

IN THE SUPREME COURT OF NEW ZEALAND

SC 38/2011
[2012] NZSC 15

BETWEEN	FONTERRA CO-OPERATIVE GROUP LIMITED Appellant
AND	THE GRATE KIWI CHEESE COMPANY LIMITED First Respondent
AND	KAIMAI CHEESE COMPANY LIMITED Second Respondent

Hearing: 14 February 2012

Court: Elias CJ, Blanchard, Tipping, McGrath and William Young JJ

Counsel: A R Galbraith QC, J D Every-Palmer and T C E Miller for Appellant
J A MacGillivray for First and Second Respondents
S J Mills QC and B Hamlin for Commerce Commission as Intervener

Judgment: 15 March 2012

JUDGMENT OF THE COURT

- A The appeal is dismissed.**
- B The appellant is to pay the respondents costs in the sum of \$15,000 plus disbursements to be fixed, if necessary, by the Registrar.**
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REASONS

(Given by Tipping J)

Introduction

[1] On this appeal Fonterra Co-operative Group Ltd, as appellant, contends that it was not obliged to supply raw milk to the respondents, The Grate Kiwi Cheese

Company Ltd and Kaimai Cheese Company Ltd, under reg 4 of the Dairy Industry Restructuring (Raw Milk) Regulations 2001. Fonterra's obligation to supply raw milk under that regulation arises only if those seeking such supply are "independent processors", as defined. The Commerce Commission,¹ the High Court² and the Court of Appeal³ have each ruled against Fonterra on the basis that Grate and Kaimai were independent processors. Fonterra challenges that conclusion. Its essential proposition is that the meaning which has so far been given to the expression independent processor does not properly reflect the context and purpose of the relevant Regulations. For the reasons which follow, we consider that the meaning given to the expression by the Commission and the Courts below represents a natural meaning of its definition. The context and purpose of the Regulations support that meaning. Fonterra's appeal must therefore be dismissed.

Background

[2] The legislative and factual background can be stated quite briefly. When Fonterra was established following the merger of New Zealand's two largest dairy producers and the New Zealand Dairy Board, it was necessary to enact legislation authorising the merger for the purposes of the Commerce Act 1986.⁴ The legislation included provisions designed to guard against the risks to competition posed by the merger of the previously autonomous producers into one entity which then occupied a dominant position in the market. Section 4 of the Dairy Industry Restructuring Act 2001 sets out its purpose. The crucial provision, for present purposes, is s 4(f) which says that a purpose of the Act is to "promote the efficient operation of dairy markets in New Zealand by regulating the activities of new co-op [Fonterra] to ensure New Zealand markets for dairy goods and services are contestable".

[3] Section 115(1)(a)(i) empowered the Governor-General, by Order in Council made on the recommendation of the Minister, to require Fonterra to supply raw milk

¹ *Kaimai Cheese Company Ltd*; and (separately) *The Grate Kiwi Cheese Company Ltd v Fonterra Co-operative Group Ltd* New Zealand Commerce Commission, 5 June 2009.

² *Fonterra Co-operative Group Ltd v The Grate Kiwi Cheese Company Ltd* HC Wellington CIV-2009-485-1223, 3 March 2010.

³ *Fonterra Co-operative Group Ltd v The Grate Kiwi Cheese Company Ltd* [2011] NZCA 67.

⁴ That legislation was the Dairy Industry Restructuring Act 2001.

in New Zealand.⁵ Pursuant to that power, reg 4(1) of the Regulations mentioned above required Fonterra to supply raw milk to independent processors. Regulation 3(2)(c) expressly incorporated into the Regulations the definition of independent processor contained in the Act.

[4] It is the terms of that definition which are at the heart of the case. Independent processor is defined as meaning “a processor of milk or milksolids or dairy products who is not an associated person of new co-op [Fonterra]”.⁶ The definition also includes New Zealand Dairy Foods Ltd (now Goodman Fielder Ltd) and any associated person of that company other than Fonterra.⁷ The issue is whether in order to qualify as an independent processor the party concerned must physically process the raw milk it obtains from Fonterra “in its own facility”, as the Commerce Commission put it in its determination;⁸ or whether it is sufficient for the party concerned to do the processing by what has been called “toll processing”.

[5] The expression toll processing describes a situation where the processor does not use its own facilities to process raw milk but makes use of spare capacity within the facilities of another party, pursuant to contractual arrangements entered into for that purpose. This latter and wider meaning of the definition was adopted by the Commission in its determination. The key difference between the rival contentions is that, in Fonterra’s submission, an independent processor must personally process the raw milk it acquires from Fonterra. The argument favoured by the Commission and in the Courts below allows a person to be an independent processor when that person does not do the processing of the raw milk personally but arranges for the processing to be done by someone else, pursuant to contractual arrangements made for the purpose.

[6] Both Grate and Kaimai personally processed certain dairy products including cheese but when they sought raw milk from Fonterra they were not proposing to process that milk personally, having arranged to have that processing done, on their behalf, by a company called Open Country. The raw milk thus processed was to be

⁵ Later amended with no material effect for present purposes.

⁶ Dairy Industry Restructuring Act, s 5, definition of “independent processor”, para (a).

⁷ Dairy Industry Restructuring Act, s 5, definition of “independent processor”, para (b).

⁸ At [56].

used by Grate and Kaimai in their downstream production. Being of the view that in this situation Grate and Kaimai were not independent processors, Fonterra declined to supply the raw milk they had each sought.

[7] Regulation 8 provides that Fonterra and an independent processor may agree a price for the supply of raw milk. If agreement is not reached the regulation provides a formula whereby a default price is established. Regulation 11(2) sets a limit on the volume of raw milk Fonterra is obliged to supply to independent processors under reg 4. That limit, or cap as it was called, was initially set at 400 million litres per season. This was subsequently raised to 600 million litres. It is the existence of the cap that is relevant, not its precise amount. Fonterra argued that if toll processing was permitted there would be inappropriate upwards pressure on the 600 million litre cap. This argument seemed to be based in part on the premise that the default price under reg 8 was unfavourable to Fonterra. But, for interpretation purposes, the Court must proceed on the basis that the reg 8 default formula is designed to produce a price that is fair to both parties.

[8] Regulation 11(4) provides that the total amount Fonterra is required to supply under reg 4 to Goodman Fielder is 250 million litres per season. Regulation 11(3) provides that any other single independent processor cannot obtain more than 50 million litres per season from Fonterra under reg 4.⁹ That then is the background against which the point in issue is to be determined.

Submissions

[9] The parties differed as to the purpose of the Regulations. Fonterra contended that they were narrowly focused. They were targeted, as it was put, at raw milk supply, particularly so as to encourage competition at the farm gate. Grate and Kaimai, supported by the Commission, submitted that the Regulations had a distinctly wider purpose and were focused on competition and efficiency within dairy markets generally, that being an essential purpose of the Act.

⁹ Regulation 5C (introduced by the Dairy Industry Restructuring (Raw Milk) Amendment Regulations 2008) provides for pro rata abatement if the total milk supply required by independent processors exceeds the cap specified in reg 11(2).

[10] Fonterra submitted that its interpretation would more effectively provide for access to raw milk and would increase farm gate competition for raw milk in the long run. On its behalf Mr Galbraith QC contended that the Regulations had this targeted purpose and the wider aspects of competition in dairy markets generally were of lesser importance. He contended that to allow toll processing would be inconsistent with the purpose of the Regulations. More specifically, counsel submitted that several consequences inconsistent with the purpose of the Regulations would follow from the interpretation which has so far prevailed. First, that interpretation would tend to neutralise the 50 million litre cap; second, it would decrease the amount of raw milk available to “actual” processors under the 600 million litre cap; third, it would or might perpetuate undesirable reliance on the pool of milk regulated under reg 4; and fourth, it would permit Fonterra to be a toll processor itself, which would be inimical to the purpose of the Regulations.

[11] In response Mr MacGillivray argued for Grate and Kaimai that an interpretation which permitted toll processing enhanced the purposes of efficiency and competition in dairy markets generally, as specified in s 4(f) of the Act. It was important in his submission that the Regulations had expressly adopted the definition of independent processor in the Act. It could not therefore have been the purpose of the Regulations that the definition should be read down to the extent of applying only to one subset (raw milk) of the three categories contained in the definition of independent processor (milk, milksolids and dairy products). Grate and Kaimai were independent processors because they undoubtedly processed dairy products.

[12] Mr MacGillivray submitted that, contrary to Fonterra’s argument, a party became an independent processor if the party either actually, or through toll processing, processed any of the three categories of product mentioned in the definition. Counsel also contended that the interpretation adopted below was apt to increase farm gate competition by lowering barriers to entry. Furthermore, there was nothing in the Regulations to suggest that their purpose was to benefit only raw milk processors and not downstream processors who were also reliant on a supply of raw milk, whether already processed or not.

Discussion

[13] Having considered the competing submissions we can state our conclusion quite briefly. The meaning of the definition of independent processor must be derived from the statute's text and in the light of its purpose.¹⁰ The key words of the text define an independent processor as "a processor of milk or milksolids or dairy products". As there is no suggestion of any association between Grate and Kaimai on the one hand and Fonterra on the other no further reference need be made to the independence aspect of the definition. Any person who processes either milk, milksolids or dairy products satisfies the processor part of the definition.

[14] Although the meaning advanced by Fonterra is a possible one, there is nothing in the text of the definition or in the Act or Regulations to suggest that a processor must make use of its own facilities when undertaking the processing. If that had been intended, express words to that effect could have been expected in view of the frequency with which commercial parties contract out aspects of their operations. Similarly, if this sort of restriction had been intended, one would have expected to see some provision dealing with the situation where the facilities used were not owned by the party concerned but were operated under lease, licence or were used under some other contractual arrangement. Provided the processing is done beneficially on behalf of the person claiming to be an independent processor, the Regulations do not envisage any restriction on how the processing is physically or contractually arranged. Hence, on a textual basis, Grate and Kaimai qualified as independent processors both on account of their intention to arrange for the processing of the raw milk acquired from Fonterra to be done on their behalf, and on account of their actually processing other dairy products in their own facilities.

[15] We cannot discern any sufficient basis upon which it would be appropriate to read down the simple language of the definition. Had a more limited meaning such as that suggested by Fonterra been intended, those who framed the Regulations could hardly have expressly incorporated the Act's definition of independent processor. A more limited and targeted definition would have been adopted. While the

¹⁰ See Interpretation Act 1999, s 5, and *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [22].

enhancement of farm gate competition was no doubt one of the purposes of the Regulations, that purpose is not necessarily inconsistent with the meaning of the definition adopted by the Courts below. Furthermore, the Regulations were designed to address aspects of competition in dairy markets generally rather than simply competition in respect of raw milk. Downstream processors, as well as processors of raw milk, have an interest in obtaining regulated supplies of raw milk.

[16] The Regulations require Fonterra to supply up to a specified quantity of raw milk to independent processors of dairy products at an agreed or regulated price. To this extent Fonterra is restrained from taking advantage of its dominant position by refusing to supply or charging an excessive price. There is no basis for narrowing the class of persons who can take advantage of Fonterra's obligation to those who process raw milk personally. To do so would not enhance efficiency (by taking advantage of spare capacity) nor would it enhance competition in all the relevant processing markets. The Regulations do not contain any express statement of their purpose so it is reasonable to conclude that they were promulgated to achieve the general purposes of the Act.

[17] We do not consider the natural meaning of the definition undermines the 600 million litre cap or the 50 million litre cap. Fonterra cannot be compelled to supply more than the total capped volume under the Regulations. And a person who toll processes raw milk on behalf of another party does not by doing so get another 50 million litres on their own behalf. The toll processor is simply making use of spare capacity in its facilities for the benefit of the other party. It is the other party that is the processor for the purposes of the Regulations. To prevent the use of that spare capacity by adopting an unnaturally restrictive interpretation would not be conducive to efficiency in the relevant dairy market. Nor would a restrictive interpretation be conducive to competition and contestability.

[18] To require a new entrant to possess or borrow the capital necessary to establish its own facility would establish a significant barrier to entry into the market. Toll processing enhances contestability. Even if toll processing might

arguably in the short run reduce demand for milk at the farm gate,¹¹ we are not satisfied that this is a factor of sufficient weight, when viewed in a wider context, to overcome both the ordinary and natural meaning of the definition and the general purposes of the Act and the Regulations. For these reasons the meaning naturally derived from the text of the definition was correctly adopted below.

[19] All that is necessary to become an independent processor, as defined, is for the party concerned to be intending to process the regulated raw milk it obtains from Fonterra either personally or by means of contractual arrangements entered into for that purpose. Fonterra is not, however, obliged to supply raw milk to a party who intends only to on-sell the raw milk without its being processed by or on behalf of that party. That limitation is inherent in the context in which the word “processor” is used in the definition.

[20] For these various reasons the appeal should be dismissed with costs of \$15,000 plus reasonable disbursements to be fixed if necessary by the Registrar.

Solicitors:
Russell McVeagh, Wellington for Appellant
Tompkins Wake, Hamilton for First and Second Respondents
Meredith Connell, Auckland for Commerce Commission as Intervener

¹¹ The sunset provisions in the Act (ss 147 and 148) anticipate that over the longer term appropriate contestability in dairy markets generally would develop so as to enable the regulatory provisions to be removed.