

Summary of Minimum Taste Standard Complaint Decision - 1 November 2017

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1) Introduction

Seeka lodged a complaint with the KNZ Board on 7 June 2017 challenging aspects of the Zespri minimum taste standards (MTS) for Hayward conventional and organic kiwifruit. It alleged in particular that recent changes to the MTS breach the non-discrimination rule in regulations 9 and 10 of the Kiwifruit Export Regulations 1999.

The non-discrimination rule is one of the mitigation measures set out in Part 3 of the Regulations which are designed to mitigate the potential adverse effects of Zespri's statutory monopsony. KNZ has the responsibility for monitoring and enforcing the measures.

The Board established the Minimum Taste Standard Complaint Committee and delegated the investigation of this complaint to the Committee. The Committee consisted of Victoria Casey QC (Chair), Andrew Fenton (KNZ Director), and Kieran Murray (Economist). The purpose of the Committee's investigation was to determine whether Zespri had failed to comply with the non-discrimination rule.

Below is a summary of the complaint and the Committee's discussions and findings. The full decision is available on the KNZ website.

2) Result

The Committee did not uphold the complaint. The Committee considered that Zespri was not in breach of the non-discrimination rule in relation to the current minimum taste standards for Hayward organic and conventional fruit.

3) Background

Zespri introduced its MTS in 2006. Fruit not meeting the MTS threshold is not accepted by Zespri into its Class 1 inventory.

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 into class 1 inventory by Zespri. Dry matter is considered by Zespri as a good predictor of the sweetness of the fruit and a proxy for consumer liking for kiwifruit.

In each of the past two seasons, Zespri has increased the MTS thresholds. For the 2016 harvest, the MTS threshold was increased to 15.5% dry matter on average (50%) in a sample from a maturity area.

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. 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).

4) The Complaint

Seeka's complaint was that Zespri's minimum taste standards operate to exclude Hayward conventional and organic kiwifruit that do not meet the standard from the Class 1 inventory, which has an adverse impact on some suppliers.

Seeka's complaint did not challenge the underlying premise of the MTS, nor did it challenge the appropriateness of dry matter as a predictor of brix or a consumer's liking for kiwifruit. Rather its complaint made a range of allegations including:

- a) The changes to the taste mechanism from 2016 to 2017 do not promote efficient price signals to shareholders and suppliers.
- b) Regulation 9 imposes a duty not to discriminate unjustifiably and that the minimum dry matter threshold is arbitrary and not supported by the market or any market statistics.
- c) As the sampling method is not reliable it is not justifiable to discriminate using dry matter.
- d) The treatment of the fruit between the 2016 and 2017 thresholds needs closer examination.

5) Findings

Breach of the non-discrimination rule requires two elements to be established, first, that there has been discrimination between suppliers, and second, that the discrimination is not justified as being on commercial grounds.

Was there Discrimination?

The Committee noted that 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. Discrimination also includes the concept of "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. The fact that Zespri offers the same terms and conditions to all suppliers does not by itself rule out the possibility of discrimination between suppliers.

The Committee was of the view that the minimum taste standards are potentially discriminatory and noted that it 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 and therefore increased the scope for more suppliers to be adversely impacted, and for that impact to be greater, than was previously the case.

The Committee was of the view that 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.

However, the fact that the minimum taste standards are potentially discriminatory did not mean the change to the MTS breached the non-discrimination rule, rather any such discrimination must be justifiable on commercial grounds.

Is any discrimination unjustified

Seeka suggested the concept of unjustifiable discrimination would include discrimination “not in accordance with accepted standards of fairness or justice”. The Committee agreed with Zespri’s submission that that meeting the “minimum requirements of fairness” is not the test set out in the Regulations and noted its role was to consider only whether the difference in treatment between suppliers was made on commercial grounds.

The Committee considered that there were four key areas of contention raised by the complaint.

- 1 *Whether there were commercial grounds for the increase from 50% to 70% of fruit as requiring 15.5% of dry matter.*

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. Under the 2017 MTS standard, in which the threshold was increased to 70% exceeding 15.5% dry matter, approximately 24% of the fruit pieces would be below the point where more than 25% of consumers dislike the fruit. The 2017 increase to the MTS standard therefore reduced the probability of a negative experience for consumers of kiwifruit.

The Committee considered that Zespri’s decision to lift the threshold from 50% to 70% was justified on commercial grounds, relating to product features and quality.

- 2 *Whether it is commercially justifiable to exclude fruit from the inventory when there is (or could be) a market for that fruit.*

The Committee agreed 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. 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.

- 3 *Whether the variability in sampling results means that the regime is effectively arbitrary in its operation.*

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

The Committee agreed that a sampling method that is unreliable would have the effect of discriminating among suppliers on an essentially arbitrary basis, which would not be commercially justified. 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 reviewed Zespri's sampling methodology and the audit programme in place to calculate uncertainty. These audit results do not support Seeka's claim that the sampling method is effectively arbitrary. The Committee did not agree with Seeka's contention that the sampling processes is not sufficiently reliable to justify discriminating between suppliers on the basis of dry matter.

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

Seeka sought closer examination of the treatment of fruit between the 2016 and 2017 thresholds. Seeka contended that 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.

The Committee was of the view that 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%. 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. The Committee considered such an outcome was inherent in any commercial arrangement which must rely on sampling to measure the quality of produce supplied. It did not by itself render the regime commercially unjustified.