IN THE SUPREME COURT OF NEW ZEALAND SC 150/2016

BETWEEN FONTERRA CO-OPERATIVE GROUP LIMITED

Appellant

AND McINTYRE AND WILLIAMSON PARTNERSHIP & ORS

Respondents

Hearing:	27–28 July 2017
Coram:	Elias CJ William Young J Glazebrook J O'Regan J Ellen France J
Appearances:	J E Hodder QC, D T Street and H K Wham for the Appellant D J Goddard QC, B M Russell and K M Kendrick for the Respondents

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CIVIL APPEAL

MR HODDER QC:

May it please the Court, I appear with my learned friends Mr Street and Ms Wham for the appellant.

ELIAS CJ:

Thank you, Mr Hodder, Mr Street, Ms Wham.

MR GODDARD QC:

May it please the Court, I appear with my learned friends Mr Russell and Ms Kendrick for the respondents.

ELIAS CJ:

Thank you, Mr Goddard, Mr Russell, Ms Kendrick.

Thank you for accommodating us by starting early. We'll take the adjournment at 11, the morning adjournment, and we'll resume after lunch at two rather than 2.15 if that's all right.

Yes, Mr Hodder.

MR HODDER QC:

May it please the Court, what I propose I do subject of course to what the Court wishes to do is to concentrate on the statutory interpretation aspect of this case. In our respectful submission this is a matter where there is not much choice but to metaphorically roll the sleeves up and wrestle with the statute, in Part 2(5), because it's the different reading of the statutes that leads to the different approaches taken in the submissions that the Court have and it's the success of the respondent's approach which underpins the results in the High Court and the Court of Appeal with which we respectfully disagree. So I don't in what I am about to do propose to follow particularly the written submissions, the Court has had those and I'm sure has had the chance to look at them. So I'll be covering ground principally by reference to the 2011 reprint of the Dairy Industry Restructuring Act 2001, which is tab 2 in our bundle of authorities. We have the original Act as enacted there, but it's simpler I think if you use the 2011 reprint for our purposes; it's the one that was in force at the time of the events we are concerned or close to.

So the uncontentious territory on which there will be no disagreement is that we are required to engage with the text of this legislation and in light of its purpose, and that is to say text must be cross-checked against purpose having regard to the context, including the immediate context of the statute itself and the social, commercial and other objectives of the enactment, which is what this Court said in an earlier case involving Fonterra and the Commerce Commission which is in the bundle of authorities as well. There is also an expectation that statutory terms and concepts are used consistently and they're used purposefully. Again, no dispute about that. And on this appeal we are primarily concerned with two terms. The first term is "new entrant" and the second term is "milk supplied as a shareholding farmer", and it's our contention of course that the latter informs the former. And it's interesting that that latter phase "milk supplied as a shareholding farmer" is used 10 times in subpart 5 of Part 2, and we'll touch on those in the course of my submissions. But the short point is the Court appreciates from our written submissions is that we contend that supply as a shareholding farmer, that is that phrase that's used consistently in Part 2(5), means share-backed supply and it doesn't mean contract supply, and it does not mean, as the Court of Appeal and the High Court held, supply by somebody who owns any number of shares, one of more shares, in Fonterra.

We also say, and again this is in our written submissions but I will want to emphasise the point, that the focus of Part 2(5) is on an open entry/open exit regime, and that is where the significance, we say, of the concept of supply as a shareholding farmer derives from and informs the interpretation of the various parts of the relevant provisions.

So again, no controversy, we're concerned with the dairy industry and the Dairy Industry Restructuring Act. The dairy industry is based on the supply and processing of milk from dairy cows, and the purposes are set out in section 4 of the Act, and the ones that we are concerned with – and again no dispute about this – is section 4(a) and section 4(f). So section 4(a) is the enabling part of the legislation, it enabled the amalgamation that produced the new co-op, Fonterra, to proceed by giving clearances otherwise troublesome

under the Commerce Act 1986. Section 4(f) refers to, "Promoting the efficient operation of dairy markets in New Zealand by regulating the activities of new co-op to ensure New Zealand markets for dairy goods and services are contestable," so efficiency, contestable markets, for dairy goods and services, including the supply of raw milk, which is what we are concerned with, and again to this point nothing I think that's controversial. But what we say is that that concept of contestable markets to achieve efficiency is what drives the provisions that set up the open entry/open exit regime.

So just to touch briefly on the establishment of the new co-op. Fonterra was intended to be and is a co-operative dairy company under that particular legislation, there's a passing reference to that in section 161 but we don't need to go there, and it was authorised in terms of being a business acquisition with public benefits that outweighed any substantial lessening of competition and market by virtue of section 7(1) of the Act we have before us. So the Act gives the clearance as opposed to the Commission giving the clearance and, as is well known, there had been a previous attempt to obtain Commerce Commission clearance which had run into difficulties because of the market share that the new co-operative would have. So that was section 7(1) that gives an authorisation under 67(3)(b), that's business acquisition with public benefits. And then section 11 given an authorisation under section 58 of the Commerce Act in relation to contracts, arrangements and understandings that might substantially lessen competition, and does that for various provisions in schedule 1 which are extracts from new co-ops' Constitution. And if we turn to the schedule, which commences at page 114 of the reprint of the statute…

ELIAS CJ:

Sorry, what page?

MR HODDER QC:

114, schedule 1. And unsurprisingly these provisions are particularly concerned with the supply of raw milk to the new co-op. And in particular what we find out for our purposes is in clause 2 – and these are extracts only

from the Constitution, I'll go the full Constitution in a moment – but these are the extracts that are authorised for the purposes of the Commerce Act. Section 2.3 is most relevant for our purposes. "The Board may in its absolute discretion decide, (a), whether or not to accept application by a person to become a shareholder made in accordance with clause 2.2 or any other procedure; and, (b), whether or not to accept the supply of milk from any person on such terms and conditions as the Board thinks fit without requiring that person to become a shareholder in respect of that supply." So there's a distinction between shareholder applications and applications by others, and in both cases there is a discretion. Now it's again common ground that the discretion that Fonterra has under the Constitution is virtue of section 135 of this Act subject to the provisions of Part 2(5). So in the event of a clear conflict then the statute wins.

The provisions of the schedule we're looking at go on and 2.4 has some constraints on issuing shares, 2.5 talks about the separate designations for suppliers from each farm dairy. 2.6 says there can be requests for separate designation for supplies from the same dairy, that is to say one can treat milk coming from one farm, as it were, and split into two kinds of supply and they can have separate co-operative shares attaching to each supply, and then 2.7 says you can request a split where some of the milk is covered by being a shareholder and others is supply from a person not required to become a shareholder in respect of that supply, and so we're starting to get towards the idea of a contract supply as distinct from a share-backed supply, so that's clear enough here.

Over the page, on page 116, we have clause 3, the presumptive share standard, in 3.2, "The share standard for each season, and therefore the number of co-operative shares a shareholder shall hold for that season, shall be one co-operative share for each kilogram of milk solids obtainable from milk supplied to the company by that shareholder in that season." So the acronym kgMS is used for the kilograms of milk solids and it's the basis of payment and it's the basis of acquiring shares. So the average dairy farm, I understand, may produce something like 140, 150,000 kilograms of milk

solids a year. Being fully shared up, it would hold the relevant number of shares, 140 or 150,000, and to do so, as we'll come to in the Part 2(5) we're concerned with, there are provisions about how that price was set and when it was payable.

If we can turn to the –

ELIAS CJ:
Sorry, just on these provisions, do they make it clear that everything is farm-specific except where there has been a split in accordance with these arrangements?

MR HODDER QC:
For Fonterra's purposes, 2.5 makes it farm-specific subject to the splits, yes.

ELIAS CJ:
Yes, thank you.

MR HODDER QC:
The concept of a farm dairy is less evident in the Act itself, the Act's provisions.

WILLIAM YOUNG J:
It's not defined.

ELIAS CJ:
But it must simply be surplus usage in a way, mustn't it, if the scheme is that it's all farm-specific then it's –

MR HODDER QC:
Well, farm-dairy-specific, to be precise. So conceptually one could have one milking dairy supporting two different farms, for example. That may be one of the reasons behind it. So if you have a centrally located milking shed it may have two different supplies, there may be different ownership arrangements

as to the two sorts of supplies. There also can be expansions where the paddocks next door are purchased and converted from grazing land into dairy land. That supply will go through the same farm dairy.

WILLIAM YOUNG J:

So is farm dairy the milking shed?

MR HODDER QC:

Effectively. If I can briefly take the Court to the full Constitution, that's in volume 6 of the agreed bundle or case on appeal, at the very beginning of the volume at page 928. 926, et cetera, is the contents. 928 is clause 1, and just to briefly pick up on some clauses that are not in schedule 1 and are not authorised – volume 6, Ma'am.

ELIAS CJ:

Thank you, and pages?

MR HODDER QC:

Page 928 is where I'm starting.

ELIAS CJ:

Yes, thank you.

MR HODDER QC:

So page 928 sets out the purpose. Again, no surprises there. The purpose of the company in carrying out its business is to maximise the wealth of its shareholders by the sale of their milk, by providing a purchaser of that milk and enhancing the value of the co-operative shares. So we see immediately, we say, the connection between the shares and the importance of shares and their relationship to milk and, in particular, then we go into 1.2, the principal activities of the company are, (a) the manufacture and sale of various things, products derived from milk or milk solids supplied to the company by its shareholders, and then we go on to have the provisions we've seen in 2 about applications and the concept of the share standard. What you don't see in

schedule 1 but we see on page 930 is clause 3.4 about contract supply, and contract supply then, well, 3.3 and 3.4, contract supply described, firstly, in terms of unshared supply under 3.3, but there's limits on the overall amount of those shares and, 3.4, contract supply where a shareholder can supply milk to the company on a seasonal contract supply. Then there's a series of provisions, which I don't need to go into for present purposes, about fair value, but the basic proposition is that the fair value price is the price of entry and the price of exit under the Constitution as well. And the standards in terms of supply have to be disclosed by new co-op on its shareholders and they are binding, that's clause 9.6.

So what we say about that is that one cannot read DIRA without appreciating that the legislature understood perfectly well the way that the new co-op would operate. It would operate in accordance with its Constitution and it would operate in the normal way in which co-operative dairy companies have operated for some time, that is to say the shareholders provide the milk and the capital, and if you provide the milk you have to buy the capital and if you buy the capital you're entitled to provide the milk. So the link between milk and capital and therefore shares we say is fundamental in the business operation that was being authorised by this special legislation.

The only other thing I should do before we leave the Constitution for my purposes completely is take the Court to 9.4.2, the terms and conditions of supply – some but not all of these provisions are to be found in schedule 1 – and there for 9.1, "Shareholders to supply all milk to the company," now that in fact is subject to the 20% rule which is to be found in the statute itself, 9.2, notice to a supplier to cease supplying milk can't be given unless it's in accordance with the terms and conditions, 9.3 authorises the Board to fix standard terms and conditions, 9.4 says there can be special terms and conditions, and for reasons I don't fully understand 9.3 and 9.4 are omitted from schedule 1. And 9.4 goes on to say at the end of it the Board's special terms can reflect among other things the arrangements for the contract supply of milk under clause 3.4 and/or requirements of the Board

under 5.2, 9.5 says the terms and conditions must be notified, 9.6 they are binding.

ELIAS CJ:

So you said that these are omitted from schedule 1?

MR HODDER QC:

Yes, on page 133 of the statue you have an extract from 9, you have 9.1, 9.2, 9.5 and 9.6.

ELIAS CJ:

Yes.

MR HODDER QC:

I'm simply pointing out that those ones are missing. They're the authorising provisions. I can't at the moment see there's anything particularly offensive about them but I'm just pointing out they've been omitted.

ELIAS CJ:

But what do you say the relationship is? Presumably if there was anything in the Constitution that was inconsistent with the provisions of the Act, including the schedule, then they would yield?

MR HODDER QC:

They would.

ELIAS CJ:

Yes.

MR HODDER QC:

Yes, I'm introducing the concept of terms of supply because terms of supply are something that's mentioned in section 106, which is kind of one of the reasons why we're here.

ELIAS CJ:

But they're not authorised, the provisions –

MR HODDER QC:

The empowering.

ELIAS CJ:

Yes, they are not – the actual provisions adopted are not authorised by the statute.

MR HODDER QC:

Well, curiously, 9.5 and 9.6 are premised on there being terms and conditions.

ELIAS CJ:

Yes, I understand that.

MR HODDER QC:

So, as I say, that's the reason I say it's not clear what the point of not authorising them is, because they are binding according to 9.6, at least they're authorised to be binding under 9.6.

ELIAS CJ:

Yes.

MR HODDER QC:

I don't think a great deal turns on that, as I say, I'm merely introducing the fact that there are terms of supply contemplated, as one would expect, in the Constitution, and that phrase "terms of supply" crops up at a couple of points in Part 2(5).

ELLEN FRANCE J:

Just in terms of clause 3.4 dealing with contract supply: that is still linked to a shareholder isn't it?

MR HODDER QC:

It is.

ELIAS CJ:

What do you say is the significance of that or lack of significance?

MR HODDER QC:

3.4 as we see it is an elaboration and probably simply a belts and braces approach to 2.3(b). So clause 2.3(b) gives the Board an absolute discretion to issue, sorry, to accept supply without any shares being, well, no shareholder in respect of that supply and that's to any person, we would say "any person" includes a shareholder, and 3.4 is a clarification or an amplification of that.

GLAZEBROOK J:

How do you relate that to the unshared supply, 3.3, sorry, because –

MR HODDER QC:

Well, 3.3 is, I think, a qualification on the compliance with the share standard. I'm not sure that I have a clear answer as to what 3.3 and 3.4 are different on.

GLAZEBROOK J:

That's what I was seeking your assistance on.

ELIAS CJ:

Is there a difference between share-backed supply and shareholder eligibility to supply by contract?

MR HODDER QC:

Yes.

ELIAS CJ:

Yes?

MR HODDER QC:

Yes. Well, that's the essence of our case.

ELIAS CJ:

Well, is that what this is, the –

MR HODDER QC:

Not quite. Contracts – both of these, 3.3 and 3.4, are framed in terms of shareholders and 3.3 is mostly about a limitation and how many shares of this kind – the cap as to how many shares you can have and that the time you are supplying less than the co-operative shares would comply with the standard. So there's a 20% constraint.

ELIAS CJ:

Well, that's understandable perhaps that's a – but that's a qualification for entering into a contract of supply, is it, that level of shareholding?

MR HODDER QC:

Yes, I –

ELIAS CJ:

But it's not a share-backed supply?

MR HODDER QC:

In terms of 3.3 it looks mostly like share-backed supply with a discretion or a, more or less 20% added to it.

ELIAS CJ:

I see.

GLAZEBROOK J:

And just to be clear, these people don't come under that.

MR HODDER QC:

For my purposes they come under 2.3(b).

GLAZEBROOK J:

Well, I understand what you're saying but you're saying that there isn't the 3.3 restriction on these people?

MR HODDER QC:

No, well, there – no, not at all.

GLAZEBROOK J:

And why was that?

MR HODDER QC:

On the – are we talking about the suppliers?

GLAZEBROOK J:

Well, why don't they have to comply with 3.3?

MR HODDER QC:

Because they're supplying under a contract.

GLAZEBROOK J:

But if you see 3.3 and 3.4 as working together, how can you supply under 3.4 without meeting 3.3?

MR HODDER QC:

3.4 looks like it's a specific contractual regime. 3.3 looks like something different, and I haven't been focusing on 3.3, I don't know that it has a major role here. 3.4 is certainly contemplating –

GLAZEBROOK J:

But 3.4, 3.3 says you can't have unshared supply, doesn't it, except within those limits, so I'm not sure why you can have contract supply and not be within the 3.3 limits as well.

MR HODDER QC:

Because I think 3.4 is one that overrides 3.3. It's a more specific provision.

GLAZEBROOK J:

Okay, so you can get around 3.3 by pretending it's 3.4.

MR HODDER QC:

My friend, Mr Street, reminds me that 3.3 is about a modification of the supply of the share standard for those who are otherwise complying with a share standard. Contract supply is something being outside the share standard.

GLAZEBROOK J:

Well, I just don't quite understand why that would be the case.

WILLIAM YOUNG J:

Well, is unshared supply, is that where something's gone wrong, when someone's got more milk than anticipated or more milk than they –

MR HODDER QC:

It would allow for that, overs and unders, but in terms of 3.4 we say it's a specific provision that says that it operates and as we see it it operates as an elaboration of 2.3(b).

GLAZEBROOK J:

Well, 2.3(b) is overwritten by the Act, isn't it? You accept that?

MR HODDER QC:

I accept that all of this will be overwritten where there's a direct conflict.

GLAZEBROOK J:

Well, 2.3(b) there is clearly a direct conflict, at least with the in-season applications or on-time applications.

MR HODDER QC:

Yes, absolutely. But, well, the follow-up proposition of course, as you know, is that what we say is that the Act doesn't touch contract supply so there is no conflict between 3.4 and any part of the Act.

GLAZEBROOK J:

I suppose I understand that, but what I'm really asking you is that it does seem to me that even contract supply is predicated on being a shareholder, and what I can't understand then is why the 3.3 limitation is going to apply. Because otherwise you could, as long as you were within that aggregate, you could allow anybody to have contract supply and ride roughshod over the whole regime.

MR HODDER QC:

Well, you couldn't ride roughshod over the regime if they made an application during the application period.

GLAZEBROOK J:

No, no, I'm talking about just taking contract supply rather than taking milk from shareholder. But anyway, you can –

ELIAS CJ:

You're saying that 3.4 is a stand-alone provision, and what's being put to you is actually there might be a pattern in this in which 3.3 also applies to contract supply under 3.4.

MR HODDER QC:

Yes, and my essential response to it is that 3.4 is elaboration of the power in 2.3(a), which is not qualified –

ELIAS CJ:

It's not connected though is it? There's no internal referencing.

MR HODDER QC:

No, there isn't.

ELIAS CJ:

No.

MR HODDER QC:

If there was we possibly might not be having this argument.

ELIAS CJ:

Yes.

MR HODDER QC:

But the basic proposition is we say there's no doubt that under 2.3(b) there is a power to accept supply without requiring the person to become a shareholder in respect of that supply, that's standard, unqualified. We say that 3.4 is an elaboration of that, so that where the "any person" in 2.3(b) happens to be a shareholder there can be a contract – that part of that supply they give is given on the basis that they don't have to have shares in relation to those but there can be a requirement for a minimum of co-operative shares to be held throughout the term of the contract. 3.3, we say, doesn't have a great deal to do with anything under these circumstances. The main propositions are 2.3(b) and 3.4, and 3.3 doesn't relevantly qualify anything that we are concerned with on this appeal.

ELLEN FRANCE J:

Is this argument dependent on these being applications that were accepted under 2.3(b)?

MR HODDER QC:

Essentially, yes. I suppose I should add we don't see it makes much difference when 2.3(b) and 3.4, they're the same effect. So it depends on how we regard the shares. So for these, the particular plaintiffs or the suppliers that we are concerned with here, there is no doubt that they were required to hold the minimum of 1000 shares. Now that's a purely token amount. So we say that is a classic case of de minimis. But if one says –

GLAZEBROOK J:

Well, don't they have to already be a shareholder?

MR HODDER QC:

For?

GLAZEBROOK J:

To have contract supply.

MR HODDER QC:

Not under 2.3(b).

GLAZEBROOK J:

Well, no, not under 2.3(b) but under 3.4 don't they?

MR HODDER QC:

Yes. Well, that includes holding the minimum number of co-operative shares.

GLAZEBROOK J:

Well, no, you may require them to hold a minimum number, but they have to be a shareholder in order to have contract supply don't they, despite what 2.3(b) appears to allow you to do? Or are you saying 2.3(b) would allow contract supply other than in accordance with 3.4?

MR HODDER QC:

Yes, they both provide ways of providing contract supply. One has a requirement for shares explicit, the other doesn't.

GLAZEBROOK J:

Well, were they operating under 3.4 or some other provision?

MR HODDER QC:

We say they're operating under a combination of 2.3(b) and 3.4.

GLAZEBROOK J:

So the proposition is under 2.3(b) you can have contract supply without someone being a shareholder, and that's a stand-alone power?

MR HODDER QC:

Yes.

ELIAS CJ:

But you can't have a bob each way can you?

GLAZEBROOK J:

But why would you have 3.4 in?

ELIAS CJ:

What were they relying on? Were they relying on – they must have been relying on 3.4.

MR HODDER QC:

I'm not sure a bob each way is right, they're simply relying on powers under the Constitution, they have two powers under the Constitution: the two provisions we're looking at.

ELIAS CJ:

Well, it was a matter of indifference to them that these were shareholders, on that view?

MR HODDER QC:

No, what they wanted, what Fonterra was seeking to have was, that they would hold a minimum number of shares. So it looks more like a 3.4 proposition, I accept that.

GLAZEBROOK J:

But don't you already have to be a shareholder before you do it? Isn't the minimum number of shares just saying that you can say you can't contract supply unless you hold 50,000 shares?

MR HODDER QC:

That's a temporal aspect but –

GLAZEBROOK J:
Well, because you have to be a shareholder before you're allowed to supply milk, so just saying that – so it's not that – all it says is we won't allow contract supply unless you're already a shareholder at this minimum level.

MR HODDER QC:
The way it works –

GLAZEBROOK J:
Ie, if you're a small farmer supplying two bits worth we won't let you do contract supply. We'll only allow the large shareholders to do that.

MR HODDER QC:
I don't think that the temporal aspect is clear and that it's simply the proposition is that at the time that you commence supply you are a shareholder. That's when it matters, and by that time you will have done so because as the end of 3.4 says, you will be required to hold a minimum number of co-op shares. You will be a shareholder at the time you start supply. Well, at least you've applied for it which is all that matters. The idea that you cannot even begin to contemplate the contract supply under 3.4 until you have already become a shareholder isn't, we say, to be taken from 3.4 anywhere else. At the end of it you will be a shareholder because you will have the minimum number of shares and you'll also have contract supply, and we say effectively that's what happened here.

If it's convenient, I was going to go back to the definitions in section 5. I should have, sorry, said when I opened that I have through the Registrar sent to the Court members and to my friends a small, one-page flow chart. I'll get to that later on but that's, just to let you know that's not an accident. It's kind of – that does have some design to it. So in terms of the definitions with section 5, perhaps starting, as it were, with the semi-constitutional ones on page 16, we see the definition of the "new co-op amalgamation". So it's the new co-op amalgamation which is being authorised by section 7.

Then we have “new co-op” which is the amalgamated company and for all our purposes we can call it either new co-op or Fonterra.

Just going back a couple of pages, we come back to page 12 and we see “co-operative share”. So a co-operative share is a share in new co-op, which we’ve just seen, issued or to be issued from either the original amalgamation or be in relation to the supply of milk to new co-op by new entrants or shareholding farmers. Now we’re going to have to deal with new entrants and shareholding farmers as we go along but just at this stage can I emphasise the concept that it’s related to the supply of milk, and we say that again informs the phrases that we are concerned with as we go on.

The “co-operative share standard” goes back to the Constitution and for all practical purposes one share for every kilogram of milk solids supplied, and then across the page on page 13 –

ELIAS CJ:
Sorry, I’m not sure what pages you are referring to.

MR HODDER QC:
I am referring to the pages I hope on the bottom of the reprint.

GLAZEBROOK J:
Sorry, what was the last definition? Was that the co-operative share standard you were referring to? What were you – the last definition you referred to, Mr Hodder.

MR HODDER QC:
I referred to the co-operative share standard definition.

GLAZEBROOK J:
That’s what I thought, thank you.

ELIAS CJ:

Do you have those page numbers?

MR HODDER QC:

Yes, and I was pointing out that that takes you back to the Constitution, one share per kilogram of milk solids.

ELIAS CJ:

We don't have those page numbers.

MR HODDER QC:

At tab 2.

ELIAS CJ:

No, on mine –

GLAZEBROOK J:

Is it –

ELIAS CJ:

123 is –

GLAZEBROOK J:

At the bottom of the page, is it?

ELIAS CJ:

21.

GLAZEBROOK J:

Have you?

ELIAS CJ:

Yes, 121.

WILLIAM YOUNG J:

Is that tab 2?

ELIAS CJ:

Yes.

MR HODDER QC:

At the very beginning of the –

ELIAS CJ:

Can you just refer to the section number and paragraph then or is that –

MR HODDER QC:

Well, it's section 5(1) so it's several pages of definitions which is why I was using the page of the statute.

ELIAS CJ:

Well, at the bottom of section – the first page of section 5, I have page 121.

O'REGAN J:

That might be the schedule, section 5 of the schedule.

ELIAS CJ:

Sorry, yes, yes, I'm back.

MR HODDER QC:

Yes, Justice O'Regan is right.

ELIAS CJ:

I had left it open, thank you.

MR HODDER QC:

Yes, so schedule 1 starts at page 114. Everything up to that is the main body of the Act.

ELIAS CJ:

Yes.

MR HODDER QC:

So if we're on page 12, so that in terms of where I was, the Chief Justice, I've been looking at page 16 before, which is the definitions of new co-op and new co-op amalgamation.

ELIAS CJ:

Yes.

MR HODDER QC:

And then I go on to page 12 which are the definitions of "co-operative share" and "co-operative share standard".

ELIAS CJ:

Yes.

MR HODDER QC:

And then back on page 13, firstly there is default price. Now a default price is the price you pay or one of the prices you would pay for a co-operative share. But what we can note here is that in relation to a co-operative share it means the June price if that price is in the price range, "In the first season for the supply of milk to which an application to supply as a shareholding farmer relates." And so we say that phrase "supply as a shareholding farmer", that's what the default price is relating to. And then above that we have "dairy farmer", a dairy farmer who produces milk from dairy cows as a business, elsewhere we see that there is a minimum supply requirement of 20,000 kilograms of milk solids a year – I'll come to that – but this all goes to reinforce our point that 1000 kilograms or 1000 shares is quintessentially token and de minimis.

Over the page on page 14 we see the other aspect of the market feature of clause 2.5, and we'll come to that. But the idea is an independent processor,

"An independent processor is a processor not associated with new co-op," and so our contention is that the contestability sought in relation to the raw milk market or markets, depending on how you do the geography, are independent processors, as opposed to Fonterra as processor.

The agricultural or biological nature of the industry is well-known, the peak sort of normally October, but on page 17 we find the definition of "season", being a period of 12 months beginning on each 1 June. And in contrast with that date of 1 June, if we go back to page 11 we see the definition of the "application period": it's a period set by a new co-op as an application period under section 75. If we turn for the moment to section 75, which is on page 61 of the reprint, we see that an application period must be set by new co-op that is before the commencement of each season in which new entrants may apply to supply milk, "As a minimum an application period must span the dates 15 December to 28 February in the next year." So the sequence is you have an application period that's notified early, it covers the period from at least 15 December to 28 February, as a matter of practice that is the application period that's been used, and then it's the following 1 June that the new seasons starts. So the effect of that is that from effectively 1 March through to the end of May there is a three-month period in which Fonterra can organise itself to deal with peak supply, if it can. So the application period's quite a narrow period if you take 52 weeks as a whole, but I don't think it's in dispute that the principle reason for that is to enable Fonterra to deal with that peak milk that's going to come sometime in the spring of the new seasons commencing 1 June.

Now we were looking at section 75, we see there the concepts of shareholding farmers and new entrants. We'll come back to these sections in more detail. But going back to the definitions on page 17 we have "shareholding farmer" below "season", means a dairy farmer we see in that definition, "Who is registered as a holder of co-operative shares," and that simplicity, we say, is beguiling. It has beguiled the Courts below into the proposition that any share held means that the person is a shareholding

farmer and all the provisions that refer to “shareholding farmer” apply to such a person.

The “new entrant” definition is on page 16 and, as we see, it means, “A dairy farmer who is not a shareholding farmer,” the two definitions we have already seen, “who applies to become a shareholding farmer under section 73.” Now we’re going to have to spend time on section 73 obviously, before I do can we just pause at the slightly earlier provisions in subpart 5. So subpart 5 starts on page 59. Section 70 states a purpose for the part which is effectively a paraphrase of the purpose we saw earlier in section 4(f), so section 70 doesn’t use a language of contest or markets. It refers to efficiency and efficient operation. But section 4(f) is a pretty clear clue that what that is to be done is by having contestability in the markets.

Then section 71 we say is important and we say that section 71(a) through to (e) are related and they are all related to the concept of open entry and open access, exit and contestability. So (a) is about the independent processors, the ones who are going to compete with Fonterra. They must be able to retain more milk and other dairy goods and services necessary for them to compete. That means they have to be able to get raw milk. (b) says new co-op must accept applications by new entrants and shareholding farmers to supply it with milk as shareholding farmers, and we say the fact that it goes on to say “as shareholding farmers” is meaningful. It doesn’t stop with the word “milk”. So that means that people who are raw milk producers have the option of going into Fonterra subject to compliance with certain conditions. (c) reinforces that by saying there’s not to be discrimination between those who are already supplying and those who are not. (d) then says you have open exit. You can withdraw from new co-op and must receive their capital back without unreasonable delay. So they can’t be tied in. So the independent processor knows that if they want to dump somebody at the end of a contract, both they and the farmer know the farmer has an ability to get into Fonterra and if they want them to get out of Fonterra to lure them away then there’s open exit which is covered by (d) and reinforced by (e). That is to say, when you get paid out you pay the same amount that people are paying to come in

at the same time. So the combination of (a) to (e) as we apprehend it is what is described as the open entry/open exit regime.

And the connection between milk supply and capital payments is clear in these subparagraphs. We're talking about raw milk. We're talking about milk supply to processors, we're talking about people having to produce capital and receiving their capital back.

We then come onto the core sections that we are concerned with which are sections 73 to 76, although the whole, almost all of section Part 2(5) helps in this process. So let's start with section 73 and section 74, and our proposition is they have to be read together. The driving aspect of in terms of open entry is in fact section 74(1), "If an application referred to in section 73 is made to new co-op in an application period, new co-op must accept the milk," it doesn't have a choice, it overrides the discretions in the Constitution, that is the mandatory open entry. So what are the applications under section 73? We say that perhaps the easier example is to take section 73(2). Let's assume we have an existing shareholding farmer who wants to increase, divide the milk supply, the adjoining paddocks have been bought from the sheep farmer next door or whatever the scenario might be. So how does that work? Well, that farmer makes an application under 73(2) in the application period, and their application must be accepted under section 74(1). 74(2) says they're required to satisfy the applicable terms of supply. And then 74(3) goes on and says, well, actually, if you're outside the application period but you applying to supply milk as a shareholding farmer, then new co-op has a discretion is has a choice, you can accept that or not. So let's go back to 73(2), "New co-op must accept an application to increase the volume of milk supplied as a shareholding farmer to new co-op that is made by a shareholding farmer in an application period." So we have somebody who already is a holder of shares. The talk, the language of 73(2) is about new milk being supplied as a shareholding farmer, and we say the Courts below have not engaged sufficiently with the concept of supply as a shareholding farmer, that that phrase is meaningful, and the only sensible meaning for it is not that you are a holder of shares, because otherwise 73(2) makes no sense, you already hold

some shares, it's about share-backed supply, and that is consistent, as I go on to submit, with the purposes of these provisions.

So we say at this stage you're making an application as a shareholding farmer under section 73(2), you've got to get your application in by the end of February, and from 1 June in the new season you are entitled to have all your new supply taken by Fonterra. The same thing we say applies to section 73(1). 73(1) is a person who's not yet a shareholding farmer. So 73(1) has the language, "New co-op must accept an application to become a shareholding farmer that's made by a new entrant," in the Courts below it's essentially said that means an application to become a shareholding farmer, "shareholding farmer" is defined as somebody who holds a share, so if they hold a share and they're applying for a share they must be a new entrant. Our response is no, the person applying under section 73(1) is in precisely the same position for all practical purposes as the one under 73(2), they are offering new supply or they want to put new supply in in the new season, supply that hasn't been given to Fonterra in the past or bought by Fonterra in the past. What they are looking to do is supply milk as a shareholding farmer. And that becomes clear in both section 74(3), which talks about applications outside the application period from a dairy farmer, including a shareholding farmer, so anybody who's seeking to apply, as a shareholding farmer, doesn't discriminate or distinguish between those who were shareholding farmers and those who were not. Likewise in section 75, when it talks about the application period it's talking about an application period in which new entrants may apply and shareholding farmers may apply to supply milk as shareholding farmers. So, "New entrants may apply to supply milk as shareholding farmers." So 73(1) must be read, we say, as an application to supply milk as a shareholding farmer, that is as a share-backed supplier, it isn't just any application that happens to have a share or two attached to it, and that's the point at which either we parted company or likely the High Court and the Court of Appeal parted company with us to get the point where we are now.

GLAZEBROOK J:

If these people applied in the next season would they be new entrants?

MR HODDER QC:

If they'd done nothing in the season we were concerned with?

GLAZEBROOK J:

No, no, they supplied as, you say, a contract supplier. Are they new entrants if they make an application in the next season required to be accepted?

MR HODDER QC:

Well, that depends on the terms of their contract supply.

GLAZEBROOK J:

Well, why does it depend on the terms of their contract supply?

MR HODDER QC:

They have to comply with the existing terms that they are under.

GLAZEBROOK J:

So they can never apply, is that the –

MR HODDER QC:

Well, until their contract expires they are bound by the contract.

GLAZEBROOK J:

So effectively a contract supplier can never become a shareholding contractor?

MR HODDER QC:

Well, that assumes –

GLAZEBROOK J:

Well, say somebody who's left and come back wants to come back in, are they new entrants?

MR HODDER QC:

If they have no contract supply, yes.

GLAZEBROOK J:

All right, so they're new entrants. But if you get a contract supply you can actually circumvent section 73 by keeping them out of being able to apply as contract-back shareholders.

MR HODDER QC:

If they have a straightforward contract to supply for let's say five years, then yes, they have a contract supply for five years.

GLAZEBROOK J:

So basically if you apply outside of the period Fonterra can decide forever that you will never be a contract shareholder at least for whatever period Fonterra ties you up, that's the proposition?

MR HODDER QC:

Well, if it ties you up, yes. But if you don't want to you can make an application during the application period.

ELIAS CJ:

Can I just ask, it's probably entirely irrelevant, but in the submissions there were suggestions that there are causation issues yet to be determined in these proceedings.

MR HODDER QC:

There are.

ELIAS CJ:

Is that in relation to the Fair Trading Act 1986 and Contractual Remedies Act 1979 determinations?

MR HODDER QC:

Everything.

ELIAS CJ:

Well, what are the causation issues in this?

MR HODDER QC:

Well, the causation issue will be a slightly different one, but that's questionably whether if the appeal is unsuccessful and there is a continued finding of a breach of section 106, the question will be what damages flow from that, there is a right to damages.

ELIAS CJ:

Oh, I see.

MR HODDER QC:

So that will be a causation issue alongside the causation issues –

ELIAS CJ:

So there's a causation issue in this as well, it's not just, it doesn't all fall on the interpretation point, there's an assessment issue there.

MR HODDER QC:

Yes, before we get to the end of the proceedings, but not for the appeal purposes.

ELIAS CJ:

Yes, I understand, that's fine.

WILLIAM YOUNG J:

If any of the respondents had said, "Okay, we'll do something else with our milk for the 2013/2014 season," they would have had a right to come in as new entrants the following year?

MR HODDER QC:

Yes. And they have choices – we'll come to this point – but Your Honours have seen in the summaries of the evidence at least, there was a contestable process, the Commerce Commission came to the view there were credible

other bidders, there was no issue about contestability for their milk, they wanted their retros paid, that was what this was all about. And so Justice Glazebrook's point –

WILLIAM YOUNG J:
So they couldn't get their retros unless they signed up for the five-year deal or six-year deal.

MR HODDER QC:
Six-year deal, that's right. So that was the quid pro quo effectively for the retro payments to come through, a deal to involve the retro payments, the requirement and the condition for it was that they signed up on these terms, and they did.

WILLIAM YOUNG J:
Did anyone not – I mean, they did get a hundred percent?

MR HODDER QC:
Eventually, and just as I understand it, but yes.

But Justice Glazebrook's raised the important point about, well, does that mean that there can be oppression of people in some circumstances? Our proposition is that's unrealistic. But the general proposition is that insofar as the industry operates on Fonterra's Constitution and powers of contract, the powers of contract of both suppliers and Fonterra, that's the base only to the extent that Part 2(5) overrides that, these are anything other than just ordinary terms of contract, and we say it doesn't override it when there is an existing contract for supply in place.

In terms of the application period –

GLAZEBROOK J:

There's nothing in the Act that picks up the ability to have contract supply is there? The Act seems to me to be predicated on the fact that you actually have share-backed supply.

MR HODDER QC:

Well, the proposition –

GLAZEBROOK J:

Because the whole point of having a co-operative is that it is share-backed supply.

MR HODDER QC:

Yes –

GLAZEBROOK J:

And that you are obliged to take the milk solids or the raw milk from those shareholders.

MR HODDER QC:

Yes.

GLAZEBROOK J:

And you're not really allowed to circumvent that by going outside except if you've already fulfilled those shareholders and it's an ability to increase the value of the shares, et cetera.

MR HODDER QC:

Yes, if you're a shareholder then it's a quid pro quo. If you're a shareholder supplier then you supply the capital, they take the milk.

GLAZEBROOK J:

But that's the whole point of the Act, it's looking at a co-operative company, isn't it, where you will have share-backed supply?

MR HODDER QC:

Yes, and it's looking at a –

GLAZEBROOK J:

So is there anything in the Act that refers to contract supply? That was my question.

MR HODDER QC:

Yes, section 107. If we'd like to look at that it's on page 77.

GLAZEBROOK J:

No, I think you're going to take us to that, I think that's –

MR HODDER QC:

I'm going to go to section 107, but it is –

GLAZEBROOK J:

Yes.

MR HODDER QC:

It recognises both the contracts that are associated with share-backed supply. So share-backed supply still says you have to sell and be, there's still a sale and purchase of raw milk involved, and then it talks more generally about contracts that aren't limited to that kind of contract in the latter part of section 107, and there's a constraint on those that are for longer terms, which is partly I think the answer, one of the answers to Justice Glazebrook's point, that the Act is concerned to make sure that people aren't tied up forever because they can't then be available to independent processes, and that's what section 107 is about, or the latter part of section 107. But we will come to that.

At this stage I'm just going say section 76 emphasises the importance of the statutory provisions put on the application period. It has to be published throughout the land in old-fashioned media and in modern media

continuously, so it's clearly got a significance, people are meant to be paying attention, and recalling that we are talking about dairy farmers who are in the business of supplying milk, it's a major multimillion dollar business for dairy farmers, it isn't normally where you switch on a whim, there is a progressive decision-making process and factored into that is the terms of the application period.

There are then a series of sections about the co-operative share price and the co-operative share standard, sections 77 to 85. This is a key component of open entry. The effect of these provisions is that in advance the person wanting to become a share-backed supplier knows the price of the shares and knows the number of the shares by reference to the standard they're required to come up with. Again, these have to be set and published and ignoring the peak notes for present purposes we get into section 77 that Fonterra is required to set a price. The scope to amend it, there has to be a June price under section 77(4), then section 79 requires a setting of a co-operative share standard. Section 80 requires the publication of the prices and the standards in the way we've seen before under section 80(4).

Then section 81 goes on to deal with a situation where there's an application made in an application period. That gives an option between the June price and 81(1)(a) and the default price under 81(1)(b).

Under section 82, which are requirements for an application outside the application period, that is to say the section 74(3) is applicable, then there isn't a choice. It's simply the June price and that partly reflects the fact that it will be by definition a late application.

Section 83 then goes on to provide that there can be no further payments for accepting milk supply as a shareholding farmer. So again, that concept of as a shareholding farmer is picked up in that provision.

So all of these provisions, 81 and 82, are clearly related to supply as a shareholding farmer. It's not just clear from 83. Section 81(1) is framed in

terms of 81(1)(a), the supply of milk to which the application relates. That is an application to supply milk as a shareholding farmer.

Section 82(1) and (2) refer to applications to which section 74(3) applies and we say those are applications to supply as a shareholding farmer.

Likewise, in 85(2) we get the same language relating to the payment beyond a deposit, the supply of milk to which the application relates. The application is going back to sections 73 and 74 and they are for supply as a shareholding farmer.

Sections 84 and 85 say that in relation to section 73 applications, that is to say, made in time there is a restriction on the deposit payable and there's some restrictions on when the balance of the purchase price is payable. There's nothing about that for late applications and it might be dealt with under section 74(3).

Then we come to section 86 and following, we have some exceptions to open entry. There are a long series of provisions about capacity constraint notices but the effect of it reinforces what we know about the structure. If under 86(1) Fonterra has a reasonable opinion that it would be unable to process the volume of milk, you can't reasonably manage to process that increased volume in the new season and can give a notice saying pause and that has a whole series of complicated provisions around it which we don't need to wrestle with, to the best of my understanding.

But that's the first exception if Fonterra issues a notice. No such notices are involved in our case.

GLAZEBROOK J:

So effectively if Fonterra is getting a whole lot of milk from contract suppliers which you say it's perfectly entitled to get as much as it likes, it could issue a pause notice and get around section 73 and 4 because it doesn't have a

capacity to process the milk because it's getting a whole pile of milk from contract suppliers including, you say, people who do have shares in Fonterra.

MR HODDER QC:
Hypothetically, yes.

GLAZEBROOK J:
Well, doesn't that suggest it might be against the scheme of the legislation, your argument?

MR HODDER QC:
Not –

GLAZEBROOK J:
Because the whole argument is that you have open entry, so if Fonterra can artificially constrain that open entry by tying itself up with a whole lot of contract milk suppliers, it can effectively close that down to existing shareholders.

MR HODDER QC:
Well, we're talking only about new suppliers.

GLAZEBROOK J:
Well, exactly, so it can start constraining itself to –

MR HODDER QC:
But there has to be some capacity to do it. The statute doesn't require Fonterra to build a new factory –

GLAZEBROOK J:
Well, no, exactly. But in this case what it can do is get a whole pile of contract suppliers and then say, "I'm at capacity, sorry, I can't take anyone new."

MR HODDER QC:

It may do that. It's a question obviously about whether they're artificially doing it or it just happens. But if they are already full up in the factory and they can't take it then they're not obliged to take what they can't process, nor are they required to breach contracts they may already have. So again, it's a process that recognises there's a practicality about processing and in a sense those who are already supplying Fonterra are entitled to a priority, that's what section 86 and following recognise.

GLAZEBROOK J:

Well, I would have said as shareholders rather than as contract milk suppliers, but in terms of the scheme of the Act that's quite true, but not in terms of my argument I would have thought.

MR HODDER QC:

I'll come back to some aspects of that a little later, but at this stage staying with the exceptions the next kind of exception is the one in section 94, which is on page 70 of the statute, and that requires a minimum supply of 10,000 kilograms, so this is an exception to the open-entry proposition that says you have to be substantial enough. Now 10,000 kilograms of milk solids in the scheme of things these days is not a large number, but it is the minimum specified in the statute. That's the first exception.

The second exception is a transport cost one, and again Fonterra can say, "No, you may be applying under section 73 but the cost of doing so to this particular location is higher than the cost of transporting any other milk we've got in the area and we don't have to take it." Again, we don't have to wrestle with what the finer details of that are for our purposes, I just note it as being one of the exceptions, so one of the practical exceptions which the statute recognises, and unsurprisingly so, because the principle purpose of this Act was to make sure that the Fonterra co-operative succeeded, it was evidently not deemed to fail in this process, and so the practicalities of being able to deal with its own operations efficiently are recognised in these exceptions.

Then we come to the open exit aspect of this regime, and that starts at section 97. So, "A shareholding farmer who wants to cease or reduce the supply of milk as a shareholding farmer," we see that phrase again, "to new co-op may give a notice of withdrawal. The right of a shareholding farmer to cease of reduce the supply of milk as a shareholding farmer is subject to the terms governing the relationship between new co-op and the shareholding farmer." Then there's a discussion of the surrender value. If given during an application period, ie the period we know about, then the sums must be paid out promptly, and that is provided for in section 101. But again, section 97, notice of withdrawal, and section 98 refers that back to being a surrender during the application period is when the notice is done, and the phrase "supply as a shareholding farmer" is cited again in section 101. So, as I said, that's the second aspect of open, of contestability, is the open exit propositions. But if you are going to be exiting in the ordinary course you give a notice during the application period and new co-op must pay out your surrender value within 30 days of the end of the season, that is by 30 June in the year of, which would normally be in the year in which the notice has been given.

Then we get to section 106 and 109, and if I can come to 106 last, section 109 provides for the sale of milk vats by a shareholding farmer who withdraws totally from new co-op and is no longer supplying, and that's again a practicality. If you have a major substantial vat operation on the farm and you're going to supply someone else, you need a vat. This gives you the opportunity to buy the vat at valuation. Again, consistent with the idea of open exit and the ability to provide milk to some independent processor.

Section 108 gives an entitlement to shareholding farmers to allocate an independent processor up to 20% of their weekly production throughout the season. Again, this is what enables independent processors to have a chance to contest Fonterra's position by turning raw milk supply from shareholding farmers in this case.

Coming back up to section 107(3), which is what I was alluding to in my response to Justice Glazebrook earlier, it's a different kind of contract 107(3) to 101 and 102. 107(1) says that new co-op must offer the new entrants of contracts of milk supply as shareholding farmers for one season. They can't be required to commit for more than one season.

Subsection (2) is new co-op may offer either new entrants or shareholding farmers longer term contracts if there's compliance with subsection (3). Subsection (3) is a limitation on how much of the milk solids being produced not just by Fonterra but within a 160 kilometre radius of any point in New Zealand is either supplied under contracts of independent producers and processors or is supplied under contracts with new co-op that may expire or be terminated by the supply of the end of the current season without penalty or on expiry of termination and on expiry of termination and/or the suppliers' obligations to supply milk to new co-op.

So one-third of the total of the supply in the area must be available to contest. It can't all be locked up by long-term contracts by Fonterra, otherwise there would be no contestability. But what this is contemplating, of course, is that there will be contracts for supply and there'll be contracts for supply for milk as shareholding farmers as subsection (1) of 107 and more general kinds of contracts are contemplated by section 107(3).

GLAZEBROOK J:
Is that right? Because you can't – doesn't subsection (3) actually apply both to 1 and 2 as well? I just don't see that this contemplates that there are other types of contracts that Fonterra can enter into. Doesn't it have to ensure that it's not tying up that amount for longer terms, whatever, as a shareholding farmer or any supply? I'm not quite sure where you get that Fonterra can have contract supply under this. I mean, it might – it doesn't say anything about contract supply.

MR HODDER QC:

The reason I say that is that 107(3) is not limited in any way expressly to the idea of supply as a shareholding farmer.

GLAZEBROOK J:

Well, I sort of understand that because it can't be because (3)(a) has got a supply with contracts with independent processors. So if an independent processor has a five year contract with someone else, then of course it's not tied to it. The independent processor can have any contract it wants. It doesn't have to be share. It can be whatever it likes, presumably.

MR HODDER QC:

No issue about (3)(a).

GLAZEBROOK J:

I'm not sure where you get from subsection (3) that Fonterra can have contract supply. I mean, it doesn't say it can't but I'm not sure where you get that it clearly contemplates that it can.

WILLIAM YOUNG J:

But is contract – contract from a shareholding farmer can be contract supply.

GLAZEBROOK J:

If 3.4 is – yes.

MR HODDER QC:

There's always a contract. Milk is bought and sold so there's always a contract. The question is whether there –

WILLIAM YOUNG J:

Can there be a contract with a shareholding farmer that goes beyond we'll pay you whatever the price is for the time being?

MR HODDER QC:

Based – the price would be based on whether you are share-backed.

WILLIAM YOUNG J:

Yes, but can someone contract to provide milk as a shareholding farmer for five years?

MR HODDER QC:

Yes.

WILLIAM YOUNG J:

Which effectively is they promise they won't exit the industry, for instance?

MR HODDER QC:

Yes, and they can promise to supply –

GLAZEBROOK J:

Yes, although that's subject to subsection (3) and the 20% limit.

MR HODDER QC:

Across the whole geographical area, yes.

GLAZEBROOK J:

Oh, 33% limit, sorry, across the – yes, yes.

MR HODDER QC:

But they could –

WILLIAM YOUNG J:

And by implication promise subject to subsection (3) that they won't supply anyone else?

MR HODDER QC:

Yes. That's the constraint that's built in here about tying up long-term supply, but the supply could be either as a share-backed farmer or it could be supply as a contract with a token number of shareholdings.

WILLIAM YOUNG J:

But this is –

MR HODDER QC:

Or it could be pure contract.

WILLIAM YOUNG J:

Sorry, I haven't really put the point very clearly. This is dealing with supply from new entrants and shareholding farmers. It's not dealing with what you've earlier talked about as contract supply.

MR HODDER QC:

No, we've kind of – it's sort of possibly taken on a life of its own. The point about 107 is that it's trying to make sure that there is contestability for independent processors. They can contest the raw milk supply that's available from dairy farmers. So the first proposition in 107 is, (1) is when you do have new entrants coming in then you offer them a contract, you must offer them a contract for one season and they can choose to have one season or you can offer a longer-term contract to any new supplier or any suppliers who are offering share-backed supply as long as you comply with subsection (3). So that means that in terms of Your Honour's question if you were offering share-backed supply as a shareholding farmer, say, you can be offered a contract for five years subject to the proposition that Fonterra has to make clear or be certain that across the whole 160 kilometre radius area there is one-third of all the supplies available for the independent processor at the end of the season, either because the contracts – that there already are contracts and independent processors or because whatever the contract is with Fonterra it can be terminated at the end of the current season. It doesn't specify that the contract has to be one for share-backed supply, and so

conspicuously we say when the phrase “supply as a shareholding farmer” is used at all sorts of points in this part of the legislation, that doesn’t qualify as subsection (3)(b) of section 107.

ELIAS CJ:
Well, that’s because it applies to all supply.

MR HODDER QC:
Precisely.

ELIAS CJ:
Yes.

MR HODDER QC:
Which means, for Fonterra that means contract plus share-backed. That’s all there is.

ELIAS CJ:
Yes.

MR HODDER QC:
And so I’m not sure that we may be in reasonably vigorous agreement or –

ELIAS CJ:
Yes.

MR HODDER QC:
And then the last point is just simply that three months’ notice is not a penalty of any kind for the purposes of 3(b)(i).

Then coming back to section 106, which is at the heart of this, and I will come back to this a bit further into the Act, but the immediate proposition if we sort of go backwards, as it were, is section 106(4) says you can’t treat a shareholding farmer exercising an entitlement under this subpart any less favourably than a shareholding farmer who does not do so, and an obvious

candidate for that is in section 108. So if the shareholding farmer decides to supply 20% to an independent processor then section 106(4) says there can be no retaliation, and again it promotes the idea of contestability. There is no cost to a shareholding farmer in exercising that one under section 108. So that's – reinforces contestability.

Section 106(1), which is what this case has been largely about, or the present purposes, "New co-op must ensure that the terms of supply that apply to a new entrant are the same as the terms that apply to a shareholding farmer in the same circumstances," or differ only if the circumstances are different, and that, we say, is a simple proposition that says there will be no premiums paid, for example, for new suppliers because one of the ways in which contestability can be constrained is by cherry-picking the potential suppliers who are the most desirable ones to get there. So there's no difference to be allowed between new entrants for these purposes and shareholding farmers, and that basis, we say, is the most consistent for the general purpose of these provisions which is about contestability. That's the provision that says there should be effectively equal treatment because it enhances contestability, which is what the rest of the Part of the Act, or subpart of the Act, is about.

Now what I'm going to come back to is the proposition advanced by my learned friend successfully to the Courts below that no, this is actually more than that, this is some kind of shareholder or dairy farmer's Bill of Rights and applies to require equal treatment at all times. We say that simply reads too much into it. It has a particular purpose and a particular open entry/open exit context.

ELLEN FRANCE J:
In relation to that, the heading to 106 to 109 and section 72(5) say that this is about regulating the supply of milk to new co-op which suggests on its face it's about the regulation of milk supplied to new co-op.

MR HODDER QC:
In a way which enhances contestability, is what we're saying.

ELLEN FRANCE J:

Well, you're adding that in.

MR HODDER QC:

That's what section 108(1) does. That's a regulation of milk supply, so you're going to take your supply of milk from a shareholding farmer having got through the application processes, say, under section 73 but it's regulated to the extent that you cannot stop them from supplying 20% of their milk to somebody else. That's a form of regulation and the purpose of the regulation is contestability.

WILLIAM YOUNG J:

One way of looking at it, I suppose, which isn't helpful from your point of view is that Fonterra didn't have to take on the respondents because they applied outside the period but having done so they're new entrants and have to be treated as other new entrants.

MR HODDER QC:

As other shareholding farmers?

WILLIAM YOUNG J:

Yes, or as shareholding farmers but the Act doesn't contemplate that because Fonterra bought the business or assets of the former dairy company at a price that enabled the retros to be paid that that's something that they can set off under here.

MR HODDER QC:

Well, that's the heart of section –

WILLIAM YOUNG J:

That's the heart of the case, yes.

MR HODDER QC:

Yes. That's the main 106 argument, which I'll come back to. At the moment I'm really focused on what is a new entrant or are these players new entrants or not.

WILLIAM YOUNG J:

You say they're not new entrants because they're contracted suppliers?

MR HODDER QC:

For the purposes of Part 2(5) because Part 2(5) is about contestability and these people were not seeking to or part of the contestability processes. There wasn't an open exit/open entry exercise in any sense. It was a contractual arrangement.

ELLEN FRANCE J:

The Act seems to contemplate, though, that you will either be a shareholding farmer or a new entrant. It doesn't seem to envisage that there'll be someone else, some other category.

MR HODDER QC:

That's the part that's regulated. It doesn't stop contract supply outside that. Contract supply just remains in terms of the ordinary powers under the constitutional contract.

ELLEN FRANCE J:

Why would you only regulate the part you say is regulated? What's the purpose of that?

MR HODDER QC:

Because the norm for supply of milk in New Zealand then and now is share-backed supply to Fonterra. The overwhelming majority of the milk in New Zealand is processed as share-backed supply. So if you want to have an ability to go into the norm as a default if the independent processor won't take your milk or can't take your milk or you don't like it, is you need to have

people to be a backstop, which is to go back to share-backed supply. But you have to provide the capital when you do that. So that's why you have the open exit and the application period. No other regime or destination would enable the dairy farmers to with confidence go out of Fonterra in the norm of share-backed supply, sell their shares, go to a new supplier as NZDL was, not have to pay for shares, get a better price, and then come back again at some point. The question of when you come back is then governed by 2 point – 2(5), which then says you can come back as a matter of right if you apply during the application period. But if you don't apply during the application period, you don't have a right and then it becomes a matter of discretion. As a matter of discretion, Fonterra can say yes or no and if it says no there is still the general power to contract. Nothing in this Act abolishes the power to have a contract that isn't one for share-backed supply.

WILLIAM YOUNG J:

It's not a very strong protection for new entrants if it can be defeated simply by saying, well, you're not a new entrant, you're a contract supplier.

MR HODDER QC:

Well, the new entrant has to have enough foresight to be able to plan and make an application in time if this is critical to their operations. After that, there's all the protection in the world. What you can't do is say, gosh, it's mid-March. I think I'd like to supply Fonterra coming in the season starting 1 June. Just doesn't happen.

WILLIAM YOUNG J:

But that's in a sense not a great argument because Fonterra had the infrastructure anyway, that was the whole deal, that it was getting the infrastructure to take the supply.

MR HODDER QC:

But again this is in abstract of course.

WILLIAM YOUNG J:

Yes.

MR HODDER QC:

But at the level in terms of what is Fonterra compelled to do, Fonterra is compelled to take supply from people who apply under section 73.

WILLIAM YOUNG J:

Just looking at the counterfactual, if Fonterra had said, "Well, we're not prepared to pay 50 million," or what was the figure it paid, 48 or 50 million?

MR HODDER QC:

Twenty million I thought wasn't it? Forty-eight point five, total. Forty-eight point five.

WILLIAM YOUNG J:

If it had said, "We're not prepared to pay that, we're going to pay what we think the breakup value of the plant's worth," someone else would have come in.

MR HODDER QC:

Yes. And the suppliers would have got not all of their retros, they would have got some possibly but not all of them, or they might have got none of them. But there were certainly under-bidders as the Commerce Commission decision makes clear.

WILLIAM YOUNG J:

Would the bidders have wanted their supply, presumably they would have assumed they'd get it?

MR HODDER QC:

Well, yes, then the nature of the industry is that for the most part it has extraordinarily expensive stainless steel sort of located at various points, and the more you can put through it the better

WILLIAM YOUNG J:
So how localised is it, are you pretty much tied to the local factory?

MR HODDER QC:
Well, there's a transport issue around that. But once you've got it you want to use it to the maximum that you sensibly can, so you're always going up to the edge. And because it's got this peak seasonal aspect to it you've got to be able to try and handle the peak supply, which is one of the reasons for the notice provisions, but subject to that you want as much supply as possible. Having a whole lot of stainless steel that isn't being used is not efficient.

WILLIAM YOUNG J:
And peak supply is October?

MR HODDER QC:
Yes.

The last part of subpart 5 that I wanted to spend a moment or two on is towards the end, just briefly noting that on page 87 of the Act the Commerce Commission has a role under sections 120 and following, there's a sort of elaborate series of provisions going through to 133 all about determinations by the Commission. So, "A person," which could be an independent processor or a dairy farmer, "may apply to the Commission for a determination if the person has a dispute with new co-op about the application of this subpart of regulations made under section 115." So a dispute about the application, Part 2(5) can be referred to the Commerce Commission, so there's a regulatory role imposed in there as part of this process.

And then there is the sunset provision aspect of this, which we find on pages 96 and through to 99, et cetera. So the effect of this is that all of this subpart can be terminated if there is sufficient milk being taken by independent processors. So section 147(1), has to be satisfaction, "That independent processors have, directly or indirectly, collected 20% or more of milk solids on or from dairy farms in the North Island or from the South Island in a season."

If that were to happen and the Minister were then to take the appropriate steps that are contemplated by these sections, Part 2(5) disappears, and we say that's a reasonably telling clue and the proposition that this isn't a general Bill of Rights for dairy farmers, this is about contestability, and if contestability gets to this level all this regulation goes away. Now it hasn't happened, and there are various contemplations for the changes of legislation that we don't need to be worried about. But the statutory structure is just that, that once contestability is achieved none of this regulation stands, it all goes.

Now if I can spend a moment suggesting to the Court that that is precisely what Parliament had mind, what I've just been describing, then the starting point –

GLAZEBROOK J:
When you say "contestability" you're saying it's not misusing your monopoly that it's aimed at but only ensuring that you have independent processors that are able to come in. Is that what you mean by contestability?

MR HODDER QC:
Yes, it is. Using your monopoly power is still governed by the Commerce Act, so apart from the provision –

GLAZEBROOK J:
Well, not really in relation to individual farmers is it, because it will be governed by the Commerce Act in terms of keeping out other people –

MR HODDER QC:
And also refusals –

GLAZEBROOK J:
– but not in terms of how individuals are treated, one assumes.

MR HODDER QC:

To the extent that section 36 of the Commerce Act reaches to refusals to deal, including deal on terms, then as part of the general law where DIRA doesn't apply, section 36, neither the protective nor the other provisions apply and then section 36 is available.

GLAZEBROOK J:

Well, why wouldn't this be dealing with section 36 situations? Why would you leave that to the Commerce Act when you've actually regulated the industry under this? Why would you leave that one bit out of your regulation of the new co-op?

MR HODDER QC:

Well, it's other way round in our submission that you have a specific bespoke set of regulations in Part 2(5) and where that doesn't apply for whatever reason you have the general law, whether it's contract or the Commerce Act.

GLAZEBROOK J:

I'm just saying why would you do that? Why wouldn't it be Part 5 generally looking at behaving like a monopoly and protecting people from the sort of things that can occur when you have a monopoly?

MR HODDER QC:

Because the concern here was that the industry needed to be efficient and the efficiency was going to be achieved by providing some competition or providing scope for competition with Fonterra, or at least the threat of competition from independent processors, and so independent processors have this key role either explicitly or implicitly throughout.

GLAZEBROOK J:

Well, why say you have to accept someone? Surely that's nothing to do with making sure you've got independent processors?

MR HODDER QC:

Yes, it is.

GLAZEBROOK J:

How – I can't quite –

O'REGAN J:

It's the open entry/open exit.

GLAZEBROOK J:

Well, no, I understand the exit.

MR HODDER QC:

But that's entry.

GLAZEBROOK J:

But if you're allowed to enter there, that's not helping independent processors. It's stopping you behaving like a monopoly and keeping people out.

O'REGAN J:

Well, yes, it is because it means people will feel confident about going to independent processors because if things go wrong they can come back.

WILLIAM YOUNG J:

But they can come back.

GLAZEBROOK J:

No, no, no, that's the open exit, not the open entry.

O'REGAN J:

No, if they go to an independent processor and it goes wrong, they can come back, so they don't take a risk in going to a new entrant because if things go wrong they can come back to Fonterra.

GLAZEBROOK J:

But if you're a totally new entrant, aren't you starting from scratch and you're required to be accepted?

O'REGAN J:

If you're a totally new entrant you are, yes.

MR HODDER QC:

Yes.

GLAZEBROOK J:

Well, that's all I'm saying, that they are stopping you acting like a monopoly by keeping out new entrants altogether and forcing them to independent processors or no one.

MR HODDER QC:

Outside the application period, I imagine.

GLAZEBROOK J:

Well, yes, I understand that but it still is regulating that, monopoly behaviour that would keep people out of the industry.

MR HODDER QC:

Well, if they are planning to become dairy farmers then they have only to give a notice in the application period and they have access. There's no issue about that.

GLAZEBROOK J:

No, I understand that.

MR HODDER QC:

And so –

GLAZEBROOK J:

It just seems to me that it's actually protecting against monopoly behaviour outside of mere contestability. The open exit helps contestability but I don't see the open entry does.

MR HODDER QC:

Well, the open entry –

GLAZEBROOK J:

It just requires you to be accepted by the monopolist.

MR HODDER QC:

Perhaps there's a – we'll get to the same point. There's a premise that it's good for there to be more dairy farming activity going on and within the Act so the industry succeeds and is efficient. So new entrants are encouraged. They can either go directly to independent processors, in which case this Act has nothing to do with it, they can have pure contract terms with Fonterra in which case this Act has got nothing to do with it, or they can come through what I'm reluctant to call the gate provided by section 73 in the application period, but once they're in then they can go out again and so the purpose of the entry is not only for new entrants but also for those going out, and remember those who've gone out will come back as new entrants. So if they have left and exercised the open exit rights –

GLAZEBROOK J:

No, I understand that part of it is the – so I accept what you say about open exit.

MR HODDER QC:

Our submission, and I'm really doing no more than saying what Justice O'Regan said, is that open entry and open exit are kind of linked throughout this entire process and it's the ability to go in and out –

GLAZEBROOK J:

All my point is that open entry means something more than that. It enables you to get into the industry and force the monopolist to purchase from you.

MR HODDER QC:

For new entrants who have –

GLAZEBROOK J:

Within the application period.

MR HODDER QC:

Agreed, agreed. So if you're an absolutely new dairy farmer, you've never supplied anybody before, you can do that and likewise it also applies to those who have been dairy farmers and have switched either from Fonterra to an independent processor and back or started to be an independent processor and want to come back, so yes.

According to this clock it says there are four seconds until the Court said it was going to take it's adjournment so I'd probably –

ELIAS CJ:

Yes, how are you going, Mr Hodder? Where are you on this outline, this flow? You're not really into that yet?

MR HODDER QC:

I haven't got to that flow yet.

ELIAS CJ:

No, that's what I thought.

MR HODDER QC:

But I'm not going to spend long on it. It's just meant to be an aide memoire, as it were.

ELIAS CJ:

Yes, I see.

MR HODDER QC:

So how am I going? I'm going to be going until lunchtime. And probably a bit after that.

ELIAS CJ:

Yes, all right. I fully accept that. I just want to know if you would appreciate a bit more time in developing your submissions.

MR HODDER QC:

Well, I was planning to develop my submissions further during the period between now and early afternoon, but yes.

ELIAS CJ:

Yes, exactly. That's fine, thank you.

COURT ADJOURNS **11.01 AM**

COURT RESUMES **11.21 AM**

ELIAS CJ:

Yes, thank you.

MR HODDER QC:

May it please the Court, could I return to one topic on which I was on the hoof not as comfortable as I wanted to be that I properly read 3.3 of the Constitution. If I could take the Court back and say a little more about that, that's in volume 6 at page 929. So this sequence really starts with 3.2. 3.2 defines the share standard in this Constitution.

ELIAS CJ:

Sorry, I can't remember. Is contract supply –

GLAZEBROOK J:
That's 3.4.

ELIAS CJ:
Oh, that's 3.4. Thank you.

MR HODDER QC:
I'm coming to that. So there's a share standard but it doesn't apply to contract supply. 3.3 is about shareholders who are trying to comply with the orthodox contract supply, but they don't hold enough co-operative shares as required by the share standard and they're given a dispensation up to 20%. So that's one where the share standard would otherwise apply by – the Board can permit up to 20% less than the share standard requires, but the general proposition is they're still generally supplying under the share standard, i.e. share-backed supply.

We get to contract supply. This is where the exclusion from 3.2 applies. There is no requirement to comply with the share standard. The constraint on this is that it can't be more than 15% of the total milk solids that Fonterra gets from shareholders. So it can't convert all its supply to contract. It's constrained in this sense by 3.4 but can still require for those contract suppliers, notwithstanding they're not complying with the share standard in the orthodox sense, it may require in 3.4(b) a minimum number of co-operative shares.

So what we take from that – or at least the case that I'm advancing – is that you have three categories of contract, in a sense. The first is pure contract, no shares at all that are relevant, and that is authorised by 2.3(b). You have share-backed supply which is what 2.3(a) and clause 1 is also concerned with. The share standard, the orthodox share standard, would apply under 3.2 but subject to the 3.3 dispensation. Then you have the contract supply provided for under 3.4 which is a contract plus some token shares. That's authorised by clause 2.3(a) and (b). 3.2, there's the exception that applies

and then 3.4 applies which is subject to the overall limit on Fonterra's take of milk.

So I hope that's a slightly more coherent explanation of those provisions that I was able to offer before the adjournment.

GLAZEBROOK J:
Thank you.

MR HODDER QC:
But I had not been focusing on 3.3 and I apologise that it hadn't in my radar, particularly, up to this point.

So what I wanted to do next if it pleases the Court was to go to the legislative history provisions, going back to my theme of contestability, and in our bundle of authorities at tab 4 we find the first of the materials that I was proposing to refer to which is the explanatory note. This dates from the 19th of June 2001, and we know that because there's a reference to the legislative history at the very end of the original Bill or the original Act. So in this we see on the first page in the third bullet point this reference again, "To ensure that New Zealand markets for dairy goods and services are contestable," that of course comes through into the section 4(f). Over the page on page 2, below the bullet points, there's the authorisation of the merger of the two largest co-op companies to produce the company which will be dominant in a number of key New Zealand dairy markets, "The Bill provides for a comprehensive regulatory package to mitigate the risks that would otherwise be present in this situation. It has been designed to impose the lowest regulatory and compliance costs on the industry while still achieving key policy objectives, including addressing the interest of consumers and minority dairy industry participants. The regulatory package will stay in place until there is a level of competition in the market for processing raw milk in each of the North and South Islands," and we saw section 147 and following that relate to that.

So then we come down to the regulatory impact and compliance cost statement. The first point is to, "Maximise the economic performance of the dairy industry by allowing the structure to evolve," second is to get rid of the existing constraints, thirdly to, "Facilitate the emergence of new competition and new strategies in the dairy industry," that obviously implies the concept of independent processors, "Limit the potential for dairy farmers, New Zealand consumers and other firms or co-operatives in the dairy industry to be adversely affected by the use of monopoly power by the newly formed company, and ensure the lowest regulatory and compliance costs consistent with achieving the other public policy objectives." So it's rather a kind of Christmas list in a sense, but the general proposition is clear, it's a combination of trying to guard against what might be damaging for the industry from monopsony power in the terms of Fonterra's buying ability, particularly in the raw milk market, and the lowest regulatory and compliance costs that there could be to make sure they achieve the public policy objectives, one of which is that the industry as a whole, including Fonterra, has good economic performance. So the statement of the problem that is set out at the top of page 3 talks about a virtual monopoly in the market for the purchase of raw milk from New Zealand farmers, potential to use market power to the detriment of existing and potential dairy farmers. And then it goes on to discuss a series of options. The first is competition between, within the two major suppliers, Kiwi and NZ Co-op, or a merger with structural remedies normally required by competition authorities, over on page 4, merger plus a regulatory office, and then the one that was chosen, merger with regulation of supplier entry and exit, the creation of a market for milk, and other matters, and that's what we have, regulation of supplier entry and exit to create a market for milk. "This option creates a regulatory structure that is easily removed if the market share of GDC," which is new co-op, "decreases to the point where it no longer has market power but at the same time provides GDC with incentives to facilitate the entry of new suppliers and new manufacturers into the New Zealand dairy industry." So that facilitation of entry of new suppliers is the point I think Justice Glazebrook and I were discussing before the break. "The choice between these options," it goes on to say, "must be influenced by the proposed continuance of the co-operative

structure," nobody thought the co-operative structure was going away, and that has, "Implications for their performance and design of a regulatory regime and it may differ from that of firms with a non-co-operative structure." Then there's a discussion of the benefit, which we may note but don't need to spend time on, although it does talk about, I should note in the bullet point, the first bullet point on page 5, "Exposure of the industry once the merger has concluded, to all of the commercial disciplines of the Commerce Act," and then, "The proposed merger also has detriments." The main ones are the overall risk, in the first bullet point, perhaps a loss of innovation to the second point, then then third, "The creation of a large monopoly which without an effective regulatory regime may use its dominant market position to reduce the overall level of contestability in both the domestic consumer product and raw milk markets." So there we have that focus of the concern about the risk of the size of new co-op. It might reduce the overall level of contestability and that might reduce pressure on the industry to be efficient which over time would result in losses of income to farmers and price increases. It's a macroeconomic focus.

Business compliance cost statements, the proponents of GDC have agreed that they see efficient management of their operations in the future as requiring that they post prices at which farmers may enter and exit on demand, and at which milk may be bought and sold on demand.

Regulations place on GDC a requirement to manage and develop the market infrastructure associated with supplier entry and exit and the raw milk market. In other markets, this cost is borne by all market participants, but the extremely high market share of GDC makes it most practical to place the requirement on it. Unlikely to be significant.

Perhaps the main cost of GDC will be the need to adequately provide for open entry. Where it's an issue, it's likely to take the form of bringing forward in time expansions in capacity and/or some additional transport costs. But it's open entry that is the key to mitigating a co-operative's monopsony power, and we say that is reflected consistently in the provisions of Part 2(5). Open

entry mitigates the monopsony power that was the concern of the legislature when this was being enacted.

GLAZEBROOK J:
Sorry, I've lost exactly where you were.

MR HODDER QC:
Sorry?

GLAZEBROOK J:
Sorry, I lost where you were referring to.

MR HODDER QC:
Yes, I'm on page 6, Ma'am, and I'm on the end of the –

GLAZEBROOK J:
Yes, I have that. I just lost where it was.

MR HODDER QC:
The end of the second full paragraph. The paragraph begins, "Perhaps the main cost."

GLAZEBROOK J:
I can see it, thank you.

MR HODDER QC:
And it's the last couple of lines, "But it is open entry that is the key." And I don't need to spent time on it. We –

GLAZEBROOK J:
Which was actually the point I was making, that it was wider than merely contestability that was stopping them, stopping people coming into the industry, including dairy farmers, which would be an exercise of monopoly power.

MR HODDER QC:

Yes, and I don't dispute Your Honour on that.

GLAZEBROOK J:

Right.

MR HODDER QC:

That's a part of it although as I say in terms of the open entry/open exit, open entry also serves the wider contestability issues.

GLAZEBROOK J:

Absolutely, absolutely.

MR HODDER QC:

It doesn't add a great deal to things but on pages 12 and 13 there's a concise summary of the provisions of subpart 5. In my reading of it, and I invite the Court to have a glance at it at its convenience, is that it's consistent with the approach that we are urging on the Court. The focus is on that open entry/open exit regime and not particularly beyond that, but including consciously those provisions on the sunset scale.

Hopefully in the volume that you have of the appellant's bundle of authorities there should be a couple of blue pages which distinguish between the end of the explanatory note and the beginning of the Select Committee's report which is headed, "Dairy Industry Restructuring Bill Government Bill as Reported from the Primary Production Committee."

ELIAS CJ:

Yes, we have it.

MR HODDER QC:

So that came back on the somewhat memorable date of the 11th of September 2001 and contains a number of provisions that are significant for us. So again at the end of the introduction paragraph it records

that Fonterra will be dominant in a number of key markets. The Bill provides for a comprehensive legislative package of measures to mitigate the risks of that. And then over the page at the top of page 2 we get the concept of the cornerstone. "The cornerstone of the measures to mitigate Fonterra's dominance is an open entry and exit regime to the co-operative. For this regime to function properly it is critical that, at any given time, Fonterra charges the same price…for entry…as it pays upon exit. It's also essential that all other barriers to entry and exit are removed or at least reduced to an absolute minimum." So again we say that's consistent with our analysis of that.

There's quite a lot of words in the rest of the report, not necessarily a particular amount of – but there is a recognition on page 11 of the report under the heading "Peak Notes". There's a recognition in the second paragraph, a reference to reflecting the cost of capital infrastructure and that shareholders contribute fairly to this cost.

GLAZEBROOK J:
Where are you now?

MR HODDER QC:
I'm on page 11.

GLAZEBROOK J:
So am I. I just don't know where you are on page 11.

MR HODDER QC:
I'm on the second paragraph under the heading "peak notes" at about four lines down.

The cost of capital infrastructure in that shareholders contribute to it, that is the essence of the co-operative dairy regimes. It has been for a very long time and there's no change broadly contemplated in that, at least for a new co-op.

There's also a discussion on page 12 on the bottom of the 20% rule designed to promote choice and flexibility in the market for raw milk.

Then on page 17, there's a heading "Governance arrangements for Fonterra" recognising, of course, that if Fonterra is to be a co-operative company and the principal activity relates to milk solids supplied to the company by its shareholders. "We have no ability," says the Select Committee, "to alter the Constitution of Fonterra, although the Bill overrides some provisions in it. We accept the Bill is designed to put pressure on Fonterra to perform through ensuring contestability rather than via governance arrangements." So again we say that it's consistent with our analysis of what Part 2(5) is all about.

GLAZEBROOK J:
Sorry, I've lost you again.

MR HODDER QC:
I'm sorry, Ma'am. It is on page 17 under the heading "Governance arrangements for Fonterra" and I was referring to the last few lines on the page.

After page 21 – and I'm hopeful that the Court will find another blue page beyond which is the second reading debate from Hansard from 18 September 2001 – the passage that I think we referred to in our written submissions is to be found on page 11780 and almost halfway down the page there's a paragraph beginning, "I conclude with a few comments on the open entry and exit provisions that lie at the heart of the legislative regime contained in the Bill. The Bill seeks to create a contestable environment in which competitors to Fonterra have a realistic opportunity to enter the New Zealand dairy industry. To create contestability, it's important that farmers exiting Fonterra receive adequate compensation for the value of their shares in the co-operative," and so on and so forth. "A traditional regulatory approach would have sought to achieve this by direct regulation of the share price."

Next paragraph, “The preferred alternative is the open entry and exit regime. This is designed to put strong commercial pressure on Fonterra to set a share price that accurately reflects the expected future earnings of the company. That must be posted and then accept all exit to and from the company apply for that price. To work properly, it is essential the only barrier to entry to the co-operative is that capital cost of entry. This means that aside from a small number of specific situations provided for in the Bill, Fonterra must accept all new entrants and their milk if they agree to pay the capital cost of entry. Fonterra must also promptly pay existing farmers exactly the same amount per kilo of milk solids as Fonterra charges farmers to join the co-operative at the same time. It’s also essential that Fonterra does not discriminate between existing supplying shareholders and new entrants. That is not to say that Fonterra can’t respond to entry of new competitors. It must apply its response to new entrants and existing shareholders alike.”

So the cornerstone, the key, the fundamental aspect of all this is the open entry and open exit regime.

And contestability was, in fact, a feature of what surrounded the events which led to this litigation. So if I can ask the Court briefly to go to tab 13 in this bundle of materials, this is the 6 December decision of the Commerce Commission to grant clearance for the acquisition of the NZDL business or assets by Fonterra, so this is one of the conditions of the sale and purchase agreement, one of the other conditions of which was that all these suppliers entered into the milk supply agreements, which I’ll be coming to.

So for our purposes can we turn to the page 6 to start with and paragraph 19, just describing what’s going on, “Fonterra is a supplier-owned milk processor and marketer of dairy products, it has about 10,500 shareholders. Its Constitution requires new suppliers who wish to become “share-backed” to purchase one Fonterra share per kilogram of milk solids each produces per year. The current price is $4.52,” and then it goes on to anticipate Trading Amongst Farmers, which is not a major issues for present purposes. But that

proposition, we say, fairly describes what the essence of the Constitution is and what Parliament had in mind when it was enacting DIRA, that the essence of the Constitution is share-backed supply, that is to say the equation between equity capital and the supply of milk. Now there's reference in paragraph 21 to Growth Contracts, and that talks about the initial thousand shares followed by shares to cover the sharing up over a period of time.

On page 8 there's the beginning of a discussion that carries on later in the decision about things that are features of the dairy industry. One is Fonterra's co-operative structure and the second is the industry's specific regulation which applies, and that's summarised as being the two issues in paragraph 25 on page 8. Paragraph 26 goes on to point out the link between co-operatives and their rationale of furthering the interests of their shareholder suppliers. And then on the next page, page 9, at paragraph 28, there's a sort of a quite a convenient summary of what the industry's specific regulation involves at various stages including, as we say, as fundamental, "Farmer suppliers may enter and leave Fonterra without penalty."

The market definition is to be found at page 12, paragraph 43. Not a major issue for us but it was focused on unsurprisingly in the North Otago and South Canterbury regions. 46 notes Fonterra's pointed to the fact that these farms in the lower South Island are large, being conversions as opposed to traditional dairy farming country for the most part, and then paragraph 47 on page 13, the Commission's assumed that the South Island market is the market for the acquisition of raw milk processing assets.

Page 14 is marked by a series of redactions which we haven't sought to overcome, but we do note at 55 that under Fonterra's bid, "The relevant farmers would receive the full value of the retrospective payments owed to them by NZDL for raw milk supplied during the 2011/12 season." Those are now well-known in the litigation as "the retros".

Page 15 sets out some reference to the biding process in 57, "An open bidding process," 58, "The Commission has interviewed the receivers and has

been provided with their analysis of the [blank] bids received." That analysis showed that while they concluded that Fonterra's bid was significantly higher they also considered that another was a credible bid and that [unidentified party] was the receiver's preferred under–bidder and [unidentified] was interviewed by the Commission and confirmed that it was very interested in purchasing NZDL. So there is no suggestion that there wasn't contestability for these assets, the central feature of what happened was about the retros. There were any number of people who would take the milk, there were competitors for the business, but what was critical in the process and central to the process was the suppliers who successfully banded together to try and extract some sums which would compensate for the retros they were owed by the defunct NZDL operation.

Over to page 16, and there's a heading, "Loss of choice for farmer supplier," and there's a discussion about this but the Commission doesn't consider that the removal of the option of supplying NZDL equates to a substantial increase in Fonterra's buyer-side market power. Fonterra would have no greater ability to reduce prices, et cetera, and the Commission is not offering any evidence than an under-bidder would have paid a higher payout to farmers.

Over to page 17 and paragraph 74 and 75 addresses the possibility of other processors and new entrant suppliers were foreclosed and considers that that would not lead to a substantial lessening of competition, paragraph 75. NZDL had no difficulty attracting suppliers when it was operating. It said that, "Certain suppliers were attracted to it by the absence of a need to provide capital to purchase Fonterra shares. Certain suppliers prefer to use that capital instead to invest in an increased production of their own farms."

Secondly, "Concerns over access to raw milk by processors are alleviated by the DIRA, which requires Fonterra to supply 15 million litres of milk and ensure that at all times a minimum one-third of milk solids produced in any region is supplied to an independent processor or available to be supplied under supply contracts that can expire." That's section 107 that we were looking at before.

Page 19 paragraph 80, “There are a number of factors which constrain Fonterra, both the factual and the counterfactual, the most significant of which is Fonterra’s particular co-operative structure.” 81, “The members are both shareholders as well as suppliers.” It goes on to describe how there’s no incentive to pay below competitive prices and discussion of the co-operative ethos, particularly in paragraphs 87 and 88.

Then the conclusion relevant to that is on page 22 of paragraph 99. “The Commission considers that Fonterra’s co-operative structure removes the incentive and ability of Fonterra to depress raw milk prices below competitive levels in both the factual and counterfactual.”

So we say that is useful for context in relation to what this litigation is about. There were alternative buyers and there was the ability of others to pick up the milk and there was no increase in Fonterra’s market power by this acquisition because particularly of the co-operative ethos and the specific terms of Part 2(5) of DIRA.

GLAZEBROOK J:
If you could just go for contract supply, then that reasoning wouldn't apply, would it, because you could have forced the existing suppliers to that dairy factory to accept a lower price. I know that’s not what happened but the logic of the position is that the understanding of the Commerce Commission as to that being protective was actually false. Because if you allowed contract supply and it’s outside of the period and if you get a contract supply in place, you can keep them there for six years and not allow them in as new entrants. I’m not saying that’s what happened. I’m just saying that that must be the logic of the –

MR HODDER QC:
And that is what you just said before. As a hypothetical possibility, we say that if there was a contract then the parties were bound by it. They didn't have milk to offer.

GLAZEBROOK J:

So in fact the Commerce Commission got it wrong or was put wrong because it was told that that was one of the protective measures that were in place?

MR HODDER QC:

Perhaps but to the best of my knowledge the Commerce Commission had access to the contracts. I think there might be a reason for it.

ELIAS CJ:

What's their reasoning, then?

GLAZEBROOK J:

Possibly not the argument in terms of the retros, that was all.

MR HODDER QC:

Well, there's a difference between the hypothetical –

GLAZEBROOK J:

I've no idea whether they did or didn't.

MR HODDER QC:

In terms of the hypothetical and the specific, in the specific the contracts allowed for sharing-up over a period of years, so that was kind of designed to get to that result anyway. But Your Honour can put the hypothetical – to which I don't have an answer other than it's contract – than if outside of this there had been a contract in place for several years which is a pure contract it will constrain those suppliers for that period of the contract, yes.

ELIAS CJ:

And then there would be an argument not under this Act but under the Commerce Act, would there?

MR HODDER QC:

Yes, Ma'am, yes.

In terms of what actually happened, I'm not sure how much time we need to spend on the facts and I wasn't proposing to spend a lot on it. In our written submissions, there is an appendix that sets out a chronology of the events that we say are the most material. That's at pages 27 and 28 of our written submissions and it may be worthwhile just quickly going through that and if the Court has any points it wants elaboration on I'm happy to do that but – so for relevant purposes it's useful to start with the end of the application period in the end of February 2012. That's the application period to supply for the new season commencing 1 June 2012 and ending on 31 May 2013. Now NZDL was placed into receivership in May and the suppliers as we know were unsecured creditors. They had $20 million in what are called retros. The suppliers' main priority, and they made it well known to the receivers, was that they wanted to be paid in full by NZDL. So it wasn't just a question of saying, "We want our milk picked up in the new season." That wasn't the problem. The issue was they wanted to be paid their $20 million of retros. In the circumstances, the application period had closed, it was known in fact to everybody, and on the 5th of June the Fonterra executives provided an update on the sales process to the Fonterra board. There had been other board processes and papers and Fonterra submitted its conditional bid to purchase the NZDL assets at a price which would enable the suppliers to receive their retros in full in order to secure the suppliers' future milk supply necessary to contribute to best use of the NZDL Studholme plant. So yes, we – as long as have a kind of a secure access to the supply of milk for a period of time then it makes sense to buy these assets because they can be used together with other supply that Fonterra could organise, but that was a condition of it being secured, and the bid was on the express condition that all the suppliers entered into six-year milk supply contracts as approved by the Fonterra board. On the 14th of June the Fonterra board resolved to acquire the New Zealand NZDL assets under a conditional sale and purchase agreement including the 100% supply requirement, and that was signed later that day.

And it may be worthwhile, to save going back later, just to take the Court to volume 6 of the case and to page 1190. Volume 6, page 1190, are the

minutes of the Board meeting on the 14th of June at which the Board resolved to proceed with the sale and purchase agreement. It was a telephone conference meeting, most of the Board participating and various senior executives attending. There had been a background paper that was outlined by the Chief Executive and others spoke to it, and then the notes record, "It was noted that the transaction was conditional on 100% of the volume of milk supplied to NZDL in the 2011/12 season being secured to the plant through Fonterra six-year Growth Contract with suppliers, varied for the purposes of the transaction," and that variation are the special conditions that the respondents have objected to in this litigation. "It was also conditional on receipt of a clearance from the Commerce Commission." That's what we've just seen. That didn't come through until September. "Prior to the conditions being fulfilled it was proposed that the parties enter into the interim arrangements under which Fonterra would operate the plant," and we'll come to that but what happened was that when the new season started NZDL was defunct, Fonterra operated effectively as an agent for the receivers until this became unconditional in September. "The board discussed the proposal and valuation, the arrangements with milk suppliers and the overall value of the transaction to Fonterra." Now the arrangements with milk suppliers, it's clear from the evidence that's been traversed within the trial and the materials, those were the special conditions, the variations to the Growth Contract. So this was a decision made by the Board about how this milk supply was to be addressed and it was a decision made on 14 June in anticipation.

Carrying on with the chronology, then the 15th of June there are meetings at Studholme. Various documents are distributed. There's a further meeting and the milk supply agreements are picked up. Now the milk supply agreements, a sample of them can be found, for example, on page 1258. Perhaps not the best – I think we could perhaps go to 1260. There's a more legible version of the same document, page 1260 of volume 6. This is a three-way agreement which reflects what we've just been looking at. Between Fonterra and –

GLAZEBROOK J:
You're at 1258, did you say?

MR HODDER QC:
1260 seems more legible, Ma'am.

GLAZEBROOK J:
Thank you.

MR HODDER QC:
Just a better photocopy.

So 1260, Fonterra, NZDL being the receivers and each of the suppliers signed up on the terms. The first heading is an interim period under NZDL ownership, so this is the period until the Fonterra purchase became unconditional, assuming it did become unconditional, and there was an operational agreement whereby Fonterra was acting on behalf of NZDL to pick up the milk from these suppliers broadly on NZDL's existing terms but also in compliance with Fonterra's collection terms. You'll see just above (iii) the reference to the same terms as the existing terms a supplier has with NZDL.

So for this period which lasted for perhaps a little under three months then in fact these suppliers were not Fonterra suppliers at all. They were suppliers still to NZDL.

Then after that, i.e. from settlement which is paragraph (b), from the settlement the arrangement comes to an end. Fonterra assumes obligations and subject to the terms of acceptance of the suppliers' application to supply Fonterra, Fonterra agrees to acquire milk on and the supplier agrees to comply with the terms of the Fonterra 2012 Growth Contract in the form attached except as follows. The exceptions on page 1261 are firstly a slightly lower price per kilogram of milk solids than the contract milk price being used

for the other Growth Contracts. Two, there would not be the purchase or obligation to purchase the milk vat, but there would be an option in favour of Fonterra, and further there would be no entitlement to become Fonterra fully share-backed in the 2012/2013 season under this contract. The supplier could become fully share-backed in subsequent seasons and it would be the full milk price that would still be bound to supply Fonterra for the entire contract term.

It's those provisions, the lower price particularly and the inability to become fully share-backed for the 2012/13 season had already started which are the bones of contention is this litigation.

Now, I should say – but I don't think I need to go to it in any great detail – volume 8 of the case on appeal is effectively the bundle of documents that were provided to the suppliers at the first of the meetings at Studholme which they were able to go away and get advice on as they chose and discuss, then come back at the second meeting and ask questions and then they signed up to this particular form.

So as the chronology says, on 22 June all the ex-NZDL suppliers signed the MSAs and related documents and became in our submission contract suppliers to NZDL until settlement of the SPA subject to the Commerce Commission approval. After that, they became contract suppliers to Fonterra.

There's no suggestion in any of this that they were going to become on settlement share-backed suppliers. There was a contemplation to become share-backed suppliers if they wanted to and they'd have an option after that season but not at this time.

ELIAS CJ:

But once – perhaps I'm wrong on this and you'll need to put me right – once they entered into the agreements there wasn't the option to become share-backed suppliers.

MR HODDER QC:

There was after, for the next season. Not for the 2012/13 season but for the 13/14 season.

ELIAS CJ:

But for the 13/14 season?

MR HODDER QC:

Yes.

WILLIAM YOUNG J:

But only a percentage, though, wasn't it?

MR HODDER QC:

They had an option to become fully share-backed in subsequent seasons. That's what it says at the end of the last few lines and under the words "miscellaneous" on page 1261.

ELIAS CJ:

Yes, that's what I'm querying because I hadn't understood that that was the effect.

MR HODDER QC:

There's an option under all the Growth Contracts to share up early if you want to. Your obligation is you must share up at the least one-third during the last three seasons, but you can advance that if you wish to as a supplier and all this sentence does, that is say, "The supplier can become fully share backed in subsequent seasons and received the full milk price," was what was contemplated. What wasn't contemplated was that they would share up in the season they were already in, the 2012/2013 season.

GLAZEBROOK J:

Are normal people under these option Growth Contracts when they only become shareholding suppliers, you say, when they are fully share-backed, is that the proposition?

MR HODDER QC:

Yes. Well, in respect of their supply we, our cases are based around only they have a separate supply. In relation to the supply that is already share-backed, once they start to become share-backed, that is subject to all the other provisions, but –

GLAZEBROOK J:

Well, how does that work? Because they're only share-backed for portion of what they supply aren't they?

MR HODDER QC:

Yes, that's right. So insofar as –

GLAZEBROOK J:

So it's only that portion that they –

MR HODDER QC:

That portion, yes. So there's –

GLAZEBROOK J:

So otherwise they're, what, contract suppliers for the extra portion?

MR HODDER QC:

Yes. So the focus – this goes back to our theme that this regulatory regime is about milk supply, not about counting heads of farmers, and the milk supply that's back by shares is what's regulated, and if it's not backed by shares it's effectively outside the regulatory regime because that's not part of the open exit/open entry regime.

GLAZEBROOK J:

So even in the application period these people are only shareholders, so you could have that on any terms you liked as long as you only had the same terms for what was actually share-backed. The rest of it, even if it's contemplated they'll become share-backed on these Growth Contracts, Fonterra's free to have any terms they like.

MR HODDER QC:

It rather depends which particular focus one's looking at. But to take one example, if these people did have shares and if they were seeking to provide additional milk so that –

GLAZEBROOK J:

No, no, I'm talking about just I'm a total new entrant and I'm coming in on a share-backed – I'm presumably a sharemilker who's managed to scrape together some money to buy a farm but not enough to buy the shares.

MR HODDER QC:

Then we say you wouldn't be coming under the section 73.

GLAZEBROOK J:

Well, no, I enter into a Growth Contract, which I gather is a relatively standard practice isn't it?

MR HODDER QC:

Yes, and then you're there under the terms of your contract.

GLAZEBROOK J:

The logic of this is that Fonterra, if I come in on a Growth Contract I'm only protected against monopoly behaviour in respect of the supply that's linked to the actual shares I have, and the rest of it Fonterra can put any terms they like on.

MR HODDER QC:

In terms of the non-share-backed supply –

GLAZEBROOK J:

Subject to the section 36 issue.

MR HODDER QC:

Yes, subject to section 36. But the terms of, and as you see in the, what we've seen in the Growth Contracts, the terms contemplate moving towards becoming shareholder suppliers.

GLAZEBROOK J:

Oh, no, I understand that it's – well, that's why I was referring to a sharemilker.

MR HODDER QC:

But the potential that there could be unfavourable terms for part of the supply is there, but we say it's governed by a whole series of things, the co-operative ethos which the Commerce Commission talks about, general industry and political opinion, this is a highly political industry, the regulatory force that there is under the Commerce Commission under section 120 as well as section 36, there's a whole range of constraining propositions, but one can't deny the hypothetical possibility that there might be some onerous terms somewhere for those that aren't applying for the share-backed supply, the non-share-backed supply part of their supply.

GLAZEBROOK J:

So the only constraint is the other provisions of the Commerce Act and public opinion. Sorry, was there another one?

MR HODDER QC:

Section 120 of this and the DIRA, insofar as the Commerce Commission determines whether there has been compliance of Part 2(5).

GLAZEBROOK J:

So what was 120?

MR HODDER QC:

120 gives power to the Commerce Commission to consider complaints.

GLAZEBROOK J:

Oh, yes.

ELIAS CJ:

A dispute. So what –

GLAZEBROOK J:

Yes, but there'd have to be a dispute to start with, if it's a dispute under the Act, so if they don't have any obligations under the Act it would have to be under the other provisions of the Commerce Act wouldn't it?

MR HODDER QC:

It does. But it puts it into a public forum and creates all the other pressures that will go with it.

ELIAS CJ:

That was the question I had.

MR HODDER QC:

So just finishing off the chronology, at the bottom of the page on page 27 of the submissions, the Commerce Commission approves the sale and purchase agreement, observes other processors could have taken the suppliers' milk and that the relevant market remained competitive. And over the page, Fonterra then promptly informed the suppliers about the clearance and wrote to them to say that they would now be a Fonterra contract supplier, which is, of course, what we say they were. And then the settlement takes place on the 14th. Payment is made about that time, and then a bulk Fonterra board

resolution approves the issue of 2.25 million shares of various kinds including 1000 shares to each of the 30 or so suppliers.

It appears from doing some arithmetic around one of the Fonterra board papers that on average these suppliers had been supplying about 260,000 kilograms of milk solids. So had they been fully shared up they would have had 260,000 shares on average which would have been worth at $4.52 around about 1.18 million. What they were required to take up was 1000 shares costing four and a half thousand dollars, which is why we say it is de minimis or token or whichever phrase is appropriate.

So that all happens and then it's a little over 12 months later that lawyers for the suppliers first assert there's been a breach of section 106 of DIRA and that has led, in the way that these things sometimes do, to where we are now, in front of Your Honours.

Now there is a theme, or possibly an undercurrent. In my learned friend's submissions it says that this arrangement that was reached was one which took advantage of vulnerable suppliers and that the Act is designed to deal with people's whose processor goes broke outside the application period. In our submission that's not what the Act is about and it isn't actually what happened here either. The suppliers were substantial businesses. They were multi-million dollar businesses. They were savvy. They understood perfectly well that if they wanted to get their retros they did have a bargaining chip in terms of their collective supply and the commitment of that for a period, and that was one of the ways of trying to get to their retros and – but retros aside, the market for their milk was, in fact, contestable. They could have sold the milk, if that was all it was about, to others, but what they were after was retros and those retros were duly paid.

GLAZEBROOK J:

So what were the options in the area to sell to others?

MR HODDER QC:

That's referred to in the Commerce Commission.

GLAZEBROOK J:

Yes, I just want to –

MR HODDER QC:

I don't have the details of who the others were but they were, there were –

GLAZEBROOK J:

I thought it was someone coming in to purchase rather than other options in the particular area but I might have misunderstood that.

WILLIAM YOUNG J:

There was Westland and Synlait had put in offers.

MR HODDER QC:

There were various –

ELIAS CJ:

But those were offers to purchase the business.

GLAZEBROOK J:

Yes, because there's transport issues in terms of going over to the West Coast with milk.

MR HODDER QC:

There were offers to purchase the assets.

GLAZEBROOK J:

Yes.

MR HODDER QC:

And there were more or less offers to pay a price which would cover some of the retros as well.

GLAZEBROOK J:

But one assumes to do it in that particular factory rather –

MR HODDER QC:

Yes.

GLAZEBROOK J:

What I was asking, were there other factories in the area that were practical, or do we have anything – I'm not sure it matters particularly.

MR HODDER QC:

I don't know we have any evidence on that but the range of tankers and factories these days is quite substantial so I – but I can't –

GLAZEBROOK J:

Yes, but there is a transport issue in terms of going outside of the relatively immediate area, as I understand.

MR HODDER QC:

Well, there's a provision about refusal of supply –

GLAZEBROOK J:

Exactly, exactly.

MR HODDER QC:

– for an application. I don't know that anybody was, has raised that issue so I don't know if we've got evidence on it.

GLAZEBROOK J:

Well, no, I was just asking are there any other dairy factories in the area they could have supplied to.

MR HODDER QC:

I don't think there's anything in the –

GLAZEBROOK J:

Or was it only people buying the NZDL assets that would enable them to supply.

MR HODDER QC:

I don't have a strict answer to that. All I can say is I think there is evidence in the Fonterra board papers that there was contemplated that Fonterra would bring in milk from outside the area to that factory, so presumably it works the other way as well, but I'll check with my learned friend, Mr Street, who may have some more clear-cut references but that's to the best of my recollection at the moment.

ELIAS CJ:

There's no obligation on any other processors to take milk.

MR HODDER QC:

No.

ELIAS CJ:

And the focus of the Commerce Commission report I assumed from, although we only skimmed through it, but that focus was on the merger. Did anyone actually look at the options in terms of milk supply, by these producers?

MR HODDER QC:

No, there's only that comment in the report that says that others would have taken the milk.

GLAZEBROOK J:

But one assumes that means taken the assets and the milk.

MR HODDER QC:

And I don't think I have evidence directly on that point.

GLAZEBROOK J:

No, that's all I was – if there was anything else.

MR HODDER QC:

Yes, I'll check if there's anything on that but at the moment I can't give you a better answer than that.

GLAZEBROOK J:

It may be that the Commerce Commission wasn't particularly concerned about that because the issue was whether there was going to be a difficulty in them purchasing that plant.

MR HODDER QC:

Insofar as the Commission was considering the counterfactual, I think they were considering the very factors Your Honour is asking questions about.

GLAZEBROOK J:

Although more if someone else came in and purchased it, one assumes.

MR HODDER QC:

Yes, yes.

GLAZEBROOK J:

The counterfactual would be, I would have thought.

MR HODDER QC:

Would be a purchaser of the asset.

GLAZEBROOK J:

Yes, yes.

MR HODDER QC:

And taken the milk.

GLAZEBROOK J:
Mhm.

MR HODDER QC:
Now, with the risk of the degree of repetition, if I can take Your Honours back to the flowchart that I handed up at the very beginning of the day, I'm hopeful this is of some assistance. It's not meant to be an advocacy tool much, but it's designed to create a logical sequence in the way that this works and I'm not going to go through it in detail but I did want to point out the provisions where the phrase "milk supplied as a shareholding farmer" occurs. So if we look at the first one, what you do in preparation for the new season, there's a question mark about what the application period relates to and what price might be paid and then we have to then take into account the default price. Now, the default price definition in section 5(1) is the first place that you find this phrase "milk supplied as a shareholding farmer".

If we come down to publication, it must be published and what's been published is the application period and the application period is for the supply of milk as a shareholding farmer. That comes from section 75 and comes through into section 76.

The application itself uses the phrase in 73(2) and 75(1) that I've identified there and we say that it actually relates back into section 73(1) as well. So the 73(2) is the existing shareholding farmer. 73(1) is a new entrant and 75(1) we've mentioned.

We get to acceptance. The principle is set out in section 71B in the first bullet point. It again has the phrase "supply as a shareholding farmer".

Now, the third bullet point where there's reference to section 74(3) for applications outside the period, again, that's another provision that refers to supply as a shareholding farmer.

Going on to the terms of supply, the reference to milk supply as a shareholding farmer for one season is found in section 107(1). That's the third bullet point under the terms of supply block. The next block, this is about the issue of shares among other things and the third bullet point, there can't be a requirement for collateral payments for supply of milk as a shareholding farmer, and section 83 we find the phrase again.

In terms of withdrawal, section 97(1) in the first line is where we find the phrase again and likewise in the second bullet point in section 97(2) and the tenth and last one that I can identify where this phrase is used is the very last reference which is section 101(1), which is the date for payment of the shares.

So in terms of consistency of statutory interpretation, we say this phrase has been used deliberately consistently throughout Part 2(5) and it has to mean something. The way in which it is effectively used in the reasoning in the High Court and the Court of Appeal is it means milk supply, full stop. It doesn't mean anything else. We say that can't be right because it leaves out the words "as a shareholding farmer" and we say that indicates against the background of both the industry and the regulatory objectives that it's talking about share-backed supply because that is the paradigm for supply of milk in New Zealand and serves the purposes of open entry and open exit.

So those 10 references and the materials from the legislative history we say provide the strong support for the principal argument that we've been making, which is that these suppliers were not new entrants for the purposes of Part 2(5) including section 73 and section 106.

Now what I'd like to do is to wrestle briefly with some of those key sections again, partly taking into account the Court of Appeal's analysis, partly taking into account our friend's submissions, and going back first to section 73. The Court of Appeal approached section 73 essentially on a literal basis. It said, well, section 73(1) says there's an application to become a shareholding farmer, and the shareholding farmer is defined as anybody who has any co-operative shares, these people were applying to get the token number of

1000 shares therefore they were applying to become a shareholding farmer, end of story. And that's to be found in the Court of Appeal judgment at paragraphs 50, in 89(b) and in 91 to 93.

GLAZEBROOK J:
Well, they were to an extent applying to have the chance of becoming a shareholding farmer but not just in that particular season, because that's what –

MR HODDER QC:
More than a chance.

GLAZEBROOK J:
Well, more than a chance, the right to become a full shareholding farmer but not – or share-backed farmer, whatever your phrase is – but not until the following seasons.

MR HODDER QC:
Well, they had an option to become a share-backed supplier –

GLAZEBROOK J:
Well, they had a right to become one if they exercised that option, so they were applying effectively to become a shareholding, a fully share-backed supplier.

MR HODDER QC:
Well, the question whether they were applying for anything really arises, they were entering into a contract and the applications are slightly superimposed formalism in relation to this.

GLAZEBROOK J:
Well, I understand that, but I mean I would have thought that if you agree to a contract somebody's not going to say, "That wasn't an application; you should have filed an application form under section 73."

MR HODDER QC:

But you don't need to, you're already a shareholder, you're already supplying on terms you've agreed to. You don't need anything else.

ELLEN FRANCE J:

It is an application; they've plainly applied under 74(3).

MR HODDER QC:

They've made an application to supply, because it's under section 74(3) is the real issue, Your Honour. So 74(3) –

WILLIAM YOUNG J:

But, well, we must have the applications.

MR HODDER QC:

Yes, yes. Well, the application is as modified by the MSA terms we were looking at. But, yes, probably simplest to go to –

GLAZEBROOK J:

But I'm talking about the MSA terms. They applied for those terms. Those terms include the right to become a fully share-backed supplier, just not in the first season, that's what we've just established from the Board –

MR HODDER QC:

Yes.

GLAZEBROOK J:

– actually I haven't seen those, but we haven't been taken to those, but from the Board papers you say that's what they were able to do, because that was the effect of the variation on the Growth Contract?

MR HODDER QC:

Under the contract they had both the option to become a share-backed, fully share-backed supplier any time –

GLAZEBROOK J:

So they were applying to become one.

ELIAS CJ:

But on your argument they'd have to apply again.

GLAZEBROOK J:

No. They had a right. It's what you said they had.

MR HODDER QC:

They had a contract. They had a contractual right. It was a contractual right.

GLAZEBROOK J:

They had a right to – if they wanted to and they paid up the money, not in the first season but in the second season they had a right to become fully share-backed suppliers.

MR HODDER QC:

Correct, and that was what the contract gave them.

GLAZEBROOK J:

And that's what they were applying to do.

MR HODDER QC:

Well, they were entering into a contract. They weren't making an application under section 74(3) or 73.

WILLIAM YOUNG J:

Is there actually an application – is there a form, "We apply under section 73"?

MR HODDER QC:

We apply to become a – a Growth Contract which includes the obligation to take up shares and gives the options, et cetera, obligations.

WILLIAM YOUNG J:

Can you show – it's in volume 6 or 7?

MR HODDER QC:

Volume 8 has the full suite of them. Just bear with me for a moment. Yes, that's probably as good a place to start. So if we start at the very beginning of volume 8, there's the letter that was sent, provided by Fonterra as the cover letter for all these documents, signed by the then Chair of Fonterra, and what was described as a pack, and so about two-thirds of the way down the page the contents of the pack are listed.

GLAZEBROOK J:

Actually, can I just ask, under the Growth Contract you actually have an obligation to become fully share-backed, don't you, but just over a period of time and you have an option to become fully share-backed later?

MR HODDER QC:

Yes.

GLAZEBROOK J:

I just can't see that that's not an application to becoming a fully share-backed supplier, just not necessarily immediately but over time. What's the – why aren't you making an application under 73 in those circumstances to become a fully share-backed supplier but at the end of however many years the Growth Contract allows you to or requires you to share up?

MR HODDER QC:

Because the dominant legal foundation for what happens is the contract, not the Act. This contract has nothing to – it doesn't depend on the Act in any way.

GLAZEBROOK J:

Well, no, I'm talking I'm just a new entrant and I want a Growth Contract and I come and say, "I want to become a shareholder and I want to do it under,"

and I apply to Fonterra and say, “I want to become a shareholding contractor. I can’t pay immediately. I want one of your Growth Contracts that you do. Accept me or – accept me.”

MR HODDER QC:

And we say Fonterra could say, “No.”

GLAZEBROOK J:

And you say that you can – Fonterra can say no because you’re not immediately a share-backed supplier, and then what?

MR HODDER QC:

Fonterra says, “But we have a Growth Contract and you don’t have to apply during the application period. You can apply any time.”

GLAZEBROOK J:

But that’s not what happens, is it?

MR HODDER QC:

Well, it’s what happened here.

GLAZEBROOK J:

Well, I know that’s what happened here but normally these Growth Contracts I’d understood were for the sort of situation I was postulating where people can’t afford to come in immediately and they’re effectively funded in through Fonterra on a Growth Contract.

MR HODDER QC:

Indeed. Indeed, and normally there’s no issue. Fonterra’s normally going to be –

GLAZEBROOK J:

But you’re saying that those people who apply during the application period for a Growth Contract can, despite section 73, be told, “No, because you’re not a new entrant.”

MR HODDER QC:

Yes.

GLAZEBROOK J:

Okay, fine.

WILLIAM YOUNG J:

So where is one that's been signed, if I just get my –

MR HODDER QC:

One that's been signed?

WILLIAM YOUNG J:

Yes.

GLAZEBROOK J:

So 73 only protects those people who want to come in immediately and say, "I want to come in immediately and I can pay the full price."

MR HODDER QC:

Yes, what we say is that sections 73 and 74 are about share-backed supply. If you're not coming in with share-backed supply for the new season then you're not coming in under 73 and 74. You may come in under a contract, and that's what these people and other Growth Contract suppliers do, but you're not coming in under 73 and 74.

ELLEN FRANCE J:

Is the Borst one, an application?

MR HODDER QC:

The Borst one is in volume 7 at 1496, Your Honour.

GLAZEBROOK J:

Sorry, 1?

MR HODDER QC:

Volume 7, 1496. Volume 7 is full of these things but 1496 is a legible one for Mr Borst.

GLAZEBROOK J:

And is this just an ordinary Growth Contract as against the –

MR HODDER QC:

Yes, yes. So it wasn't, there wasn't a special form created for this particular –

GLAZEBROOK J:

No, no, sorry, I meant is this an ordinary Growth Contract with someone other than one of these people or is it – thank you.

MR HODDER QC:

This is one of these people.

GLAZEBROOK J:

So this is a modified one?

MR HODDER QC:

No, the – well, the form itself wasn't actually modified. It was just they just used the form that they use for everybody. The modification is in the MSA.

GLAZEBROOK J:

Okay.

ELLEN FRANCE J:

Yes, as I understood it this was the standard form. That's what we see in volume 8. This is exactly the same.

MR HODDER QC:

It is, just signed.

ELLEN FRANCE J:

This is just the one that was signed by Borst.

MR HODDER QC:

So the variations to it, or we say this is the derivative of the core MSA, but sort of mutatis mutandis because this was the standard form and the special conditions aren't referred to in it. But in terms of Justice Young and your inquiry about that, where that takes us to, probably page 1498, if we're looking at the Borst application, describes the co-operative shares requirement, and you will see that it says as the second paragraph there on page 1498 under 8, "As a new supplying shareholder, you are required to hold one share for every kilogram of milk solids of your estimated supply after allowing for production not required to be backed by shares under any contracts you are awarded," and what was going on here was that they were coming in under contracts that did not require them to be backed by shares. And as I say, this contract or these forms were not constrained by anything to the application period. They were a matter that Fonterra could at any stage sign people up to and, as Justice Glazebrook said, there is an advantage to them because it means that people who don't want to put their money into the capital have a long period before they have to front up. But what it does give them is it gives them the option to share up.

GLAZEBROOK J:

Where is that, sorry? Does that come through the Growth Contract supply? This one's just a conversion form that doesn't say anything about what's not – so then you go on to the Growth Contract supply application, do you, on 1500?

MR HODDER QC:

Well, the form is headed "dry farm conversion". The normal Growth Contract would be a dry farm conversion. That's why the form was used and designed to achieve that.

GLAZEBROOK J:

What I'm having a bit of trouble with is 8 seems to require you to actually be shared up.

MR HODDER QC:

Except when your contract supplying.

GLAZEBROOK J:

That's why I asked whether you then moved on to what's on 1500 because you're applying for a particular type of contract then. Is that right?

MR HODDER QC:

Right, I can go to the –

ELIAS CJ:

Go to which one you prefer, perhaps.

MR HODDER QC:

Well, we've gone to page 1500 or thereabouts because Justice Young was looking for a signature but if I can go to one that's not signed, we can go to volume 8, page 2115.

GLAZEBROOK J:

Not on mine.

MR HODDER QC:

Volume 8, page 2115.

GLAZEBROOK J:

2115, thank you.

ELIAS CJ:

Headed "Growth Contract supply schedule"?

MR HODDER QC:

Right, so these are the terms that are picked up by the application form we were looking at.

WILLIAM YOUNG J:

Did all the respondents share up the following season?

MR HODDER QC:

Sorry – no, they've all shared up now but they didn't share up immediately. I mean, by that stage – all but one is shared up now. But at the time, no, there was a kind of a – one of the issues that underpins it, this is the economic one which is that the price of shares went up in the next season and because TAF had come in and the consequence of that turned out to be, as was predicted, a share price rise. So it's taken some time for most of them to share up. Some have shared up but they've all shared up at different stages.

ELIAS CJ:

Is there any consideration of that effect in the Board papers at the time? Was that an element considered?

MR HODDER QC:

That they would be sharing up?

ELIAS CJ:

No, that there would be an increase, an expected increase in the share price.

MR HODDER QC:

Not in the Board papers. I think there was –

ELIAS CJ:

There was disclosure, was there?

MR HODDER QC:

No, I don't think so. There was an expectation in the industry that it would go up, but I don't know that the Board papers focused on it going up.

ELIAS CJ:

They wouldn't have to.

GLAZEBROOK J:

There were findings in the lower Courts that one of the purposes was to stop these people getting access to the higher share price.

MR HODDER QC:

Yes. There was an expectation that they would benefit.

GLAZEBROOK J:

Well, no, there were findings that that was the purpose.

MR HODDER QC:

I was referring to the expectation that the price would go up, but yes, there was an expectation.

GLAZEBROOK J:

The purpose was – the findings were that the purpose was to make sure these people didn't share in that.

ELIAS CJ:

And that it was punitive.

GLAZEBROOK J:

Yes.

ELIAS CJ:

I just wonder if there had been any consideration in the Board papers.

MR HODDER QC:

I don't think the Board papers touch on that aspect of it. The Board papers are the ones that say these are the terms we want to have, the ones that we've already seen.

WILLIAM YOUNG J:

So the losses that are claimed are what the 10 cents per kilogram for the first season at least –

O'REGAN J:

Five.

WILLIAM YOUNG J:

What?

O'REGAN J:

Five.

WILLIAM YOUNG J:

No, it's five plus five, isn't it?

ELIAS CJ:

Yes, but the plus five is a different provision.

WILLIAM YOUNG J:

I thought it was if they had been able to buy the shares immediately they would have been 10 cents a kilogram better off.

O'REGAN J:

Oh, I see.

MR GODDARD QC:

That's right.

ELIAS CJ:

But there are two different clauses, aren't there, that achieve that effect? That's what I was referring to.

WILLIAM YOUNG J:

And secondly the fact that the shares went up in cost.

MR HODDER QC:

Correct. That's what the claim is for. I don't know it's been quantified yet but that's the basis of it, and obviously the price is fluctuating over time since TAF. But those are niceties we haven't wrestled with, at least I haven't.

WILLIAM YOUNG J:

I'm just trying to get a handle on the scale of the issue.

MR HODDER QC:

Well, the effect of scale, as I understand it, it's a relatively large number at the end of that claim.

ELIAS CJ:

But what is attributable to the lower price and what is attributable to the share value?

MR HODDER QC:

Well, it's fluctuated substantially as the share prices have gone up and down.

ELIAS CJ:

No, well, I understand that but sort of roughly.

MR HODDER QC:

I think my learned friend is better to answer that than I am.

WILLIAM YOUNG J:

The total supply is how much? You've told us but I've forgotten.

O'REGAN J:

I think he said 260,000 per farmer. Of course, that's the average.

WILLIAM YOUNG J:

Oh, some of them were more.

ELIAS CJ:

How many respondents are there?

MR HODDER QC:

Thirty-odd.

MR GODDARD QC:

Twenty.

MR HODDER QC:

Oh, sorry. 20 respondents. Originally 30-something suppliers.

WILLIAM YOUNG J:

That's around five million, a bit over five million kilograms a year.

MR GODDARD QC:

The respondents represent about eight million kilograms of milk solids per annum, so about 80% of the supply originally, and the bulk of the claim relates to the increased cost of sharing up, although a non-trivial amount relates to the increased – sorry, to the lower price paid while they were not shared up.

WILLIAM YOUNG J:

So that lower price claim will be about 800,000?

MR GODDARD QC:

Yes, per annum for however many years.

WILLIAM YOUNG J:
Well, it may only be for one.

MR GODDARD QC:
Well, that's one of the issues we have to determine on a causation basis. It depends when they shared up and at what rate.

WILLIAM YOUNG J:
And plus a dollar for every increase over $4.50 or whatever, then that's claimed.

MR GODDARD QC:
Yes, so the total claim at present is around $15 million.

WILLIAM YOUNG J:
Fifteen, okay.

MR HODDER QC:
I am not sure how much detail Your Honours need in relation to the growth supply terms. In broad terms it says you have a contract supply which you can reduce. The consequence of reducing is that you replace it with share-backed supply and there's an obligation to do so with a minimum of one-third for each of the last three seasons of the six years and there's an option in there to share up earlier, completely if one chooses to do so. That's the standard Growth Contract structure.

Sorry, where I was I think a while back was that I was suggesting that the Court of Appeal had focused on the idea of becoming a shareholding farmer simply by having any number of shares and not becoming a fully share-backed supplier, but that disregarded the role of supply as a shareholding farmer. Supply as a shareholding farmer is what sections 73 and 74 are about. It doesn't mean just (a) supplying milk and (b) having shares. It means there are shares that go with the milk supply directly in the form of share-backed supply because that is the norm and that's what the

regime is directed to. And so for that reason the Court of Appeal doesn't really engage with what as a shareholding farmer means. I think it assumes that it just means somebody who holds one or more shares, and we say that that isn't right and once you get that different perspective on it then the rest of Part 2(5) makes complete sense, but that these people are not new entrants. So the literal approach, focusing on the word "become" in section 73(1), as we say, ignores the supply context because in the application the section 73 is related to a supply of milk, that's what it says in relation to 73 and 74. 74(1), "Accept the milk to which the application relates," the application at 73 doesn't relate to contract supply milk, it only relates to share-backed supply milk, and likewise you can extract that from section 107 as well.

And then we come back to the regulatory context. We say that the relevant question is why is Fonterra required to accept section 73 applications, and we say it's required to accept because of the contestability factor, it's the keystone, so the cornerstone, or the key, depending on which language one wants to use, to the overall regime of open entry/open exit, that why there's an obligation to accept it, not simply because people can acquire some shares in Fonterra. Of course when people do seek and gain share-backed supply arrangements they of course become shareholders in the process, because that's what share-backed supply necessarily involves. And in our submissions we've talked about analysing this in terms of there being a status and an activity, to satisfy the terms of sections 73 and 74. The status is that one is a shareholder by holding one of more shares but the activity is supplying milk that is back in accordance with the share standard.

WILLIAM YOUNG J:

What was the case for the respondents at trial? Was it that they should have been offered new entrant shareholder supply arrangements in terms of which they had to pay up by the 1st of June, although it was a bit late for that, the full value of the shares, or where they saying, "We should have been offered the standard Growth Contract but permitted to share up at any stage"?

MR HODDER QC:

The case for the respondents I think has always been that they should have been offered a simple Growth Contract when they could have – they say, we say, there's an issue around that as well but that's a causation issue – could have shared up the day they got the shares and benefited from TAF. But they say that all the special terms set out in the milk supply agreement that they signed could not be applied because DIRA, that they were contrary to section 106.

ELIAS CJ:

I'm sorry, this is probably going backwards, but what's the status directed at? The ability to participate in a contract of supply?

MR HODDER QC:

The status of being a shareholder?

ELIAS CJ:

Yes.

MR HODDER QC:

Well, it has a series of consequences to it in terms of, you know, being –

ELIAS CJ:

Yes, but what as is relevant here?

MR HODDER QC:

As is relevant here it simply just recognises that at the end of this process one has the status of a shareholder. So I think Your Honour's responding to my proposition about there being a status of being a shareholder and being an activity.

ELIAS CJ:

Yes.

MR HODDER QC:

We say the two have to be together, because that's the nature of what share-backed supply is, whereas we say the Court of Appeal judgment focuses on the status without focusing on the activity, and the activity is supplying as a shareholding farmer.

ELIAS CJ:

You say they have to go hand-in-hand and not be look at separately?

MR HODDER QC:

For there to be section 73 and 74 engaged, yes.

ELIAS CJ:

So then what's the purpose of the 1000 shares?

MR HODDER QC:

The 1000 shares gives them the status.

ELIAS CJ:

Why do they need the status?

MR HODDER QC:

Well, I think that's part of the co-operative ethos, the idea that behind these Growth Contracts and generally is the people will become share-backed suppliers, which is the norm, in due course.

WILLIAM YOUNG J:

It's the first step towards becoming a fully share-backed supplier.

MR HODDER QC:

Yes.

ELIAS CJ:

But there isn't anything that requires that first step to be taken.

MR HODDER QC:
By Fonterra?

ELIAS CJ:
By the parties.

MR HODDER QC:
No, that's a matter of contract we say. So they want to enter the industry, they have an absolute right to come in and pay up on a share-backed basis during the application period. In many cases, as we've been discussing, it may be more convenient if they don't have to pay up all their share capital in the beginning. As I said, if the average supplier had come in with 260,000 share requirement to be share-backed, that was 1.2 million, $1.18 million, so it may be that it was easier not to do that at that stage or for them or some comparable farmer somewhere else.

ELIAS CJ:
So the 1000 shares is just an earnest, is it?

MR HODDER QC:
It's a token.

ELIAS CJ:
Okay.

MR HODDER QC:
But it means that they are involved to a degree in the Fonterra organisation by information, by voting, by all of the stuff that goes with it, but what it isn't is a key to supply as a shareholding farmer which we, as I've been saying rather often, is the key to this whole part of or subpart of the Act.

So section 74, one of the points that I am responding to in terms of particularly my learned friend's submissions is that under section 73 there has to be an application during the application period and, indeed, we know that a new

entrant is defined by somebody who makes an application under section 73, and there's no doubt that nobody made an application under section 73, ie, within the application period here, so what were they? My learned friend says they made an application under section 74(3) and therefore they're effectively treated as if they were making an application under 73 apart from the timing. We say no, there is a discretion under section 74 and either you come in as a fully share-backed shareholder supplier as you would under 73 or, alternatively, you come in as a contract supplier and that is what happened here, acknowledging that there is this token shareholding as part of the process. So section 74(3) makes it clear that Fonterra has a discretion to accept an application to supply milk as a shareholding farmer. Discretion means as a choice. It isn't a regulated choice, it's just a choice. It's not said to be described as an extreme position to say that that's what it is. Fonterra can say yes or no.

What the Court of Appeal did is it finds that Fonterra did exercise its discretion under section 74(3), and this is paragraphs 92 and 98 of the judgment, when it issued the shares, the 1000 shares each, on the 22nd of September 2012. It says at that point the NZDL suppliers became new entrants.

We say firstly that the suppliers were clearly agreeing to supply milk on contract terms. It may have been the first step towards becoming share-backed, fully share-backed, at some point down the track but for the 2012/2013 season the application was, if that's what it was, was to supply on contract terms and they did and they signed a contract. They were not share-backed suppliers and they were not supplying as shareholding farmers. That's the, kind of the statutory argument, as it were.

The second argument is that the Fonterra discretion, we say, was exercised not in September when they issued 1000 shares but the discretion that Fonterra had under 2.3(b) or 3.4 was exercised back in June when the Board considered and approved the terms of these contracts. That was the point at which Fonterra was exercising a discretion about taking on the supply or not, and it said subject to the conditions, you sign the contract and the

Commerce Commission gives clearance, those will be the terms of the supply. What happened in September was a formality. And so the use of the modified Growth Contract and the associated issue of those 1000 shares in September –

ELIAS CJ:

So what – I'm still a bit hung up about what is this formality? What was the formality for?

MR HODDER QC:

It gave effect to the arrangement already effectively agreed to that they would come in on a Growth Contract which required them to take up 1000 shares.

ELIAS CJ:

Well, giving effect to an agreement is oddly described as a formality, I would have thought, but anyway that's right.

MR HODDER QC:

Well, at that stage the – Fonterra's signed a contract. The suppliers have signed a contract. They're conditional. The conditions have gone. That's the point at which one exercises the issue of shares.

ELIAS CJ:

It's giving effect to it –

MR HODDER QC:

It's giving effect to the –

ELIAS CJ:

– whereas the obligation, the exercise of the option was when the agreement was entered into.

MR HODDER QC:

Yes, the essential decision by Fonterra we say was made back in June. There was no discussion, well, I don't know this but it seems implausible there

was a discussion about the terms when they were issuing two and a half million shares of whom 30,000 were the 1000 shares per supplier in September.

ELIAS CJ:

Did that 1000 share-back any supply?

MR HODDER QC:

That's not clear. My learned friend's sotto voce or almost sotto voce saying, "Yes." It doesn't say so, it just says you just hold a thousand shares. We would accept –

ELIAS CJ:

But I'm just talking about as a matter of fact really.

MR HODDER QC:

I think in the way it was treated that they were treated as being share-backed shares.

ELIAS CJ:

Yes. So what supply was linked?

WILLIAM YOUNG J:

A thousand kilograms.

ELIAS CJ:

Yes, a thousand kilograms.

MR HODDER QC:

A thousand kilograms, out of 260,000.

ELIAS CJ:

Oh, yes, that's right.

WILLIAM YOUNG J:
So it's $100.

MR HODDER QC:
Yes.

ELIAS CJ:
Yes.

MR HODDER QC:
So the short proposition that we're now kind of familiar with from my submissions is that the suppliers were not share-backed suppliers, in the DIRA context they weren't supplying as a shareholding farmer, and neither the language or the purpose of the new entrant provisions is designed to have these provisions applied to the people in the position that the respondents are.

My learned friend says, and we've had some discussion on this this morning, that actually there's a risk protection purpose for Part 2(5), so my learned friend's submissions, that the legislation was designed to protect dairy farmers who moved to independents which failed. Well, that's hard to find in the legislation, it's hard to find the legislative materials, it isn't necessary for the open entry/open exit. Businesses do take risks. The answer is simply found by the way in which the regime works. There is a very clearly delineated and clearly fundamental application period, and it runs from mid-December to the end of February. That's the period where obligations on Fonterra and rights for farmers arise. Outside that there are no obligations and there are no rights, subject to the question of the Commerce Act. So outside that we say the acceptance of milk supply is discretionary, there can be the exercise of a discretion to take supply under section 74(3) if it is share-backed supply, and there's also a discretion to enter into a contract supply, which is what we say happened here. So we say we cannot find anywhere in the legislation or its history the idea that this was somehow or other a protect-suppliers-from independent-processor-insolvency provision. But it's that very expansive idea

that this is a very protective regime for each farmer that underpins the general approach that the case in favour of liability under section 106 has been based.

My learned friend's submissions also place some weight on sections 82 and 83, which we've touched on, but I'll perhaps go back to for a moment. The point that I think that's being made is that section 82 refers to the idea that there can be new entrants in response – or making an application to which section 74(3) applies, which we don't dispute, that is what the discretion under section 74(3) can do. As long as it is supplying milk as a shareholding farmer, that's what an application in which section 74(3) applies is, and Fonterra does have a discretion to take that supply either from a new entrant in that context or from a shareholding farmer outside the application period, and it's dealt with on the basis that it's a share-backed supply application. What it doesn't do is constrain Fonterra from entering into contracts which aren't in relation to share-backed supply.

The submission goes on, and this is a point partly touched on –

GLAZEBROOK J:
Can I just check, in terms of – I mean, presumably these Growth Contracts require you to share up at whatever the price is at the time?

MR HODDER QC:
Yes.

GLAZEBROOK J:
And that's stated in the contract. But you're saying that that will just be a contractual provision rather than something required under the statute because these people aren't shareholders?

MR HODDER QC:
Yes. The terms of the contract say when and on what basis they share up.

GLAZEBROOK J:

So these people are totally outside of the Act altogether, these Growth Contracts, they're something totally different, whether there's an application within the period or not?

MR HODDER QC:

Yes, they're not to supply as a share-backed supplier, or supply as a shareholding farmer.

GLAZEBROOK J:

I'm not talking about these particular people, I'm talking about anybody who goes into a Growth Contract has none of the protections in the statute, you say.

MR HODDER QC:

Yes, yes. We say that's right and the application period is irrelevant to them. That can be done at any time.

GLAZEBROOK J:

Okay.

MR HODDER QC:

The theme about vulnerability on behalf of the respondents in their submissions goes on to say, well, what does happen if there are – Fonterra hypothetically accepting half of a new supplier's milk under 74(3) and imposing a charge for accepting the other half. Now that's the proposition that's set out in my friend's submissions. The first response, of course, is it's fanciful and disregards the power of industry and political opinion and the co-operative ethos and the Commerce Commission and statutory roles, but the strict answer is that freedom of contract does apply except where excluded by the open entry regime and if open entry as we say applies to share-backed supply and for whatever reason there was part share-back supply and part contract supply, the contract supply is on whatever terms the parties agree, and that will be the position, of course, if Part 2(5) is lifted. If

Part 2(5) were lifted because the 20% contestability criteria had been satisfied, it would all be contractual and constitutional, no surprises about that, because, we say, the Part is about contestability and the macro level of the concerns about the size of Fonterra.

So my learned friend's submissions go so far as to say it's absurd to suggest that you can have that was regulated and half that was not in terms of a supply, to which we respond that's the consequence of having the very specific application period prescribed in the legislation.

So this part of my submissions, and this is going to be the major part of what I'm going to say, I'm really focusing on the primary submission about question 1, "Were these suppliers new entrants?" to which our answer is no, they were not for the purposes of any of Part 2(5) including section 74. 73 clearly is not applicable. We say they're not within 74 either because that's about supply as a shareholding farmer and that's not what the contracts were about, and the shares, the 1000 shares on the side were simply a token.

That is the main submission in relation to this part. It depends on the way in which one views the case.

In terms of section 106, we say that's consistent with our analysis and so we say 106 says a limited but important role on open entry and it's of benefit to independent processors because it means that Fonterra cannot buy off any suppliers that independent processors may wish to acquire, and as we've seen section 106(4) also goes to the question of contestability, and if we're focused on the supplier rather than on the individual as a person, as a person who is a dairy farmer, then all this makes perfect sense.

So where does that take me to, and I promise that after lunch I'll be very brief on question 2, but on question 1 can I try and bring together what I've been trying to say this way? The purpose of Part 2(5) is to promote contestability in the market for raw milk as far as we're concerned. That means processors are able to compete for milk supply from dairy farmers. That means the focus

is on milk supply, not on individual farmers and their obligations or entitlements.

The cornerstone of this whole contestability regime is the open entry/open exit regime. Open entry and open exit to what? Open entry and open exit to the ranks of Fonterra share-backed suppliers because that's what the vast majority of the industry has and it means that people can go to another independent processor and come back again. It is the predominant form of supply in the industry and that's reflected, indeed understood, by the legislature in framing what we have before us.

And, of course, it recognises, as the Minister's speech does, the fundamental proposition that milk supply and share capital are linked. You can come in but you must pay the full share capital. If you don't, you're on some other basis.

Outside that open entry/open exit regime, ordinary rules apply. The Constitution can be given effect to, contracts can be given effect to and entered into, the Commerce Act can be wielded, if appropriate, political opinion can be stirred up, but it doesn't bring anybody into section 73 and 74, and so the core of open entry, as we've seen, is section 74(1), that's the one that says Fonterra must accept an application under section 73, which is one to supply milk as a shareholding farmer. And likewise open exit is the one that says you can give notice to cease supplying as a shareholding farmer. And a section 73 application by a new entrant will be one to apply for share-backed supply and, as a consequence of that, to become a shareholder by virtue of being issued the shares associated with that supplier.

And the last point that I've made many times, in all that scheme a token number of shares that clearly has no relevance to the supply in any meaningful way, and with a thousand shares, doesn't change contract supply to share-backed supply and nor does it transfer or transform a contract supplier into a new entrant.

So that's the core submission for us and the core explanation of the statute for our purposes. We have of course fall-back positions and there are three of those. But the main principle is that these suppliers were not new entrants. The fall-back position, which I can mention briefly before we adjourn at one is that if we're wrong and the Court of Appeal and the High Court are right that section 73(1) is about any application that involves any number of shares, ie one or a hundred or a thousand, then –

GLAZEBROOK J:

Well, they were applying to get more shares than that but just over a longer period, in this case, they weren't just applying for a thousand shares, they were applying to get fully share-backed but just over six years. So they weren't just applying for a thousand shares –

WILLIAM YOUNG J:

It's a season-by-season thing isn't it?

MR HODDER QC:

That's what I –

WILLIAM YOUNG J:

You're applying for the next season?

MR HODDER QC:

This is the season that's –

GLAZEBROOK J:

Well, yes, but they applied to become partly share-backed. Because the argument would then be that if they said, "Well, we want to get half of it or three-quarters of it and then we want a contract for the rest," they're still not share-backed.

MR HODDER QC:

And that's why the contract is a constraint, as you'd expect a contract to be a constraint. In the ordinary case, if a new entrant or a shareholding farmer comes in through the application period and becomes a supplier that's their open entry, they're entitled to exit at the end of the season.

GLAZEBROOK J:

So you say it's a season-by-season basis, is that the –

MR HODDER QC:

Yes, that's for ordinary share-backed supply. The contract constrains that, that's why it's a contractual-based relationship not a statutory-based relationship.

GLAZEBROOK J:

And how does that fit in with the requirements that you're not allowed to contract people for longer than on season in certain circumstances? Do you get around that?

MR HODDER QC:

Well, that's for people who are supplying as shareholding farmer, ie, share-backed supplier.

GLAZEBROOK J:

So it's in effect the answer is yes, you get around that by having a longer term contract with these people.

MR HODDER QC:

Well, Your Honour says, "Get around it," we simply say it doesn't apply.

GLAZEBROOK J:

Well, I would have thought the legislature might have thought you were getting around it, because they set limits on the extent to which you can do that.

MR HODDER QC:

But what the legislature's doing in section 107 is making sure that independent processes are not thwarted by the fact that Fonterra has tied up a large percentage of people for a long period of time so they can't be contestable, and in relation to the application to supply as shareholding farmers then the norm is that the new entrant gets to be offered one season that is the norm, there's an ability to offer for a longer period which isn't mandatory, and it is also subject to the overall 33% requirement in terms of what is tied up by contract and what is not. So we say section 107 isn't something to be got around, it simply happens to be there to enhance contestability. And insofar as we're talking about non-share-backed supply we're talking about contract supply, then that is constrained by section 107(3). If Fonterra happened to have a combination of supply contracts, pure contract and share-backed contracts that went beyond that, then that would defeat the purposes that the legislature's clearly indicating in section 107, but that's as far as it goes.

So if the Court pleases what I propose to do briefly after lunch is to say if we were wrong on what a shareholding farmer is and it's just somebody who happens to hold one or a thousand shares, then there is the issue about the four existing shareholders who already had the shares, that's in relation to question one. On question two we will say that the new entrants are only new entrants to the extent of their share-backed supply, which we say was a thousand shares, if that, or alternatively they were in different circumstances and they were in different circumstances because nobody else was being paid out of Fonterra shareholder funds, the 20 million or so that went onto retros, and this was the particular arrangement that was of benefit to both sides and completely distinguished their circumstances from anybody else in the overall dairy industry. But I can say that quite shortly I think but I will need a bit of time after two to do so.

ELIAS CJ:

You might need to take us to the findings in the lower Courts on that last point.

GLAZEBROOK J:

I'm actually relatively interested in that last point, not so interested in your first point, as you might have gathered.

MR HODDER QC:

The different circumstances?

GLAZEBROOK J:

And much more interested in the section 106 point.

MR HODDER QC:

Yes, well, I mean there won't be any surprises about this because it's already in our written submissions. We say if there was ever a group of farmers who were distinguishable from any other farmers it's these ones, because they got paid $20 million from the Fonterra shareholder funds. No other farmers in history have ever had that. But that's the proposition we'll be putting forward.

ELIAS CJ:

All right, thank you, we'll take the adjournment and we will resume at two.

COURT ADJOURNS: 1.02 PM

COURT RESUMES: 2.02 PM

ELIAS CJ:

Yes, Mr Hodder.

MR HODDER QC:

Thank you, Your Honour. I had intended to have, well, to have little to say, at least voluntarily, as it were, in relation to the section 5 of our submissions on discrimination. Most of what I want to say is actually set out there and the way in which one approaches section 106 which is at the heart of this does depend how you see 106 in the overall statutory scheme. But the short proposition from us is that there are the two main submissions. The first is that if we're wrong and these suppliers were new entrants to whom 106

applied then they were only new entrants to the extent of their share-backed supply in the season in question and that was de minimis. If we're wrong on that, the issue then comes back to what were the – what was the impact in terms of section 106(1)? Were there different circumstances in relation to those, to which we say obviously there were different circumstances in relation to those.

So in relation to that, it may be useful if I go to the Court of Appeal's judgment briefly and just pick up on the points that the Court of Appeal makes.

GLAZEBROOK J:

Can I just – there would have to be a link, wouldn't there, even if there were different circumstances between the response to those different circumstances and the – what actually occurred, because say if you're – if you assume, and leave these people out of it, you're somebody who applied during the period and you got a Growth Contract in the normal way of things, one actually would expect that you might be paying some interest component on the fact that you're allowed to supply but without being share-backed and that would be a rational response to the fact that you're getting time to what would normally be the response of having to become share-backed immediately. But if you imposed other requirements on them, such as you get a tenth of the price for the rest of your milk during the period, that would not seem to be a response to not having to – or at least it would be an extravagant response to the time value of not paying up your capital immediately.

MR HODDER QC:

Well, I'm not sure that I'm capturing it precisely but if Your Honour's suggesting there needs to be a rational relationship between the discrimination, as it were, and what's going on in the circumstances then we would agree with that.

GLAZEBROOK J:

Okay, thank you.

MR HODDER QC:

Right. So then the question is what's rational in the circumstances?

GLAZEBROOK J:

Right, thank you.

MR HODDER QC:

And what are the circumstances that are relevant to the question about rationality.

GLAZEBROOK J:

Do you accept that there must be a – the response has to –

MR HODDER QC:

Yes, I accept that there can't be an irrational proposition and we don't accept, of course, that these were irrational responses to the circumstances.

GLAZEBROOK J:

Well, it goes further than irrational, though. It's a proportionate response to those circumstances, I would have thought.

MR HODDER QC:

Well, there may be a difference between irrational and proportional in terms of how one judges it and I haven't in the submissions gone into the detail on that. Myself, I prefer to adhere to the idea of irrational, so you have a reasonably bright line. If it simply can't be justified on a rational basis, then it's out. If it can be, it's in. Proportionality gets into a vast amount of second-guessing in commercial decision-making of a kind that just seems incredibly difficult to contemplate.

So for the purposes of this exercise, as the Court understands from our written submission, we say this was a rational response. They were in different circumstances and the Board had a whole range of circumstances to consider, including the upcoming TAF. The problem, as we've emphasised in

our written submissions, is not that these people had left Fonterra and were coming back. That wasn't the issue. The issue was that they were coming back on the basis of $20 million of shareholder funds being spent on them, which is what makes them completely different and that was the issue that the Board considered and we say the reason we say that it wasn't irrational and it was appropriate that there be some kind of different treatment in terms of the way in which they came in on a Growth Contract. It related to –

ELIAS CJ:

The payment didn't relate to the debt, did it? I mean, it was for the assets of the company, wasn't it, and it went to receivers.

MR HODDER QC:

Formally it was a price for the assets but there's no doubt in the evidence it was tailored to take into account that it was an obligation under the supply – the sale and purchase agreement that the money had to be paid in full out to the suppliers. So there is simply no credible basis for saying there was any misunderstanding that this was funds that were going to go into the hands of the suppliers via the receivers to pay off all the retros. That was the condition.

GLAZEBROOK J:

Where would it go otherwise? Could the receivers have paid it to anyone else?

MR HODDER QC:

They had a contractual obligation to pay it to the suppliers.

GLAZEBROOK J:

I understand that but in a receivership you can't just decide to pay it to anybody so was there anybody else who could have –

MR HODDER QC:

Unsecured creditors, you mean?

GLAZEBROOK J:
That's my question, yes.

MR HODDER QC:
Yes, I think there were some unsecured creditors. I seem to recall that the receivers took some care to make sure that they weren't –

ELIAS CJ:
Preferring.

MR HODDER QC:
– causing grief under the insolvency provisions. I haven't, I confess, got into that in detail in recent times.

WILLIAM YOUNG J:
There were other bidders for the property but they were not going to offer enough to pay out the retros.

MR HODDER QC:
Correct.

GLAZEBROOK J:
It's just that I wouldn't have thought you would – well, you don't know the answer. We can perhaps ask Mr Goddard. It's just that I'm not sure that having a contractual obligation to pay them out, if you were obliged to pay somebody else out in preference –

MR HODDER QC:
It hasn't really been an issue. The fact is that the contract provides for it.

GLAZEBROOK J:
Well, I suspect that everybody was paid in full, therefore.

MR HODDER QC:
Again, I can't help you on that.

WILLIAM YOUNG J:
The transactions were linked, though, weren't they? The agreement for the assets were conditional on the supply agreements being entered into.

MR HODDER QC:
Yes. So there's no question about what the deal was. The deal was that Fonterra would buy the assets and with a price included enough for all the retros to be paid in full, all the suppliers had to sign up to the MSAs and the Commerce Commission had to give clearance. That kind of architecture of the deal is uncontested.

So in those circumstances, and mindful that it has this TAF issue coming along, and it's just used $20 million of shareholders' funds to secure this deal and that part goes to the suppliers in this rather unprecedented circumstances, we say the Board was entitled to rationally say it's appropriate to have a visible difference between these and other people coming in on the Growth Contract, and it did. That's the difference.

Now, when one attaches a label of penalty to it, it seems perhaps to sound worse but it simply is different treatment. The question is whether it's justified or unjustifiable or rational or irrational. So in terms of the way the Court of Appeal approached it, the Court of Appeal discusses this aspect of the case in the judgment most relevantly starting at about paragraph 119, in terms of its principle justifications, and first it says, "The payments of the retros didn't justify Fonterra offering less favourable terms because the evidence establishes beyond dispute that Fonterra made a bid of $50 million for NZDL's assets as part of a sales process –

GLAZEBROOK J:
I must be on the wrong – I think you said paragraph 119?

MR HODDER QC:

I was looking at 120, but yes, the discussion starts at 119.

GLAZEBROOK J:

Right, I've got you now.

MR HODDER QC:

120 is the first of the principal justifications. So the first proposition is that beyond dispute Fonterra made a bid in December 2010, 18 months earlier, which is roughly the same price that it paid under the sale and purchase agreement here, and that was based on an answer given by one of the receivers when he was asked questions in cross-examination by my learned friend, and there was no other evidence, we touched on this directly, because the whole issue about the process for setting prices was held over until the next stage of the case if we ever got there, which is the question of damages and causation and so on and so forth, so there was no evidence about the rationale for the number in the Fonterra bid, and there was an exchange of correspondence in which –

GLAZEBROOK J:

Well, are you saying there wasn't a bid for 50 million earlier or –

MR HODDER QC:

Yes, I am, I'm saying there was no bid, and the reference is at –

GLAZEBROOK J:

Well, what are we supposed to do with that, in light of a finding there?

MR HODDER QC:

All I can do is point Your Honours to my footnote 29 reference, which it is clear Board papers that say there was no bid, or a clear Board paper that says there was no bid. So that's in volume 6, page 1073.

WILLIAM YOUNG J:

What's hearsay against hearsay.

GLAZEBROOK J:

Yes.

MR HODDER QC:

Yes. Well, these were the people who were inside the company rather than outside the company.

ELIAS CJ:

Sorry, what page are we at?

MR HODDER QC:

1073 of volume 6. So as I say, the evidence wasn't really addressed to this point, which means that the reply that this is all based on was sort of unexpected in that sense, at least by me. But what was there, and which I confess we didn't raise with the Court at the time or raise with the witness at the time, was on page 1073 which is the Board's paper from the 28th of May 2012, this is about two weeks before the final sign-off on the entry into the sale and purchase agreement. But the background records, in paragraph 2.4, Fonterra did not make a formal offer for the NZDL assets through Morgan Stanley at the previous round, indicated it was interested in the assets. And then over on the next, two pages on, 1075 at paragraph 7.1, "In December 2010 Nutritek appointed Morgan Stanley to run a sale process. Fonterra did not participate directly in that process but management indicated a potential interest in the assets at a price of around $50 million." So it never got to the Board, there was no bid signed off by the Board.

ELIAS CJ:

Are you saying that this issue was, that this was not in issue in the High Court and Court of Appeal?

MR HODDER QC:

As far as we were concerned, no, as far as we were concerned it wasn't an issue.

ELIAS CJ:

Well, was it flagged in the pleadings?

MR HODDER QC:

No.

ELIAS CJ:

This is one of these unsatisfactory divided hearings isn't it?

MR HODDER QC:

Yes.

ELIAS CJ:

Well, was it pleaded that – how would it have been pleaded –

MR HODDER QC:

I don't think it was in the pleadings at all. It arose –

GLAZEBROOK J:

Well, what you'd say is, "We exchanged this," that the evidence established beyond doubt that Fonterra expressed an interest, a potential interest, in purchasing the assets at around 50 million.

MR HODDER QC:

Yes, that's –

GLAZEBROOK J:

So if we just change that you'd accept that?

MR HODDER QC:

We'd accept that.

GLAZEBROOK J:
Right.

MR HODDER QC:
Well, we'd accept that's what the evidence shows so far. It's not meant to be some kind of issue of estoppel where you get to the next stage when there is evidence on the point.

GLAZEBROOK J:
Well, it's a bit difficult to say that and to rely on the Board paper on 28 May but you want to do that.

WILLIAM YOUNG J:
Well, do we know what the difficulties and doubts were about suppliers that are referred to?

MR HODDER QC:
At that time in relation to the December 2010 exercise?

WILLIAM YOUNG J:
No.

MR HODDER QC:
We didn't call any evidence on that. What we had done was we had acknowledged in correspondence between the solicitors that the financial impact of the special conditions that applied to the NZDL suppliers didn't make any difference to the economic effect of the transaction, or they weren't the difference between it being economically viable and not. That was partly meant to explain that all the stuff about the finances associated with the bid were not discoverable and would only be discoverable when we got to the second stage of the hearing, if we got there, which is why there is this absence of evidence apart from the question in cross-examination my learned friend asks and, as it turns out, this Board paper.

So what we say is that what you have is only the proposition that –

ELIAS CJ:
Sorry, was there a pleading that the deal was structured to meet the – on a punitive sort of basis.

MR HODDER QC:
By the plaintiffs?

ELIAS CJ:
Yes.

MR HODDER QC:
Yes. Just bear with me.

ELIAS CJ:
Yes. Don't you have to address that in evidence on – at this stage of the proceeding?

WILLIAM YOUNG J:
Well, you'd say he would because you've shown that the circumstances were different. All you have to do is show the circumstances are different.

O'REGAN J:
I don't see why the financial benefit to Fonterra really matters. It's a question of is it justified to treat these people differently because they're in a different situation? That's all we have to decide, isn't it?

GLAZEBROOK J:
But one would have thought that might be related to whether there was actually a punitive – whether in fact paying that out made any difference to Fonterra in terms of the finances.

O'REGAN J:

It's really just have they already got a benefit i.e. $20 million worth of payments for their previous debts that justify treating them differently on future supply.

GLAZEBROOK J:

Or would they have got that anyway because you have to pay 50 million in order to get the assets because otherwise if you'd paid less an under-bidder might have been a preferred buyer. I've no idea who these under-bidders were but depending on how close they were it might be you had to pay that amount in order to get the assets in the first place, which Fonterra wanted, one assumes.

O'REGAN J:

To me that doesn't matter.

WILLIAM YOUNG J:

The fact that they've got the assets for cheaper but they wouldn't have guaranteed supply.

MR HODDER QC:

That's right.

WILLIAM YOUNG J:

But in a sense this business of punitiveness is a bit circular. The reason why, I imagine, that Fonterra was reluctant to offer the respondents the same deal as existing shareholders is because their existing shareholders would think the circumstances were different.

MR HODDER QC:

Exactly, that got reduced to the phrase "optics" but the optics that were important were the optics that these were people who were being paid money having gone away and lost money – potentially or actually – in terms of their previous exercise and in the nature of the industry there is no payment of this

kind made for incoming suppliers. So that together with the fact that they had this critical vote on the capital restructuring coming up were we say perfectly rational, relevant considerations that the Board took into account.

ELLEN FRANCE J:

Sorry, in terms of the timing the – what you might call the special conditions or the different conditions came after, didn't they, after the decision to – as to the amount of the bid.

MR HODDER QC:

There were always discussions going on throughout the process about what was going to come on but the final decision was made on 14 June by the Board, yes.

WILLIAM YOUNG J:

Was it not always conditional on supplier agreements?

MR HODDER QC:

I think right throughout the internal Fonterra process, such as there is in relation to this transaction, the answer was yes. The commitment of the supplier was critical to the deal.

ELLEN FRANCE J:

Yes, I was thinking of things like not buying the vats and so on, that comes – the bids may or the indicative bid is made on the 5th of June, the decisions about the nature of the special conditions if you like come later, is that –

MR HODDER QC:

Well, they're working their way through, they're formally signed off, and they develop through to 14 June, yes.

ELLEN FRANCE J:

Well, was there any suggestion prior to the 5th of June, for example, that they wouldn't buy the vats?

MR HODDER QC:

I don't recall that there was. I mean, Your Honour Justice France has raised the question about which is the relevant point at which we should be examining this issue, and in my submission it's at the 14th of June, that's the point at which these things are signed off by the Board. And so the circumstances that had to be considered were the circumstances at the 14th of June, and the transaction was of course conditional on, or the bid was conditional on, the Board's approval up to that point.

So the receivers, it's clear, and again not contradicted by anything, I think, that the receivers made it absolutely clear that the suppliers were determined to try and get all their retros back and everybody knew what that number was, and Fonterra responded to it. How other bidders responded to it is a matter of inference, but they didn't respond as much as Fonterra did, but that was the nature of a competitive bid.

WILLIAM YOUNG J:

It's referred to in some of the documents what I think the Westland bid would have produced by way of payment.

MR HODDER QC:

Yes, it was quite a lot less.

WILLIAM YOUNG J:

Yes. And I can't remember, was it also discussed in relation to Synlait?

MR HODDER QC:

I'm not sure there was a number given to both of them, I think it was only given to one of them. But so when the Court of Appeal says at 121, "There's no evidence that the price Fonterra ultimately paid was increased to enable

the retros to be paid," we say that the difference between the break-up value on what was paid was precisely about the retros because that was the key to getting the supply, and so in the circumstances we say we can't understand how the Court says in the next paragraph, "The price paid was unaffected by the advantage to the respondents in securing payment of the retros." If they had not wanted the retros the price would not have been the price it was, it would have been the break-up value for the assets.

Then in 122 the Court goes on to say, "It resulted in the acquisition of assets at a price that represented a gain in capital terms." Maybe so, but that's why you would rationally enter into a transaction. And then it goes on to say, "The payment of the retros was influential in securing for Fonterra the benefit of the milk produced by the NZDL suppliers." Yes, indeed, but all these things are interrelated, that's what made the circumstances unique. And then 123, "We agree with the Judge that the main reason for imposing the less favourable terms was to placate the existing shareholders who might have harboured concerns that the respondents were being allowed to 'waltz back in'," one of those classic phrases from an email which will live on in infamy in certain quarters, but it's what the email said. But what the waltzing back in involved was waltzing back in with $20 million of Fonterra shareholder funds in the pocket, not just waltzing back in period, not recognised at this stage, well, at all, we say, in the Court of Appeal's reasoning. Then it says, "Fonterra concedes the financial viability of the Growth Contracts offered to the respondents did not depend on acceptance of the less favourable terms," that was the correspondence between the solicitors I referred to. And then, "It is difficult to escape the Judge's conclusion they were imposed as a penalty for the respondents' perceived disloyalty." Well, disloyalty would be leaving. The issue here, we say, was not leaving, was coming back with shareholders' funds being paid to them.

ELIAS CJ:

Don't take us to it – can you remind me what paragraph they're referring to in the High Court decision?

MR HODDER QC:

I'm referring to the Court of Appeal decision at 123.

ELIAS CJ:

Yes, but they're referring to the High Court conclusion.

WILLIAM YOUNG J:

It's around 113 of the High Court judgment, page 117.

MR HODDER QC:

Then we get to, perhaps it comes back to the point of rationality. The Court below says, "The fact that Fonterra might have considered the offer of less favourable terms as being the best interests of itself and its shareholders" – i.e. because it will encourage the TAF vote in the long term – "cannot be relied upon to justify offering less favourable terms to suppliers. Offering less favourable terms to the respondents in order to penalise them for perceived disloyalty cannot justify discrimination under section 106."

With respect, we say that's circular. If they're in the best interests of itself and the shareholders that they be treated differently and be seen to be so, that is a matter of different treatment. Calling it a penalty doesn't really take us anywhere in terms of the analysis that's required and just to repeat the point, disloyalty perceived as loyalty really diverts from the issue that was the focus in this context.

Then the Court goes on to refer to Justice Winkelmann's decision in the kiwifruit context, and as I read that case it's really saying that when there is a legal framework which says what a proper purpose and improper purpose is, as they were under the kiwifruit regulations, then you couldn't do something which was for an improper purpose and that can hardly be argued with. But here the question is, well, how would you say that the Board is somehow acting ultra vires if it says rationally we think there should be a different condition applying to these particular suppliers because they come in, in quite extraordinary circumstances.

So 125, reference to disciplining and penalising suppliers with the regulations, and then 126 they agree with the High Court Judge that Fonterra's expressed concerns that the forthcoming TAF proposals could not justify offering less favourable terms to the respondents. This was in the same category as the possible concerns. It was merely in Fonterra's own interests.

GLAZEBROOK J:

Where were those concerns expressed? Because you said the Board didn't ever say anything about this. So where do these findings come from? Presumably from something Fonterra said, if not the Board.

MR HODDER QC:

Well, the evidence – this is partly from the party that we cited our submissions from, Mr Monaghan's proposition, our footnote 28 on page 22 is the essence of it. That's the Board responding to that.

GLAZEBROOK J:

Sorry, what footnote?

MR HODDER QC:

28 on page 22 of our written submissions. One of the memorable points of the trial was Mr Monaghan saying that he never died wondering what his members thought and this was one of those issues.

GLAZEBROOK J:

Sorry, I was meaning specifically in relation to TAF.

MR HODDER QC:

I might need a moment to find the stuff relating directly to TAF.

GLAZEBROOK J:

You probably don't need to.

ELIAS CJ:

Well, I think you might need to take us to the evidence on that, mightn't you?

WILLIAM YOUNG J:

There were minutes of meetings between Fonterra representatives and the respondents which may have recorded concerns about TAF on the part of the respondents.

MR HODDER QC:

The fact was that TAF was overshadowing most of the documents that Fonterra was generating at that stage. But I was looking at Mr Monaghan's evidence-in-chief but no, it doesn't appear to refer to TAF directly.

GLAZEBROOK J:

Would it help to look at Justice Muir's judgment? I can't remember whether there's anything specifically in there.

ELLEN FRANCE J:

There's some discussion when Mr Monaghan's questioned by the Court, page 777 volume 5, where he talks about being in the middle of Trading Among Farmers, which is being very contentious in the shareholder base, et cetera. And over to 778.

O'REGAN J:

At 113(e) he says, the High Court Judge says, "The prohibition on sharing-up was intended to deprive the suppliers of the expected gain in the share price post-TAF as part of the optics," that was his finding.

GLAZEBROOK J:

Was that just an inference from the fact that they weren't allowed to share up immediately and that it was anticipated there would be an increase, rather than anything specifically said? Because I'm just looking at Justice Muir's judgment, I can't find anything that he's specifically referring to in his –

O'REGAN J:

He refers to their concerns in 38.

GLAZEBROOK J:

Yes, it seems to be more of an inference than a – they were certainly asking to be able to share up earlier.

MR HODDER QC:

It was certainly raised at the meetings, "Why can't we share up?" and the answers to that were what caused sufficient confusion –

GLAZEBROOK J:

Well, "No, you can't."

MR HODDER QC:

– that we got to the other findings which we're not appealing.

Part of the exercise – I suppose this again somewhat at a distance – but I took you before to the covering letter that was sent to all the suppliers by the Chair, that's at the beginning of volume 8, and of the documents that were sent to them one of the largest in the bundle was the thing about trading among farmers, *What You Need To Know* booklet. Again that doesn't take us a long way, but it's indicative of the fact that at the top of – page 2042 in the first batch of bullet points, it's referred to as the last of those. And the document itself, which is a lengthy one, starts at page 2128 and goes through to 2160, so it's a 30-page document setting out the details of TAF and it's clear the vote was coming up.

ELIAS CJ:

So what was the reason why the having 20 million in pocket precluded their participation in TAF?

MR HODDER QC:

There's not a direct, if you like, immediate causal connection, it's simply there were different turns to reflect the fact that there is this money being –

ELIAS CJ:

I'm just trying to work out – I can understand the discounted price argument but why not allow them to acquire the shares from the outset?

MR HODDER QC:

Well, it partly goes to the list of different circumstances which we set out in our paragraph 5.7 on page 20 of our written submissions, that that is only one aspect of the different scenario, there are a whole series of issues including timing.

GLAZEBROOK J:

Because on one basis they're allowed to keep 20 million and use it rather than putting it into Fonterra.

MR HODDER QC:

Yes.

GLAZEBROOK J:

So they're – if there wasn't an anticipated share price that would actually be quite a good deal, I guess, because they get to keep all this money and they don't have an obligation to share up, plus they get paid out at –

MR HODDER QC:

Yes, it would have been another windfall if the price had gone up in the way that was expected. But in terms of our list of unique circumstances in paragraph 5.7, we list the connection with the MSAs being conditional, that it all depended on the purchase of the business, the understanding that the price had to include enough to pay the retros and therefore there was an effective and unique payment, approximately $600,000 per supplier, in addition to milk price for this supply to come in. So they were effectively

indemnified from the risks realised and supplying another processor, which is the Christchurch Casino comment made to Mr Monaghan referred to in the footnote.

Then G, they weren't bound to become shareholders and supply Fonterra until they were paid the retros and, indeed, we haven't got it here but the fact was it was still conditional on Commerce Commission approval which wasn't a given, but did come through eventually in September. It could have come through later. Nobody could tell whether that was going to happen or whether it was going to be litigated. In the end, it wasn't. So there was uncertainty around the timing, among other things. The TAF vote was coming up in that period of 2012.

GLAZEBROOK J:
Although they logically wouldn't have become shareholders until the Commerce Commission approval had come through, won't they?

MR HODDER QC:
Correct. So they were – they had conditional expectations, rights, whatever they were under the contract but the condition had to be satisfied as it was in September.

So in terms of Your Honour the Chief Justice's question about show me where the discussion of the Trading Among Farmers is, I'm not sure that I can do any better than point you to pages – as I think have been referred to – pages 777 and 778 where Mr Monaghan is responding to questions. Under tab 50, "We're in the middle of Trading Among Farmers, i.e. middle of the process getting towards Trading Among Farmers, which had been very contentious in the shareholder base which is borne out in the final results. Nearly a third of our shareholders voted against us and there was a lot happening around the value of shares at that point in time and different views on that."

Then at the bottom of that page, "We'd been discussing TAF for probably five years. Very contentious. We were in the process where we were going for a

second, from my recollection, major vote that had given us issues with that and we were aware of that. A section of the shareholder base" – et cetera.

So again, I'm not sure that it's disputed that the presence of TAF or the eminence of TAF was a major consideration for the Board in coming to the view it did on 14 June. But the full details of all that, again, they're not adduced on the grounds that the full details of how that process worked relate more to questions of causation and damages.

So in terms of the Court of Appeal judgment that I was working my way through, the discussion of TAF is at 126 and 127. It had the effect of ensuring that the respondents did not benefit from the expected increase in Fonterra price post-TAF. This was a matter of concern to the respondents and raised in the June meeting. They were less favourable but in terms of their supply of milk, they had options and, indeed, in terms of the supply of milk plus getting some of their retros back they had options. But they chose to go with this particular arrangement and so we say this arrangement and there the suppliers' involvement in it in a very detailed and direct way did add up to the different circumstances and the response to the Board was perfectly rational. In making a rational response, the Board is obliged to have regard to its own interests, or that is to say the interests of Fonterra and its shareholders. That's what boards of directors have to do.

In the end, our submission is the relatively short one I made, I think, before lunch that says if you stand back at this these shareholders were simply in a quite unique position. If they weren't in different circumstances to all the other dairy farmers in the country, nobody would be. And that, we say, is the answer to section 106, the claim of 106, assuming all our other prior arguments are not accepted by the Court.

So they were getting the benefit of the $600,000 each out of this deal. That was what drove the rest of the thinking behind the decisions about what the special conditions were and, yes, accept that there was an expectation that the shares would go up in value after TAF, not a guarantee but an

expectation, and the effect of this would be to deprive the suppliers of that at whatever point they became shareholders which depended, shareholders and suppliers, which depended on the Commerce Commission processes and which might or might not have been completed during the period up through and till September or thereafter.

Now Your Honours, that's rather longer on this topic than I intended because, as I said, I believe we've covered the ground in our written submissions but if there are other questions I'm happy to try and respond to them.

ELIAS CJ:
No, thank you, Mr Hodder.

MR HODDER QC:
As Your Honours please.

ELIAS CJ:
Yes, Mr Goddard.

MR GODDARD QC:
Your Honour, I think in the 16 or so minutes available before we finish this afternoon, I will just try to cover a few preliminary points and, in particular, get straight both the respondents' case and some important things.

What the respondents wanted was to be allowed to share up in full and supply milk on a fully shared-up basis when they became suppliers to Fonterra following the collapse of NZDL, in many cases when they came back to Fonterra, and I'll return to that later.

O'REGAN J:
Can you just pull the mic down a little bit?

MR GODDARD QC:
I'm sorry, and probably if I didn't lounge all over the place and stood up straight it would also help.

So they wanted to be able to supply on a fully share-backed basis. To pick up a question from Your Honour, Justice Glazebrook, earlier, they were indifferent as to whether that happened as a result of simply subscribing for those shares without any Growth Contract or entering into a Growth Contract and then exercising the right that every other supplier under a Growth Contract had which was to share up early at any time. So you could have cut straight to the chase and just come in as a share-backed supplier, and we'll see how that's contemplated by the application form when we go to it in a moment, or they could have signed a Growth Contract but had the same right that everyone else had to immediately say, "And I'd like to share up early. I'd like to share up in full," and there were two reasons for wanting to do that. The first was so that they could get the full price for their milk. Neither the standard five-cent discount that applies to all Growth Contracts apply nor the extra five-cent penalty that was applied to them, and I'll go to the internal Fonterra emails describing it as a penalty either later today or first thing tomorrow. So the –

WILLIAM YOUNG J:
Can I just ask you, the 10-cents discount on what a shared-up farmer would receive doesn't seem very much as against the interest to be saved on $4.60 or whatever.

MR GODDARD QC:
There's a separate dividend which is paid on the capital as well, Your Honour.

WILLIAM YOUNG J:
I see.

MR GODDARD QC:

So this is – so what a farmer gets when they supply Fonterra on a share-backed basis is they get a dividend on the share and that pays for the capital and then they get a milk price which pays for the milk and –

WILLIAM YOUNG J:

So what sort of dividend's being paid, do you know?

MR GODDARD QC:

It's in the 40 cents-odd space.

WILLIAM YOUNG J:

I see, okay, so it's material.

MR GODDARD QC:

So it's material and now, of course, post-TAF, you can buy units as a non-farmer which entitles you to get that dividend and you get the milk price and last time, last time I was before this Court on matters relating to the Dairy Industry Restructuring Act was all about the process of separating out the bundled amount paid to farmers into the dividend amount and the milk price and it was the cost of capital, *Commerce Commission v Fonterra Co-Operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 . But anyway, so what we're talking about here is, of course, because they didn't have shares they weren't going to get the dividend on those shares. They weren't going to be paid for the capital and that's why Your Honour, Justice Glazebrook's, assumption that the five-cent had some relation to the cost of capital is not, with respect, right. That's not how it works. You get paid for the capital by your dividend on the capital and then –

GLAZEBROOK J:

Yes, although presumably the normal growth thing is an extra cost of – it is essentially an extra cost – well, otherwise how do they justify the discount of five cents?

MR GODDARD QC:

They call it a contract fee and it's really –

GLAZEBROOK J:

Well, it really is because you're not sharing up immediately though, isn't it?

MR GODDARD QC:

Yes, but it's not related to the cost of that capital because that's paid for by the dividend.

GLAZEBROOK J:

No, no, I understand that.

MR GODDARD QC:

So what they wanted to do was to stump up with –

GLAZEBROOK J:

It might be related to the cost of the capital for the particular people but –

MR GODDARD QC:

Yes.

GLAZEBROOK J:

Yes.

MR GODDARD QC:

So they wanted to share up and they wanted to get 10 cents per kilogram of milk solids more, in addition, of course, getting the dividend on the shares which would fund the purchase of the shares and, critically, they wanted to be allowed to buy the shares at the price set by Fonterra as the fair value for the shares in that season, $4.52, rather than be forced to wait until after TAF when there was a general expectation, and the Fonterra witnesses confirmed this, that the price would go up, as indeed it did, which would mean that in order to ultimately hold the shares they would be required to hold in respect of this supply they would have to pay a whole lot more.

So there were two compelling reasons to want to share up. The causation issue, which is for the second part of the trial, is really all around that Fonterra denies that they would have shared up and says, well, maybe some of them couldn't have afforded to, and there will be a trial about that and about the financing available to them from the banks. That's not our issue now. But for present purposes the complaint is, "We wanted to share up. We weren't allowed to. We didn't mind what route we took, just to share up or via a Growth Contact with the same rights everyone else had." They were refused the ability to do either of those. They were presented with what Fonterra has repeatedly described as a take it or leave it offer, and Mr Monaghan emphasised that, Mr Murphy emphasised that and my learned friend, Mr Hodder, spent a lot of time saying it was a take it or leave it offer which resulted in a contract in the Court of Appeal.

So it was a take it or leave it offer and it was a take it or leave it offer that involved three material differences from what everyone else was offered, whether they were existing shareholders increasing supply or, for that matter, other new entrants at the time, and those are the three differences that the Court has heard about.

Probably worth just reminding ourselves of how that works. If we take out volume 8 of the case on appeal, and go to the very first page in it, 2042 of the case on appeal, this is the letter to which my learned friend went briefly from the chairman of Fonterra to each of the suppliers providing them with various documents they were required to sign and explaining that all of them had to sign up by the 22nd of June or none of them would get this deal and after setting out, on the first page, what was enclosed and inviting them to share up and become part of the Fonterra family, about five centimetres from the bottom of the page, "Our offer to you is based on a normal growth supply contract with the following exceptions: a discount of five cents…applied to the standard Growth Contract pricing," so 10 cents below the full milk price. "We won't be purchasing your vat but have an option to do so," and, "You won't be entitled to share up in the first season beyond the minimum required holding

of 1000 shares," and as we'll see when we go to the email, internal email conversation that led to the imposition of these terms within Fonterra tomorrow, the reason for that last bullet point, the prohibition on sharing up, was that the discount of five cents had been flagged as desirable as a tougher term, as a penalty, and I'll take the Court to the evidence that this was an arbitrary number designed to be a small but material amount that could be pointed to, say, look, they're getting worse terms, see, it was the optics. There was no financial rationale for five cents rather three cents or 10 cents. It was designed to be a small but material visible penalty, and then in the internal correspondence one executive said of course they could avoid that by sharing up early like everyone else under a Growth Contract and a senior executive comes back and says, "We shouldn't allow that. We should prohibit sharing up for at least one year and maybe three," and where it landed was the one year. So we're not going to let them do what everyone else can do so that the penalty sticks for at least a year, and we'll go to that correspondence tomorrow, but the whole point of this was that there should be a penalty and that it should stick for at least a year. And the –

WILLIAM YOUNG J:

Does it really matter if it is just all circular, that they had to satisfy at a practical level the concerns of their existing shareholder farmers who would not accept a deal that didn't represent the differences between shareholder farmers supplying the ordinary course of business and people coming in who have, on one view of it, received $20 million in relation to debts that are owed by a third party?

MR GODDARD QC:

So I'll come back to the $20 million but in my submission if we look at, and perhaps if we're just having a quick look at section 106 and look at the test that we're applying when we ask those questions. So my friend's authorities, tab 2, page 76, "New co-op must ensure that the terms of supply that apply to a new entrant," and it's common ground they weren't the same so we're not interested in (a), it's (b), "differ from the terms that apply to a shareholding farmer in different circumstances only to reflect the different circumstances."

So there has to be what Her Honour, Justice Glazebrook, described as a proportionate link or I would say the sort of connection you would see in a workably competitive market between the difference in circumstances and the different term, and there's no –

WILLIAM YOUNG J:
Well, there's no calculation of it.

O'REGAN J:
Are you saying that it's more than 20 million, because if it's less than 20 million it's okay, isn't it?

MR GODDARD QC:
No, it's not, Your Honour, because the way in which that 20 million was dealt with was designed by Fonterra to secure the supply but it didn't in any way increase the price paid. If you could say it's cost us X dollars more to –

O'REGAN J:
It doesn't matter though, does it? The fact is these farmers got paid $20 million that was owed to them by a third party and no other Fonterra farmers had that benefit so they're entitled to provide them with terms that said, "Well, you've got 20 million of our money and over the next six years we'll recoup it slowly."

MR GODDARD QC:
In a workably competitive market you would have seen two large South Island dairy companies seeking to attract supply from these farmers and against that backdrop you would expect to see the same outcome.

O'REGAN J:
But that's not what the section requires. The section just says is there a difference between party A and party B and the answer here is yes, it's a 20 million difference and they're entitled to have a 20 million different term.

MR GODDARD QC:

No, in my submission that's not correct because the difference has to only reflect the difference in circumstances. When one asks what does it mean to only reflect that difference then against the concern that this is addressed to, which is misuse of monopsony power, one has to ask whether you would expect that difference to exist in a workably competitive market, and that's the approach that my friend also accepts in his submissions to this Court. So you say in a workably competitive market would you expect to see the difference in circumstances produced as difference in terms? So more expensive to take supply from someone? Of course. You're going to pay them less. Goes without saying.

WILLIAM YOUNG J:

But it was more expensive to take supply from these people.

O'REGAN J:

But it was $20 million more expensive so –

MR GODDARD QC:

No, it wasn't $20 million more expensive. They paid what they were willing to pay anyway. They paid no more –

O'REGAN J:

Well they were paid what they were willing to pay with these terms.

MR GODDARD QC:

And they paid no more – and what they were willing to pay beforehand. My friend's right that it was an indicative bid a few months earlier in the context of the Morgan Stanley sale process, but there was no adjustment to the purchase price because the retros were going to be paid.

O'REGAN J:

It doesn't matter. We're looking at the benefit to these farmers and it doesn't matter whether Fonterra thought it was going to cost them a lot of money or

not, the fact is these farmers got $20 million of Fonterra's money, albeit indirectly, which they weren't owed by Fonterra. They were owed it by somebody else.

MR GODDARD QC:
In a – well, first of all they didn't get an extra $20 million. They would have received a substantial amount of the retros based on other purchasers who didn't contract specifically for that. Secondly, they –

O'REGAN J:
We don't know what terms of milk supply they would have got from those –

MR GODDARD QC:
No, so Fonterra can't demonstrate that there was an incremental gain to these farmers over and above what they would have expected to see in a competitive market.

O'REGAN J:
But we're comparing these farmers to other Fonterra farmers, not to what they would have got from another buyer.

MR GODDARD QC:
So other Fonterra farmers supplied milk to whoever they were supplying to, and got paid for it, whether it was to Fonterra, whether it was to some other independent processor, and then if they came across to Fonterra at this time, they got the full price for these shares – they got the opportunity to share up.

O'REGAN J:
Yes, but their supplier didn't go broke.

MR GODDARD QC:
But that's not a relevant difference for this purpose.

O'REGAN J:
Well why not? I mean it's just a fact.

WILLIAM YOUNG J:

I find it hard to see that it's relevant. I mean can you really just dissect the, look at this contract, which is really a sort of a whole and say well you can't point to any bit of it in there that is referable to the farmers that mightn't have been there anyway, and therefore there's no difference, because that seems to be a bit of what your argument is about.

MR GODDARD QC:

My argument is one that applies in most discrimination contexts which is that the point where there's a different treatment between the two groups, you have to show that the difference in treatment is a proportionate, to use Your Honour Justice Glazebrook's term, a commercially driven, in the context of economic regulation, difference that results from the difference in circumstances. If you're looking forward to different costs of taking supply from someone, that drives something, but these are sunk costs effectively – the insolvency of NZDL. There was no, it's not as if Fonterra said, oh well look, let's pay more with one hand to compensate these people for the retros, but on the other hand claw it back, and the –

WILLIAM YOUNG J:

But that's exactly what they did do isn't it?

MR GODDARD QC:

No, the evidence was first that Fonterra does not seek to recover differential costs of taking milk from different farmers, so I cross-examined at some length both Mr Murphy and Mr Monaghan about that, and they accepted that the cost to them of a particular plant, the cost to them of receiving the milk and processing at that plant, does not in any way drive what they pay the farmers.

WILLIAM YOUNG J:

That's because they have a national price.

MR GODDARD QC:

Yes, so they can't say, so to treat these people as receiving less because it costs them more to take supply, if that had been the case would itself actually, in terms of, you know, plant costs, and this is a contractual cost to acquire the plant, would itself be a difference that they weren't, a difference in the approach from anyone else. So that itself would be a problem. But then the Fonterra witnesses also accepted that the terms emerged, this is Your Honour Justice France's question earlier, these terms emerged after the indicative bid at $48.5 million on the 5th of June.

WILLIAM YOUNG J:

The precise terms that – the one about not sharing up emerges about the 7th or 8th of June?

MR GODDARD QC:

Yes, that's right.

WILLIAM YOUNG J:

But the indicative offer was always subject to satisfactory supply arrangements.

MR GODDARD QC:

Satisfactory terms of supply, yes, but the idea that these should be the terms of supply came on the scene later. It's not as if Fonterra said, how can we afford this price, well only if we get this corresponding reduction in what we pay for the milk that we purchase, and when we look at the internal correspondence, what the Court says, that it was very optics-driven and indeed Mr Murphy explains, it was addressed not only to these farmers but to future farmers who might consider leaving Fonterra in the hope of coming back, and this was a signal that there would be consequences for doing that, and that's directly –

WILLIAM YOUNG J:

Well there can only be consequences if they fall outside the application period.

MR GODDARD QC:

Yes, and the odds of doing that are pretty high because it's a pretty small window of time. The monopsony power obviously isn't seasonal, it lasts all year round, and the risk of it being abused lasts all year round, and I'll come back to that when I look at the new entrant –

GLAZEBROOK J:

And you might want to deal with Mr Hodder's point about the Commerce Act dealing with that outside of this regime.

MR GODDARD QC:

And the short answer of course is that it doesn't. There are two basic ways in which you can misuse market power. One is by attempting to harm the competitive process going forwards.

WILLIAM YOUNG J:

I didn't think there were any ways after the *Commerce Commission v Telecom Corporation of New Zealand Ltd* [2010] NZSC 111, [2011] 1 NZLR 577 case. I thought that market power was something that couldn't be abused but perhaps I've missed something.

MR GODDARD QC:

So some commentators would suggest, but section 36 is targeted at misuse of market power to distort competition in the future, but it doesn't limit a monopolist, in an ordinary sense, charging monopoly prices, which in the case of a monopolist in supply means more than is efficient, in the case of a monopsonist means paying less than is efficient. If that's to be dealt with under the Commerce Act at all it's dealt with under Part 4, and this regulatory regime is designed to deal with both those concerns, both screwing the scrum in terms of future competition, and it's designed to ensure that the

monopsonist Fonterra does not either directly or indirectly pay less than an efficient price to some or all of the farmers. It's 3 o'clock. I should presumably stop.

ELIAS CJ:

Well finish, we're not scrambling to get into that gear. Just conclude.

MR GODDARD QC:

I think that's a reasonably logical point. I'm obviously going to have to come back to section 106. I'd like to do that after I've gone through the facts and how Fonterra came up with these terms and what it saw the purpose of the terms as, because in my submission it's very clear that on the facts this was not only to reflect the different circumstances. The linkage was an optics one, and optics is precisely what you're not allow to do under this Act. You're not allowed to discriminate because you're existing owners will love it, which is really what Fonterra it saying. Fonterra is saying here, we are allowed to discriminate because it's in our, and our owners, best interests, but the whole point is that it will be in their best interests to discriminate. That's why you need 106 Your Honour. You have to have 106 because otherwise it will always be in the interest of the monopsonist, and its existing owner suppliers, to treat new entrants less favourably, and there's a carefully designed statutory regime which is intended to prevent that, and 106 is the residual provision which says you can't do it in any other way, and I need to deal with that tomorrow, but I'd like to do it on the basis of facts because I think it's been a little bit abstract today and the facts in this case are stark.

ELIAS CJ:

Thank you. Yes, again, can we start at 9.30 tomorrow?

MR GODDARD QC:

Yes, I think Madam Registrar has already made that enquiry of counsel and we've all said yes that's fine Your Honour.

ELIAS CJ:

Thank you. So 9.30 again tomorrow.

COURT ADJOURNS: 3.03 PM

COURT RESUMES ON FRIDAY 28 JULY 2017 AT 9.32 AM

ELIAS CJ:
Yes Mr Goddard.

MR GODDARD QC:
Your Honour. The Court should have three pieces of paper. My usual road map and then a better copy of page 1079 of volume 6. The Court asked some questions about geography and the location of alternative purchasers yesterday. There is a map attached to a Fonterra Board update in volume 6 of the case on appeal at page 1079, but it's one of those horrible black and white photocopies of photocopies of photocopies. This is a colour version helpfully provided by my learned friends. Then we also have the third document, a blown up version of the immediate locality showing the current position with Studholme and Clandeboye as Fonterra plants. This was attached to my friend's submissions in the High Court and we thought that might be helpful as well.

Just coming back to the picture of the South Island, what the Court will see is that the triangle marked "New Zealand Dairies", a plant that went into receivership, is not that far, by South Island standards, from Fonterra's plant at Clandeboye, then heading north there's a Synlait plant, and then what's described as a Westland hub, which I understand could be used to receive milk from the east coast, have some of the volume removed, and then shipped across to the Westland plant on the West Coast.

So the position was that, and we'll see this with some of the documents I go to briefly in a moment, Fonterra without purchasing the NZDL plant could absorb about a third of the milk produced by these suppliers, and there were other potential purchasers of the milk, even without the plant, but I think it's common ground that not all of the milk that went into the NZDL plant could have been absorbed by other plants. Someone needed to buy the NZDL plant and keep it running in order for all the milk to find a home. I hope that's helpful.

ELIAS CJ:

Yes, thank you.

MR GODDARD QC:

So turning then to my road map, I'm going to spend about 45 minutes on some facts, because I think they're helpful, and then I'm going to turn to the scheme of the Act and the way in which it controls the exercise, seeks to control the exercise of monopsony power as effectively the price tag for the dairy companies having been permitted to merge in a manner that would otherwise not be permitted under the Commerce Act, and then look at the implications for the two questions on which leave was granted – are the respondents new entrants and does section 106 apply – and I'll spend more time on the second question because I apprehend that that's the one that the Court is particularly interested in.

So first, and I started this in my 16 minutes yesterday, the application is made by the 19 respondent farmers, and I'm pleased to be able to say that we are all at one on how many respondents there are now, always reassuring to have that sort of thing straight. There were 20, one has discontinued, there are 19.

So, the respondents applied to become shareholders in respect of their entire milk supply including at least 1000 kilograms of milk solids in the forthcoming 2012/13 season, and we see that in the application form they were required to fill in, which I want to go to in a little more detail than my learned friend did yesterday. So the easiest most legible version is in volume 8, which the Court will remember is the pack that Fonterra distributed to the NZDL suppliers at the first meeting that it held with them on 15 June. The AO1 form is completed by all new suppliers, although it's headed, "Dry Farm conversion", Ms Burr, who manages these things for Fonterra, confirmed that it wasn't confined to that situation. If someone was coming to Fonterra from another plant, for example, they would fill this in. So after section 1 applicant details and 2 farm location we come –

GLAZEBROOK J:

I'm sorry, volume 8, where?

MR GODDARD QC:

I'm so sorry. I'm in volume 8, 2044. Overenthusiastic, probably because of these early starts.

ELIAS CJ:

Speaking of which, we'll take a break at 11 again.

MR GODDARD QC:

Thank you Your Honour. So in 2044, just after the letter from Henry van der Heyden, saying he looks forward to have the farmers as part of the Fonterra family. For some of you this is a return home. So 2044. The "Applicant Details", "Farm location." Then over the page, "Milk Supply Information." After, "Sharemilker Details," and "Speciality Milks", "Contract Details … are you considering supplying some of your milk under Growth Contract? Yes or no. If yes, estimated Growth Contract offer quantity … if yes," in other words, if you're asking for a Growth Contract, on what basis are you applying and (A) says if I'm not asking for a Growth Contract, "Then this is an application to supply as a fully share-backed shareholding supplier and I acknowledge I will be required to hold shares for my estimated supply. If I make a formal application to supply under Growth Contract and that application is not accepted," then I'd like to be fully shared up. So that's option (A). And option (B) is, I'm applying under a Growth Contract and if you don't accept that I don't want to supply you at all. In other words if I don't get the Growth Contract I don't want to come –

WILLIAM YOUNG J:

So did they all tick B or they probably had to did they?

MR GODDARD QC:

No, I think they were all required to apply for Growth Contracts, Fonterra told them they'd been agreed –

WILLIAM YOUNG J:

That's what I meant. That's (B).

MR GODDARD QC:

No that's (A) Your Honour.

O'REGAN J:

No, (B) is you won't supply at all.

MR GODDARD QC:

No that's (A) Your Honour. That's (A).

WILLIAM YOUNG J:

Oh I see.

MR GODDARD QC:

It's the second half of (A). I don't think it mattered very much.

WILLIAM YOUNG J:

Oh I see, it's a slightly awkwardly drafted format.

GLAZEBROOK J:

Yes, very awkward.

MR GODDARD QC:

It's clunky. And then we come over on the next page to 7, "Meeting Shareholding Requirements." This explains that, "Depending on when you commence milk supply," i.e. before or after the Trading Among Farmers, "… you will be required to comply with the relevant requirements to hold shares. If you commence milk supply before the "Trading Among Farmers' … you will be required to pay for the shares before your milk is first collected." And that's what was anticipated in relation to at least 1000 shares and as we'll see no more than 1000 shares for that season. Then if you commence milk supply after TAF is implemented you need to acquire your shares on the market from a third party.

Then 8, "Co-operative Shares Requirement," sets out the Fonterra share standard. One co-operative share for each kilogram of milk solid supplied, excluding milk supplied on contract.

WILLIAM YOUNG J:
Can I just ask you a question? The third paragraph down there, that suggests there's a closed number of shares?

MR GODDARD QC:
Sorry, in which paragraph Your Honour?

WILLIAM YOUNG J:
"If you commence your milk supply after the Trading Amongst Farmers regime is implemented, you will need to acquire your shares on the Fonterra shareholders' market or from a third party."

MR GODDARD QC:
Yep, so –

WILLIAM YOUNG J:
Whose is – so did – what happens if milk supply increases, as presumably it does?

MR GODDARD QC:
Then, it's quite a complicated structure. Fonterra manages the number of shares on issue to –

WILLIAM YOUNG J:
I see, so it's accommodated?

MR GODDARD QC:
Yep. It's accommodated and there are units as well which are tradeable among people like us who are not dairy farmers and which are exchangeable in certain circumstances for shares. It's quite a sophisticated structure which was designed to get away from the problem that if a significant number of

farmers left Fonterra would have to pay out that capital. Instead, there – and no one other than a dairy farmer could hold shares and this created a structure in which other people could provide capital to Fonterra and farmers wanting to leave had to sell into the market, farmers wanting to come in had to buy on market, instead of Fonterra either issuing or –

WILLIAM YOUNG J:
Or taking back or cash them.

MR GODDARD QC:
Yes, or taking back, repurchasing shares.

WILLIAM YOUNG J:
Right.

MR GODDARD QC:
There are explanations of it somewhere in here, possibly even in this volume, I suspect. It's not easy to follow and fortunately I don't think we have to in detail today.

So then 8, "Co-operative shares requirement. The Fonterra share standard is one co-operative share for each kilogram of milk solids supplied, excluding milk supplied on contract," and the Court saw this in some of the provisions of the Constitution which I will look at briefly later. "As a new supplying shareholder, you are required to hold one share for every kilogram of milk solids of your estimated supply after allowing for production not required to be backed by shares under any contracts you are awarded," and then how that's calculated as described.

9, "The co-operative share price election," is irrelevant because it only applies to applications during the application period, so that was provided, crossed out, and then 10's important, "Acknowledgement and consent to be a shareholder. I/We acknowledge that: (a) by submitting this form I/we will be applying to become a supplying shareholder of Fonterra." So they were all

applying to become supplying shareholders of Fonterra, and that they will be contractually bound to make available for supply, and then the next –

WILLIAM YOUNG J:
Was there any explanation for that, why the form says that when it also contemplates supply as a contract supplier?

MR GODDARD QC:
Because even a contract supplier would always be required to have at least 1000.

WILLIAM YOUNG J:
Had to have 1000 shares. Okay, right.

MR GODDARD QC:
So everyone was applying and as we'll see in a moment this is an action an application for all the shares you will ever need because even if you come in on a Growth Contract you have to take 1000 initially and in years 3, 4 and 5 you have to buy another third, and this is the application for all of those shares. We'll see that in the terms. It's explicit. So here you are applying for all the shares you will ever need to become a fully shared up supplier of Fonterra.

GLAZEBROOK J:
And effectively are obliged to buy those shares –

MR GODDARD QC:
Yes.

GLAZEBROOK J:
– subject to the exit provisions, but you can't stay on without doing that.

MR GODDARD QC:
Exactly, Your Honour. And then the reason for that I suspect lies in the next paragraph, "I/We agree to be bound, as a supplying shareholder, by

Fonterra's Constitution." So by taking up the 1000 shares importantly you become bound by the Constitution, that's recognised in here, but that would be the case anyway by virtue of section 31, I think, of the Companies Act 1993. One should remember.

ELIAS CJ:
Yes.

MR GODDARD QC:
I think it's 31. Anyway, you're bound by the Constitution if you hold shares, "the terms and conditions of supply set out in the suppliers' handbook and any other policies relating to the supply of milk made by Fonterra's board," and so on down, and that has to be signed.

Then there are various forms.

If we turn over to page 2052, there's a helpful explanation of what you're signing up to under the heading, "Understanding our terms," "Meeting shareholding requirements. Depending on when you commence milk supply … you will be required to comply with the relevant requirements to hold shares," and how that works, especially if you supply before TAF, is explained.

"Payment for shares," the next heading, "You will be required to pay for the shares before your milk is collected. Fonterra's policy is to stop issuing shares during a season from the end of September," and that's important because the ordinary policy involved issuing shares right up to the end of September, so there was no inconsistency with the ordinary policy of Fonterra in these farmers receiving shares sufficient to back all of their supply, and I explored that in gruesome detail with Ms Burr in particular in cross-examination, but that's a neat summary of the position.

And then the heading, "Contract Supply." "Contract supply enables shareholders to supply milk that is not backed by shares. If you are interested

in supplying milk under contract please discuss your options with your area manager." So we'll see this theme again and again.

GLAZEBROOK J:
So that's 3.4 in the Constitution?

MR GODDARD QC:
Yes, Your Honour.

Mr Murphy talked about how he was involved in developing that. It's a reasonably recent development which was intended to reduce the up-front capital cost of existing shareholders increasing supply or new people coming in. They had to become shareholders, they had to share up over time, but this effectively smoothed the path, but it was only an option for shareholders. They had to be shareholders in Fonterra to take up Growth Contract supply and, as Your Honour, Justice Glazebrook, noted a moment ago, there was that initial requirement to take up 1000 shares and then a right and an obligation to become fully shared up over time.

WILLIAM YOUNG J:
But it's not much of an obligation though, is it, because presumably they can just – the open exit provisions apply? They can't really be held – or can – am I wrong?

MR GODDARD QC:
No, they are. They are required to stay in for the six years –

WILLIAM YOUNG J:
But –

MR GODDARD QC:
– and there are –

WILLIAM YOUNG J:

But say they just say, "Okay, well, we will come in and then we'll go out. We'll fully share up and we'll fully share out," as it were?

MR GODDARD QC:

Even if they fully share up later they are required to continue supply under the Growth Contract for the whole of the contract period.

WILLIAM YOUNG J:

Would that be sustainable against the policy of the Act?

GLAZEBROOK J:

Well, you are allowed it as long as it's not more than 30%, aren't you, or 33%?

MR GODDARD QC:

Yes, subject to the 107(2) requirements, exactly, Your Honour.

GLAZEBROOK J:

Yes.

WILLIAM YOUNG J:

I see. So it's wouldn't be inconsistent with the walk in/walk out policy?

MR GODDARD QC:

No. This arrangement is not. So these people were tied in, and there's the bit of the catch-22 that Her Honour, Justice Glazebrook, explored with my learned friend yesterday that on Fonterra's approach to this these people could never be new entrants and could never get the protection of the Act because they were required to take up some shares outside the application period, Fonterra says without being new entrants, and then they were committed to continuing to supply as shareholders under this contract for six years without ever being able to make a new application as a new entrant since they were already a shareholder.

WILLIAM YOUNG J:
But they can share up, so what's the –

MR GODDARD QC:
They can share up but at a much –

WILLIAM YOUNG J:
So what's the practical difference with that – what do you – I mean, if they can share up and then be paid for share-backed supply?

MR GODDARD QC:
Because they never get the benefit of the protections against the exercise of monopsony power that apply under 74. I'll come back to that, if I may.

WILLIAM YOUNG J:
Right.

MR GODDARD QC:
So, and that's 2052.

GLAZEBROOK J:
When you said the relatively recent development, were you talking about the Growth Contract or the contract supply, the growth –

MR GODDARD QC:
It's the same thing in this context.

GLAZEBROOK J:
Okay.

MR GODDARD QC:
There was provision, Your Honour's right, for some sort of contract supply in the Constitution.

GLAZEBROOK J:
Well, exactly, that's what –

MR GODDARD QC:
But I – if one looks at the Growth Contract provision in the Constitution and the limit on how much milk can be purchased under that, what one sees is a clear concern that the vast majority of milk purchased by Fonterra be share-backed and restrictions on the use of that and there was no evidence of a power to take pure contract supply without any shareholding being required, happening, or certainly happening on any scale at all, and no, when we see descriptions of the options on which this milk could be taken in the internal emails, the internal correspondence says, all says, there are two ways this could be done, either as fully share-backed or under Growth Contracts. There was never a suggestion there could be some other approach for these suppliers. So the theoretical possibility is contemplated by the Constitution. As I say, no evidence of it happening, no evidence it was ever contemplated for these people.

Then if we have a look at the Growth Contract – just to complete the picture, the milk supply agreement which modifies the standard Growth Contract is on pages 2057 to 2058, I think my friend went to it briefly, and that includes the three unfavourable terms. They are on 2058. The additional five cent per kgMS discount or penalty, as it was described by Fonterra internally, no obligation to acquire the milk vat and no entitlement to become Fonterra fully share-backed in the 12/13 season, and that was an explicit restriction on rights that would otherwise have existed under the Growth Contract, and Your Honour Justice Young will see that the supplier can become fully share-backed in subsequent seasons and receive a formal price but will still be bound to supply Fonterra for the entire contract term. So that's the question Your Honour asked me a couple of minutes ago.

Then we turn to the 2012 Growth Contract booklet, that's on page 2104, and this explains how Growth Contracts work, and provides some worked examples, and then it attaches some supply terms to which these suppliers

were signing up, and it's an important element of understanding what the deal was. So over on 2107, "Growth Milk." A Growth Contract can only be obtained for growth milk considered to be milk from new farms which commenced supplying in 2012/13 or milk supplied by existing suppliers over what was supplied in 2011/12 on a share-backed standard contract-backed or growth – now we see this phrase a number of times but let's just pause for a minute. There's a reference to, "Milk supplied by existing suppliers over and above what was supplied in the 2011/12 season (on a share-backed, standard contract-backed or Growth Contract-backed basis.)" So milk supplied by existing suppliers, by existing shareholders, includes milk supplied share-backeded and contract-backed. Fonterra has the discretion to determine what's contract growth milk and then how it works with the requirement to progressively share up is explained in the subparagraphs and underneath those subparagraphs, about half way down the page, "The reducing contract milk quantity in the fourth, fifth and sixth seasons reflects the share purchases made at the start of the fifth and sixth seasons and the start of the 2018/19 season respectively."

Then, "2012 Growth Contract holders must hold a minimum 1000 shares. For new farms commencing supply to Fonterra in the 2012/13 season, the contract milk quantity will be reduced by the volume of milk represented by the number of shares held … thus if 1000 Fonterra shares are acquired on commencement … the Growth Contract quantity for the 2012/13 season will be volume of milk supplied … less 1000." That answers another question the Court asked my learned friend yesterday. Is some of this supplied on a share-backed basis? It's yes. The 1000 at least, more if you buy more shares, and this is a worked example, examples 1 and 2.

Over on page 2108, the next page, there's also a heading, "Impact of holding additional shares," which says, "You may hold, purchase or surrender additional shares (that is shares in excess of the number you are required to hold ...) during the first three seasons of your 2012 Growth Contract." So this explicitly recognises that you have to take 1000 but you can take more, and then the way that affects your share-backed supply and your contract supply

and what you get paid, is explained in here. I'm not going to go into the details. Once at trial was enough.

Then if we come over to 2110, there's a heading at the top of the page, "Eligibility. Anyone applying to supply milk under a Growth Contract starting in the 2012/13 season must be an existing shareholder in Fonterra or have submitted an application to become a Fonterra shareholder." So again you have to be or apply to be a Fonterra shareholder to get these contracts. Pricing is explained. "The milk price that will be paid for milk supplied under a Growth Contract during the 2012/13 season will be the Fonterra milk price, for which there will be deducted a contract fee. For the 2012/13 season the contract fee will be 5 cents." So that's the standard contract fee which applies for anyone supplying under a Growth Contract, and then there was the additional five cent penalty added to these suppliers. We'll come to that.

Turning over to page 2113, there's an example, example 2, of a new supplier who exceeds the estimated production level. The excess is not important. This just has a worked example through all the relevant seasons of the –

ELIAS CJ:
Sorry, does that mean that the five cents deduction described as the contract fee wasn't specific to this arrangement.

MR GODDARD QC:
Yes.

ELIAS CJ:
It applied to all who entered into –

MR GODDARD QC:
Yes, all Growth Contract suppliers.

ELIAS CJ:
Yes.

GLAZEBROOK J:
There was another one.

MR GODDARD QC:
And then there was another five cents –

ELIAS CJ:
Yes, yes, I know that there was the additional, yes.

MR GODDARD QC:
And this gets confusing because sometimes one sees reference to a 10 cent discount, and that's the standard five and the extra five.

ELIAS CJ:
Yes.

MR GODDARD QC:
And sometimes one sees –

ELIAS CJ:
Well when you say "penalty" was referred to, presumably it's to the second.

MR GODDARD QC:
Yes.

ELIAS CJ:
Yes. Not to this?

MR GODDARD QC:
Absolutely.

So if we look at example 2, we've got Karen, a new supplier converting a sheep farm, estimate of 300,000 kg invested in the first season, she can apply for a –

ELIAS CJ:

So does – I'm sorry – so why is it a matter of complaint, the contract fee?

MR GODDARD QC:

Because if you shared up in the first season you didn't have to pay the contract fee either.

ELIAS CJ:

Yes, I understand – but that's really a complaint about the restriction on being able to share up.

MR GODDARD QC:

Yes. Yes, exactly.

ELIAS CJ:

Not a complaint about the contract fee, the first five cents, yes.

MR GODDARD QC:

Yes, although as we'll see, they were linked in Fonterra's thinking because there was reference – first of all the idea of the penalty came up and then an employee said, "Of course, they can avoid it by sharing up in the first season," and a senior executive came back and said, "I am not happy with that. They need to," you know, "have that penalty for at least a year, so they have to be locked in for at least a year and maybe three." Fonterra ultimately landed on one, and that was what –

WILLIAM YOUNG J:

Well, they couldn't do it for three, could they? Wouldn't that be inconsistent with the scheme of the Act, because they – the following year wouldn't they – well, you say they can't apply as new entrants. I'm –

MR GODDARD QC:

Fonterra's stance was that they couldn't apply as new entrants in those later years and I think that's probably correct because I think they were supplying shareholders at that point.

WILLIAM YOUNG J:

But that's – so you're a different – but you've got a different reason?

MR GODDARD QC:

Yes. We both agree on the outcome but for slightly different reasons.

WILLIAM YOUNG J:

Well, I'm not so sure I agree on the outcome but anyway, it probably doesn't matter.

MR GODDARD QC:

So only a few aspects of this were example I want to point to. We've got production quantities, the Growth Contract quantities. So in the first year –

WILLIAM YOUNG J:

I suppose the point, the trouble is I can't see – I struggle to see, anyway, how they could contract out of their right to become a new entrant.

MR GODDARD QC:

You can't contract out of a right to become a new entrant but you can take up shares which means that you are a shareholding farmer and those are clearly two different categories. They are mutually exclusive categories in the Act.

WILLIAM YOUNG J:

But can't you be a new entrant in relation to the additional supply?

MR GODDARD QC:

No, the way the Act works –

WILLIAM YOUNG J:
All right, well, I'll have to think –

MR GODDARD QC:
– and Fonterra's Constitution works, is per farm basically. So in respect of a farm, a farmer is either a new entrant or a shareholding farmer. There's no contemplation that a share can be issued to anyone else and a shareholding farmer is any supplier who holds a share in Fonterra. I'll go through some of these documents but that is – I think that much is reasonably clear.

So coming back to this example, example 2, we see the levels of production by Karen on her farm and in the production row year on year, and then the next row is Growth Contract quantity and in each case that's the production less the minimum required shareholding in the relevant year. So the gap opens up as Karen's required to share up in the last three years, and there's a bold row about in the middle of the page, "Shareholding minimum required shares," and we see that Karen's required to hold 1000 shares for four years and then 112,000, 223,000, 335,000, and the way that works is explained in the notes beginning with, "Karen needs to purchase minimum of 1000 shares at the beginning of the 12/13 season." And the share standard applies to Karen all the way through, it's just that as the Constitution explains and as these terms confirm when you apply the share standard you do not count any milk that's supplied under a Growth Contract. So you're required to have one share for each kgMS of milk supplied but you ignore milk supplied under the Growth Contract. So as the contract quantity reduces in the last three years, the share standard which has always applied to you requires you to hold more shares.

Don't need to work through, happily, the rest of those worked examples.

Over on 2116 there's a heading, "Growth Contract supply 12/13," "Rules relating to applications to supply Growth Contract milk." Again, clause 2, "Eligibility," we see the rule that to be eligible to submit an application you must be an existing shareholder or have submitted an application to become a

shareholder in Fonterra for the 12/13 season. This was important to Fonterra. This was not nominal. This was not token. It was an integral part of the structure that to be a Growth Contract supplier you had to be a shareholder. They say it 20 times through these documents. It was an integral part of the deal.

O'REGAN J:
Are you referring to 2.1(a) there?

MR GODDARD QC:
2.1(a), exactly, Your Honour.

O'REGAN J:
Yes, okay.

MR GODDARD QC:
And then we see that again over on page 2118, section 7 of the rules, "Acknowledgments. 7.1 By completing the application form and submitting an application, you acknowledge and agree that: (a) the offer quantity relates to milk that you intend to supply over and above any milk that you supply in the 2011/12 season as a shareholder," and again we have that open brackets, "(whether share-backed or standard contract-backed or Growth Contract-backed)," so this is extra milk over and above milk you supply as a shareholder and the milk you supply as a shareholder is treated as including anything you supply under a pre-existing Growth Contract for example, as well as share-backed supplier, and then (c), "You warrant to Fonterra that you are the person who is registered as, or who will on acceptance of an application to become a Fonterra shareholder be registered as, a shareholder," so you're actually required to warrant that you are or will be a shareholder or an agent of that person, and are duly authorised to make an application, and that's necessary because section 50 of the Companies Act requires a written signed consent to take up shares that impose an obligation on a shareholder as these do under the Constitution.

Then the glossary over on page 2119 defines "contract supply" as, "The supply of milk to Fonterra by a shareholder in a season pursuant to the Constitution without the milk solids … being taken into account for the purposes of … share standard." So again contract supply is the supply of milk to Fonterra by a shareholder and, "'You or your' means the shareholder or applicant to become a shareholder, who has made an application to supply growth milk under contract supply." Again that shareholding concept is central to Growth Contract supply.

Then we have the terms, why there has to be rules and terms I don't know, but that's the lawyer's fault – and we get the term of the contract and supply from the commencement date to the final date, so the final date is six years down the track, and again, just picking up Your Honour Justice Young's point, "Subsequent seasons: you acknowledge that if your contract milk quantity for the 2013/14 season or any subsequent season is zero then you will still be required to supply all your milk to Fonterra… until the end of the 2017/18 season," so that's certainly what they tried to contract for. I'll come back to Your Honour's concern about whether they can do that. And required to supply in the 2018/19 season subject to certain exceptions.

Then, "Shareholding and Farm," item 2. "2.1, Fonterra's standard terms apply." That's fine. "2.2, Shareholder: In each season during the term, you agree to: (a) remain a shareholder in Fonterra; and (b) supply all milk produced on your farm to Fonterra (subject to the standard terms and any applicable by law)." Being DIRA of course. "2.3, Acquired Shares: (a) subject to paragraph (c) below, on or before each share date, you must acquire the number of shares applicable to that share date." Then, "2.4, Application for Shares: (a) If, at any time before the date on which the new Constitution comes into effect under clause 49.4 of the Constitution, you held fewer shares than required by this agreement or the Constitution on a share date, you must immediately make all necessary applications to Fonterra to acquire the additional required shares. If you have not done this, Fonterra may issue you with the additional required shares at the fair value for the relevant season. By entering into this agreement, you are deemed to have

made any necessary applications to Fonterra for this purpose." So this is an application to take up all the shares you're required to have.

Then if we just jump over to the defined terms on 2125 and 2126, probably the most relevant definitions are on 2126. At the top of the page, "Contract supply means the supply of milk to Fonterra by a shareholder in a season pursuant to the Constitution," and, yes, I think that's probably the only one we need to pause to look at actually.

So as I say in my road map at 1.1(a), the A01 form was necessary to meet the requirements of section 50 of the Companies Act, and no further application was needed for future share issues over six years as it was covered by this application, and I refer back again to 2120 which confirms that the shareholders made all necessary applications to Fonterra for that purpose, and I explored that with Ms Burr, who manages share issues for Fonterra farmers, and has done for a long time, and I provide the reference, I won't go to it, and she agreed that yes, no further applications were needed. If you did nothing then pre-TAF Fonterra would just issue you with the shares you were required to have in each of years 3, 4 and 5 and if you didn't write a cheque for those shares it would just be backed off your milk cheque. You were fully committed to taking up all the shares necessary to have fully share-backed supply without any further formalities. You could do it earlier and there was a form that you could fill in to share up early. I won't go to it but the Court might like to note that there's an example in volume 7, page 1872, and that's not actually an application for shares, and again Ms Burr confirmed this. That's just – and that's saying, "I'd like to reduce my contract quantity," and if you say to Fonterra, "I want to reduce my contract quantity," it automatically follows that you're required to hold more shares under the Constitution and under these contracts and they would be issued to you.

1.2, as the Court saw yesterday, Fonterra's Constitution treats supply under a Growth Contract as supplied by a shareholder. We're just having a quick look at a couple of provisions of the Constitution. That's in volume 6, the first document in volume 6, and to save coming back to it let me just go to two

other clauses first. So on page 928, under the heading "Shareholders", worth noting 2.2, "Irrevocable application: The supply by any person of milk to the company is an irrevocable application by that person to become a shareholder and to hold the number of co-operative shares from time to time required by the share standard," so the actual fact of supplying milk in itself was also an application to become a shareholder, which 2.3, "The Board may accept in its … discretion," subject, of course, to DIRA, that's come around.

2.5, and this is relevant.

WILLIAM YOUNG J:
So just pause there. So 2.2, does Fonterra take the view that the application, that the Growth Contract application, is an application for the purposes of 2.2?

MR GODDARD QC:
I don't know that there's any evidence about the view Fonterra takes but that follows from 2.2 and it is, in any event, on the terms of the Growth Contract and application to take up all the shares you'll be required to have to become fully share-backed. But yes, if you're supplying under a Growth Contract you are making that irrevocable application.

And then 2.5, "Separate designation for supplies from each farm: The supply of milk to the company from each farm shall be treated as a supply from a separate shareholder, and the company shall take appropriate steps," to register them accordingly. So Fonterra, consistent with 2.5, does not treat someone who is a Fonterra supplier from farm A as being a supplying shareholder in respect of another farm. They purchase farm B, they're not making an irrevocable application to become a shareholder in respect of that merely because they supply from another one.

O'REGAN J:
So does that mean when you're a new entrant when you apply in relation to a new farm?

MR GODDARD QC:

Yes. That's the approach that Fonterra has taken in the past. In my submission, it's the correct approach. My friend is arguing in this Court for the first time that that's not the position and that as a result four of the 19 respondents were already supplying shareholders and can't be new entrants, which wasn't argued below. I'll come later to why it's much too late to raise that because there are other arguments. If they were to be treated as supplying shareholders, we would've amended the claim to claim under 106(4) which relates to discriminating against existing shareholders, but in any event, in my submission, this clause, which is one of the clauses that Parliament was aware of because it's authorised in schedule 1 to DIRA, reflects a conceptual framework for subpart 5 in which each farm is dealt with separately, and that's sensible, and the scheme wouldn't make sense otherwise.

ELIAS CJ:

And what's the position if you buy – is a farm as we've discussed before essentially something that has a dairy shed?

MR GODDARD QC:

A farm dairy, yes.

ELIAS CJ:

I'm just thinking about the suggestion that if you buy a couple of paddocks next door or something.

MR GODDARD QC:

It's linked to the farm dairy and in fact the original provision in the original Constitution, as authorised by DIRA, refers to each farm dairy, and the language here each farm must have been changed at some stage, I don't know when. Let me just check to see whether "farm" is defined in clause 48. I should have looked at this but I haven't. So on page 1020 of the bundle, "Farm means any farm, farm dairy, or group of farm dairies (whether physically located on the same property or not) that the Board may from time

to time determine to constitute a farm for the purposes of this Constitution, and the Board's determination on that issue shall be made on a case by case basis may differ according to the circumstances."

ELIAS CJ:
Right. It's flexible.

MR GODDARD QC:
So if Your Honour is wiser as a result of that then Your Honour is doing better than I am. But basically the two concepts are linked. I suspect the more flexible definition comes from the fact that some farms are so big that they have multiple milking sheds now, and a couple of the respondents gave evidence that they had two or three milking sheds on their quite large farms, and that's still one farm. Again, just thinking back to things like the 20% rule in subpart 5, you're always entitled to supply 20% of your milk. If all your farms were aggregated, that would mean that if you already supplied Fonterra from one farm, and you bought another farm through the same legal vehicle, you'd have to supply all your milk except 20% of the overall production, whereas if you treat them separately you've got a free choice about who to supply from that second farm, so it would be fundamentally inconsistent with the scheme of DIRA and undermine the protections it provides.

ELIAS CJ:
It's also potentially inconsistent with the regional scheme as well I suppose.

MR GODDARD QC:
Yes, there'd be a number of complications that would emerge. So up until its submissions, not even its application for leave, up until its submissions in this case Fonterra has always proceeded on the same understanding that the respondents have, which is that you do this on a farm by farm basis. There is a bit of a throwaway argument in a few paragraphs of their submissions in this Court for the first time that four of the respondents were not new entrants because they had other farms that were supplying Fonterra. Can't be right,

essentially for these reasons. I deal with it in my written submissions in a bit more detail as well.

Then we come to 3, "Co-operative share standard." There's the obligation in 3.1 to hold a number of co-operative shares equal to the share standard. 3.2, the share standard, as my friend said, one share for each kilogram of milk solids obtainable, excluding milk supplied on contract supply. There's a discretion to accept unshared supply provided that the number of shares held is not more than 20% below the standard. That's not the discretion that's been exercised here. Rather there's – and my friend said, and I think he's right, that Fonterra treats 3.3 and 3.4 as separate freestanding discretions that apply to different circumstances. And 3.4, which is the one that's been imposed here, is the capitalised concept of Contract Supply, which is that, "The board may, at its discretion and on such terms as it sees fit, permit a shareholder to supply milk to the company in a season on contract supply." So again this is linked to being a shareholder, which is important when I come back to the fact that these people are new entrants because they're applying to become shareholders, and you have to be a shareholder. "The aggregate amount of milk solids obtained from all milk supplied to the company by shareholders in a season on contract supply shall not exceed 15% of the total milk solids obtained from all milk supplied by the shareholders to the company in a 12-month period prior to the commencement of that season." And, "Without limiting the terms which the Board may set for contract supply … the Board: (b) may require a shareholder to hold a minimum number of co-operative shares continuously throughout the term of any arrangements for the supply of milk … by that shareholder on contract supply." And we know that the number currently designated by the Board is 1000.

Just looking again at a couple of the definitions in the Constitution, if we jump over to page 966, "Clause 48, Definitions and Interpretation," and we have that familiar definition of "contract supply" over on 966. "Supply of milk to the company by a shareholder pursuant to clause 3.4 in a season without the milk solids obtainable from that milk being taken into account for the purposes of the share standard," and over on 969 we have the definition of "shareholder"

which the Court of Appeal also noted. "Shareholder means a person whose name is entered in the share register as the holder for the time being of one or more shares," and again I mention that only to make the point that my friend's argument that 1000 shares is a nominal amount that should be completely disregarded is inconsistent with the status of shareholder which is central to the discretion of the Board under 3.4 to the whole regime of contract supply, the defined term set up by this Constitution.

That's my 1.2. As I say in 1.3 of my roadmap, what happened was that shares were issued to the respondents in September of 2012, as a result of which they became shareholders. That meant they were bound by the Constitution, as the Constitution says, and as section 31(2) of the Companies Act says, and they became shareholding farmers for the purposes of DIRA. Just looking at that definition very quickly in my friend's authorities under tab 2, the definition of "shareholding farmer" which is on page 17 of the Act means a dairy farmer who is registered as the holder of co-operative shares, and these people were that. They were dairy farmers, which I think at least is uncontroversial, and they were registered as the holder of shares in Fonterra. So they were shareholding farmers from the time that the shares were issued to them in September 2012.

Fonterra, this is my 1.4, saw itself as issuing these shares under sections 73 and 74 of DIRA. Won't go to all the references here but if, in volume 6, we just look at the resolution for the issue of these shares, it's under 1312 –

ELIAS CJ:
Sorry, which volume are you in now?

MR GODDARD QC:
Sorry, I'm still in 6.

And we saw similar Board papers in almost identical form running even after the – after the end of the application period in July, August, September. Ms Burr confirmed that this was the last one for the year and for that matter

she said the last ever because with TAF coming in this never happened again. So there we are on 25 September 2012 and again Ms Burr confirmed it was an effective cut-off date a couple of days before that but that at any time up to that if you applied to share up, if you held a Growth Contract or if you came in with a farm saying, "I can begin supply this year after all. Things have gone better than expected. My irrigation's on," whatever, you know, then you would get your shares. She did say that she would grumble quite a lot if it came in in the week or two before that but it would still get processed.

Purpose of the paper, to approve issues and surrenders of shares.

2, "Executive summary," and it's (a) that's important for these shareholders and (b) that's the important comparator. "(a) Issue shares to new shareholders for the 12/13 season and to existing shareholders who submitted late elections to cover expected production." So the respondents were new shareholders for the 12/13 season. That's how they were described. And also (b), they were issuing shares to ensure shareholders who have reduced or cancelled their contract supply arrangements, or who supply under Growth Contracts, hold the minimum required shareholding. So people who reduced their contract supply arrangements automatically had to have more shares, and they were being issued more shares as well, and the formal resolution over the page on 1313 that applied to these suppliers, to the respondents, was, under the heading, "New shareholders for the 12/13 season," "To issue, in accordance with clause 5.1(a) of the Constitution and sections 73 and 74 of DIRA, the number of shares listed in this row to accepted dry farm conversion applicants to supply for the 12/13 season (including those who have been awarded Growth Contracts) and also purchasers of existing farms without shares," so some 1.9 million shares were issued at $4.52 each to people in this category including about 30,000 to our respondents, and anyone else who was a Growth Contract supplier who wanted to share up more, for example, could get more under (b), and so on. And what we see, I should have drawn the Court's attention to, that these shares are described as being issued in accordance with clause 5.1(a) of the Constitution, the share issue clause, and section 73 and 74 of DIRA. So the

Board recognised, rightly in my submission, I'll come to this later, that it was issuing these shares under 73 and 74 of DIRA.

So that's the process by which the respondents became shareholders in Fonterra supplying milk to Fonterra in the 2012/13 season as shareholders on a mix of share-backed and Growth Contract-backed supplier.

Now I'm going to look briefly at the reasons for imposing the three unfavourable terms because again the facts are crucial when we come to ask whether the difference in terms was only to reflect the different circumstances, and both Courts below held that it was necessary that there be an objective justification for the difference. That it's not enough to say, well, we wanted to please an internal audience, and in my submission that approach was right.

But first of all let's get straight the facts on why those unfavourable terms were imposed. There are concurrent findings of fact on this in the Courts below. I don't understand them to be challenged and they really can't be challenged on this appeal. So if we go to the High Court judgment, volume 1, tab 12, and we turn to page 117. The discussion of question 2, the 106 question begins on page 116 and what His Honour Justice Muir held at 110 was that the underlying purpose of the section, section 106, "Is to ensure that, in respect of new entrants, Fonterra cannot use the market power invested in it as a result of the legislated merger to achieve outcomes not available in a workably competitive market." In my submission that's right and I'll come back to that later. "To that end the 'different circumstances' recognised by the section must, in my view, be objective differences in circumstances," and I adopt that, "and of a nature that could be – "

GLAZEBROOK J:
Sorry, I think I've lost you.

ELIAS CJ:
Yes.

MR GODDARD QC:

I'm so sorry. So I'm on page 116. I said go to 117 and then I started at 116 which is incredibly unhelpful.

GLAZEBROOK J:

Well no wonder I lost you.

MR GODDARD QC:

It's entirely my fault.

ELIAS CJ:

What paragraph of the judgment?

MR GODDARD QC:

Paragraph 110 Your Honour. So I was, after setting out Fonterra's arguments His Honour said that, "The underlying purpose of the section is to ensure that, in respect of new entrants, Fonterra cannot use the market power invested in it as a result of the legislated merger to achieve outcomes not available in a workably competitive market." In other words farmers, and purchasers of raw milk, but here we're concerned with farmers, shouldn't be worse off than they would be if this merger had not gone through, when there were two large competitors and some minnows around the two large competitors in particular. "To that end the 'different circumstances' recognised by the section must, in my view, be objective differences in circumstances and of a nature that could be expected to result in different terms in a workably competitive market. So, for example, differences in the quality of the milk supplied or particular difficulties of access to a new entrant's farm may justify a difference in the terms of supply. But a workably competitive market would not allow Fonterra the luxury of 'sending messages to its shareholders'." So I'll come back to the law on this, but against that backdrop – perhaps also while –

ELIAS CJ:

Sorry, what's the finding of fact that you're –

MR GODDARD QC:

I'm going to come to the findings of fact, I just first of all thought it would be helpful to identify the question His Honour thought he was addressing.

ELIAS CJ:

I see, thank you.

MR GODDARD QC:

And the other distinction that His Honour drew, which I should draw the Court's attention to so we don't have to come back to it, is at 111. "it seems to me that a desire on the part of the Board to, as Mr Goddard phrased it, 'keep the shareholders sweet', however attractive that may have seemed to the Board, was not a valid difference in circumstances for the purposes of s 106. Not only do I consider this implicit in the section, but s 106(4) explicitly recognises that the imposition of sanctions for perceived disloyalty, for example, by exercise of a farmer's right to supply up to 20 per cent of his or her milk to a competitor, is not a valid basis for differential terms of supply."

So then we come to the findings of fact, 113, "Focusing then on the reasons for the differences in the present case, the plaintiffs say, in submissions which I accept, that," and then there's a list of factual findings. "(a) The main reason was to placate existing shareholders (and internal stakeholders)." Some managers. "It was, as Mr Murphy put it, about the 'optics.'" Factual finding 2, "The financial viability of the deal did not depend on these terms as confirmed by Chapman Tripp's letter of 26 August 2015, where it was stated that: Fonterra is not saying, on its pleadings or in its evidence, that amendments to the Growth Contract (listed at [29](c)] of the second amended statement of claim) were the difference between financial viability and non viability of the overall transaction. (c) The five cent per kilogram milk price discount," that's the second of those five cents Your Honour, not the contract fee, "was a small and relatively arbitrary figure," and I'll come back to the importance of it being arbitrary, "designed to be and perceived to be a 'penalty'," the words used by a very senior manager in explaining it, I'll go to those emails, "for suppliers who had previously left the co-operative and couldn't therefore be expected to

simply 'waltz back in. The financial benefit to Fonterra was identified as being in the order of $3 million," that's actually for the 10 cents, the five cents extra penalty was worth 1.5, "but this was not a material factor in the decision to impose the penalty." And Mr Murphy accepted that.

"(d) The prohibition on sharing up was to ensure that the five cent milk price penalty would apply for at least one year to all suppliers. That appears from Mr Wickham's email of 7 June and was confirmed by Mr Murphy on cross-examination. (e)," factual finding, "The prohibition on sharing up was also intended to deprive the suppliers of the expected gain in share price post-TAF as part of the 'optics'." And His Honour explored this with Mr Murphy in questions after I'd finished by cross-examination and as frustratingly, as so often the way, the Judge's cross-examination was in some ways more effective than mine, and Mr Murphy confirmed this.

(f), another factual finding, "The decision on the part of Fonterra not to buy the plaintiffs' vats immediately was also driven by 'optics' rather than financial considerations." We'll see Mr Murphy acknowledging it was something else we could point to. Say, look, we're not even buying their vats from them. So those are –

WILLIAM YOUNG J:
What are the vats worth?

MR GODDARD QC:
About $30,000 each and they said they would consider it eventually, so what I explored with Mr Murphy, and I will go to this very briefly later, is that the cost of buying the vats would have been in the region of $1 million, and that they were intending to do it eventually, they were just sending an initial signal, we're not going to buy these from you immediately and maintain them for you immediately, which they do for everyone else, and so it's talking about the time value of money. I asked him if this was at all material to the transaction, financially, no, it was about the optics. Again, so we could say to our existing

suppliers that getting less than you, can't share up pre-TAF and look we're not even buying their vats from them and maintaining their vats at our cost.

ELIAS CJ:

This, the language that's used which you say are the findings of fact, it is a matter of presentation of it. Presumably you would accept that treating shareholders fairly would not be an irrelevant consideration. Would not be something that the law wasn't entitled to do.

MR GODDARD QC:

No, I think that puts it too broadly Your Honour, and the problem is that the shareholders are the owners of the monopsonist purchaser, so treating them fairly in the sense of not expecting them to overpay of course.

ELIAS CJ:

Yes.

MR GODDARD QC:

So if the milk, as His Honour said, is of lower quality, if it's worth 20 cents per kgMS less than other milk, then of course you could say, well we'll pay you the 20 cents per kgMS less. But remembering 106 says "only" to reflect the difference in circumstances. You couldn't pay them 30 cents less, or 40 cents less. Similarly if your costs –

WILLIAM YOUNG J:

Can the circumstances not include the fact that the purchasers want, the suppliers want not only to be paid for the milk, but also to be paid for the milk they supply to someone else.

MR GODDARD QC:

But they're not being paid separately for that. It's just the terms of being attached to the purchase price for the assets –

WILLIAM YOUNG J:

But that's just looking at the matter in a sort of an atomised way. As at the beginning of June the suppliers wanted two things. They wanted to be able to have someone who would take all their milk for the following season, but they also wanted to be paid everything they were owed.

MR GODDARD QC:

And a number, I'll come to this later, but a number of the offers would have produced that result or close to it.

WILLIAM YOUNG J:

Yes, yes, but I don't think –

MR GODDARD QC:

Synlait, for example, was offering 100 cents to –

WILLIAM YOUNG J:

But it may have offered less favourable terms –

MR GODDARD QC:

For the receivers.

WILLIAM YOUNG J:

– for supply.

MR GODDARD QC:

Yes.

WILLIAM YOUNG J:

So why can't we just look at it in terms of what the suppliers were hoping to get out of the bargain for their milk, compared to what other suppliers who didn't care about what had happened to the last year's milk supply.

MR GODDARD QC:

The first point is that there was evidence from some of the suppliers that they would have preferred to go elsewhere and have better terms going forward and take their chances on what they got from the sale.

WILLIAM YOUNG J:

Well, it was up to them. They could've scuttled the deal by not signing.

MR GODDARD QC:

But they had to scuttle the deal and so Mr Borst, for example, who was the last one to sign up –

WILLIAM YOUNG J:

Sorry, who was?

MR GODDARD QC:

Mr Borst.

WILLIAM YOUNG J:

Yes.

MR GODDARD QC:

Who was the last one to sign up, at some time three and 5 o'clock on the last day, gave evidence about receiving telephone calls from other people in his community who were anxious about the deal being scuppered and the strong community cohesion and his reluctance to have bad relationships with his neighbours for the rest of time, and so he, although he would have preferred better terms from someone else, felt he had no real choice but to go with this. So –

WILLIAM YOUNG J:

But does all of that matter, because in a way, I mean, how everyone broke down the bargain in their own minds can't really be controlling it. What is it

they – can't we look at it in terms of the fact they wanted more for their milk supply than just a contract price for their milk?

MR GODDARD QC:
And the answer is no because –

WILLIAM YOUNG J:
No. I thought you might say that.

MR GODDARD QC:
The answer is no because the question in an antidiscrimination provision of this kind has to be whether the treatment offered by the decision maker differentiates only on appropriate grounds and to an appropriate extent, not whether the person for other reasons nonetheless felt that this was the best deal on the table. So –

WILLIAM YOUNG J:
Well, I'm not particularly interested in whether they thought it was the best deal on the table or not. I'm just interested in whether they were getting more for their promise to supply milk than other suppliers were, and it does seem to me they were.

MR GODDARD QC:
And the answer is that they weren't because all that – because, yep, they weren't getting more than other suppliers because all other suppliers had also – their ability to supply the milk to Fonterra depended on Fonterra having made an investment in a plant to receive, and this $48.5 million purchase price for this plant was just an investment in the capacity to take the milk like any other.

WILLIAM YOUNG J:
But it could've been – conceivably they could have bought it for 40 million if they, if – but that would've resulted in less payment of retros.

MR GODDARD QC:

If there was evidence that they had approached it on that basis and added an amount only in order to do this then that might represent an extra cost.

WILLIAM YOUNG J:

Who does it really – why do we have to look at it in that way? Can't we just look at it as a matter of logic that they were paying one sum and getting one set of benefits and there was a sort of a push-you pull-you between them?

MR GODDARD QC:

There are a couple of paths to this conclusion. One of them say is the orthodox approach to provisions designed to control discrimination which is you look at the extent of the justification to the decision-maker of making that distinction going forward between the different classes of people, the person and the comparator, but the reason that's specific to this statute goes back to what it was intended – what it permitted and what it was intended to control. So absent DIRA there would have been two large milk co-operatives competing for supply and which could have been expected to compete for this plant when NZDL failed, and if you ask what would have happened in that scenario then it seems, I think, pretty clear, and we'll see some Board papers [inaudible], that both would have had a strong incentive to offer a price at this level or higher and to seek to secure supply to keep the plant full by structuring the deal in a way that a certain proportion of the price would go into the retros. So the competitive outcome, absent the merger with two large players, is that they would have been expected to pay no less than this for the plant, to pay all the retros and not to have the unfavourable terms because in a workably competitive market you do not have the luxury of saying to a supplier, "I'm going to pay you less because some of my shareholders don't like you."

WILLIAM YOUNG J:

No, but that's not what –

O'REGAN J:

I just don't see it. I mean, here your clients were $20 million better off than all the other Fonterra suppliers were and they're claiming 15. So they're actually still 5 million better off on –

MR GODDARD QC:

No, they weren't 20 million better off, Your Honour, because even with some of the other bids –

O'REGAN J:

But it doesn't matter what the other bids were. We're comparing, this is a clause requiring a comparison with what other suppliers to Fonterra get, not what these suppliers could have got from someone else.

MR GODDARD QC:

No, I think Your Honour – I will come to the Act and go through. I think it's easier to see what 106 is doing when I work through the provision.

O'REGAN J:

Okay, well leave it until then if you like.

MR GODDARD QC:

But let me get the facts straight first and then let me explain why that approach is, in my submission, wrong. Why the Courts below were right to focus on objective reasons for Fonterra to offer less favourable terms in relation to the supply of milk. Because remember what's being regulated in subpart 5 is the supply of milk on an ongoing basis.

O'REGAN J:

But it depends a bit, what you take as the contract for the supply of milk. Is it just that bit or is it the fact that there was a bigger deal that involved a $20 million windfall.

MR GODDARD QC:

It wasn't a $20 million windfall because on any approach there would have been a substantial payment of the retros potentially up to 100% from some bidders but less for other creditors. I'll come to the numbers for the deal as well but let me –

WILLIAM YOUNG J:

Sorry, just one last query. A rational purchaser would look at both aspects of the deal, would say how much am I going to pay for the plant, how much will I have to pay for milk, round the whole thing up and come to a deal.

GLAZEBROOK J:

You mean for ensuring milk supply in that context?

WILLIAM YOUNG J:

Yes.

MR GODDARD QC:

And in a competitive market where you have two large players, each of whom could achieve the same, you know, synergy gains and fill the plant in that way. What you would not expect to see is, you would expect to see them saying our purchase of this plant is conditional on getting a substantial proportion of the milk supply, and offering incentives to attract it, and the evidence was clear that the reason for offering to pay the retros was to get a commitment to supply this plant rather than supply Westland or Synlait. So you would expect any purchaser to have that incentive, and we see that in almost all the serious bids that were made, and I'll go to the discussion of those, and then – so anyone who was offering to buy this plant needed also to have milk for it so they were going to always say, this is what we're wanting to pay and we want –

WILLIAM YOUNG J:

But they wouldn't divide it in half. Wouldn't they say we're looking at this as a package. The more we pay for the plant the less we'll pay for the milk and

vice versa. Isn't that the rational thing to do? It's one set of economic benefits that are being obtained by Fonterra or another hypothetical purchaser, and they're not very hypothetical, Synlait and Westland were in the works.

MR GODDARD QC:

Were in the mix. Of course there is an overall value proposition but what is clear from the internal analysis by Fonterra is that for any large player without finance issues, and with other dairy operations, the assets had a value far in excess of what was paid and –

WILLIAM YOUNG J:

But that's not necessarily what a distressed vendor would get.

MR GODDARD QC:

No but if you had two large players competing for this you'd have a very different dynamic from the one that resulted from the merger, which was one large player and a couple of very small financially constrained players with less capacity, again, to shift milk around to achieve synergy benefits. So you have a very different dynamic as a result of the merger from the one you would otherwise have had, in which it would have been worth paying this level of price, and remember the price paid was what Fonterra had indicated it was willing to pay before any question of retros emerged in the context of the Morgan Stanley sale process. So it's not as if Fonterra came to us and said, oh, we'll have to pay more in order to pay the retros, in order to incentivise supply. We'll pay what we were always going to pay but we're going to require as a condition that these people sign up and to encourage them to sign up we will say that if you sign up then part of the purchase price we will require to be used to pay your retros. Any bidder was going to do that and we'll see how the bidder is doing it –

O'REGAN J:

So is it your case that in a workably competitive market, we could be sure that the price would have had a full payment of retros, and a fully undiscounted

milk price. And if so, how do you get to that? I mean is there any evidence to support that?

MR GODDARD QC:

My case is that there was no economic linkage between the payment of the retros and the unfavourable terms, and this is starkest in relation to the vats, but it's also clearly the case when we come to the evidence which –

WILLIAM YOUNG J:

But it's not, I agree there doesn't seem to be any attempt to calculate it out but there's no sort of – an uncalculated allowance for it. We've paid quite a lot that enables retros to be paid. That's not the deal that our other shareholders are getting therefore we'll reflect this in the purchase price.

MR GODDARD QC:

But that's not Fonterra's analysis. That wasn't Fonterra's reason. Fonterra did not say, "We have paid more to secure supply so we need to recoup that."

WILLIAM YOUNG J:

No, I think they were saying, "We've paid more to these people than we've paid to other shareholders."

MR GODDARD QC:

No, they're not even saying that. What they're saying is, "These people are, because of the way we're structuring this deal, going to get their retros. That will upset some of our existing shareholders who will see that as a reward for disloyalty and so to send a message to them, to the existing shareholders, that disloyalty will not be rewarded, we are going to impose this arbitrary penalty," and that's very clear on the evidence which I would like just to work through and then, as I say, come back to the framework.

GLAZEBROOK J:

Did you say that there was evidence that the assets were more, worth more than 50 million, because that might give you a clue as to what would happen in a competitive market –

MR GODDARD QC:

Exactly.

GLAZEBROOK J:

– if there were such evidence.

MR GODDARD QC:

Yep.

GLAZEBROOK J:

If you could take us through it at some stage.

MR GODDARD QC:

I will. I'm going to go through in chronological order some of the material on this.

GLAZEBROOK J:

I suppose the other thing though is in a competitive market you would be able to offer extra incentives in terms of the milk supply to people because there would be nothing to stop you being fair between the new entrant and your existing shareholders.

MR GODDARD QC:

So you could offer more.

GLAZEBROOK J:

Well, you – it could well be structured in a different way effectively.

MR GODDARD QC:

Yes, and Mr Murphy gave evidence about how he had limited tools available to him to incentivise all of the NZDL suppliers to supply Fonterra and the one he had, really, he said, because he couldn't offer extra, was to say, "Look, we will, although we're paying the receivers what we were always willing to pay for this plant anyway without any question of retros, we will require as a term of the contract that they use a chunk of it to pay your retros." So at no – Fonterra didn't dip into its pocket for one dollar more than it was willing to pay, and we'll see again evidence from Mr Grace, the receiver, who said that he got an early telephone call from a Fonterra executive saying, "Well, a few months ago in the context of the Morgan Stanley process we offer 50 mil so that will be our price again," and then –

GLAZEBROOK J:

I asked Mr Hodder yesterday whether that would have been the function of what happened with the receivers anyway. When they say it was a requirement that they paid retros, were there other demands on the receiver?

MR GODDARD QC:

So there were about – there was a secured creditor of about 18 million. We'll see this in one of the papers I'm going to go to but there was a secured creditor of about 18 million. There were retros of, the figures are in the low twenties. I keep seeing different numbers in different documents. It ranges from 20, which I think must be a rough approximation, to 22. I saw another figure at 24, I think. Anyway, low twenties for the retros.

GLAZEBROOK J:

Well, all I'm really saying is was that actually –

MR GODDARD QC:

And then there were a few million. There were a few million other unsecureds, and what we see is that the receiver said in his evidence, I think, that the other unsecureds got something like 85 cents in the dollar but actually the liquidator's final report, which the Court of Appeal asked about this as well,

and what the Court of Appeal was advised based on the final report of the liquidator is that the unsecureds other than the dairy farmers were paid 87.8 cents in the dollar.

GLAZEBROOK J:
So in fact even without the requirement they would've got pretty near 100 anyway?

MR GODDARD QC:
Yeah, they'd have got near 90 because you think that because, of course, they've got 100. The others got 87.8.

GLAZEBROOK J:
They would have been the bulkiest –

MR GODDARD QC:
They were most of it but it would still be at around 90%. So even without the special term on the –

WILLIAM YOUNG J:
What do you mean by the special term?

MR GODDARD QC:
Requiring 100% payment of the retros.

ELIAS CJ:
With the receivers.

WILLIAM YOUNG J:
Yes, but it depends on how much was paid for the assets though.

MR GODDARD QC:
Yes, but on this –

WILLIAM YOUNG J:
I mean, if 30 million had been paid for assets then it wouldn't have happened.

MR GODDARD QC:
Yes, of course.

WILLIAM YOUNG J:
Yes.

MR GODDARD QC:
Well, unless there was a requirement that some of that be used to incentivise ongoing supply on the basis that was integral to even the 30 million price paid because, of course, the stainless steel, without any milk supply, is probably worth less than 30 too. So – but anyway, let me just work through some of this.

So went through 113, and also in the High Court judgment, and I really am on page 119 now, wanted to look at the factual findings in 115, and this may help. "Other justifications advanced by Fonterra were in my view either not material to Fonterra's decision" –

GLAZEBROOK J:
Sorry, 11 – okay, I'm right.

MR GODDARD QC:
115, paragraph, sorry, on page 119. The similarity's unhelpful. Mea culpa. "Either not material to Fonterra's decision or designed to draw the focus away from its real reasons and/or not relevant differences for s 106 purposes. These included: (a) Recovery of its investment," including, you know, this is basically the recovery of the price for the plant. This was Your Honour Justice Young's – His Honour rejected that. " The evidence was that Fonterra does not seek to recover the cost of investment in any particular plant from suppliers to that plant and did not as a fact impose different terms on other suppliers to the Studholme plant. Nor was there evidence that this was more

costly capacity than any other plant operated by the company. As indicated, the financial benefit arising from the terms imposed was modest and not material in the context of the purchase. Moreover, by imposition of the restriction on sharing-up in the first year, Fonterra was foregoing capital it might otherwise have had." The moratorium was irrelevant. It's common ground timing, that's irrelevant, and Fonterra doesn't seem to be pushing that anymore. "(d) The ease of attracting supply or desire not to split the supply base. Again I consider this reason unmeritorious."

"(e) Sharing-up would have placed the NZDL suppliers in a difficult financial position." But again that was not justified on the facts. And, "(f) It facilitated payment of the 'retros'. These were, however, paid by NZDL out of the purchase price. That could have occurred without the three unfavourable terms. Fonterra's indicative bid of $50 million on 5 June was given before any decision had been made to impose the terms. And Mr Grace," the receiver, "gave evidence that Fonterra had bid $50 million for the same assets in a pre-receivership sale process." My learned friend is quite right to say it was an indicative bid not a formal offer capable of contractual acceptance. But – and then His Honour went on to say, "I am therefore satisfied that the price paid by Fonterra and the resulting payment of the NZDL suppliers' retros did not depend on the imposition of the three unfavourable terms."

GLAZEBROOK J:
Does it matter whether it depends on it or whether it's either proportionally or rationally I think Mr Hodder would say, connected to it, but maybe you'll talk to us about that when you get to the -

MR GODDARD QC:
I will. I would say it must be objectively and proportionately connected.

WILLIAM YOUNG J:
But isn't it just enough to look at what the statute says?

MR GODDARD QC:

Well it's the "only" word that's important and you have to work out what it means to say "only".

WILLIAM YOUNG J:

Yes but doesn't section 106 effectively have its own equivalent. It can only differ to the extent that it's necessary to reflect the different circumstances.

MR GODDARD QC:

Yes, so one has to ask what is necessary and that's the key. Necessity by what – so 106, Your Honour is –

WILLIAM YOUNG J:

It doesn't say necessary only to reflect.

MR GODDARD QC:

Only to reflect the different circumstances. So again it's my example of if it costs you 20 cents more to take supply from someone, you can have terms that differ by 20 cents. But any greater difference is not only to reflect the different circumstances. So where there is a difference –

WILLIAM YOUNG J:

So on this basis would you be entitled to recover the surplus, that is the extent to which they were treated less favourably than was warranted by the different circumstances. I mean is it all or nothing or –

MR GODDARD QC:

Yes, it must be. It must be. If there was a difference which was relevant. So in my example if it was going to cost Fonterra 20 cents per kgMS more to take supply from someone, and they said 30 cents take it or leave it, and take it or leave it was an important part of Fonterra's approach to this, you could recover the 10. And here the –

WILLIAM YOUNG J:

So if the benefit to the purchaser – the suppliers was some component of the retros, then that would be deducted from whatever they're entitled to be paid by way of relief, or is that not right?

MR GODDARD QC:

No, because again, in my submission, it has to be that the reflection of the different circumstances is a reflection of the difference in cost to Fonterra, or benefit to Fonterra. Fonterra is not allowed to say, well this is very beneficial to you so in the exercise of our monopsony power we'll drive you down to whatever you're willing to take. And this is why I want to tackle this in the context of a coherent examination of subpart 5, the whole purpose of it is to control the exercise of monopsony power and of course, you know, given how supply curves slope, there are always inframarginal purchases for a vendor, inframarginal supplies for a purchaser. There are people who will still supply you if you pay less than the competitive price, if you offer less than competitive terms. The point is that's not efficient, that's not the outcome you'd expect to see in a workably competitive market. A whole range of provisions in subpart 5 are designed to ensure that Fonterra can't exploit that market power by saying, oh but it's a benefit to you to get less than a competitive price. You're still doing better than you would any other way. So that's all you're getting from us. And that's not a sufficient justification.

ELLEN FRANCE J:

Sorry, just on the take it or leave it point, and you may be coming back to this, what's the relationship between the other two causes of action and either of the parties succeeding or failing in relation to the appeal on this point?

MR GODDARD QC:

On this point, on the basis of the judgments in the High Court and the Court of Appeal, we say that the farmers are entitled to recover the loss to them caused by the three unfavourable terms, and there will be a trial about what that is, but in principle we say that's the lower price paid. It's a small amount in respect of having to maintain and own their own milk vats – that's not really

material – and it's critically the loss of the ability to share up pre-TAF and the additional cost of buying the shares. Under the other causes of action, the claims which have succeeded and which have not been appealed to this Court, are that Fonterra misled the farmers about the possibility of sharing up, that Fonterra told them it was impossible when in fact it was possible if Fonterra exercised its discretion favourably, and the claim is that if Fonterra had not misled these farmers, if it had told them the correct position which is, "We have a discretion but we're not minded to exercise it in your favour," then they could have said, "Well, we're not minded to deal with you unless you do," so they lost the opportunity to push back and insist that the Board exercise its discretion to have a negotiation on that. So it's a claim for loss of opportunity is what I said in response to –

ELIAS CJ:

But presumably, if you were to succeed in this matter, the – you have an entitlement and the Fair Trading Act claims go away.

MR GODDARD QC:

Yep, and so the other claims go away. Yes, and that's why the Court of Appeal described them as secondary to this.

ELIAS CJ:

Yes.

MR GODDARD QC:

If this succeeds, the Fair Trading Act and Contractual Remedies Act claims add nothing. If this appeal on these issues were to succeed then the claims under the Fair Trading Act and Contractual Remedies Act would be for, as I think I accepted in the Court of Appeal, a lesser amount because they would represent the loss of an opportunity to negotiate for the same benefit rather than the loss of that benefit. So this is the cause of action on which the farmers have consistently put emphasis, put their focus, because it is the one that says, "We have been discriminated against to this extent and we should get the loss we have suffered from the discrimination." The others are, "We

have lost the opportunity to refuse to supply you unless you come to the party."

ELIAS CJ:

And I don't know whether this is what Justice France was putting to you but we wouldn't want to say anything that would –

MR GODDARD QC:

Queer the pitch.

ELIAS CJ:

Yes. So could we in this, in what you're, in what's being asked here?

MR GODDARD QC:

Yes, I think there is a risk of, by venturing opinions on the difference in position of the farmers with and without this deal, of having an impact on the causation and quantum hearing, if that's – yes, I didn't quite understand that but Your Honour's quite right, there is a risk of that. Now my approach, of course, just to say that 106 is an analysis that has to be undertaken from Fonterra's perspective. You ask what's the difference to Fonterra. So it's like if people are complaining, "Well, we do a job which is equivalent to this other person over here but we're being paid less," the inquiry is on the employer's position and whether the work is of any less value to them, is there less responsibility, is, you know, does it deliver less value. So it's an inquiry from the perspective of the person setting the terms. Do they have a justification for discriminating based on the benefits to them or the costs to them of having person A and person B, and in my submission 106 is intended to work in the same way. It's intended to say looked at from Fonterra's eyes is there any objective justification for paying these people less on an ongoing basis, and particularly for preventing them from sharing up. And let me pick that up actually because that's perhaps the best answer to Your Honour Justice Young's questions. The prohibition on sharing up did not provide any material financial contribution to Fonterra. If Fonterra had permitted sharing up then as the High Court Judge found it would have had their capital in

exchange for any outgoing on that, so there was no financial benefit that was treated as material, and Mr Murphy, I'll go to the passages in cross-examination, Mr Murphy agreed that any financial benefit from that prohibition was not material to Fonterra. That was not what they were trying to do. They were not trying to claw back some amount of the retros they paid out. The purpose of this was to placate internal shareholders. But if you're a monopsonist, and a monopsonist co-operative, so you're existing so far as are your shareholders, then they will always want to pay less than the competitive price to a new entrant. The whole point of subpart 5 is to prevent that, and this was inconsistent with that.

Let me – so I'm going to go quickly to the Court of Appeal judgment and the findings there, then I'm going to go, sparingly given the time, to a little bit more evidence then loop back to the Act and permissible distinctions drawn under 106. So Court of Appeal judgment, volume 1, tab 15, paragraphs 119 and following, beginning at page 190, the discussion of the facts is interlinked with the legal analysis, so I'll go through very quickly paragraphs 119 to 128. So – perhaps it's worth going back to 117 where the Court recorded the agreement between counsel that the question of whether, "A shareholding farmer 'in the same circumstances' … must be answered by an objective examination of the circumstances," and then accepted by submission that, "A relevant circumstance is one that would be likely to result in a difference in the terms of supply in the particular commercial context in an ordinary competitive market."

Then at 119, "Approached on this basis, we agree with the Judge that offering the three less favourable terms at issue amounted to a breach of s 106. We agree with the reasons the Judge gave," so that includes the factual findings at 113, "but we will focus only on the principal justifications advanced by Fonterra on appeal."

120, "First, the payment of the retros did not justify Fonterra offering less favourable terms of supply to the respondents. The evidence establishes beyond dispute that Fonterra made a bid of $50 million for NZDL's assets as part of a sales process initiated in December 2010, approximately 18 months

before the receivership. Obviously, Fonterra's bid at that level was not influenced in any way by the payment of the retros, an issue that had not then arisen. Importantly, there is no evidence that the price Fonterra ultimately paid was increased to enable the retros to be paid. A Fonterra internal email dated 4 June 2012 noted that an offer of $50 million, based on 100 per cent of NZDL's suppliers contracting to supply milk to Fonterra at a discount of 10 cents per kgMS, would result in a net present value of $72 million." Without the 10 cents it would be 69, that's in the same paper which I'll go to. So NPV of 69 or if there's a 10 cent discount for three years that improves to 72 million. "This represented a gain of some $22 million for Fonterra." And that's why I say, coming back to Your Honour Justice Glazebrook's question, that there's every reason to think that the outcome in terms of purchase price and payment of retros would have been no less favourable in a competitive market and that they would have been no, and that you couldn't safely offer the unfavourable terms and expect to attract supply.

ELIAS CJ:

Again, is it really accurate to talk about this discount of 10 cents?

MR GODDARD QC:

Yes, because you could avoid it if you shared up. You'd avoid the whole 10.

ELIAS CJ:

Yes, but that's a consequence on the prohibition on sharing up.

MR GODDARD QC:

So five if it's the penalty, and the other five is a consequence of the prohibition on sharing up. So that bundles together those two unfavourable terms.

ELIAS CJ:

I see, yes, I understand.

MR GODDARD QC:

So that represents the difference from the two unfavourable terms, and the milk vats are vanishingly small, so they don't tend to get – in fact there's no discussion of them that we could find in internal correspondence or Board papers. Apart from just announcing the term. "So we are satisfied," the Court said, that, "the price paid by Fonterra for NZDL's assets was unaffected by the advantage to the respondents in securing payment of the retros. The transaction between Fonterra and the NZDL receivers was advantageous to Fonterra and its shareholders in two main ways. First, it resulted in the acquisition of assets at a price that represented a gain in capital terms. Second, and more importantly, the payment of the retros by the receivers from the sale proceeds was influential in securing for Fonterra the benefit of the milk produced by the NZDL suppliers. We agree with the Judge that the main reason for imposing the less favourable terms was to placate existing shareholders who might have harboured concerns that the respondents were being allow to 'waltz back in'. Fonterra concedes that the financial viability of the Growth Contracts … did not depend on acceptance of the less favourable terms. It is difficult to escape the Judge's conclusion that they were imposed as a penalty for the respondents' perceived disloyalty." So they were finding that it wasn't only to reflect a benefit, it wasn't only to reflect a cost to Fonterra. It was, the main reason, this is a factual finding, the main reason was a penalty for perceived disloyalty. So even if one reason had been, "Well, they're getting something else that other people aren't getting," nonetheless the fact that the key objective, the central objective, was to impose a penalty would mean 106 wasn't satisfied. That's a reason which is absolutely counter to the scheme of subpart 5.

124, "As Mr Goddard submitted, the fact that Fonterra might have considered the offer of less favourable terms as being in the best interests of itself and its shareholders cannot be relied on to justify offering less favourable terms to suppliers. Offering less favourable terms to the respondents in order to penalise them for perceived disloyalty cannot justify discrimination under 106." It's not a relevant different circumstance that we want to punish these people,

which was a key reason, factual finding, key reason equals to punish these people, is that only for different circumstances? No.

And I don't think I need to go through the rest, through to 128. It's one minute after 11. I'm conscious –

ELIAS CJ:
Yes. Do you want to finish with the Court of Appeal reasons? Does that –

MR GODDARD QC:
Yes, let me do that then, Your Honour. So 125, it's a legal finding that discrimination as a means of disciplining or penalising suppliers was inconsistent with the regulations. I should say, again coming back to – I'll go to the evidence but this again is relevant to Your Honour, Justice Young's, questions, Mr Murphy's evidence was not only that this was about the retros being given to their suppliers but that it was intended to send a message to other suppliers who might be thinking of leaving Fonterra that they would be punished, and that again is outside the 106 circumstances. He agreed with my question, it's like parking fines. It's to deter bad behaviour by others, bad behaviour being exercising your subpart 5 rights. So that's another reason why it wasn't only for relevant different circumstances.

Finally, 126, "We agree with Justice Muir that Fonterra's expressed concerns about the ... TAF proposals could not justify offering less favourable terms to the respondents. This suggested justification falls into the same category as possible concerns by the existing shareholders about allowing the respondents to come back into Fonterra as suppliers. If Fonterra saw this as not being in its own interests, it did not afford any commercial justification for offering the respondents less favourable terms."

"In summary," at 128, "we find the Judge was correct to conclude that Fonterra breached 106 by offering the respondents terms of supply that were less favourable than those available to existing shareholders," and then I'll go to the evidence quickly after the break and, in particular, to the emphasis on

being seen to punish these people, not a financial quid pro quo for paying their retros but being seen to punish them to send them a message and to send other suppliers a message.

ELIAS CJ:
Right, we'll take the morning adjournment now, thank you. Thank you, Mr Goddard.

COURT ADJOURNS: 11.03 AM
COURT RESUMES: 11.19 AM

ELIAS CJ:
Thank you, yes Mr Goddard?

MR GODDARD QC:
Just in terms of cutting my clock, am I right to understand that we're finishing at one?

ELIAS CJ:
No.

WILLIAM YOUNG J:
It would be good if we could.

ELIAS CJ:
Some of us would find it helpful if we could but we think it probably will go into the afternoon and you shouldn't feel that you have to finish.

MR GODDARD QC:
That's helpful.

O'REGAN J:
So you'll be unpopular but you'll still be able to continue.

MR GODDARD QC:

I'm just a bit worried about what Your Honour might do to me for the sake of optics, addressed both to me and other counsel in the future, but let's see how we go.

So I'm now on 2.2 of my road map. That's not quite that bad in terms of progress but sort of covers some other material. As the Courts below found the main reason for imposing these terms was optics relating to suppliers not waltzing back in, sending message, not funding payment of retros or offsetting a benefit in any financial or economic sense. It was about sending a message. And the way that emerges I have picked some key references, I'll work through them very quickly. If we take out volume 6 of the exhibits, and first of all at 1073, what we have is the first paper to the Fonterra board.

GLAZEBROOK J:

Have we got these references on here or not?

MR GODDARD QC:

Yes, in my 2.2.

GLAZEBROOK J:

Right so these are all in the –

MR GODDARD QC:

Yes.

GLAZEBROOK J:

Thank you. It just saves me writing them down.

MR GODDARD QC:

Absolutely. I was conscious of trying to provide them in a convenient form, and I'm going to zip through most, but not all of these, having regard to time.

So the first – there are three relevant board papers that Fonterra considered in the course of this process. This is the first of the three. From 28 May there's an executive summary. Perhaps worth noting at 2.5 the receiver was appointed on 17 May. The receiver advised management that VTB, that's a Russian bank, the only secured creditor, are owed about $18 million. Then over at section 5 of the paper on 1074, which my friend took the Court to, are some numbers, "NZDL had approximately 35 contracted suppliers, supplying a total of … 120 – 150 million litres of raw milk per annum." And it's common ground that that equates to about 10.6 million kilograms of milk solids per annum. That's a figure I've taken from my learned friend's submissions at 4.25 and we agree. And at 5.3, in terms of retros there's an estimate of about 600,000 on average per supplier, around $20 million.

Over in section 6 Fonterra is looking at the possibility of buying the milk, or some of the milk, but not the plant, and at 6.3 Fonterra says it, "has limited buffer capacity in the South Island… not in a position to unconditionally contract all NZDL suppliers if requested to do so. Management estimates that we can accept an additional 250,000 peak day litres of supply," so that's about a third of the 800,000 peak referred to in 5.1. "While ensuring there is sufficient capacity to process the milk of our existing suppliers. Management to process to accept new contracts on standard Fonterra Growth Contract terms up to this volume only." So at that point Fonterra staff were actively going out and canvassing NZDL suppliers for their willingness to supply to other Fonterra plants on standard Growth Contract terms, and the way that works is then described.

The sale process, 7.1, I think the Court has already seen it, "In December 2010 Nutritek appointed Morgan Stanley to run a sale process. Fonterra did not participate directly in that process but Fonterra management did indicate to Morgan Stanley a potential interest in the assets at a price of around NZD 50 million." And Mr Grace says in his evidence the receiver, that when he was contacted by Fonterra after the receivership, Fonterra rang up and said well we were at 50 million before, we'll get 50 million now.

Valuation approach, section 8, over the page, "A preliminary valuation of the NZDL assets has been undertaken based on both the value of the site to a third party and also the value to Fonterra based on retaining a majority of the NZDL suppliers on Fonterra terms." A number of valuation sensitivities. "If there were no Fonterra synergies incorporated based on FY11 data, management's current estimate of value is in the vicinity of NZD 40 million while paying suppliers the Fonterra farmgate milk price. If all Fonterra synergies were incorporated this could rise to over NZD 70 million."

May I come back to my submission about farmers not being worse off than they would have been absent the merger, this is an important part of the picture. Two large players with synergies across different plants in the South Island would obviously be in a very different position from a single large player with lots of plants, and then a few small players with, you know, one or maybe two plants in various places. So that's that update.

Then the numbers continue to be crunched internally and if we turn over to 1092 we see Mr Campbell (GM Strategy), a very senior executive within Fonterra, emailing Theo Spierings, the Chief Executive and others, updating on 4 June, recommended next steps, and 1, "Receiver. After discussions with the receiver we are of the view we should offer approximately 50 million for the plant if all the milk can be contracted with approximately 100% of the current supply on a three plus three basis at a discount of 10 cents per kgMS for unshared milk." So that contemplates the 10 cents. "Note this would improve the model below from an NPV of 69 million to 72 million, hence a 50 million offer would have a transaction NPV of 22 million." Obviously, without the unfavourable terms, still 19. "The offer would be constructed in such a way that a minimum of the suppliers and the bank," ie, the secured creditor, "would be paid."

Then there's valuation which Fonterra didn't want to disclose and that was the context within which Chapman Tripp provided their reassurance that the financial viability of the transaction did not depend on the unfavourable terms. We went back and said, "We want all this," and they said, "We don't want to

give it to you," and we said, "But we need to explore the economic significance of these terms," and they said, "It's not relevant to the financial viability." On that basis we left the question of discovery.

Now, so that's that, and then if we turn over to 1102, that's the 5 June Board paper, the second of the three Board papers, which provides a further update. There's an executive summary. And over the page on 1103, the heading, "NZDL suppliers." Position summarised. 5.2, "Ongoing discussions between the receivers and the NZDL suppliers who we understand are owned significant amounts in relation to milk supplied from 1 April to 17 May as well as retro payments for the season. At the time of writing it appears no suppliers have terminated their contracts pending being advised of the outcome of the sale process."

And then 5.4, "NZDL suppliers have accepted advice from the receiver the best opportunity they have for being paid the outstanding amounts is for the assets to be sold with supply contracts in place," and 5.5, "Any Fonterra offer will be subject to a large majority of the NZDL suppliers entering into Fonterra Growth Contracts. These contracts will be on no better terms than the standard offer and management will be seeking to negotiate a 10 cents per kgMS discount to the milk price payable over the first three years. This impact has not been incorporated into the baseline valuations." There's a couple of things here. The baseline valuations on the basis on which the Board was being asked to make decisions didn't assume the discount and what is acknowledged here is that management would seek to negotiate it, and we say that's a frank recognition that that would be pushed back on by the farmers. We also say the reason they didn't push back is because they were misled about the position and that will be relevant to the Fair Trading Act and Contractual Remedies Act quantum hearing. The negotiation would have happened and we say had a good prospect of producing a different outcome but for the subsequent misleading and deceptive conduct of Fonterra.

We come then to the chain of emails in which the three unfavourable terms took shape. We start at page 1110 and about two-thirds of the way down the

page, it's annoying the way one has to read email chains, there's an email from Mr Campbell, the GM Strategy, to the Chief Executive and others with an update on 6 June. Over the page, first bullet point, "Met with receiver today after conditional 50 million bid made last night." Fonterra the preferred bidder. Then the next bullet point, "Discussed appropriate mechanisms to make retro payments owed to existing NZDL farmer suppliers. Those who agree to enter into new supply arrangements with Fonterra will receive full repayment. The first three years will be discounted as per Board update (10 cents per kgMS)." That's what was being discussed with the receiver, that that last Board update, they had tried to negotiate that.

If we turn back to 1110, what we have at the top of the page is an email from Mr Murphy who was the General Manager, Milk Supply, and subsequently Director, Milk Supply, across the relevant period, who gave evidence at the trial, and Mr Murphy is pushing back a little bit. He says, "Hi, Paul, a couple of points from an MS," that's milk supply, "point of view. Not sure where the minus 10 cents comes from. I assume the thinking here is a special contract, ie, 10 cents off the milk price and three years of supply. I would prefer to go to the new suppliers with the existing minus five cents off the milk price for three years of contract supply and then a requirement to share up over three years," ie, standard Growth Contract. "This will be easier to sell amongst the existing supply base, the message being we won't be doing anything special for the NZDL suppliers. We do need to ensure we manage the messaging around the potential purchase and if it goes ahead … and in particular the messaging around the retro payments very carefully. I am not sure that our existing suppliers in the South Island will understand why we would bail the NZDL suppliers out and pay the retro to a bunch of farmers who they feel deserted the co-op." So that's where we get this idea they're deserters, they're disloyal, "Why would we pay the retros? We need to manage the messaging," but that doesn't, Mr Murphy thinks, affect what price should be paid.

If we turn then to 1116, half way down the page we see Todd Muller emailing in response to that chain, they depart and then link up again, "Hi Paul, thanks

for update. Steve Murphy will support integration team from milk supply … have concern over intent to cover the retro payments … likely push back from Fonterra suppliers. Easier to defend if we have inventory to offset but I assume that is unlikely. Also support Steve's view that we would prefer our standard 2012/13 contract: 3+3 with 5 cent differential." So two execs saying I don't know where the 10 comes from, we should just do the plain one. Then at the top of page 1116 we get Mr Campbell coming back, a more senior executive, "OK. We will work on the messaging but will be at 3+3 with a 10c differential for this group (for unshared). We [we being Fonterra] will not make the retro payments – the receiver will do this from the proceeds of the plant sale. I agree we will need to carefully manage messaging around this."

Then the next paragraph, "I'm not keen on offering them the standard terms – the small discount (additional 5c) reflects this – and I am hoping we can write this to profit (to be determined) – they had their chance but if we're purchasing the plant we need all the milk and we've got to show a good return." That's, they had their chance, in other words they were Fonterra shareholders, they bailed on us and they've missed that opportunity. So again not linked in any way to offsetting the cost to Fonterra of paying the retros or the financial benefit to the farmers of payment of the retros. It's all about them having had their chance.

We come over then to 1120, what we see is that email we just looked at, at the bottom of the page and Mr Muller's response to that up above, "Hi Paul. Thanks for clarity around the retro payments, distinction helpful, and agree messaging vital. Understand rationale for the slightly tougher terms and endorse." So he's agreeing with the idea that they had their chance and they're going to be treated differently.

Then if we turn to – I just missed – yes, then if we go to 1114 we have Gareth Lash, half way down the page, emailing some of the team about the sale process. Talking about recommendation, towards the middle of the page, we need to agree on supply terms. Recommended that, it's the interim period, and then over the page, "2. Suppliers are offered the 6 year Growth

Contract which requires suppliers to purchase 1000 shares up front and then purchase a third of the required shares at the end of the 4th, 5th and 6th seasons. These suppliers would be paid milk price less $0.10 per kgMS for the first three years of the contract." Then importantly, "Suppliers can fully share up sooner than the six year term to receive the full milk price." That's what Mr Lash says. Then he says in bold, "Can you please confirm whether you are happy with the above recommendation or otherwise by tomorrow morning?"

And Mr Wickham, on 1114 at the top of the page, comes back to Gareth Lash, again Mr Wickham, more senior manager to whom Mr Lash and Mr Murphy had a report line, or dotted line, I can't quite remember which. "Gareth, I am happy with the proposal with exception that we give thought to not allowing the ex NZDL shareholders to share up until end of first year or maybe until end of third year - in other words strictly enforce 3+3 with no early share up. i.e. so there is a differential milk price penalty for at least one year – they just can't expect to waltz back in and get full milk price if they share up." So again, no linkage there to the cost of Fonterra of the retros. No linkage there to the benefit to farmers of the retros. It's about not expecting to waltz back in and get the full milk price if they share up. It's punishment.

We look at 1120. 1134, is Mr Lash pulling together all these disparate threads and saying, "Hi Paul," he's writing to Paul Campbell, and actually on 1133 Mr Campbell then sends it on to Theo Spierings, the Chief Executive, "Please see attached memo regarding supplier terms. Kelvin – the terms include the points you made last night that they can't share up in the first year and for the interim payment, if we don't get CC approval, then we will pay retros over the same period as Fonterra suppliers." They can't share up in the first year is now part of the deal, and that's on a June, and the supply terms are summarised in the memo on 1135 to 1136. It was sent on to the chief executive.

So I asked Mr Murphy about all of this, and if we go to volume 4 of the case on appeal, and a long conversation with Mr Murphy.

O'REGAN J:

Have we finished with 6 now?

MR GODDARD QC:

I am for the moment Your Honour yes. I don't we need the emails in front of us to understand the interchange. If I've got that wrong I'll apologise and go then back to them but I don't think so. So Mr Murphy, if we begin at page 600 of the bundle, line 14: "Now if we come back to page 382, working backwards in the annoying way that you have to with email chains, we see Mr Wickham, the outgoing boss of your area responding to Mr Lash's." "And he's happy with Mr Lash's proposal with one exception." "Yes." "… give thought to not allowing the ex-NZDL shareholders to share up until the end of the first year or maybe until the end of third year." "He's reacting to the point Mr Lash has made that they can share up at any time." "Under the standard Growth Contract." "And what he's saying is well hang on we should think about not allowing that until some later point." "Correct." "And the reason he gives to strictly enforce three plus three with no early share up." "Yes." Over the page: "And the reason for that is so there's a differential milk price penalty for at least one year?" "Yes." "And the reason he wants that penalty for at least one year is that the suppliers just can't expect to waltz back in and get full milk price if they share up?" "Yes." "So the point that your former boss is making is that these people had left Fonterra and now they were seeking to waltz back in?" "That's the way he's phrased it, yes." "And that there should be a penalty to reflect that, that's what he's saying, isn't it?" "Yes." "And the way that penalty is going to be made to stick for at least one year is by preventing sharing up for at least one year?" "Yes." "There's no suggestion in this email that this restriction is driven by the economics of the deal, is there?" "Not in this particular email, no." "There's no financial analysis of it anywhere in here?" "No."

So that's where it came from.

Then 605, if we turn over to 605, and basically line 8, say: "'We think this offer meets the requirements of the current NZDL suppliers while giving us a

position we can defend with Fonterra shareholders.'" "Yes." "So you're looking to two audiences there, the current NZDL suppliers and existing shareholders?" And Mr Murphy says there's a third audience, the internal stakeholders.

His Honour asked who's in that category. He refers to two senior executives.

So what he's saying is there are three audiences we're talking to here. We need to persuade the ex-NZDL suppliers to come on board, but we also need to manage messaging to our shareholders and to certain internal managers with strong views.

So at 23: "So for example in order to ensure that Mr Wickham is fully on board and supportive, his idea has been included?" And Mr Murphy, "His idea actually went a little bit further, didn't it, and we brought it back to being the one year." "He floated a prohibition for either one or three years and you went with the minimum?" "Yes we did."

And then I explored how that differed from the standard contract over the page 606, line 27, "And the reason you needed an express variation to that effect," prohibiting sharing up, "is that on the standard Growth Contract they could share up in year one … is not a normal consequence of a Growth Contract." Over on 607, line 7, "It's a disadvantage compared with every other Growth Contract … supplier … and not having that choice is a disadvantage?" "Yes."

Then at line 29: The reason to have one year prohibition rather than zero like everyone else, "Included the reason given by Mr Wickham?" "Yes it did." "Which was to ensure that there was a penalty which stuck for at least one year?" "Yes, whilst you are phrasing that as a penalty, I think that Mr Wickham was … aware of the discussions … how would our supply base perceive us buying NZDL plant and allowing the ex-NZDL suppliers to become suppliers of Fonterra." No suggestion it's about the retros. It's about

how will they see us letting these people back in. "We can go back to 382, the term 'penalty' is Mr Wickham's own."

8. "Can I suggest to you that what he is doing here is expressing both his own view that there should be a penalty for this group, and also reflecting a view which he anticipates some other suppliers might have, that there should be a penalty for this group?" "Yes." "And the reason for the penalty is that they have left and they're trying to come back in?" "There were other aspects around that, as well. Around things like, for example, the discussion we had … with regards to TAF …"

18. "We'll come to that, but you said as well, I think you accept that this was certainly one of the reasons?" "Absolutely, yes." "To have a visible penalty for these people?" "Yes." "And you're suggesting there were some other reasons as well?" "Yes."

And then in his brief he didn't use the word "penalty", as I noted at 30, "But what you're saying is the existing shareholders need to be able to look at this and see these people were paying a price for leaving and coming back?" Answer, "I think there were two aspects to it. The first one, absolutely, we needed to make that the optics around this, into our existing supply base, was as you've expressed it, but the second optic we needed to make sure was available was that … existing shareholders saw this as value for the co-operative." So maybe two reasons here. The value of the co-operative but also sending a message.

Then at 26.1: "What you're saying is it mustn't look as if we're bailing them out, it must be clear that this rescue comes at a price?" "Yes, this is …" "And the discount's the price?" "Yes." "And not being able to share up in year 1 part of the price?" "Yes, depending on what happens, yep." "And not buying the milk vat also part of the visible price?"

Then we have a bit of a conversation about milk vats, not very exciting. If we turn over to 614, actually I do come back to vats, line 5, "Let's deal with,"

it says “that” but I think I said “vats”. “Let’s deal with vats. Don’t think it will take long. I think we can agree that Fonterra does normally own its suppliers’ milk vats?” “Yes.”

And I go through how vats normally work. And the punch line after six or seven minutes of discussion with Mr Murphy is over on 616 at line, I’m talking about how immaterial the amount was, at line 14, having worked out roughly what was involved in buying the vats: “And that’s certainly not a material amount for this deal?” “Not enough to scupper a deal, no.” “No, or even to, yeah occupy any serious discussion time. That’s why you didn’t have to crunch the numbers with much precision.” “Correct.” “It was, however, another obvious disadvantage for the NZDL suppliers that could be pointed to if the deal was questioned by another shareholder, wasn’t it?” “Yes.” “So it had some optics value?” “Yes.” “And that was one of the reasons for adopting that term, wasn’t it?” “I think it was part of the total mix, yes.” “Probably actually more important than the small-time value of money saving?” “Yes.” So again, what’s the main driver for this? It’s to be able to say, “Look, we’re punishing these people.”

Then we come to 618 line 8. “The position is that Fonterra has formally confirmed to the plaintiffs that the three variations” – “Yes” – “did not make the difference between financial viability and non-viability?” “Correct.” “And that’s plainly right, isn’t it?” “Yes.”

We had a bit of a discussion about the MPV of the transaction and Mr Murphy said, well, he wasn’t very close to that. But over on 619 at the top of the page, “Are you in a position to express a view on whether somewhat less than 1.5 million” – “Yes” – “was material to this transaction or not? I mean, it wasn’t, was it?” “ I don’t think it was, no.” So it wasn’t a material amount.

GLAZEBROOK J:
Is that the vats?

MR GODDARD QC:

No, that's the five cents discount. The five cents is worth about 1.5 million over three years, and I said, "So does this really matter to the transaction?" "No, it's not about the money." That was confirmed further on. Indeed, the same point is made after a discussion of some of the internal documents I took the Court to about the NPV. So if we look at 622 of the bundle, line 26, "It would be fair to say, wouldn't it, that the NPV, the impact of this extra discount, was a nice-to-have for Fonterra but not essential? It was more about optics?" "Yes."

Then over to 632, and we went round a few loops on this and at line 20, "So if it's a cost-effective purchase," buying the plant in this way rather than building it yourself, "the only reason to have this differential is the optics reason, isn't it, it's not a financial reason?" Answer, "Well, the financial drivers were not the predominant reason for the five cent discount, you're correct, but they certainly contributed to it." So I said what's the main reason? "The main reason for the five cent discount is optics?" "Yes." So again, as distinct from –

O'REGAN J:

I'm not sure that 15 times is any better than 10 times, is it? He's answered the question "yes".

MR GODDARD QC:

I think His Honour might have felt that, actually, too, by that point. We've got some different points coming up. Over on 637, the question about having their chance at line 7 and he's saying maybe there were two chances. One is being part of the co-operative in the past and the other is the suggestion they might buy one-third of the milk on standard growth terms. So 15, "But either way however many chances they had they blew them," "Mhm," "and now they're going to face a less attractive proposal?" "Yep."

And line 23, the main reason was, "That Fonterra be seen not to be offering standard terms?" And that was the time, and we're talking 8 June at line 32,

"which across a couple of areas of Fonterra that decision was locked in?" "Yes."

And then in terms of quantification, if Your Honour, Justice O'Regan, will bear with me a second, over on 638, we've got at line 7, "Again, the key driver for this extra five cents is the optics?" "Yes." And then down at 15, "There's no analysis offered for why it should be five rather than two or three cents, for example?" "No." "It's really just a small but non-negligible number that Mr Campbell has plucked out of the air, isn't it?" "Yes." It's not linked in any way to cost to Fonterra or benefits to the farmers. "It's point is to be a small and identifiable penalty. That's what it's doing?" "It definitely is but there's the optics."

Over at 640 there's a discussion at line 11 and following about showing Fonterra shareholders that the shareholders aren't getting a special deal, so it's nothing to do with buying versus building. Confirmation at lines 26 through 30 that it wasn't necessary to make the deal work financially, and then importantly over at 641 I say at 8, "That was the view," that's Mr Campbell's view, "that prevailed and drove the discount?" "Well, yes, and the other aspect around, you know, making sure we talked about the optics. The optics are to the existing supplier base, there's also a message there, isn't there, about, you know, being part of the co-operative and what happens if you leave. So that's part of the whole optics story that we were putting out there." I asked, "So it's a bit like parking fines? You impose them not only to punish the people who've park there too long," "Mhm," "but also to discourage people like you or me from parking too long in the future?" "Yeah, I think that was part of the optics that we were certainly aware of." So again, part of the point of this was to send a deterrent message to other shareholders about exercising rights under subpart 5, the right to leave and the right to come back in.

ELIAS CJ:

Don't you have to read the next answer, though?

MR GODDARD QC:

Yes. "So you want to punish these people and deter others." I was going to do that. "No intention to punish people." And then again at 29, "Never an intention to punish anybody." So I said, "Well, there was intention to impose a penalty, wasn't there?" and he says, "The intention was to make the deal work, not to punish people."

And over at 4, "An important element of the deal for at least some senior executives was that there'd be a visible penalty?" "Yes." "You've explained to His Honour that served two purposes; one was these people pay a penalty for having left and coming back, the other one was to deter other people from doing the same thing in the future?" "I agree with your last point," to deter others in the future. "I don't agree with your second point." I think he must have meant first. "I don't think there was any intention to, as you phrase it, penalise individuals," and then there was a clarification and an exchange with the Judge and we went through the penalty point.

Then over the page, he explains the distinction he was drawing, so page 643 line 19. "So is the distinction you are drawing that having a penalty for circumstances of this kind was seen as desirable but there was no individual vindictiveness involved?" "Yes." So that, I think, picks up Your Honour the Chief Justice's point. Yes, there was a penalty but it wasn't vindictiveness that was driving it. It was about messaging to existing shareholders and deterring some of the behaviour in the future.

The last reference in this cross-examination I want to go to on 674 line 24, "So you were looking to be in a position to say to existing suppliers these people, the NZDL people are missing out on two benefits you've got. They're getting less for their milk and they're going to have to pay more for their shares." "Yep, we definitely wanted to be able to go to our supply base and say, 'We're shelling out a considerable amount of money. We're ensuring the retros are paid, the quid pro quo for you as existing shareholders is those two aspects you mentioned.'" "So when you say the quid pro quo, no financial disadvantage in having them share up with their capital?" Top of the page

675. “No, but there was definitely a message, if you like, out there, you know, the existing shareholders turning around and saying, ‘There’s no sweet deal being done here, is there?’ We’re saying, ‘No, there’s not.’” “So it’s not so much the quid pro quo in the sense that a payment for a right. It’s more the tit-for-the-tat. They’re getting this benefit over here, but look, they’re taking a hit over there?” “Well, that’s certainly part of the – to be able to turn around and say, ‘Hey, look, there’s two parts to this. There’s a part that’s good for the existing shareholders and there’s a part which is good for the NZDL suppliers, being the retros.’”

ELIAS CJ:
Who is Mr Murphy?

MR GODDARD QC:
Mr Murphy was the general manager of milk supply at Fonterra, so he was the person who is responsible for contracting milk supply and he says, “I would have liked to have done whatever I could to get milk. That was my job. But I didn't have many tools because it’s co-operative,” which is a point I explored with Justice France and Justice Glazebrook earlier. “The one tool I had was saying to the receivers, ‘Well, part of the purchase price should be used to pay the retros in full.’”

So as I say at my 2.3 of my roadmap, the terms weren’t imposed to fund payment of the purchase price retros or to reflect any difference in the ongoing economics of supply by those farmers, and there are some more references in that paragraph of my main submissions and I won’t go to them.

Fonterra’s not suggesting – and it couldn't suggest, based on the evidence – that there’s any relationship at all between the quantum of the retros paid via the purchase price or the incremental recovery of retros by the farmers compared with other options and the value to Fonterra or cost to farmers, there was none. The amount of the penalty and the other unfavourable terms were not based on any financial analysis or rationale and

that, I think, is established both by the internal documents and by the cross-examination of Mr Murphy.

I say it is relevant at 2.5 that other bidders also sought to fund payment of retros to secure ongoing milk supply. I won't go to the documents which I refer to there in volume 6, but perhaps if we just look at Mr Grace's evidence in volume 5 of the case on appeal. So Mr Grace, the receiver called by Fonterra to give evidence, the main focus of his evidence was on what happened at the two meetings in relation to the Fair Trading Act. But he was asked some questions by the Judge at the end of his evidence and it's under tab 60 and if we turn over to 920, the Judge was asking about the bids. At line 18, in response to a question about discussions with Fonterra representatives about where their bid had to be he said, "We didn't have any discussions with them. The nature of it was that the first time I had correspondence with Simon O'Connor he rang to register interest and said, 'Our bid limit the last time was 50 mil so that's the level we'd bid again.' I confirmed with Morgan Stanley that was the original bid level, so their bid level didn't change other than 1.5 million discount," went down to 48.5.

Then the Judge said, "At some stage, Fonterra was apprised of the fact that a bid at about that level was going to be sufficient to repay all the suppliers the outstanding amounts to them?" Mr Grace, "Yes, and you know all the bids we received had appreciation of repaying the suppliers including the Synlait and the Westland bid. They were all aware of the outstanding retro payments." "Right." "Sorry, so the Synlait one and the Westland offers were structured in a way that were – tried to give some preferential treatment to the milk suppliers, at the expense of other, unsecured creditors … Well-known figure among all the bidders."

And then he goes on to say at lines 14 to 15, "Actually, the unsecureds, I think, received about 80 cents," and as we know the position was in fact closer to 90, ultimately, and they were comfortable they could do that without a preference issue because of the value of milk supply to the overall sale price and the relative benefits to creditors.

O'REGAN J:

How did they pay the retros in preference to the other unsecureds? It seems just a complete breach of the normal requirements, doesn't it?

MR GODDARD QC:

The sale and purchase agreement – can I give Your Honour two references?

O'REGAN J:

Yes, sure.

MR GODDARD QC:

The two references I'd give Your Honour are first of all the sale and purchase agreement which is in volume 6 at page 1154 and following and that's very carefully structured to try to deal with Your Honour's concern. And then what we see is –

WILLIAM YOUNG J:

They're a sort of a close payment to the –

ELIAS CJ:

The receiver.

WILLIAM YOUNG J:

No, in favour of the suppliers.

MR GODDARD QC:

Sort of, and an emphasis that this was an essential condition of being willing to pay anything at all. There's a Buddle Findlay advice to the receivers about how this and all the other offers stacked up, which was quite interesting to shed some light on the under-bidders and the way in which they were trying to deliver more value to the farmers who weren't offering as much for the plant but they were also trying to structure the deal to pay 100 cents in the dollar of the retros, for example, in a slightly different structure. We see that reviewed

in volume 6, the Buddle Findlay letter, at page 1285 and following. So that's where the answer is, such as it is.

O'REGAN J:
That's fine.

MR GODDARD QC:
I'm not going to go there. But those are the references I think are most helpful.

So now what I want to do is to just spend a little while on how the subpart 5 regulatory regime works. My learned friend has already taken the Court – so that's in my friend's authorities under tab 2 to the purpose statement in section 4 and I agree that the two critical paragraphs which are two sides of the same coin are (a), that the purpose of the Act was to allow the amalgamation but then there's this concern that we saw in the legislative history materials to which my learned friend went that this couldn't be achieved under the Commerce Act because of the dominance that would result from a merger of the two large co-ops, Kiwi and New Zealand Dairy Group, and so there had to be a tailored regulatory regime to promote the efficient operation of dairy markets in New Zealand by regulating the activities in a new co-op to ensure the New Zealand market for dairy goods and services are contestable.

Then when we come to subpart 5 which begins on page 59 of the Act, again, for the purpose of the subpart to promote efficient operation of dairy markets in New Zealand and the 71 principles, "New co-op must accept applications by new entrants and shareholding farmers to supply it with milk as shareholding farmers and new co-op must not discriminate between new entrants and shareholding farmers whose circumstances are the same."

Just pausing there, my learned friend is right to say that open entry and open exit are at the heart of this regulatory regime but of course whether entry and exit are truly open depends on the terms attached to entry and to exit. A

monopsonist has an incentive to pay below the competitive price for milk in this case and the result of paying less than a competitive price is that you purchase less than the efficient quantity of that product. Of course, there are a number of ways in which you can pay less than a competitive price. One is to say, "This is the price and it's less than you would otherwise pay," but also to say, "No, I'll give you the same price but there's a fee to pay to be allowed to supply us," or, "Here are some terms which are less advantageous." There are different ways in which the people with market power can adjust the price they pay or which they're paid for something that's supplied.

This subpart is all about ensuring that open entry and open exit happen at a competitive price and that neither directly nor indirectly is that price reduced below what's being paid to other people, existing suppliers, and we see the provisions dealing with that concern.

So 73, as my learned friend said, a new co-op must accept an application in an application period. It's common ground that the reason to impose that obligation is because Fonterra otherwise is a monopsonist which would have incentives not to accept supply from some people, in particular, people who are not already shareholders but even increased supply from existing shareholders, like a cartel, a very efficient one, among existing owner-suppliers.

Why the restriction to the application period? Well, again, this is common ground. It's not that the monopsony power is only present for two months in the year. It's that it's not reasonable to expect Fonterra to accept supply at very short notice which it may not have the capacity to take. It needs some lead time to manage the peak which, as my learned friend said, comes in October. That's why to have a right to supply you have to get in before the end of February. But – and we'll come to this in a moment – the monopsony power doesn't disappear on 28 February each year.

O'REGAN J:

But that is the mechanism, isn't it? There's that period you're guaranteed you get the same deal as everybody else if you're in that camp.

MR GODDARD QC:

Yes, and we'll look in a moment at all the rules around getting the same deal, including 106, of course, and that's designed to say, you know, not less favourable deals, all those things.

O'REGAN J:

But there isn't any doubt here that you do get the same deal if you come in, in the application period, you get precisely the same deal as everybody else.

MR GODDARD QC:

Including that you can't tweak it in some way that the legislators haven't thought of to make it less favourable. That's what 106 is doing. I'm going to follow through how all these provisions fit together when you come in, in that period, with the right to come in and I think that sheds –

O'REGAN J:

But you don't really need 106 if you apply during the application period, do you?

MR GODDARD QC:

No, you do.

O'REGAN J:

Because you're just saying, "I'll have the same as everybody else."

MR GODDARD QC:

But it's 106 that entitles you to that. I'll come to that in a moment. But 106 is what says you're entitled to the same as everyone else. There's nothing earlier that says everything else must be the same. 106 is what's doing that

and that's why I say it also works that way when you're accepted outside the application period under 74(3).

So this is just about saying you must accept it either from a new entrant or from a shareholding farmer who wants to increase their supply and says so during the application period and how you give those applications is dealt with in three and four.

When do you have to accept the supply from? So this deals with the first thing. Can you say, "Oh, yes, we'll accept your supply but not for a year?" Answer, "No." That's what 74(1) is saying. If the application is made in an application period, a new co-op must accept the milk from the beginning of the season following that application period. So you have to take it in the next season. You can't defer it subject to the capacity constraint issues my learned friend went through, which are not relevant here.

Then subsection (3), a new co-op may in its discretion accept an application made outside an application period from a dairy farmer including a shareholding farmer, including a shareholding farmer, to supply milk as a shareholding farmer. So what's the position where you apply outside the period and you're accepted? My learned friend accepts that if you come in under 74(3) – and I say that's exactly what happened here – that the regulatory regime applies, that you're treated as a new entrant with all the constraints that follow and that makes sense because the only reason not to have the 73(1) obligation year-round is to manage the risk of Fonterra being capacity-constrained. But if Fonterra is not capacity-constrained, if it can take your milk, then all the policy reasons for regulating the terms of entry for a timely application apply equally strongly. The market power doesn't come or go.

75 deals with application periods and they're published, as my learned friend said.

I think if we now look at applications within the application period we see how this risk of misuse of monopsony power is managed.

77 deals with publically setting prices for co-operative shares.

79 deals with publically determining the co-operative share standard. We don't need to worry about peak notes. They were no longer a feature of the environment we were in at the time we are interested in. Those have to be published under 80.

Then 81, so we've said we have to accept the supply but at what price? 81(1) says – regulates the price of a co-operative share issued to a new entrant or shareholding farmer in response to an application that a new co-op is required to accept, and if you apply in the application period you've got a choice of two prices, the June price or the default price, and you make an election. We don't need to enquire about the mechanics of those, just that you've got a choice. And which share standard applies to those people, to people who apply under 73 is dealt with in 81(3).

Then just to save coming back to it on 82 requirements applying to co-operative shares and peak notes for applications outside the application period, so this is if you apply under 74(3). "The price of a co-operative share issued to a new entrant or a shareholding farmer in response to an application to which 74(3) applies is the June price."

So just pausing there, that tells us something very important, which is –

ELIAS CJ:
Sorry, which provision are you referring to on this?

MR GODDARD QC:
82(1), Your Honour. This is very important because it's theoretically possible that Parliament might have decided not to regulate the terms on which Fonterra accepted supply outside an application period. It would be odd from

a policy perspective given that the monopsony power persists, but what 82(1) tells us is that Parliament intended this regulatory regime to apply where you apply late but under 74(3) Fonterra can take the milk and agrees to take the milk.

Subsection (1) regulates the price of the shares issued to that new entrant or shareholding farmer. It also confirms, incidentally, that a new entrant can be someone who applies outside the application period. (2) regulates the share standard to be applied to a new entrant or shareholding farmer who applies outside the application period and deals with the timing issues on that.

Then 83, this deals with one aspect of misuse of monopsony power, so how many shares you can make them buy and what price you can make them pay, but what about requiring people to pay a premium? So 83 goes on and deals with that. A new co-op must not require payment from a new entrant or a shareholding farmer for accepting milk suppliers as a shareholding farmer other than payment to purchase co-operative shares and peak notes. So that's one way in which you might squeeze the balloon and if you can't pay less on the price, effectively reduce the price by charging a premium.

Then we have 84 and 85 dealing with deposit restrictions and the balance of purchase price. Can you make some people effectively accept less for their milk by requiring them to pay a deposit early? No. There's strict rules around that, and when you can require them to pay up.

I don't need to deal with capacity notices but if we then go on there are the exceptions that my learned friend has dealt with in 94 through 96.

Pausing there, we've regulated the price per share, regulated how many shares you can be made to take up, and said no premiums can be required and you can't make people pay early. But there are lots of other ways in which you could misuse monopsony power or even just use monopsony power in a way which effectively reduces the price paid to a purchaser. For

example, they are requiring them to own and maintain their own milk vat which imposes an additional cost of supply on them and not other people.

106 deals with all of that. 106(1) says, "A new co-op must ensure the terms of supply that apply to a new entrant are the same as the terms that apply to a shareholding farmer in the same circumstances or differ only to reflect the difference circumstances." So coming back to Your Honour Justice O'Regan's question, is it needed for someone who applies in the application period, it's 106 that says you can't disadvantage a new entrant by, for example, requiring them to own and maintain their own milk vat. If all your other shareholders are supplied with a milk vat at Fonterra's expense, which is the position, then you can't say to a new entrant, "You have to fund your milk vat."

If all other suppliers are offered particular windows within which their milk will be collected, you can't offer materially less favourable collection regimes, so that they incur extra cost of storage of milk, or so that their milk deteriorates and is less valuable and they then get paid less because of penalties. So it's, 106 is a critical element of the control of monopsony power in relation to applications during the application period, and that's its purpose, and it has to be understood in light of that purpose, that it's addressed to attempts by Fonterra to hinder the effect of supply of milk by a new entrant, or pay less to a new entrant in a way that would not be expected to happen absent Fonterra's monopsony power. That's the essence of it. That's what it's for. And that's why if circumstances are the same you have to offer exactly the same terms on collection, on vats, on everything else. If there's a difference then you are allowed to have different terms of supply but 106(1)(b) the difference must only reflect the different circumstances. That tells us that there has to be an assessment of the difference in circumstances and what difference in terms objectively is justified. It's not left to Fonterra to say, oh there are different circumstances so we can do whatever we want. It's for the Court to ascertain whether the difference only reflects the different circumstances, and the concerns misuse of monopsony power to effectively provide less favourable terms. Again subsection (2) must ensure that terms

and effect of securities offered or issued in new co-op are the same for new entrants as for shareholding farmers, particularly the shares and peak notes and then (4) "New co-op must not treat a shareholding farmer who exercises an entitlement under this subpart any less favourably than a shareholding farmer who does not do so." So if I'm a shareholding farmer and I choose to supply 20% of my milk to someone else, which is my entitlement under 108, fortunately it's on the same page, then Fonterra can't say, "Well, other suppliers are unhappy about that and if we let this go unaddressed other suppliers might also take advantage of that opportunity. We will treat you less favourably in some way." More importantly for our case, one of the rights, as my learned friend said, is to exit under the open exit provisions. Most of these respondents had supplied Fonterra from the relevant farms. Some were new farms but most had supplied Fonterra from these farms before going to NZDL. They exercised their right to exit. What we see explicitly in the email traffic that I've taken the Court to is less favourable treatment of them because they had left and wanted to waltz back in with a view to punishing them and deterring other people from doing it. Now we didn't proceed on the basis of 106(4) because of what was, and I think common ground at least by way of tacit assumption in the Courts below, that these people were not at the time of the NZDL collapse shareholding farmers in respect of these farms because they didn't supply Fonterra from these farms. What you have is Fonterra now saying in this Court for the first time, "Well, yes, they were shareholding farmers because they held shares in respect of other farms." If that had been pleaded, we would have said, "Well, in that case in the alternative we claim under 106(4)," and we would have led additional evidence directly designed to address that comparison. Actually, most of the evidence is in there anyway in the cross-examination, as it happens, that there would be a breach of 106(4). But that's why again I say that can't be raised.

But subsection (4) is helpful because, of course, it might well be in Fonterra's best interests and in the best interests of Fonterra's existing shareholders to treat a shareholding farmer who exercises their rights less favourably. It might well be good optics. "You've decided to sell 20% of your milk elsewhere. We're going to treat you less favourably. That's what the shareholder base

wants to see." But what subsection (4) confirms is that good optics playing to the internal gallery is illegitimate and that's unsurprising because for a monopsonist owned by its existing suppliers that's always going to be an attractive thing to do, and the whole point of 106 is to prohibit certain conduct that would otherwise be in Fonterra's financial interests and its existing shareholders' financial interests and pleasing to its internal audience. Those are not legitimate reasons for discriminating under 106, and just as they're not legitimate under (4), they are not legitimate under (1). So what we're trying to do is control the exercise of monopsony power, not treat its exercise as a good commercial justification for what's being done.

I think I've covered my 3.2. These provisions are a package including 106 to address the risk of exercise of monopsony power, and I've covered my 3.3 that 106 is addressed to the use of monopsony power by prohibiting differences unless and except to the extent that the difference would be expected to result from a difference in circumstances absent monopsony power, ie, in an efficient or workably competitive market. That approach, as I say, gives effect to the purpose of subpart 5, the efficient operation of the markets impaired by supply terms that result from the exercise of monopsony power and also gives effect to the principle in 71(c). The "only" in 106(1)(b) is important. The Courts below were right to find that this requires an objective justification of any difference in terms. Once there's a difference in terms, Fonterra needs to be able to justify objectively the existence of a difference in terms and the extent of that difference. So if it costs 20 cents a kgMS more to pick up the milk, Fonterra can justify that and that's not a breach. If it – and so on. Hence my (a), if the cost to accept supply from a farmer A is greater than the normal range by X cents or if the value of the product is less by X cents, price paid can be reduced by that amount but no more, and (b), the argument that differences can be justified by reference to optics in the sense of pleasing internal stakeholders and/or deterring disloyalty, or by reference to Fonterra's best interests, can't be reconciled with 106(4) or with the purpose and principles underpinning subpart 5. There were points at which my learned friend seemed to be suggesting yesterday that all we were concerned with here was the structural consequences in the long run, facilitating entry by

other processers but, and I think this is obvious from seeing that, subpart 5 is intended to go beyond that, and to protect individual farmers from the consequences of misuse of market power, and we see that –

ELIAS CJ:

So on your argument rational reasons for discrimination don't matter. They are prohibited unless there is a reason for the –

MR GODDARD QC:

Difference, that you would not expect a monopsonist – unless there is a reason for a difference that would also be a good reason for a non-monopsonist to draw that distinction. In other words, someone who did not have monopsony power would also be expected to have that difference. So you're always going –

WILLIAM YOUNG J:

Are there assuming that there are barriers to entry that there's only likely to be one dairy factory in an area –

MR GODDARD QC:

I'm proceeding on the basis that there are significant barriers to entry and that that's the underlying assumption of this whole regulatory regime.

WILLIAM YOUNG J:

Yes, sorry, I mean presumably, I mean it's possible that if Westland had acquired the plant, it would have sought to recoup indirectly it what it paid suppliers, what it had paid on top of the breakup value of the plant.

MR GODDARD QC:

Anything is possible and the question would be could they do the deal.

WILLIAM YOUNG J:

But why, it might have done that, and it's not a monopsonist.

MR GODDARD QC:

But then if they had been competing with Kiwi Dairies to acquire that supply –

WILLIAM YOUNG J:

But that's, but I mean they're still –

MR GODDARD QC:

You wouldn't see that.

WILLIAM YOUNG J:

Well –

GLAZEBROOK J:

You're never going to pay just the breakup value anyway because the whole point about getting it is to use it. So if you had excess capacity already then you might acquire it and just to use that excess capacity but mostly you'd be trying to increase your capacity I would have thought.

MR GODDARD QC:

What you'd expect in the context of a distressed sale, is that, but with a number of significant players with an interest in acquiring the asset, is, as Your Honour said, it would be above the breakup value, but it wouldn't be what you hoped to get in the context of a non-receivership sale. But the presence of multiple players, with an interest in acquiring the asset, would lead to the expectation you'd get a price somewhere between its ordinary market value and its breakup value, and that going forwards to attract supply, you would have to pay the suppliers a competitive price. You couldn't hope to recover what you'd spent in the past from the suppliers if they were free to go elsewhere.

WILLIAM YOUNG J:

But are you assuming that there isn't another dairy factory nearby that they can go to?

MR GODDARD QC:

I'm assuming that there is not a workably competitive market for purchasing raw milk.

WILLIAM YOUNG J:

Yes, I know that, I'm trying to work out what that means.

MR GODDARD QC:

It means that there is not a level of competition in the market which puts farmers in the position they would have been in absent the merger. So you can have –

WILLIAM YOUNG J:

But there wouldn't necessarily be another dairy factory there absent the merger.

MR GODDARD QC:

But there were two very large players in the South Island before the merger, Kiwi Dairies and New Zealand Dairy Group, and if we look at the concerns expressed in the legislative history materials about this merger, it's mostly around the merger of those two companies and the loss of competition to acquire raw milk as a result. Now there were minnows around then, like Westland, and the possibility of Westland joining in fact was provided for though it chose not to. But it's explicitly a foundation of the Act that the competition concerns arise from the merger of the two large players. We see discussion of that in the explanatory note and in the regulatory impact analysis, and that if they are allowed to merge then whether or not Westland comes in there will be competition concerns, the market will not be sufficiently competitive that farmers will be protected from the exercise of monopsony power. My learned friend took the Court to the provisions for the expiry of the subpart, which require that a certain level of supply be received by independent processes, and that hadn't been reached. So I say here, as I did in the High Court, and as the Judge accepted, that the fact that this hasn't been disapplied shows that the premise is still that this is not a workably

competitive market and that a regulatory regime is required to protect farmers from the consequence of that. And the Commerce Commission observed I think in its clearance decision that before this transaction, I think it was before, Fonterra had 82% of the market for raw milk in the South Island.

O'REGAN J:
But is it a national market, though? Aren't there geographic markets depending on the distance from dairy factories?

MR GODDARD QC:
The Commission didn't land on the market. It said we'll assume conservatively that we're talking about Northern Otago/Southern Canterbury and ask what's happening in there, but then the figures they used were island-based figures and the Act works on the basis that you have to get across a certain threshold –

O'REGAN J:
On each island.

MR GODDARD QC:
On each island, it's done on an island basis and then what that triggers is not automatic misapplication of the Act, it's a report by the Commerce Commission which enquires into whether getting across that means that there is workable competition and that hadn't happened.

GLAZEBROOK J:
Actually, it would be difficult to interpret the Act in any event as saying, well, let's have a look, what was around in that area and see whether there was competition because it's a take-all or leave-all. It's not – well, it's not looking at particular markets.

MR GODDARD QC:
That's exactly right.

GLAZEBROOK J:

Except to the extent that it has requirements in terms of 33%. 107 is what I mean.

MR GODDARD QC:

Your Honour is exactly right. This regulatory regime leaves no scope for saying, "Oh, but actually it's competitive here so we don't need to apply the regulatory regime in this little area." The whole premise of this subpart is that there's a significant competition problem which results from the merger authorised by this Act and that it's necessary to impose conditions on what the monopsonist created by this Act can do, and a critical part of that set of conditions is 106(1) which says you can't come up with other creative ways to exercise your monopsony power that we haven't thought of, like charging a different price for the shares or requiring more shares, or charging a premium, or requiring early payment. Try anything else? 106 says you can't do it unless there's an objective justification. In that context, what does "objective justification" mean? It must mean that you'd expect to see the same difference in terms in a market where you didn't have monopsony power and whatever one might speculate about the interplay between pricing, what is quite clear is that the reason that Fonterra had for doing this was not related to the cost to it of the retros. No discussion of that kind in the internal traffic or in the Board papers. It was not related to the financial benefit to the suppliers of the retros other than very indirectly. Some people will see the structure of this deal resulting in the receiver paying the retros and may wonder why we bailed these people out. We better send a message that they've got some disadvantages as well. That's exactly what 106 doesn't allow, playing to your internal shareholder in the monopsony audience.

Then my 3.5, which I was just going to move on to, this is not just about structural issues. It's not just about ensuring that in the long run independent processes can enter. What's very clear from the scheme of the Act is that individual farmers have individual rights under this scheme and they can recover compensation if those rights – including the rights under 106 – are infringed and I list a number of provisions which make that clear. But the

starkest, of course, is 143 under which this claim is brought which I don't think my learned friend went to. That's on page 94, section 143, actions for damages. "Every person is liable for damages for loss or damage caused by that person engaging in conduct that constitutes a contravention of this subpart" or the raw milk regulations, then there are some procedural provisions.

So there's not just a structural goal of facilitating entry by independent processers over time, but also protection of individual farmers from the harm caused by the exercise of monopsony power. What one might think of as addressed to the concern of using market power to obtain a favourable price, the Part 4-type issue in Commerce Act terms, not just the section 36 issue.

I then turn in section 4 of my road map to the point that the respondents were new entrants. I dealt with this in some detail in my written submissions and I didn't, and I have the impression that the Court is, doesn't require me to spend too much time on this, but if I'm wrong please do say so. What is very clear from section 82 is that the term new entrant includes applicants outside the application period, at least if their applications are accepted, because there's no capacity constraint under 74(3). That's also inherent in a number of the definitions in section 5 and the Courts below went through this, in particular the definitions of "shareholding farmer", "co-operative share" and "co-operative share standard".

Co-operative share, if we look at that, because my learned friend didn't spend much time on it, on page 12 of the Act, "Co-operative share means a share in new co-op issued or to be issued," either from the amalgamation, we're no longer talking about that obviously, or "(b) in relation to the supply of milk to new co-op by new entrant or shareholding farmers." This reflects the assumption that pervades subpart 5, which is that there only two types of people to whom shares can be issued: either a new entrant or a shareholding farmer, because once a new entrant has been issued a share, and are no longer a new entrant, they must be a shareholding farmer. On my learned friend's approach he says that the respondents got shares even though they

were neither, those first 1000 shares, they were neither new entrants nor shareholding farmers, and that the subsequent shares that were issued to them in years 4, 5, 6 presumably weren't issued to them as new entrants, because he says they're not new entrants anymore, and weren't issued to them, or were they, as shareholding farmers, did they become shareholding farmers, well he says no. He says that shareholding farmer means something other than a dairy farmer who's registered as the holder of co-operative shares. It must mean that you've got some large number. So there just can't be this mysterious third category issued in the shadows to people who are neither new entrants or shareholding farmers. No third category as the Courts below accepted.

It's quite clear that section 82 applies to new entrants who are accepted outside the application period under 74(3), and I think my learned friend accepts that where someone is accepted under 74(3) or the other protections in subpart 5 apply including section 106. Obviously it would make no sense to regulate the price of the share and the share standard, which is what 82 deal with, but not restrict payment on premiums, otherwise you fail to regulate the monopsony power not to restrict other unfavourable terms like you have to pay for your own milk vat, otherwise, this was described somewhat unattractively, and it's probably my fault, initially in the High Court as the squeezing the jellyfish problem. If you squeeze a jellyfish in one place it pops up somewhere else, a balloon might be a more attractive metaphor. But just as for people who apply during the application period, there's a comprehensive package which says you can't misuse your monopsony power. You can't say well if we can't use it over here we'll just use it over here. So too if you apply outside and you're accepted, the whole of the regime applies, including 106. And I go through that in detail in my main written submissions.

So as I say at 4.5, "The subpart 5 constraints were meant to bite where an application is made and accepted outside the application period," but on Fonterra's approach if Fonterra can say, oh we'll take some of your milk under 74(3) and the rest on contract, and the terms of the contract supply are

completely unregulated, then obviously there's no regulation at all, because you can say yes, we'll take half your milk on a share-backed basis, and we'll pay you the price that we pay everyone else, no premium, but for your contract supply we'll pay you much, much less, or we'll require you to pay a premium for the contract supply, so effectively that eviscerates the entire regularly regime, can't be right, makes a nonsense of the regulatory regime. So if Fonterra accepts milk from a farmer outside the application period, and accepts that at least some of it will be share-backed, and we don't need to go further for the purposes of this case, the regime applies to all the terms of supply, or it wouldn't work.

I've dealt with item 5, the new argument in relation to four of the respondents. As I say, if Fonterra had pleaded they're not new entrants because they're shareholding farmers for the four who had other farms, then we would have responded in two ways. First, we would have said, well, that's inconsistent with the scheme of the Act and with your own Constitution, and it would seriously undermine the regulatory regime in, for example, the 20% rule, if you were bound by the Constitution to supply from your second farm subject only to the 20% rule simply because you've bought another one.

But also we would have responded by pleading that if they were existing shareholders and they were protected by 106(4) and that had been breached, and we would have won that argument probably just with the evidence, actually, the Court has before it but certainly we would have called some other evidence as well, just to lock that in.

Then we come back again to a point I think we've mostly covered, and it's slightly to my own surprise it's possible I'll finish in time for us to finish at one, sufficiently terrified by Justice O'Regan's threat of enduring unpopularity.

ELIAS CJ:

It's not just Justice O'Regan you have to be concerned about.

MR GODDARD QC:
All the more reason to get a move on.

Item 6 of my roadmap, the different terms did not only reflect different circumstances and I say that because it's very clear that there must be an objective justification for the difference in terms, and there wasn't. It was what do we feel like doing to these people? What will the internal audience applaud?

I make the point in 6.2 that in an efficient market, in a workably competitive market, a purchaser can't pay some suppliers less in order to send a message to them or to internal stakeholders. You can't, if you're a New Zealand company, say to a supplier, "Well, you're an Australian company and our shareholders don't like Australians very much so we're going to pay you less."

6.3, Fonterra states – and I should have added and the findings of the Courts below – that this was a take it or leave it offer which incorporated less favourable terms for optics reasons. It actually confirms that this was an exercise of monopsony power of the kind that subpart 5 is intended to prevent. I make the submission that I made before. What is the likely outcome absent the merger? What would happen if you had a couple of very large players bidding for the supply? Well, the price for the assets is likely to be at least as high. The retros would have been paid by the price. Everyone was trying to achieve that to incentivise 100% commitment of supply and there would have been no unfavourable terms.

Then at 6.5, Fonterra sees the different terms as in the commercial interests of Fonterra and its shareholders and says that that is what the Board is supposed to do. But this is the Board of a regulated company that's not entitled to act in its own best interests where that involves the exercise of monopsony power in a way which is inconsistent with subpart 5.

It's the very reason why 106 is needed, that Fonterra's best interests will often be served by misuse of its market power. It's not a reason to refrain from applying that provision.

Unless there's anything I can assist the Court with.

ELIAS CJ:
No, thank you, Mr Goddard.

MR GODDARD QC:
Your Honour.

ELIAS CJ:
Thank you. Yes, Mr Hodder.

MR HODDER QC:
The fact that somebody else now is potentially at the end of the timing issue has not gone unnoticed by counsel for the appellant.

ELIAS CJ:
Don't worry about it. You take as much time as you need, Mr Hodder.

MR HODDER QC:
Thank you, Your Honour.

Clearly there's a fundamental difference about the way we look at the Act in terms of both what section 73 and 74 are related to and clearly also the permissible considerations in relation to section 106.

In part, that goes to the overall function of Part 2(5) of the Act. Is it meant to be a comprehensive kind of quasi-Commerce Act for the industry, excluding as it were the Commerce Act trying to prevent the Commerce Act being relevant or not, and is it meant to provide some kind of rights opportunities for all the dairy farmers in New Zealand. So if I can deal with, perhaps start with

talking about the Commerce Act aspect of it. The Court recalls our submissions, the Commerce Act remains in place and is available where required. So there's a brief comment by my friend where expressing disagreement with the proposition that section 36 would apply in this case and I confess I didn't understand that and the reason I didn't understand that –

MR GODDARD QC:
I accept that 36 applies as well as this regime.

MR HODDER QC:
Sorry, and that reply is to the possibility of not providing supply, refusal to deal was the point that's relevant here. So if there had been refusal to deal because there are a bunch of farmers who have no supplier mid-season and they turn up and what to be supplied, is Fonterra able to say, no, not interested, ignore any issues about plant, it's just the suppliers themselves, then as I understand the Court of Appeal's decision in the data case, the judgment written by Your Honour Justice Glazebrook, the proposition there is that section 36 would apply if there is a, if there would not be a similar refusal to supply by somebody in a competitive market, and that I think would come very close. Now the data tails case, and the reference to that is *Telecom Corporation of New Zealand Limited v Commerce Commission* [2012] NZCA 278, in the discussion I am referring to is within 10 paragraphs or so, paragraph 132, I wasn't going to take the Court due to the timing factor, but the general proposition was about an essential input. The proposition is more broad than that, as I understand it, which is that if there is an exclusion of somebody from the market, which would be effectively what would happen if dairy farmers turned up on the door and said we need to give you our milk. Then if it would not be refused in a competitive market then it's likely a breach of section 36, so section 36 is available on our analysis and provides that kind of coverage, and it is available. It's available when DIRA Part 2(5) is in place, and it will be available when Part 2(5) is abolished, that's assuming the hypothesis under the Act might be realised at some point at which 20% of supply is going to independent processors.

So section 36 in that respect. The other aspect of section 36 which kind of carries in here, and there's a passing reference in our written submissions, it's the other major *Commerce Commission v Telecom Corporation New Zealand Ltd* case of recent times, which is the "0867" case, the essence of which, again as I understand it, and we referred to in the submissions, is that in a competitive market, where you have customers that nobody would take in the circumstances because they would adversely affect the particular players' operations, in the circumstances they're a player, then you're obliged to take them. So if we go back to our scenario, when you have something as fundamental as a capital restructuring involving TAF, you can't ignore that for the purposes of the analysis. That analysis would apply in a scenario under section 36 because you don't expect that kind of self-inflicted wound type activity by any rational player, that's why I have adopted the approach of rational reasons because rational reasons are reflected in the very reasons that this Court gave in the 0867 litigation.

ELIAS CJ:

Why would it lead to a self-inflicted wound?

MR HODDER QC:

Because if you were going to lose TAF, because the price of brining in these farmers and paying their retros, you wouldn't do it.

GLAZEBROOK J:

It's accepted there wasn't any financial effect. In fact is was a positive NPV so what's it got to do with TAF?

MR HODDER QC:

Because TAF was huge as far as Fonterra was concerned. It involved –

GLAZEBROOK J:

But if this was a positive NPV how could it possibly affect TAF?

MR HODDER QC:

Because of the optics point, as it's been described –

GLAZEBROOK J:

So it's just optics. And what was the optics going to affect because people would be sulking?

MR HODDER QC:

Well there's a series of interrelated propositions and the language is possibly taken on a life of its own, but there's a complete inter-relationship in what happened we say between the retros, the TAF relationship, or the TAF proposals and –

GLAZEBROOK J:

But nobody's – I think I asked you before where in the materials there was anything to do with TAF in respect of this.

MR HODDER QC:

Your Honour did and it's probably –

ELIAS CJ:

Mr Hodder, perhaps in answering the question you could also answer – I can accept that commercially it may have been something that dominated the mindset of the company and quite validly, but how does that permit the Act to be disregarded if it applies? I mean, in a way I don't see that the motive really helps here.

MR HODDER QC:

Well, at this stage I think I'm talking in terms of an analogy with section 36, so perhaps if I come to why or one of the pieces of material I should have referred to, Her Honour Justice Glazebrook in response yesterday, I'll just take the Court to volume 6 page 1142. This is the Board paper that is the paper that was before the Board at the critical meeting on 14 June, which I took the Court to yesterday. The meeting minutes on that are page 1190 of

this volume. The Board paper is 13 June. That's at 1142. The relevant issues around that are perhaps usefully summarised on page 1149. At item 12 on page 1149 there's reference to the fact that Fonterra will be announced this transaction at a time when there is heightened scrutiny of Fonterra to be prepared for the final trading among farmers vote.

GLAZEBROOK J:
Sorry – oh, I see, yes.

MR HODDER QC:
That was 12.1 and it talks about various communication issues but C, the transactions occurring up in the lead-up to the final vote on trading among farmers with pockets of dissent in the farming base. Farmer shareholders may perceive Fonterra is bailing out disloyal farmers.

I just pause there. Bailing out is not the same as disloyalty. Bailing out means paying them money. It's a retro and those who are coming back without retros, there's no issue. It's not disloyalty in the sense that they left and they're coming back. It's their coming back and then being paid retros that's the issue, as Mr Monaghan's proposition that I referred to yesterday says. There are other issues and other communications.

GLAZEBROOK J:
Were they worried that people would be so annoyed that they wouldn't vote for TAF?

MR HODDER QC:
Yes.

GLAZEBROOK J:
So they cut of their noses to spite their faces because there was going to be – I mean, it can't have it both ways. Either there was going to be an increase in price and you were trying to keep these people out or there wasn't going to be

an increase in price and virtually all of the other stuff we were dealing with was just disloyalty.

MR HODDER QC:

Well, in fact, no, I don't have the time to do it now, Your Honour, but if you go through the materials that my learned friend took you through, particularly the later part of Mr Murphy's cross-examination, Mr Murphy kept coming back to the fact that TAF was a factor. Retros were a factor. It wasn't about just the fact they left and came back because that actually had no relevance. The relevance was about retros, TAF and rescue, was the word I think was used. They weren't rescued by taking their supply. They were being rescued by being paid the retros. So what the second paragraph 12.4 in the first sentence is a perfectly valid description of what Fonterra was trying to do and what it did do. And as my learned friend has said, and it's fair to say, among other things Fonterra wanted that to be one that actually happened rather than was bypassed by virtue of sharing up in the first year. So that was a ban on the share in the first year. With the benefit of hindsight we now know that the price did go up. Certainly there were expectations it would go up but like everything else it was an expectation not a given. So we don't accept the proposition that this was about simple disloyalty and the fact that people might have left the co-operative some years earlier to go to NZDL was the reason for this exercise. It was all about the retros, that's what the problem was, and so you can't, in our submission, say you just ignore the retros and ignore the rescue when you're looking at what happens in terms of section 106, if we get that far.

ELIAS CJ:

Well, yes, but it might be entirely, as I said before, understandable that the company would be focused on how it would appear, the optics, it's a rather unfortunately –

MR HODDER QC:

Yes.

ELIAS CJ:

And that's fine, but the only point is whether objectively the statute has been complied with, isn't it?

MR HODDER QC:

Indeed, and what we're talking about is what are the circumstances, and our submission for the Court is that the circumstances cannot disregard what has been unfortunately compressed into the word "optics' but if you pass out optics into the proposition that farmers who were not part of the co-operative were coming back into the co-operative in some form or other, and being paid $600,000 each for money owed by somebody else, that was part of the circumstances.

ELIAS CJ:

Yes, but is that relevant under the statutory scheme which requires you to treat the – to treat suppliers on the same basis.

MR HODDER QC:

What the statute requires in section 106(1)(b0) is to treat them differently if they're in different circumstances. We say these were the different circumstances. They were unique circumstances.

ELLEN FRANCE J:

So are you saying it's sufficient that although the statute talks about "only reflect" sufficient if one of the reasons was rational et cetera?

MR HODDER QC:

Yes. The reason, there is one reason, the one reason is that there was a problem with the shareholder base. That's the principle that we've got here. That is the reason and we say that is a legitimate circumstance and the reason that the shareholder base is unhappy is because of the retros.

ELLEN FRANCE J:

How does that fit in with the use of the word "only"?

MR HODDER QC:

"Only" means nothing more than.

WILLIAM YOUNG J:

If it wasn't for the retros they wouldn't be worried.

MR HODDER QC:

No.

WILLIAM YOUNG J:

So it's only to do with the retros –

GLAZEBROOK J:

Well they might be, we don't know.

ELLEN FRANCE J:

But they can't be right if you're accepting there were other reasons.

GLAZEBROOK J:

We don't want these disloyal people to come in and get a chance at TAF.

MR HODDER QC:

All the reasons are related to the retros, we say.

GLAZEBROOK J:

They might, how do we know?

MR HODDER QC:

Well the very topic we're talking about, I don't think there's any – the only difference between what my learned friend says and I say about this is that he says it's about disloyalty, and I say it's about disloyalty, and his concept of disloyalty misunderstands or misinterprets what is going on in relation to the concerns, and the concerns are clearly about retros. If you take retros out of the –

GLAZEBROOK J:

Well, you say that, but that's not what most of the stuff that's been shown to us by Mr Goddard actually says.

MR HODDER QC:

And I can only repeat, Your Honour, that if one goes back –

GLAZEBROOK J:

So you have to read in that it comes back to this.

MR HODDER QC:

No, you have to read – if one goes back and reads what Mr Murphy says, and perhaps I should go back to Mr Murphy in volume 4 for a moment. Now Mr Murphy was asked a lot of questions, many of them with remarkable similarity during this period, but they –

ELIAS CJ:

They were quite precise propositions that were put to him too with words that he simply answered yes or no to for a lot of it.

MR HODDER QC:

Yes, over a long period.

ELIAS CJ:

I know that it's thought that that's unexceptional but I do remember old-fashioned Judges saying that it doesn't assist in the value of the evidence.

GLAZEBROOK J:

Well, that might be right but he is an intelligent man who had plenty of opportunity to say, "No, that's not quite right."

MR HODDER QC:

That's precisely what he did. If we turn to 602 for an example, the top of 602, this is where my learned friend has been asking questions about locking in

penalty at the bottom of 601. Over the page, “That was the motivation, wasn’t it?” and he says “Rephrase it”, “Mr Wickham’s desire to ensure the penalty wouldn't bite for one year, that’s the original motivation.” “Don’t agree that was the only aspect. We were considering this in terms of how we managed this and the key consideration was how do we make sure that the largest supply base is actually accepting these new suppliers?” “Why was that an issue?” “Because they were being paid the retros.”

GLAZEBROOK J:
Where does he make that link?

MR HODDER QC:
Well, I’m coming to that, Your Honour.

GLAZEBROOK J:
Okay, thank you.

MR HODDER QC:
The deterrent proposition comes up if we go to 674 line 13. My learned friend took you to about line 24. Clearly the most accurate explanation was the question at line 10. His understanding was that there was one particular reason. “There were lots of reasons and one of them was we decided the best way to get this deal through both internal and external stakeholders was to put that moratorium in the first year, one because it would ensure the discount but also because of the situation with regards to TAF.” Over the page on 675 it was again the same.

GLAZEBROOK J:
What do you think he was – does he explain what he meant with the situation in regard to TAF? He was asked whether because they wouldn't be able to get the benefit of a share price, so there wasn’t anything there about being worried about the vote?

MR HODDER QC:

Both here and on the next page, page 675 around line 7 where he's talking about there's two parts to this, there's a part which is good for the existing shareholders and there's a part which is good for the NZDL suppliers, being the retros. Everybody knew the retros were part of this deal. The receivers had told Fonterra at the outset that they wanted to recover the retros. Every discussion about this whole detail had retros at the heart of it, so you can't in our submission come to this point in the hindsight analysis and say retros had nothing to do with it.

GLAZEBROOK J:

Actually, I wasn't suggesting retros had nothing to do with it. I was suggesting that in the material we've been taken to, they don't specifically mention retros in respect of the penalty.

MR HODDER QC:

And in my submission, when one reads the whole thing – and I'm sorry to raise that prospect – the theme that emerges from it is that all those things are related to the concept of a penalty, the concept of disloyalty as it's, I think, misleading when it's used in this way all ties back to the concept of TAF and retros. Retros were against corporate ethos, therefore there was a problem for TAF. TAF was far more important than this deal. If there was to be an NPV gain of $20 million, it was insignificant in a company of the size of Fonterra which has got its capital base measured in terms of billions of dollars and which had been struggling for years to get a new capital structure in place. It simply was a relevant circumstance and would be for any player in similar circumstances. But I'm sorry Your Honour, I was referring to my learned friend's submission about Your Honour's question in my responses.

ELLEN FRANCE J:

I didn't understand from Mr Murphy's evidence that he was concerned about the existing shareholders walking away from the TAF arrangements, that was he was concerned about was that they wouldn't like it. In other words, they

wouldn't be particularly happy about it as opposed to going to that further step of saying, “And we’d walk away.” Am I right or am I misreading that?

MR HODDER QC:

I think that omits the proposition that TAF was being promoted by the Board. It was not their first attempt to try and get a capital restructure in place. So the Board was trying to win converts among what is now famously known in this case as The Base. If the Board are associated with something as unattractive as paying $600,000 each in retros to these people, then the Board would lose support and its proposal for TAF would lose support. That was the logic of it.

GLAZEBROOK J:

I’m just not convinced that that is something that you would be allowed to take into account, is it, in terms of discriminating between shareholders to try and get votes for something being promoted by the Board? I mean, obviously they were thinking that that was in the best interests of the company but they still have to get the support of the shareholders.

MR HODDER QC:

Well, all I can do is repeat that we say that for any party that was a clear circumstance if you hypothesise or abstract it. In this case it was the dominant circumstance and it was the foundation for what happened.

GLAZEBROOK J:

Well, you could say, well, the shareholders aren’t going to like us bringing in new people at any stage. I’m just not sure you can take that. I can understand the retro question. I just can’t understand this particular one because that would then provide a justification for paying and requiring people to pay premiums or whatever outside of the application period and it just doesn’t seem to me to be in accordance with the Act. I can understand the retro question subject, obviously, to the NPV and matters of that kind.

MR HODDER QC:

Well, the comparison is with shareholding farmers who were already in the co-operative, people who were going to become shareholders and therefore shareholding farmers in the status sense coming in under this transaction. They were in different circumstances. They were entitled to be taken into account.

GLAZEBROOK J:

Well, as I say, I can understand that in terms of the retros. I just can't understand that in terms of we have to garner votes for something.

WILLIAM YOUNG J:

What you're saying is that the concern about the votes is connected to the retros issue and it amplifies it.

GLAZEBROOK J:

Well, if that's the argument than I can understand that.

MR HODDER QC:

Yes, and I make an objection to the arguments advanced, again, by my learned friend. If I'm trying to disaggregate the circumstances and put to one side the core drivers, then you'd finish up with a completely unhelpful view of what was going on and no sensible way to approach section 106.

ELIAS CJ:

Well, I still struggle to see that the motive matters at all. It's the effect as to whether there is discrimination and you say there isn't discrimination because of the retro payment.

MR HODDER QC:

No, I say there is discrimination and there are terms – we get to this point under section 106, this question. There is different treatment. It's just because there were different circumstances.

ELIAS CJ:

But – sorry, the different circumstances you point to –

MR HODDER QC:

And I say there's a causal connection between the different circumstances and different treatment. Now, I'm not sure whether motive or causation is the right way to describe that but there's a linkage. That's all I'm contending for.

ELIAS CJ:

Yes. Well, I would have thought the background of concern as to how the shareholding base is going to treat knowledge of the retros and the impact that might have had on TAF is not something that is relevant under the legislation. It's simply what was the effect. It may be entirely understandable but it's not the source of the relevant discrimination.

MR HODDER QC:

Well, that brings us back to how does one make that judgement? What criteria does one apply? That's a point at which my learned friend and I coincide briefly, as it were, but not completely in the sense that one takes an objective view, one looks to see what might happen in a workably competitive market. We say in a competitive market you would take into account the fact that this is damaging and therefore you wouldn't do it unless you had some arrangements in place. So in effect these suppliers were sort of onerous to take on. You would do it only if you had protection against the damage they could inflict, and that's what this is about.

ELIAS CJ:

All right. We'll take the adjournment now.

MR HODDER QC:

As Your Honour pleases, but I'm happy to box on.

ELIAS CJ:

I think it would be better to take the break, myself, but I don't really mind.

O'REGAN J:

Your decision, that's fine.

ELIAS CJ:

What would suit you, Mr Hodder?

MR HODDER QC:

I get a vibe that it may be best if I carry on, but I may be mistaken.

GLAZEBROOK J:

There's only one, I think, who would like you to carry on.

MR HODDER QC:

I'm in the Court's hands. If one can have longer to think about it, one can be shorter in delivery.

ELIAS CJ:

All right, 2 o'clock.

COURT ADJOURNS **1.01 PM**

COURT RESUMES: **2.01 PM**

ELIAS CJ:

Thank you.

MR HODDER QC:

Briefly Your Honours. There are a handful of points I'll address quickly and give references rather than taking the Court to various points if I may, but just following up a couple of points that we discussed before the lunch adjournment, I want to sort of complete my answer to Justice France's question about the linkage between shareholders and TAF and retros. I don't think I can do better than refer back to the passage that Your Honour

identified yesterday, volume 5, pages 777–778 where Mr Monaghan the director addresses it directly.

The other thing I should have said in relation to more general proposition about circumstances and why we say that the retros were relevant circumstances was actually quite nicely captured by my learned friend where he said that the retros were a tool used to secure supply, and he's absolutely right. That having got the tool you can't really ignore them, we say, for the purposes of section 106.

Shortly after my learned friend commenced yesterday I thought I heard him say that the majority of sharing up took place outside the application period and therefore it was a very small window. We don't have a lot of evidence on that but Ms Burr, who was a sort of Fonterra guru on these matters, said that the majority of the shares were applied for during the application period issued, I think, in June. Her evidence at paragraph 27 of her evidence-in-chief touches on that.

The right to share up, my learned friend took the Court to a form which is found in volume 7 at page 1872, and he's right to say that the way that the Growth Contracts work is you reduce the contract supply which requires you then to increase your share-backed supply. That form is actually headed application to increase share-backed supply. It is a form or application for share-backed supply at that point. And at that point the applicant is a shareholding farmer because they already have their nominal number of shares, so the concern that Justice Young I think may have been expressing, that said well how come you can bypass being a new entrant, because once you get into the Growth Contract you are a shareholding farmer relevantly enough to have the status, and if the activity you're working is to move into share-backed supply, then you're covered covered, we say, for those sufficient purposes.

There was a reference briefly to what the alternative bids were and what they might mean for the retros, and I'm not sure I understood how far my friend

wanted to take this but we say the evidence is consistent with what the High Court found in paragraph 32, which is that the best alternative would give 45 cents in the dollar, and there's discussion of that in various parts of the discussions between the receivers and the suppliers at the time, and also, although there's quite a lot of redaction in the wrong place in the Buddle Findlay and BDO documents found in volume 6 at pages 1283 and 1290, the second of which I think my learned friend took the Court to.

On the question of the four suppliers, we raised that question, as I said yesterday, because as we read the Court of Appeal and the High Court decision it says if a farmer has one share they're a shareholding farmer for all relevant purposes, and we said that doesn't seem right to us, and for example if you look at these four farmers who had ongoing farms supplying Fonterra, they were holders of Fonterra shareholdings throughout the period so how does that work. And the reason that's important is because section 106 doesn't apply to shareholding farmers, it applies to new entrants, and what my friend now says is that, well you have to read that by reference to a farm which, as I understand it, is agreement that you cannot accept the Court of Appeal and High Court reasoning on that proposition as any share will do, and if that's the case then we probably can't take that point much further.

Thirdly, of course we say what you do have to do is when you're – having then not taking a literal approach because a literal approach doesn't work, then you have to actually read it in the context and by reference to the purpose, and that's where share-backed supply comes in.

GLAZEBROOK J:

I had a bit of trouble understanding your point made before about they are shareholders because I thought your point was they never were shareholders, even if they became share-backed because they were on a contract and that was outside of the provisions, that's what you said before.

MR HODDER QC:

Yes, they have shares, I'm not denying they have shares and have the status of being shareholders –

GLAZEBROOK J:

I think you said they became share-backed shareholders, well that was contrary to what you told us before, that they never became that.

MR HODDER QC:

If they were applying for, if you had a Growth Contract and you were issued with your 1000 shares you became a shareholder and a shareholding farmer in the literal definition of that point. We say that when you apply, or when you go through the process under the contract, then what you are doing is giving effect to the contract, not giving effect to DIRA.

GLAZEBROOK J:

Well that's what I understood so I don't think, on that argument they never come under the Act because the Act doesn't apply to contract shareholders you say?

MR HODDER QC:

Yes.

GLAZEBROOK J:

It's just you said something different in terms of meeting Justice Young's point.

MR HODDER QC:

It's probably better described as a fallback position. If it's necessary to go there –

GLAZEBROOK J:

So on your fallback position, all right, it's a fallback position, I understand.

MR HODDER QC:

Then, then the new entrant issue isn't, I think, an issue in the analysis that I understood Justice Young was putting forward.

GLAZEBROOK J:

All right, I understand that.

MR HODDER QC:

The next point is touched on briefly but the suggestion is that when the Board resolved in September 2012 to issue shares and some million, it was maybe a couple million shares, and included the 30,000-odd shares that involved these suppliers, the resolution refers to it being under, I think it's clause 5.1 of the Constitution and sections 73 and 74. What the resolution makes clear, and this is at page 1313 of volume 6, is it's covering a wide range of share issues, including for complete new conversions that will be fully share-backed, which of course would come under section 74. So we say there's nothing in that to read other than and/or as we suggested, and that actually is a constitutional rather than a statutory resolution, and as I said yesterday, the real decision comes back in June.

My learned friend submissions on section 106 said it has a pivotal part to play in protection dairy farmers who are seeking to provide further supply to Fonterra, and we say that is somewhat undermined, in fact more than somewhat undermined, by the fact that section 106 doesn't apply to section 73(2) applications. So the Court will recall that a section 73(2) application is an application by a shareholding farmer to increase the amount of milk supplied as a shareholding farmer, but where that happens, we look to section 106, we discover there's nothing that applies to whatever happens to that shareholding famer's new supplier, it's only about new entrants, and we say that, among other things, says that section 106 has a different rule, and in fact my learned friend didn't respond to this but I maintain the proposition that actually section 106 goes the other way. It's not about penalties, it's about trying to avoid premiums because the real concern is that Fonterra, or new co-op in this position, does want supply because of the nature of economies

of scale in this industry, and what section 106(1) does, among other things, is to prevent it from buying off the opposition, so they can't get supply. That is consistently with the idea of contestability which you heard me at length on yesterday.

GLAZEBROOK J:
What about subsection (4) of 106?

MR HODDER QC:
I touched on that yesterday. I agree it applies to people who try and use, or who do use section 108. It avoids some sort of retaliation.

GLAZEBROOK J:
Well isn't entitlement under the subpart included in that, under 73(2), to increase the volume.

MR HODDER QC:
I'll just do that. It probably does. My point was really directed to the commentary on section 106(1), which I thought was being described by my learned friend in his discussion.

GLAZEBROOK J:
Well, no, I think he was referring to (4), as well.

MR HODDER QC:
I don't think – well, obviously I misheard the reference.

GLAZEBROOK J:
I mean, obviously one doesn't apply but I would have thought (4) does. Slightly awkwardly, it has to be said, but that is an entitlement under the subpart, is to ask for more shares for more supply.

MR HODDER QC:

Well, I don't want to misrepresent what he may have said but I'd certainly understood the section to be one that section 106(1) in particular provides the general charter.

GLAZEBROOK J:

No, I think it's 106 generally was the submission.

MR HODDER QC:

Well, I accept that section 106(4) would apply in those circumstances although it's odd that it's more narrow proposition than section 106(1) or, perhaps, it doesn't have the same formula to it. It's not clear to me why you wouldn't – if you're doing the same and looking for the same result in relation to applications under section 73 and 74, simply refer to shareholding farmer on 106(1) but I don't have a particularly persuasive answer myself as to why that might be.

My learned friend has suggested to you that what section 106 is about is the fact that there is were two large players premerger that were competing and what section 106 was designed to do was to put things back as if that hadn't happened. Well, that's probably a slightly clouded view of what happened. Prior to the merger, there were two large co-operatives but they were geographically based. They weren't competing directly in all places. There was competition at the margins but there weren't tankers from each company operating on every farm road in New Zealand. As we submit it, what was really in the minds of the legislature – or should be attributed to them – was that those two players could evolve into competitive players because they already had some infrastructure and that evolving evolution would be prevented by the fact they were going to merge rather than compete and therefore what was required was to find a substitute for the development of competition, not to provide an immediate assumption of competition and that development is the contestability, the fact of 2(5) being in place until 20% of supply was going to independent processers et cetera, but that's the role of it as opposed to saying there was perfect competition or there was competition

between two major players all over the place before the merger and this was meant to be maintained by the effect of section 2(5).

My learned friend again in his oral presentation as well as his oral submissions makes a great play of section 82 which is the provision that talks about shared prices for applications made outside the application period. Now, we are in agreement that if an application is made to supply as a shareholding farmer outside the application period and is accepted under section 74(3), then the protections of the Part 2(5) will apply to it. So the question when we get to section 82, which is the price of a co-operative share issued to a new entrant or a shareholding farmer in response to an application to which section 74(3) applies is the June price, the question is what is the application, to which we say the application is one to supply as a shareholding farmer, i.e. share-backed supply. So we don't disagree that 82 has a role in relation to those. What we do say is that it doesn't apply to every application to supply any kind of milk to Fonterra outside the application period. It must be one to supply as a shareholding farmer.

I'm sure the Court has sort of heard my repetition of the phrase "as a shareholding farmer" more than enough, but what is conspicuous for us and one of the reasons why we are here is we don't find that phrase analysed and given a meaning in the High Court judgment or in the Court of Appeal judgment or in my learned friend's submissions. We say it has a role in Part 2(5) and that role is to identify the core role of share-backed supply in the dairy industry, and that is what the regulatory regime is directed to, and not to other matters.

It was getting the share-backed supply access up to the point where 20% of supply was going to independent processers, which was a trigger for taking Part 2(5) away and letting the ordinary law, including the Commerce Act, apply thereafter.

Now Your Honours that has taken me, according to this clock, 15 minutes and 16 seconds, which is probably better than I thought I was going to do, but I'm happy to try and answer any questions if there are any left.

WILLIAM YOUNG J:

Can you deal with this for me please? One of the points Mr Goddard made is that the prohibition on sharing up in the first year was of no benefit to Fonterra, and could therefore be taken to be simply a penalty, not commensurate to the costs of meeting the retros. Do you have a response to that?

MR HODDER QC:

They were both factors in the process. I think Mr Monaghan refers about that as well. So Mr Monaghan at page 778 is asked about the waltz back in proposition, and the question that's put to him is, is the question, how is it that these people have just waltzed back in and picked up their large farms and very large shareholding entitlements, you know, to pick up x million dollars, uplifted their share value, which is the expectation about what TAF would bring, and Mr Monaghan said, "Yes, that would have been the conversation." So the conversation is about why are you actually having these shareholders coming back in. So it's part of the same deal.

WILLIAM YOUNG J:

Well I suppose I'm reasonably sympathetic to the view, despite what Mr Goddard said, that the cost of ensuring that the retros were paid was part of the deal by which the milk was acquired, and that to the extent to which the milk was acquired on terms that roughly, though plainly there wasn't a calculation to compensate or allow for the other side of the bargain, that doesn't trouble me much, but what was in it? The refusal to permit them to share up didn't have any particular economic benefit to Fonterra. It did have a political benefit in terms of ensuring that the base remained on site, but it didn't compensate Fonterra for money it had to outlay.

MR HODDER QC:

Well the primary reason I think it's referred to in the email trail that we were taken through, and the other emails that we weren't, is the idea that emerges is well if we come to the view that there should be something visible, and if that's legitimate then we don't want to bypass an end run being done on it by sharing up immediately that the contract is signed, and that's the –

WILLIAM YOUNG J:

Okay, I understand what the point is.

MR HODDER QC:

So it's a reinforcing of that as opposed to the, and by the way they're not going to get any benefit of the possible or probable uplift.

WILLIAM YOUNG J:

I understand.

ELIAS CJ:

Any other questions?

MR HODDER QC:

May it please Your Honours.

ELIAS CJ:

Thank you Mr Hodder. Thank you Mr Goddard, counsel, for your submissions. We will reserve our decision in this matter. Thank you.

COURT ADJOURNS: 2.18 PM