

## DETERMINATION

### In the Matter of a Complaint by

████████████████████:

### Orchardist

pursuant to the provisions of the

Kiwifruit Export Regulations 1999

### Background

1. By letter dated 4 July 2006 ██████████ (the complainant), a kiwifruit grower, complained that Zespri Group Limited (Zespri) discriminated against him, “in paying differing amounts to growers whose fruit Brix and dry matter falls within a level requested by Japanese retailers [and] their fruit is packed into identical trays [and] it is impossible to distinguish any difference in the individual fruit ... Zespri sells this fruit at the same price to the retailers, but returns differing amounts to the growers.”
2. Kiwifruit New Zealand Board (KNZ) accepted the complaint as falling within the provisions of Regulation 9 of the Kiwifruit Export Regulations 1999 (the Regulations) which imposes on Zespri a duty not to unjustifiably discriminate. Regulation 9 provides:

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

  - (a) ...
  - (b) The terms of the purchase contract.”

A supplier for the purposes of the Regulations includes a grower; see Regulation 2 and *Aotearoa Kiwifruit Export Limited and others v Southlink Limited and Zespri Group Limited* [CIV 2003, 470-478], paragraphs 57-61.

KNZ approached the complaint on the basis that the complainant was alleging that the purchase contract (the 2006 Supply Agreement) for the 2006/2007 season entered into by him with Zespri included provisions in particular relating to the use of the Taste Zespri Indicator (TZI) for the purpose of calculating a Supply Taste Payment (STP) which discriminates among suppliers. Because some issues raised are also relevant to the other taste payment based on the Taste Zespri Grade (TZG) and are similar to those raised in respect of the TZI, reference in the remainder of this determination is made only to the STP and TZI.

3. The 2006 Supply Agreement was offered by Zespri to all suppliers. The STP payment varies according to the dry matter level of kiwifruit supplied to Zespri. The complainant alleged that the use of the TZI did not take into account populations of fruit which in fact produce higher dry matter fruit, resulting in some fruit with average lower dry matter being accepted for export and some fruit with higher average dry matter not being so accepted. The complainant also alleged that the sample method used to determine the TZI was unsatisfactory, making the whole system a lottery.
4. The material supplied to KNZ by the complainant was made available to Zespri and it was given the opportunity to comment thereon. The responses received by KNZ from Zespri were made available to the complainant and he was given an opportunity to comment thereon.

#### **Consideration of the Issues Raised by the Complaint**

5. The primary focus of the complaint was an allegation of discrimination by Zespri associated with the use of the TZI as part of the 2006 Supply Agreement purchase contract with suppliers when paying for New Zealand grown kiwifruit, including that as

kiwifruit was not sold differentiated for dry matter, only one premium payment should be made for taste payments. Although Regulation 9 imposes on Zespri a duty not to discriminate it is in the context that the discrimination is unjustifiable. Regulation 10 identifies the matter in these terms:

“(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.”

6. The question for determination was whether the TZI system and methodology incorporated within the 2006 Supply Agreement amounted to discrimination between suppliers and if so whether that discrimination was justifiable on commercial grounds.

7. Zespri considered that its market research established to its satisfaction that there was a quantifiable market value for kiwifruit taste, which could be expected to support price premiums and/or volume into that market if taste could be improved. Zespri therefore sought a method by which it could send “accurate market pricing signals, to encourage the delivery of fruit with the desired market characteristics” whereby both low dry matter fruit was reduced, and average dry matter fruit was increased. In addition to the research undertaken, Zespri consulted widely within the kiwifruit industry before adopting the TZI system. The complainant has acknowledged that suppliers are aware of Zespri’s objectives and rationale for adopting the TZI system. There appears to be widespread industry support for what is being pursued but some questioning of the way and how much growers are being paid for their fruit.

8. A TZI based supply taste payment (STP) programme was introduced and incorporated into the 2006 Supply Agreement (see clause 8.1 (a) and (b) in the 2<sup>nd</sup> schedule and

clause A2.7(e) of the Pricing and Payment Manual). In short, the purpose of the STP was to achieve a:

- Supply of good tasting fruit to Japan (as the best priced market) in order to maintain that market and achieve a low variability in fruit quality; and
- Focussed inventory management to maximise the provision of 'Taste Zespri' fruit to Japan.

For those purposes 'Taste Bands' were set by the Industry Supply Group, consisting of representatives of Zespri, suppliers and growers, based on different TZI values which measured the dry matter content of the fruit. The 2006 Supply Agreement was offered consistently throughout the industry.

The price paid to suppliers for fruit is ultimately determined by the proceeds Zespri receives in its markets and it has included payments for taste based on the dry matter content. The research upon which Zespri has relied suggests that dry matter is a 'crude' proxy for taste such that consumers can distinguish better tasting fruit according to the level of dry matter, prefer higher dry matter fruit and are prepared to pay for it. Such a preference will provide market support as consumers come to understand that the Zespri brand is underpinned by higher dry matter fruit, and reflect in average market pricing. As a measure of taste, dry matter has a significant advantage. It can be used at the time of fruit harvest without the need to ripen fruit. Although the complainant has suggested a possible alternative, it was not argued in such detail as would enable KNZ to come to a view that there was not a rational basis, founded in research, for the system adopted by Zespri. Zespri argues that marketing the quality of kiwifruit on the basis of dry matter content is 'commercially justifiable', and that the TZI system is the best available based on existing science and technology. Could there be a better way to underpin the marketing of high quality good tasting kiwifruit? KNZ has no information

of sufficient detail to indicate there was. Zespri was undertaking industry wide discussions about the programme and its application. This is appropriate given the reservations some suppliers have about it. Realistically, what happens in the future is a matter for Zespri and the kiwifruit industry collectively to address. It cannot, and indeed should not be determined by KNZ as a consequence of considering a complaint of discrimination about the construct or application of the current system.

9. Zespri submits:

- That higher payments for fruit of higher TZI values does create incentives on suppliers to provide better tasting fruit and to maintain and improve the taste of fruit supplied to the Taste Zespri programme over time. TZI values provide a measure of fruit quality or allow fruit to be distinguished by product features. Actions which discriminate among suppliers for those purposes are justifiable.
- That in respect to the methodology and fruit sampling techniques underpinning the TZI value system, there is no discrimination for the reason that:
  - The same system and rules are applied to the whole crop.
  - The methodology is sufficiently robust and does not create arbitrary or inconsistent results as between suppliers.

10. The complainant is concerned that the use of dry matter as a means of determining the taste quality of fruit acquired by Zespri under the 2006 Supply Agreement and therefore the level of payment to individual suppliers, is unfair and is more in the nature of a lottery. That perception of the outcome of what is being attempted by Zespri is unfortunate for the industry which is largely structured around cooperative principles and pooling of the fruit of many individual suppliers to enable the fruit to be marketed profitably in very competitive and distant markets. Although the results of a fruit sampling method can vary depending on when it is taken and in what quantities, KNZ

has no clear evidence of there being a better alternative to that adopted at this time. The STP is designed to incentivise fruit availability that minimises the delivery of low dry matter fruit into Japan. For the STP to be paid requires the kiwifruit to meet the required quality characteristics. Fruit is accepted on the basis of the results of a sample designed to reveal the amount of fruit in the crop as a whole (from which the sample is taken) that falls below a lower level of dry matter. The higher the amount of fruit that falls within the lower level, the less likely it is to be accepted. Whether the fruit that the sample represents is accepted or rejected is based on a sampling based statistical methodology. It appears that sampling through a process that destroys the fruit that is sampled is the only current methodology available that can be used practically to accept or reject fruit for export to Japan.

11. Alternative technology that might be used to measure the dry matter of every piece of kiwifruit without destroying it is available but is currently inaccurate and expensive. It is therefore currently not practicable to individually measure the dry matter of every individual piece of fruit.
  
12. As a consequence of not being able to measure the dry matter of every piece of fruit the decision to accept or reject each piece of fruit becomes one as to whether to accept or reject the sample as a whole, and as a consequence the crop that the sample represents. It follows from applying this approach for the delivery of fruit into Japan, whilst increasing the average dry matter of the fruit delivered, can also operate to exclude some high dry matter fruit. Apparently there is no current practical way to separately identify this high dry matter fruit. It appears however that the circumstances in which this occurs is limited to crops where the combination of the mean dry matter of the sample and its high level of variability means that the sample contains high dry matter fruit as well as enough low dry matter fruit such that the sample and the crop it

represents does not qualify for submission for delivery to Japan. In order to exclude the low tasting fruit in the sample from shipment to Japan, so also the high dry matter fruit is rejected. In short, Zespri could have more high dry matter kiwifruit available for export to Japan, but currently has no practicable means by which to identify it. The practical effect of this is that crop (represented by the rejected sample) does not qualify for delivery to Japan, and is replaced by another crop (where the sample is accepted), which does.

### **Determination**

13. For the purpose of applying the relevant provisions of the Regulations the following meanings have been applied:

- ‘Discriminate’ means to single out a particular person or group for special favour or disfavour, and
- ‘Unjustifiably’ means not in accordance with accepted standards of fairness or justice; discrimination not based on commercial grounds.

14. On the material available at this time, the Zespri submission is accepted. Given that the 2006 Supply Agreement has been consistently offered across the industry to all suppliers it cannot be said that Zespri is discriminating unjustifiably “among suppliers and potential suppliers in respect of – the terms of the purchase contract.” Nonetheless the unfortunate consequence of the TZI and STP within the 2006 Supply Agreement is that the money received by growers is seen as variable. 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. To help guide the industry in this sensitive area, the Regulations identify a series of grounds for justifiable discrimination yet leaves the door open to identify other commercial grounds

for so doing. If what Zespri is doing with its TZI system and related payments amounts to discrimination, then in our view it amounts to justifiable discrimination “on commercial grounds.” Those commercial grounds relate in particular to product features and quality, good tasting fruit, which in turn translates into better potential returns. The complaint is not upheld.

### **General Observations**

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 has been explained. This has led to a negative perception of overall fairness of the outcome for some growers. The complainant’s concern is therefore understandable.

16. While Zespri has designed a taste payment system that incentivises reward for higher taste quality, it does so incrementally rather than at just one level. The payments are designed to ensure performance from all sectors of the industry and different suppliers will achieve different results and payments due to fruit characteristics, performance and achievement of other matters such as the fulfilment of orders. It has so far not been possible with the current technology available to Zespri for it to achieve perfect calibration of payments to growers with what Zespri receives for quality fruit in the market. Close calibration between market proceeds and grower payments is desirable given the cooperative nature of the industry. Realistically, given the available technology and commercial realities, imperfect calibration cannot be seen as amounting to discrimination.

17. At a general level the need for a system to help achieve and maintain high fruit quality is essential in an increasingly competitive international marketplace if New Zealand grown kiwifruit is to keep its place at the top end of that market. A price differential to growers based on differing quality for fruit supplied to Zespri therefore has a sound commercial basis to assist that objective.

18. Whilst not agreeing that the complaint has identified unjustifiable discrimination there is agreement that further refinement of the system being applied by Zespri is justified and ongoing education about its rationale and application are necessary for the continued cohesiveness of the industry.

19. We note that as a result of industry concern about the effect of the TZI and STP regime, which is accepted as not being perfect, Zespri is conducting a wide ranging review, in consultation with the industry. That in our view is the correct approach to a fundamentally important and complex issue potentially affecting the future prosperity and cohesiveness of the industry. The industry itself must address whatever problems are perceived to be associated with the current system and determine what amendments or changes are needed to improve it so as to increase its perceived fairness. Whilst the complainant has not been able to obtain the remedy he seeks by way of the complaint procedures for which KNZ is responsible, he does have the opportunity to air his concerns before the industry of which he is part and to persuade its participants to support changes which he considers are better than those currently operating.

**For and on behalf of the Kiwifruit New Zealand Board**

**[Original signed by Sir Brian Elwood]**

**Chairman**

**20 February 2007**