



Proposed Amendments to the Kiwifruit Export Regulations 1999

Regulatory Impact Statement

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1 Agency disclosure statement

This Regulatory Impact Statement (RIS) has been prepared by the Ministry for Primary Industries (MPI). It provides an analysis of proposals to amend the Kiwifruit Export Regulations 1999 (the Regulations) to ensure that New Zealand's kiwifruit industry is well positioned to take advantage of current and future opportunities for growth and to achieve the best returns for kiwifruit growers.

While the underlying intent and scope of the Regulations remain generally 'fit for purpose', a MPI commissioned independent review of Kiwifruit New Zealand (the regulator) and MPI analysis of a self-initiated industry review, have identified a discrete set of regulatory problems to be addressed. These are:

- the increasing concentration of voting power amongst growers;
- the restrictive definition of Zespri's core business and the burdensome process for decisions about non-core business activities; and
- the governance, accountability and funding arrangements for Kiwifruit New Zealand that don't align with best practice.

MPI has considered a range of alternative options for addressing the problems. The analysis of the options, which is contained in this RIS, has been informed by feedback on a public discussion document released by MPI in early 2016. It has also been informed by feedback from government agencies, including the Treasury, Ministry for Business, Innovation and Employment and the Ministry of Foreign Affairs and Trade.

Subsequent to public feedback on the discussion document and input from government agencies, MPI has continued to develop and refine the recommended options. Further, more targeted consultation with Zespri, Kiwifruit New Zealand, and New Zealand Kiwifruit Growers Incorporated (NZKGI) has been undertaken on the final proposals.

All options have been assessed against the objectives of improving the certainty, effectiveness and administrative efficiency of the Regulations. As the Regulations could have implications for New Zealand's international trade obligations, careful consideration has been given to ensuring the options are consistent with these. Similarly, some options proposed by the industry had the potential to impact on private property rights associated with share ownership, and the analysis has identified and addressed this where appropriate.

The analysis has also considered the potential impact of proposals on competition within various parts of the kiwifruit sector within which Zespri operates. However, as the proposals seek to recognise Zespri's current practice, and work shows competition is already evident, we do not consider the proposals have any significant regulatory impacts on competition that require further analysis or management.

The nature of these proposals does not lend itself to a standard form of cost benefit analysis, as the proposals relate mainly to governance arrangements, ownership structures and the clarification of existing and future functions. The analysis has relied heavily upon qualitative analysis and expert industry opinion, which is referenced through the RIS.

Despite the absence of a formal cost-benefit analysis, we are confident that the proposed amendments to the Regulations will result in substantial net benefits to kiwifruit growers as well as the wider public through the continued growth and strengthening of the kiwifruit industry. Key examples of the expected benefits include: reduced compliance costs for Zespri and Kiwifruit New Zealand; increased confidence of our overseas trading partners in New

Zealand's regulatory systems; and significant and sustained investment by the industry in innovation and productivity improvements, relevant not only to kiwifruit, but potentially a number of other horticulture sectors also.

We do not believe there are any other substantial gaps in the analysis. Our proposed monitoring of the changes will assist us to gauge the extent to which the impacts meet expectations.

Jarred Mair, Director Sector Policy, Ministry for Primary Industries

8 July 2016

2 Executive summary

1. New Zealand's kiwifruit industry is a regulated industry. The Kiwifruit Industry Restructuring Act 1999 (the Act) and the Kiwifruit Export Regulations 1999 (the Regulations) establish Zespri as the single desk exporter of New Zealand-grown kiwifruit, except to Australia. The Regulations seek to balance the benefits generated from a single desk export structure with mitigating the risks for growers associated with having a monopsony¹ buyer for their kiwifruit.
2. The recent reviews of the Regulations and the regulator (Kiwifruit New Zealand) have identified a discrete set of regulatory problems that need to be addressed. These are:
 - the increasing concentration of Zespri share ownership and potential misalignment with the interests of growers;
 - the restrictive definition of Zespri's core business and the burdensome process for decisions about non-core business activities; and
 - the governance, accountability and funding arrangements for Kiwifruit New Zealand that don't align with best practice.
3. The overriding purpose of reviewing the Regulations is to ensure that New Zealand's kiwifruit industry is well positioned to take advantage of current and future opportunities for growth, and to achieve the best returns for kiwifruit growers and New Zealand. Therefore, any changes to the Regulations to address the above problems must enhance and/or contribute to one or more of the following objectives:
 - provide more certainty (for example, Zespri is able to undertake its business activities and make long-term investment decisions, and shareholders' and suppliers' private property rights are protected);
 - enhance effectiveness (for example, the Regulations are practical, durable, enforceable, and the likelihood of compliance is increased); and
 - be administratively efficient (for example, costs and risks to the Crown, Zespri, shareholders and suppliers and Kiwifruit New Zealand from complying with the Regulations, and any other associated costs are reasonable and in proportion to the risks being managed).
4. This Regulatory Impact Statement (RIS) considers options to address the identified problems. The options have been publicly consulted on through the release of a public discussion document in February 2016. A number of government agencies have also been consulted, including the Treasury, Ministry for Business, Innovation and Employment and the Ministry of Foreign Affairs and Trade.
5. Most of the options originally outlined in the discussion document have been revised to reflect the input and views of submitters and government agencies. Further targeted consultation with key stakeholders on the revised proposals has been undertaken.
6. Analysis of competition, international trade, and private property right impacts of each option has been undertaken. In addition, wider 'best practice' approaches across government for establishing governance, accountability and funding arrangements for industry regulators have been taken into account.

¹ A monopsony is a market arrangement in which there is one dominant buyer.

7. As a result of the analysis and consultation, a package of regulatory amendments is being recommended. These include changes to:
- enable all Zespri shareholders, regardless of levels of supply, to vote to amend its constitution to restrict dividend payments and set rules about maximum shareholdings in the same way shareholders of other companies can under the Companies Act 1993;
 - provide greater certainty and clarity with respect to Zespri’s core business and improve the process for making decisions about non-core business activities by:
 - adding marketing and market development of New Zealand grown kiwifruit, and kiwifruit research and development to the definition of core business; and
 - amending the point at which shareholder and supplier approval must be sought for non-core business activities from being activities “not necessary” for core business, to activities that “do not support” core business; and
 - requiring approval of over 75 percent of shareholders and suppliers voting for non-core activities, with the risk exposure to those who do not agree being minimised as far as reasonably practical.
 - provide for two additional independent directors and an independent chair to be appointed on the Kiwifruit New Zealand board – with the appointment by the Minister from a list compiled by MPI, in consultation with Kiwifruit New Zealand, for skills and expertise identified as necessary by the board;
 - improve Kiwifruit New Zealand’s reporting and accountability by requiring three-yearly statements of intent (SOI) for Ministerial approval, annual engagement with MPI on performance, and six-yearly independent reviews of performance;
 - provide more clarity, flexibility and certainty to Kiwifruit New Zealand’s funding, and align it with established cost recovery principles; and
 - encourage and facilitate a greater focus on collaborative marketing by Zespri and Kiwifruit New Zealand.
8. The recommended regulatory amendments outlined in this document will ensure that the industry as a whole is better positioned to take advantage of emerging opportunities for growth, and is best-placed to continue its strong performance in forthcoming years.

3 Background

3.1 NEW ZEALAND'S KIWIFRUIT INDUSTRY

9. By volume, New Zealand is the second largest kiwifruit exporting country after Italy and holds approximately 30 percent of the global market share of kiwifruit exports.
10. By value, New Zealand is the largest kiwifruit exporting country. Growing steadily over the past thirty years, kiwifruit is now one of New Zealand's major export industries and most valuable horticulture export. 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.
11. Zespri is New Zealand's primary exporter of kiwifruit to all countries other than Australia. Zespri currently exports approximately 94 percent of New Zealand's total kiwifruit crop. It had global sales of about \$1.9 billion for the year to 31 March 2016, of which \$1.7 billion came from the sale of New Zealand-grown kiwifruit.² Zespri currently sells kiwifruit in 53 countries.
12. There are approximately 2,500 kiwifruit growers that supply Zespri. Total orchard gate returns per hectare of kiwifruit grown have increased from just under \$30,000 in 2005/06 to nearly \$65,000 in 2015/16, due largely to the commercialisation of Zespri's gold kiwifruit cultivars, Zespri's marketing activities, as well other innovations that have increased orchard productivity.
13. Forecasts for growth are also strong. In 2015/16, Zespri exported about 130 million trays of New Zealand-grown kiwifruit, and sold nearly 15 million trays of overseas-grown kiwifruit. By 2020/21, Zespri forecasts that it will export about 180 million trays of New Zealand-grown kiwifruit, and will sell an additional 30 million trays of overseas-grown kiwifruit.
14. The vast bulk of the industry is centred in the Bay of Plenty. In 2015/16, the top three kiwifruit growing towns were Te Puke (\$500 million), Tauranga (\$145 million), and Katikati (\$120 million). Outside of the Bay of Plenty, kiwifruit contributed \$40 million to the Northland's regional economy, the next largest growing region.
15. Industry production volumes have fully recovered from the impact of the Psa-V³ virus which was first detected in late 2010. This is largely due to the coordinated response and rapid replacement of the Hort16A gold kiwifruit cultivar (which was susceptible to the bacteria) with the g3 cultivar (which is resistant to the bacteria).
16. The g3 cultivar is one outcome of Zespri's significant investment in research and development. Zespri has an annual research and development spend of \$25 million, of which \$10 million is spent on its long-term plant breeding programme. Zespri has the largest kiwifruit cultivar development programme in the world. Successful kiwifruit varieties can take over 10 years to develop.

² Zespri also sells kiwifruit grown in overseas markets in order to maintain 12 month supply to customers.

³ *Pseudomonas syringae* pv. *actinidiae* (Psa-V) is a bacteria that can result in the death of kiwifruit vines.

3.2 THE REGULATORY MODEL

17. The Kiwifruit Industry Restructuring Act 1999 (the Act) and the Kiwifruit Export Regulations 1999 (the Regulations) set the current industry structure. The Act and Regulations establish Zespri 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’ or ‘single desk’. The Regulations make some provision for other marketers to export kiwifruit through collaborative marketing arrangements with Zespri, but this is relatively small proportion of New Zealand’s overall kiwifruit exports.⁴
18. 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 a monopsony buyer of New Zealand-grown kiwifruit for export.
19. The single desk arrangement has enabled the kiwifruit industry to improve the value of exports by making use of economies of scale, setting standards for high fruit quality, developing markets, and investing in research and development. This has assisted Zespri to compete effectively on the international stage, and to develop and maintain a premium for its kiwifruit. Kiwifruit growers benefit from the price that Zespri pays for their fruit.
20. While the single desk supports the industry to achieve a premium for their fruit, it also creates a number of risks. The single desk:
 - concentrates risk throughout the industry. Kiwifruit growers are reliant on the price that Zespri pays for their produce. If Zespri’s strategy is not successful, the industry as a whole does not perform well;
 - captures kiwifruit growers. With a captured supply, the incentives on Zespri to operate in a cost effective way and to offer its suppliers a top price for their kiwifruit are reduced; and
 - concentrates market power, which, unless safeguarded against, could be used for anti-competitive gains. Domestically, the kiwifruit industry is fully competitive and any firm can invest in on-shore post-harvest services, in kiwifruit-related business activities, and (with approval) can export kiwifruit in collaboration with Zespri. However, unless appropriately monitored, Zespri could leverage its privileged export right to compete against other firms in the kiwifruit industry.
21. The Regulations aim to balance the benefits that can be generated from a single desk export structure while mitigating the associated risks. To mitigate the potential risks to captured suppliers and shareholders, the Regulations set out three rules and requirements controlling aspects of Zespri’s operation:
 - 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;

⁴ In 2014/15, 2 percent of New Zealand grown kiwifruit were exported to countries other than Australia through collaborative marketing arrangements with Zespri.

- the non-diversification rule (regulation 11) – prohibits Zespri from undertaking activities that are not necessary for its core business unless providers of capital have approved the activity, and the activity does not expose those who have not agreed to more than a minimal risk; and
 - 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.⁵
22. The Regulations also 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.
23. The Regulations are bolstered by other regulatory frameworks, such as the Companies Act 1993 and the Commerce Act 1986, which also apply to the kiwifruit industry.
24. Other provisions of the Regulations that are directly relevant to proposals considered in this document include:
- regulations 22 and 23 seek to ensure that Zespri is operating in the interests of kiwifruit growers by only allowing kiwifruit growers to purchase shares, and by tying the voting rights of those shares to shareholders’ supply of kiwifruit to Zespri;
 - regulations 2 and 11 give shareholders and suppliers additional opportunities to manage their risk / return exposure to Zespri’s business activities that are not necessary for the purchase and export of New Zealand-grown kiwifruit; and
 - regulations 32 - 41 establish Kiwifruit New Zealand as the independent regulator of Zespri, whose role is to implement the mitigation measures contained in the Regulations and consider applications for collaborative marketing.

3.3 THE KIWIFRUIT INDUSTRY STRATEGY PROJECT

25. In 2013, the kiwifruit industry, including Zespri and NZKGI, initiated a review of its own institutions and operations through the Kiwifruit Industry Strategy Project (KISP). The purpose of the review was to determine how the industry could best take advantage of emerging opportunities for growth in a changing global business environment.
26. The KISP review resulted in eight proposals for reform (outlined below). In March 2015, the industry held a referendum to determine support for the proposals, in which every kiwifruit grower who supplies Zespri was entitled to vote. All of the proposals received over 90 percent support from those growers who voted.⁶ The KISP proposals were:

Proposal 1 reconfirm grower support for single point of entry.

⁵ The Director General 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.

⁶ 65 percent of growers by number and 80 percent of growers by volume voted in the industry organised referendum.

- Proposal 2 align the ownership of Zespri shares with its 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 four 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 enable New Zealand Kiwifruit Growers Incorporated to appoint an independent director on the Kiwifruit New Zealand board, if required, 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.

- 27. Proposals 1, 3, 4, 5 and 8 do not require any changes to the Regulations to be implemented. These are decisions that the industry is best placed to take. As such, with the exception of proposal 8, these proposals are not examined in detail in this RIS.
- 28. Proposals 2, 6, and 7 require changes to the controls and restrictions established by the Regulations and therefore are assessed in the analysis below. Proposal 8 is also considered due to the effectiveness of the implementation of the collaborative marketing provisions playing a critical role in how well the Regulations manage the risks associated with the single desk.

3.4 GOVERNMENT’S RESPONSE TO KISP AND THE SCOPE OF THE REGULATORY REVIEW

- 29. In April 2015, the Minister for Primary Industries received a request from the industry to change the Regulations to support the KISP reform process. The Minister for Primary Industries agreed to review the Regulations to determine their fit for purpose and determine whether to give effect to the intent of the KISP proposals.
- 30. The Minister for Primary Industries also asked MPI to review Kiwifruit New Zealand to determine whether its design and operation remain fit for purpose. To this end, MPI commissioned the Institute for Business Research at Waikato University to undertake an independent review of Kiwifruit New Zealand (i.e. ‘the independent review’). The review concluded that consideration should be given to amending the requirements

relating to Kiwifruit New Zealand's funding, governance, and accountability settings. The overall aim of the proposed amendments is to strengthen the capability, skills, and independence of Kiwifruit New Zealand as a regulator, and to establish greater government oversight and monitoring of Kiwifruit New Zealand's performance.

31. On 22 February 2016, Cabinet authorised MPI to release a discussion document to seek public submissions on proposed amendments to the Regulations. The proposals drew on both MPI analysis of the KISP proposals and the findings of the independent review.
32. In total, 33 submissions were received, including a form submission from 769 signatories organised by the grower organisation New Zealand Kiwifruit Growers Incorporated (NZKGI). Submissions were received from a range of stakeholders in the kiwifruit industry including: kiwifruit growers, pack house operators, collaborative marketers, owners of proprietary varieties of kiwifruit, Zespri, NZKGI, and Kiwifruit New Zealand. Submissions were also received from the Chilean Exporters Council, the Chilean Ministry of Foreign Affairs, and Shantou Long Full (based in China).

4 Problem definition

33. While the underlying intent and scope of the Regulations remain generally ‘fit for purpose’, the work by KISP, the independent review of Kiwifruit New Zealand, and feedback on the discussion document indicates that they need to be updated to accommodate more recent changes in the kiwifruit industry and in the global fruit market. There are three main areas where the Regulations require updating that are addressed in this RIS:
- ownership of Zespri shares – over time, the ownership of Zespri shares has become concentrated in a smaller group of kiwifruit growers. This is a problem because the ownership of Zespri shares is a key way in which the Regulations provide for growers to retain control over the export and sale of their kiwifruit.
 - Zespri’s core business – the regulations are overly restrictive of the core business activities that Zespri can undertake without seeking Kiwifruit New Zealand and/or shareholder and supplier approval, and do not reflect the types of activities expected of an effective value maximising single desk exporter. This imposes unnecessary compliance costs on Zespri and creates ongoing uncertainty around decisions to invest in long-term, strategic projects such as the plant breeding programme, or innovative consumer products.
 - regulatory oversight - Kiwifruit New Zealand’s governance, funding and accountability requirements need to be updated to align with best practice for a regulator of an industry the size and importance of New Zealand’s kiwifruit industry.
34. Comprehensive problem definitions for each of the three issues are contained in the relevant analysis sections of this RIS.

5 Objectives of the review

35. The overriding purpose of reviewing the Regulations is to ensure that New Zealand’s kiwifruit industry is well positioned to take advantage of current and future opportunities for growth and achieve the best returns for kiwifruit growers and New Zealand.
36. The Regulations seek to balance the benefits that can be generated from a single desk export structure while mitigating the associated risks.
37. Any changes to the Regulations must enhance and/or contribute to one or more of the following objectives:
- provide more certainty (for example, Zespri is able to undertake its business activities and make long-term investment decisions, and shareholders’ and suppliers’ private property rights are protected);
 - enhance effectiveness (for example, the Regulations are practical, durable, enforceable, and the likelihood of compliance is increased); and
 - be administratively efficient (for example, costs and risks to the Crown, Zespri, shareholders and suppliers, Kiwifruit New Zealand (the regulator) from complying with the Regulations, and any other associated costs are reasonable and in proportion to the risks being managed).

6 Scope

38. The recommendations and other enhancements discussed in this regulatory impact statement can be grouped as follows:
- Zespri's share ownership;
 - Zespri's core business; and
 - Kiwifruit New Zealand:
 - board composition;
 - reporting and accountability;
 - funding; and
 - collaborative marketing.
39. The regulatory impact analysis for each of these areas is addressed in turn below.
40. Changes to the industry's single desk export structure are outside the scope of the review of the Regulations. As such, no analysis has been undertaken on the relative pros and cons of the single desk export structure or any potential alternative arrangements. Issues relating to the single desk export structure are also not discussed, except to the extent they are relevant to addressing the issues listed in paragraph 33 above.

7 Zespri's share ownership

7.1 BACKGROUND

41. When the Act established Zespri as the single desk exporter in 1999, shares in Zespri were vested in the producers of kiwifruit as at 31 March 2000 based on the supply history of their land. The intent was to ensure that the growers of kiwifruit retained control over Zespri, the monopsony buyer of their fruit, and that Zespri conducted its business in a way that best served the interests of suppliers.
42. The Act establishes Zespri as a company under the Companies Act 1993, and Zespri must act in accordance with this Act. However, the Regulations provide some exceptions to the Companies Act to ensure regulatory oversight of key aspects of Zespri's corporate form and constitution, as well as provide additional protections to shareholders that are not provided in the Companies Act 1993. In particular:
 - Regulation 22 covers matters relating to Zespri's corporate form and its constitution, including, inter alia:
 - enabling orchard leaseholders with a lease of at least one year to be considered a producer for the purpose of share ownership and trading; and
 - preventing Zespri making rules about maximum shareholding (e.g. implementing a share cap).
 - Regulation 23 amends default settings under the Companies Act 1993, including, inter alia:
 - preventing Zespri from not paying an equal dividend on all shares; and
 - preventing Zespri from not distributing an equal share of any surplus assets.
43. Regulation 23 was amended in 2001 to enable Zespri to limit shareholders' voting rights based on the supply of kiwifruit through its constitution. This was to ensure participation in decision making reflected the level of shareholders investment in growing. As a consequence, while each share in Zespri provides one voting right, this is subject to a cap, with the maximum votes limited by each shareholder's proportion of supply. This means that shareholders who do not supply Zespri with kiwifruit (i.e. dry shareholders) do not have voting rights. Under the Regulations, dry shareholders are entitled to receive dividends.⁷
44. Only producers of kiwifruit (growers) are able to buy shares in Zespri, although there is no requirement for producers to own shares, and there is no requirement that shareholders sell their shares when they sell their orchard (hence the existence of dry shareholders).
45. There is no limit on shareholdings and shares are fully tradable among kiwifruit producers, using the existing trading platform. The share price is set through the interaction of demand and supply, although shares are traded infrequently and the market has little liquidity. For example, in 2013/14, Zespri reported that out of a total of

⁷ It should be noted that dry shareholders voted to amend Zespri's constitution such that their voting rights would be restricted. This would have been done on the basis however, that the Regulations protect their ability to receive dividends.

120,717,335 shares on issue, approximately five percent, or six million shares, changed hands. Other key statistics include:

- around 20 percent of growers don't own shares and therefore don't vote on Zespri's business decisions or receive dividends;
- around 16 percent of shares are owned by dry shareholders;
- around 24 percent of shares do not have voting rights attached to them (i.e. due to restrictions based on supply); and
- around 1.6 percent (35 shareholders) of the total number of shareholders (2,108) own total shares more than four times their level of supply of kiwifruit.

7.1.1 Problem

46. The problem with share ownership is the growing misalignment between the ownership of shares in Zespri and the interests of growers. This misalignment is evidenced by the increasing numbers of dry shareholders (16 percent), the number of growers who don't own shares in Zespri (20 percent), and the number of shares with no voting rights (24 percent).
47. There is a risk that the misalignment between share ownership and grower interests reduces the effectiveness of the governance and regulatory arrangements within the industry because:
 - the protections available to growers from Zespri's monopsony power are weakened if they do not own shares in Zespri;
 - Zespri management cannot act in the best interests of growers if growers are not voting as shareholders and making their interests known; and
 - a smaller group of grower interests are exercising voting rights that do not necessarily reflect the diverse views of all growers.
48. Ultimately, it will become increasingly difficult for government and other stakeholders to remain confident that Zespri is acting for the benefit of all New Zealand's kiwifruit growers, rather than for minority interests.
49. The misalignment is expected to increase in the future, with the associated impacts becoming more acute. This is because many growers are nearing retirement (the average age is 63 years) and likely wanting to sell their orchard, but retain their shares to receive a dividend.
50. KISP was also concerned that enabling share ownership by lease holders with leases of less than 3 years could exacerbate dry shareholdings, if these lease holders purchased shares and did not continue to invest in growing.
51. Zespri has previously sought to address misalignment through encouraging non-shareholding growers to buy shares and offering a share buy-back.⁸ According to Zespri, these efforts have been relatively unsuccessful. This could be for a range of reasons. For example, the incentives to hold shares to receive dividends are strong and the price offered by Zespri previously may not have been sufficiently attractive. There

⁸ Zespri offered a share buy-back in 2005. This resulted in a reduction in the number of dry shareholders from 389 to 289, and the total number of shares held by dry shareholders from 1.9 million to 1.5 million. Currently, about 1.9 million shares are held by dry shareholders.

are also a range of reasons why growers don't own shares, including personal choice, alternative investment strategies, and affordability, particularly for new entrants to the industry.

52. Under the status quo, Zespri is unable to address misalignment in the same way that other companies may choose to under the Companies Act 1993, because the Regulations prevent it from restricting dividend payments and setting rules about maximum shareholdings.

7.2 OPTIONS

7.2.1 Option 1: Status Quo

53. Under this option, the status quo (outlined above) would continue.
54. Most submitters on the discussion document supported the need to achieve alignment within the industry. Submitters who supported the status quo generally did so because they believed that the alternative proposal of imposing a share cap and restricting dividends would unduly interfere with property rights and the operation of the market. Submitters who opposed the status quo did so because it would not achieve alignment.

7.2.2 Option 2: KISP proposal for share ownership

55. KISP proposed that the existing regulations (i.e. regulations 22 and 23) be removed in their entirety so that Zespri can seek shareholder support to achieve ownership alignment in the same way any other company would, through changes to its constitution. In particular, KISP recommended that Zespri amend its constitution to:
 - set the lease period at 3 years;
 - restrict dividend payments to dry shareholders to incentivise them to divest their shareholdings;
 - cap individual shareholding entitlements at 4 times the level of kiwifruit supplied; and
 - give leaseholders priority over landowners in share ownership.
56. Submitters on the discussion document who supported this option did so because it would achieve alignment. Submitters who opposed this option did so because it would remove additional protections contained in regulations 22 and 23 that protect shareholders as well as the ongoing government and regulatory oversight of Zespri's corporate structure.

7.2.3 Option 3: Targeted amendments to achieve KISP proposals

57. Under option 3, targeted regulatory amendments would be made to achieve the specific outcomes sought by KISP as outlined in paragraph 55 above. This would include changing the period of a lease required to purchase or trade shares from 1 year to 3, and enabling Zespri to limit dividend payments to shareholders based on the supply of kiwifruit. The provision preventing rules on maximum shareholdings would be amended to enable Zespri to set a share cap based on kiwifruit supply.

58. There were many submitters on the discussion document who supported this option. They did so because it provided for alignment, while retaining relevant government oversight. Those submitters who did not support this option did so because it was not what the industry had requested, or because the option may unduly affect private property rights.

7.2.4 Option 4: Empower Kiwifruit New Zealand to change regulations

59. Under option 4, Kiwifruit New Zealand (the regulatory body) would be given the power to approve alterations to the relevant regulations (i.e. regulations 22 and 23) for the purpose of achieving the KISP recommendations. Any changes made by Kiwifruit New Zealand would be subject to the approval of Zespri's shareholders.

60. Feedback on the discussion document indicated that submitters were not comfortable with the proposal that Kiwifruit New Zealand have the power and authority to change regulations. Many felt that it was the role of Government to make regulations, and the role of MPI to be responsible for the underlying policy decisions. Only Kiwifruit New Zealand supported this proposal.

7.2.5 Option 5: Prevent non-suppliers from owning shares, but provide for existing dry shareholders to receive compensation

61. Option 5 involves amending the Regulations to clarify that only those supplying Zespri with kiwifruit can hold shares in Zespri. A transition period of seven years (as suggested by KISP) would be provided to enable those not complying with this requirement to divest their shares. Existing dry shareholders would be given a power similar to that contained in sections 110 and 118 of the Companies Act for interest groups to require Zespri to buy their shares. Regulatory amendment would also be made to enable Zespri to cap future shareholdings based on supply.

62. The lease period would not be changed to avoid distorting investment signals through regulation (i.e. giving preference to one form of investment in kiwifruit growing over another) and restricting Zespri's future ability to raise capital.

63. This option was developed following the receipt of feedback on the discussion document and therefore the views of stakeholders are not known. This option was developed on the basis of concerns raised in relation to options 2 and 3 about the impact on personal property rights and the operation of the market.

7.2.6 Option 6: Enable Zespri to act as any other company under the Companies Act 1993 [recommended option]

64. Under option 6, the Regulations would be amended to enable Zespri to operate as any other company under the Companies Act 1993 to:

- restrict dividend payments to shareholders; and
- impose rules about maximum shareholdings.

65. The exercise of this power would be subject to the making of a Special Resolution⁹ under Section 106 of the Companies Act, in which all shareholders, regardless of supply, are entitled to vote. This would give dry shareholders and overshared shareholders back their full voting rights on decisions about these specific issues, but nothing else.
66. Assuming dry shareholders and/or overshared shareholders are identified as an ‘interest group’ for the purposes of the Special Resolution, the protections available under section 117(1) of the Companies Act 1993 would be available. This means that those not supporting a successful vote could require Zespri to buy their shares at a fair and reasonable price.
67. It seems likely that dry and overshared shareholders would be considered ‘interest groups’ for the purpose of voting on decisions about maximum shareholdings and restricting dividend rights. However, this is a matter for Zespri to determine when implementing the relevant provisions of the Companies Act.
68. Under option 6, the lease period would not be changed to avoid distorting investment signals through regulation (i.e. giving preference to one form of investment in kiwifruit growing over another) and restricting Zespri’s future ability to raise capital.
69. This option was developed following the receipt of feedback on the discussion document. While the views of the wider sector on this option are not known, MPI has discussed it with Zespri, Kiwifruit New Zealand and NZKGI. All of these stakeholders supported this proposal.

7.3 IMPACT ANALYSIS

70. Table 1 below sets out options 1 to 6 for the ownership of Zespri shares, and assesses them against the criteria of certainty, effectiveness, and administrative efficiency. An overall assessment/conclusion of each option is provided.

⁹ **Special resolution** means a resolution approved by a majority of 75 percent or, if a higher majority is required by the constitution, that higher majority, of the votes of those shareholders entitled to vote and voting on the question.

Table 1: Analysis of options for improving alignment between the ownership of Zespri shares and the interests of growers

Options	Certainty (for the Crown, Zespri (e.g. roles, responsibility, investment), shareholders and suppliers (e.g. property rights), and the regulator)	Effectiveness (regulations achieve purpose, are practical, durable, enforceable, and likelihood of compliance is increased)	Efficiency (does not impose unreasonable costs on regulator, shareholders and suppliers, sector, New Zealand, or the Crown)	Conclusion
Option 1: Status quo	<p style="text-align: center;">-/+</p> <ul style="list-style-type: none"> • additional protections for shareholders and suppliers share entitlements not provided in the Companies Act • certainty about treatment of leases for purposes of share ownership and trading • reduced supplier input to Zespri decision making means Zespri uncertain if its acting in best interests of all growers • reduced supplier representation as shareholders means Government uncertain monopsony acting in best interests of suppliers 	<p style="text-align: center;">-/+</p> <ul style="list-style-type: none"> • provides regulatory oversight of Zespri's corporate form, share ownership, and key aspects of its constitution • misalignment between share ownership, voting rights and grower interests is reducing grower control over Zespri's decision making and business activities and undermining the effectiveness of the regulations • growing misalignment means regulations are not durable in longer term 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> • Zespri unable to address matters relating to share ownership in same ways other companies can under the Companies Act • dry shareholders unable to vote on matters affecting their share ownership and dividend payments 	Partially meets objectives
Option 2: KISP proposal for share ownership	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> • removing all regulatory oversight and protections may provide Zespri with more control than intended by KISP proposals • Zespri still reliant on shareholder agreement to improve alignment 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> • no future regulatory oversight of Zespri's corporate form, share ownership or key aspects of constitution • high risk of unintended consequences associated with removing regulations in entirety • nothing in regulation to prevent dry shareholdings occurring again in future 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> • full flexibility for Zespri to achieve the KISP alignment proposals through constitution • dry shareholder's dividend entitlements removed without an opportunity to vote and no guarantee of compensation • legal and financial risk to Crown from impact on shareholders private property rights through de-regulation • increasing lease period to 3 years may disincentivise investment in growing and restrict Zespri's ability to raise capital in future 	Does not meet objectives
Option 3: Targeted amendments to achieve KISP proposals	<p style="text-align: center;">-/+</p> <ul style="list-style-type: none"> • provides the industry with certainty that Zespri can act to implement the KISP proposals • risk that ability to restrict dividends could be used for unforeseen purposes 	<p style="text-align: center;">-/+</p> <ul style="list-style-type: none"> • regulatory oversight of Zespri's corporate form, share ownership or key aspects of constitution retained • less risk of unintended consequences than option 2 • nothing in regulation to prevent dry shareholdings occurring again in future 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> • dry shareholder's dividend entitlements removed without an opportunity to vote and no guarantee of compensation • legal and financial risk to Crown from impact on shareholders private property rights through regulation • increasing lease period to 3 years may disincentivise investment in growing and restrict Zespri's ability to raise capital in future • concern from some stakeholders that regulation is being used where commercial solutions should be available 	Partially meets objectives

Options	Certainty (for the Crown, Zespri (e.g. roles, responsibility, investment), shareholders and suppliers (e.g. property rights), and the regulator)	Effectiveness (regulations achieve purpose, are practical, durable, enforceable, and likelihood of compliance is increased)	Efficiency (does not impose unreasonable costs on regulator, shareholders and suppliers, sector, New Zealand, or the Crown)	Conclusion
Option 4: Empower Kiwifruit New Zealand to change regulations	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> stakeholders unlikely to support Kiwifruit New Zealand undertaking this role unclear for other stakeholders (Zespri, Crown) as to what amendments will be made 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> concern about whether Kiwifruit New Zealand and shareholders have sufficient expertise or understanding to develop regulations inappropriate for regulator to develop regulations it then enforces (lack of transparency, risk of bias) 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> likely to be difficult and time consuming process to achieve agreement significant cost to Kiwifruit New Zealand to acquire necessary capability and capacity shareholders with no voting rights and suppliers without shares won't be able to participate in decisions affecting their rights and entitlements concern from some stakeholders that regulation is being used where commercial solutions should be available 	<p style="text-align: center;">Does not achieve the objectives</p>
Option 5: Prevent non-suppliers from owning shares, but provide for existing dry-shareholders to receive compensation	<p style="text-align: center;">+</p> <ul style="list-style-type: none"> establishes clear process for addressing misalignment certainty for all shareholders and growers that must supply kiwifruit to own shares 	<p style="text-align: center;">+</p> <ul style="list-style-type: none"> ensures no future dry shareholdings narrow and targeted amendments so less risk of unintended consequences than options 2, 3 and 4 provides adequate time to transition to new arrangements and for dry shareholders to choose how they divest their shares 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> imposes direct cost on Zespri by requiring them to compensate dry-shareholders if requested distorts market that dry shareholders and others can sell shares into by imposing timeframe dry shareholder's dividend entitlements removed without an opportunity to vote legal and financial risk to Crown from impact on shareholders private property rights through regulation those wanting to become dry shareholders may feel aggrieved that they won't receive same compensation for shares as existing dry shareholders 	<p style="text-align: center;">Partially meets objectives</p>
Option 6: Enable Zespri to act as any other company under the Companies Act 1993	<p style="text-align: center;">+</p> <ul style="list-style-type: none"> certainty for all stakeholders that provisions of Companies Act apply enables Zespri to act to address this issue with access to same options as any other company gives all shareholders back their full voting rights for decisions affecting their share entitlement and dividends provides same protections for all shareholders (including those whose votes have been previously restricted) as other shareholders receive under the 	<p style="text-align: center;">+</p> <ul style="list-style-type: none"> enables Zespri to have access to full range of commercial options to address issues relating to share ownership seems unlikely that dry shareholders will vote in support of restricting their dividend rights, however there are a number of alternative options available to Zespri to achieve alignment on commercial terms, such as issuing new shares or offering to buy-back shares at a higher price than previously offered there is a small risk that overshared 	<p style="text-align: center;">+</p> <ul style="list-style-type: none"> individual property rights protected as all shareholders have ability to vote on any changes affecting their share entitlements enables Zespri to develop proposed rule changes on terms that are likely to be attractive to affected shareholders minimises legal and financial risk to the Crown as no direct impact on property rights through regulation could be costs to Zespri associated with buying back shares from affected shareholders, although this is consistent with a commercial resolution of the current alignment issues 	<p style="text-align: center;">Fully meets objectives</p>

Options	Certainty (for the Crown, Zespri (e.g. roles, responsibility, investment), shareholders and suppliers (e.g. property rights), and the regulator)	Effectiveness (regulations achieve purpose, are practical, durable, enforceable, and likelihood of compliance is increased)	Efficiency (does not impose unreasonable costs on regulator, shareholders and suppliers, sector, New Zealand, or the Crown)	Conclusion
	<p>Companies Act</p> <ul style="list-style-type: none"> • no guarantee that dry and overshared shareholders will be considered 'interest groups' under the Companies Act by Zespri, • small risk that the government is perceived as supporting the restriction of dividends to dry shareholders, some of whom have deliberately retained Zespri shares to provide a source of retirement income. However, under the proposal, any move to do this would likely require the agreement of 75 percent of dry shareholders. 	<p>shareholders will not vote in support of share caps, although they have indicated that they will do this through the KISP process (assuming a 7 year transition period)</p> <ul style="list-style-type: none"> • consistent with transparency, fairness, and reasonableness principles of the Companies Act 		

7.4 CONCLUSION

71. Option 6 (enable Zespri to act as any other company under the Companies Act 1993) meets all of the three objectives of improved certainty, effectiveness and administrative efficiency. This option recognises that Zespri is best placed to address issues relating to share ownership, rather than the government through regulation. It amends the current regulatory restrictions that prevent Zespri from managing its share ownership in the same way other companies can under the Companies Act 1993, and ensures Zespri has access to the full range of mechanisms to do this.
72. Option 6 also protects private property rights and ensures that all shareholders, including dry shareholders, have the same opportunities to vote on issues that affect their share ownership and/or share entitlements. Option 6 is the most effective option for managing financial and legal risks to the Crown that can arise from impacting private property rights through regulation. Option 6 is the recommended option.

8 Core Business

8.1 BACKGROUND

73. 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 is not 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.
74. Zespri's single desk status makes it different from other companies in that it is not subject to the same competitive pressures across all areas of its business. In particular, growers wanting to export kiwifruit to any country other than Australia must sell their fruit to Zespri to export (or enter into a collaborative marketing arrangement with Zespri). This means the growers are effectively 'captured' by Zespri and must accept the price offered for their produce. It also means that Zespri could use revenue that would otherwise be returned to growers to run its business. This model poses some risks to growers that the Regulations aim to mitigate.
75. One of the key ways the Regulations mitigate the potential risks associated with Zespri's monopsony position is by diverging from the Companies Act 1993 and specifying the activities that Zespri can undertake as its core business. Another way is by providing a framework for decisions about non-core business activities to be made (i.e. the non-diversification rule), the operation of which is overseen by Kiwifruit New Zealand:
- Regulation 2 defines Zespri's core business as "the purchase of New Zealand grown kiwifruit for export"¹⁰; and
 - Regulation 11 (i.e. the non-diversification rule) prevents Zespri from carrying out any activities, or owning or operating any assets, not necessary for core business unless:
 - the providers of capital to be used for those activities have been asked and have agreed to the use of their capital for those activities; and
 - the shareholders and suppliers who have not agreed are not exposed to more than a minimal risk from those activities.
76. Kiwifruit New Zealand's role is to determine whether any business activity that Zespri undertakes (e.g. marketing, research and development, or supply chain management) is necessary for its regulated core business. If Kiwifruit New Zealand deems the activity necessary for core business, Zespri can go ahead and undertake it. If Kiwifruit New Zealand does not consider an activity to be necessary for core business, then the activity is subject to the non-diversification rule outlined in paragraph 73. This means that Zespri can undertake a broad range of activities outside of its core business if it has the specified level of support from its providers of capital (i.e. shareholders and suppliers).
77. If operating well, the non-diversification rule will:
- enable captured suppliers (growers) to control their risk / return exposure;

¹⁰ This excludes the export of kiwifruit to Australia and the sale of kiwifruit in New Zealand.

- support the maintenance of a contestable and competitive on-shore supply chain by providing transparency over non-core business activities; and
 - provide a certain and efficient process through which Zespri can confirm the support of shareholders and suppliers to engage in non-core business activities that are innovative and which deliver value to the kiwifruit industry.
78. The operation of the non-diversification rule is supported by a number of information disclosure requirements set out in the Regulations and the Kiwifruit Information Disclosure Handbook. These, combined with information disclosure requirements contained in the Companies Act, help to ensure shareholders, suppliers and other stakeholders have sufficient information about Zespri’s business activities.
79. As well as the competition related provisions in the Regulations, a High Court decision¹¹ in 2011 confirmed that the Commerce Act 1986 applies to Zespri’s conduct and any contracts and agreements it enters into.¹²
80. To date, the workability and effectiveness of regulation 11(1) has never been tested. This is because Kiwifruit New Zealand has previously assessed Zespri’s business activities as being “necessary” for its regulated core-business. Activities currently undertaken by Zespri in addition to the purchase of New Zealand grown kiwifruit for export, include:
- research and development;
 - new plant cultivar development;
 - plant variety ownership;
 - marketing and market development;
 - supply chain management; and
 - the purchase of non-New Zealand grown kiwifruit to ensure 12 month supply in overseas markets.

8.1.1 Problem

81. There are two problems with the core business provisions in the Regulations. The first is that the definition of core business is overly restrictive of the activities that Zespri can undertake without the approval of Kiwifruit New Zealand and/or shareholders and suppliers. In particular, the definition of core business does not include some of the key activities that an effective exporter of kiwifruit would be expected to undertake (e.g. marketing and market development).
82. An overly restrictive definition of core business imposes unnecessary compliance costs on Zespri and Kiwifruit New Zealand (i.e. as the non-diversification rule is applied more than necessary), and creates uncertainty for Zespri’s and its shareholders when making decisions about long-term investment and innovation.

¹¹ TURNERS AND GROWERS LTD V ZESPRI GROUP LTD HC AK CIV 2009-404-004392

¹² The only exceptions to this are the ‘export ban’ and ‘export authorisation’ provided in the Regulations, which are exempt from the restrictive trade practices provisions of the Commerce Act as they are “specifically authorised” in the Regulations (see section 43(1) of the Commerce Act).

83. The second problem relates to the non-diversification rule 11(1). Although never fully tested, MPI considers the rule is likely to be impractical to implement, will fail to appropriately balance the interests of all kiwifruit growers with the minority few, and creates a high risk of activities that are likely to generate significant returns to kiwifruit growers and the wider sector being thwarted. In particular:
- regulation 11(1)(a) sets out that all providers of capital, including shareholders, suppliers, banks and other lending institutions, must be asked and unanimously agree to an activity. In protecting banks and other lending institutions, the Regulations give undue consideration to institutions that are not captured by the single desk and can manage their own risks through contracts; and
 - regulation 11(1)(b) sets out that if only one shareholder or supplier does not agree (and faces more than minimal risk) the activity cannot proceed, regardless of the potential net benefit to all other suppliers, shareholders, the wider sector and New Zealand as a whole.
84. The current impact of these problems is relatively minor, and mostly in the form of uncertainty for Zespri and its shareholders when undertaking business planning and making investment decisions with long-term commitments. However, the minor impact is not an accurate reflection of the scale of the potential problem, as it is primarily the result of the way the Regulations have been interpreted and implemented to date. Discussions with Zespri and KNZ confirm MPI's view that regulation 11(1)(a) and (b) are difficult to interpret and implement. In part because of this, Kiwifruit New Zealand has adopted a very broad and permissive interpretation of the Regulations and the types of activities deemed necessary for core business.¹³
85. If, however, Kiwifruit New Zealand were to revise its test for determining whether or not an activity was necessary for core-business (e.g. due to a more conservative interpretation of the Regulations or a change in interpretation from a board with different technical expertise) or Zespri wanted to undertake a new, higher risk activity, the full impact of the poorly designed non-diversification rule would be felt.
86. Overall, MPI considers that there is a high risk that the status quo will impede Zespri's future ability to undertake innovative business activities that have historically generate significant returns to kiwifruit suppliers, Zespri shareholders, and the wider sector, particularly given the changes recommended for Kiwifruit New Zealand's structure and accountability outlined below.

8.2 OPTIONS

8.2.1 Option 1: Status quo

87. Under this option, the status quo (described above) would continue.
88. Submitters on the discussion document who supported this option did so because they were concerned to retain regulation 11 oversight of wider-Zespri activities. Most submitters did not support this option because it would not provide Zespri with adequate certainty for investment.

¹³ For example, one way of viewing Kiwifruit New Zealand's current approach to interpreting the term 'necessary' for core business is that it tends more towards being 'desirable' for core business rather than 'essential' for core business.

8.2.2 Option 2: KISP proposal for core business

89. Option 2 is the recommendation presented to the Government by the industry as a result of KISP. It involves expanding the current definition of core business contained in the regulations to include, in addition to the purchase of New Zealand grown kiwifruit for export:

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

90. The activities listed above are all currently undertaken by Zespri. The difference from the status quo under this option would be a shift in decision-making power from shareholders and suppliers (with oversight by Kiwifruit New Zealand) to Zespri's board. If so desired, shareholders would still be able to vote on a special resolution to amend Zespri's constitution to limit core business activities.

91. This option does not involve any changes to the non-diversification rule, except for making the above list of activities to be Zespri's core business.

92. Submitters on the discussion document had mixed views on this option. Many who supported the option did so only in part – they were comfortable with some activities being included, but not others. A number of submitters did not support this option because of concerns about the impact on competition or a reduction in the ability to influence Zespri's overseas-supply programme.

8.2.3 Option 3: KNZ board approves 'non-significant' 'non-core' activities

93. Option 3 would involve giving the KNZ board the ability to approve projects or activities outside core business, but below a specified threshold, for example, "non-significant activities outside of core business". Significance could be determined based on measures of expected financial risk, expected risk to brand or reputation and/or the uniqueness, novelty or contentiousness of the activities. For activities above the threshold, the same considerations set out in regulation 11 as at present would apply.

94. Submitters on the discussion document did not support this option. There was near universal concern about Kiwifruit New Zealand's ability to effectively carry out a new role that involved identifying and applying threshold of 'non-significant' activities.

8.2.4 Option 4: Shareholders and suppliers vote every six years

95. Under option 4, the current definition of core business would be retained, as would the current processes for monitoring and making decisions about non-core business activities under regulation 11. The changes would be instead to the processes and timeframes for shareholders voting on activities outside of core business. These would be more clearly defined, and the interval at which such activities would need to be

approved would be six years, rather than every 3 years adopted as is the voluntary a generally practice by Zespri at present.

96. Submitters on the discussion document did not support this option. There was near universal concern that this option would not provide either sufficient certainty for investment nor adequate shareholder control.

8.2.5 Option 5: Expand the definition of core business and improve the workability and flexibility of the non-diversification rule [recommended option]

97. Option 5 seeks to address the problems for core business by combining changes to the definition of core business with changes to the non-diversification rule. Option 5 includes:

- expanding the definition of core business so that, in addition to the purchase of New Zealand grown kiwifruit for export, it includes:
 - marketing of New Zealand grown kiwifruit;
 - market development for New Zealand grown kiwifruit; and
 - research and development of kiwifruit; and
- lowering the threshold for activities subject to the non-diversification rule in regulation 11 from activities “not necessary for” core business to activities that “do not support” core business; and
- providing greater flexibility for Zespri to undertake non-core business activities by:
 - requiring the approval of 75% or more shareholders and suppliers, rather than the unanimous agreement of all providers of capital; and
 - requiring that risks to those shareholders and suppliers that don’t agree be minimised as far as reasonably practical (e.g. undertaking the activity through a separate legal entity to limit any financial risks).

98. This option was developed following the receipt of feedback on the discussion document. While the views of the wider sector on this option are not known, MPI has discussed it with Zespri, Kiwifruit New Zealand and NZKGI. All of these stakeholders support this proposal.

8.3 IMPACT ANALYSIS

99. Table 2 below sets out options 1 to 5 for core business, and assesses them against the criteria of certainty, effectiveness, and administrative efficiency. An overall assessment of each option is also provided.

Table 2: Analysis of options for decisions about Zespri's core business

Options	Certainty (for the Crown, Zespri, shareholders and suppliers, and the regulator)	Effectiveness (practical, durable, enforceable, and likelihood of compliance is increased)	Efficiency (does not impose unreasonable costs on regulator, sector or the Crown)	Conclusion
Option 1: Status quo	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> high levels of uncertainty for Zespri about ongoing ability to undertake non-core business activities due to potential for differing interpretation and application of regulations over time 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> difficult and impractical to implement, resulting in a very broad and permissive interpretation to date more literal interpretation could have unintended impact of preventing Zespri's undertaking activities that the majority of shareholders and suppliers support as unanimous support required 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> overly restrictive on Zespri's core business activities as doesn't include activities an effective marketer must undertake (e.g. marketing and market development, research and development) imposes unnecessary compliance costs on Zespri and Kiwifruit New Zealand as core business definition so narrow creates uncertainty for Zespri which could impede long term investment significant risk of lost revenue and growth opportunities if more literal interpretation applied (e.g. as a result of Zespri's plant breeding programme) 	Does not meet objectives
Option 2: KISP proposal for core business	<p style="text-align: center;">-/+</p> <ul style="list-style-type: none"> high level of certainty for Zespri that it can continue doing the activities it is currently doing reduced level of certainty for shareholders, suppliers, the Crown and overseas trading partners, as the categories of activities provided for are very broad and could involve a range of different activities of varying cost and risk 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> reduced oversight of Zespri's business activities by Kiwifruit New Zealand and shareholders and suppliers unlikely to provide stakeholders with confidence that Zespri not undertaking activities that negatively impact competition or comply with international obligations hard to enforce due to broad activity categories less protection for captured suppliers 	<p style="text-align: center;">-/+</p> <ul style="list-style-type: none"> enables contestable activities as part of core business (e.g. supply chain management, plant variety rights ownership) thus may impact negatively on competition within sector enables high risk/cost activities as part of core business (e.g. 12 month supply, plant variety rights ownership) thus exposes shareholders and suppliers to higher risk reduced compliance costs due to very broad scope of core business definition 	Partially meets objectives
Option 3: Zespri board approves 'non-significant' 'non-core' activities	<p style="text-align: center;">-/+</p> <ul style="list-style-type: none"> improves certainty for Zespri about ability to undertake 'non-core' 'non-significant' activities, depending on ability to define these less certainty for other stakeholders about 'non-core' 'non-significant' activities, although information disclosure provisions still apply 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> reduced oversight of Zespri's 'non-core' 'non-significant' business activities by Kiwifruit New Zealand and shareholders and suppliers – less protection for captured suppliers likely to be difficult to define and agree (with Zepsri and Kiwifruit New Zealand) what 'non-core' 'non-significant' activities are 	<p style="text-align: center;">-/+</p> <ul style="list-style-type: none"> may reduce compliance costs for Zespri and Kiwifruit New Zealand depending on ability to identify and agree 'non-core' 'non-significant' business activities, however more likely to just shift compliance costs on to Kiwifruit New Zealand 	Partially meets objectives

Options	Certainty (for the Crown, Zespri, shareholders and suppliers, and the regulator)	Effectiveness (practical, durable, enforceable, and likelihood of compliance is increased)	Efficiency (does not impose unreasonable costs on regulator, sector or the Crown)	Conclusion
Option 4: Shareholders and suppliers vote every six years	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> provides more certainty for Zespri in relation to decisions about some longer term investments (e.g. can get approval for funding for 6 years rather than 3), although for the types of investments being considered (e.g. plant breeding programme which runs indefinitely) this is unlikely to make any meaningful difference may reduce opportunities for shareholders and suppliers to input to business decisions 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> no noticeable improvement on the status quo in terms of addressing current problems of overly restrictive core business definition and uncertainty 	<p style="text-align: center;">-</p> <ul style="list-style-type: none"> very minor reduction in compliance costs in relation to process for some decisions made by Zespri shareholders and suppliers no noticeable improvement on the status quo in terms of addressing current problems 	<p style="text-align: center;">Does not meet objectives</p>
Option 5: Expand the definition of core business and improve the workability and flexibility of the non-diversification rule	<p style="text-align: center;">+</p> <ul style="list-style-type: none"> provides all stakeholders with more certainty about Zespri's ability to undertake activities expected of an effective value maximising exporter (i.e. marketing and market development) provides Zespri with certainty about its ability to undertake and invest in research and development relating to kiwifruit (e.g. plant breeding programme in which \$10 million is invested annually) shareholders and suppliers still able to control level of risk exposure 	<p style="text-align: center;">+</p> <ul style="list-style-type: none"> provides a more practical and achievable process for making decisions about business activities that do not support core business higher level of flexibility and practicality means more likely to be implemented as intended is essentially including activities Zespri already undertakes within definition of core business to reduce compliance costs and remove uncertainty, thus likely to be no 'visible' impact higher risk, high return activities able to be undertaken where 75% or more shareholders and suppliers agree and won't be thwarted by minority 	<p style="text-align: center;">+</p> <ul style="list-style-type: none"> confirms Zespri's ability to continue its research and development (currently spends \$25 million per year) which to date as delivered significant benefits e.g. Psa-V resistant gold kiwifruit reduces compliance costs as less activities subject to review by Kiwifruit New Zealand and/or the non-diversification rule risks to those who don't support higher risk, higher return activities will be minimised as far as reasonably practical may be some costs to Zespri to minimise risk to non-supporting shareholders and suppliers (if this is how they choose to minimise risk), although cost must be reasonable in the circumstances research and development is a contestable activity and Zespri has been doing it since regulations enacted with no noticeable impact on competition there is significant evidence of existing alternative providers across the supply chain (e.g. Turners and Growers, Massey, Otago and Waikato Universities, GroPlus, Plant and Food, and various pack houses such as Seeka and EastPack) 	<p style="text-align: center;">Fully meets objectives</p>

8.4 CONCLUSION

100. Option 5 (expand the definition of core business and improve the workability and flexibility of the non-diversification rule) fully meets the objectives of improving certainty, effectiveness and administrative efficiency.
101. Option 5 will ensure that only those captured by the single desk are given a role in controlling the industry's risk / return exposure and that Zespri undertakes the activities expected of an effective single desk exporter (i.e. marketing and market development, and research and development) as part of its core business.
102. Also, option 5 clarifies the thresholds and process for Zespri to undertake non-core business activities where this is desired by the majority of shareholders. It also ensures that those that do not agree to non-core business activities have their concerns addressed as far as is reasonable in the circumstances.
103. Finally, compliance costs on Kiwifruit New Zealand and Zespri are reduced as a result of expanding the definition of core business, and Zespri is given greater certainty to continue to make long-term investments in kiwifruit research and development that support the long term performance of the industry. As these activities are already being undertaken by Zespri, there are no further identifiable additional impact associated with this proposal. Option 5 is recommended.

9 Kiwifruit New Zealand

9.1 BACKGROUND

104. Subsequent to the industry's request for amendments to the Regulations, the Minister for Primary Industries also agreed to review Kiwifruit New Zealand to determine whether its design and operation remain fit for purpose. To facilitate this, MPI commissioned an independent review of Kiwifruit New Zealand by Institute for Business Research at Waikato University.
105. The independent review identified four key areas for improvement, which are addressed in turn below:
- governance – the composition of the board;
 - reporting and accountability;
 - funding; and
 - collaborative marketing.

9.2 KIWIFRUIT NEW ZEALAND BOARD

9.2.1 Problem

106. The independent review undertaken by Waikato University's Institute for Business Research identified the following problems with the current Kiwifruit New Zealand board composition:
- competence - limited ability to appoint people with the expertise required to undertake the range of regulatory functions (e.g. international marketing, economic analysis, and competition law); and
 - independence – a perception that the KNZ board lacks independence as it is currently dominated by growers. While the Regulations and Kiwifruit New Zealand don't regulate growers as such, growers can be conflicted if participating in the regulatory body and potentially being a Zespri shareholder and/or growing a Zespri-owned cultivar under licence. Growers may also be shareholders of collaborative marketing companies that apply to Kiwifruit New Zealand to enter into a collaborative marketing arrangement with Zespri.
107. MPI's view is that the potential impacts of the problems identified could be significant, and include:
- concerns about the board's ability undertake its role and responsibilities effectively due to potential bias and/or skill and knowledge gaps;
 - loss of confidence in Kiwifruit New Zealand and its decisions from industry participants, collaborative marketing applicants and the government; and
 - reduced confidence by international trading partners that we are meeting our trade obligations.

108. Two key examples of how these impacts may manifest are:

- reduced applications for collaborative marketing due to loss of confidence in the assessment and decision making process. This could impact negatively on industry competition and innovation, and lead to lost opportunities for growers to increase returns; and
- negative international reaction, not just for kiwifruit products but also other New Zealand exports.

9.2.2 Options

Option 1: Status quo

109. The Regulations currently provide for a board consisting of five members - three directors elected by growers, one director appointed by NZKGI, and an independent chair appointed by the Kiwifruit New Zealand board. There is no oversight of the election or appointment process by the government, and there is no requirement to consult with MPI. There is limited opportunity, except through the NZKGI appointee, to appoint for the skills required by the board (unless the grower appointees happen by chance to have the required skills and expertise).

110. Feedback on the discussion document indicated little support for the status quo, although this option is preferred by NZKGI.

Option 2: Six member board – 3 grower elected, 2 independent and an independent chair [recommended option]

111. Option 2 involves amending the Regulations to require a six member board consisting of:

- 3 directors elected by growers (status quo);
- 2 independent directors to fill skills identified by the board and appointed by the Minister from a list compiled by MPI in consultation with the board; and
- 1 independent chair appointed by the Minister from a list compiled by MPI in consultation with the board.

112. A definition of ‘independent’ will be provided in the Regulations to mean: “no financial interests or directly related to someone with financial interests in the kiwifruit industry”.

113. The chair will have the casting vote and the board quorum will be increased from 3 to 4 directors to ensure that at least one independent director is always present at board meetings. Each director will be elected/appointed for a term of three years, and may be reappointed/re-elected at the end of their term, with a maximum of 3 terms. For current directors, their current and previous terms on the board will count towards the maximum term limit.

114. Feedback on the discussion document indicated that most submitters supported the broadening of the skill-set of the board, including governance skills. They also supported having more independent directors to provide greater ability to manage potential conflicts of interest, and to discharge responsibilities impartially.

115. Discussions between MPI and Kiwifruit New Zealand and Zespri indicate that they support this option. NZKGI has expressed concern at losing their ability to appoint a director and feel this will result in them having less oversight of Kiwifruit New Zealand's performance. MPI disagrees with this view and notes that the proposals outlined below regarding Kiwifruit New Zealand's reporting and accountability will address this concern.

Option 3: Seven member board – status quo plus two independent directors

116. Option 3 involves a 7 member board consisting of the status quo plus 2 independent directors. This retains the existing grower elected majority on the board, but adds 2 additional independent directors to provide the skills and expertise identified as necessary by the board. The independent directors and chair would be nominated in the same way as for option 2.
117. A number of submitters on the discussion document felt that a 7 member board was too big and would be too costly to run. Kiwifruit New Zealand and Zespri have both expressed a desire for a 5 or 6 rather than 7 member board due to the associated costs.

Option 4: Seven member board – 3 grower elected, 3 independent and independent chair

118. Option 4, like option 3, involves a 7 member board. The board would consist of 3 directors elected by growers, 3 independent directors appointed for skills identified by the board as necessary, and an independent chair. This combination provides for the independent directors to hold the majority representation. The appointment processes for the independent directors and the independent chair would be the same as outlined for options 2 and 3 above.
119. The same comments from submitters on the discussion document in relation to board size outlined under option 3 are relevant to option 4. In addition, NZKGI do not support the proposal for the board to have a higher number of independent directors than grower elected directors.

Option 5: Option 2, 3 or 4, with 3 directors appointed by NZKGI

120. Option 5 involves replacing the 3 grower elected directors in options 2, 3, or 4 with directors appointed by NZKGI. This would mean that the balance of grower and independent directors under each option would stay the same as currently proposed. The only difference is that the process for growers electing grower directors would be replaced by NZKGI appointees.
121. A number of submitters on the discussion document opposed devolving nomination of Kiwifruit New Zealand board directors to NZKGI or to any other industry group. Some commented that the process for appointing directors must be free of industry and political interference. Most submitters preferred retaining the 3 grower-elected directors.

9.2.3 Impact Analysis

122. Table 3 below sets out options 1 to 5 for the Kiwifruit New Zealand board, and assesses them against the criteria of certainty, effectiveness, and administrative efficiency. An overall assessment of each option is also provided.

Table 3: Analysis of options for composition of Kiwifruit New Zealand board

Options	Certainty (for the Crown, Zespri, shareholders and suppliers, and the regulator)	Effectiveness (practical, durable, enforceable, and likelihood of compliance is increased)	Administrative Efficiency (does not impose unreasonable costs on regulator, sector or the Crown)	Conclusion
Option 1: Status quo	-	-	-	Does not meet objectives
<ul style="list-style-type: none"> there is little oversight of the current board by government or wider industry stakeholders 	<ul style="list-style-type: none"> there is little oversight of the current board by government or wider industry stakeholders 	<ul style="list-style-type: none"> the independent report raises questions about the effectiveness of the current arrangements 	<ul style="list-style-type: none"> limited opportunity to appoint directors with skills/expertise required by board 	
Option 2: Six member board – 3 grower elected, 2 independent, independent chair	-/+	+	+	Mostly meets objectives
<ul style="list-style-type: none"> appointment of independent directors by Minister will give confidence that proper process has been followed maybe a perception that board is not truly independent due to balance between independent members and grower elected members, however actual independence is achieved through other means (chair has casting vote) 	<ul style="list-style-type: none"> appointment of independent directors by Minister will give confidence that proper process has been followed maybe a perception that board is not truly independent due to balance between independent members and grower elected members, however actual independence is achieved through other means (chair has casting vote) 	<ul style="list-style-type: none"> retaining grower representation will bring industry knowledge to the board mix of 3 grower elected plus independent directors will provide more flexibility to structure committees for collaborative marketing applications and appeals in truly independent manner identification of required skills/expertise by board will improve competency 	<ul style="list-style-type: none"> costs associated with additional board member, although where this fills a current capability gap, this may offset costs currently allocated elsewhere (e.g. consultants' fees). 	
Option 3: Seven member board – status quo plus two independent	-	+/-	-	Partially meets objectives
<ul style="list-style-type: none"> fewer independent members than grower members may raise concerns about quality of processes and decisions 	<ul style="list-style-type: none"> fewer independent members than grower members may raise concerns about quality of processes and decisions 	<ul style="list-style-type: none"> a grower dominated board will not provide sufficient independence independent members will improve capability 	<ul style="list-style-type: none"> additional financial costs of a seven member board are likely to outweigh any benefits 	
Option 4: Seven member board – 3 grower elected, 3 independent, independent chair	+	+	-	Partially meets objectives
<ul style="list-style-type: none"> greater number of independent directors will give higher level of certainty about independence size of board membership combined with number of directors appointed for skills will provide higher level of confidence in capability and decisions 	<ul style="list-style-type: none"> greater number of independent directors will give higher level of certainty about independence size of board membership combined with number of directors appointed for skills will provide higher level of confidence in capability and decisions 	<ul style="list-style-type: none"> additional independent member provides more opportunity for obtaining necessary skills and expertise 	<ul style="list-style-type: none"> additional financial costs of a seven member board are likely to outweigh any benefits 	
Option 5: Option 2, 3, or 4 with 3 directors appointed by NZKGI	-	-/+	-	Partially meets objectives
<ul style="list-style-type: none"> appointment of directors by an industry body likely to raise concerns about industry and/or political interference and lack of independence maybe blurring of director responsibilities if they feel they have to report to or represent NZKGI 	<ul style="list-style-type: none"> appointment of directors by an industry body likely to raise concerns about industry and/or political interference and lack of independence maybe blurring of director responsibilities if they feel they have to report to or represent NZKGI 	<ul style="list-style-type: none"> NZKGI has capacity to run an appointment process risk that growers who are not members of NZKGI do not feel 'represented' 	<ul style="list-style-type: none"> cost to NZKGI of running election process additional financial costs of a seven member board are likely to outweigh any benefits 	

9.2.4 Conclusion

123. Option 2 (six member board with 3 grower elected, 2 independent and an independent chair) fully meets the objectives of improved effectiveness and administrative efficiency, and mostly meets the objective of improved certainty. This option involves an even balance between grower elected and independent directors, which may create a perception that the board is not ‘truly’ independent. However, practical independence will be achieved by the independent chair having the casting vote and the process for nominating and making appointments of independent members. The mix of directors also provides sufficient opportunity to establish fully independent sub-committees for considering collaborative marketing applications and appeals.
124. The cost of running the six member board under option 2 is higher than at present, however the benefits achieved through increased independence and capability are expected to significantly outweigh the additional cost. Plus the additional costs are likely to offset costs currently required to ‘buy-in’ expertise. This option is also supported by Zespri and the current Kiwifruit New Zealand board which will assist in its implementation. Given the above, MPI recommends option 2.

9.3 KIWIFRUIT NEW ZEALAND REPORTING AND ACCOUNTABILITY

9.3.1 Problem

125. The independent review of Kiwifruit New Zealand found that the current reporting and accountability requirements are weak for a regulator. Particular concerns noted were there being no requirement for Kiwifruit New Zealand to report to the government and no regular external review of performance. Problems with Kiwifruit New Zealand’s reporting and accountability requirements have a number of potential impacts, including:

- lack of accurate information about whether Kiwifruit New Zealand is undertaking its role efficiently and effectively, and to the standard expected of a regulator of a billion dollar industry;
- lack of domestic and international confidence in the implementation of the Regulations, leading to the types of outcomes outlined in paragraph 105 above; and
- limited ability of government to detect emerging problems with the performance of Kiwifruit New Zealand or the performance of the wider regulatory framework before its possibly too late.

9.3.2 Options

Option 1: Status quo

126. Under the status quo, Kiwifruit New Zealand publishes its annual report and a report on its collaborative marketing decisions, and makes these publically available. There is no requirement that these be submitted to the government. There is also no requirement for a regular independent review of Kiwifruit New Zealand’s performance. However it is always the Government’s prerogative to undertake such a review at any time if it wishes.

127. Feedback on the discussion document indicated strong support for improving the reporting and accountability requirements for Kiwifruit New Zealand.

Option 2: Statement of Intent (SOI), regular engagement with MPI and six yearly reviews [recommended option]

128. Option 2 involves amending the Regulations to require Kiwifruit New Zealand to prepare a Statement of Intent (SOI) every three years. The SOI must be prepared in consultation with MPI and approved by the Minister for Primary Industries. The SOI will outline how Kiwifruit New Zealand intends to deliver its roles and responsibilities under the Regulations over the next three years, including:
- consideration of collaborative marketing applications and how this provision is implemented to increase overall wealth of New Zealand kiwifruit growers;
 - monitoring of Zespri with respect to the risk mitigation measures in the Regulations (the non-discrimination rule, the non-diversification rule, the information disclosure requirements, and compliance with the collaborative marketing requirements); and
 - adequacy of Kiwifruit New Zealand’s funding to provide for good governance while still meeting the government’s cost-recovery principles.
129. Option 2 also involves requiring annual engagement between MPI and Kiwifruit New Zealand to monitor Kiwifruit New Zealand’s performance against its SOI and identify and address any issues of concern. An independent performance review of Kiwifruit New Zealand will also be undertaken every six years.
130. Submitters to the MPI discussion document generally supported greater transparency and further reporting by Kiwifruit New Zealand to the government, as well as independent performance reviews. However, many wanted the scope of the SOI to be limited to Kiwifruit New Zealand’s regulatory functions and not to undermine Kiwifruit New Zealand’s independence. Some submitters considered that the SOI and six-yearly reviews would be unnecessary with if there were independent directors with the necessary skills on the Kiwifruit New Zealand board, and annual engagement between MPI and Kiwifruit New Zealand.

9.3.3 Impact Analysis

131. Table 4 below sets out options 1 and 2 for Kiwifruit New Zealand’s reporting and accountability, and assesses them against the criteria of certainty, effectiveness, and administrative efficiency. An overall assessment of each option is provided.

Table 4: Analysis of options for improving Kiwifruit New Zealand's reporting and accountability

Objectives	Options	
	Option 1: Status quo	Option 2: SOI, annual engagements with MPI and six yearly reviews
Certainty (for the Crown, Zespri, shareholders and suppliers, and the regulator)	- <ul style="list-style-type: none"> Government and other stakeholders have low level of certainty about standard of Kiwifruit New Zealand's performance low levels of certainty for Zespri and collaborative marketers as to how Kiwifruit New Zealand intends to undertake its role and responsibilities 	+ <ul style="list-style-type: none"> Government has more accurate understanding of effectiveness of Kiwifruit New Zealand and wider regulatory framework domestic and international stakeholders have more certainty that government is holding Kiwifruit New Zealand accountable for its performance, and therefore Regulations working as intended improved certainty for collaborative marketers and Zespri as SOI will outline Kiwifruit New Zealand approach to enforcing the Regulations
Effectiveness (practical, durable, enforceable, and likelihood of compliance is increased)	- <ul style="list-style-type: none"> poor incentives for Kiwifruit New Zealand to perform efficiently and effectively due to low levels of accountability and transparency 	+ <ul style="list-style-type: none"> improved incentives for Kiwifruit New Zealand to undertake its functions efficiently and effectively due to greater transparency any emerging issues with the Regulations or Kiwifruit New Zealand's performance can be detected and managed in a timely manner
Administrative efficiency (does not impose unreasonable costs on regulator, sector or the Crown)	-/+ <ul style="list-style-type: none"> low compliance costs for Kiwifruit New Zealand and MPI stakeholders unable to easily access information that provides accurate overview of performance (e.g. must rely of making requests under Official Information Act 1982 which involves costs for all parties) 	-/+ <ul style="list-style-type: none"> cost to MPI of increased engagement with Kiwifruit New Zealand and annual review additional compliance costs for Kiwifruit New Zealand in preparation of SOI and annual engagement with MPI stakeholders able to access better information about Kiwifruit New Zealand's performance at lower cost planning undertaken as part of preparation of SOI likely to improve ongoing performance
Conclusion	Partially meets objectives	Mostly meets objectives

9.3.4 Conclusion

132. Option 2 (3 yearly SOI, annual engagement with MPI and 6 yearly independent reviews) fully meets the objectives of improved certainty and effectiveness and mostly achieves the objective of improved administrative efficiency. Option 2 will ensure Kiwifruit New Zealand is subject to the type of reporting and accountability requirements expected of an industry regulator and critical for stakeholder confidence in the regulatory framework. There will be a minor increase in costs from the proposed changes, of about \$60,000 to \$80,000 a year. MPI's costs will be funded out of MPI's baseline funding, and Kiwifruit New Zealand will recover its costs from the industry. MPI recommends option 2.

9.4 KIWIFRUIT NEW ZEALAND FUNDING

9.4.1 Problem

133. MPI, in consultation with Kiwifruit New Zealand, have identified several problems with the approach to Kiwifruit New Zealand's funding as currently set out in the Regulations. While the underlying approach based on cost recovery remains sound, the provisions:
- do not support the ability of the board to obtain adequate funding to provide the regulatory oversight and governance expected of a good regulator;
 - do not provide adequate flexibility for the board to cost recover from the direct and indirect beneficiaries of collaborative marketing programmes in a way that supports quality applications; and
 - do not align with established cost recovery principles.
134. Kiwifruit New Zealand board's view is that the 'cost-effective' requirement in regulation 34 hinders good governance as some interpret this as requiring them to always take a 'least cost' or cheapest approach to carrying out their functions. They believe that as a regulator they must do what is right and necessary to implement the Regulations effectively, and taking the cheapest rather than the most effective option can have significant negative repercussions for the industry and New Zealand (e.g. not investing in professional capability to make technical decisions).
135. Kiwifruit New Zealand also considers that the pressure to take the 'cheapest option' means they are unable to invest in developing capability and improving systems and processes.
136. The KISP review also recommended that Kiwifruit New Zealand's funding provisions be made more flexible to improve collaborative marketing uptake.
137. MPI agrees with the findings of KISP and views of Kiwifruit New Zealand outlined in paragraphs 132 to 134 above.

9.4.2 Options

Option 1: Status Quo

138. Under the status quo, Kiwifruit New Zealand is required to 'perform its functions in a manner that is as efficient and cost-effective as possible (regulation 34). In addition, regulation 39(1) provides that Kiwifruit New Zealand must be funded on a cost recovery basis by charging-
- ZGL [Zespri], in accordance with the export authorisation, for the costs incurred by the board in administering that authorisation, including the monitoring and enforcement of the risk mitigation measures; and
 - applicants under the collaborative marketing regime; and
 - ZGL and the applicants for the reasonable costs of the board's communications with producers.

139. Some submitters on the discussion document questioned whether the problem is more of an interpretation issue, rather than an actual problem. They also asked, if the cost effectiveness requirement is removed, how costs will be managed. MPI notes that it is likely to be a lack of clarity with the Regulations that is creating the ‘interpretation’ issue, and that ongoing uncertainty, particularly if it is affecting Kiwifruit New Zealand’s performance, is not desirable.

Option 2: Replace cost effectiveness requirement with established cost-recovery principles [recommended option]

140. Option 2 involves removing regulation 34, which is the requirement that Kiwifruit New Zealand perform its functions in a manner that is as efficient and cost-effective as possible. To ensure that Kiwifruit New Zealand continues to operate in an efficient and cost effective manner, the following cost recovery principles will be added to regulation 39:

- equity – funds are sourced to the extent practicable from beneficiaries of the function;
- efficiency – costs are generally allocated and recovered in order to ensure maximum benefits delivered at minimum costs, encouraging efficient resource use;
- justifiability – funds are collected only to meet the reasonable costs (including indirect costs) for the provision or exercise of the relevant functions; and
- transparency – costs are identified and allocated as closely as practicable in relation to tangible service provision.

141. These principles are consistent with the principles applied by MPI in other regulatory regimes and will ensure that Kiwifruit New Zealand performs its cost recovery functions to a standard expected of other industry regulators. This will ensure that Kiwifruit New Zealand remains an efficient operator and the board is able to provide for good governance overall.

142. Most submitters on the discussion document supported funding flexibility for Kiwifruit New Zealand’s collaborative marketing function, and retaining the cost recovery provision. Many noted that they wanted to ensure that Kiwifruit New Zealand continued to act in a cost-effective manner.

9.4.3 Impact Analysis

143. Table 5 below sets out options 1 to 2 for improving Kiwifruit New Zealand’s funding and assesses them against the criteria of certainty, effectiveness, and administrative efficiency. An overall assessment of each option is provided.

Table 5: Analysis of options for improving Kiwifruit New Zealand's funding

Objectives	Options	
	Option 1: Status quo	Option 2: Replace cost effectiveness requirement with established cost recovery principles
Certainty (for the Crown, Zespri, shareholders and suppliers, and the regulator)	-	+
	<ul style="list-style-type: none"> creates uncertainty for Kiwifruit New Zealand and stakeholders about Kiwifruit New Zealand's ability to take the most effective approach rather than the cheapest approach pressure on Kiwifruit New Zealand to take cheapest approach creates uncertainty about the quality of their processes and decisions and therefore could undermine confidence in the regulator 	<ul style="list-style-type: none"> provide certainty that Kiwifruit New Zealand does not have to take cheapest option, but can take most effective option collaborative marketing applicants have greater certainty that they are not cross-subsidising other beneficiaries of their applications greater certainty for Kiwifruit New Zealand that it can build improved capability overtime, retaining stakeholder confidence
Effectiveness (practical, durable, enforceable, and likelihood of compliance is increased)	-	+
	<ul style="list-style-type: none"> risk that pressure to take cheapest option is resulting in poor outcomes and compromising good governance current provisions are not well aligned with standard cost recovery principles used in other regulatory frameworks pressure to take cheapest option doesn't support durability through building of capability and improvements 	<ul style="list-style-type: none"> aligns with government's cost recovery principles used in other regulatory frameworks provides Kiwifruit New Zealand with adequate funding to undertake its full range of regulatory functions effectively and efficiently more reasonable charges for collaborative marketing applications may lead to more applications
Administrative efficiency (does not impose unreasonable costs on regulator, sector or the Crown)	-	+
	<ul style="list-style-type: none"> costs of collaborative marketing applications are not being allocated across all of the direct and indirect beneficiaries thus cross subsidisation occurring requirement to take cheapest option means opportunities for future cost savings through improved systems and processes are lost 	<ul style="list-style-type: none"> costs can be allocated efficiently across all direct and indirect beneficiaries of activities removing risk of cross subsidisation costs will more accurately reflect the benefits received by those paying
Conclusion	Partially meets objectives	Fully meets objectives

9.4.4 Conclusion

144. Option 2 (replacing the current cost effectiveness provision with established cost recovery principles) fully meets all three objectives of improved certainty, effectiveness and administrative efficiency. It will ensure that Kiwifruit New Zealand is able to perform its roles and responsibilities to the standard expected of a regulator of a billion dollar industry, whilst ensuring its approach to cost recovery aligns with best practise. It is also likely to have flow on benefits in terms of encouraging more collaborative marketing applications because the equity principle will provide greater scope for

Kiwifruit New Zealand to consider the collaborative marketing benefits that flow to Zespri. Option 2 is recommended.

9.5 COLLABORATIVE MARKETING

9.5.1 Background

145. Collaborative marketing involves a third party working with Zespri in the marketing of kiwifruit exported to markets other than Australia. The Regulations require that collaborative marketing arrangements are approved and overseen by Kiwifruit New Zealand. The key requirement for Kiwifruit New Zealand to consider when approving a collaborative marketing arrangement is that it must increase the overall wealth of New Zealand kiwifruit suppliers (i.e. growers).
146. Collaborative marketing is intended to increase grower choice of exporter, incentivise innovation, ensure a broad range of market opportunities can be realised, and ultimately enhance industry performance and returns. In this way, the provisions play an important role in mitigating the potential impacts of Zespri's monopsony status.
147. Collaborative marketing arrangements are generally for one year, but the Regulations do not prevent Kiwifruit New Zealand from approving multi-year arrangements, and do not prevent Kiwifruit New Zealand from renewing a collaborative marketing approval. There are no quantitative limits in the Regulations for collaborative marketing approvals. Since the collaborative marketing provisions were introduced in 2000, approvals have covered approximately 1.5 to 2 percent of kiwifruit exports by volume per year.

9.5.2 Problem

148. The independent review of Kiwifruit New Zealand commissioned by MPI commented that there are no incentives for collaborative marketers to invest in market development due to the short term nature of the approvals that have historically been approved; and when investments come to an end, they have zero value to the collaborative marketers. The review also noted that there are significant opportunities to improve the process:
 - applications involve complicated forms and processes with constrained timelines;
 - the approval process involves Kiwifruit New Zealand directors with limited access to marketing expertise;
 - there is implicit tension between Zespri as a collaborator and as a competitor which may inhibit information sharing; and
 - programmes must be consistent with Zespri's marketing strategy, which can be hard for applicants to understand.
149. Based on the findings of the independent review, MPI agrees that there are opportunities to improve the implementation of the collaborative marketing provisions. This is evidenced by the fact that since the provisions came into force, collaborative marketing uptake has been very low (1.5 to 2 percent of total New Zealand kiwifruit export volume each year). The collaborative marketing agreement with Turners and

Growers¹⁴ for the 2016 is the first multi-year and multi-market agreement to have been approved. .

150. MPI considers that the regulatory provisions relating to collaborative marketing remain sound and justified, but there are problems associated with their implementation.
151. The impact of the poor implementation of the collaborative marketing provisions is difficult to quantify, but is likely to be a lower number of applications that might have otherwise been made if applicants had access to the necessary information, felt confident about the assessment process, and could see real opportunities for longer term arrangements. Ultimately, the impact of this problem is potentially reduced innovation and competition within the sector, and lower returns for growers.

9.5.3 Options

152. Given the problem relates to the implementation of the existing regulatory provisions, rather than the provisions themselves, MPI has identified a range of non-regulatory options for addressing the problem.

Option 1: Status quo

153. The Regulations require Kiwifruit New Zealand to approve collaborative marketing applications if they determine the arrangement will increase the overall wealth of New Zealand kiwifruit suppliers. Kiwifruit New Zealand can determine its own procedures for this purpose in a way that is consistent with the rules of natural justice.
154. Some submitters on the discussion document commented that the industry needs more commercial tension to drive efficiencies and drive out some of Zespri's current high costs. Some felt that the current provisions were flawed and designed to fail, as there is no residual value from any arrangements and the approvals are not long term. Others commented that a successful collaborative marketing programme should never be terminated unless Zespri can demonstrate that its programme in the same market will deliver a much greater wealth for kiwifruit suppliers. These views are consistent with the findings of the independent review.

Option 2: Status quo with improvements suggested by industry

155. Option 2 involves the status quo combined with changes the industry has already indicated it intends to make to improve collaborative marketing as a result of the KISP review. These include Zespri further integrating collaborative marketing into their marketing plans to focus on market development, innovation and serving customers not already served by Zespri. The recent arrangement entered into with Turners and Growers is an example of the types of arrangements the industry is wanting to see more of in the future.
156. Feedback on the discussion document indicated strong support for this option.

¹⁴ The multi-year arrangement includes Turners and Growers exporting 1 million trays of kiwifruit in the 2016 season to its South East Asian markets in which Zespri doesn't have a presence, and involves both Zespri and Turners and Growers brand kiwifruit.

Option 3: Option 2 plus greater focus on collaborative marketing by Kiwifruit New Zealand [recommended option]

157. Option 3 involves building on the industry's own initiatives as outlined in option 2, and enhancing Kiwifruit New Zealand's focus on collaborative marketing through greater government engagement with Kiwifruit New Zealand as outlined elsewhere in this RIS, including:

- the proposed SOI;
- annual engagement between MPI and Kiwifruit New Zealand; and
- six-yearly independent reviews of Kiwifruit New Zealand's performance.

158. Matters that MPI will work with Kiwifruit New Zealand to address include:

- clarifying Kiwifruit New Zealand's ability to approve multi-year programmes and promoting more of these programmes;
- encouraging Zespri to proactively map out the opportunities available, and make this information available to potential collaborative marketers;
- providing guidance to improve the quality of applications; and
- encouraging Kiwifruit New Zealand to recognise situations where substantial ongoing business value remains at the end of an arrangement due to a collaborative marketer's investment in developing a specific market.

159. In addition to the above, the proposed changes to the composition of the Kiwifruit New Zealand board (i.e. improvements to capability and independence), as well as the proposed changes to funding (i.e. more efficient allocation of costs across all beneficiaries of collaborative marketing arrangements) will support collaborative marketing applications and provide greater confidence in Kiwifruit New Zealand's systems and processes for making collaborative marketing decisions.

160. Most submitters recognised the value of collaborative marketing to the industry. A number supported Kiwifruit New Zealand setting collaborative marketing objectives in its SOI, clarifying assessment criteria, and providing guidance for better quality applications. There was also support for more multi-year approvals.

9.5.4 Impact Analysis

161. Table 6 below sets out options 1 to 3 for the improving collaborative marketing and assesses them against the criteria of certainty, effectiveness, and administrative efficiency. An overall assessment of each option is provided.

Table 6: Analysis of options for improving collaborative marketing

Options	Certainty (for the Crown, Zespri, shareholders and suppliers, and the regulator)	Effectiveness (practical, durable, enforceable, and likelihood of compliance is increased)	Efficiency (does not impose unreasonable costs on regulator, sector or the Crown)	Conclusion
Option 1: Status quo	-	-	-	Does not meet objectives
	<ul style="list-style-type: none"> • current guidance and support for applicants provides inadequate certainty around process • lack of certainty for applicants that multi-year arrangements are possible • poor information about current opportunities 	<ul style="list-style-type: none"> • other than recent Turners and Growers arrangement, relatively low level of success in past 	<ul style="list-style-type: none"> • overly costly and burdensome process for applicants (as found in the independent review of Kiwifruit New Zealand) • lost opportunities for future gains to sector as a result of short term arrangements 	
Option 2: Status quo plus Zespri initiatives	+	+	-	
	<ul style="list-style-type: none"> • more clarity for applicants and Kiwifruit New Zealand about how collaborative marketing arrangements can work with and build on Zespri's strategy 	<ul style="list-style-type: none"> • more strategic approach by Zespri likely to result in clearer, more viable opportunities for applicants with potentially significant benefits for growers 	<ul style="list-style-type: none"> • some additional cost to Zespri associated with developing more strategic and planned approach 	Mostly meets objectives
Option 3: Option 2 plus greater focus on collaborative marketing by Kiwifruit New Zealand	+	+	+	Fully meets objectives
	<ul style="list-style-type: none"> • higher levels of certainty for potential applicants about opportunities • higher level of certainty for applicants about process for applying and approval • higher level of certainty for government about effectiveness of implementation of provisions 	<ul style="list-style-type: none"> • significant improvement in the implementation of the collaborative marketing provisions • should result in receipt of more quality applications, the approval of more arrangements, and higher returns to growers • greater opportunity for government to identify any fundamental problems with the provisions due to greater ongoing engagement with Kiwifruit New Zealand 	<ul style="list-style-type: none"> • involves additional cost to MPI from engagement with Kiwifruit New Zealand, but this engagement will be occurring as a result of other proposals anyway • guidance and process improvements will lower costs for applicants • clear strategy, improved guidance and process will lower administrative costs for Kiwifruit New Zealand • an increase in costs to Zespri due to an increase in applications and added flexibility to Kiwifruit New Zealand through the equity principle to recognise benefits and apportion costs. 	

9.5.5 Conclusion

162. Option 3 (option 2 plus greater focus on collaborative marketing by Kiwifruit New Zealand) fully meets all three objectives of improved certainty, effectiveness and administrative efficiency and option 3 is recommended. As option 3 includes option 2, both options are effectively recommended. As option 2 is essentially Zespri led and voluntary, MPI does not recommend relying solely on this option to address the problems that have been identified. In addition, Kiwifruit New Zealand has a key role to play in ensuring that the collaborative marketing provisions are implemented effectively, and this will be given effect to through option 3.

10 Consultation

163. Stakeholder consultation was undertaken through a public discussion document, entitled “Proposed Amendments to the Kiwifruit Export Regulations 1999,” which was released in February 2016. A submission period of five weeks was provided and 33 submissions were received. Two of these were form submissions. There were 769 signatories to the NZKGI form submission and four signatories to the Trevelyan Group (pack house operator) form submission.
164. The full breadth of the industry was represented in submissions, with submissions received from: kiwifruit growers, pack house operators, collaborative marketers, owners of proprietary varieties of kiwifruit, Zespri, New Zealand Kiwifruit Growers Incorporated (NZKGI), and Kiwifruit New Zealand. Submissions were also received from the Chilean Exporters Council, the Chilean Ministry of Foreign Affairs, and Shantou Long Full (an import company based in China).
165. Issues raised by submitters on the objectives, problems and alternative options are outlined in the analysis sections above. Where relevant, MPI’s response to the key issues raised by submitters is also provided.
166. However, it should be noted that in response to the submissions received on three key issues (i.e. ownership of Zespri shares, core business, and Kiwifruit New Zealand board composition) MPI amended the proposals originally contained in the discussion document. To the extent possible, the amended proposals were discussed with Zespri, Kiwifruit New Zealand and NZKGI. These stakeholders now support the proposals recommended by MPI in this RIS, with the exception being NZKGI not supporting the process for appointing independent directors and the Chair to the Kiwifruit New Zealand board.
167. In preparation of the Cabinet paper, MPI consulted with the Ministry of Foreign Affairs and Trade, the Ministry of Business, Innovation and Employment, Te Puni Kōkiri and the Treasury. The Department of Prime Minister and Cabinet was given a copy of the Cabinet paper for information.
168. The Cabinet paper incorporates all feedback provided by the consulted agencies, and they agree with the recommend options in this paper. The following three key issues were raised by the agencies:
- retaining protection of private property rights under any proposal to align Zespri shareholding with kiwifruit supply. This concern has been addressed in this paper by ensuring that all shareholders, regardless of supply, are able to vote on changes to share holdings and restrictions on dividends;
 - ensuring clear justification for expanding the definition of Zespri’s core business, including robust analysis of any potential impacts on competition. This concern has been addressed by noting that the addition of the proposed activities to Zespri’s core business is expected to have little impact on competition as Zespri is already undertaking these activities and there is clear evidence of existing alternative providers (i.e. the regulatory amendment merely reflects the actual status quo); and
 - ensuring that the process for appointing independent directors to the Kiwifruit New Zealand board is ‘truly independent, by requiring MPI to identify candidates, in consultation with Kiwifruit New Zealand, for appointment by the Minister. This concern has been addressed by directly including this process in the recommended proposal for board appointments.

11 Conclusions and recommendations

169. In summary, MPI recommends the following changes to the Regulations:

- amend the Regulations so that Zespri can address matters relating to share ownership in the same way any other company would under the Companies Act 1993. This involves ensuring that shareholders can vote, regardless of their supply to Zespri. This will allow Zespri to amend its constitution to implement rules about share structure and maximum shareholdings, subject to the shareholder vote;
- amend the non-diversification rule so that:
 - only those interest groups who are captured by the single desk are given a vote in deciding the industry’s risk / return exposure;
 - 75% of shareholders and suppliers must approve a proposal for Zespri to undertake a non-core business activity;
 - where Zespri undertakes non-core business activities, it mitigates the risks as far as is reasonable in the circumstances for those shareholders and suppliers who do not approve;
 - lower the threshold for triggering the non-diversification test by replacing “not necessary for core business” with “does not support core business”;
- amend the definition of Zespri’s core business to include marketing and market development for New Zealand-grown kiwifruit and kiwifruit research and development;
- restructure the Kiwifruit New Zealand board so that it has:
 - 3 directors elected by growers (status quo);
 - 2 independent directors (who have no financial interests or are directly related to someone with financial interests in the kiwifruit industry), to fill skills identified as necessary by the board, and appointed by the Minister from a list compiled by MPI in consultation with the board;
 - 1 independent chair (who has no financial interests or is directly related to someone with financial interests in the kiwifruit industry) appointed by the Minister from a list compiled by MPI in consultation with the board;
 - increasing the board quorum from 3 to 4 directors;
 - each director to be elected/appointed for up to three years, and may be reappointed/re-elected at the end of their term, with a maximum of 3 terms;
 - for current directors, their current and previous terms on the board will count towards the maximum term limit.
- enhance Kiwifruit New Zealand’s reporting and accountability provisions by:
 - requiring Kiwifruit New Zealand to develop three-yearly Statements Of Intent for Ministerial approval;
 - providing for annual MPI-Kiwifruit New Zealand engagement to discuss Kiwifruit New Zealand’s annual and collaborative marketing reports, and Kiwifruit New Zealand’s performance against its SOI; and
 - requiring six-yearly independent reviews of Kiwifruit New Zealand’s performance against its SOI and the Regulations.

- improve the flexibility of Kiwifruit New Zealand's funding by replacing the cost-effective and efficiency requirement contained in regulation 34 with standard cost recovery principles.

12 Implementation plan

170. MPI is aiming to have policy agreement from Cabinet to the policy direction by August 2016, and to have Regulations come into force later in 2016. Zespri will be required to pass amendments to its constitution to give effect to improved alignment of ownership and supply. This can be accomplished either by special general meeting in 2016, or at its annual general meeting in 2017.
171. All regulatory changes will be carried out by MPI. MPI will consult with key affected stakeholders throughout the drafting of the amending Regulations, and will inform them when the amended Regulations are approved. All potentially affected individuals and groups will be notified of the amended Regulations by notice in the Gazette prior to coming into effect.
172. The main risk around implementation is that the changes to the Regulations may not meet the timeframes originally requested by Zespri, NZKGI and Kiwifruit New Zealand. This matter has been discussed with these stakeholders, and they understand that the appropriate process must be followed to amend the Regulations. They will communicate this and manage the expectations of the wider sector.

13 Monitoring, evaluation and review

173. The proposals involve a number of enhancements to the way in which the Regulations are currently monitored, evaluated and reviewed. In particular, MPI will have more regular and closer involvement with the regulatory body through the proposed development of the Statement of Intent and annual discussions around performance. There will also be six yearly independent reviews of Kiwifruit New Zealand.
174. MPI officials will also monitor the performance of the wider aspects of the Regulations, and in particular the implementation of the proposed non-regulatory improvements to the way in which the collaborative marketing provisions are implemented. MPI expects to see significant improvements in this area prior to the first independent review of Kiwifruit New Zealand.
175. In addition to MPI's role in monitoring the impact of the proposed amendments, the ongoing application of the Commerce Act 1986 will play a key role in ensuring that the actual impacts on competition of the proposed amendments align with MPI's assessment in this RIS.