**IN THE COURT OF APPEAL OF NEW ZEALAND**

**CA736/2015**
**[2016] NZCA 538**

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| BETWEEN | FONTERRA CO-OPERATIVE GROUP LIMITED<br>Appellant |
| AND | MCINTYRE AND WILLIAMSON PARTNERSHIP AND ORS<br>Respondents |

| | |
|---|---|
| Hearing: | 13 and 14 September 2016 |
| Court: | Randerson, Winkelmann and Brown JJ |
| Counsel: | J E Hodder QC, D T Street and H K Wham for Appellant<br>D J Goddard QC and B M Russell for Respondents |
| Judgment: | 16 November 2016 at 2.15pm |

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## JUDGMENT OF THE COURT

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**A The appeal is dismissed.**

**B The appellant must pay the respondents costs for a standard appeal on a band A basis and usual disbursements. We allow for second counsel.**

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## REASONS OF THE COURT

(Given by Randerson J)

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## Introduction

[1] The respondents are dairy farmers in South Canterbury and North Otago. In the 2011/12 dairy season they were all suppliers of raw milk to New Zealand Dairies Ltd (NZDL), which processed the milk through its plant at Studholme, South Canterbury.

[2] On 17 May 2012 NZDL went into receivership. The receivers sought tenders for the Studholme plant. The appellant Fonterra was the successful tenderer. It was a condition of sale that the respondent suppliers enter into Milk Supply Agreements (MSAs) committing their milk supply to Fonterra for a six-year period.

[3] In the High Court the respondents claimed that the MSAs offered by Fonterra were less favourable in a number of respects than the standard terms on which Fonterra purchases milk under supply arrangements known as Growth Contracts. In particular, the respondents claimed there were three exceptions to the standard terms:

(a) They were not permitted to purchase more than 1,000 shares in Fonterra until after the end of the first 12-month dairy season.

(b) The milk price offered by Fonterra for the first three years of supply was five cents per kilogram of milk solids (kgMS) less than the standard Growth Contract price.[1]

(c) Fonterra was not obliged to purchase the suppliers' milk vat.

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[1] The milk price under the standard Growth Contract was already five cents per kgMS less than Fonterra's standard milk price, so the total price reduction for the respondents was actually 10 cents per kgMS below the standard milk price.

[4] The respondents' principal cause of action was that Fonterra had breached s 106 of the Dairy Industry Restructuring Act 2001 (DIRA) by discriminating against them as "new entrants" in respect of the terms of supply.

[5] Section 106 provides:[2]

> **106 No discrimination between suppliers**
>
> (1) New co-op [Fonterra] must ensure that the terms of supply that apply to a new entrant—
>
> (a) are the same as the terms that apply to a shareholding farmer in the same circumstances; or
>
> (b) differ from the terms that apply to a shareholding farmer in different circumstances only to reflect the different circumstances.
>
> (2) New co-op must ensure that the terms and effect of financial products offered or issued in new co-op are the same for new entrants as for shareholding farmers.
>
> (3) In this section, **financial products** has the same meaning as in section 7 of the Financial Markets Conduct Act 2013.
>
> (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.

[6] The respondents also alleged that pre-contractual statements made by Fonterra representatives at meetings on 15 and 20 June 2012 constituted misleading and deceptive conduct in breach of s 9 of the Fair Trading Act 1986 (the FTA) and amounted to misrepresentations in terms of s 6 of the Contractual Remedies Act 1979 (the CRA).

## The issues

[7] The parties agreed in the High Court to deal separately with liability and quantum. They also agreed that any question of reliance by the respondents on the statements made by the Fonterra representatives would be dealt with at a later date. This agreement was reflected in a consent order in which the Court was asked to determine five questions:

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2 Fonterra is referred to in the Dairy Industry Restructuring Act 2001 as "new co-op".

**Question 1** Were the [respondents] "new entrants" for the purposes of s 106 of DIRA? Or were they supplying milk to [Fonterra] on a basis other than as "new entrants"?

**Question 2** If the [respondents] were "new entrants" within s 106, did [Fonterra] breach s 106 in offering the [respondents] the terms of supply set out in the Milk Supply agreements signed by the [respondents]?

**Question 3** Did [Fonterra] advise the [respondents] about the extent of the [respondents'] ability to buy shares and to supply milk on a shared-up basis in terms or to the effect pleaded in paragraph 31 of the Amended Statement of Claim, or as pleaded in paragraph 31 of the Amended Statement of Defence?

**Question 4** Was such advice misleading and deceptive conduct in trade in breach of s 9 of the FTA? (For clarity, this issue excludes any question of reliance by the [respondents] on the alleged advice as pleaded in paragraph 53 of the Amended Statement of Claim, but all other factual — including contextual — issues raised in the pleadings of relevance to liability will be traversed.)

**Question 5** Did [Fonterra's] advice to the [respondents] about the extent of the [respondents'] ability to buy shares and supply milk on a shared-up basis (as per Question 3, above) amount to a misrepresentation in terms of s 6 of the CRA? (For clarity, this issue excludes any question of reliance by the [respondents] on the alleged advice as pleaded in paragraph 56 of the Amended Statement of Claim, but all other factual — including contextual — issues raised in the pleadings of relevance to liability will be traversed.)

[8] Muir J found in favour of the respondents on each of the questions.[3] Fonterra appeals against the judgment, contending that all five questions ought to have been determined in favour of Fonterra.

[9] At the heart of the submissions made by Mr Hodder QC on behalf of Fonterra are the propositions that the respondents were not "new entrants" and that s 106 of DIRA does not apply to milk supply contracts such as those entered into by the respondents. In relation to the causes of action under the FTA and the CRA, Fonterra's essential submission is that the respondents failed to satisfy the onus of proof and that the Judge was wrong to find in favour of the respondents.

3 *McIntyre and Williamson Partnership v Fonterra Co-operative Group Ltd* [2015] NZHC 3012 [High Court judgment].

## The facts in more detail

*Events leading to the sale agreement between Fonterra and the receivers*

[10] NZDL was placed into receivership shortly before the 2012/13 dairy season was due to begin on 1 June 2012. The receivers met with the NZDL suppliers on 18 May 2012 to discuss NZDL's financial position and to give an overview of the forthcoming sale process. The suppliers formed a committee to represent their views to the receivers and to potential buyers of NZDL's business.

[11] At the time of receivership NZDL's suppliers were owed approximately $20 million and were unsecured creditors of the company. The Judge found their paramount concerns were to recover past amounts due to them (referred to in evidence as "retros") and to find a buyer for their milk in the forthcoming season.

[12] Between 25 May and 1 June 2012 Fonterra entered into direct correspondence with the suppliers. The Judge found the suppliers wished to remain united. They appreciated they had a greater chance of their retros being paid in full if they all supplied the new owner of NZDL's business. Conversely, dispersing the supply among various milk buyers would have significantly undermined their prospects of recovery.

[13] On 28 May 2012 Fonterra's management circulated a paper updating its Board on the sale process of the NZDL plant. This paper recorded that NZDL had approximately 35 contracted suppliers, supplying a total of approximately 120–150 million litres of raw milk per year. The outstanding retro payments were understood to average over $600,000 per supplier. It was explained that, in terms of DIRA, Fonterra was not required to accept applications by the suppliers to become shareholders in Fonterra because the application period under DIRA for the 2012/13 season had closed (an issue to which we will return). However, management proposed to accept new contracts of supply on the basis of Fonterra's standard Growth Contract terms.

[14] On 1 June 2012 Fonterra's milk payments manager Mr Lash sent an internal email outlining two options for buying milk from the NZDL suppliers. The first was

"fully share-backed supply" and the second was the standard 2012 Growth Contract. The first option required a supplier to purchase one Fonterra share for each kgMS supplied to Fonterra in a dairy season. In return, a fully share-backed supplier receives the Fonterra standard milk price and any dividends on the shares. The share price for the 2012/13 season was $4.52 per share.

[15] The email summarised the terms of the second option (the standard Growth Contract) in these terms:

> (a) A Growth Contract provides flexibility as it enables suppliers to share up [acquire more shares] for new milk over six seasons. Suppliers are only required to purchase 1,000 shares up front.
>
> (b) For the 2012/13, 2013/14 and 2014/15 seasons suppliers are not required to share up in relation to the quantity of Growth Milk that they supply Fonterra in those seasons.
>
> (c) The quantity of Growth Milk they supply in the 2014/15 season will be their Contract Milk Quantity for the 2015/16 season.
>
> (d) They will share up in respect of 1/3 of the 2015/16 season Contract Milk Quantity at the start of the 2016/17 season, a further 1/3 at the start of the 2017/18 season and the final 1/3 at the start of the 2018/19 season.
>
> (e) Suppliers will receive the Fonterra Milk Prices less a Contract Fee for Growth Milk. In the 2012/13 season the Contract Fee will be 5 cents per kgMS. They will not receive any dividend in relation to milk supplied that is not backed by shares.
>
> (f) The supplier is bound to supply Fonterra over the term of the contract.

[16] The Judge said the aim of the standard Growth Contract was to provide flexibility for new suppliers by staging their capital requirements over a number of years. This also made it easier for Fonterra to acquire new suppliers.

[17] A further Board paper dated 5 June 2012 recorded that Fonterra had held discussions with the receivers with a view to Fonterra acquiring the NZDL assets. The paper recorded:

> 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 discount to the milk price payable over the first three years.

[18] It was proposed Fonterra would make a bid of $50 million for the NZDL assets. The Board paper recorded that bidders had been asked by the receivers to assume that the assets of NZDL would include not less than 100 per cent by volume of its current milk supply contracts. The paper also set out management's proposal that an offer be structured in such a way that the receivers could fairly demonstrate they had met all their obligations to creditors including payment of the amount due to NZDL's secured creditors in full, payment to NZDL suppliers for all amounts due for the 2011/12 season, and payment to other unsecured creditors if sufficient funds were available.

[19] On the same day, Fonterra made a formal bid by letter to the NZDL receivers. The key terms were:

> Fonterra is prepared to submit an Offer for the land and manufacturing assets of the Company (including certain raw materials, spare parts and the benefit of certain manufacturing related contracts and consents) ("Assets") of NZD50 million subject to the following conditions:
>
> - Fonterra Board approval;
> - the finalisation and execution of a mutually acceptable sale and purchase agreement ("SPA") and ancillary documentation (including delivery of certain transfer documents on settlement) within 10 working days of the date of this letter;
> - the continued supply on satisfactory terms of no less than 100% of the existing milk supply; and
> - New Zealand Commerce Commission approval of the acquisition.

[20] In this next part of the judgment we adopt the Judge's summary of email exchanges by Fonterra executives between 6 and 8 June.[4] On 6 June Mr Campbell[5] suggested a 10 cent per kgMS discount for three years. In response, Mr Murphy[6] expressed his view that the NZDL suppliers should be offered a contract with a five cent per kgMS discount for three years, and a requirement to share up over the following three years:

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4 High Court judgment, above n 3, at [23]–[27].

5 General Manager, Strategy.

6 General Manager, Milk Supply.

> I am not sure where the -10cents comes from, I assume the thinking here is a special contract – i.e. -10c off the milk price and 3 years of supply. I would prefer to go to the "new" suppliers with the existing -5cents off the milk price 3 years of contract supply and then a requirement to share up over 3 years. 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. … 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.

[21] Mr Campbell responded stating that the "retro" payments would in fact be made by the receivers, not by Fonterra. Mr Campbell stated:

> We will work on the messaging but we 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 both for Fonterra current suppliers AND NZDL suppliers.
>
> 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.

[22] Mr Muller[7] replied, stating that he "[understood the] rationale for the slightly tougher terms and endorse".

[23] In a different chain of emails, also sent on 7 June 2012, Mr Lash proposed that the NZDL suppliers should be paid 10 cents less per kgMS for the first three years. His stated reason for supporting a lower price was to reassure existing shareholders that the NZDL suppliers were not being treated more favourably:

> Suppliers are offered the 6 year Growth Contract, which requires suppliers to purchase 1,000 shares up front 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. Suppliers can fully share up sooner than the 6 year term to receive the full Milk Price.
>
> The larger discount than the $0.05 per kgMS contract discount is to reflect the unique circumstances. It shows Fonterra shareholders these suppliers aren't getting a special deal, and it can be justified to NZDL suppliers that it is necessary to make the deal work.

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[7] Managing Director, Co-operative Affairs.

[24] Mr Wickham[8] agreed with Mr Lash's proposal, and suggested an additional condition that the NZDL suppliers be barred from sharing up for at least a year:

> 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. …

[25] The variations to the 2012 Growth Contract for NZDL suppliers were confirmed in an email from Mr Campbell to the Chief Executive of Fonterra[9] on 8 June 2012:

> - Suppliers will incur a discount to the Contract Milk Price of $0.05 per kgMS (i.e. because the Contract Milk Price is $0.05 per kgMS less than Fonterra's Milk Price for the 2012/13 season, suppliers who enter into this contract will in effect get Fonterra's Milk Price less $0.10 per kgMS).
>
> - This additional $0.05 per kgMS discount will apply for the first three years of the contract term.
>
> - Suppliers will have no entitlement to become Fonterra fully share backed in the 2012/13 season under this contract. They can become fully share backed in subsequent seasons (and receive the full Milk Price), but will still be bound to supply Fonterra for the entire contract term.

[26] Progress with the negotiations was reported in a further Board paper of 13 June 2012. After discussions with the receivers, Fonterra had agreed in principle to a revised price for the NZDL assets of $48.5 million. The sale and purchase agreement would be conditional on securing 100 per cent of the milk volume supplied to NZDL in the previous season through the standard Fonterra Growth Contract with the variations already discussed.

[27] The proposal for payment of the retros was described in these terms:

> 5.4 The receivers will be undertaking to 2011/2012 NZDL suppliers who sign Fonterra contracts that they will receive 100% of the amounts outstanding to them for the 2011/12 season as soon as the sale to Fonterra is completed. This may amount to as much as $2.30 per kg of milk solids or on average over NZD 600,000 per supplier. Those

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8 Group Director, Supplier and External Relations.

9 Mr Speirings.

> suppliers who do not sign with Fonterra will become unsecured creditors of NZDL and are likely to receive 50 – 60 cents per dollar due. The insolvency experts advised the receivers have advised that this allocation of the purchase price on a preferential basis is justifiable as the overall enterprise value is dependent upon securing certainty around future milk supply, and the meeting of these retrospective payments is critical to securing that supply.

[28] Previous concerns by Fonterra management about the reaction of its existing shareholder suppliers and the proximity of the final vote on the share trading proposal known as TAF (Trading Among Farmers) were raised. The Board paper relevantly refers to the "key communication issues":

> 12.2 …
>
> (c) The transaction is occurring in the lead-up to the final vote on Trading Among Farmers amid pockets of dissent in our farmer base;
>
> (d) Farmer shareholders may perceive Fonterra as "bailing out" disloyal farmers;
>
> (e) Fonterra's bid enables the receivers to ensure that NZDL suppliers are paid in full. Other creditors will not be so there is potential for them to complain about the deal;
>
> …

[29] Fonterra's proposed communications strategy was also described in the Board paper:

> 12.3 In the first instance, Management will highlight Fonterra's white knight credentials, enabling NZDL suppliers to be paid in full and have their milk processed from the start of the new season ("no spilt milk"). It will be important to win support from NZDL's suppliers as this will in turn help to earn the support of local community leaders. While Fonterra will take the lead in communicating with suppliers, we need to work closely with the receivers to ensure they explain to suppliers that this is the best available outcome for them.
>
> 12.4 At the same time, we need to emphasise to our own farmer shareholders that we are not providing any special treatment or "favours" to these new suppliers; that they will be signed up on the basis of a discount to the standard Growth Contracts and will become Fonterra shareholders over time. Equally, we need to show that this transaction is consistent with Fonterra's business strategy and is not a purely opportunistic move.

[30] The Board resolved to approve the acquisition of the NZDL assets. A formal agreement for sale and purchase (SPA) between the NZDL receivers and Fonterra was entered into the following day, 14 June 2012.

*The terms of the sale agreement with the receivers*

[31] The recitals at the beginning of the SPA record the acknowledgement by the parties that the value of the assets to Fonterra as purchaser was "tied to continuing milk supply from the existing farmer suppliers". The parties also acknowledge that the existing farmer suppliers had not been fully paid by NZDL for their milk supplies prior to receivership. Recital D then states:

> As such, it is a fundamental assumption supporting the commercial rationale for the transaction and an essential term of this Agreement that the existing farmer suppliers who meet Fonterra's criteria enter into new supply arrangements with Fonterra on Fonterra's terms, and that these milk supply arrangements along with all relevant dairy manufacturing and processing assets (including all plant and equipment) comprise the relevant assets to be acquired by the Purchaser and Fonterra pursuant to this Agreement. The purchase price reflects the negotiated position reached by the parties on the value of these assets, valued on a going concern basis. The parties further acknowledge that in order for the Purchaser and Fonterra to acquire the assets on this basis, the Vendor must pay to farmer suppliers who enter into the new supply arrangements that part of the Supplier Owed Amounts which relates to them from the proceeds of the purchase price.

[32] Clause 3.1 of the SPA records the total purchase price as $48.5 million, which the parties acknowledge includes the value attributed to the ongoing milk supply achieved through satisfaction of a condition contained in cl 4.1(a) of the SPA. This condition, which we set out below, relates to the supply contracts to be entered into between Fonterra and NZDL's suppliers.

[33] Clause 3.2 sets out the mechanism for payment of the purchase price upon settlement. Fonterra agreed to pay the purchase price to the receivers less the amounts due to NZDL suppliers for the retros. Fonterra would then pay these sums directly to the suppliers on behalf of the receivers.

[34] Clause 4.1 provides that the SPA is conditional upon satisfaction of two conditions:

> (a) each of the farmer suppliers under not less than 100% of the Supply Contracts … (i) entering into a milk supply agreement with NZDL and Fonterra for the supply of milk up to and following Completion and on terms satisfactory to NZDL and Fonterra (acting reasonably) and (ii) filling in a "Fonterra Application for Supply" (in Fonterra's standard form) (such farmer suppliers being, where their applications have been accepted by Fonterra, "Fonterra Contracted Suppliers"); and
>
> (b) the Purchaser obtaining a clearance on terms that are reasonable for the Purchaser to accept for the acquisition under section 66 of the Commerce Act 1986.

[35] The first of these conditions was to be satisfied no later than 22 June 2012, although this could be extended if necessary to 29 June 2012. The second condition relating to Commerce Act approval was to be fulfilled no later than 60 business days after the date of the agreement.

*The meetings on 15 and 20 June*

[36] Given the time constraints for satisfaction of the conditions of the SPA, meetings took place on 15 and 20 June 2012 between the receivers, the suppliers and Fonterra representatives. The receiver, Mr Mayo-Smith, confirmed that Fonterra's offer was the only one giving the suppliers a full return of their retros. Alternative offers had promised the suppliers a recovery of their retros of less than 45 per cent. Mr Mayo-Smith also advised the suppliers that, to get the benefit of the deal offered by Fonterra, they should stick together.

[37] The terms of Fonterra's offer, including the exceptions to the standard form of Growth Contract, were explained. The suppliers were concerned to know why they were being offered less favourable terms than other suppliers under Growth Contracts. Prominent amongst these concerns was the prohibition on sharing up until after the end of the 2012/13 season.

[38] We will consider in more detail below the statements made by the Fonterra representatives and the challenge to the Judge's conclusions on the FTA and CRA claims.

*Fonterra's letter of offer and the information pack*

[39] At the meeting on 15 June 2012 the suppliers were given an information pack prepared by Fonterra. This included a letter signed by the Chairman of the Board. The letter explained that, in terms of the arrangements with the receivers, Fonterra would be operating the NZDL plant from the beginning of the season on an interim basis pending approval from the Commerce Commission for the acquisition. Amongst other things, the letter stated:

> Ultimately our investment will become your investment if you choose to share up and become part of the Fonterra family. I know some of you have been with us in the past and we welcome the opportunity to have you back in the Co-op.

[40] The information pack accompanying the letter included:

(a) Application forms to supply Fonterra.

(b) The MSA.

(c) The Growth Milk 2012/13 Contract.

(d) Fonterra's Suppliers' Handbook.

(e) The Group Investment Statement for Fonterra.

(f) A booklet about the TAF scheme.

[41] The letter further explained:

> Our offer to you is based on a normal growth supply contract with the following exceptions:
>
> - A discount of 5c per kgMS applied to the standard growth contract pricing
> - We will not be purchasing your vat but have an option to do so
> - You will not be entitled to share up in the first season beyond the minimum required holding of 1000 shares

> These exceptions allow Fonterra [to] structure this move to acquire the assets ensuring you receive your full retro payment and giving you certainty for the season ahead.

[42] The letter continued:

> I look forward to having you as part of the Fonterra family – for some of you, this is a return home.

[43] The letter ended by explaining that, in order to be fully prepared for the beginning of the 2012/13 season, Fonterra needed to have the application forms completed by 22 June 2012.

*The application forms*

[44] Before setting out the relevant terms of the application forms, we need to explain a little more about the process set out in DIRA by which "new entrants" may apply to become "shareholding farmers" in Fonterra. This is relevant to Mr Hodder's submission that the NZDL suppliers were not new entrants with the consequence that s 106 did not apply.

[45] DIRA distinguishes between new entrants and shareholding farmers.

[46] A "new entrant" is defined in s 5(1) as meaning:

> a dairy farmer who is not a shareholding farmer who applies to become a shareholding farmer under section 73

[47] And "shareholding farmer" means:

> a dairy farmer who is registered as the holder of co-operative shares

[48] For reasons relating to management of milk production and processing capacity, milk supply applications by new entrants or by existing shareholder suppliers to increase supply must be made within a defined period prior to the commencement of the following season. Section 75 provides:

> **75 Application periods**
>
> (1) New co-op must set an application period that is before the commencement of each season in which new entrants may apply to

supply milk, and shareholding farmers may apply to increase the volume of milk supplied, as shareholding farmers.

(2) As a minimum, an application period must span the dates 15 December in a year to 28 February in the next year.

[49] The application period specified for the 2012/2013 season commenced on 15 December 2011 and ended on 29 February 2012. The respondents were being invited to complete their applications in June 2012 and were therefore outside the application period.

[50] DIRA provides differently for applications made during an application period and those that are not. Under s 73 an application by a new entrant to become a shareholding farmer or an application by a shareholding farmer to increase the volume of milk supplied must be accepted by Fonterra if it is made within the application period:

**73 New co-op must accept application**

(1) New co-op must accept an application to become a shareholding farmer that is made by a new entrant in an application period.

(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.

(3) New co-op must notify acceptance to the applicant within 15 working days of receipt of the application.

…

[51] To complete the picture to this point, s 74 is also relevant:

**74 Commencement and terms of supply**

(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 to which the application relates from the beginning of the season following that application period.

(2) Despite subsection (1), new co-op is not required to accept milk if the shareholding farmer fails to satisfy the applicable terms of supply.

(3) New co-op may, in its discretion, accept an application made outside an application period from a dairy farmer, including a shareholding farmer, to supply milk as a shareholding farmer.

[52] The effect of this section is that if an application referred to in s 73 is made to Fonterra within an application period, Fonterra must accept the milk to which the application relates from the beginning of the following dairy season unless the shareholding farmer fails to satisfy Fonterra's applicable terms of supply.[10] Importantly, even if an application is made outside the relevant application period, Fonterra may, in its discretion, accept an application from a dairy farmer (including a shareholding farmer) to supply milk as a shareholding farmer.

[53] Given Mr Hodder's submission that the respondents were not new entrants applying under s 73, it is important to identify exactly what they applied for in the applications they completed after the meetings on 15 and 20 June. The application form provided by Fonterra to the respondent suppliers with Fonterra's letter of offer was form A01. This is described as an "Application to Supply: Dry Farm Conversion". The respondents were existing dairy farmers but nothing turns on the use of the expression "Dry Farm Conversion". The form begins:

> This form shall be completed if you wish to become a Fonterra supplier. If Fonterra accepts your application then you will be contractually bound to supply milk to Fonterra. …

[54] The form provides for two ways of supplying milk: under a Growth Contract or as "a fully share-backed shareholding supplier". The respondents completed a separate form described as an "Application for Growth Contract Supply". So far as it relates to the respondent suppliers, the form states:

> (b) I/We wish to offer [ ] kgMS as the **Offer Quantity** for Growth Contract commencing in the 2012/2013 season. If I am/we are an existing Fonterra supplier, then I/we acknowledge the Offer Quantity will not be adjusted as a result of my actual 2011/2012 season production.
>
> (c) I/We acknowledge that if this application is successful:
>
> (i) then I/we must hold at least 1,000 shares and that these will be issued to me/us if we do not already hold shares;
>
> (ii) the Contract Milk Quantity for each of the 6 seasons during the term of the Growth Contract will vary and will be determined in accordance with the Growth Contract Supply Terms 12/13;

10 Subject only to limited exceptions set out in ss 94 and 95 that have no application in the present case.

(iii) any Additional Shares I/we hold in any of the 2012/2013, 2013/2014 and 2014/2015 seasons (being shares in excess of the number I am/we are required to hold in accordance with the share standard for those seasons) may reduce my/our Contract Milk Quantity in accordance with the Growth Contract Supply Terms 12/13; and

(iv) that I/we will be required to purchase Co-operative Shares on 1 June 2016, 1 June 2017 and 1 June 2018, in addition to any end of season or new season adjustments, in accordance with the Growth Contract Supply Terms 12/13.

I/We understand that under the Growth Contract Supply Terms 12/13 I am/we are required to continue to supply all milk production on the farm (subject to the Constitution and applicable law) during the 2018/2019 season unless I/we reduce my/our Contract Milk Quantity to zero, and fully share up, before the start of the 2017/2018 season.

*The Milk Supply Agreements*

[55] Despite their concerns, each respondent completed the application form and the MSA by 25 June 2012. The MSA is a two-page document but it incorporates by reference the Fonterra 2012 Growth Contract. The MSA first addresses the interim period between August and settlement of Fonterra's acquisition of the NZDL assets. We need not refer to this except to note that cl (a)(v) says:

(v) NZDL will pay, under arrangements it has agreed with Fonterra under an Operational Agreement, retrospective and final payments to Suppliers, on the same payment schedule as Fonterra's other contract milk payments.

[56] The relevant part of the MSA dealing with the period after Fonterra's acquisition of the NZDL assets states:

(b) From Settlement:

(i) the [interim] arrangement described in paragraph (a) above shall terminate, Fonterra shall assume all of NZDL's obligations under paragraph (a)(v) and the Supplier shall release NZDL absolutely from such obligations; and

(ii) Subject to the terms of acceptance of the supplier's Application to Supply Fonterra, Fonterra agrees with the Supplier to acquire milk on, and the Supplier agrees to comply with, the terms of Fonterra 2012 Growth Contract in the form **attached** except as follows:

(1) the price is $0.05 per kgMS less than the Contract Milk Price for the then current season (and because

> the Contract Milk Price is $0.05 per kgMS less than Fonterra's fully shared Milk Price for the 2012/2013 season, suppliers who enter into this contract will in effect get Fonterra's Milk Price less $0.10 per kgMS) for the first three years of the contract term.
>
> (2) Fonterra will not be obliged to acquire any Milk Vat but will have an option (but not obligation) to acquire the Milk Vat at fair market value by notice in writing to the Supplier. Any dispute as to value shall be determined by arbitration.
>
> The Supplier will have no entitlement to become Fonterra fully share backed in the 2012/13 season under this contract. The Supplier can become fully share backed in subsequent seasons (and receive the full Milk Price), but will still be bound to supply Fonterra for the entire contract term.

[57] We need not refer to any of the other terms of the MSA other than to note it includes an entire agreement clause. We discuss this later in this judgment.

*Approval under the Commerce Act 1986 and issue of shares*

[58] On 7 September 2012 Fonterra wrote to the suppliers advising the Commerce Commission had approved Fonterra's acquisition of the NZDL assets. The suppliers were advised that, from 15 September 2012, they would become a Fonterra contract supplier. The letter further informed the suppliers they would receive a letter advising they owed $4,520 for the issue of the minimum 1,000 Fonterra shares. This sum would be deducted from the milk payment made on 20 October unless the supplier chose to pay by 28 September.

[59] On 25 September 2012 the Board resolved to issue shares to both new and existing shareholders. The executive summary in the relevant Board paper states the company proposed to:

> (a) issue Shares to new Shareholders for the 2012/2013 Season and to existing shareholders who submitted late elections to cover expected production in the 2012/2013 Season;
>
> (b) issue Shares to ensure Shareholders who have reduced or cancelled their contract supply arrangements with the Company, or who supply under Growth Contracts, hold the minimum required shareholding;
>
> (c) surrender Shares for shareholders who submitted late elections to surrender Additional Shares, and to ensure other shareholders are correctly shared at the start of the 2012/2013 season.

[60] The resolution relating to "New Shareholders for the 2012/2013 Season" reads:

> (a) 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 2012/2013 Season (including applicants who have been awarded Growth Contracts) and purchasers of existing farms without Shares at the consideration for each Share of $4.52 (being both the Default Price and the June Price for the 2012/2013 Season).

**The statutory scheme**

[61] We have already referred to some of the key provisions of DIRA at issue in this appeal, but it is necessary to describe DIRA's broader context. DIRA gave effect to a major restructuring of the dairy industry in New Zealand. Its principal purpose was to give effect to an amalgamation of two of New Zealand's largest dairy companies, the New Zealand Co-operative Dairy Co Ltd and Kiwi Co-operative Dairies Ltd, along with other companies.[11] To enable this to occur, DIRA gave all necessary authorisations under the Commerce Act 1986.[12]

[62] The amalgamated entity was named Fonterra, although as already noted it is described in DIRA as "new co-op". By s 11 of DIRA, Fonterra was authorised to adopt in its constitution and give effect to clauses set out in sch 1 of the Act. These clauses facilitated the Commerce Act authorisation by establishing the key aspects of Fonterra's co-operative structure. The authorisation to adopt these clauses ceased to apply if Fonterra changed them or their effect.[13]

[63] Another important purpose of the amalgamation was to:[14]

> promote 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;

[64] It is clear from the legislative history of DIRA that there was a concern that the restructuring of the dairy industry created in Fonterra a monopsony and that, if

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[11] Dairy Industry Restructuring Act 2001, s 4(a).
[12] Section 7.
[13] Section 11(1).
[14] Section 4(f).

the industry was to operate efficiently, measures would be needed to mitigate Fonterra's dominance. We discuss this history later in this judgment.[15]

[65] Subpart 5 of pt 2 of DIRA contains provisions for the regulation of dairy markets and sets out Fonterra's obligations in that respect. The promotion of the efficient operation of dairy markets is emphasised in a purpose provision:

> **70 Purpose**
>
> The purpose of this subpart is to promote the efficient operation of dairy markets in New Zealand.

[66] This section is followed by a statement of principles. Relevantly, it provides:

> **71 Statement of principles**
>
> The intention of this subpart is to promote the following principles:
>
> …
>
> (b) new co-op must accept applications by new entrants and shareholding farmers to supply it with milk, as shareholding farmers:
>
> (c) new co-op must not discriminate between new entrants and shareholding farmers whose circumstances are the same:
>
> …

[67] Section 72 gives an overview of the content of subpart 5 comprising ss 73 to 150. Sections relevant to the present case (ss 73 to 85) are said to:[16]

> describe the obligation of new co-op to accept applications from new entrants and shareholding farmers to supply milk, as shareholding farmers.

[68] Sections 73 to 75 then follow. We have already set these out, noting the distinction DIRA makes between new entrants and shareholding farmers as well as between applications under s 73 made within and outside the application period set under s 75.

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15 At [109]–[114].
16 Section 72(1).

[69] Sections 77 and 79 require Fonterra to set the "co-operative share price" to apply from the beginning of each application period and the "co-operative share standard". These terms are defined:[17]

> **co-operative share** means a share in new co-op issued, or to be issued,—
>
> (a) from the new co-op amalgamation; or
>
> (b) in relation to the supply of milk to new co-op by new entrants or shareholding farmers
>
> **co-operative share standard** means the share standard referred to in new co-op's constitution that determines the number of shares that a new entrant or shareholding farmer is required to hold

[70] Mr Goddard QC on behalf of the respondents also emphasised ss 81 and 82, which also draw the distinctions we have identified:

> **81 Requirements applying to co-operative shares for applications in application period**
>
> (1) The price of a co-operative share issued to a new entrant or a shareholding farmer in response to an application that new co-op is required by section 73 to accept is—
>
> (a) the June price in the first season for the supply of milk to which the application relates if the new entrant or shareholding farmer elects to pay that price; or
>
> (b) the default price if that election is not made.
>
> (2) An election under subsection (1)(a) must be made with the application from the new entrant or shareholding farmer.
>
> (3) The co-operative share standard that applies to a new entrant or a shareholding farmer who makes an application under section 73 that new co-op is required to accept is the co-operative share standard published at the beginning of the application period in which the application is made.
>
> **82 Requirements applying to co-operative shares for applications outside application period**
>
> (1) 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 in the first season for the supply of milk to which the application relates.

[17] Section 5(1).

> (2) The co-operative share standard that applies to a new entrant or a shareholding farmer who makes an application to which section 74(3) applies is the co-operative share standard published at the beginning of the application period in the season immediately before the first season for the supply of milk to which the application relates.

[71] Section 81 applies to applications made under s 73 by a new entrant or a shareholding farmer within the application period. It specifies the price for co-operative shares issued to a new entrant or shareholding farmer and the relevant share standard applying to each.[18]

[72] The significance of s 82 is that it specifies the co-operative share price and the standard for shares issued to new entrants and shareholding farmers in response to an application to which s 74(3) applies. As already noted, s 74(3) permits Fonterra to accept, as a matter of discretion, an application to become a shareholding farmer outside the application period. Again, no distinction is drawn between new entrants and shareholding farmers.

[73] A number of additional provisions in DIRA support the statutory policy of reducing the risk of anti-competitive behaviour caused by the concentration of monopsony power. Counsel described the scheme effecting this policy as an "open entry/open exit" regime. In addition to Fonterra's obligation under s 73 to accept timely applications to become a shareholding farmer or to increase the volume of milk supply, s 83 prohibits Fonterra from requiring any payment from a new entrant or a shareholding farmer for accepting milk supplies as a shareholding farmer other than payment of the purchase price of co-operative shares. And ss 84 and 85 support the statutory policy by regulating the size and timing of deposits Fonterra may require of suppliers, and the timing of payment of the balance of the purchase price.

[74] As well, ss 97 to 105 are detailed provisions applicable where a shareholding farmer gives notice to withdraw. These are designed to ensure the shareholding farmer receives a payment (usually based on the June share price) immediately following the application period in which the notice of withdrawal is given.[19]

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18 Section 81 also refers to the applicable peak note standard established under s 79 but this has no relevance for present purposes.

19 Section 98(1).

[75] Finally, we mention ss 106 to 109, which are part of subpart 5 and appear under the heading "Regulation of milk supply". We have already mentioned s 106, and will return to it below. Section 107(1) provides that Fonterra must offer new entrants contracts for milk supply as shareholding farmers for one season. Subject to subs (3), Fonterra has a discretion under subs (2) to offer new entrants and shareholding farmers longer term contracts for milk supply. By s 108(1), shareholding farmers are entitled to allocate up to 20 per cent of their milk production to independent processors.

## Fonterra's Constitution

[76] The provisions of Fonterra's Constitution are important but DIRA is paramount. Section 135 of DIRA provides that subpart 5 applies despite anything in Fonterra's Constitution or the Companies Act 1993.[20]

[77] Clause 1.1 of Fonterra's Constitution provides:

> **1.1** **Purpose:** The purpose of the Company in carrying out its business is to maximise the wealth of its Shareholders by:
>
> (a) the sale of their Milk;
>
> (b) providing a purchaser of that Milk; and
>
> (c) enhancing the value of the Co-operative Shares.

[78] Clause 2 of the Constitution is entitled "Shareholders", and relevantly provides:

> **2.1** **Applications for supply:** Any person that intends to commence the supply of Milk to the Company shall give written notice of that intention to the Company and complete such application in the form and by the time the Board may from time to time determine in a manner consistent with any applicable enactment.
>
> **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, or by the Board under clause 3.3, as applicable.

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[20] The override enures during the life of subpart 5 which may expire in the circumstances set out in ss 147–149.

2.3 **Board may accept application:** The Board may in its absolute discretion decide:

(a) whether or not to accept an application by a person to become a Shareholder made in accordance with clause 2.2 or any application procedure which the Board may from time to time determine; 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.

2.4 **Board may not issue Co-operative Shares to certain persons:** The Board may not issue Co-operative Shares to a person:

(a) whose supply or estimated supply of Milksolids obtainable from Milk to be supplied to the Company by that person in a Season is less than 1,000 kilograms of Milksolids or such minimum level of supply as determined from time to time by the Board, being a level not more than 15% greater than the level applying in the preceding Season; or

(b) who is a Sharemilker who has not been approved by the Board as a Shareholder in accordance with either any rules established by the Board from time to time or any applicable enactment.

[79] We make three points in relation to these provisions. First, cl 2.2 provides that the supply by any person of milk to Fonterra is an irrevocable application to become a shareholder and to hold the number of co-operative shares required from time to time by the Share Standard. Second, the discretion under cl 2.3 must be read subject to ss 73 and 74 of DIRA. Third, Fonterra required the suppliers in the present case to acquire 1,000 shares.

[80] We set out in full the provisions relating to the co-operative share standard:

3.1 **Obligation of Shareholders to hold a number of Co-operative Shares:** Subject to clauses 3.3, 3.4 and 5.1(d) to 5.1(f) each Shareholder supplying Milk to the Company in a Season shall hold a number of Co-operative Shares for that Season:

(a) at least equal to the number of Co-operative Shares determined in accordance with the Share Standard for that Season; and

(b) not greater than the number of Co-operative Shares determined in accordance with the Share Standard for that Season, plus a number of Co-operative Shares (rounded down to the nearest whole number of Co-operative Shares)

equal to 20% of the number of Co-operative Shares determined in accordance with the Share Standard for that Season.

**3.2** **Share Standard:** The Share Standard for each Season shall be one Co-operative Share for each kilogram of Milksolids obtainable from Milk supplied to the Company by a Shareholder in that Season (excluding Milk supplied on Contract Supply).

**3.3** **Unshared supply:** The Board may permit, at its discretion and on such terms as it sees fit, Shareholders to hold fewer Co-operative Shares than required by the Share Standard in a Season, provided that no Shareholder may hold a number of Co-operative Shares which is less than the number of Co-operative Shares required by the Share Standard in a Season by a number of Co-operative Shares which is greater than 20% of the number of Co-operative Shares required by the Share Standard in that Season.

**3.4** **Contract Supply:** Without limiting any other provision of this Constitution, 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. The aggregate amount of Milksolids obtained from Milk supplied to the Company by Shareholders in a Season on Contract Supply shall not exceed 15% of the total Milksolids obtained from all Milk supplied by Shareholders to the Company in a 12-month period prior to the commencement of that Season selected by the Board. Without limiting the terms which the Board may set for Contract Supply under clause 9.4, the Board:

(a) shall set, or determine the methodology for setting, the amount to be paid to a Shareholder for Milk supplied to the Company on Contract Supply; and

(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 to the Company by that Shareholder on Contract Supply.

[81] The general effect of these provisions is that a shareholder supplying milk to Fonterra is required to hold one co-operative share per kgMS of milk supplied. In addition, a shareholder may be permitted to hold additional shares up to 20 per cent above the number of shares determined in accordance with the share standard for the season. Any such additional shares are dealt with under cl 5.1(f) of the Constitution. The requirement to hold shares in terms of cl 3.1 is subject to cl 3.3, under which the Board may permit a shareholder to hold fewer shares than those required by the share standard, and cl 3.4, relating to contract supply, upon which Mr Hodder relies.

[82] We make two points with regard to these provisions of the Constitution. First, the share standard set under cl 3.2 specifically excludes milk on Contract Supply under cl 3.4. Second, the discretion available to the Board under cl 3.4 is to permit a "Shareholder" to supply milk under contract. A "shareholder" means "a person whose name is entered in the Share Register as the holder for the time being of one or more Shares".[21] This definition in the Constitution does not differ in any material way from the definition of "shareholding farmer" in DIRA.

**Question one: Were the respondents "new entrants" for the purposes of s 106 of DIRA? Or were they supplying milk to Fonterra on a basis other than as "new entrants"?**

*Fonterra's argument*

[83] Fonterra's position is that the respondents were not new entrants for the purposes of s 106 or otherwise. The essence of Fonterra's argument on this issue is founded on the following propositions:

(a) DIRA focuses on Fonterra's usual milk supply arrangement involving 100 per cent share-backed supply consistent with the share standard requirement of one share for each kgMS supplied. DIRA's open entry/open exit provisions are directed to supply arrangements of this kind.

(b) At least outside the application period, Fonterra has the ability to enter into supply arrangements that are contract-based. Arrangements of this type are essentially unregulated by DIRA.

(c) The respondents were not new entrants in terms of s 73 since they did not apply within the defined application period.

(d) The discretion under s 74(3) to treat them as having applied within time was neither sought by the respondents nor exercised by Fonterra.

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21 Clause 48.1 of Fonterra's Constitution.

(e) Rather, the respondents contracted with Fonterra on the special terms set out in the MSA as part of the wider transaction in which Fonterra acquired NZDL's assets from the receivers, thereby enabling payment of the retros to the respondents.

(f) Fonterra's position is unaffected by the requirement that the respondents were each to hold 1,000 Fonterra shares. This was a token shareholding that did not make them shareholding farmers either in fact or in terms of DIRA.

(g) Alternatively, if the requirement to hold 1,000 shares were considered to be of greater significance, then DIRA could only apply to the share-backed supply of 1,000 kgMS. The balance of the shares to be acquired over time was governed by the terms of the MSA.

*The Judge's approach*

[84] Muir J began by rejecting an argument raised by the respondents that an application to become a shareholding farmer meant that the applicant was to be regarded as a new entrant from the time of the application even if the application was outside the application period.[22] The respondents did not pursue this argument on appeal. We consider it was rightly rejected in the High Court for the reasons the Judge gave.

[85] The short point is that the definition of new entrant applies only to a dairy farmer who is not already a shareholding farmer and who applies to become one "under s 73".[23] An application under s 73 is one made by a new entrant within the application period.[24] Since it is common ground that the applications made by the respondents were outside the application period, they could not be regarded as applying under s 73. The consequence is that they were not new entrants at that point and could only become so if Fonterra exercised its discretion under s 74(3) to accept their applications outside the application period.

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22 High Court judgment, above n 3, at [95].
23 Section 5(1).
24 Section 73(1).

[86] As to the respondents' substantive argument on this point, the Judge accepted the submission that the respondents had become new entrants because Fonterra had exercised its discretion under s 74(3) to accept their application to become shareholders and had issued shares on that footing.[25]

[87] Addressing Fonterra's fall-back argument that the respondents became new entrants only in the limited sense of having 1,000 shares, the Judge said:

> [102] Subpart 5 of Part 2 of DIRA was clearly intended to address concerns that the merger resulting in the creation of Fonterra would reduce the level of contestability in the domestic raw milk market. Its aim was to reinforce existing competition law with a series of very specific prescriptions relevant to that particular market. In this sense, DIRA, like the Commerce Act 1986, can be regarded as regulating market participants, that is individuals and/or corporations, inter se.
>
> [103] In the present case that relationship is between dairy farmers wishing to become shareholding farmers and Fonterra. The concept that one party to that relationship might be defined not as an individual but as a proxy for a block of shares to which, and in respect only of which, obligations of equality apply, would in my view be an unusual interpretation of legislation designed to ensure that individual farmers are not disadvantaged by Fonterra's dominance in the raw milk market. It would, as Mr Goddard submits, effectively deprive late entrants of any real protections, leaving them at the mercy of Fonterra's monopsonist powers. Of course, for valid reasons Fonterra retains a discretion in terms of whether it accepts such entrants into the shareholding farmer "fold", but why, having elected to do so, it should be able to discriminate against the individuals concerned in a way not possible in respect of timely applicants seems to me a proposition which struggles for a basis in principle.

[88] After setting out further reasons for this finding, the Judge concluded:

> [105] So the scheme of the Act logically envisages new entrant status applying to an individual at a particular point in time — the point at which a dairy farmer becomes a registered holder of co-operative shares. At that point individuals become part of what Fonterra's director Mr Monaghan referred to at the meeting on 15 June, as the "Fonterra family" and the "terms of supply" came, in my view, to be governed by s 106. If, in respect of a late applicant, that was not a consequence acceptable to Fonterra it could negotiate for an exclusively contractual supply. In relation to such an applicant there was no obligation to accept them as a "shareholding farmer". But I do not consider Fonterra was in a position to treat the [respondents] as shareholding farmers for some purposes but not for others. It had never purported to do so in respect of any other farmers on Growth Contracts. It accepted applications from the [respondents] to become shareholding farmers. It issued shares to them as "new shareholders … pursuant to ss 73 and 74". Such shares were co-operative shares within the "shareholding

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[25] At [101].

> farmer" definition. Each supplier committed to being fully shared up over time without the requirement for any further application or step; each was immediately subject to the share standard, albeit the volume supplied on contract was excluded. Fonterra took suppliers on as "new entrants" but now wishes to create a subcategory within that definition of new entrants with inferior rights. I cannot accept that this was in Parliament's contemplation. To the contrary, I accept the submissions of Mr Goddard …
>
> (footnote omitted)

*Question one — discussion*

[89] We begin our analysis with three undisputed propositions:

(a) Sections 73 to 75 apply to applications by both new entrants and shareholding farmers to supply milk as shareholding farmers.

(b) The respondents' applications to become shareholding farmers were outside the application period but Fonterra had a discretion to accept them under s 74(3) notwithstanding.

(c) Subject to ss 73 and 74, it is open for Fonterra to agree under cl 2.3 of the Constitution to accept the supply of milk without share backing.

[90] However, we are unable to accept Fonterra's submission that the MSAs in this case were supply contracts without share backing. Or, to put it another way, that the MSAs were not agreements to supply milk as shareholding farmers.

[91] We reach that conclusion essentially for the reasons advanced by the respondents and accepted in the High Court. First, we are satisfied on the facts that the application forms Fonterra provided to the respondents to complete were applications to become shareholding farmers. In applying for "Growth Contract Supply", the respondents acknowledged they were required to hold at least 1,000 shares from the outset and that they would be obliged to become fully shared up in the last three years of the contract in order to meet the share standard applicable to Growth Contracts. It is not in dispute that no further application for shares would be

necessary to acquire shares in the later years. That simply followed as a term of the Growth Contracts.[26]

[92] Second, we are satisfied on the evidence that Fonterra exercised its discretion under s 74(3) to accept the respondents' applications as new entrants. That is clear from the Board's resolution we have referred to above at [60] stating the shares were issued to the respondents "in accordance with clause 5.1(a) of the Constitution and sections 73 and 74 of DIRA". We are not persuaded by Mr Hodder's submission that the reference to ss 73 and 74 of DIRA is attributable to the fact that the shares were issued to others beside the respondents. Counsel accepted the resolution applied to the shares issued to the respondents. It matters not that the resolution may have been applicable to others as well. The reference to cl 5.1(a) of the Constitution refers to the issue of shares to persons whose applications to become a new shareholder or to supply more milk have been accepted by the Board under cl 2.3 of the Constitution. Mr Hodder did not rely on this provision. Rather, he submitted Fonterra exercised its discretion to enter into contract supply arrangements under cl 3.4 as we discuss below.

[93] Third, as soon as Fonterra accepted the respondents' applications and they became registered as holders of co-operative shares they became "shareholding farmers" in terms of the DIRA definition. In doing so they became bound by the terms of the Constitution.[27]

[94] Fourth, we do not accept Mr Hodder's submission that Fonterra relied on cl 3.4 of the Constitution to enter into "Contract Supply" with the respondents. There is no evidence to support that submission and it is inconsistent with the evidence we have already mentioned. In any event, the exercise of any discretion under cl 3.4 does not assist Fonterra since the discretion to permit the supply of milk under Contract Supply is only available under cl 3.4 to a shareholder of the company.[28]

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26 As already noted at [79], cl 2.2 of the Constitution also treats the supply of milk to Fonterra as an irrevocable application by the supplier to become a shareholder.
27 See s 31 of the Companies Act 1993.
28 See above at [82].

[95] Fifth, we do not accept Fonterra's submission that 1,000 shares is merely a token holding that could be ignored. We agree the number is small in relation to the milk quantities involved but it cannot be dismissed as de minimis. It is set at a level that is effectively the minimum entitlement under the Constitution.[29]

[96] Sixth, we accept Mr Goddard's submission that DIRA identifies two categories of dairy farmers to whom co-operative shares may be issued, namely new entrants or shareholding farmers as defined. This is supported by the definitions of "co-operative share" and "co-operative share standard" and numerous other provisions of subpart 5. As Mr Goddard submitted, there is no third category of a "contract supplier holding shares" who may be treated as being exempt from regulation under DIRA.

[97] Mr Hodder did not press the alternative submission that DIRA could apply to the 1,000 shares but not to the remainder the respondents were obliged to acquire in later years. We reject that submission for the reasons given by the Judge in the passages cited above at [87] and [88].

[98] In conclusion, we agree with the Judge that once Fonterra had exercised its discretion under s 74(3) the respondents were new entrants in terms of subpart 5 of DIRA, including for the purposes of s 106.

**Question two: If the respondents were "new entrants" within s 106, did Fonterra breach s 106 in offering the respondents the terms of supply set out in the Milk Supply Agreements signed by the respondents?**

[99] The Judge found that Fonterra breached s 106 by offering the respondents terms of supply that differed from those offered to other suppliers under the standard Growth Contracts in the three respects relied upon by the respondents (as identified above at [3]). Fonterra submitted that if s 106 were, contrary to its submission, found to apply to the respondents, then the Judge was wrong to reach this conclusion.

[100] For convenience, we set out s 106 again:

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[29] Clause 2.4(a).

**106 No discrimination between suppliers**

(1) New co-op must ensure that the terms of supply that apply to a new entrant—

(a) are the same as the terms that apply to a shareholding farmer in the same circumstances; or

(b) differ from the terms that apply to a shareholding farmer in different circumstances only to reflect the different circumstances.

(2) New co-op must ensure that the terms and effect of financial products offered or issued in new co-op are the same for new entrants as for shareholding farmers.

(3) In this section, **financial products** has the same meaning as in section 7 of the Financial Markets Conduct Act 2013.

(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.

*The Judge's approach*

[101] The Judge considered the underlying purpose of s 106 was to ensure that, in respect of new entrants, Fonterra could not use the market power vested in it as a result of the legislative merger to achieve outcomes not available in a "workably competitive market".[30] In his view, the "different circumstances" recognised by s 106 must be objective circumstances of a kind that could be expected to result in different terms in a market of that description. Examples might include differences in the quality of the milk supply or particular difficulties of access to a new entrant's farm.

[102] In Muir J's view:

> [110] … a workably competitive market would not allow Fonterra the luxury of "sending messages to its shareholders". Nor in my view is it relevant that the differences in terms will benefit Fonterra or its shareholders or were otherwise seen as desirable to Fonterra or its shareholders. If that were the case then s 106 would be pointless. It is in my view intended to prevent discrimination for precisely such reasons.

[103] The Judge went on to accept submissions made by the respondents that the differences in terms could not be justified in order to "keep the shareholders sweet",

[30] High Court judgment, above n 3, at [110].

no matter how attractive that might have seemed to the Board.[31] Similarly, the imposition of sanctions for perceived disloyalty could not justify the differences. The Judge did not accept Fonterra's submission that the "terms of supply" in s 106 should be construed narrowly as a reference to practical matters rather than other terms as to price that were set by DIRA and the Constitution. In that respect, the Judge said this would mean:[32]

> … a key dimension in respect of which market power would expect to be exercised, namely "price", would not be effectively regulated by Subpart 5. I cannot accept that this was intended.

[104] The Judge then rejected a number of justifications advanced by Fonterra to justify the different terms of supply offered to the respondents. In particular, he found that the main reason for the differences was to placate existing shareholders (and internal stakeholders), referring to Mr Murphy's evidence that the changes were about the "optics".[33] He accepted the respondents' submission that the financial viability of the transaction did not depend on those terms, as had been formally acknowledged by Fonterra's legal advisers; the five cent per kgMS discount was a small and relatively arbitrary figure designed to be, and perceived to be, a penalty for suppliers who had previously left Fonterra and could not therefore expect to simply "waltz back in" (a phrase used in the email exchanges we have already referred to); the prohibition on sharing up for the first 12 months was intended to deprive the respondents of the expected gain in share price post-TAF as part of the "optics"; so too the decision not to buy the respondents' vat immediately.

[105] The Judge also rejected a number of other justifications advanced by Fonterra for the differences in the terms of supply. We need not refer to these because, on appeal, Mr Hodder focused principally on the payment of the respondents' retros as being the unique feature justifying the difference in the terms offered to the respondents. The Judge's conclusion on this point was:[34]

> … 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

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31 At [111].
32 At [112].
33 At [113].
34 At [115(f)].

> been made to impose the terms. And Mr Grace[35] gave evidence that Fonterra had bid $50 million for the same assets in a pre-receivership sale process. 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.

*Fonterra's submissions*

[106] Mr Hodder submitted that the justification for differences in the terms of supply for a new entrant must relate to commercially relevant matters. To support that submission, counsel emphasised the word "only" in s 106(1)(b). In this case, the circumstances of the respondents were truly different from other parties supplying milk under Growth Contracts. In particular, Fonterra was effectively and uniquely paying the respondents' retros in order to secure future supply. The Judge had applied the wrong test in concluding that the price paid by Fonterra for NZDL's assets did not depend on the imposition of the three unfavourable terms. Rather, the justification was that Fonterra had made a bid for the NZDL assets at a price sufficiently high to pay the retros. Without the supply offered by the respondents, Fonterra would not have acquired the plant.

[107] Counsel further submitted that the "terms of supply" referred to in s 106(1) were to be given a narrow meaning. In particular the section did not cover rights associated with shares or milk price since those matters were specifically addressed elsewhere in DIRA and the Constitution.

[108] Mr Hodder also submitted that the Judge was wrong to approach the matter on the basis of the terms that might be expected to be offered in a "workably competitive market". This import from Commerce Act jurisprudence was neither pleaded nor suggested by expert evidence; it was unnecessary and would invite debatable counter-factual arguments. Finally, counsel submitted that the inequality of treatment was justified by the Board's proper concern about the views of its existing shareholders who were due to vote in late June 2012 on the Board's proposal to introduce the major and controversial TAF changes. Mr Hodder submitted these changes were considered to be in Fonterra's best interests and were plainly much more significant than the NZDL acquisition. The Board took the

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35 Mr Grace was responsible on behalf of the receivers for managing the sale of NZDL's assets.

unsurprising view that, in the circumstances, the respondents should not be seen to "waltz back in" with their retros paid by the existing shareholders.

*Question two — discussion*

[109] The explanatory note to the Dairy Industry Restructuring Bill 2001 provides helpful insight into the public policy objectives of the proposed merger and restructuring of the dairy industry. An identified detriment of the proposed merger was:[36]

> the creation of a large monopoly that, 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.

[110] Proponents of the Bill had agreed that efficient management required that:[37]

> they post prices at which farmers may enter and exit on demand, and at which milk may be bought and sold on demand.

[111] Further, open entry was seen as "the key to mitigating a co-operative's monopsony power".[38]

[112] This theme was echoed in the report of the Primary Production Committee to the House:[39]

> 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 (per kilogram of milksolids) for entry to the co-operative as it pays upon exit. It is also essential that all other barriers to entry and exit are removed or at least reduced to an absolute minimum.

[113] Finally on this topic, we refer to the speech made by the then Minister of Agriculture[40] at the second reading of the Bill:[41]

> 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

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36 Dairy Industry Restructuring Bill 2001 (139-1) (explanatory note) at 5.
37 At 5–6.
38 At 6.
39 Dairy Industry Restructuring Bill 2001 (139-2) (select committee report) at 2.
40 The Hon Jim Sutton.
41 (18 September 2001) 595 NZPD 11780.

> 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 is important that farmers exiting Fonterra receive adequate compensation for the value of their shares in the cooperative. A traditional regulatory approach would have sought to achieve this, by directly regulating Fonterra's share price. However, the Government received clear advice that, in this instance, such an approach was likely to fail.
>
> 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. Fonterra must post a share price, then accept all entry and exit, to and from the cooperative, applied for at that price. To work properly, it is essential that the only barrier to entry to the cooperative is the 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 exiting farmers exactly the same amount per kilogram of milk solids as Fonterra charges farmers joining the cooperative at the same time.
>
> It is also essential that Fonterra does not discriminate between existing supplying shareholders, and new entrants to the cooperative. This is not to say that Fonterra cannot respond to the entry of new competitors. However, Fonterra must apply its response to new entrants and existing shareholders alike.

[114] The objective of promoting the efficient operation of dairy markets is stated to be one of the important purposes of the amalgamation, as noted above at [63]. It is also reflected in the purpose of subpart 5 of pt 2 of DIRA (cited above at [65]). The efficiency objective and the removal of barriers to entry are again referred to in the statement of principles we have set out above at [66]. Particular importance attaches to the requirement that Fonterra must accept applications by new entrants and shareholding farmers to supply it with milk as shareholding farmers and to the principle that Fonterra must not discriminate between new entrants and shareholding farmers whose circumstances are the same.

[115] The approach to interpreting s 106 must be guided by the clearly stated policy objectives and purpose of DIRA. On this basis, we are not persuaded that the expression "terms of supply" should be narrowly construed as Mr Hodder submitted. There is nothing to suggest the terms of supply should be confined to practical matters such as tanker access as counsel submitted. It would not be consistent with the purpose of s 106 to construe it as applying only to some of the terms of the MSAs. We accept that some terms of supply such as the share price are fixed by DIRA and/or the Constitution, but the existence of a mechanism to fix the milk price

was not seen by Fonterra as an obstacle to offering to purchase the respondents' milk at 10 cents below that price.

[116] It could not have been intended that a differential on a fundamental term such as the milk price would be treated as outside the scope of s 106. So too, the ban on sharing up in the first year of the contract. To exclude terms such as these from the scope of s 106 would run counter to the open entry/open exit policy and would create the very sort of barrier s 106 was designed to avoid.

[117] The question becomes: what is meant by a shareholding farmer "in the same circumstances"? Counsel are agreed this question must be answered by an objective examination of the circumstances applying to new entrants and those applying to an existing shareholding farmer. As Mr Goddard submitted, 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. Examples might include a difference in the cost to Fonterra of accepting supply or a difference in the nature and value of the products supplied. The use of the word "only" in s 106(1)(b) serves to emphasise that extraneous or collateral matters are to be put to one side in the analysis.

[118] Although Mr Goddard submitted differences in circumstances were to be construed by a comparison with a notional competitor to Fonterra, we consider some care is needed before importing notions from the Commerce Act to the s 106 analysis, which is to be construed in its separate statutory context.

[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 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.

[121] 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. This represented a gain of some $22 million for Fonterra.

[122] We are satisfied 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.

[123] 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 allowed to "waltz back in". Fonterra concedes that the financial viability of the Growth Contracts offered to the respondents 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.

[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 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 s 106. As

Winkelmann J said in the context of alleged discrimination amongst suppliers of Zespri in the kiwifruit market:[42]

> It is difficult to imagine discrimination being justifiable where the power to discriminate is used to achieve some collateral purpose, in that it is unconnected to the exercise of commercial judgment by Zespri in relation to the particular purchase.

[125] As the Judge observed in that case, discrimination as a means of disciplining or penalising suppliers was inconsistent with the regulations at issue. The Judge concluded that discrimination against potential suppliers was not justifiable on commercial grounds because its rationale was to discipline them for suspected breaches of an export ban.[43]

[126] Finally, we agree with Muir J that Fonterra's expressed concerns about the forthcoming 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.

[127] Significantly, the prohibition on the acquisition of shares for 12 months had the effect of ensuring that the respondents did not benefit from the expected increase in the Fonterrra share price post-TAF. This was a matter of real concern to the respondents and was raised by them in the June meetings with Fonterra. It meant that the terms offered to the respondents were substantially less favourable than those available to Fonterra's existing suppliers under Growth Contracts.

[128] In summary, we find the Judge was correct to conclude that Fonterra breached s 106 by offering the respondents terms of supply that were less favourable than those available to existing shareholders under Growth Contracts.

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[42] *Aotearoa Kiwifruit Export Ltd v Southlink Ltd* HC Auckland CIV-2003-470-478, 3 February 2006 at [70].

[43] At [73].

[129] We now turn to Questions three and four which it is convenient to deal with together.

[130] In view of the conclusion we have reached on Questions one and two it is not strictly necessary for us to address the remaining questions. The respondents would be entitled to relief under s 143 of DIRA. Mr Goddard accepted that any such relief would likely be commensurate with, if not greater than, any relief granted under the FTA or CRA. However, we will address these issues for completeness.

**Question three: Did Fonterra advise the respondents about the extent of the respondents' ability to buy shares and to supply milk on a shared up basis in terms or to the effect pleaded in paragraph 31 of the Amended Statement of Claim, or as pleaded in paragraph 31 of the Amended Statement of Defence?**

**Question four: Was such advice misleading and deceptive conduct in trade in breach of s 9 of the Fair Trading Act 1986?**

*The pleadings*

[131] The respondents alleged that at the meetings on 15 and 20 June 2012 some of the suppliers asked Fonterra representatives why they were not able to buy shares beyond the minimum of 1,000 in the first year. At [31] of the second amended statement of claim, the respondents alleged they were told by a Fonterra representative that:

> (a) this was not legally possible because the application period had closed; and
>
> (b) Fonterra was not permitting even its existing shareholders to purchase additional shares at that time, subject to a limited exception that enabled existing shareholders to purchase up to 20% more shares than they currently held, to accommodate expected growth in milk supply.

[132] It was alleged that the statements were made at the 15 June meeting by Mr Murphy and/or Mr Monaghan (a Fonterra director). It was said the statements were made at the 20 June meeting by Mr Murphy and/or Ms Burr.

[133] Fonterra's response to these allegations in its statement of defence to the second amended statement of claim was as follows:

… [Fonterra]

31.2 says that the NZDL milk suppliers were told by its representatives that the special contractual terms of supply offered were those that had been signed off by the Board and required all such suppliers to accept them if the Sale Agreement were to be completed and they were to receive their arrears in full;

31.3 says further, in relation to the allegation pleaded in paragraph 31(a), that NZDL milk suppliers were told by its representatives that, as the new supply arrangements being offered would be entered into outside the published application period, they had no entitlement to commence supply in the 2012/13 season on a fully shared up basis;

31.4 says further, in relation to the allegation pleaded (for the first time on 25 March 2015) in paragraph 31(b), that the Board had previously decided that there would be (and Fonterra sought to apply) a moratorium on the issue of additional "dry" shares (as distinct from "wet" shares required and applied for in relation to specific production increase proposals) to existing shareholders until after the expected commencement of the TAF scheme (referred to in paragraph 32, below) in late 2012, and that the NZDL milk suppliers were told of this moratorium by Fonterra's representatives at the 20 June 2012 meeting; and

31.5 otherwise denies paragraph 31.

[134] The respondents relied on s 9 of the FTA. The Judge recorded the parties' agreement that:

(a) Incorrect information about legal rights and remedies could amount to a breach of s 9;[44] and

(b) The relevant test was whether the alleged conduct was capable of misleading and likely to mislead a reasonable person with the respondents' characteristics in all the circumstances of the case.[45]

*The Judge's factual findings*

[135] The Judge carefully reviewed the oral evidence given in relation to both meetings. The respondents' evidence came from Messrs Borst, Tennent, Ellis, Lowe and Willans. In addition, there was evidence from Mr Lodge, who was NZDL's

44 High Court judgment, above n 3, at [120] citing *Clifton-Mogg v National Bank of New Zealand Ltd* (2001) 10 TCLR 213 (HC).

45 At [121] citing *AMP Finance NZ Ltd v Heaven* (1998) 6 NZBLC 102,414 (CA).

quality and compliance manager at the relevant time. The Judge regarded him as an independent witness. The Fonterra representatives who gave evidence were Mr Monaghan, Mr Murphy and Ms Burr. Not all the witnesses were present at both meetings, as the Judge recorded.[46]

[136] There were no verbatim transcripts of the meetings but contemporaneous notes were made by Mr Lodge and by Mr Tennent's wife. The Judge accepted the contemporaneous documents were of the utmost importance, but he also took into account the evidence of the participants, all of whom he regarded as genuine in their attempted recollections of what was said.[47] Noting that both parties agreed that statements made by Fonterra's representatives at the two meetings must be taken into account (on the footing that what was said at one meeting could shed light on what was said at the other), the Judge found it was the overall impact of Fonterra's conduct that was relevant. He added:

> [126] … Although I deal with the two "non-eligibility representations" separately, I do so therefore live to the fact that each must be considered in the context of the other. The [respondents'] case is that the overall message was that they were not eligible to share-up both because they were out of time and (with very limited exceptions relating to production increases), because no suppliers were able to acquire shares at that time.

*The first representation — not legally possible for the respondents to acquire shares*

[137] Having established his general approach to the evidence, the Judge then carefully analysed the alleged representations. In the first instance, he did so separately by reference to each of the two meetings. Addressing the first allegation, he reviewed the contemporaneous notes and the evidence of the relevant witnesses, and concluded in respect of the 15 June meeting that:

> [136] … neither Mr Monaghan nor Mr Murphy stated that it was legally impossible for the suppliers to share-up but that the suppliers were told that they could not share-up and/or that this was not "allowed", or words to that effect. I find also that Fonterra communicated its position in un-negotiable terms.

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46 High Court judgment, above n 3, at [123].
47 At [124].

[138] Turning to the meeting of 20 June, the Judge noted the respondents' witnesses had a consistent recollection of the words "legally impossible" being used.[48] This had been put on the basis that the respondents were outside the application period. The Judge reviewed all the relevant evidence, both documentary and otherwise.

[139] He also took into account evidence from two of the respondents' witnesses about discussions they had with Fonterra's area manager, Mr Griffiths. He was present at both meetings but not called at trial. Mr Griffiths was also present at a meeting at the offices of the respondents' solicitors in April 2013 at which Mr Monaghan and others were present. The gist of the evidence called by the respondents was that Mr Griffiths said on several occasions that when they [the Fonterra representatives] said at the meeting it was legally impossible to buy shares, he [Mr Griffiths] "almost stood up at the meeting and corrected them as it was not actually quite right". The Judge considered it was appropriate to draw an adverse inference that Mr Griffiths' evidence would not have assisted Fonterra and that he was not called for that reason.

[140] The Judge then made his findings in relation to the 20 June meeting:

> [153] My overall conclusion in relation to the 20 June meeting is that the "legally impossible" allegation represents an extrapolation from, rather than a precise record of, what was said. Again, had those exact words been used I would expect them to have featured in one or other of the contemporaneous notes. However, that is not an answer in itself. Question 3 invites me to find whether there was advice "in the terms or *to the effect*" pleaded in paragraph 31 of the Amended Statement of Claim. Consistent with the admissions made by Mr Griffiths and the evidence of Mr Lodge, I consider that the overriding "message" or impression left by the Fonterra representatives was that the suppliers could not share-up because they were outside the application period and/or the fact that because they were outside such period it could not be "allowed". Taken in combination with Fonterra's further representations relating to the inability of existing shareholders to buy shares (which I will next address), and the absence of any reference to Fonterra's discretion, that, in my view, resulted in a breach of s 9 to the extent that it was both capable of misleading and likely to mislead a reasonable person with the [respondents'] characteristics into believing that the fact that they were out of time was necessarily fatal.
>
> (emphasis in original)

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48 At [137].

[141] The Judge's conclusion was reinforced by his finding that there was no explicit reference at the meetings to the Board having any discretion in respect of an application outside the application period or to the Board having chosen not to exercise it in favour of the suppliers. He said:

> [152] … Mr Monaghan accepted that any such explanation would have provoked questions about why the discretion was not being exercised in the suppliers' favour and that no such questions occurred. Mr Murphy also acknowledged as "absolutely, it's a possibility" no mention of the discretion had occurred. None of that is surprising. As Mr Monaghan stated, to have told the suppliers that Fonterra had a discretion which it was specifically exercising against them would not have been a very "up-beat" message in the context of a presentation designed to sell the deal.
>
> (footnotes omitted)

*The second representation — inability of other Fonterra shareholders to buy shares*

[142] Muir J noted it was undisputed that at both the June meetings comments were made by Fonterra representatives about the inability of other Fonterra shareholders to buy shares in the company at the relevant time. He recorded the contents of the record kept by Mr Lodge in these terms:[49]

> [155] … Mr Lodge's minutes of the meeting of 15 June record the exchange previously identified in terms:
>
> > Dave Ellis Unique situation, why not allow us to share-up straight away.
> >
> > Steve Murphy Can't allow this as Fonterra has many other existing suppliers on contract.
>
> [156] His minutes of the 20 June meeting in turn record:
>
> > Robert Tennent What disadvantage to Fonterra if we don't have to share-up.
> >
> > Steve Murphy we have many others who can't buy shares at moment.
> >
> > Christine Burr we don't issue shares after the end of September. There is no market mechanism to change for value share after that.
> >
> > TAF on table — we going through "end of season". Not allowing existing shareholders to buy additional shares.

[49] High Court judgment, above n 3 (footnote omitted).

[143] On this issue, there was substantial focus at trial on Ms Burr's evidence. Muir J recorded Fonterra's position to be that when Ms Burr referred to a moratorium on the purchase of shares she was referring to "Additional Shares", a technical term used to mean the moratorium Fonterra had, on 22 May 2012, imposed on the acquisition of "dry" shares as part of the lead-up to TAF.[50] This was a moratorium applying to both existing shareholders and to any new entrants who might be accepted.

[144] The true position is that existing shareholders (including those supplying under Growth Contracts) could buy "wet" shares, but the proposal was that the respondents would not be able to do so in their first season.[51]

[145] The Judge recorded what he regarded as an important acknowledgement made by Ms Burr in cross-examination to this effect:

> Q. Someone who heard you say "no additional shares" and who read this paragraph could reasonably understand that people on growth contracts weren't being allowed to share up in respect of their existing supply?
>
> A. Maybe, yes that could be.
>
> Q. And that would be wrong?
>
> A. Yes.

[146] The Judge then gave his conclusions about the effect of Ms Burr's evidence in these terms:

> [160] I have no doubt that when Ms Burr talked about additional shares she was, given her own intimate knowledge of the workings of Fonterra and its share register, meaning dry shares. However, her audience was not equally versed in Fonterra's specialist internal terminology. Nor in fact was that terminology consistently used by Fonterra. For example, the phrase "Additional Shares" in Fonterra's 2012 Growth Contract Booklet appears to refer (and Mr Murphy agreed) to wet shares (additional shares over and above Fonterra's minimum 1,000 requirement which might be purchased in the first three years of a Growth Contract with a commensurate reduction in the volume of contract milk supplied).

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50 At [157].

51 The term "dry shares" refers to shares that are not linked to the supply of milk. "Wet shares" are those linked by the share standard to the quantity of milk supplied.

> [161] At all times suppliers under Growth Contracts could buy more shares as long as they were happy for those to be treated as production-backed shares that reduced their contract quantity. It was precisely this that some of the suppliers at the meetings of 15 and 20 June wanted to do. The restrictions on the acquisition of dry shares were simply irrelevant in that context and, in my view, capable of misleading and likely to mislead. The following passage in Ms Burr's cross-examination is relevant:
>
> > Q. So the restrictions on acquiring dry shares that applied to other shareholders were not restrictions that there (sic) relevant to the desire of these shareholders to acquire wet shares, agree with that?
> >
> > A. Yes.
> >
> > Q. So answering their questions about why they couldn't acquire shares by reference to the moratorium was at best confusing wasn't it?
> >
> > A. To them, yes maybe, I don't know.
>
> (footnotes omitted)

[147] Muir J went on to refer to concessions made by Mr Murphy in cross-examination that the statements made about the moratorium on the purchase of shares could have been potentially confusing. Mr Murphy said he expected that any such confusion could be cleared up later, perhaps at the meeting on 20 June.

[148] The Judge did not accept that explanation, finding:

> [163] I do not consider the confusion "cleared up" at the meeting on 20 June 2012. Indeed, I consider that meeting compounded the problem in a way which, albeit unintentionally, [misled] or deceived within the terms of s 9. The overall message was that the suppliers were not being treated differently from other Growth Contract suppliers in relation to sharing up when in fact they were.

[149] Finally, the Judge rejected submissions made on Fonterra's behalf that the ability of the respondents to seek legal advice from the June meetings was relevant to the FTA allegations and that the entire agreement clause in the MSAs was relevant to a breach of s 9.

*Fonterra's submissions on appeal*

[150] Fonterra raised a number of arguments challenging the Judge's findings on the misrepresentation issue. The primary submission made was that the respondents

had not satisfied the onus of proof. This was said to be a heavy onus in circumstances where the terms of the proposed MSAs were in the hands of the respondents at the time of the meetings, and clearly stated that:

> The Supplier will have no entitlement to become Fonterra fully share backed in the 2012/13 season under this contract.

[151] There was, counsel submitted, no misunderstanding about the terms Fonterra was offering. Rather, the respondents' allegations related to Fonterra's reasons why they could not acquire shares for the first season. It was also submitted the Judge had erred in his approach to the meeting notes. While emphasising the importance of the terms of the contemporaneous records, the Judge had placed greater emphasis on the oral recollections of the witnesses. This was said to be significant because the Judge found the notes did not support the allegations in the terms pleaded by the respondents. The Judge was wrong to "extrapolate" from the contemporaneous notes that do not refer to the words "legally impossible".

[152] Many other points were made in Fonterra's submissions: the allegations were essentially questions of law rather than fact; the respondents were knowledgeable about the dairy industry and a number of them had previously supplied Fonterra; Fonterra had made it clear the deal offered was non-negotiable; properly understood, references in the evidence to Fonterra not having a "mandate" to allow sharing up in the first year meant that the Board had advised Mr Murphy it could not change the contractual terms and that he had no authority to offer any different terms; Mr Griffiths' absence was immaterial and the Judge ought not to have drawn an adverse inference from his absence; the allegation that Fonterra was not permitting its existing shareholders to purchase shares at the time was only belatedly included in the pleading after Mr Lodge's notes of the meetings had been discovered by Fonterra some months after the initial statement of claim was filed; at best, there may have been some confusion on this issue but mere confusion was not sufficient to meet the onus of proof borne by the respondents; and the Judge had erred in concluding that the entire agreement clause was relevant only to the assessment of relief under s 43 of the FTA.

*Our assessment*

[153] We are mindful of the approach to be taken in general appeals. The Supreme Court stated in *Austin, Nichols & Co Ltd v Stichting Lodestar* that those exercising general rights of appeal are entitled to judgment in accordance with the opinion of the appellate court, even where that opinion is an assessment of fact and degree and entails a value judgment.[52] If the appellate court's opinion is different from the conclusion of the court or tribunal appealed from, then the decision under appeal is wrong even if it was a conclusion on which minds might reasonably differ.

[154] The Supreme Court added:[53]

> … The appeal court must be persuaded that the decision is wrong, but in reaching that view no "deference" is required beyond the "customary" caution appropriate when seeing the witnesses provides an advantage because credibility is important. Such caution when facts found by the trial judge turn on issues of credibility is illustrated by *Rae v International Insurance Brokers (Nelson Marlborough) Ltd* and *Rangatira Ltd v Commissioner of Inland Revenue*.

[155] In *Austin, Nichols* the Supreme Court was dealing with an appeal against a decision of the Assistant Commissioner of Trademarks. The Court considered there was no basis for caution in differing from the assessment of the tribunal since no question of credibility arose and the case turned on a judgment of fact and degree.[54]

[156] In the present appeal Mr Hodder submitted this Court was just as well equipped as the trial Judge to assess questions of fact. While we accept no issue of credibility arises, we do not accept Mr Hodder's submission. In *Rae v International Insurance Brokers (Nelson Marlborough) Ltd* this Court expressed in very firm terms the difficulties an appellant faces in challenging findings of fact.[55] Richardson P and Tipping J observed that:[56]

> Any tendency or wish to engage in a general factual retrial must be firmly resisted. This Court will not reverse a factual finding unless compelling grounds are shown for doing so.

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52 *Austin, Nichols & Co Inc v Stichting Lodestar* [2007] NZSC 103, [2008] 2 NZLR 141 at [16].
53 At [13] (footnotes omitted).
54 At [17].
55 *Rae v International Insurance Brokers (Nelson Marlborough) Ltd* [1998] 3 NZLR 190 (CA).
56 At 198.

[157] Thomas J was the third member of the Court. He concurred with the observations made by Richardson P and Tipping J and then, as is well known, set out in some detail the advantages enjoyed by a trial Judge who sees and hears the witnesses. Thomas J observed:[57]

> It may not be fully appreciated that the deference of an appellate Court to the findings of fact of the Court at first instance is founded on a number of pragmatic considerations which make it inappropriate for the appellate Court to intervene. The advantages possessed by the trial Judge in determining questions of fact are manifest. Of paramount importance, of course, is the fact the trial Judge hears and sees the witnesses first hand over a matter of days, or even weeks, of taking evidence. He or she can form an impression of the reliability of witnesses and, where necessary, their credibility – although in deference to the witness's feelings the Judge may not always express an adverse conclusion in that regard. As the evidence unfolds the trial Judge gains an impression from the evidence which is not necessarily or usually apparent from the cold typeface of the transcript of that evidence on appeal. The Judge forms a perception of the facts in issue from which he or she adds or subtracts further facts as witnesses give their evidence, and so obtains as complete a picture as is possible of the events in issue. The Judge perceives first hand the probabilities inherent in the circumstances traversed in the evidence and can obtain a superior impression of those probabilities as a result.

[158] The advantages enjoyed by the trial judge on issues of fact have been recently reiterated by this Court in *Green v Green*.[58]

[159] In the present case, the trial occupied a total of nine sitting days, the written transcript of the oral evidence alone running to 645 pages. It is the very sort of case in which the observations made in *Rae* and in *Green* should be kept in mind. We regard this case, depending as it does largely on disputed oral evidence, as calling for the "customary caution" in dealing with challenges to factual findings, as endorsed in *Austin, Nichols*.

[160] With these observations in mind, we have ourselves reviewed the key parts of the evidence. Having done so, we find ourselves in agreement with the Judge in respect of his conclusions on the FTA issues and see no basis to interfere with the factual findings he made. Our reasons follow.

[161] We begin by stating the facts not in dispute:

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57 At 199.

58 *Green v Green* [2016] NZCA 486 at [31].

(a) The respondents were not in any doubt about the actual terms offered and that they differed from those applying to suppliers already on Growth Contracts with Fonterra.

(b) The offer was made on a "take it or leave it" basis.

(c) The respondents asked the Fonterra representatives at the June meetings why they could not share up in their first season.

(d) The respondents were told at the June meetings that because the new arrangements being offered were outside the application period, they had no "entitlement" to commence supply in the 2012/13 season on a fully shared up basis.[59]

(e) There was no written record of the respondents being told it was "legally impossible" for them to share up in the first season.

(f) It was not suggested at the meetings that the respondents could have shared up in the first season but that Fonterra had decided, as a matter of discretion, not to permit this to happen.

(g) The respondents were also told at the 20 June meeting there was a moratorium on the issue of shares to existing shareholders until after the expected commencement of the TAF scheme.

[162] The factual dispute over the first representation centred on the reasons why the offer precluded the respondents from sharing up in their first season. A major focus of the oral evidence was whether the respondents were told Fonterra "would not" or "could not" offer the respondents the opportunity to share up as the existing contract suppliers could. This distinction was framed on the basis that "would not" meant Fonterra's Board was adamant sharing up would not be permitted. This was described in one of the written records of the meetings as "a hard nosed" approach.

59 The term "entitlement" is used in Fonterra's pleadings.

In contrast, “could not” meant it was not possible by law, including by the provisions of Fonterra’s Constitution.

[163] In reaching his factual finding on this point (succinctly summarised in the passage reproduced at [140] above), Muir J relied on the evidence of Mr Lodge (who he properly regarded as independent), the admissions made by Mr Griffiths (the witness Fonterra did not call), and the absence of any suggestion at the meetings that Fonterra could have allowed sharing up but had chosen not to do so. These factors, in combination with the Judge’s finding on the second representation, led him to the conclusion that the overriding message or impression left by the Fonterra representatives was that the respondents could not share up because they were outside the application period.

[164] We are satisfied the Judge’s conclusions are logical and properly grounded in the evidence. Given the agreed form in which Question three was expressed, it was entirely appropriate for the Judge to conclude that, despite the absence of any express reference to the words “legally impossible” as pleaded, this was the gist of what was conveyed. So too his conclusion that the statements made by the Fonterra representatives were reasonably understood in that way by the respondents. The explanation that the respondents were outside the application period, in the absence of any reference to the available discretion, could only have been understood to be a consequence of a legal requirement under DIRA or in the company’s Constitution. As pleaded by Fonterra, the respondents were told they had no “entitlement” to share up. That term too could only have been understood as no legal entitlement — “could not” in the terminology used at trial.

[165] Given the admitted existence of the discretion under s 74(3) to accept a late application and the absence of any reference at the meetings to the existence of that discretion, the Judge’s findings inevitably led to the conclusion that the first representation was both capable of misleading and was likely to mislead the respondents in terms of s 9 of the FTA.

[166] We do not accept Fonterra’s submission that there was a heavy onus of proof on the respondents with regard to the representations. This submission appears to be

based on the proposition that the terms offered by Fonterra were clear and well understood. This overlooks the fact that the respondents' case was not focused on the terms offered but on the reasons for them. The ordinary civil standard of proof applies.

[167] Nor do we accept the submission that the Judge was wrong to rely on the evidence of Mr Griffiths. The admissions he made to the respondents' witnesses were admissible as such and the Judge was entitled to draw an adverse inference when he was not called.[60]

[168] We reiterate the point made during the hearing of the appeal that it is unfortunate that the issue of reliance on the representations was left for determination at a later date. Fonterra submitted that the respondents knew what the terms offered were and signed the MSAs with that knowledge. This may be relevant to the issue of reliance but, for present purposes, the submission has no relevance.

[169] As to the second representation, we have reviewed the relevant evidence including, in particular, the evidence of Ms Burr and Mr Murphy. This evidence includes concessions they each made in cross-examination. We have summarised the Judge's reasoning and conclusions on this issue at [142] to [149] above. Again, we are satisfied the Judge's conclusions are both logical and supported by the evidence. It was open for him to conclude that references by the Fonterra representatives to the moratorium on the purchase of shares pre-TAF conveyed the message that the respondents were not being treated differently from the existing Growth Contract suppliers in relation to sharing up when, in fact, they were.

[170] Ms Burr's concession that the respondents may have been confused about the difference between dry and wet shares is significant. She explained in evidence that the moratorium applied only to dry shares. The Judge found this distinction was not clarified at the June meetings. If it had been, it would have been apparent to the respondents they were not being treated the same way as existing Growth Contract suppliers in relation to the acquisition of wet shares. This was the focus of the

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[60] *Ithaca (Custodians) Ltd v Perry Corp* [2004] 1 NZLR 731 (CA) at [153].

respondents' concern and their questions at the meetings. Their questions were plainly directed to wet shares, not dry shares.

[171] We conclude that the Judge was right to find the respondents were misled on this issue and that a breach of s 9 of the FTA was established.

*Remaining issues on Questions three and four*

[172] Three remaining points made by Fonterra need to be addressed. First we discuss the issue of confusion induced by misleading conduct. We accept there is authority for the proposition that conduct that merely induces a state of wonderment as to the true state of affairs is not sufficient to establish an infringement of s 9.[61] But where the misleading conduct induces a positive misunderstanding that is incorrect, liability may arise.[62] In the present case, Muir J has found that Fonterra's conduct unintentionally misled the respondents by representing they were not being treated differently from existing Growth Contract suppliers. This arose because Fonterra representatives did not clarify the shares to which the moratorium applied.

[173] Second, we deal with Fonterra's submission that the FTA and the CRA apply only to representations of fact, not law. This argument is relevant to the first representation found by the Judge to the effect that the suppliers were given the overriding message that they could not share up because they were outside the application period. We are not persuaded that the representation found by the Judge is confined to a question of law. In our view, the misleading conduct on this issue was substantially a question of fact or, at least, a mixed question of fact and law.

[174] It is a matter of fact that the arrangement being offered by Fonterra to the respondents was outside the application period under DIRA. In those circumstances, Fonterra had a discretion under s 74(3) to accept applications under s 73 notwithstanding. The existence of that discretion was not disclosed by Fonterra.

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[61] *Parkdale Custom Built Furniture Pty Ltd v Puxu Pty Ltd* (1982) 149 CLR 191 at 198, 210 and 225; *Unilever New Zealand Ltd v Cerebos Gregg's Ltd* (1994) 6 TCLR 187 (CA) at 192; *Geddes v New Zealand Dairy Board* CA180/03, 20 June 2005; *Stevens v Premium Real Estate Ltd* (2006) 11 TCLR 854 (HC) at [28]; and *Bing! Software Pty Ltd v Bing Technologies Pty Ltd* [2009] FCAFC 131, (2009) 180 FCR 191 at [42]–[50].

[62] See, for example, *Trust Bank Auckland Ltd v ASB Bank Ltd* [1989] 3 NZLR 385 (CA) at 389–390.

Nor did Fonterra disclose to the respondents that their reasons for treating the respondents differently had to do with a range of other considerations, including the intention to penalise or discipline the respondents for perceived disloyalty as already discussed. We are satisfied Fonterra's conduct in this respect was well capable of amounting to an infringement of s 9.

[175] In any event, we accept Mr Goddard's submission that the law has evolved substantially from the previous understanding that a statement of law could not be treated as a misrepresentation. We refer to the helpful discussion on this point in *Chitty on Contracts*.[63] Mr Goddard also referred us on this point to a discussion by French J in *Inn Leisure Industries Pty Ltd v D F McCloy Pty Ltd (No 1)*.[64] We also note the decision of William Young J in *Clifton-Mogg* in which it was held that misrepresentations made as to the true nature of the terms of an insurance policy amounted to an infringement of s 9 of the FTA.[65]

[176] Finally, we address Fonterra's submission on the entire agreement clause in the MSAs. The relevant clause reads:

> This agreement together with the existing agreement between NZDL and the Supplier (as varied by this agreement) and the Fonterra 2012 Growth Contract constitutes the entire agreement of the parties and supersedes all prior agreements, arrangements, understandings (including the unsigned draft memorandum of understanding prepared by the parties) and representations (whether oral or written) given by or made between the parties, relating to the matters dealt with in this agreement.

[177] Muir J rejected Fonterra's submission that the entire agreement clause was relevant to the question of a breach of s 9. He accepted the respondents' submissions that, at most, a clause of this kind is relevant as a factor going to causation or to the remedial discretion under s 43 of the FTA.[66]

[178] In *PAE (New Zealand) Ltd v Brosnahan* this Court accepted as settled law the proposition that a party cannot contract out of the s 9 prohibition on misleading or

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63 H G Beale (ed) *Chitty on Contracts* (31st ed, Sweet & Maxwell, London, 2012) vol 1 at [6–016].
64 *Inn Leisure Industries Pty Ltd v D F McCloy Pty Ltd (No 1)* (1991) 28 FCR 151 (FCA) at 164–165.
65 *Clifton-Mogg v National Bank of New Zealand Ltd*, above n 44.
66 High Court judgment, above n 3, at [165].

deceptive conduct.[67] The policy justification is that the FTA is designed to protect the consuming public. However, this Court found that while the policy factors were a starting point, the consumer protection purpose was not necessarily an absolute or decisive consideration.[68] Supporting this point, the following passages from this Court's earlier decision in *David v TFAC Ltd* were cited:[69]

> [63] While such mechanisms are not determinative, it has been accepted that they are relevant to the s 9 analysis. For example, in *Kewside Pty Ltd v Warman International Ltd* (1990) ATPR (Digest) 46-059, French J said (at 53,222):
>
> > "A disclaimer or exclusion clause will affect liability for misleading or deceptive conduct only if it deprives the conduct of that quality or breaks the causal connection between conduct and loss. Whether it has that effect in a given case is a question of evidence and not a question of law."
>
> See also *Butcher v Lachlan Elder Realty Pty Ltd* (2004) 218 CLR 592 (HCA) at [50]–[51]. But a disclaimer or similar clause may be overwhelmed by oral assurances or other conduct (see *Phyllis Gale Ltd v Ellicott* (1997) 8 TCLR 57 (HC) at 65–66 and *Cornfields* [*Ltd v Gourmet Burger Co Ltd* (2000) 9 TCLR 698 (HC)] at [41]).

[179] The position under the CRA is different. In terms of s 4(1), an entire agreement clause may be effective if it is fair and reasonable that the provision should be conclusive between the parties. In *PAE* the relevant principles were summarised in these terms:[70]

> [15] An entire agreement clause, however, is not absolute or conclusive. Section 4(1) recognises a wide judicial discretion to determine whether it is "fair and reasonable that the provision should be conclusive". While the issue is to be determined "having regard to all the circumstances of the case", the specified criteria focus the inquiry on an assessment of the relative positions of the parties and their access to independent legal advice. Its apparent purpose is to protect one party's relative vulnerability from another party's power to impose an exemption from liability which is contrary to the factual reality or an existing legal obligation and is thus unreasonable and unfair. Section 4(1) is a mechanism for striking balances, both individually between parties and conceptually between freedom of contract and unfair or unreasonable commercial conduct. (See also *Dawson* and *McLauchlan* The Contractual Remedies Act 1979 (1981) at 36-40.)

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67 *PAE (New Zealand) Ltd v Brosnahan* [2009] NZCA 611, (2009) 10 TCLR 626 at [42].
68 At [43].
69 At [43] in *PAE*, citing *David v TFAC Ltd* [2009] NZCA 44, [2009] 3 NZLR 239.
70 *PAE (New Zealand) Ltd v Brosnahan*, above n 67.

[180] For present purposes, it is sufficient to focus on the relevance of the entire agreement clause to the FTA claim. The Judge effectively left any question about the application of the entire agreement clause to be considered and determined as part of any later inquiry into reliance and damages. We are satisfied this was appropriate for two main reasons. First, the parties specifically left issues of reliance and relief for later determination. Second, the significance of the entire agreement clause could not appropriately be considered by reference to the position of the respondents as a whole. Rather, it is necessary to consider the relative positions of Fonterra and each of the respondents individually. There was no or insufficient evidence before the High Court on these issues and the Judge made no findings on them.

[181] We also observe that this is not a case involving substantial commercial parties who might be considered to have equal bargaining power as was the case in *PAE*. We are satisfied the relevance of the entire agreement clause is best left to later determination. Similar considerations apply to an assessment under s 4(1) of the CRA.

**Question five: Did Fonterra's advice to the respondents about the extent of the respondents' ability to buy shares and supply milk on a shared up basis amount to a misrepresentation in terms of s 6 of the Contractual Remedies Act 1979?**

[182] On this issue, the Judge noted that the essential elements of a cause of action under s 6 of the CRA and s 9 of the FTA were the same or similar save that the CRA requires a plaintiff to show the defendant intended to induce the plaintiff to enter into the contract on the basis of the misrepresentation.[71] The parties were agreed that the principal issue for determination in relation to the CRA claim was the same question of fact arising in the FTA claim.

[183] Given our conclusion that the Judge's findings on the FTA claim are sound, there is no need to deal further with Question five.

**Result**

[184] For the reasons given, the appeal is dismissed.

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[71] High Court judgment, above n 3, at [170].

[185] The appellant must pay the respondents costs for a standard appeal on a band A basis and usual disbursements. We allow for second counsel.

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