv) continuing requirements as to Zespri's corporate form (regulation 22); and
- (v) contents of the constitution of Zespri designed to protect shareholders (regulation 23).

Each of these measures is intended to contribute to achieving the purpose of regulation 8.

- (e) Regulation 8 does not set out standalone obligations on Zespri.

#### **Limits on the Board's function of monitoring and enforcing the mitigation measures**

- 4.9 Before turning to the content of the mitigation measures relevant to the complaint, we set out the limits of the Board's monitoring and enforcement role. These limits arise by virtue of regulations 4 to 7.
- 4.10 Regulation 4 requires the Board to authorise Zespri to export kiwifruit.<sup>15</sup> The terms and conditions of the export authorisation must be in accordance with regulations 5, 6 and 7.
- 4.11 Regulation 7 provides that the export authorisation "must provide for an enforcement regime to ensure reasonable compliance with the matters referred to in regulation 33(1)(b)" (including the monitoring and enforcement of the non-discrimination rule, the non-diversification rule and the information disclosure requirements). That enforcement regime "must include provisions for, among other things, remedies, including provisions enabling affected persons to initiate, by way of complaint to the Board, an action through the enforcement regime and to receive an appropriate remedy if their claim is made out" (regulation 7(2)(c)). The range of enforcement options in the export authorisation, and any variation thereto, is to be approved by the Minister (regulation 7(4)(a) and (b)).
- 4.12 Regulation 7 is subject to regulation 6, which states that the export authorisation must **not** provide for (among other things):
- (a) the basis on which Zespri is to purchase and pay for kiwifruit (other than in connection with the non-discrimination rule) (regulation 6(1)(c));
  - (b) an assertion of rights by the Board over any of Zespri's assets, including intellectual property (regulation 6(1)(d));
  - (c) the Board to have any right or obligation to approve any transactions entered into by Zespri (other than in respect of collaborative marketing) (regulation 6(1)(e));
  - (d) the Board to have any rights or powers in respect of kiwifruit pool administration or control (other than in respect of collaborative marketing) (regulation 6(1)(f)); and
  - (e) any variations of the provisions in Part 3 (regulation 6(1)(k)).
- 4.13 In carrying out its function of monitoring and enforcing the mitigation measures, the Board (and therefore this Committee) must comply with the enforcement regime set out

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<sup>15</sup> Kiwifruit Export Regulations 1999, reg 4(1).

in the export authorisation and may not conduct itself in such a way that breaches the restrictions imposed by the Regulations upon the content of the export authorisation.

### **Mitigation measures**

- 4.14 The "mitigation measures" set out in Part 3 of the Regulations include the non-discrimination rule, the non-diversification rule and the information disclosure rules. It is these measures on which the complaint primarily focuses. We now set out the legal principles applicable in respect of these measures.

### ***The non-discrimination rule***

- 4.15 Regulations 9 and 10, read together, provide the non-discrimination rule. They read as follows:

#### **9 Duty not to discriminate unjustifiably**

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

- (a) a decision on whether to purchase kiwifruit; or
- (b) **the terms** of the purchase contract.

#### **10 Justifiable discrimination**

- (1) Discrimination (or the extent of the discrimination) is justifiable if it is on commercial grounds.
- (2) A commercial ground includes, but is not limited to, matters relating to product features, quality, quantity, timing, location, risk, or potential returns.

[Emphasis added]

- 4.16 The core prohibition is imposed by regulation 9. The prohibition is that "ZGL, and its directors and managers, must not unjustifiably discriminate...". As the Board stated in its [REDACTED] decision of 20 February 2007:<sup>16</sup>

The Regulations recognise that in the purchase of fruit some discrimination on commercial grounds is inevitable by identifying Zespri's duty as not to discriminate unjustifiably.

### ***The meaning of "discriminate"***

- 4.17 The word "discriminate" is not defined; but in ordinary legal usage it means to treat someone differently from someone else when those people are in comparable circumstances.<sup>17</sup> In the context of the Regulations, that could manifest itself in:

- (a) a decision to purchase kiwifruit from supplier A, but not supplier B;
- (b) offering supplier A different purchase terms than those offered to supplier B; and

<sup>16</sup> Decision of the New Zealand Kiwifruit Board in the matter of [REDACTED] dated 20 February 2007 at [14].

<sup>17</sup> Black's Law Dictionary defines discrimination to mean "differential treatment; esp., a failure to treat all persons equally when no reasonable distinction can be found between those favoured and those not favoured" (Bryan Garner (ed) *Black's Law Dictionary* (10th ed, USA, 2014) at 566). The form of discrimination most readily applicable in a commercial context is price discrimination. Price discrimination is defined in Black's Law Dictionary to mean "the practice of offering identical or similar goods to different buyers at different prices when the costs of producing the goods are the same" (Bryan Garner (ed) *Black's Law Dictionary* (10th ed, USA, 2014) at 1382).

- (c) offering supplier A the same purchase terms as those offered to supplier B, in circumstances where those terms on their face result in different treatment of supplier A and supplier B.

4.18 The Committee notes that discrimination between suppliers that arises because of the manner in which Zespri implements the terms of its purchase agreement is not captured by regulations 9 and 10.

*The meaning of "unjustifiably"*

4.19 Use of the adverb "unjustifiably" indicates, however, that not all different treatment is prohibited; only unjustifiable discrimination is.

4.20 Curiously, the phrase "unjustifiably discriminate" is not defined. Rather, regulation 10 set out what is to be regarded as "justifiable discrimination". One possible reading of regulation 10 is that it does not exhaustively define the circumstances in which discrimination will not be unjustified. However, we do not believe that is the intended meaning. As noted at paragraph 4.3(d) above, the relevant empowering provision in the Act (section 26(1)(g)) enables regulations to be made that restrict discrimination among suppliers of kiwifruit for export "to commercial grounds". In our view, therefore, regulation 10 is exhaustive. Discrimination that does not fit within the terms of regulation 10 is not justifiable within the terms of that regulation and is, by dint of that conclusion, unjustifiable discrimination for the purposes of regulation 9. That construction of regulation 10 is consistent with the purpose set out in regulation 8(c) of minimising the potential risks and costs arising from the monopsony by "providing appropriate protections for ZGL's shareholders and suppliers". The Committee notes that the purposes set out in regulation 8, particularly regulation 8(c), may be relevant to the question of whether any particular commercial ground justifies discrimination in any given case.

4.21 The interpretation we have adopted is consistent with the judgment of Winkelmann J in *Aotearoa Kiwifruit Export Limited v McNaughton* in which her Honour stated that:<sup>18</sup>

**Unjustifiable discrimination is discrimination that is not justifiable on commercial grounds...**

Given the purpose of the mitigation measures, and the provisions of Regulation 10, it would appear that justifiable discrimination is that which operates between a buyer and a seller in any given market, relating to commercial aspects affecting a particular purchase decision or its terms and conditions. Thus, it would entitle Zespri to refuse to take product, for example:

- i. If it became available at a time when Zespri had no corresponding demand for supply,
- ii. If it was at a location that Zespri believed did not justify the costs of shipping,
- iii. If it was a variety of kiwifruit that there was no demand for at the time,
- iv. If the product was of poor quality.

This of course, is not intended to be an exhaustive list.

[Emphasis added]

<sup>18</sup> *Aotearoa Kiwifruit Export Ltd v Southlink Ltd* HC Auckland CIV 2003-470-478, 3 February 2006 at [68]–[69].

*The meaning of "supplier"*

- 4.22 We note that the term "supplier" is defined in the Regulations to mean "a person from whom ZGL acquires the property in kiwifruit grown in New Zealand". In *Aotearoa Kiwifruit Export Limited v McNaughton* Winkelmann J held that all parties in the contractual chain through which title in kiwifruit passes from the grower to Zespri are capable of falling within the definition of supplier for the purposes of regulation 9.<sup>19</sup>

*The scope of regulation 9: approach to discrimination*

- 4.23 A further, and more complex, interpretation issue arises in respect of the non-discrimination rule. The question we have identified is whether regulation 9 prohibits discrimination:
- (a) only when, and to the extent that, it occurs within the limited class of suppliers of each particular kiwifruit variety ("**the intra-variety approach**");
  - (b) when it occurs across different kiwifruit varieties ("**pan-variety approach**"); or
  - (c) when it occurs within the limited class of suppliers of each particular kiwifruit variety or when it occurs across different kiwifruit varieties ("**intra- and pan-variety approach**").
- 4.24 Implicit in both the complaint, and Zespri's response, is the assumption that the non-discrimination rule prohibits unjustifiable discrimination across varieties. Certainly the complaint can only succeed if the pan-variety or the intra- and pan- variety approach to the non-discrimination rule is correct. To demonstrate the difference in approaches, the complaint has not alleged that within the group of suppliers of Hayward kiwifruit (to take an example of a kiwifruit variety), different prices or different terms and conditions are offered by Zespri to different suppliers. Rather, the complaint is that suppliers of Hayward kiwifruit as a group are offered different (and inferior) prices as compared to suppliers of Zespri PVR varieties, and, in particular, that Zespri is paying returns to the benefit of growers of Zespri PVR varieties at the expense of Hayward growers.
- 4.25 As both parties have accepted the pan-variety approach to regulation 9, we proceed on that approach; however, for completeness we note our view that it is not necessarily the case that the Regulations were intended to prohibit discrimination on a pan-variety basis.

**Information disclosure**

- 4.26 Regulations 12 to 21 deal with information disclosure. The complaint has raised regulations 13 and 14 particularly.
- 4.27 Regulation 13 concerns the matters that may be included in the Handbook. It does not in and of itself impose any information disclosure requirements upon Zespri.
- 4.28 Regulation 13 reads:

**13 Kiwifruit Information Disclosure Handbook**

The responsible chief executive may from time to time publish a Handbook which may provide for all or any of the following:

- (a) the definition of ZGL's business activities:

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<sup>19</sup> *Aotearoa Kiwifruit Export Ltd v Southlink Ltd* HC Auckland CIV 2003-470-478, 3 February 2006 at [60].

- (b) the allocation methodology that must be used for preparing the financial statements and allocating the expenses, revenues, assets, and liabilities amongst ZGL's business activities:
- (c) the disclosure of the manner in which the allocation methodology has been applied:
- (d) the information that must be specified in the financial statements disclosed under regulation 12:
- (e) the disclosure of transfer payments (whether actual or notional) amongst the business activities:
- (f) the disclosure of financial performance measures, or information from which financial performance measures may be derived, or both:
- (g) the form of the disclosures (including requirements as to separate, consolidated, and reconciliation information):
- (h) the audit and certification of disclosed information:
- (i) the retention of data on which disclosed information is based and associated documentation.

4.29 Regulation 14 provides for the disclosure of kiwifruit purchase terms and conditions. It reads:

**14 Disclosure of kiwifruit purchase conditions**

- (1) ZGL must publicly disclose, 1 month before coming into effect,—
  - (a) its terms and conditions, and any amendments to those terms and conditions, for the purchase of kiwifruit grown in New Zealand; and
  - (b) the period for which each set of terms and conditions, including amendments, is applicable.
- (2) If it is not practicable to make the disclosure under subclause (1) 1 month before coming into effect, ZGL must make that disclosure as soon as practicable and no later than the date of coming into effect.
- (3) ZGL must publicly disclose, within 3 months after the end of each financial year (beginning with the 2000/01 financial year),—
  - (a) the number of suppliers to which each set of terms and conditions were applied; and
  - (b) the volume of kiwifruit to which each set of terms and conditions were applied.
- (4) ZGL must publicly disclose,—
  - (a) within 3 months after the beginning of each financial year, the methodology used at the beginning of that financial year to determine the payments for kiwifruit; and
  - (b) any change in the methodology, or adoption of a different methodology, within 1 month of the change or the different methodology taking effect.
- (5) Every disclosure under subclause (4) must include key details of the methodology including—

- (a) the relationship between purchase prices and selling prices; and
- (b) the key costs (including cost of capital incurred by ZGL) and other factors that explain the differences between purchase prices (paid to suppliers) and selling prices; and
- (c) any other information on which ZGL is relying to justify discrimination amongst suppliers.

4.30 The requirement in regulation 14, and elsewhere in the disclosure provisions, is to publicly disclose the information specified. The term "publicly disclose" is defined in regulation 2 to mean:

... to make information available in the following ways:

- (a) by making copies of that information available for inspection, during ordinary office hours, at ZGL's or the Board's (as the case may be) principal office; and
- (b) at the request of any person, by posting a copy to the person or providing the person with a copy of that information for collection, during ordinary office hours, from ZGL's or the Board's (as the case may be) principal office.

#### ***Non-diversification of Zespri's core business***

4.31 The "non-diversification" rule is set out in regulation 11. It reads as follows:

- (1) ZGL must not carry out activities, and must not own or operate assets, that are not necessary for the core business unless—
  - (a) the providers of capital used or to be used for those activities have been asked and have agreed to the use of their capital for those activities; and
  - (b) the shareholders and suppliers who have not agreed are not exposed to more than a minimal risk from those activities.
- (2) Subclause (1) does not apply to sales of New Zealand-grown kiwifruit in New Zealand where the level of sales is incidental to the size of the total New Zealand market provided that the incidental sales are not more than 300,000 trays of kiwifruit sold by ZGL in the New Zealand market.
- (3) Subclause (1) does not apply to sales of New Zealand-grown kiwifruit in Australia.
- (3A) Subclause (1) does not apply to procuring the supply and marketing, before 1 April 2001, of non-New Zealand-grown produce that is underwritten by Kiwifruit International Limited (**KIL**) in accordance with the Annual Business Plan for 1 April 2000 to 31 March 2001 agreed to by Zespri International Limited (**ZIL**) and KIL under the agreement relating to the management of KIL and any funding of ZIL made between KIL and ZIL and dated 10 August 1999.
- (4) In this regulation, **use of capital** includes, for the avoidance of doubt,—
  - (a) the use of any resources that are or would be represented on ZGL's balance sheet as shareholders funds:
  - (b) the entering into of any arrangements that provide, directly or indirectly, for recourse to shareholders or suppliers funds or that would otherwise expose those funds to risk:
  - (c) the use of any funds that would be available for payment to suppliers or distribution to shareholders.



4.32 The central prohibition is contained in regulation 11(1), and relates to Zespri carrying out activities, or owning or operating assets, that are not necessary for the core business, unless the exceptions stated in regulation 11(1)(a) and (b) apply.

4.33 The two key terms in this central prohibition are "necessary" and "core business".

4.34 The term "core business" is defined in regulation 2, as follows:

**core business—**

(a) **means the purchase of New Zealand-grown kiwifruit for export** where the point of acquisition of title to fruit is at FOBS **and the export of that fruit:**

(b) excludes the export at FOBS<sup>20</sup> of kiwifruit for consumption in Australia:

(c) excludes the sale of kiwifruit in New Zealand.

[Emphasis added]

4.35 The term "necessary" is undefined in the Regulations. Black's Law Dictionary defines necessary to mean "needed for some purpose or reason; essential".<sup>21</sup> The Committee is of the view that something is to be considered "necessary" for a purpose if that thing is "essential" for that purpose. In any particular case, what is essential will take colour from the context. Part of the relevant context here is a deliberate policy decision by Parliament to create a monopsony in favour of Zespri, and to put in place a number of mechanisms to "ensure that increasing the overall wealth of kiwifruit suppliers remained the primary objective".<sup>22</sup> Recognising Zespri's privileged position in the market, the Regulations require Zespri to gain the consent of its providers of capital before it extends its activities, or ownership of assets, beyond its core functions; that is, beyond the functions for which it has been granted a monopsony. In the Committee's view, Zespri is not confined to undertaking the bare logistics of the physical purchase of New Zealand-grown kiwifruit and the export thereof. Other activities that support the core business can be classified as essential within that context. The Committee also notes that should its preferred approach result in a narrowing of what Zespri understood its core business to be, then individual non-core projects can be approved under regulation 11(1)(a).

*Regulation 11(1)(a)*

4.36 Regulation 11(1)(a) requires "the providers of capital used or to be used for those activities" to have been asked and to have agreed "to the use of their capital for those activities". As noted at paragraph 3.11(b) above, the complaint has raised a concern that Zespri's practice of seeking shareholder approval for diversified activities does not comply with regulation 11 because it is growers, not shareholders, who must consent to any diversified activities under the Regulations.

4.37 The Committee notes that:

(a) The relevant consent is the consent of the "providers of capital used or to be used for those activities".

(b) The term "providers of capital" is not defined in the Regulations.

<sup>20</sup> For reference, the term "FOBS" is defined by in reg 2 to mean "stowed on board the ship or aircraft on which the kiwifruit is exported".

<sup>21</sup> Bryan Garner (ed) *Black's Law Dictionary* (10th ed, USA, 2014) at 1192.

<sup>22</sup> *Splice Fruit Ltd v The New Zealand Kiwifruit Board* [2016] NZHC 864 at [2] per Heath J: "As a result of a deliberate policy decision, and consistent with the views of a majority of industry participants, a monopsony was created in favour of Zespri, so that it is the sole entity that is entitled to export kiwifruit to anywhere other than Australia. A number of mechanisms were put in place to minimise the possibility of abuse of Zespri's market power, and to ensure that increasing the overall wealth of kiwifruit suppliers remained the primary objective." (Footnotes omitted)

- (c) The term "providers of capital" is to be interpreted in light of the text, context and purpose of the relevant regulations:
- (i) Regulations 11(1)(a) and 11(1)(b) have a parallel structure. Regulation 11(1)(a) refers to the requirement that "the providers of capital" consent to the use of their capital for non-core activities. Regulation 11(1)(b) refers to "the shareholders and suppliers" who have not given that consent. The parallel structure of regulations 11(1)(a) and 11(1)(b) suggests that the term "providers of capital" is wide enough to embrace both shareholders and suppliers.
  - (ii) Regulation 11(4) defines "use of capital" to include "the use of any funds that would be available for payment to suppliers or distribution to shareholders" (regulation 11(4)(c)). This definition suggests that the term "providers of capital" is wide enough to embrace both shareholders and suppliers.
  - (iii) The purpose of regulation 11 is to mitigate the potential costs and risks arising from the monopsony by "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" (regulation 8(a)); and by "providing appropriate protections for ZGL's shareholders and suppliers" (regulation 8(c)). Interpreting the term "providers of capital" as being wide enough to embrace both shareholders and suppliers is consistent with that purpose.
- (d) The relevant providers of capital will be determined by the context.

4.38 Therefore, in the Committee's opinion, to the extent Zespri has a practice of seeking shareholder approval for diversified activities, the question of whether that complies with regulation 11(1)(a) in any given instance will depend on the particular circumstances.

*Regulation 11(1)(b)*

4.39 Regulation 11(1)(b) requires that shareholders and suppliers, who have not agreed to the use of their capital for those activities, are not exposed to more than a minimal risk from those activities. We note that the Regulations do not define the term "minimal risk". What constitutes minimal risk in any given case will depend on the particular circumstances.

## 5. DISCUSSION

5.1 In what follows we set out our decision in respect of each of the matters raised by the complaint (under the sub-headings adopted in the description of the complaint).

### **Lack of a fair return for Hayward growers**

#### ***Non-discrimination rule***

*Regulation 9(a)*

5.2 The complaint does not contain allegations of conduct by Zespri that is contrary to the prohibition contained in regulation 9(a). Indeed, the complainant appears to accept that Zespri does not breach regulation 9(a).<sup>23</sup> The Committee notes that Zespri offers the Supply Agreement to all suppliers. For this reason, Zespri does not treat certain

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<sup>23</sup> In an email received from the complainant on 6 April 2016, the complainant states that "Zespri say in paragraph 4 that there is no breach of regulation 9 (a). That may be true but the 'negotiation' with 'registered suppliers' is hardly a negotiation as much as a consent manufacturing exercise."

suppliers differently to other suppliers in respect of a decision on whether to purchase kiwifruit. Accordingly, there is no evidence that Zespri has breached regulation 9(a).

*Regulation 9(b) and 10: unjustifiable discrimination*

- 5.3 Regulation 9(b) provides that Zespri must not unjustifiably discriminate among suppliers and potential suppliers in respect of the terms of the purchase contract. All suppliers (whether they are suppliers of the Hayward variety of kiwifruit, or any other variety of kiwifruit) are subject to the same terms of purchase. These terms are contained in the Supply Agreement.
- 5.4 The complainant has submitted that Zespri is discriminating against suppliers of Hayward in favour of suppliers of Zespri PVR varieties and/or cross-subsidising in favour of Zespri PVR varieties.<sup>24</sup> We understand the complainant to be concerned that Zespri is over charging costs, or under allocating revenue, to suppliers of Hayward's varieties relative to suppliers of gold kiwifruit.<sup>25</sup>
- 5.5 The amount paid to the suppliers of each variety is determined by Zespri's pricing methodology. That pricing methodology is set out in the Pricing and Payment Manual, which is a schedule to the Supply Agreement.

*(i) Zespri's pricing methodology*

- 5.6 The Pricing and Payment Manual stipulates that kiwifruit supplied to Zespri under its Supply Agreement are allocated to a "pool".<sup>26</sup> There are seven pools specified in the Pricing and Payment Manual.<sup>27</sup> These pools include the "Zespri Green Kiwifruit" pool and "Zespri Gold Kiwifruit" pool.
- 5.7 The Pricing and Payment Manual requires Zespri to calculate a "fruit return" for each pool. Critically, the Pricing and Payment Manual applies the same pricing methodology to all pools. That methodology is as follows:<sup>28</sup>

- (a) Net sales
- Less**
- (a) Promotion Costs
- (b) Direct Costs
- (c) Zespri Margin
- Equals Total fruit and service payments**
- Less**
- (d) Service Costs
- (e) Fruit Incentives

<sup>24</sup> Letter of complaint, dated 4 December 2015 at 1.

<sup>25</sup> The term "cross-subsidy" has a particular meaning in economics (an amount less than the incremental cost or more than the standalone cost); we understand the complainant to be using the term in its more general sense, meaning to allocate revenue or costs to favour one item over another.

<sup>26</sup> Pricing and Payment Manual, clause A2.1.

<sup>27</sup> These pools are Zespri Green Kiwifruit, Zespri Green Organic Kiwifruit, Zespri Sweet Green Kiwifruit, Zespri Gold Kiwifruit, Family Kiwi Green Kiwifruit, Family Kiwi Green Organic Kiwifruit and Family Kiwi Gold Kiwifruit. see Pricing and Payment Manual, clause A2.1. The Zespri Pool Policy Manual (updated June 2015) lists 8 pools in the definition of "pool" with the addition of "Family Kiwi Sweet Green Kiwifruit". Appendix A of the Pool Policy Manual (page 31) shows calculations for 9 pools – "green", "organic", "gold", "G14", for both class I and class II, and "other pool".

<sup>28</sup> Pricing and Payment Manual, clause A2.2.

### Equals Fruit Return

- 5.8 In summary form, the total amount of money paid to all suppliers of fruit to each pool - the "total fruit and service payments" - is calculated by aggregating the amounts received from the sale of the fruit allocated to the pool, less costs incurred by Zespri in selling that fruit.
- 5.9 Zespri deduct from the "total fruit and service payments" for each pool, the aggregate amounts paid in "service costs" and "fruit incentives" to suppliers of fruit to that pool, to arrive at the "fruit return". Zespri then fixes a fruit price for the kiwifruit supplied to it in each pool that returns all of the "fruit return" to suppliers of fruit to that pool during the season.<sup>29</sup>
- 5.10 An individual supplier would then receive the fruit return for each variety supplied to Zespri, plus additional amounts for fruit incentives and service costs, as well as, potentially, a loyalty payment.<sup>30</sup> The amount of fruit incentives and service costs may vary per tray equivalent, depending upon the characteristics of the fruit and delivery arrangements.
- 5.11 A term of the Supply Agreement which discriminates or results in a cross-subsidy against Hayward suppliers in favour of the suppliers of Zespri PVR varieties could conceivably enter the pricing method in relation to the:
- (a) calculation of the "net sales" amount;
  - (b) the deductions from the net sales to arrive at the "total fruit and services payments" amount; or
  - (c) the deductions from the "total fruit and services payments" figure to arrive at the "fruit return" amount.
- 5.12 We review each of these calculations in turn.
- (ii) *Net sales*
- 5.13 In arriving at the amount received for the sale of the fruit from a pool - the "net sales" figure - Zespri recognises:<sup>31</sup>
- (a) any discounts, credits, rebates or brokerage or commissions on the sale of the kiwifruit *in that pool*;
  - (b) the revenue, less costs for kiwifruit sold under a collaborative marketing agreement; and
  - (c) amounts recovered from insurers or other third parties for losses in kiwifruit post-FOBs.
- 5.14 By following these calculations, Zespri would arrive at a total amount it receives for the fruit allocated to a pool. This part of the pricing methodology would not give rise to cross-subsidisation between pools, as the revenue received from the sale of kiwifruit

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<sup>29</sup> Pricing and Payment Manual, clause A1.2.

<sup>30</sup> This loyalty payment does not vary between varieties and therefore is not considered further.

<sup>31</sup> Pricing and Payment Manual, clause A2.6. The Committee notes that the complainant included in the complaint photos of Zespri Gold and Hayward fruit selling for the same price in a store in France in May 2015, in two stores in Japan in 2013 and 2015. These photos demonstrate only that in those particular stores at the particular time the photographs were taken, Zespri Gold and Hayward fruit was being sold at the same price. These photos are not to be taken as evidence that Zespri's returns for the sale of Hayward fruit and Zespri PVR varieties are equivalent in the market.

allocated to a pool is attributed to that pool. The same terms apply to all varieties of kiwifruit.

- 5.15 As Zespri markets several varieties of kiwifruit and maintains 7 pools, it is inevitable that some revenue, and some costs, can be ascribed to more than one pool. The Pricing and Payment Manual requires Zespri to adjust the "net sales" figure for a proportion of the revenue received in relation to more than one pool.<sup>32</sup> The Pricing and Payment Manual requires that allocation be "consistent with the proportion by which those costs or revenues were incurred by the respective Pools".<sup>33</sup>
- 5.16 The rules for allocating revenue (and costs) across the pools are set out in the Pool Policy Manual. These rules are updated annually and agreed by the Industry Advisory Council each June.<sup>34</sup> The rules itemise the calculation of net sales and the costs incurred in making those sales and specify how the revenue and costs are to be allocated to each pool. In some instances, the allocation is done on a volume basis, for example, the portion of fumigation and agricultural inspection fees allocated to a pool is set at the same percentage as the portion of trays supplied by the pool to total trays supplied.<sup>35</sup> In other instances, the allocation is done on the basis of value, for instance, marine cargo insurance premiums are allocated across pools based on the value of each pool as a percentage of total value.<sup>36</sup>
- 5.17 At a general level, all allocation methods are potentially open to criticism because, if a revenue or cost is shared by two or more pools, the reality is that the cost is ascribable to the pools together.<sup>37</sup> However, an allocation rule is required. The Committee has reviewed the Zespri Pool Policy Manual, and is satisfied that the allocation methods described in the Manual apply to suppliers of all varieties and would not give rise to a cross subsidy from suppliers of one variety to another variety. The annual review by the Industry Advisory Council provides a mechanism to seek improvements to the allocation rules.

*(iii) Deduction of promotion costs, direct costs, and the Zespri margin*

- 5.18 From the "net sales" amounts for each pool, Zespri deducts the costs of promoting the kiwifruit in that pool.<sup>38</sup> Zespri also deducts the "direct costs" it incurred in purchasing, exporting, marketing, handling, and selling the kiwifruit in that pool.<sup>39</sup>
- 5.19 Generally in cost allocation methodologies, the term "direct costs" refers to costs that can be wholly attributable to one service, in this case, one pool.<sup>40</sup> However, Zespri also allocates a proportion of the costs it incurs in relation to more than one pool in its calculation of direct costs.<sup>41</sup> The rules for allocating costs across the pools are also set out in the Pool Policy Manual. As with revenue, the general approach under the Pool Policy Manual is to allocate costs in accordance with the proportion by which those costs are incurred by the relevant pool. As observed, the allocation methods set out in

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<sup>32</sup> Pricing and Payment Manual, clause A2.12.

<sup>33</sup> Pricing and Payment Manual, clause A2.13.

<sup>34</sup> Having taken into account the complainant's position in respect of the Industry Advisory Council (set out at paragraph 3.32(b)) the Committee is satisfied that it is reasonable for the Pool Policy Manual to be reviewed by the Industry Advisory Council, as the Council is a cross-representative group of members of the kiwifruit industry.

<sup>35</sup> Zespri Pool Policy Manual, updated June 2015, at 16.

<sup>36</sup> Zespri Pool Policy Manual, updated June 2015, at 16.

<sup>37</sup> See, for example, William J Baumol, Michael F Kohen, Robert D Willig, "How Arbitrary is 'Arbitrary'? – or, toward the deserved demise of full cost allocation" (Public Utilities Fortnightly, 3 September 1987).

<sup>38</sup> Pricing and Payment Manual, clause A2.7.

<sup>39</sup> Pricing and Payment Manual, clause A2.8.

<sup>40</sup> See, for example, the definition of directly attributable cost set by the Commerce Commission in its Consolidated Electricity Distribution Input Methodologies Determination, Part 2 Input Methodologies for Information Disclosure, available at <http://www.comcom.govt.nz/regulated-industries/input-methodologies-2/electricity-distribution/>.

<sup>41</sup> Pricing and Payment Manual, clause A2.13.

the Pool Policy Manual do not give rise to a cross-subsidy from the suppliers of one variety to the suppliers of another variety.

- 5.20 Finally, Zespri deducts its margin. The Pricing and Payments Manual requires Zespri to request its external auditors to confirm that the calculation of its margin accords with the amount specified in the Manual as part of the annual audit of Zespri's financial statements.<sup>42</sup>
- 5.21 The effect of these deductions is that the "total fruit and services payments" calculated for each pool reflects the amounts obtained by Zespri for the sale of fruit within that pool, less the direct costs Zespri incurs in selling that fruit (including its margin) and an allocation of its shared costs. The same rules are applied to each pool, and hence to the suppliers of each variety.
- 5.22 A pricing method which passes back to the supplier of a variety the revenue received from the sale of that variety, less the costs of bringing that variety to the market, does not discriminate between suppliers. It does not treat suppliers of different varieties differently. Suppliers of different varieties may receive different payments, if one variety obtains higher market revenues than another variety or is less costly to market, but that different payment is not a result of the terms of the purchase of kiwifruit treating suppliers of different varieties differently. The non-discrimination rule in regulation 9(b) does not guarantee equality of outcome, it guards against unequal treatment of suppliers in respect of the terms of the purchase agreement.
- 5.23 If the Committee is wrong in this view, and a rule that passes higher revenue, or lower cost, for a particular variety back to the suppliers of that variety does discriminate, then that discrimination would be commercially justifiable. The High Court in *Aotearoa Kiwifruit Export Ltd v Southlink Ltd* observed that "justifiable discrimination is that which operates between a buyer and a seller in any given market ...".<sup>43</sup> Commercial terms which pass back to the supplier higher revenues, or lower costs, in marketing their product are common place. Indeed, a pricing rule which did not pass back differences in revenues or costs in this manner could very well be contrary to the purpose of Part 3 of the Regulations, as it may impede efficient price signals and discourage innovation (regulation 8(b) and (a)).
- (iv) *Deductions to arrive at the "fruit return"*
- 5.24 From the "total fruit and service payments" for each pool, Zespri deducts the aggregate amounts paid in service costs and fruit incentives to suppliers of fruit to that pool, to arrive at the "fruit return".
- 5.25 Zespri has confirmed in correspondence to the Committee that these deductions are calculated and charged at an individual pool level, such that the costs that relate to an individual pool remain within that pool.<sup>44</sup> Hence, these deductions cannot give rise to a cross-subsidy between varieties, or discriminate between varieties.
- 5.26 The application of the fruit incentives payments, which result in different payments to suppliers of the same variety, has already been determined by the Board to be made on commercial grounds and hence justifiable.<sup>45</sup> In any event, the Board does not perceive the complainant to be challenging the application of the fruit incentive payments within a pool.
- 5.27 Service costs are payments made by Zespri to contractors for delivery costs, differences in packaging costs and supplying fruit at times other than during the main pack.<sup>46</sup> As

<sup>42</sup> Pricing and Payment Manual, clause A3.2.

<sup>43</sup> *Aotearoa Kiwifruit Export Ltd v Southlink Ltd* HC Auckland CIV 2003-470-478, 3 February 2006 at [69].

<sup>44</sup> Zespri's letter to the Committee, dated 4 April 2016, at 1.

<sup>45</sup> Decision of the New Zealand Kiwifruit Board in the matter of [REDACTED] dated 20 February 2007.

<sup>46</sup> Pricing and Payment Manual, clause B1.1.

compensation for costs incurred in delivering fruit to Zespri in the form required by Zespri, these payments neither cross-subsidise nor discriminate between suppliers.

(v) *Verifying that the pricing methodology is applied*

5.28 The Board (and therefore this Committee) is empowered to monitor and enforce Zespri's obligation not to unjustifiably discriminate among suppliers and potential suppliers in respect of its decisions on whether to purchase kiwifruit or the terms of the purchase contract. It is outside our powers to monitor and enforce the accuracy of the data inputs into the calculation of prices under that methodology.

5.29 However, we considered it would provide useful context for this decision to describe in general terms the processes followed by Zespri to verify the accuracy of its pricing calculations. Zespri described the processes it adopts in a letter to the Committee dated 4 April 2016, as including:

- (a) Zespri management reviews the outputs from pool allocations regularly to ensure the resulting forecasts and grower payments are reasonable.
- (b) Zespri's Internal Audit will review the calculations from time to time to ensure compliance with the Supply Agreement and the Payment and Pricing Manual.
- (c) In 2014/2015 an external audit was undertaken on the Freight and Promotion costs.
- (d) Zespri's Audit and Risk Management Committee (a sub-committee of the Zespri Board) has oversight in this area and reviews all external and internal audit reports.
- (e) Under the Supply Agreement, Zespri is required to report certain pool costs to the Industry Advisory Council annually and explain any variances.
- (f) New Zealand Kiwifruit Growers Incorporated and growers ask for explanations from time to time on pool costs and allocation methodology.

5.30 All verification and checking processes incur costs and hence inherently involve a trade-off between the costs incurred and the degree of assurance provided. By limiting the powers of the Board to monitoring and enforcing the discrimination rule, the Regulations provide for the decisions on this cost–assurance trade-off to rest with Zespri and its suppliers and shareholders, not with the Board.

(vi) *Conclusion on pricing methodology*

5.31 For the reasons outlined above, the Committee concludes that the pricing methodology, as set out in the Pricing and Payments Manual does not discriminate between suppliers of Hayward and Zespri PVR varieties. If the Committee is wrong in that conclusion, the discrimination (which passes differences in revenue and costs back to suppliers) is justified on commercial grounds (in accordance with regulation 10(1)), and is therefore not contrary to regulation 9(b).

*Zespri's marketing and allocation decisions*

5.32 The Committee recalls that the complaint located its allegation of unjustifiable discrimination in the context of a broader complaint that Zespri is abusing its monopsony powers, as evidenced by its marketing and allocation decisions taken as part of its global optimisation strategy (see the table at paragraph 3.8 above).

- 5.33 The Committee accepts Zespri's submission that the non-discrimination rule is limited in scope, and does not govern how Zespri markets and distributes kiwifruit once purchased from New Zealand suppliers.
- 5.34 This limit arises by virtue of the text of regulation 9(a) and (b). The textual limit is clear, and a more expansive interpretation of regulation 9 is not available, for the following reasons:
- (a) as noted above at paragraph 4.8, although the purpose of Part 3 of the Regulations is to mitigate the potential costs and risks arising from the monopsony, that purpose is not a standalone standard against which any and all of Zespri's conduct can be tested; and
  - (b) as noted above at paragraphs 4.9–4.13, there are limits on the Board's (and therefore this Committee's) monitoring and enforcement function. Of particular relevance is the requirement set out in regulation 6(1)(f) that the export authorisation not provide the Board any rights or powers in respect of kiwifruit pool administration or control (other than in respect of collaborative marketing). Resolving complaints in respect of marketing and allocation decisions would come perilously close to asserting powers in respect of the administration and control of kiwifruit pools.
- 5.35 Given that the relevant function of the Board (and therefore this Committee) is to monitor and enforce the non-discrimination rule, it is outside our powers to monitor and enforce Zespri's marketing and allocation decisions in this forum.
- 5.36 That said, we offer some general observations on this issue at paragraph 6.2 below.

***The information disclosure requirements***

*Regulation 13(e)*

- 5.37 Zespri is correct in its submission that regulation 13(e) does not create an obligation on Zespri. Instead, regulation 13(e) states one matter that may be required to be disclosed under the Handbook published in 2004 by the Chief Executive of the Ministry of Primary Industries. Accordingly, the complaint that Zespri is contravening regulation 13(e) is dismissed.
- 5.38 Interpreted generously, however, this complaint could be read as an allegation that Zespri is contravening the disclosure requirements contained in the Handbook relating to transfer payments amongst business activities.
- 5.39 In respect of this allegation, the Committee notes:
- (a) The Handbook contains rules for the financial separation of Zespri's core and "other" businesses.
  - (b) Clause 3.1 of the Handbook requires Zespri to "disclose information relating to transfer payments (both income and expenditure including capital expenditure) made between the core and 'other' businesses."
  - (c) Zespri is correct to identify that the purchase and export of both Hayward and Zespri PVR varieties falls squarely within the definition of "core business" in regulation 2 (set out in paragraph 4.34 above).
  - (d) Therefore, the Handbook does not require Zespri to disclose transfer payments, if any, between Hayward and Zespri PVR varieties.



5.40 For these reasons, the Committee concludes that Zespri has not breached either regulation 13(e) or clause 3.1 of the Handbook.

*Regulation 14(4) and 14(5)*

5.41 The Committee has concluded that it has not been established that Zespri has not complied with regulations 14(4) or 14(5) in respect of the complainant. Addressing the issues raised in the complaint, our reasons are as follows:

- (a) the methodology used to determine the payments for kiwifruit is set out in the Supply Agreement, a copy of which the complainant has; and
- (b) this methodology (described at paragraphs 5.5-5.31 above) meets the requirements of regulations 14(4) and 14(5).

5.42 That said, we offer some general observations on this issue at paragraph 6.3 below.

**Non-diversification of Zespri's core business**

5.43 The Committee has concluded that Zespri's practice of itself holding "grower pool funds" rather than holding them in a separate trust is not a breach of regulation 11, for the following reasons:

- (a) Funds held by Zespri are not properly characterised as "grower pool funds". Neither growers nor any other subset of suppliers are legally or beneficially entitled to the gross returns from export sales held by Zespri. Instead, suppliers (including growers) are entitled to receive payments of the amount, and at the time, specified in the Supply Agreement.
- (b) In any event, Zespri's practice of holding the gross returns from export sales, meeting costs and liabilities in accordance with the Supply Agreement, and making fruit payments of the amount and at the time specified in the Supply Agreement is necessary for Zespri's core business because doing so is essential to the purchase and export of New Zealand-grown kiwifruit.

5.44 The Committee notes that our application of regulation 11 in this instance does not turn on a broad understanding of the definition of "core business"; rather it turns on the definition of "core business" in regulation 2 - being the "purchase of New Zealand-grown kiwifruit for export ... and the export of that fruit".

5.45 The Committee offers general observations on this issue at paragraphs 6.4–6.5 below.

**6. GENERAL OBSERVATIONS**

**Regulation 9: discrimination**

6.1 By way of observation, the Committee notes that it is aware that schedule 6 of the Supply Agreement provides for the ability of Zespri to make Service Level Agreements ("SLAs") available during the kiwifruit season to all contractors, or to specific contractors. Theoretically, if SLAs were used by Zespri to treat contractors differently, that could constitute discrimination and Zespri would need to justify any such different treatment with reference to commercial grounds. However, the Committee has not had to consider this issue because that question has not been raised in either the complaint or in Zespri's response to the complaint. We simply note the potential issue.

### **Monopsony abuse**

- 6.2 The Committee recalls that it has not decided upon the merits of the allegations within the complaint of monopsony abuse where to do so would have been beyond the Committee's mandate under the Regulations (see paragraphs 5.32–5.33 above). However, the Committee offers the general observation that the complainant may seek to air these concerns (either as to Zespri's conduct or our response to that conduct in these proceedings) with the appropriate policy agency, that being the Ministry of Primary Industries. In saying this, we should not be understood as suggesting that there is actual monopsony abuse that is beyond our ability to deal with. We are simply flagging that matters of policy are for the Ministry of Primary Industries.

### **Information disclosure**

- 6.3 At paragraph 5.41 above, we recorded our conclusion that in respect of the complainant Zespri has complied with regulation 14(5). However, the Committee offers the general observation that Zespri may wish to consider collating in one clearly accessible place a summary of the key details of its pricing methodology including the factors identified in regulation 14(5)(a), (b) and (c). Zespri might also consider whether aspects of its pricing methodology could be described more clearly.<sup>47</sup> The Committee is aware of the Grower Payments handout, but is of the opinion that regulation 14(5)(c) can be read to encourage Zespri to be even more explicit in respect of the information on which it relies to justify any discrimination amongst suppliers.

### **Diversification of Zespri's core business**

- 6.4 The Committee acknowledges that the complaint, and Zespri's response, puts at issue the question of whether it would be (a) possible, and (b) desirable for Zespri to implement some form of grower pool trust in relation to funds received due to the export of New Zealand-grown kiwifruit.
- 6.5 The Committee is of the view that it cannot properly decide upon these matters as they do not concern compliance by Zespri with regulation 11. That said, the Committee repeats the observations made in paragraph 6.2 above, that matters of policy are for the Ministry of Primary Industries.

## **7. CONCLUSIONS ON MERITS OF COMPLAINT**

- 7.1 The Committee has reached the following conclusions:
- (a) it has not been established that Zespri breached the non-discrimination rule;
  - (b) it has not been established that Zespri breached the non-diversification rule; and
  - (c) it has not been established that Zespri breached the information disclosure requirements in regulation 13(1)(e), regulation 14(4) or regulation 14(5).
- 7.2 Accordingly, the complaint is dismissed.

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<sup>47</sup> As noted above, the description of direct costs in the Pricing and Payments Manual in fact takes in direct and indirect costs, and the Committee needed clarification from Zespri on whether the deductions for incentives and services costs are calculated and charged at an individual pool level.

**8. RELIEF AND COSTS**

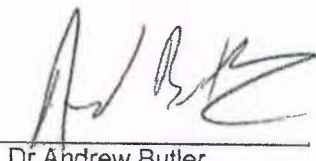
- 8.1 Given the Committee's conclusions set out at paragraph 7.1 above, the Committee does not grant any relief to the complainant. The Committee expresses no view on whether, had it upheld any aspect of the complaint, it would have granted any of the relief sought.
- 8.2 In this instance, each party will be responsible for their own costs. The Committee notes that the costs associated with this inquiry have not been insignificant, but have enabled a thorough analysis of wide-ranging complex issues, which - the Committee hopes - will bring wider benefits for suppliers and Zespri. Costing decisions are necessarily circumstantial, and the Committee notes that it may not always be the case that each party is responsible only for their own costs.

Decision of the Committee, being composed of Kristy McDonald QC, Dr Andrew Butler, and Kieran Murray

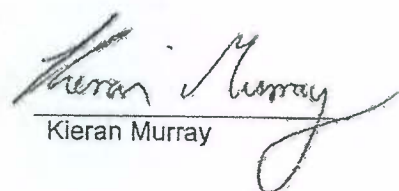
16 June 2016



Kristy McDonald QC  
Chair



Dr Andrew Butler



Kieran Murray