Decision of	the New Zealand Kiwifruit Board
In the matter of	Minimum Taste Standard Complaint
Under	the Kiwifruit Export Regulations 1999
Dated	1 November 2017

INTRODUCTION AND SUMMARY

1 This is the final decision of the Minimum Taste Standard Complaint Committee on a complaint lodged by Seeka Limited on 7 June 2017.

2 Seeka's complaint challenges aspects of the Minimum Taste Standards (MTS) for Hayward conventional and organic kiwifruit, alleging in particular that recent changes to the standards breach the non-discrimination rule in regulation 9 of the Kiwifruit Export Regulations 1999. The complaint is brought under the enforcement regime established by the Authorisation to Export Kiwifruit granted to Zespri Group Limited pursuant to the Kiwifruit Industry Restructuring Act 1999 and the Kiwifruit Export Regulations 1999.

INVESTIGATION PROCESS

3 The KNZ Board established the Minimum Taste Standard Complaint Committee and delegated the investigation of this complaint to the Committee on 22 June 2017, in accordance with cl 11 of Schedule 2 of the Regulations. The delegation authorised the Committee to set its own procedure, subject to the requirements of the Export Authorisation, the Regulations, and the Act.

4 The Committee issued a Notice of Investigation to the parties in accordance with cl 6.2.2 of the Export Authorisation on 3 July 2017 and set out a preliminary process and timetable for the investigation. The Committee aimed for its process to be consistent with the rules of natural justice and to allow the investigation to be conducted in a manner that is speedy, inexpensive and simple, as directed by cl 7.1(b) of the Export Authorisation.

5 The first step in the process was to invite Seeka to identify the specific alleged breaches of the regulations, to provide all information in support of its complaint and to make any submissions in support of its complaint by 10 July 2017. Seeka responded to that invitation within the required timeframe.

6 Following concerns raised by Zespri regarding the scope of the investigation a teleconference was convened on 18 July 2017. A Process Update was then issued including a list of questions for Zespri that the Committee considered particularly relevant to the investigation. Zespri was invited to address those questions and to provide any other information or submissions it wished to provide in response to the complaint. Zespri proposed that it provide its response by 10 August, which was agreed by the Committee.

7 Following review of Zespri's submission of 10 August the Committee issued a further list of questions, and Zespri's response was provided on 31 August (dated 29 August). Seeka was given the opportunity to respond to Zespri's submissions of 10 and 31 August, and provided its response on 14 September. In turn, Zespri replied on 26 September.

8 The Committee subsequently requested the provision of further documentation from Zespri relating to its audit process, which was provided on 5 October. Seeka was invited to make any comment on this material by 5pm on 10 October but no comment was received.

9 In accordance with cl 6.2.11 of the Export Authorisation the Committee released a provisional decision to Zespri and to Seeka on 12 October, and invited their responses by 19 October. Zespri provided its response on the due date, and that has been taken into account in this final decision. Seeka did not provide a response to the provisional decision.

10 A number of other procedural issues were addressed through the investigation process, as set out below.

Clause 6.1.3(c) of the Export Authorisation and the scope of the investigation

11 In a letter dated 7 July 2017 Zespri raised the issue of whether cl 6.1.3(c) of the Export Authorisation applied, such that the investigation should not have been commenced. Clause 6.1.3(c) provides that a complaint should not be investigated if, in KNZ's opinion:

> the complaint is the same as, or is similar to, a complaint previously received and resolved, or raises matters which are the same as, or similar to, matters previously investigated by KNZ.

12 Zespri relied on the investigation of a complaint in 2006 by Mr Barry Bartling relating to aspects of the taste standards.[1] Zepri suggested that the *Bartling* investigation was sufficiently similar to the current complaint that cl 6.1.3(c) ought to have been applied.

13 Following the teleconference on 18 July the Committee Secretary responded to this issue in a letter to the parties dated 24 July. The letter set out the Committee's understanding that Zespri had been concerned about a potential investigation into the general lawfulness of the MTS itself. Zespri did not assert that *Bartling* was sufficiently similar to rule out an investigation into recent changes and issues with the current

[1] Decision dated 26 February 2007 http://www.knz.co.nz/wordpress/wp-content/uploads/BBartling-Final-Determination-200207.pdf

application of the MTS, which was the subject of the current investigation. On this basis, the Committee understood that Zespri's concern that cl 6.1.3(c) might be applicable had been resolved. Zespri was advised that if it took a different view, it should raise any objection in writing as soon as possible. Zespri did not raise any objection.[2]

Confidentiality

14 In the Notice of Investigation, the Committee requested the parties to specifically identify any information that was considered to be confidential and for which restrictions on disclosure were sought. Zespri sought confidentiality restrictions for one report provided to the Committee as part of its submissions of 10 August 2017, titled "Taste sensory – all cultivars – 2014: A global study of consumer taste preferences for kiwifruit". Zespri requested that this report not be disclosed to Seeka, because it was subject to an obligation of confidence to a third party and its disclosure would cause commercial prejudice to Zespri.

15 The Committee noted that this report was specifically provided to support Zespri's statement in its submission of 10 August at [64] that:

> The results of numerous studies have confirmed dry matter is a good predictor of the eventual brix (a proxy for sweetness) and that dry matter is also a good proxy for consumer liking for kiwifruit.

16 On the basis that this proposition was not disputed by Seeka,[3] and in light of Zespri's confirmation that the report did not specifically support the recent changes to the minimum taste standards, the Committee reached the view that it was not necessary for the report to be considered as part of the investigation. The parties were accordingly advised on 1 September that the report would not be considered. Neither party objected to that decision.

Submissions from NZKGI

17 On 22 September, after Seeka had made its final submissions and shortly before Zespri was due to provide its final reply, New Zealand Kiwifruit Growers Incorporated

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[2] In its submission in response to the provisional decision Zespri requested that the Committee record that it raised objections in separate communications with the KNZ Board, which it did not provide to the Committee. The Committee has therefore proceeded on the basis presented to it by Zespri in response to its letter of 24 July.

[3] While Seeka's initial submission received 10 July 2017 questioned whether "dry matter is a valid quality characteristic", Seeka subsequently confirmed that its complaint did not relate to the MTS concept itself, which is based on the correlation between dry matter and taste, and that it did not challenge the appropriateness of dry matter as a predicator of brix or a consumer's liking for kiwifruit. See the record of the teleconference of 18 July 2017 in the Process Update of the same date, the letter from the Committee dated 24 July 2017 and Seeka's letter of 24 August 2017.

approached the Committee with a request that it be allowed to make submissions to the Committee on the investigation.

18 NZKGI advised that it wished to bring to the attention of the Committee the following points:

> 1. The taste standards implemented by Zespri for the 2017 season were supported by NZKGI, Zespri and the majority of suppliers through the Industry Advisory Council.
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> 2. Extensive consultation on the proposed changes to the taste standards was undertaken by both NZKGI and Zespri.
>
> 3. The proposed changes were discussed in detail by the NZKGI Forum (which includes 27 representatives from regions and supply entities) and it was agreed by a clear majority to support them.

19 NZKGI further requested that:

> In order for NZKGI to make a submission to the sub-committee and provide detailed information of relevance we need to better understand the nature of the complaint and subsequent investigation that is being undertaken.

20 The Committee determined that it would not delay the investigation process to allow NZKGI to make submissions on the complaint. This was based on a number of factors:

20.1 The procedure required by the Export Authorisation did not provide for parties other than Zespri and Seeka, as the complainant, to make submissions. While the Committee would be entitled to seek information or comment from any other person or body that it considered could assist it in its investigation, it was not obliged to provide a general right to be heard to other parties.

20.2 The Committee's processes are required to be speedy, inexpensive and simple.

20.3 Zespri had raised with the Committee in July the prospect that submissions could be received from NZKGI and sought confirmation that it could share information about the Committee processes with NZKGI. The Committee confirmed that there were no restrictions on sharing information about the Committee processes, but after discussion at the teleconference on 18 July directed that it would not provide a general right to be heard to any other parties. The Committee invited Zespri and Seeka to put forward information or submissions from NZKGI or any other party if they considered that these would

be relevant to the investigation. The parties were invited to express any objection to this approach, but neither did so.

20.4 NZKGI's request to the Committee, made late in the investigation, would have resulted in re-opening and extending the submissions process to allow Zespri and Seeka to respond to the new submissions, and to reply to each other's response. This would cause delay and further costs to the parties.

20.5 Zespri had already provided the level of information it considered to be relevant about the issues that NZKGI indicated that it wished to address. The delay and further cost to allow additional submissions on these matters did not appear to be warranted.

THE NON-DISCRIMINATION RULE

21 This complaint alleges that Zespri has breached the non-discrimination rule, set out in regulations 9 and 10. These provide:

> **9 Duty not to discriminate unjustifiably**
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> 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.

22 The non-discrimination rule is one of the mitigation measures set out in Part 3 of the Regulations. These are measures designed to mitigate the potential adverse effects of Zespri's statutory monopsony.[4] As regulation 8 explains:[5]

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[4] The regulations setting the mitigation measures were made under s 26 of the Kiwifruit Industry Restructuring Act 1999. Section 26(1)(g) refers specifically to "restricting discrimination among suppliers of kiwifruit for export to commercial grounds", which was recognised as a key protection for suppliers against Zespri's market power. See for example the speech of the Minister of Finance on introduction of the Kiwifruit Industry Restructuring Bill on 20 July 1999 and the select committee report, both discussed in *Turners & Growers Ltd v Zespri Group Ltd* (2010) 9 HRNZ 365 at [46] – [50].

[5] As amended from 1 August 2017 by the Kiwifruit Export Amendment Regulations 2017. Nothing in this decision turns on the amendments to this regulation.

8 Purpose of Part

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

(a) encouraging innovation in the kiwifruit industry while managing risks associated with activities that are not the core business; and

(b) promoting efficient pricing signals to shareholders and suppliers; and

(c) providing appropriate protections for producers and ZGL's shareholders and suppliers; and

(d) promoting sustained downwards pressure on ZGL's costs.

23 KNZ has the function of monitoring and enforcing the non-discrimination rule under regulation 33(1)(b)(i), and is directed to do so in such a way as to "to best achieve the purpose in regulation 8" (see regulation 33(2)).

24 It is important to note that KNZ's role in this context is limited to monitoring and enforcing the specific mitigation measures set out in the Regulations. KNZ is not empowered to inquire into whether Zespri's conduct in and of itself meets the objectives of regulation 8, nor to assess the general merits of Zespri's commercial decisions and judgements.

25 This limit on KNZ's role is further confirmed by regulation 6, which provides that the Export Authorisation set by KNZ must *not* provide for a range of matters relating to Zespri's business decisions, including:

(b) a requirement that ZGL purchase any particular proportion of the kiwifruit crop:

(c) the basis on which ZGL is to purchase and pay for kiwifruit (other than in connection with the non-discrimination rule) …

BACKGROUND: THE MINIMUM TASTE STANDARDS

26 Zespri introduced its Minimum Taste Standard (MTS) in 2006.[6] Fruit not meeting the MTS threshold is not accepted by Zespri into its Class 1 inventory.[7] From the 2006 to the 2015 seasons, 50% of a sample of kiwifruit from a maturity area needed to contain at least 14.5% dry matter to be accepted by Zespri. Dry matter is considered by

[6] Zespri Grower Premium Harvest 2006 Booklet, page 5.

[7] Zespri's Grower Premiums Booklet produced for the 2006 harvest states "fruit below the MTS will not be accepted for Class 1 inventory". Grower Premium Booklets since that time have similarly made it clear that fruit below the MTS would not be accepted into Class 1 inventory.

Zespri as a good predictor of the sweetness of the fruit and a proxy for consumer liking for kiwifruit.

27 In each of the past two seasons, Zespri has increased the MTS thresholds:[8]

27.1 For the 2016 harvest, the MTS threshold was increased to 15.5% dry matter on average (50%) in a sample from a maturity area.

27.2 For the 2017 harvest, the requirement was that at least 70% of the population represented by the sample is assessed as meeting the MTS of 15.5% dry matter.

28 Changes were also made to the sampling method for the 2017 season. Vines within a gap are now sampled in 3 positions (rather than 9 positions as previously) and the sample is collected within 10cm of the centre of the fruit depth in the canopy (rather than 15 cm).

THE COMPLAINT

29 Seeka confirmed in communications with the Committee that it does not challenge the underlying premise of the minimum taste standards, nor does it challenge the appropriateness of dry matter as a predictor of brix or a consumer's liking for kiwifruit.[9]

30 Seeka's complaint, set out most fully in its submission received 10 July, encompasses a range of allegations, including the following:[10]

30.1 The changes to the taste mechanism from 2016 to 2017 do not promote efficient pricing signals to shareholders and suppliers. In support of this view, Seeka put forward the following contentions:

(a) There is no evidence the price variations in the taste payments for 2016 did not provide sufficient price signals to growers to change their growing practices; Seeka contends that the taste system operated by Zespri had incentivised and delivered higher average dry matter fruit.

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8 Zespri letter to the Committee, 10 August 2017, page 3.

9 See the record of the teleconference of 18 July 2017 in the Process Update of the same date, the letter from the Committee dated 24 July 2017 and Seeka's letter to the Committee, 24 August 2017, paragraph 2.

10 Seeka set out and elaborated on its complaint in letters dated 7 June, 10 July, 24 August, 4 September, and 14 September 2017. The Committee considered the full range of matters raised by Seeka: the summary points set out in this decision are not intended to be exhaustive.

(b) The variation in financial payments to growers based on TZG (the financial extrapolation of dry matter) is not linked to any premiums from the market; Seeka observed that in its Hayward growers' pools for the 2016 season, the lowest taste payment per tray was $0.47 and the highest was $2.21 per tray.

(c) No allowance is made for the range of dry matter; fruit above the threshold may have very high dry matter results, or a market in general may have a preference for lower dry matter fruit; while Seeka accepts the new standard has the effect of delivering less variability in a tray, it still means the market was being delivered some fruit below the threshold of 15.5% dry matter.

(d) The standards make no allowance for dry matter at different stages of the harvest (for example, early start versus main season); Seeka suggests the market might be more tolerant of lower dry matter fruit early in the season.

(e) There is no research that a market will not accept fruit which is below the 70% taste threshold.

30.2 Regulation 9 imposes a duty not to discriminate unjustifiably. Seeka argues that:

(a) the minimum dry matter threshold is arbitrary and not supported by the market or any market statistics; Seeka contends that Zespri has not provided information or market research to suggest there was a market signal to shift from 50% to 70%, or that there is no market for fruit that sits between the 50% and 70% thresholds; and

(b) fruit which in previous years had been sold for good market return is no longer accepted; Seeka provided two anecdotal examples of growers whose fruit was unable to be harvested because it failed to achieve the threshold, when in Seeka's view the fruit could have been sold in a market delivering economic benefit to the grower and to the industry.

30.3 Seeka argues that to meet the commercially justifiable threshold the system should have the following features:

(a) Reliability, accuracy and consistency; Seeka contends that growers are currently benefiting or not benefiting from error as the current sampling is unreliable and results in wide variations of outcome. Seeka is aware

of grower results varying widely on consecutive days and even on the same day, resulting in an increased level of sampling.[11] As the sampling method is not reliable, it is not justifiable to discriminate using dry matter.

(b) A connection between the minimum taste standard and market signal that fruit below this level can no longer be sold.

(c) A close calibration between market proceeds and grower payments.

30.4 Seeka contends that the treatment of fruit between the 2016 and 2017 thresholds needs closer examination. It argues this fruit may be sold alongside other fruit (that received a payment premium) and some of the fruit not receiving the payment premium would, in fact, have a higher average dry matter.

31 As outlined above, the Committee formed the view that the material put forward by Seeka raised a number of questions. Zespri was invited to respond to specific questions posed by the Committee, as well as provide the Committee with whatever further information and submissions it wished to have considered by the Committee.[12] Key aspects of Zespri's submissions are discussed below. As with Seeka's submissions, the Committee has considered all the information provided to it.

HAS ZESPRI BREACHED THE NON-DISCRIMINATION RULE?

32 Clause 6.2.1 of the Export Authorisation sets out the purpose of the investigation into a complaint as:

> The purpose of an investigation conducted under this enforcement procedure is to determine whether ZGL has, on the balance of probabilities, failed to comply with any of the matters referred to in Regulation 33(1)(b)(i) – (iii).

33 Regulation 33(1)(b)(i)[13] refers to the non-discrimination rule described in regulations 9 and 10. Breach of the non-discrimination rule requires two elements to be established:

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[11] Seeka described what it referred to as an extreme example of this where an unidentified major organic grower separated his crop into three sections, all of which failed to meet the 70% threshold, but the whole orchard (tested on the same day) passed the threshold. Seeka offered to provide further examples of variations in sampling results.

[12] Zespri's responses are set out in its letters and submissions dated 7 July, 12 July, 19 July, 10 August, 29 August, 26 September, and 5 October.

[13] Both before and after the amendments under the Kiwifruit Export Amendment Regulations 2017.

33.1 First, that there has been discrimination between suppliers;

33.2 Second, that the discrimination is not justified as being on commercial grounds.

34 The Committee has not applied any formal burden of proof on Seeka as the complainant. Rather, the Committee sees its enforcement role under regulation 33 as itself inquiring into the issues raised by Seeka's complaint, and reaching a view on whether Zespri has, on the balance of probabilities, breached the non-discrimination rule.

IS THERE DISCRIMINATION?

35 As noted in KNZ's decision on an earlier complaint under regulation 9 determined on 16 June 2016,[14] discrimination generally means to treat someone differently from someone else when those people are in comparable circumstances. It is also described as arising where there is a difference in treatment between two people or groups in comparable situations, that disadvantages one group compared with the other.[15] Discrimination is generally seen as a broad and non-technical concept.[16]

36 As the decision making committee explained in the 16 June 2016 decision:[17]

> In the context of the Regulations, [discrimination] could manifest in:
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> (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;
>
> (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.

37 Example (c) is one way of describing "indirect" discrimination, which can arise where two groups appear to be treated in the same way, but because of the different characteristics of the groups the same treatment results in different outcomes for them. On this basis, the fact that Zespri offers the same terms and conditions to all

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[14] Grower Complaint, 16 June 2016, at [4.17] available at: http://www.knz.co.nz/wordpress/wp-content/uploads/GROWER-COMPLAINT-in-full.pdf

[15] *Ministry of Health v Atkinson* [2012] NZCA 184, [2012] 3 NZLR 456 at [55] and [136], reaffirmed for example in *B v Waitemata District Health Board* [2016] NZCA 184, [2016] 3 NZLR 569 at [84].

[16] *Child Poverty Action Group Inc v Attorney-General* [2013] NZCA 402, [2013] 3 NZLR 729 at [48], [72] and [75]; *Ministry of Health v Atkinson* [2012] NZCA 184, [2012] 3 NZLR 456 at [60]; [75] – [78] and [123] – [136].

[17] At [4.17]

its suppliers does not by itself rule out the possibility of discrimination between suppliers.[18]

38 Seeka's complaint is that Zespri's minimum taste standards operate to exclude Hayward conventional and organic kiwifruit that does not meet the standard from the Class 1 inventory, which has an adverse impact on some suppliers. The proposition is that while the terms and conditions are the same for all suppliers, they impact differently between suppliers on the basis of the quality of the fruit they produce, and thus discriminate between suppliers.[19]

39 Zespri raises two arguments in response. The first is that as the same terms and conditions are offered to all suppliers, there is no breach of regulation 9(b).[20] For the reason set out above, the Committee does not agree that the existence of standard terms and conditions necessarily rules out discrimination between suppliers. It is possible for standard terms and conditions to discriminate because of their different impact on different suppliers.

40 Secondly, Zespri argues that there is no discrimination under regulation 9(a) because Zespri does not make a "decision" on whether to purchase kiwifruit from any particular supplier: whether the kiwifruit is accepted into inventory is simply a result of the application of its standard terms and conditions. Zespri argues that regulation 9(a) is therefore not engaged.

41 This is not a persuasive argument, and would if accepted undermine the non-discrimination rule by allowing the standard terms and conditions to shield Zespri's dealings with suppliers from complaint or scrutiny. The fact that Zespri's decision on

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[18] The possibility of indirect discrimination does not appear to have been considered by the Board in the *Bartling* decision, although this may reflect the particular focus of that complaint. In its submission in response to the Committee's provisional decision on this complaint, Zespri argued that the Committee's approach to indirect discrimination is inconsistent with the decision on the 2016 complaint, and quotes the following statement from that decision in support: "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." While this Committee is not bound by comments made in any earlier decisions on complaints, we do not in any event agree with Zespri's argument. The 2016 complaint was concerned with differences in outcome that arose from Zespri passing through differences in revenues and costs. As noted above, the 2016 decision expressly refers to the potential for indirect discrimination in the purchase terms. The sentence quoted by Zespri also foreshadows that possibility, as is made clear by the sentence immediately preceding it in the 2016 decision (not quoted by Zespri).

[19] The Regulations confirm that differentiation between suppliers based on the quality of fruit can fall within the meaning of discrimination, as regulation 10 provides that product features such as quality is one of the factors that may provide commercial justification for discrimination that would otherwise be caught by the prohibition in regulation 9.

[20] Zespri refers to regulation 9(a) in its submissions of 10 August 2017 at [55], but from the context the Committee understands that the intention was to refer to regulation 9(b).

what fruit it will purchase is implemented through the minimum taste standards in the purchase conditions does not mean that this is not a decision.

42 In response to the Committee's notice of investigation, Zespri observed that the recent changes in the MTS were the result of a process involving a Taste Review Committee of grower and post-harvest representatives, consultation with growers and decisions by the Zespri Board and the IAC.[21] The Committee did not understand Zespri to argue that the recent changes cannot be discriminatory because of the broad support they have across the industry, or because of the level of consultation and industry engagement undertaken prior to their introduction.[22] This is appropriate. The Committee agrees with Seeka's point in its submission of 14 September 2017 that "while such processes can be industry wide, discrimination or the effect of it, often is not." In other words, it is no answer to a complaint of discrimination against a minority that the majority were in favour of the decision.

43 Taking a broad approach to discrimination as including indirect discrimination, the minimum taste standards are potentially discriminatory. Indeed, that is in one sense the purpose of the standards. Zespri is seeking to discriminate by purchasing only fruit which meets its required taste standards and excluding from inventory fruit which does not. It is an inevitable effect of imposing such standards that they will impact some suppliers differently compared to others. The recent changes raised the thresholds in the standards increased the scope for more suppliers to be adversely affected, and for that adverse impact to be greater, than was previously the case.

44 In addition, it appears from the information provided to the Committee that particular groups of suppliers may be more adversely affected by the recent changes than other groups. The information provided to the Committee indicates that the increased thresholds were anticipated to and are having a greater impact on suppliers of Hayward organic fruit, and possibly on suppliers in certain localities, compared to other suppliers. In recommending the increase in the threshold, the Taste Review Committee calculated the number of trays submitted and accepted in the 2015 and 2016 seasons that would not have been accepted in those years under the higher standard of 70% exceeding 15.5% dry matter. The Taste Review Committee estimated that 2.3% of the conventionally grown Hayward and 9% of the organic

[21] Zespri, 7 July 2017, Response to KNZ Notice of Investigation – Minimum Taste Standard, page 2.

[22] Zespri confirmed this position in its submission in response to the Committee's provisional decision, noting that its point was rather that widespread industry support does constitute evidence that Zespri's decision was a commercially justifiable decision that was open to Zespri to make, and not an arbitrary or irrational decision with no commercial justification.

Hayward fruit would not have been accepted in 2016 under the higher standard. The figures estimated for 2015 were 1.7% and 5.1% respectively.[23]

45 For the 2017 season, Zespri made available a Service Level Agreement to accept Hayward fruit between the 2016 and 2017 MTS under a non-standard supply arrangement. The quantity of fruit accepted by Zespri under this Service Level Agreement equated to 0.02% of the Hayward conventional grown fruit accepted in 2017, and 5.02% of the Hayward organic fruit.[24]

46 These figures indicate that suppliers of Hayward organic fruit have more difficulty in meeting the new standards than suppliers of Hayward conventional fruit. Other information provided to the Committee seems to support this conclusion. Zespri is aware of three Hayward organic maturity areas which, in 2017, fell below the 2016 MTS, but is not aware of any Hayward conventionally grown volumes which fell below the 2016 standard.[25] Seeka similarly provided anecdotal evidence of an organic grower of Hayward fruit who failed to achieve the dry matter threshold in 2017.[26]

47 Zespri suggested in its response to the Committee's questions that the primary reason for the higher failure rate for organic fruit is that the growing system used to produce organic kiwifruit is very different to the conventional growing system.[27] One example of this difference is the availability of budbreak enhancers to conventional growers – budbreak condenses flowering and tightens the maturity of fruit within a maturity area. Another reason put forward was that some regions have a higher proportion of organic crop, and regional influences such as climate can result in marked differences in dry matter between regions.[28]

48 The Committee accordingly considers that taking a broad approach to the concept of discrimination, the current operation of the minimum taste standards has the potential to discriminate between suppliers, and, from the information provided, that they appear to have had a greater adverse impact on organic growers and/or growers in some localities compared to others.

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[23] 2016 Taste Review: Final Green Recommendations from the Industry Taste Committee, pages 7 – 8.

[24] Zespri response to the Committee, 29 August 2017, response to question 5.

[25] Zespri response to the Committee, 29 August 2017, response to question 6.

[26] Seeka Ltd, 10 July 2017, Response to KNZ Notice of Investigation – Minimum Taste Standard

[27] Zespri response to the Committee, 29 August 2017, response to question 6.

[28] Zespri response to the Committee, 29 August 2017, response to question 6. However, as noted above, any regional variation does not appear to have been sufficient in the 2017 season to cause Hayward conventionally grown kiwifruit to not be eligible for the Service Level Agreement.

49 The Committee considers that this broad approach to discrimination is consistent with the purpose of the Regulations. Zespri as the monopsony purchaser has implemented changes to the minimum taste standards which have the potential to have a significant adverse impact on some suppliers, and some groups of suppliers, compared to others. It is consistent with the objective of the non-discrimination rule that the commercial justification for these changes be open to scrutiny by the regulator. A narrow interpretation of discrimination in regulation 9 would mean that such scrutiny was excluded. Indeed, it would mean that Zespri would not need to have a commercial justification for these decisions at all.[29]

50 However, the fact that the minimum taste standards are potentially discriminatory does not mean they breach the non-discrimination rule, or indeed that they are unfair or in any sense improper. Commercial entities routinely discriminate between suppliers and the Regulations impose only one constraint on Zespri's ability to do so: any such discrimination must be justifiable on commercial grounds.

IS ANY DISCRIMINATION UNJUSTIFIED?

51 Regulation 10 provides:

> **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.

52 In *Aotearoa Kiwifruit Export Limited v Southlink Ltd*, Winkelmann J stated that:[30]

> Unjustifiable discrimination is discrimination that is not justifiable on commercial grounds... Given the purpose of the mitigation measures, and the provisions of

[29] In its submission in response to the Committee's provisional decision, Zespri argued that this approach to discrimination is impractical, as it would be "impossible" to identify all possible ranges of outcomes, and difficult to distinguish between those that amount to discrimination and those that do not. However, the concept of discrimination as including indirect discrimination is well accepted and consistent with a broad and untechnical approach to establishing discrimination, which leaves the main focus on whether there is a commercial justification for the difference in treatment. This is consistent with *Child Poverty Action Group Inc v Attorney-General* [2013] NZCA 402, [2013] 3 NZLR 729 at [48], where the Court of Appeal criticised the Crown's approach to discrimination as one that would "impose too high threshold and effectively cut out the inquiry into potential discrimination too soon. The intention of the Human Rights Act 1993 is to take what has been described as a "purposive and untechnical" approach to whether there has been prima facie discrimination and so to avoid artificially ruling out discrimination in the first stage of the inquiry." In the Committee's view, the intention and objectives of the non-discrimination rule and the mitigation measures in the Regulations support a similar approach.

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

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.

53 Seeka suggests the concept of unjustifiable discrimination would include discrimination "not in accordance with accepted standards of fairness or justice" and that the 2017 changes "failed to meet the minimum requirements of fairness".[31] The Committee agrees with Zespri's submission that meeting the "minimum requirements of fairness" is not the test set out in the Regulations.[32] KNZ's role is not to determine whether the 2017 quality standard adopted by Zespri is "fair", or indeed whether any other quality standard Zespri could have adopted, such as retaining the 2016 standard, would have produced better commercial outcomes.

54 The Committee's role is to consider only whether the difference in treatment between suppliers is made on commercial grounds. The Committee considered that there are four key areas of contention raised by this complaint:

54.1 Whether there were commercial grounds for the increase from 50% to 70% of fruit as requiring 15.5% of dry matter;

54.2 Whether it is commercially justifiable to exclude fruit from the inventory when there is (or could be) a market for that fruit;

54.3 Whether the variability in sampling results means that the regime is effectively arbitrary in its operation;

54.4 Whether the differing payments for fruit with the same dry matter means that the system is not commercially justifiable.

Commercial justification for increase from 50% - 70%

55 In considering changes to the MTS in 2016, the Taste Committee was concerned that competitive pressure (in international markets) was increasing, and concluded that to stay ahead of competitors the New Zealand Hayward taste profile had to be lifted.[33]

56 Zespri submitted that the research available to it has allowed it to approximate a "dislike" curve; that is, as the dry matter of fruit increases, the portion of consumers who dislike the piece of fruit slightly or worse decreases. Zespri estimates that at

[31] Seeka Ltd, 14 September 2017, paragraphs 1, 11.

[32] Zespri, 26 September 2017, page 2.

[33] 2016 Taste Review: Final Green Recommendations from the Industry Taste Committee, page 4.

15.5% dry matter, approximately 20 to 25% of consumers indicate they dislike the fruit slightly or worse.[34]

57 Under the 2016 MTS standard, half the pieces of fruit in a cleared sample could have had a dry matter content of less than 15.5%; that is, half the fruit from the maturation area could be disliked by 1 in 4 consumers.[35] In aggregate, Zespri was delivering 330 million pieces of fruit to market which its research suggested would be disliked by 1 in 4 consumers.[36]

58 Under the 2017 MTS standard, in which the threshold was increased to 70% exceeding 15.5% dry matter, only approximately 24% of the fruit pieces would be below the point where more than 25% of consumers dislike the fruit.[37]

59 The 2017 increase to the MTS standard therefore reduced the probability of a negative experience for consumers of kiwifruit. Zespri submitted that reducing the negative experience of its customers was very important for gaining new customers and for maintaining repurchase rates of existing customers.[38] Zespri's position is that an increase in a standard which has the effect of reducing from 50% to 24% of the potential population of fruit taken to the market that 1 in 4 customers dislike is justifiable on commercial grounds. This is particularly the case where most suppliers appear to have been able to adjust to the standard and supply a higher portion of fruit customers like (see discussion at paragraphs 44 to 45 above).

60 The Committee does not agree with Seeka's complaint that the changes to the minimum taste standards is not supported by the market or any market statistics. The 2015 and 2016 reports of the Taste Review Committee, and supporting documents,[39] demonstrate that the change in standards was based on considerable research and analysis.

61 The Committee considers that Zespri's explanation and the information that supports it meet the requirements of regulation 10: the decision to lift the threshold from 50% to 70% was justified on commercial grounds, relating to product features and quality.

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34 Zespri, 10 August 2017, Appendix A, page 14.

35 This estimate assumes a standard deviation of 1%. Zespri provided information that a dry matter standard deviation of 1% is the approximate average dry matter standard deviation from a 90 fruit maturity clearance sample expected in any season for both Hayward conventional and Hayward organic and that the deviation does not tend to move significantly from season to season - Zespri response to the Committee, 29 August 2017, response to question 2.

36 Zespri presentation to Taste Committee 2016 – 1st meeting, slide 4.

37 Zespri, 10 August 2017, Appendix A, pages 15 and 16.

38 Zespri, 10 August 2017, Appendix A, page 16.

39 Including the documents, 2016 Taste Review Committee – Zespri's Taste Challenges, and Taste Committee slides (2016 review).

While not determinative, the Committee also notes that submissions received by the Taste Committee suggest the changes were well supported by industry, and it can be inferred from this that the industry itself broadly considers the changes were commercially justified. It is not the Committee's role to consider whether alternative approaches might have produced better or different commercial outcomes.

62 The Committee also does not agree with Seeka's complaint that the changes to the taste mechanism from 2016 to 2017 do not promote efficient pricing signals to shareholders and suppliers; the changes appear to have advanced the commercial objective "to lift the tail of the worst fruit in the inventory … and either change growing practices of growers … or delay harvest until a more acceptable dry matter level has accumulated".[40]

Excluding marketable fruit from the inventory

63 The Committee agrees with Zespri that Seeka's claim that fruit below the threshold could have been sold in a market is not a sufficient basis for concluding the MTS threshold is not commercially justified. As the Regulations make clear, Zespri is not obliged to accept fruit into inventory, provided there is a commercial justification for its decision to exclude certain fruit.[41]

64 Zespri's commercial justification for not accepting fruit which falls below its MTS is that providing a consistently high taste experience builds a base of loyal frequent consumers.[42] Other options might be available, including Seeka's proposition that Zespri accept all fruit for which a market could be found and then segregates lower dry matter fruit to the lower returning markets. However, the existence of other options that might also be commercially justified does not detract from the commercial justification for the decision actually made. Nor, as noted above, is it the function of the Committee in investigating this complaint to form a view on the relative merits of the commercial choices made by Zespri.

Reliability, accuracy and consistency of the sampling process

65 Seeka contends that growers are currently benefiting or not benefiting from error as the current sampling is unreliable and gives rise to wide variations of outcome.

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40 Zespri, 10 August 2017, Appendix A, page 16.

41 Regulation 6.

42 Zespri, 26 September 2017, page 1.

Seeka's proposition is that it would not be justifiable for Zespri to discriminate among suppliers using dry matter if the sampling method is not reliable.[43]

66 A sampling method that is unreliable could have the effect of discriminating among suppliers on an essentially arbitrary basis. In that situation fruit would be accepted or rejected not because of an assessment of its dry matter content, but rather due to a random outcome of the sampling and testing process. The Committee agrees with Seeka's proposition that discriminating among suppliers on an arbitrary basis would not be justifiable on commercial grounds.[44]

67 The Committee sought information from Zespri as to the reliability of its sampling method. Zespri has an audit programme in place and calculates the uncertainty in its sampling process from the combined sampling and testing methodology. Zespri advised that the estimation of measurement uncertainty (standard deviation) reported for the ISO 17025 accreditation was 0.256% dry matter.[45] The 95 per cent confidence interval for a sample result showing 70% of the kiwifruit in a 90 kiwifruit sample has a dry matter content of 15.5% or higher is between 0.555 and 0.844.[46]

68 This means that where the sampling process finds that 70 per cent of the kiwifruit in the sample had a dry matter average of 15.5% or more, the kiwifruit can be inferred as coming from a population of kiwifruit with the following properties: If 100 samples were taken from the kiwifruit population, 95 of those samples would find the percentage of kiwifruit with a dry matter average of 15.5% or more at between 55.5 per cent and 84.4 per cent. Conversely, 1 out of 20 of those samples would result in the percentage of fruit with a dry matter average of 15.5% being outside of this range (that is, the result would show less than 55.5 per cent or more than 84.4 per cent of the kiwifruit having a dry matter average of 15.5% or more). In 1 out of 40 of those samples, less than 55 per cent of the fruit would meet the criterion of 15.5% of dry matter.

69 The Committee understands that the Zespri audit programme of the sampling process for Hayward consists of 200 audit samples collected on the same day as their paired clearance samples. The audit samples, and their paired clearance samples, are tested for dry matter by the independent laboratory services provider. The audit sample results, and their paired clearance sample results, are provided to external expert

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43 Seeka submission of 10 July 2017, page 5.

44 This is confirmed in *Aotearoa Kiwifruit Export Ltd v Southlink Ltd* CIV2003-470-478, HC Auckland, 3 February 2006 at [67] – [74].

45 Zespri response to the Committee, 29 August 2017, response to question 7.

46 Calculated using the formula 0.7+/-1.96(0.7(1-0.3)/90)^0.5.

statisticians engaged by Zespri as an input into the Maturity Clearance Statistics Review prepared by the external experts.[47] The Committee was provided with a copy of the Clearance Statistics Review for 2016, and the relevant excerpts from the draft Clearance Statistics Review for 2017.

70 The audit measured the variation in dry matter samples for the 2016 season at 0.232%; that is, a slightly lower variation than reported for the ISO 17025 accreditation. In the 2017 season, the variation reduced to 0.186%. That is, the 95% confidence interval is slightly reduced compared with the accreditation interval.

71 As with any sampling process, the current method will produce errors and these errors may account for the anecdotal examples identified by Seeka. However, these audit results do not support Seeka's claim that the sampling method is effectively arbitrary. Having assessed the information provided by Zespri in response to the Committee's questions, the Committee does not agree with Seeka's contention that the sampling processes are not sufficiently reliable to justify discriminating between suppliers on the basis of dry matter.

72 An important factor for the Committee is that Zespri monitors the accuracy of the sampling method and has responded to recommendations arising from its Clearance Statistics Review on improvements to the sampling method. The Committee however endorses the similar views expressed in 2006 in *Bartling* that it is important that Zespri continue to improve both the reliability of, and grower confidence in, the practical operation of the MTS. As this complaint demonstrates, as the thresholds in the standards are lifted and the potential adverse impact on supplier's increases, the reliability of the sampling methods becomes even more critical.

Differing payments for fruit with the same dry matter

73 Seeka sought closer examination of the treatment of fruit between the 2016 and 2017 thresholds. Seeka contends that this fruit may be sold alongside other fruit (that received a payment premium) and some of the fruit not receiving the payment premium would, in fact, have a higher average dry matter.

74 Any population of fruit with a sampled level of dry matter will have a percentage of fruit both below and above that sampled level of dry matter. The increase in the MTS thresholds were designed to reduce the percentage of fruit accepted into the Class 1 inventory with a level of dry matter below 15.5%; that is, to reduce the variability in dry matter in fruit accepted into Class 1 inventory. However, the thresholds do not eliminate all fruit with a low level of dry matter from a population of fruit accepted into

[47] Zespri response to the Committee, 29 August 2017, response to question 7.

Class 1 inventory. Similarly, some fruit in a sample which fails to achieve clearance could have a higher level of dry matter than 15.5%.

75 The Committee sought further information from Zespri as to whether the NIR technology could offer a solution to the measurement of dry matter at an individual fruit level, and hence allow the potential for payments to better match the population of fruit. Zespri advised, with supporting analysis, that:[48]

> Zespri sees NIR technology as potentially offering a solution to the measurement of dry matter at an individual fruit level. Unfortunately the current state of the technology is not able to deliver this accuracy and no manufacturer of the technology is prepared to stand behind their systems to this degree.

76 In the absence of a technological solution, any process of sampling fruit for acceptance into Class 1 inventory will give rise to the result identified by Seeka – that is, some fruit in a population of fruit receiving a payment premium may have a lower dry matter than fruit in a population not receiving a payment premium. The Committee considers such an outcome is inherent in any commercial arrangement that must rely on sampling to measure the quality of produce supplied. It does not by itself render the regime commercially unjustified.

77 Similarly, the Committee does not accept Seeka's argument that the increased thresholds are not commercially justified because they do not give rise to a close calibration between market proceeds and grower payments. Seeka draws on the observation in *Bartling* that "close calibration between market proceeds and grower payments is desirable given the co-operative nature of the industry." However, the decision in *Bartling* did not suggest that failure to achieve this would render a decision in breach of the non-discrimination rule,[49] noting that: "Realistically, given the available technology and commercial realities, imperfect calibration cannot be seen as amounting to discrimination." We agree with that conclusion.

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[48] Zespri response to the Committee, 29 August 2017, response to question 9.

[49] *Bartling* at [16]. The quote appears under the heading "General Observations" with the opening statement in [15]: "Notwithstanding the view reached that there has been no discrimination by Zespri in terms of the Regulations and if there was discrimination it was not unjustifiable, being justifiable on commercial grounds, some reservations are recorded about the way in which the TZI and related STP regime have been explained. This has led to a negative perception of overall fairness of the outcome for some growers …"

RESULT AND COSTS

78 The Committee's decision is that the complaint is not upheld. The Committee considers that Zespri is not in breach of the non-discrimination rule in relation to the current minimum taste standards for Hayward organic and conventional fruit.

79 Costs should lie where they fall. As noted above, the recent increase in the minimum taste standard thresholds had the potential to significantly affect suppliers who are subject to Zespri's monopsony purchasing powers. The non-discrimination rule is intended to be a protective measure for these suppliers, and as Winkelmann J recorded in the *Aotearoa* decision:[50]

> [Regulation 9] protects a right that vitally affects the livelihood of those persons. … The availability of proper procedures to enforce Zespri's duty and seek redress for any breach is therefore similarly likely to be of vital importance to suppliers.

80 In general terms it is important that suppliers are not disincentivised from bringing genuine complaints by the prospect of an award of costs against them in the event that their complaint is not upheld following an investigation. That proposition may well give way to other factors in other cases, for example if a complainant through its conduct unnecessarily increases the costs of the investigation. However, there is no such issue in the present case.

Dated 1 November 2017

Victoria Casey QC
Chair

Andrew Fenton

Kieran Murray

[50] *Aotearoa Kiwifruit Export Ltd v Southlink Ltd* CIV2003-470-478, HC Auckland, 3 February 2006 at [79]