

Proposed Amendments to the Kiwifruit Export Regulations 1999

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1 Proposed amendments to the Kiwifruit Export Regulations 1999

1.1 EXECUTIVE SUMMARY

This discussion document seeks your views on possible changes to the Kiwifruit Export Regulations 1999 (the Regulations).

It considers proposals for regulatory change developed by the industry-led Kiwifruit Industry Strategy Project (KISP). This document also considers proposals for reform arising out of a government-commissioned independent review of Kiwifruit New Zealand (KNZ).

The Ministry for Primary Industries (MPI) has yet to reach a final view as to what mix of the proposals would best ensure that the Regulations were brought up-to-date and position the industry for growth in coming years. For this reason we strongly urge you to make your views known. Ultimately, the advice that we provide to Ministers will be based on what we believe to be in the public interest, as outlined in section 2 of this document.

The proposals relate to three matters: the ownership of Zespri shares; Zespri's core business; and the governance, funding, and operation of KNZ.

MPI has assessed the suitability of the Regulations as presently constructed and found that:

- there is a growing misalignment between those who own Zespri shares and those who supply Zespri with kiwifruit. This misalignment is likely to continue to grow under the status-quo. An increasing part of Zespri's revenue is generated from business activities other than the export of New Zealand-grown kiwifruit. Without an alignment of share ownership to supply, a growing proportion of kiwifruit suppliers will not own Zespri shares and will not directly benefit from Zespri undertaking these activities. Ultimately, this could impede Zespri's ability to make decisions that benefit the industry as a whole;
- the current Regulations relating to Zespri's core business are working adequately. There is little evidence of Zespri's decision-making being inappropriately hampered. Expanding Zespri's defined core business would significantly expand the range of activities which Zespri could undertake without having to get explicit shareholder approval, undermining accountability; and
- there are opportunities to improve KNZ's governance and funding to enable it to better fulfil its regulatory oversight and collaborative marketing functions. Central to MPI's assessment is that KNZ's relationship to the government and its accountability structures should be updated with a view to enhancing its status as an independent regulator. MPI supports collaborative marketing being more central in the industry's marketing plans.

1.2 GUIDE TO THIS DOCUMENT

This discussion document contains six sections.

Section 1 (this section) provides you with the information you need to make a submission on the proposals contained in this document.

Section 2 describes how the kiwifruit industry is regulated. Ultimately, the various options discussed in subsequent sections must cohere into an effective regulatory system that supports

the outcomes identified. Section 2 therefore guides you as to how you can frame your submission for maximum impact.

Section 3 outlines the immediate challenges and opportunities that are driving the government to consider amending the Regulations. It describes the outcomes of the industry-led Kiwifruit Industry Strategy Project (KISP), and more broadly describes changes within the kiwifruit industry and future opportunities that make this an appropriate time to assess the operation of the Regulations.

Sections 4, 5, and 6 describe the substantive amendments being considered to the Regulations. These are the main issues on which we are seeking your views:

- **Section 4** outlines possible amendments to the categories of people who can own Zespri shares;
- **Section 5** outlines possible amendments to the requirements put on Zespri when it undertakes business activities that are outside its core activity of purchasing and exporting New Zealand-grown kiwifruit; and
- **Section 6** outlines possible amendments to the governance, funding and operation of Kiwifruit New Zealand, the statutory body established by the Regulations to regulate the industry.

1.3 WRITTEN SUBMISSIONS

MPI welcomes written submissions on the proposals contained in this document. All submissions must be received by MPI no later than **25 March 2016**.

Written submissions should be sent directly to: kiwifruit.regulations@mpi.govt.nz

While we prefer to receive electronic submissions, you may also post your submission to:

Kiwifruit Regulations Submission
Forestry and Plants Team
Policy and Trade Branch
Ministry for Primary Industries
PO Box 2526
Wellington 6011
New Zealand

Questions have been provided throughout the paper to help submitters identify key issues. Please disregard questions if you do not feel they are relevant to you.

1.4 THE OFFICIAL INFORMATION ACT

MPI intends to publish a summary of submissions received on this discussion document.

In addition to this summary, everyone has the right to request information held by government organisations, known as “official information”. This includes your submission. Under the Official Information Act 1982 (the OIA), information is to be made available to requestors unless there is good reason for withholding it. The grounds for withholding information are outlined in the OIA.

If you are submitting, you may wish to indicate any grounds for withholding information contained in your submission. Reasons for withholding information could include that

information is commercially sensitive or that you wish personal information such as your name or contact details to be withheld. MPI will take such indications into account when determining whether or not to release the information.

Any decision to withhold information requested under the OIA may be reviewed by the Ombudsman. For more information please visit:

<http://www.ombudsman.parliament.nz/resources-and-publications/guides/official-information-legislation-guides>

2 The purpose and function of the Kiwifruit Export Regulations 1999

2.1 NEW ZEALAND'S KIWIFRUIT INDUSTRY

New Zealand is the second largest kiwifruit exporting country after Italy and holds approximately 30 percent of the global market share of kiwifruit exports by volume. Growing steadily over the past thirty years, kiwifruit is now one of New Zealand's major export industries. It is the second largest horticultural export after wine. The majority of New Zealand-grown kiwifruit is exported, with only around two to three percent consumed in New Zealand. Less than one percent is used in processed products.

2.2 STRUCTURE OF THE KIWIFRUIT INDUSTRY

The Kiwifruit Industry Restructuring Act 1999 (the Act) and the Kiwifruit Export Regulations 1999 (the Regulations) set the current industry structure. The Act and the Regulations establish Zespri as a company and as the primary exporter of New Zealand-grown kiwifruit to all countries other than Australia. This arrangement is commonly referred to as the Single Point of Entry (SPE) or 'single desk'. The Regulations make some provision for other marketers to export kiwifruit through collaborative marketing arrangements with Zespri, but this is a relatively small proportion of New Zealand's overall kiwifruit exports.¹

Under the Regulations, all New Zealand growers of kiwifruit wishing to export to countries other than Australia must enter into a supply contract with Zespri (either directly or through a supply entity). This means that Zespri is effectively a monopsony buyer of New Zealand grown kiwifruit for export. In addition to the purchase and export of New Zealand-grown kiwifruit, Zespri undertakes research and development, cultivar development, and through Zespri Global Supply, is involved in the sale of overseas-grown kiwifruit.

Zespri currently sells kiwifruit to 53 countries. For the 2014/15 season, Zespri announced export sales of \$1.57 billion, selling 108.4 million trays.²

The Regulations include a number of protections to mitigate the potential risks to New Zealand growers and other industry stakeholders of the SPE. These include establishing Kiwifruit New Zealand (KNZ) to monitor and enforce Zespri's compliance with the Regulations.

As well as Zespri and KNZ, there are a number of other stakeholders involved in the production, processing and export of New Zealand-grown kiwifruit, including:

- Kiwifruit growers lease or own an orchard and, under the Regulations, must sell their fruit to Zespri (unless selling domestically or exporting to Australia);
- Zespri shareholders supply capital to Zespri and receive dividend income. Voting rights are linked to the supply of kiwifruit;

¹ In 2014/15, 1.7% of New Zealand grown kiwifruit were exported to countries other than Australia through CM arrangements with Zespri.

² This figure includes the sale of both New Zealand-grown and overseas-grown kiwifruit.

- Harvest and post-harvest operators and supply chain managers contracted to prepare, package, transport and store fruit for export;
- Collaborative marketers subject to approval from Kiwifruit New Zealand, can export New Zealand-grown kiwifruit to markets other than Australia through a collaborative arrangement with Zespri;
- New Zealand Kiwifruit Growers Incorporated (NZKGI) an industry body that represents the interests of kiwifruit growers;
- Other industry stakeholders for example, other exporters, marketers, and researchers through the value chain.

The government's role is to ensure that the regulatory framework appropriately balances the interests of the different stakeholders so that the kiwifruit industry can maximise its potential and deliver benefits to the New Zealand economy as a whole.

2.3 REGULATION OF THE KIWIFRUIT INDUSTRY

2.3.1 Kiwifruit Export Regulations 1999

Zespri's single desk arrangement has enabled the kiwifruit industry to make use of economies of scale that would not otherwise be possible, to set standards to maintain consistently high quality fruit, and to invest in significant research and development and innovation activities. This has assisted Zespri to compete effectively on the international stage, and to develop and maintain a premium status for New Zealand kiwifruit. The benefit of this to kiwifruit suppliers is that Zespri delivers a strong return. The wider New Zealand economy benefits through the growth in the value of kiwifruit exports and through the level of economic activity that the kiwifruit industry generates within New Zealand.

However, there are a number of risks that can arise from a single desk structure. With little competition for the purchase of New Zealand-grown kiwifruit for export, the incentives on Zespri to innovate and to keep its operational costs low are reduced. Lack of competition also limits growers' ability to test the market to determine whether another exporter would offer a better price for their produce.

The Kiwifruit Export Regulations 1999 aim to balance the benefits that can be generated from a single desk export structure while mitigating the associated risks. In particular, the Regulations:

- impose three rules and requirements on aspects of Zespri's operation;
- prescribe certain aspects of Zespri's corporate form; and
- provide for collaborative marketing arrangements with Zespri, where other companies are approved by an independent authority to export New Zealand-grown kiwifruit to specific markets in collaboration with Zespri for a specified period of time.

This discussion document contains proposals that impact each of these mitigating measures.

2.3.1.1 Operational rules and requirements

Regulations 9 – 21 set out three rules and requirements controlling aspects of Zespri's operation:

1. the non-discrimination rule (regulations 9 and 10) – requires that Zespri not discriminate between New Zealand kiwifruit suppliers and potential suppliers on purchase or the terms of the purchase contract, except on commercial grounds;
2. the non-diversification rule (regulation 11) – prohibits Zespri from undertaking activities that are not necessary for its core business (i.e. the purchase and export of New Zealand-grown kiwifruit) unless shareholders have approved of the activity, and the activity does not expose those who have not agreed to more than a minimal risk; and
3. the information disclosure requirements (regulations 12 – 21) – require Zespri to publicly disclose its financial statements, which must be prepared in accordance with generally accepted accounting practice and the Kiwifruit Information Disclosure Handbook.³

The operational rules and requirements aim to encourage innovation in the kiwifruit industry, promote efficient pricing signals and provide appropriate protections to Zespri's shareholders and kiwifruit suppliers, and promote sustained downward pressure on Zespri's costs.

2.3.1.2 Restrictions on Zespri's corporate form

The Regulations prescribe elements of Zespri's corporate form and provide protections for shareholders. Regulation 22 requires that Zespri remain a company registered under the Companies Act 1993, and specifies who can and cannot own Zespri shares. Regulation 23 provides basic protections to shareholders, like the right to appoint or remove directors and to vote on major transactions.

The restrictions on the ability of the majority of Zespri shareholders to alter the company's corporate form aims to, for the benefit of all shareholders, prevent excessive risk-taking and ensure continued transparency over decision-making.

2.3.1.3 Collaborative marketing provisions

Regulations 24 – 31 provide for the approval of collaborative marketing applications for the purposes of increasing the overall wealth of New Zealand kiwifruit suppliers. Collaborative marketing is intended to increase grower choice, innovation, the realisation of market opportunities and, ultimately, industry performance and returns. The Regulations provide for KNZ to direct Zespri to make a certain volume of kiwifruit available for collaborative marketing arrangements in any season. Those wanting to enter into a collaborative marketing arrangement with Zespri must apply to KNZ for approval.

2.3.2 The Commerce Act 1986 and other legislation

The High Court has previously confirmed that the Commerce Act 1986 applies to Zespri⁴. The two exceptions are the export ban and Zespri's export authorisation (i.e. regulations 3 and 4 of the Regulations). These are exempt from the restrictive trade provisions in Part Two of the Commerce Act 1986, as they are specifically authorised in legislation.

³ The Chief Executive of the Ministry for Primary Industries is required, from time to time, to publish the Kiwifruit Information Disclosure Handbook. The potential content of the Handbook is outlined in regulation 13, and may include, amongst other things: the definition of Zespri's business activities; the allocation methodology that must be used for preparing the financial statements and allocating the expenses, revenues, assets, and liabilities amongst Zespri's business activities; and the disclosure of transfer payments (whether actual or notional) amongst the business activities.

⁴ TURNERS & GROWERS LTD V ZESPRI GROUP LTD HC AL CIV 2009-404-004392 [12 August 2011].

All other legislation that apply to New Zealand businesses and companies also apply to Zespri and the wider kiwifruit industry (e.g. environmental, health and safety, plant variety right, and immigration legislation).

2.4 GOVERNMENT'S INTEREST IN GOOD REGULATION

2.4.1 Aims and objectives of regulation

The government's interest in the kiwifruit industry regulations is to ensure that regulatory outcomes are consistent with the kiwifruit industry reaching its full potential, thereby maximising the industry's contribution to the New Zealand economy. This will be achieved if the regulatory framework promotes an industry that is an efficient producer of the fruit most valued by consumers, and the industry over time learns, invests and innovates in a way that maximises total net returns.

In assessing possible amendments to the Regulations, the government will have regard to the impact of any reform on all kiwifruit growers and other stakeholders. This includes:

- existing, potential and future growers;
- suppliers of associated goods and services (including processors, pack houses, and the communities more widely that supply the industry);
- shareholders in Zespri;
- New Zealand consumers;
- competing service providers to Zespri (e.g. research and development purchasers, marketers etc.);
- impacts on the wider New Zealand economy (e.g. such as could arise from inefficient price signals and flow-on effects on land-use); and
- New Zealand's broader international commitments and obligations.

Specific criteria for assessing regulatory options have been embedded in sections 4, 5, and 6 of this paper, to be viewed alongside the relevant proposals, but can also be viewed together in appendix 1.

2.4.2 The need for a systems-based approach to regulatory reform

As noted above, the Regulations aim to strike an appropriate balance between incentives for industry growth and innovation, and the appropriate protections for growers, Zespri shareholders and other stakeholders.

A key consideration for the government in enhancing the regulatory framework is understanding how any particular single regulatory change will affect the balance of the regulatory system as a whole. While this discussion document consults on individual proposals, MPI is also interested in how the various options will work together to enhance the overall effectiveness of the Regulations. MPI welcomes your submissions on this point.

2.4.3 The need to regulate responsibly

In addition to the specific interests relating to the kiwifruit industry, the government must ensure that it regulates in accordance with New Zealand's international commitments and obligations.

These expectations have been codified in Treasury's Regulatory Impact Assessment requirements for government agencies, see

<http://www.treasury.govt.nz/regulation/regulatoryimpactstatements>

Questions:

1. If you do not agree with the general aims and objectives of the government's approach to regulation in the kiwifruit industry as outlined in this section, how would you change them and why?

3 Immediate drivers for amending the Kiwifruit Export Regulations 1999

3.1 KIWIFRUIT INDUSTRY STRATEGY PROJECT (KISP) REVIEW

The kiwifruit industry, through KISP, has undertaken a two-year long review of industry institutions and operations, from orchard to export, to determine what changes it thinks are required to ensure the industry's continued performance. In March 2015, the review culminated in a referendum in which every kiwifruit grower who supplies Zespri was entitled to vote on eight proposals for change. All eight proposals were strongly supported by growers who voted in the referendum, each receiving over 90 percent support in the final vote.

KISP sought agreements to:

- | | |
|------------|--|
| Proposal 1 | reconfirm grower support for the single point of entry. |
| Proposal 2 | align the ownership of Zespri shares with its kiwifruit suppliers. This is to be achieved by ceasing dividend payments to "overshared" shareholders, to encourage them to sell down their shareholding. Overshared shareholders are defined as those who own more than four shares per one tray of kiwifruit supplied to Zespri. To give effect to this proposal, KISP proposed that regulations 22 and 23 be revoked in their entirety. |
| Proposal 3 | clarify how Zespri's revenues and costs determine dividend payments and the price set for New Zealand-grown kiwifruit. |
| Proposal 4 | amend New Zealand Kiwifruit Growers Incorporated's governance structure to create the New Zealand Kiwifruit Growers Forum, with an expanded role in monitoring Zespri's performance. Proposal 4 also sought agreement to changing how Zespri contracts with post-harvest operators for the supply of kiwifruit. |
| Proposal 5 | amend Zespri's governance arrangements, to provide for three independent directors and to have three year terms for all directors. |
| Proposal 6 | appoint an independent director on the KNZ board to bring in some required skills, while retaining the grower-elected majority on the board. |
| Proposal 7 | expand the definition of Zespri's core business to include activities other than the export of New Zealand-grown kiwifruit. |
| Proposal 8 | integrate collaborative marketing further into the industry's marketing plans. |

Proposal 1 is not seeking any change to the status quo and therefore is not discussed in this document. Proposals 3, 4, 5 and 6 do not require any changes to the Regulations to be implemented. These are decisions which the industry is best placed to take due to its superior information on industry-specific issues and its ability to drive a robust and efficient process to make decisions quickly. As such, these proposals, except for proposal 6 (KNZ board composition), are not examined in detail in this paper. KNZ board composition, with some options, is discussed in section 6 of this discussion document.

Proposals 2, 7 and 8 would require changes to the controls and restrictions established by the Regulations. Ultimately, it is for government to consider what regulatory framework will deliver the most value to New Zealand.

MPI has assessed KISP's proposed changes. While we have focused on those proposals where regulatory change would be required, we have also considered how the non-regulatory proposals fit into the regulatory system as a whole.

3.2 INDEPENDENT REVIEW OF KIWIFRUIT NEW ZEALAND (KNZ)

The Regulations have been in force for 16 years, over which time there have been a number of changes in New Zealand's domestic and global trading markets. To date, there has been no comprehensive review or assessment of the effectiveness of the Regulations and KNZ. Therefore, to support the analysis of the KISP proposals, MPI commissioned the Institute for Business Research at Waikato University to undertake an independent review of the design, operation and performance of the Regulations and KNZ (the Review).

The findings and recommendations of the Review are considered alongside the KISP proposals and MPI analysis in section 6, which outlines possible amendments to the governance, funding and operation of KNZ.

Overall, the Review concluded that changes in the economic settings over the past 16 years mean that the current approach to regulation in relation to KNZ is no longer appropriate. It recommended that consideration be given to regulatory amendments relating to KNZ's funding, governance, and accountability settings. The overall aim of these proposed amendments is to strengthen the capability, skills, and independence of KNZ as a regulator, and to establish greater public oversight and monitoring of KNZ's performance.

The Review also concluded that there has been limited uptake of collaborative marketing opportunities to date, and that it could be more central to industry operations going forward. Improving collaborative marketing uptake would increase the volume of export of New Zealand-grown kiwifruit, and the overall wealth being generated for the industry and the economy as a whole.

In addition, the Review made a number of recommendations which go beyond the scope of the Regulations, and as such are not being progressed as part of this discussion document. The Review made some recommendations of an operational nature, which have been forwarded onto KNZ for consideration. The Review also made a recommendation touching on plant variety right policy, which has been forwarded on to the Ministry for Business, Innovation and Employment for consideration, the agency responsible for the Plant Variety Right Act 1987.

For reference, the full report of the Review has been published alongside this discussion paper and is available on MPI's website.

4 Ownership of Zespri

4.1 KISP PROPOSAL

The KISP ownership proposal is to align the ownership of Zespri shares with its kiwifruit suppliers. This is to be achieved by ceasing dividend payments to “overshared” shareholders, to encourage them to sell down their shareholding. Overshared shareholders are defined as those who own more than four shares per one tray of kiwifruit supplied to Zespri. To give effect to this proposal, KISP propose that regulations 22 and 23 be revoked in their entirety.

4.2 CURRENT REGULATORY PROVISIONS FOR ZESPRI OWNERSHIP

Regulations 22 and 23 address matters relating to Zespri’s corporate form and its constitution. In particular:

- regulation 22: states that Zespri must have no voting shares other than shares that are fully tradeable at least among kiwifruit growers. Growers are defined in the Regulations to include, among others, owners of land on which kiwifruit are produced for export, and leaseholders who have at least a one year lease over kiwifruit supply.
- regulation 23: amends the default settings under companies law to require that each share in a company:
 - a) has one vote in any resolution put to shareholders (subject to supply of kiwifruit to Zespri);
 - b) attracts a right to an equal share in dividends; and
 - c) has an equal share in the distribution of the surplus assets of the company.

The Regulations were amended in 2001 to provide that the constitution of Zespri can be altered for the purpose of limiting shareholders’ rights, but **only** based on the level of the supply of kiwifruit to Zespri. As a consequence, while each share in Zespri provides one voting right, this is subject to a supply cap, with the maximum votes limited by each shareholder’s proportion of supply. This means that ‘dry’ shares (shares not attached to supply) do not carry voting rights.

There is no limit on individual shareholdings, and shares are fully tradeable among shareholders, using the existing trading platform. Zespri shares can be held and purchased by:

- kiwifruit growers who are also orchard owners;
- current leaseholder growers, provided orchard lease terms are for one year or more; and
- any other person determined by Zespri to be a grower for the purpose of tradability of Zespri shares.

4.3 THE EFFECT OF THE REGULATORY PROVISIONS ON OWNERSHIP

Zespri’s share price is set through the interaction of demand and supply for shares, informed by disclosures provided by Zespri and other market information. Zespri reports that in 2013/14, out of a total of 120,717,335 shares on issue, approximately six million shares, or five percent changed hands over the year.

The market for Zespri shares has little liquidity. Shares are traded infrequently and the price can fluctuate widely depending on the number of buyers and sellers operating at any one time (as opposed to reflecting underlying share value). As of 29 September 2015, shares were being traded at \$1.60, with a buy/sell spread of five cents.

The following statistics⁵ show the current ownership of Zespri:

- around 20 percent of the 2,548 growers do not own shares and so are not able to vote at Zespri's annual general meeting nor receive dividends;
- around 16 percent of the total number of shares are owned by dry shareholders;
- around 1.6 percent (35 shareholders) of the total number of shareholders (2108) own more than four times their supply;
- shares in excess of the proposed 4:1 share cap account for about 5.4 percent (approximately 9,124,029 shares) of the total number of shares on issue (120,717,335 shares);
- around 24 percent of shares do not have voting rights attached to them; and
- the average age of kiwifruit growers is 63, with many close to retirement.

4.4 POTENTIAL ISSUES WITH THE STATUS QUO

4.4.1 Misalignment between share ownership and supply

The government is interested in how to best encourage the long-term growth of Zespri, to the benefit of kiwifruit growers, Zespri shareholders and New Zealand as a whole. A key part of this is encouraging innovation and investment, while appropriately protecting the interests of captured kiwifruit growers and shareholders.

As Zespri has evolved over the past 15 years, business streams outside the core activity of purchasing and exporting New Zealand-grown kiwifruit have developed (including the purchase of overseas-grown kiwifruit, and royalties from protected plant varieties). Future growth in these areas is anticipated, and has the potential to add significantly to the value of the industry overall.

Traditionally, income and wealth from shares have contributed a relatively small percentage of suppliers overall income and wealth (compared to orchard values and returns from the supply of fruit). However, the development of new business streams may alter this, with share dividends becoming increasingly valuable.

On retirement, many suppliers choose to sell their orchards, but not their shares. Changes in Zespri's business will further increase the incentive for former kiwifruit suppliers to hold on to shares, and for some shareholders to increase their shareholding relative to their supply.

Along with factors such as increasing orchard land values, this means that the potential barriers to new entrants to the kiwifruit industry, and in particular barriers to share ownership, are increasing. As noted above, around 20 percent of growers are not currently shareholders. Under the status-quo, as more growers retire, it is likely that this percentage will increase.

Because dry shareholders do not have voting rights, the effects of the current trend is a potential concentration of voting power in a smaller base. This could lead to decision-making that is overly weighted to the interests of particular groups, rather than the interests of all kiwifruit growers or the industry as a whole. In turn, this has the potential to undermine the currently broad base of grower and shareholder support for the activities outside of the core business of purchasing and exporting New Zealand-grown kiwifruit, that enable Zespri to make long-term investment decisions and innovate and grow.

⁵ Information provided by NZKGI.

Given the lack of liquidity in the market and the growing misalignment between ownership and supply, KISP is seeking tools to increase the availability of shares to kiwifruit suppliers.

4.5 OTHER KISP PROPOSALS LINKED TO OWNERSHIP

In addition to the ownership proposal, the KISP process identified some non-regulatory measures intended to mitigate the possible impacts of misalignment, including:

- changing supply chain arrangements so that Zespri purchases kiwifruit directly from supply entities (at present payments are distributed through post-harvest operators which can make it difficult to unbundle dividends from fruit payments); and
- clarifying how Zespri determines its commission on the New Zealand fruit business. The commission would be based on Earnings Before Interest and Tax of two percent on sales, after the costs of sales, the payment of onshore and offshore overheads, non-plant variety innovation costs, and excess taxation.

These measures may provide increased transparency about how Zespri determines and distributes its returns, which will help kiwifruit growers make informed decisions about share ownership. As these are non-regulatory changes, grower shareholders can amend the system at their discretion if further transparency or other outcomes are desired.

The information disclosure requirements in the Regulations will also remain a critical part in providing long-term certainty and efficient price signals. As discussed in section 6, KNZ has an important role in overseeing information disclosure provisions.

Questions:

2. What risks do you see arising from increasing misalignment between Zespri shareholding and kiwifruit supply? How significant are these risks?

4.6 CRITERIA FOR ASSESSING OPTIONS

From the above discussion, MPI considers that any changes to the Regulations must ensure:

- the regulatory framework is durable and has the capacity to evolve to meet changing circumstances;
- Zespri can make appropriate commercial decisions to the collective benefit of its shareholders;
- Zespri is not unnecessarily impaired in raising of capital (now or in the future);
- price signals for growers and kiwifruit suppliers are not impaired;
- the individual interests of growers and shareholders (and classes of shareholders), including the ability to make their own risk management decisions, are proportionately protected; and
- Zespri's performance is enhanced through effective accountability to its shareholders and kiwifruit suppliers, and adequate regulatory oversight.

MPI has identified two options relating to ownership of Zespri:

- Option 1: the status quo; and
- Option 2: the KISP ownership proposal to introduce a share cap and encourage greater alignment.

If a decision is made to implement option 2, MPI has identified three alternative mechanisms for doing so:

- Option 2A: delete regulations 22 and 23 as proposed by KISP;
- Option 2B: amend regulations 22 and 23 to the minimum extent possible to give effect to the specific ownership proposals put forward by KISP; and
- Option 2C: amend regulations 22 and 23 to enable specific matters contained in those regulations to be altered based on agreement of shareholders and KNZ.

4.7 OPTION 1: STATUS QUO

The key features of the current arrangements are discussed above. There are a number of non-regulatory options available to the industry that would help to address the potential problems associated with misalignment. These include:

- promoting share ownership more effectively to growers;
- encouraging a practice whereby shareholders sell their shares with their orchards; and
- consulting and sharing information with growers in a way that promotes a culture of greater industry unity.

The effectiveness of non-regulatory approaches will depend on a number of factors. For example, to date, shareholders have been unwilling to sell shares with their orchards, driven both by the dividend they expect to receive in the future, and also a desire to maintain a longstanding interest and connection to the industry of which they are part. If the value of shares increase (as Zespri's exporting success continues to increase) there will remain little incentive for ex-orchard owners to sell their shares, unless this value can be reflected in an increased share price.

Question

3. Are there other risks or challenges with the status quo that need to be considered?
4. Do you support option 1: the status quo? Why, why not?

4.8 OPTION 2: KISP OWNERSHIP PROPOSAL TO INTRODUCE A SHARE CAP

The specific KISP ownership proposal provides that Zespri shares would only be able to be purchased by:

- kiwifruit suppliers who are also orchard owners (status quo); and
- leaseholders who have leases of three years or more (compared to the current one year).

In addition:

- shareholding would be capped at four times the level of trays supplied to Zespri, (i.e. the maximum permitted ratio of shares to trays supplied would be set at 4:1);
- no dividends for dry shareholders; and
- land owners be given priority over leaseholders in the holding of shares.

Share divestment of “ineligible” shares (shares in excess of four shares for every tray of fruit supplied, shares held by dry shareholders, and shares held by leaseholders with less than three year leases) will be given effect by:

- ceasing dividend payments on “old” ineligible shares (shares held prior to the final decision to cease dividend payments) after a **seven year** lead in period; and
- ceasing dividend payments on “newly” ineligible shares (ineligible shares accrued after the final decision to cease dividend payments) after a **three year** lead in period.

On the demand side, KISP has proposed that kiwifruit suppliers will be encouraged to hold at least one share per tray of kiwifruit supplied. Encouragement will be by way of providing for time payment options and campaigns encouraging share purchases by shareholders holding less than one share per tray supplied.

To address some of the risks of kiwifruit suppliers finding themselves unintentionally overshaired and having to divest shares or forego dividends (for example, if orchard supply falls and they already hold shares at the ratio of 4:1). Zespri proposes to use a formula of the best two out of the previous five growing seasons to calculate the ratio of shares to supply.

4.8.1 MPI comment

The KISP proposal will likely see greater alignment, with the transfer of ownership from dry shareholders and short term leaseholders to currently under-shared kiwifruit suppliers and longer term leaseholders. The degree to which this occurs will depend on how successful Zespri's efforts are to encourage kiwifruit suppliers to buy shares.

However, there is the potential for some unintended consequences that need to be considered:

- Concentrating kiwifruit suppliers' financial stake in the kiwifruit industry could make suppliers' future prosperity (income, property and related plant, and shares) increasingly dependent on the success of Zespri and the kiwifruit industry, which may work against a prudent diversification of risk for kiwifruit suppliers.
- Reducing the pool of people who may hold shares may reduce:
 - the share price and therefore industry wealth;
 - liquidity in a market already struggling to achieve reasonable share turnover. In turn, the usefulness of the share price as a mechanism to signal/incentivise performance is reduced; and
 - the ability of individual shareholders to liquidate their holdings (e.g. in time of financial hardship).
- Denying a group of shareholders their right to dividends as understood at the time of acquiring those shares could discourage share ownership by others or reduce the perceived value of Zespri shares.
- Giving land owners priority over leaseholders on the holding of shares may raise equity concerns in situations where the lease period is such that the leaseholder effectively has the same level of interest in the industry and Zespri as a land owner (i.e. long-term leases).
- Sufficient levels of certainty, rigour and transparency in the establishment, application and monitoring of the share allocation formula will be required to ensure it operates in a smooth, timely and uncontested manner.
- Reducing the ability of Zespri to access additional equity to, for example, realise market opportunities that might otherwise fall to competitors.

Finally, during the transition to remove ineligible shares, the supply of shares is likely to significantly increase relative to demand, at least from the time dividend payments cease. Zespri has the discretion to buy back shares if needed to support the share price during the transition phase. This will place some additional financial risk on Zespri and shareholders.

Questions:

5. Do you support option 2: KISP ownership proposal? Why, why not? Are there other benefits to greater shareholder alignment not covered in this document?

6. Do you agree with the potential unintended consequences outlined above? Are there any factors that mitigate against these risks? Are there other risks?

7. What else could be considered to ensure that there are efficient price signals to growers and shareholders (e.g. updating the Kiwifruit Information Disclosure Handbook)?

4.9 OPTIONS FOR IMPLEMENTING THE KISP OWNERSHIP PROPOSAL

If option 2 is preferred, then there are a number of possible mechanisms that could be used to implement it.

4.9.1 Option 2A: KISP proposal to delete regulations 22 and 23

KISP has proposed that regulations 22 and 23 be deleted (refer 4.2 above for a description of these regulations). The change would allow grower shareholders to vote to change Zespri's constitution to introduce a share cap and implement the other measures described in option 2 above. Removing these regulations would also allow any future changes to be made to ownership rights and corporate form, based on approval of 75 percent of shareholders at a Zespri general meeting.

This proposal would provide a greater degree of flexibility and autonomy for Zespri to make decisions that it sees as best for the industry. KISP indicated that the reason it is seeking the full removal (rather than amendment) of these regulations is that requiring regulatory change to implement decisions in this area imposes unnecessary cost on industry and delays Zespri's decision-making.

However, the proposal would also remove core protections for minority shareholders and the other controls placed on Zespri's corporate form. Zespri's corporate form (and whether it delivers the incentives for responsible risk-taking) affects all existing and potential kiwifruit growers, whether or not they are voting shareholders as there are no other major buyers of New Zealand-grown kiwifruit for export (other than to Australia). On this wider public interest basis, MPI's view is that there should continue to be some level of regulatory oversight of the conditions of Zespri's ownership and its corporate form.

Questions:

8. Do you support option 2A: KISP's proposal to delete regulations 22 and 23 in their entirety? Why, why not?

9. Do you want to retain key aspects of regulations 22 and 23 to provide regulatory oversight of future changes to Zespri's ownership and corporate form and protect the interests of shareholders and growers?

4.9.2 Option 2B: Amend regulations 22 and 23 to the minimum extent possible to provide for the specific KISP ownership proposals

An alternative mechanism for implementing KISP's proposal is to amend regulations 22 and 23 to the minimum extent possible consistent with achieving the ownership proposals sought by KISP. That is, amending the Regulations to allow the specific 4:1 share cap to be introduced by Zespri, and to enable the provisions for transitioning to this cap over a set time period to be put in place. Consideration could also be given to how best to give effect to the proposed share allocation formula.

Implementing option 2 in this way would retain the substantive existing protections with respect to corporate form and minority shareholder rights.

Compared to option 2A, option 2B involves greater cost for Zespri and shareholders if further alignment of share ownership to production is desired in the future (e.g. the share cap is reduced further) as regulatory amendment will still be required. However, these costs are the same as under the status quo, and regulatory amendment can be progressed with urgency if circumstances require.

Questions:

10. Do you support option 2B: Amending regulations 22 and 23 to the minimum extent to provide for the specific KISP ownership proposal, but retaining regulatory oversight of any future ownership changes? Why, why not?

4.9.3 Option 2C: Amend regulation to enable Zespri to make changes to matters addressed in regulations 22 and 23, subject to approval by grower shareholders and KNZ

This option would provide for matters referred to in regulations 22 and 23 (such as corporate form and rules about maximum shareholding, shareholder voting rights and protections) to be changed by grower shareholder resolution, but only if those matters are also approved by KNZ, as the regulator.

In determining whether to approve changes, KNZ could be required to consider the following principles:

- the benefits and risks of the proposed changes to the New Zealand economy and the kiwifruit industry;
- the advantages and disadvantages of different corporate forms;
- the interests of Zespri's (i) kiwifruit suppliers and (ii) shareholders, including minority interests;
- the changing nature of the kiwifruit industry (e.g., industry concentration, changing technology, and changing domestic and international market dynamics); and
- New Zealand's international obligations and commitments.

This option would allow for changing Zespri's mode of operation as circumstances change, while ensuring an appropriate level of protection for grower and shareholder interests. This approach is consistent with KISP's identified need to future proof the industry. This option could operate alongside other proposals on the operation of KNZ (see section 6).

Compared to option 2A, this option provides less autonomy for Zespri to make decisions and could result in some uncertainty for stakeholders until the process becomes well established. As it would involve new functions for KNZ, there will also be a need for KNZ to build sufficient capability in new areas.

Questions:

11. Do you support option 2C: Amend the Regulations to enable Zespri to make changes to matters addressed in regulations 22 and 23, subject to approval by grower shareholders and KNZ? Why, why not?

12. If you support option 2C, where do you think regulatory approval should sit (e.g. with KNZ, the Minister for Primary Industries or Cabinet)? Why? What additional resources or expertise would KNZ require to effectively fulfil this new function?

5 Zespri's core business

5.1 KISP PROPOSAL

The KISP proposal is to expand the definition of Zespri's core business in the Regulations to include activities other than the purchase and export of New Zealand-grown kiwifruit.

5.2 CURRENT RESTRICTIONS ON ZESPRI'S CORE BUSINESS

In New Zealand, the Companies Act 1993 provides that a company is able to undertake any activity or business provided it complies with the law, and unless prohibited by the company's constitution. It also provides for a company's constitution to be altered by special resolution of shareholders to, for example, allow the company to undertake activities previously prohibited by its constitution.

As commented previously, Zespri is not a typical company. The single desk structure means that Zespri is not exposed to the full force of competitive pressure in all areas of its business. As such, the regulatory framework provides safeguards to protect the interests of kiwifruit suppliers, shareholders and other industry stakeholders who might otherwise be at risk from Zespri's position. A key way in which this is currently achieved is through regulation 2, which restricts Zespri's core business to:

- a) the purchase of New Zealand-grown kiwifruit for export where the point of acquisition of title to fruit is at FOBS⁶ and the export of that fruit;
- b) excludes the export at FOBS of kiwifruit for consumption in Australia; and
- c) excludes the sale of kiwifruit in New Zealand⁷.

Regulation 11 (non-diversification) provides that Zespri is permitted to undertake activities not necessary for its core business provided that:

- Zespri has the permission of its providers of capital (essentially capital that would otherwise go to kiwifruit suppliers and shareholders); and
- those providers of capital who do not agree are not exposed to more than minimal risk from the proposed non-core activities.

Over time, and in accordance with the Regulations, Zespri has built up its business to include a number of activities in addition to those provided for in the definition of 'core business'. At present, Zespri also undertakes activities that fall into six broad categories:

- research and development;
- new cultivar development;
- plant variety ownership;
- marketing;
- the purchase of non-New Zealand kiwifruit to ensure year-round supply; and
- supply chain management.

To comply with regulation 11, the current practice is for Zespri to assess each of its activities to determine whether it is necessary for its defined core business. In some cases, advice and assessment is sought from KNZ.

⁶ Stowed on board the ship or aircraft on which the kiwifruit is exported.

⁷ Regulation 11(2) provides that Zespri is able to supply the New Zealand market provided the level of sales is incidental to the size of the total New Zealand market, and provided the total sales do not exceed 300,000 trays of kiwifruit.

Where an activity is deemed to fall outside the scope of being necessary for core business as defined in regulation 2, Zespri seeks grower shareholder approval. The practice for gaining this approval is for Zespri to present a business case and risk analysis to shareholders for a vote every three years at its AGM. The approvals sought are for specific projects (not broad expenditure categories such as research and development). To date, non-core business proposals have generally been approved with support by shareholders.

KNZ monitors Zespri's non-diversification activities, including compliance with regulation 11, and is able to enforce these regulations through Zespri's Export Authorisation. Third parties (growers, competitors, suppliers) are able to seek a review through the courts of KNZ's actions or inactions.

In accordance with its information disclosure provisions (regulations 12 to 21), Zespri must provide financial reports to shareholders that distinguish between revenue from and expenditure on core and non-core business. This allows growers, shareholders and other stakeholders to judge how non-core business is impacting their returns.

The information disclosure provisions also play a key role in mitigating the risk that Zespri might cross-subsidise its contestable activities with revenue generated by its non-contestable single desk activities. Cross-subsidisation could increase barriers to entry and/or reduce business for potential and existing alternative service providers, in turn reducing choice for growers and others and removing pressure on Zespri to control costs. Combined with oversight from KNZ and the application of the Commerce Act 1986, the information disclosure requirements are intended to address these risks.

5.3 POTENTIAL ISSUES WITH STATUS QUO

KISP identified the following issues with the current definition of core business:

- Activities within the six categories identified above are important to Zespri's and the kiwifruit industry's global competitiveness.
- There is a risk at present that shareholders could vote to cease or reduce specific non-core activities. This creates some uncertainty for Zespri, and may prevent it from taking up some strategic or longer term opportunities that add value to the industry as a whole.
- Zespri already carries out these activities and it views the proposed change as aligning the Regulations with existing practice.

A vote by shareholders to cease specific non-core activities would be most likely to occur in times of industry downturn or financial hardship. This could see grower shareholders vote to cease activities that Zespri may consider to be of long-term strategic importance, such as research and development, in order to increase their short-term returns. Grower shareholders could also vote to require Zespri to pay higher dividends to compensate for lower orchard gate returns, effectively removing any retained earnings that could otherwise be used for long-term investment.

In these circumstances, Zespri would either have to: reduce the scope of its non-core business, at least temporarily, or rely more heavily on business partners to finance its activities, thereby relinquishing some control over non-core business activities. To date, the risk of Zespri being unable to invest in key areas outside of the regulated core business definition has not eventuated. For example, during the Ps-V event, in spite of the difficulties being faced by

industry, grower shareholders continued to support non-core business being undertaken by Zespri.

As noted in further detail below, while on the face of it the change is simply aligning the regulatory framework with current practice, MPI's view is that the proposed change could significantly extend the scope of activities that Zespri could potentially undertake without grower or regulatory oversight.

Questions:

13. Do you agree with the issues that KISP has identified with the status quo in relation to the definition of Zespri's core business? Are there any other risks or relevant considerations relating to the status quo?

5.4 LINK BETWEEN CORE BUSINESS AND OTHER PROPOSALS

There are a number of options to address concerns about the possible loss of funding or support for the important but non-core business that Zespri currently undertakes. The options discussed in the ownership section above would have some impact. For example, increasing the alignment between growers and shareholding could improve grower's long-term interest in non-core activities (as growers who own shares would realise more of the value from these activities through their dividends). This would help mitigate the risk of such activities being voted against in times of industry downturn or financial hardship.

There are also strong links between possible changes to Zespri's core business and proposals concerning the role of KNZ, as discussed in section 6.

5.5 CRITERIA FOR ASSESSING OPTIONS

From the above discussion, MPI considers that any option for regulatory amendment must be consistent with the broader aims and objectives of the regulatory framework for the kiwifruit industry, as well as ensure that Zespri continues to be a high-performing exporter that is delivering benefits to the New Zealand economy as a whole. In particular, the Regulations should:

- enable opportunities for high value activities and for Zespri to make long-term investment decisions;
- ensure robust, durable, and transparent processes are in place to protect Zespri supplier and shareholder interests, proportionate to the risks; and
- appropriately manage anti-competitive risks that might arise as a consequence of Zespri expanding its activities.

5.6 OPTION 1: STATUS QUO

The key features of the current arrangement are described above. To address the problems identified by KISP, Zespri and other industry players could apply non-regulatory solutions. These could include:

- promoting industry unity;
- ensuring the value of its investments are well understood and accepted by grower shareholders; and
- increasing the level of Zespri's retained earnings.

Increasing retained earnings would allow Zespri to build up reserves during the good times to better weather some of the more extreme events that might otherwise erode grower shareholder support for its continuing non-core business. For example, the sums so accrued could be kept in a trust fund to ensure they were not accessed by Zespri for other purposes, and a cap on reserves held could be applied to ensure an excessive build up is avoided.

This would reduce the risk that capital constraints could put at risk current non-core business and recognise that value of money to grower shareholders varies over the course of the business cycle in times of economic hardship.

MPI notes that Zespri already has the ability to change its retained earnings policy, with grower shareholder support, and this was proposed as part of KISP's process. Ensuring ongoing support for non-core business could be an explicit part of these considerations.

Questions:

14. Do you support option 1: Keep the current arrangements? Why, why not?

5.7 OPTION 2: KISP PROPOSAL TO EXPAND ZESPRI'S CORE BUSINESS BY AMENDING REGULATION

KISP's proposal is to expand the regulatory definition of Zespri's core business in regulation 2 to include the categories of:

- research and development;
- new cultivar development;
- plant variety ownership;
- marketing;
- the purchase of non-New Zealand kiwifruit to ensure year-round supply; and
- supply chain management.

The change would shift decision-making power from grower shareholders (with KNZ's oversight) to Zespri's board. Shareholders would still be able to vote on a special resolution to amend Zespri's constitution in a way that limited core business activities.

Under this option, it is intended that KISP's proposed Grower Forum be given greater oversight responsibilities with respect to monitoring the expanded core businesses. However, the Grower Forum would have no statutory basis or authority and there would be no mechanism for the Grower Forum to intervene beyond interacting with Zespri and providing additional disclosures and commentary to grower shareholders. It is unclear how this oversight would relate to the role already undertaken by KNZ.

If this option was implemented, it would be possible to also alter the information disclosure regulations to ensure Zespri's disclosures separately identify the current single desk business from any 'new' core business. This would help to ensure the risk of cross subsidisation is managed and accountability to growers on the performance of the 'new' core business is achieved.

KISP considers this proposal will align the Regulations with current practice, and notes the generally high levels of grower and shareholder support for Zespri's current activities outside of core business.

However, the key difference from the status quo and KISP's proposal is that expanding the definition of core business into broad categories could significantly reduce the range of

Zespri's future activities subject to oversight/approval by KNZ and grower shareholders. For example, while growers have endorsed current Zespri projects to ensure 12 month supply, under KISP's proposal a future Zespri board could further expand such activities, and as long as they fitted within the definition within the Regulations, there would be no requirement for KNZ to monitor through the non-diversification rule, or for Zespri to seek shareholder approval.

5.7.1 MPI's Comment

The proposal to expand core business could:

- reduce the risk that grower shareholders might vote to terminate or put on hold activities of net value to kiwifruit suppliers and potentially the wider kiwifruit industry. This would increase certainty for Zespri enabling it to take advantage of some strategic, longer-term investments.
- improve decision-making, as Zespri could be expected to have better information than grower shareholders on opportunities available to it, and how best to realise those opportunities, having regard to the likely benefits, risks and costs.
- produce minor administrative savings to Zespri through reducing the need for an additional resolution at Zespri's AGM once every three years (and business case), although these savings may be outweighed by the administrative costs of potential new Grower Forum responsibilities.

However, MPI considers that there are some additional risks with the KISP proposal. In particular it could:

- dilute shareholder control by shifting the responsibility on to shareholders to oppose any proposed action. Currently, Zespri must positively get shareholder approval before undertaking non-core business activities. It's not clear that individual grower shareholders will feel sufficiently empowered to oppose Zespri if there is no alternative buyer for their product.
- undervalue shareholder interests - while Zespri may have some information advantages over grower shareholders, it will not have good information on the value its grower shareholders place on income (dividends and returns on fruit) foregone as a consequence of Zespri's investment decisions.
- reduce the incentive of other parties to invest in those services, for example, discourage collaborative marketers and investments in cultivar and market development. The action of Zespri could create barriers to entry and/or reduce business for potential and existing alternate service providers. With less competition, there would be less of an imperative for providers to deliver innovative and efficient services.

While there are disclosure and accountability requirements in place to manage some of these risks, there is no guarantee that these measures alone will be fully effective or address all of the potential risks.

Questions:

15. Do you support option 2: KISP proposal to expand the definition of core business through regulation? Why, why not? Is there a significant risk to the funding needed to support Zespri's non-core business activities?

16. Is it appropriate that Zespri be given greater autonomy to make decisions on current non-core business, absent the direct involvement of grower shareholders and KNZ? Why, why not?

17. Is there a risk that expanding the definition of core business will increase the barriers to entry for other service providers in the kiwifruit industry? Why, why not?

5.8 OPTION 3: ALLOW ZESPRI BOARD APPROVAL FOR “NON-SIGNIFICANT” NON-CORE PROJECTS AND ACTIVITIES

The Zespri board could be allowed to approve projects or activities that are outside core business, but below a certain specified threshold, for example, “non-significant activities outside of core business”. For activities that are above the threshold, the same consideration as at present would be required. That is, there would need to be grower shareholder approval as provided for by regulation 11(1). Whether an activity is deemed to be significant could depend on an assessment by KNZ of factors such as:

- whether the activity or project fits within the six categories put forward by KISP;
- the project size (cost);
- potential risk to shareholders and growers;
- whether it is a continuation of an already approved project; and
- the effect on alternative suppliers and competition.

Assessing projects and activity against the above criteria could reduce the cost to Zespri of establishing and confirming projects outside its current core activities, and reduce the vulnerability of these projects to grower shareholder vote. Also, the government and grower shareholders would retain oversight of significant projects.

However, compared to the status quo there may be some uncertainty and cost with respect to the operation of the thresholds and there would be less oversight of Zespri’s activities by KNZ or shareholders.

As this option would provide a new framework for assessing the threshold for ‘significance’, it would involve some changes for the way KNZ carries out its functions, and it will need to build sufficient skills and capability for this role.

Questions:

18. Do you support option 3: Allow Zespri board approval for “non-significant” non-core projects and activities? Why, why not? What might the threshold for significant look like?

5.9 OPTION 4: SHAREHOLDER GROWERS VOTE EVERY SIX YEARS

This option would keep the current definition of core business in the regulations, and the current processes for monitoring this definition and activities outside of core business. The main change would be that the process for shareholders voting on activities outside of core business would be more clearly defined, and the interval at which such activities needed to be approved would be longer than at present.

This is consistent with the six year cycle under the Commodity Levies Act 1990. That Act provides that levy orders expire after six years, and that in order to continue after that point, the industry body must demonstrate it has the support of the relevant industry to continue the activities funded by the levy.

Zespri could adopt a similar six-year timeframe for seeking ongoing grower shareholder support for activities outside of core business. This would see projects being approved as

they arise, with the approval lasting for a period of six years. Compared to the current system (that sees grower shareholders voting on particular non-core business every three years), this option could see:

- marginally reduced administration costs;
- retention of direct accountability from Zespri to grower shareholders; and
- less risk to the funding of non-core business, and increased certainty for Zespri in investing in longer term or innovative projects.

Questions:

19. Do you support option 4: grower shareholders voting every six years? Why, why not?

20. Do you have another option? Please provide details and your reasons for supporting that option.

6 Kiwifruit New Zealand: Governance, Funding and Operation

6.1 ENSURING APPROPRIATE REGULATORY OVERSIGHT

As noted above, the adoption of KISP proposals or any alternative options will have implications for the regulation of Zespri and the wider kiwifruit industry. In particular, the proposals are likely to mean that changes will need to be made to KNZ, including its governance, funding and operational arrangements.

The Regulations relating to KNZ have been in place for 16 years. During this time there have been a number of changes in the kiwifruit industry as well as New Zealand's domestic and export markets. However, there has been no independent review or assessment of the Regulations or KNZ's performance, and whether they remain 'fit for purpose'. As such, MPI has taken the opportunity provided by the KISP review to seek an independent review of KNZ and the associated regulations (the Review).

The following section draws on the findings of the Review, the KISP proposals, and MPI's own analysis to outline detailed options for reforming the Regulations relating to KNZ to ensure they are appropriate for the future.

6.2 CURRENT REGULATORY PROVISIONS FOR KNZ

KNZ was established on 1 April 2000 when the New Zealand kiwifruit industry was restructured through the Act and the Regulations. The Regulations establish the KNZ Board, set out its powers, membership and funding. They also require that KNZ perform its functions in a manner that is as efficient and as cost-effective as possible.

The Regulations require that the board of KNZ consist of five members: three elected by producers; one appointed by NZKGI; and one appointed by the other members, who is fully independent of the kiwifruit industry and who is to act as the chairperson of the board.

KNZ does not have a general supervisory role in relation to the kiwifruit industry or Zespri. Its functions are limited to those set out in the Regulations. In particular, regulation 33 lists KNZ's functions as to:

- authorise the export of kiwifruit and set the terms of authorisation;
- monitor and enforce:
 - the non-discrimination rule, the non-diversification rule, the information disclosure requirements, and the collaborative marketing requirements;
 - the requirement that the point of acquisition of title to kiwifruit purchased for export be in accordance with the Regulations; and
 - any other terms and conditions of the authorisation; and
- determine collaborative marketing applications.

When undertaking its monitoring and enforcement functions, KNZ must achieve the purpose set out in regulation 8, which 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 kiwifruit suppliers; and
- (c) providing appropriate protections for Zespri's shareholders and kiwifruit suppliers; and

- (d) promoting sustained downward pressure on Zespri's costs.

With respect to its role in determining collaborative marketing applications, KNZ is able to require Zespri to enter into collaborative marketing arrangements for the purpose of increasing the overall wealth of New Zealand kiwifruit suppliers.

6.2.1 KISP proposals

The KISP review proposed the following in relation to KNZ:

- retaining the provision that the majority of KNZ directors are elected by growers, while providing for the director appointed by NZKGI to be from outside the industry, to supplement the skill-set of the grower-elected directors, if this was deemed necessary based on consultation with the board;
- administrative changes to collaborative marketing – such as encouraging Zespri to identify and signal collaborative marketing opportunities as part of its global strategic marketing plan; and
- that the Regulations be amended to provide greater flexibility so that KNZ is able to determine how best to fund its operations with respect to collaborative marketing.

6.3 MPI COMMISSIONED INDEPENDENT REVIEW OF KNZ

In September 2015, MPI commissioned Professors Frank Scrimgeour and Stuart Locke of the Institute for Business Research at Waikato University to undertake an independent review of KNZ. In particular, the reviewers were asked to report on what regulatory and non-regulatory changes may be needed to:

- a) **balance accountability to government and the industry** – considering the ability of KNZ to undertake its role and functions effectively, including whether the current balance of government and industry involvement in KNZ is in line with best practice;
- b) **support take-up of collaborative marketing** – considering any barriers to achieving an increase in collaborative exporting of New Zealand kiwifruit arising from regulatory or KNZ operational settings;
- c) **support innovation** – considering the potential risks and rewards associated with Zespri's dominance as the monopsony exporter and dominant investor in industry research and development and what regulatory changes, if any, may be required to enable the government to monitor and manage any risks; and
- d) **monitor the impact of internationalisation** – considering the impact on New Zealand kiwifruit growers of Zespri's internationalisation, including accessing overseas-grown kiwifruit to ensure 12 month supply, and what regulatory changes, if any, may be required to enable the government to monitor and manage any risks.

Overall, the Review concluded that regulatory change is needed to directly improve KNZ's accountability and governance, as well as collaborative marketing. It noted that, in order to facilitate industry success, it is essential that KNZ is fit for purpose and understands the broader system within which it is operating, including the global position.

The reviewers noted the importance of KNZ's oversight of Zespri's international activities, particularly to its key stakeholders, including the government. They also commented on the need for KNZ to be proactive in its approach to innovation, especially in the areas of industry productivity and the development of plant varieties. In conclusion, the reviewers felt that there are a number of regulatory and non-regulatory options for enhancing KNZ's performance, and noted the importance of undertaking a regular review (6-yearly) of the performance of the regulatory framework.

After taking into consideration KISP's request for change, and findings and recommendations from the Review, this section seeks public submissions on:

- KNZ board composition;
- KNZ accountability and reporting;
- collaborative marketing; and
- KNZ funding.

6.4 LINK BETWEEN KNZ CHANGES AND OTHER PROPOSALS

The appropriate regulatory framework for KNZ will very much depend on the final approach taken to addressing the proposals made by KISP outlined in sections 4 and 5 above. In particular, the proposal to increase alignment of ownership in Zespri with supply could have significant implications for KNZ's functions and role, depending on which option is preferred. For example, if ownership option 2C is preferred (i.e. Zespri is able to make changes to matters addressed under regulations 22 and 23 subject to shareholder and KNZ approval) KNZ will need to have a much greater role in considering and approving changes relating to Zespri ownership.

The proposal to amend the definition of core business could also have implications for KNZ's role and functions. For example, if option 3 in section 5 is implemented (i.e. Zespri board is able to approve non-significant changes to core business activities), KNZ would acquire a new role in determining the appropriate threshold for 'significance'.

In general, it is likely that the changes discussed in sections 4 and 5 will have implications for:

- KNZ board composition with respect to both the skill-set required and independence from Zespri;
- KNZ accountability and reporting; and
- KNZ funding.

These changes will not reduce KNZ's oversight of Zespri's compliance with information disclosure requirements, which, amongst other things, help to mitigate the risk that Zespri cross-subsidises contestable activities with revenue from non-contestable activities.

6.5 KNZ BOARD COMPOSITION

6.5.1 Current provision and requirements

As noted above, the board has three key functions under the Regulations: authorising kiwifruit exports; monitoring and enforcing Zespri's compliance with the Regulations; and determining collaborative marketing applications.

The board consists of: three grower-elected directors; one director appointed by NZKGI; and an independent Chair appointed by the four directors.

The government accepted the industry view at the time of the 1998/99 industry reform that grower representation was required to bring industry knowledge and background to the board. KNZ has two staff, including its full-time Chief Executive who is from outside the industry.

6.5.2 Review findings

The Review commented that despite KNZ having a significant regulatory role, it is perceived by some to lack independence and be beholden to growers through the composition of

directors. The Review also commented that KNZ is perceived and often referred to as being answerable to growers. It identified opportunities for improving KNZ capability, in particular with respect to international activity and innovation practices.

MPI notes that a perceived lack of independence of the regulatory regime is likely to be of significant concern to the government and other key stakeholders, such as growers, suppliers, exporters and consumers.

The Review also recommends that the board focus on governance, with additional operational staff employed to support the discharging of KNZ's functions. MPI's view is that increasing operational staff would come at a significant cost to KNZ, and with reduced flexibility. MPI considers that an alternative option would be for KNZ to contract specialist expertise to supplement its decision-making as required, rather than increasing permanent staff.

The Review found that there is a concern from some parts of the industry about the transparency of KNZ decisions. There is a view that this is leading to requests for documents under the Official Information Act 1982 (the OIA) that are onerous for KNZ to process. Greater independence of the regulator is likely to build wider industry confidence. A possible side effect of this may be a reduction in requests for information under the OIA.

6.5.3 Criteria for assessing options

Given the key functions of the board listed above, the need for the regulator to provide balance and safeguards to the regulatory system, and to meet the potential role changes identified under Zespri ownership and core business sections, MPI considers that the board must:

- have the necessary expertise available to it to make good decisions (e.g. grower knowledge and experience, international business, marketing, law and/or competition or trade policy); and
- in fact and appearance, be able to discharge its responsibilities impartially.

6.5.4 Option 1: Status quo with KISP variation for board appointment

KISP has proposed that the KNZ board continue to be controlled by growers, and that the current board size be maintained with four directors and an independent Chair. The only change proposed is that the director appointed by NZKGI could be an independent director, if this was deemed necessary based on consultation with the board. This would provide for a director to be appointed solely on the skills required, so as to supplement the skill-set of the three grower-elected directors. No change to the Regulations was proposed.

6.5.5 Option 2: Increasing board independence

The Review recommends that the board be increased in size from five to seven members, including an independent Chair, to bring in independent directors with required expertise in a range of areas.

Under this option, a definition of 'independence' would be developed (including specific criteria) to guide the appointment of the independent directors. It is envisaged that the criteria would include things such as not having any significant financial interests in the kiwifruit industry or related fields and industries, and not being a director on another board with a direct conflict of interest. It is proposed that MPI would develop the definition and criteria in consultation with relevant stakeholders.

MPI considers that greater board independence could be achieved with different combinations of grower-elected and independent directors. Three possible options are presented below.

Option 2A: A seven member board as follows:

- three directors elected by growers (status quo);
- one director appointed by NZKGI (as suggested by KISP in option 1 above);
- two independent directors with expertise in international business, marketing, law or competition or trade policy, appointed by the Minister after consulting with the KNZ board; and
- an independent Chair appointed by the board.

Option 2B: A board of six members as follows:

- three directors elected by growers (status quo);
- two independent directors (replacing the one NZKGI appointee) with expertise as listed under option 2A, appointed by the Minister after consulting with the KNZ board; and
- an independent Chair appointed by the board.

Option 2C: A board of seven members as follows:

- three directors elected by growers (status quo);
- three independent directors (replacing the one NZKGI appointee) with expertise as listed under option 2A, appointed by the Minister after consulting with the KNZ board; and
- an independent Chair appointed by the board.

6.5.6 Analysis of options

MPI considers that the status quo (option 1) rates poorly against both the criteria for assessing board composition options. There is no mechanism to ensure the board has all of the essential skills required for its future roles and functions, and there is the potential for all the directors, including the NZKGI appointed director, to hold shares in Zespri as kiwifruit growers and/or in an entity applying for a collaborative marketing approval.

MPI notes that KNZ's current responsibilities, in particular as they relate to non-core business, collaborative marketing approvals, and monitoring Zespri's compliance with information disclosure requirements, require a good understanding of market competition issues. It is unclear under this option whether KNZ will have access to the necessary expertise to make these judgements.

MPI also notes that option 1 is unlikely to address the concerns about independence and impartiality of the board raised by the Review. While the proposal that the NZKGI-appointed member be independent may go some way towards addressing these concerns, the grower majority interest of the board will still be retained.

MPI's view is that options 2A, 2B and 2C are significant improvements over the status quo and the KISP proposal in relation to both criteria for assessing options (i.e. ensuring necessary expertise for good decision making, and appropriate levels of impartiality). Options 2A, 2B and 2C provide opportunities to ensure that any future board has the required skill-set to deliver its future role and functions, irrespective of their scope and form.

Increasing the board from five to seven members in option 2A and 2C will increase board capability while maintaining current grower representation. It will also be likely to add to the cost of running KNZ, which will need to be funded by the industry.

Option 2B would also increase the size and cost of the board, but provides a greater degree of balance between growers and independent directors.

Another alternative within options 2A, 2B and 2C that may create additional opportunities for further improving the board's skill base is to replace the grower-elected directors with directors appointed by NZKGI. This would also remove the cost of holding elections. The downside of this alternative is that it reduces the membership of growers on the board, and the knowledge and skills they bring (depending on who NZKGI appoints).

6.5.7 Summary of options

Table 1: Summary of options for KNZ board composition

	Board size and composition	Appointment process	Impacts
Option 1: Status Quo (KISP Variation)	<ul style="list-style-type: none"> - 3 grower-elected directors - 1 director appointed by NZKGI – appointed for expertise identified by KNZ, could be independent - 1 independent Chair appointed by the board 	<ul style="list-style-type: none"> - growers elect 3 directors, NZKGI appoints 1, and the directors appoint the Chair 	<ul style="list-style-type: none"> - grower majority - limited independence - potentially limited skill-set - limited government oversight
Option 2A: Seven member board / majority industry- appointed	<ul style="list-style-type: none"> - 3 grower-elected directors - 1 director appointed by NZKGI – appointed for expertise identified by KNZ, could be independent - 2 independent directors appointed by the Minister after consulting the board - 1 independent Chair appointed by board 	<ul style="list-style-type: none"> - growers elect 3 directors - NZKGI appoints 1 director - Minister appoints 2 independent directors - Board appoints independent Chair 	<ul style="list-style-type: none"> - more independent than option 1, but less than option 2B and 2C - improved skill-set - higher overhead costs than options 1 and 2B
Option 2B: Six member board	<ul style="list-style-type: none"> - 3 grower-elected directors - 2 independent directors appointed by the Minister after consulting the board - 1 independent Chair appointed by board. Chair has casting vote. 	<ul style="list-style-type: none"> - growers elect 3 directors - Minister appoints 2 independent directors - Board appoints independent Chair 	<ul style="list-style-type: none"> - more independent than options 1 and 2A, but less independent than option 2C - improved skill-set - higher overhead costs than option 1, but lower than 2A and 2C
Option 2C: Seven member board / majority independent	<ul style="list-style-type: none"> - 3 grower-elected directors - 3 independent directors appointed by the Minister after consulting the board - 1 independent Chair appointed by board 	<ul style="list-style-type: none"> - growers elect 3 directors - Minister appoints 3 independent directors - Board appoints independent Chair 	<ul style="list-style-type: none"> - more independent than other options - improved skill-set - Higher overhead costs than options 1 and 2B

Questions:

21. Do you agree with the Review's proposal to change KNZ board's composition to improve the board's independence from the industry and to provide greater ability to bring to the board a range of skills required by the board to discharge all its functions? Why, why not?

22. Board composition: What is your preferred option? Please explain why.

23. What is your view on the size of the board? Do you think the board should have five, six or seven members? Why?

24. As part of options 2A, 2B and 2C, would you prefer replacing the grower-elected directors with directors appointed by NZKGI? Please explain why.

25: Would you prefer another option? Please provide details of that option and why you prefer that option.

6.6 IMPROVING KNZ'S ACCOUNTABILITY AND REPORTING

6.6.1 Description of current provision and requirements

KNZ publishes its annual reports and makes them available to growers and the government. The Regulations do not require KNZ to submit its annual reports to the Minister or that they be tabled in Parliament. KNZ also submits its reports on collaborative marketing to the government each season. Again, there is no regulatory requirement on KNZ to provide this report to the government.

6.6.2 Review findings

The Review comments that regulators should be accountable to the government for their performance in promoting the public interest. The Review comments that KNZ's connection to the government is weak; it is not held to typical accountability mechanisms such as reporting to Parliament or the relevant Minister, and has not been subject to significant external review. It suggests strengthening the reporting requirements similar to those required under the Crown Entities Act 2004.

6.6.3 Criteria for assessing options

MPI considers that appropriate regulatory oversight should:

- a. enable the government to monitor the regulator's activities and performance and manage any risks in a timely manner; and
- b. be cost-effective, flexible, and proportionate for the range of the regulator's functions, and adaptable for a changing industry.

6.6.4 Option 1: Status quo

As outlined above, there is currently no requirement in the Regulations for KNZ to report to the government. KISP has not proposed any changes for KNZ's accountability to the growers, the wider kiwifruit industry, or the government.

6.6.5 Option 2: Statement of strategic intent, performance monitoring and review

To increase board accountability and performance, the Review recommends reporting provisions similar to those for Crown Entities under the Crown Entities Act 2004, with regular performance reviews of KNZ, and a regular review of the Regulations as follows:

- Minister to approve a three-yearly Statements of Strategic Intent (SSI)⁸ developed by KNZ;
- KNZ and the Regulations to be externally renewed every six years to both evaluate KNZ's performance and the appropriateness of the Regulations; and
- KNZ to be annually monitored by MPI to evaluate performance against the SSI and the Regulations, or alternatively that there is an annual engagement between KNZ and MPI for this purpose.

MPI supports the recommendations about developing a three-yearly SSI, undertaking six-yearly performance reviews of KNZ, and annual engagement between KNZ and MPI. MPI's view is that these measures will help to improve the effectiveness and transparency of KNZ performance, and improve the government's and other interested stakeholders' ability to monitor and assess the adequacy of the Regulations and their application. MPI also notes that if the appointment of independent board members by the Minister proposed in the previous section under KNZ board composition is accepted, it would also help to improve the government's engagement with KNZ.

MPI also proposes that KNZ includes in its SSI how the collaborative marketing approvals will contribute to increasing the overall wealth of New Zealand kiwifruit suppliers (regulation 24) and how KNZ will encourage innovation in the kiwifruit industry (regulation 8(a)). The SSI process will also give opportunity to the Minister to issue expectations to KNZ, such as outcomes the government wishes to seek from collaborative marketing.

MPI does not support the Review's recommendation that the Regulations be reviewed every six years by an independent reviewer. The Regulations are the responsibility of the government and the scope and timing of any review of the Regulations should be determined by the government.

6.6.6 Summary of options

Table 2: Summary of options for KNZ accountability and reporting	
	KNZ's accountability and reporting to the government
Option 1: Status Quo	- Limited reporting and accountability to the government (and the wider public) as there is no requirement in the current Regulations for KNZ to report to the government.
Option 2: Statement of Strategic Intent and Performance Monitoring (MPI's preferred option)	- Improved reporting and accountability to the government: <ul style="list-style-type: none"> • KNZ's three-yearly Statement of Strategic Intent (SSI), approved by the Minister; • external review of KNZ's performance every six years; and • annual engagement between KNZ and MPI to monitor KNZ's performance against its SSI.

⁸ Under the Crown Entities Act 20014, a Statement of Intent must set out the strategic objectives that the entity intends to achieve or contribute to over the relevant period. It must also explain other matters, including: the nature and scope of the entity's functions and intended operations; how the entity intends to manage its functions and operations and organisational health and capability; and how it will assess its performance.

Questions:

26. Do you agree with a requirement for KNZ to develop three-yearly statement of strategic intent that is approved by the Minister? Why, why not?

27. Do you agree that KNZ's performance should be independently reviewed every six years? Why, why not?

28. Is there another option or a variation of options 1 or 2 you would like to suggest? Please explain why, including the pros and cons of your proposal.

6.7 COLLABORATIVE MARKETING

6.7.1 Description of current provision and requirements

Collaborative marketing involves a third party collaborating with Zespri in the marketing of kiwifruit to export markets other than Australia. The collaborative marketing arrangements are approved and overseen by KNZ. The two key requirements for KNZ to consider when approving a collaborative marketing arrangement are:

- a. the collaborative marketing arrangement must increase the overall wealth of New Zealand kiwifruit suppliers; and
- b. the collaborative marketing arrangement must include collaboration with Zespri.

Collaborative marketing is intended to increase grower choice, innovation, the realisation of market opportunities and, ultimately, industry performance and returns. Collaborative marketing arrangements are generally for one year but the Regulations do not prevent KNZ from approving multi-year arrangements, and do not prevent KNZ from renewing a collaborative marketing approval.

Since the collaborative marketing provisions were introduced as part of the 1998/99 reforms, approvals have covered approximately 2 percent of kiwifruit exports per year. There are no quantitative limits in the Regulations for collaborative marketing approvals.

6.7.2 Review findings

The Review noted that there are only a small number of collaborative marketing approvals in place, and there is no approval in place for a significant volume of fruit⁹. The Review identified the following issues:

- Zespri has identified markets of strategic importance and this leaves little opportunity for potential collaborative marketers;
- market development is usually a multi-year activity and to date the vast majority of collaborative marketing approvals are for only one year; and
- that when collaborative marketing programme investments come to an end they have zero value, as they may simply be not approved for a future period.

Further, according to the Review, process challenges are perceived to be significant:

- applications involve complicated application forms and processes with constrained timelines;
- the approval processes involve KNZ directors with limited access to marketing expertise;

⁹ Note the Review was completed before the 2015/16 round of collaborative marketing applications were considered by KNZ, and so does not include more recent approvals.

- there is implicit tension between Zespri as collaborator and Zespri as competitor and this, among other things, inhibits information sharing; and
- collaborative marketing programmes must be consistent with Zespri's market strategy but if collaborative marketers do not adequately understand the strategy it is hard to develop high quality collaborative marketing applications.

Finally, according to the Review, it is not clear that there is adequate end of season evaluation of collaborative marketing programmes, particularly with regard to complaints about behaviour by either a collaborative marketer or Zespri.

The Review notes that, from a Zespri perspective, it is seeking to maintain top end market positioning and a number of collaborative marketing applications have been inconsistent with this criteria.

6.7.3 Criteria for assessing options

MPI has identified the following three criteria for assessing options for an improved collaborative marketing provision:

- provides certainty, predictability, and transparency for applicants, growers, Zespri and other stakeholders;
- promotes supplier choice and innovation in the marketing of kiwifruit overseas by reducing barriers to collaborative marketing arrangements; and
- protects the good returns obtained for New Zealand growers through Zespri supplied kiwifruit.

6.7.4 Option 1: Status quo with KISP variation

Under option 1, the status quo would be retained, but the KISP proposal to integrate collaborative marketing further into the industry's marketing plans would be adopted. Key areas of focus would include market development, innovation and serving customers not already served by Zespri. This would not require any changes to the Regulations.

MPI is concerned that option 1 will not go far enough to address the Review's findings with respect to collaborative marketing, particularly the issues relating to the disadvantages of short-term approvals. MPI has the following concerns with short-term approvals:

- a. greater uncertainty, reduced predictability, and high costs for a collaborative marketer if the marketer has to make new applications each year; and
- b. poor incentives for market development and seeking new markets by a collaborative marketer when there is no assurance for a long-term approval that is often required to recover the initial investment.

MPI's view is that while the intent of KISP's proposed change is good and may provide greater opportunity for collaborative marketers, there is no provision for external oversight of how this will be implemented. It will be up to Zespri how this is implemented from one season to the next.

6.7.5 Option 2: Enhance incentives for Collaborative Marketing

Option 2 draws on a number of recommendations made by the Review which have been adapted by MPI to ensure workability.

Option 2 is to:

- clarify KNZ's ability to approve multi-year collaborative marketing arrangements;
- clarify that when a collaborative marketing arrangement terminates, but substantial business value remains, KNZ can:

- suggest that Zespri purchase the collaborative marketers share of the remaining business value at a fair market price; or
- suggest that Zespri engage in a joint venture with the collaborative marketer; or
- consider approving a renewal of the collaborative marketing arrangement, either in part or in entirety, if it continues to meet the requirements for approval; and
- KNZ recommends that Zespri proactively map out collaborative marketing opportunities and make this information available to potential collaborative marketers in a timely manner.

MPI considers that this option would provide incentives for collaborative marketers to invest in market development and seek new markets. The multi-year approvals will also reduce entry barriers for collaborative marketers as they would not be required to submit new applications each year. This will give collaborative marketers greater certainty and predictability.

Option 2 could be further strengthened by amending the Regulations to clarify the criteria used by KNZ when assessing collaborative marketing arrangements. At present, KNZ is required to assess collaborative marketing applications for the purpose of increasing the overall wealth of New Zealand kiwifruit suppliers. It may be possible to provide greater clarity about how to assess the benefits to the industry of collaborative marketing applications to ensure that these support long-term growth and innovation in the industry.

A more independent KNZ board, as proposed in option 2 in section 6.5 above, would assist in implementing some of these changes. It is also proposed that KNZ includes in its three-yearly SSI how the collaborative marketing approvals will contribute to increasing the overall wealth of New Zealand kiwifruit suppliers (regulation 24), and encourage innovation in the kiwifruit industry (regulation 8(a)). The Minister would be able to use the SSI process to issue expectations to KNZ with respect to collaborative marketing and industry innovation.

Clarifying that KNZ can provide a mechanism that allows applicants to have decisions on collaborative marketing applications reviewed could further strengthen the transparency and certainty of the existing regulations. In addition, the details of a review process could be specified in the Regulations. Alternatively, they could be developed and adopted by KNZ as part of its operating procedures. The conditions of the review could either be open ended, or limited to key aspects of KNZ's decision making process (e.g. failure to give due regard to the potential benefits of the application to the kiwifruit industry).

6.7.6 Summary of options

Table 3: Summary of options for collaborative marketing

Option 1: Status Quo (KISP Variation)	<ul style="list-style-type: none"> - Generally approvals are for a year even though the Regulations do not prevent multi-year approvals. - Zespri will integrate collaborative marketing further into the industry's marketing plans.
Option 2: Enhance Incentives for Collaborative Marketing (MPI's preferred option)	<ul style="list-style-type: none"> - Make it clear that multi-year approvals (potentially renewable) are possible, with the terms being confirmed in the approval. - KNZ recommend that Zespri proactively map out collaborative marketing opportunities and make this information available to potential collaborative marketers in a timely manner. - If terminated where substantial ongoing business value remains, clarify that KNZ can recommend that:

	<ul style="list-style-type: none"> • Zespri buy this at fair market value; or • Zespri engage in a joint venture with the marketer; or • KNZ will consider approving a renewal of the collaborative marketing arrangement, either in part or in its entirety, where the requirements of approval are still met. <ul style="list-style-type: none"> - Clarify the criteria used by KNZ when assessing collaborative marketing applications. - Require KNZ to provide a process to enable applicants to have decisions on collaborative marketing applications reviewed.
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Questions:

29. Do you agree that KNZ should prepare a three-yearly statement of strategic intent, and include within it how the collaborative marketing approvals will contribute to increasing overall wealth of New Zealand kiwifruit suppliers (regulation 24) and encourage innovation in the kiwifruit industry (regulation 8(a))? Why, why not?

30. What views, if any, do you have on the proposal that it be clarified that, at the termination of a collaborative marketing arrangement, KNZ could suggest that Zespri purchase any substantial remaining business interests or enter into a joint venture with the collaborative marketer?

31. Do you think the criteria used by KNZ for assessing collaborative marketing applications should be further clarified? Why, why not?

32. Do you think it should be clarified that KNZ can provide a process for applicants to have the decision on their collaborative marketing proposals reviewed? Why, why not?

33. Please provide any other comments that you may have on option 2: Enhance incentives for collaborative marketing.

6.8 KNZ'S FUNDING

6.8.1 Description of current provision and requirements

The Regulations require that KNZ be funded on a cost recovery basis. Regulation 34 requires KNZ to “perform its functions in a manner that is as efficient and cost-effective as possible”. Regulation 39 specifies who KNZ can recover costs from and what costs KNZ may recover.

KNZ charges Zespri for all costs incurred from administering the export authorisation, the non-discrimination rule, the non-diversification rule, and the information disclosure requirements. All costs relating to collaborative marketing are recovered from collaborative marketing applicants. Those costs are calculated on the amount of time and activity expended by the board and the executive in processing and considering collaborative marketing applications.

KNZ is required to be “as efficient and cost-effective as possible.” KNZ is also prohibited from making a profit. Therefore, if KNZ over-recovers costs from either Zespri or collaborative marketers it rebates funds back to ensure a break-even financial result each year. KNZ’s view is that the “cost-effective” requirement in regulation 34 hinders good governance.

KISP proposed that KNZ's funding be made more flexible with regards to collaborative marketing, to improve uptake.

6.8.2 Review findings

The Review commented that KNZ's costs in implementing parts 2 and 3 of the Regulations (administrative costs relating to Zespri's export authorisation and operational restrictions) should continue to be met by growers, and that the costs associated with implementing part 4 of the Regulations (collaborative marketing) be met by both Zespri and collaborative marketers on a cost recovery basis.

The reviewers suggested that KNZ be funded through an export levy deducted from the grower pool. The Review concluded that a levy would provide consistent funding and would have low transaction costs.

MPI does not support a levy option for a number of reasons. In particular, many of the costs faced by KNZ are directly attributable to those that benefit from KNZ functions (e.g. export authorisations and collaborative marketing assessments). It would not be equitable to fund these types of costs through an export levy, as costs incurred by KNZ will differ for different activities. Further, a levy may reduce the incentives on collaborative marketers to submit high quality applications making them more time consuming and difficult for KNZ to consider. There is also some risk that a levy would reduce the incentives for KNZ to operate efficiently.

6.8.3 Criteria for assessing options

MPI has identified the following four criteria for assessing options for KNZ funding:

- **adequacy:** funding is predictable and stable to enable KNZ to appropriately discharge its legal obligations, including any new roles and responsibilities from any future changes to KNZ's roles;
- **efficiency:** that KNZ remains an efficient operator, and the funding model provides efficient pricing signals to users that reflect the cost of services provided and encourage the efficient use of KNZ resources;
- **transparency:** KNZ's approach to charging is developed in consultation with the industry body and affected parties, ensuring that the charges are justifiable; and
- **equitable:** funds sourced to the extent practicable from beneficiaries of the function.

6.8.4 Option 1: Status quo

As mentioned above, the Regulations currently require KNZ to operate in an efficient and cost-effective way and be funded on a cost recovery basis. MPI agrees with KNZ and KISP that the "cost-effective" requirement as currently set out in Regulation 34 could, at times, hinder good governance. For example, it does not provide KNZ with sufficient flexibility to respond quickly and appropriately in a changing environment. In addition, Regulation 34, as currently worded, could impede KNZ in undertaking new functions as proposed under the Zespri ownership and core business sections, and reporting functions outlined in this section (section 6.6) of the discussion document.

6.8.5 Option 2: Cost recovery with improved flexibility (MPI proposal)

MPI proposes to replace regulation 34 (i.e. that KNZ perform its functions in a manner that is as efficient and cost-effective as possible) with a broader requirement that KNZ's funding model promotes efficiency across the industry. This will provide KNZ with more flexibility as to how it funds its functions, particularly those for which the benefits are not immediate, or

are dispersed across a number of industry stakeholders, and where direct cost recovery is not practicable.

MPI also proposes that the Regulations be amended to allow for KNZ to apportion the costs of a particular service beyond its immediate beneficiary in situations where identifiable entities benefit indirectly from that service. This aims to ensure alignment with the adequacy, efficiency and equitable criteria identified above, and to the extent practicable, the principle that the beneficiaries of a service pay for the service.

In addition to the above, MPI proposes the following:

- a. To promote transparency, KNZ would be required to consult NZKGI at the start of each year on how it will apportion its costs and how it has considered the above matters.
- b. KNZ's approach to funding would be included in the six-yearly performance review proposed earlier in this section of the discussion paper.

MPI believes that this proposal captures the KISP proposal that funding for collaborative marketing be made more flexible. It also takes into account the outcome of the Review in regards to encouraging uptake of collaborative marketing.

While application fees can be an entry barrier for some collaborative marketing applicants, MPI notes that a number of the measures discussed under the "collaborative marketing" section of this discussion paper should go some way to reducing overall entry barriers. In particular, if Zespri (as proposed) was to compensate collaborative marketers at the expiry of a collaborative marketing arrangement for developing the market, the indirect benefits that accrue to Zespri would be equitably captured within the arrangement. Within this context, it might be preferable to charge parties directly for the costs they cause to be incurred, in particular where they accrue private benefit from the services provided by KNZ.

6.8.6 Summary of options

Table 4: Summary of options for KNZ funding

Option 1: Status Quo	<ul style="list-style-type: none"> - Keep cost recovery requirement - Current wording in Regulations is overly prescriptive and inflexible.
Option 2: Cost Recovery with Improved Flexibility (MPI's preferred option)	<ul style="list-style-type: none"> - Keep cost recovery requirement - Less prescriptive, improving the practicality and equitability of KNZ funding - Improved transparency through NZKGI engagement and provision for six-yearly reviews

Questions:

34. Of the two funding options outlined above, which do you support and why?

35: Are there any other options you prefer for KNZ funding? Please provide details and explain your reasons for supporting that option.

36. With respect to processing and monitoring collaborative marketing arrangements, should KNZ be able to apportion some of the costs to Zespri? Please explain.

7 Appendix One: Framework for assessing regulatory change

7.1 OVERRIDING OBJECTIVE

The government's interest in the Regulations is to ensure the regulatory decisions it makes are consistent with the kiwifruit industry reaching its full potential - that is, maximising its contribution to the New Zealand economy.

This will be achieved if the government's regulation promotes an industry that is an efficient producer of the fruit most valued by consumers, and the industry over time learns and innovates in a way that maximises total net returns.

In assessing options for the kiwifruit regulations, the government will have regard to the impact of any reform proposals on kiwifruit growers and their stakeholders, including:

- Potential growers
- Suppliers of goods and services (including processors, pack houses, and the communities more widely that supply the industry)
- Shareholders in Zespri
- New Zealand consumers
- Competing service providers to Zespri (e.g., R&D purchasers, marketers etc.)
- Local and central government as regulators and recipients of taxes.

The option recommended by officials to Ministers will be the option deemed to contribute the greatest net benefit to New Zealand.

7.2 CRITERIA FOR ASSESSING OPTIONS

In developing advice for Ministers, and assessing the likely impact of the different options, officials will have regard to the following criteria for assessing options:

7.2.1 Ownership

Ensure Zespri is a high-performing exporter that is delivering benefits to New Zealand. In particular ensuring that:

- the regulatory framework is durable and has the capacity to evolve to meet changing circumstances;
- Zespri can make appropriate commercial decisions to the collective benefit of its shareholders;
- Zespri is not unnecessarily impaired in raising of capital (now or in the future);
- price signals for growers and kiwifruit suppliers are not impaired;
- the individual interests of growers and shareholders (and classes of shareholders), including the ability to make their own risk management decisions, are proportionately protected; and
- Zespri's performance is enhanced through effective accountability to its shareholders and kiwifruit suppliers, and adequate regulatory oversight.

7.2.2 Core business

Ensure Zespri is a high-performing exporter that is delivering benefits to New Zealand. In particular the regulations should:

- enable opportunities for high value activities and for Zespri to make long-term investment decisions;

- ensure robust, durable, and transparent processes are in place to protect Zespri supplier and shareholder interests, proportionate to the risks; and
- appropriately manage anti-competitive risks that might arise as a consequence of Zespri expanding its activities.

7.2.3 Kiwifruit New Zealand

Ensure that KNZ has the people and systems necessary to operate an effective and efficient regulatory regime. In particular:

7.2.3.1 Governance

- have the necessary expertise available to it to make good decisions;
- in fact and appearance, be able to discharge its responsibilities impartially;

7.2.3.2 Accountability

- to enable the government to monitor the regulator's activities and performance and manage any risks in a timely manner;
- be cost-effective, flexible, and proportionate for the discharge of the regulator's functions, and adaptable for a changing industry;

7.2.3.3 Collaborative marketing

- provides certainty, predictability, and transparency for applicants, growers and other stakeholders;
- promotes supplier choice and innovation in the marketing of kiwifruit overseas by reducing barriers to collaborative marketing arrangements;
- protects the good returns obtained for New Zealand growers through Zespri-supplied kiwifruit;

7.2.3.4 Funding

- **adequacy:** funding is predictable and stable to enable KNZ to appropriately discharge its legal obligations, including any new roles and responsibilities from any future changes to KNZ's roles;
- **efficiency:** that KNZ remains an efficient operator, and the funding model provides efficient pricing signals to users that reflect the cost of services provided and encourage the efficient use of KNZ resources;
- **transparency:** KNZ's approach to charging is developed in consultation with the industry body and affected parties, ensuring that the charges are justifiable; and
- **equitable:** funds sourced to the extent practicable from beneficiaries of the function.

8 Appendix Two: Questions for submitters

8.1 QUESTIONS RELATING TO THE REGULATIONS

1. If you do not agree with the aims and objectives of the government's approach to regulation in the kiwifruit industry as outlined in section 2.4, how would you change them and why?

8.2 QUESTIONS RELATING TO ZESPRI'S OWNERSHIP

2. What risks do you see arising from increasing misalignment between Zespri shareholding and kiwifruit supply? How significant are these risks?
3. Are there other risks or challenges with the status quo that need to be considered?
4. Do you support option 1: the status quo? Why, why not?
5. Do you support option 2: KISP ownership proposal? Why, why not? Are there other benefits to greater shareholder alignment not covered in this paper?
6. Do you agree with the potential unintended consequences outlined in section 4.8.1 of this paper? Are there any factors that mitigate against these risks? Are there other risks?
7. What else needs to be considered to ensure that there are efficient price signals to growers and shareholders (e.g. updating the Information Disclosure Handbook)?
8. Do you support option 2A: KISP's proposal to delete regulations 22 and 23 in their entirety? Why, why not?
9. Do you want to retain regulations 22 and 23 to provide government oversight of future changes to Zespri's ownership and corporate form and protect the interests of shareholders and growers?
10. Do you support option 2B: Amending regulations 22 and 23 to the minimum extent to provide for the specific KISP ownership proposal but retaining regulatory oversight of any future ownership changes? Why, why not?
11. Do you support option 2C: Amend the Regulations to enable Zespri to make changes to matters addressed in regulations 22 and 23, subject to approval by grower shareholders and KNZ? Why, why not?
12. If you support option 2C, where do you think regulatory approval should sit (e.g. with KNZ, the Minister for Primary Industries or Cabinet)? Why? What additional resources or expertise would KNZ require to effectively fulfil this new function?

8.3 QUESTIONS RELATING TO ZESPRI'S CORE BUSINESS

13. Do you agree with the issues that KISP has identified with the status quo in relation to the definition of Zespri's core business? Are there any other risks or relevant considerations relating to the status quo?
14. Do you support option 1: Keep the current arrangements? Why, why not?
15. Do you support option 2: KISP proposal to expand the definition of core business through regulation? Why, why not? Is there a significant risk to the funding needed to support Zespri's non-core business activities?

16. Is it appropriate that Zespri be given greater autonomy to make decisions on current non-core business, absent the direct involvement of grower shareholders and KNZ? Why, why not?
17. Is there a risk that expanding the definition of core business would increase the barriers to entry for other service providers in the kiwifruit industry? Why, why not?
18. Do you support option 3: Allow Zespri board approval for “non-significant” non-core projects and activities? Why, why not? What might the threshold for significant look like?
19. Do you support option 4: grower shareholders voting every six years? Why, why not?
20. Do you have another option? Please provide details and reasons for supporting that option.

8.4 QUESTIONS RELATING TO KNZ’S BOARD COMPOSITION

21. Do you agree with the Review’s proposal to change KNZ board’s composition to improve the board’s independence from the industry and to provide greater ability to bring to the board a range of skills required by the board to discharge all its functions? Why, why not?
22. Board composition: What is your preferred option? Please explain why.
23. What is your view on the size of the board? Do you think the board should have five, six or seven members? Why?
24. As part of options 2A, 2B and 2C would you prefer replacing the grower-elected directors with directors appointed by NZKGI? Please explain why.
25. Would you prefer another option? Please provide details of that option and why you prefer that option.

8.5 QUESTIONS RELATING TO KNZ’S ACCOUNTABILITY AND REPORTING

26. Do you agree with a requirement for KNZ to develop three-yearly statement of strategic intent that is approved by the Minister? Why, why not?
27. Do you agree that KNZ’s performance should be independently reviewed every six years? Why, why not?
28. Is there another option or a variation of options 1 or 2 you would like to suggest? Please explain why, including the pos and cons of your proposal..

8.6 QUESTIONS RELATING TO COLLABORATIVE MARKETING

29. Do you agree that KNZ should prepare a three-yearly statement of strategic intent and include within it how the collaborative marketing approvals will contribute to increasing the overall wealth of New Zealand kiwifruit suppliers (regulation 24) and encourage innovation in the kiwifruit industry (regulation 8(a))? Why, why not?
30. What views, if any, do you have on the proposal that it be clarified that, at the termination of a collaborative marketing arrangement, KNZ could suggest that Zespri purchase any substantial remaining business interests or enter into a joint venture with the collaborative marketer?

31. Do you think the criteria used by KNZ for assessing collaborative marketing applications should be further clarified? Why, why not?
32. Do you think it should be clarified that KNZ can provide a process for applicants to have the decision on their collaborative marketing proposals reviewed? Why, why not?
33. Please provide any other comments that you may have on option 2: Enhance incentives for collaborative marketing.

8.7 QUESTIONS RELATING TO KNZ'S FUNDING

34. Of the two funding options outlined in section 6.8, which do you support and why?
35. Are there any other options you prefer for KNZ funding? Please provide details and explain your reasons for supporting that option.
36. With respect to processing and monitoring collaborative marketing arrangements, should KNZ be able to apportion some of the costs to Zespri? Please explain.