

Departmental Disclosure Statement

Commerce (Grocery Sector Covenants) Amendment Bill
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The departmental disclosure statement for a government Bill seeks to bring together in one place a range of information to support and enhance the Parliamentary and public scrutiny of that Bill.

It identifies:

- the general policy intent of the Bill and other background policy material;
- some of the key quality assurance products and processes used to develop and test the content of the Bill;
- the presence of certain significant powers or features in the Bill that might be of particular Parliamentary or public interest and warrant an explanation.

This disclosure statement was prepared by the Ministry of Business, Innovation and Employment.

The Ministry of Business, Innovation and Employment certifies that, to the best of its knowledge and understanding, the information provided is complete and accurate at the date of finalisation below.

4 May 2021

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Part One: General Policy Statement

General Policy Statement:

On 8 March 2022, the Commerce Commission released its final report on its market study into the retail grocery sector in New Zealand. The report found that competition within the sector was not working well for consumers. The retail grocery market in New Zealand is dominated by two major grocery retailers that operate as a duopoly and competitors wanting to enter the retail grocery market face significant challenges.

One of these challenges is that the availability of land and sites (in shopping malls or shopping centres) for new retail grocery store development is inhibited by major grocery retailers lodging and obtaining restrictive covenants on land, and exclusivity covenants on leases of sites. These covenants reduce competition in the retail grocery market by preventing other grocery retailers from developing stores that would compete with the major grocery retailers.

This Bill amends the Commerce Act 1986 (the **Act**), adding an additional section 28A to Part 2 of the Act which relates to restrictive trade practices. New section 28A will apply to covenants that have the purpose or effect of impeding the development of land or the use of a site for a grocery retail store. Such covenants will be deemed, for the purposes of section 27 or 28 of the Act as having the purpose, or as having or being likely to have the effect of substantially reducing competition in the relevant market. This provision will apply to covenants in existence on the date of commencement, as well as future covenants.

The reason for including existing covenants is that many are not time limited or have a term of more than twenty years. Extending the effect of new section 28A to existing covenants has the potential to provide an immediate improvement in competition in the retail grocery market. It will make it easier for new grocery retailers to enter the market or for existing retailers to expand their operations.

The prohibition will be limited to designated grocery retailers, and includes -

- Foodstuffs North Island Limited, Foodstuffs South Island Limited, and Woolworths New Zealand Limited, together with a person who is a franchisee, a transacting shareholder, or successor of one of these businesses.
- A person that is designated as a major grocery retailer by the Governor-General by Order in Council.
- A person that is an interconnected body corporate, associated person (within the meaning of section 47 of the Act) of a person referred to above.

The Bill provides that the Minister may recommend that a person be designated as a major grocery retailer if the Commerce Commission has made such a recommendation, and the Commission and the Minister are satisfied that:

- the person runs a business that supplies all or most categories of grocery products to consumers; and

- where the person is supplying groceries in competition with a major grocery retailer, there would not be a “level playing field” between the person and the major grocery retailer(s) if the person was not designated. That is, the person might have an unfair commercial advantage over the major grocery retailer(s) they are competing with.

The regime will sit within the Act and will use much of the standard competition infrastructure to support it, including authorisations, information-gathering powers, undertakings, and other enforcement, remedies, and appeals matters. Using the existing competition regime ensures that the grocery sector is already familiar with the framework. It also mitigates against unintended consequences, in particular there are two features that are useful:

- Businesses can apply to the Commission for an authorisation for a contract or covenant, on the basis of any wider public interests that outweigh the competition considerations. This may mitigate against unintended consequences, such as new stores not establishing themselves in small towns or outlying suburbs. Each request will be considered on its merits.
- Section 89 provides for court-imposed variations of contracts or covenants and/or compensation for losses where a contract or covenant is in contravention of the Commerce Act 1986. This will allow for exclusive leases that include a premium for that exclusivity to be renegotiated.

Part Two: Background Material and Policy Information

Published reviews or evaluations

2.1. Are there any publicly available inquiry, review or evaluation reports that have informed, or are relevant to, the policy to be given effect by this Bill?	YES
Commerce Commission: Market study into the retail grocery sector – Final Report, 8 March 2022; Draft Report, July 2022. See Commerce Commission - Market study into the grocery sector (comcom.govt.nz)	

Relevant international treaties

2.2. Does this Bill seek to give effect to New Zealand action in relation to an international treaty?	NO

Regulatory impact analysis

2.3. Were any regulatory impact statements provided to inform the policy decisions that led to this Bill?	NO
No Regulatory Impact Statement accompanied the Cabinet paper seeking approval for the policy to be implemented by the Bill. On behalf of the respective Ministers the Regulatory Impact Analysis Team at The Treasury and the Ministry of Business, Innovation and Employment have agreed that supplementary analysis will be provided on this policy when Cabinet makes further decisions on the wider Retail Grocery Market Government Response. This advice is expected to be provided no later than October 2022.	

Extent of impact analysis available

2.4. Has further impact analysis become available for any aspects of the policy to be given effect by this Bill?	NO

2.5. For the policy to be given effect by this Bill, is there analysis available on:	
(a) the size of the potential costs and benefits?	YES
(b) the potential for any group of persons to suffer a substantial unavoidable loss of income or wealth?	NO
<p>The Commerce Commission identified more than 90 restrictive covenants on land (60 of which are either not time-limited or have a term of over 20 years) and over 100 exclusivity covenants (90 of which are either not time-limited or have a term of over 20 years) in leases entered by designated grocery retailers. The majority of these are in major urban areas – Auckland, Wellington, and Christchurch (refer final report, at 6.77-6.80).</p> <p>The Commerce Commission considers that these covenants can have the effect of impeding entry and expansion by (brick and mortar) grocery retailers by reducing the scope of activities that can take place on a piece of land or restricting competitors from operating in the same mall or shopping centre. While MBIE has had limited opportunity to estimate the benefits of removing these covenants in advance of other potential reforms that would improve conditions for entry and expansion by competitors, we note similar reforms in Australia had a positive impact on competition. [refer https://www.accc.gov.au/media-release/supermarket-agreement-opens-way-for-more-competition].</p> <p>The designated grocery retailers who currently benefit from the constraints these covenants place on availability of sites to their competitors do stand to lose substantial wealth (unquantified) if any large-scale entrant or expanding competitor ends up operating on these sites. The position reflected in these proposals is that this wealth is currently being enjoyed at the expense of the competitive process (and therefore the long-term benefit of consumers in New Zealand).</p> <p>To varying degrees, the designated grocery retailers support efforts to address the impact of these covenants on competition. Foodstuffs (North Island) Ltd has publicly committed to not entering or enforcing the covenants identified by the Commerce Commission and is actively releasing covenants that exist for its benefit. Woolworths New Zealand instead supports making these covenants unenforceable under statute. Voluntarily removing each covenant will be time-consuming and costly, as it requires the agreement of all parties affected by the covenant or an application to the Court under the Property Law Act 2007. Prohibiting such covenants provides a consistent and faster way to address the impacts of these covenants on competition at a lower cost.</p>	

2.6. For the policy to be given effect by this Bill, are the potential costs or benefits likely to be impacted by:	
(a) the level of effective compliance or non-compliance with applicable obligations or standards?	YES
(b) the nature and level of regulator effort put into encouraging or securing compliance?	YES

Covenants that have the purpose, effect, or likely effect of substantially lessening competition are currently prohibited under sections 28 and 27 of the Commerce Act 1986, which is enforced by the Commerce Commission. The new provision in this Bill is specific to covenants relating to the grocery retailing and must be treated as resulting in a substantial lessening of competition under those existing prohibitions. This will lower the burden of proof for enforcement by the Commerce Commission. The new prohibition seeks to clearly describe which covenants are within scope to promote compliance and certainty over the unlawfulness of the covenants at issue.

This provides some prospect of parties agreeing the covenants at issue are in fact unenforceable. However, to the extent this is disputed between parties, the Commerce Commission is likely to have a role in seeking judicial intervention.

Part Three: Testing of Legislative Content

Consistency with New Zealand's international obligations

3.1. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with New Zealand's international obligations?
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New Zealand is not bound by an international treaty in relation to the matters in this Bill. MBIE considers the Bill is consistent with New Zealand's international obligations.
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Consistency with the government's Treaty of Waitangi obligations

3.2. What steps have been taken to determine whether the policy to be given effect by this Bill is consistent with the principles of the Treaty of Waitangi?

The Commerce Commission convened a series of hui to obtain the insights of Māori on the retail grocery sector. In addition, the Commission received 18 submissions from Māori on this issue. The insights and submissions were taken into account when preparing the final report. MBIE considers that the policy to be given effect by this Bill is consistent with the principles of the Treaty of Waitangi.
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Consistency with the New Zealand Bill of Rights Act 1990

3.3. Has advice been provided to the Attorney-General on whether any provisions of this Bill appear to limit any of the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990?	YES
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The Ministry of Justice has been consulted. Advice provided to the Attorney-General by the Ministry of Justice is generally expected to be available on the Ministry of Justice's website upon introduction of a Bill. Such advice, or reports, will be accessible here: https://www.justice.govt.nz/justice-sector-policy/constitutional-issues-and-human-rights/bill-of-rights-compliance-reports/ .
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Offences, penalties and court jurisdictions

3.4. Does this Bill create, amend, or remove:	
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(a) offences or penalties (including infringement offences or penalties and civil pecuniary penalty regimes)?	YES
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(b) the jurisdiction of a court or tribunal (including rights to judicial review or rights of appeal)?	NO
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The following clauses in the Bill create or amend offences or civil pecuniary penalty regimes:
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| <ul style="list-style-type: none">• clause 4 - new section 28A (certain grocery-related covenants are treated as prohibited and unenforceable) is inserted to provide that restrictive and exclusivity covenants in which a designated grocery retailer has an interest and that have the purpose, effect, or likely effect of impeding the development or use of land or sites as grocery retail store must be treated as being prohibited under sections 28 or 27 of the Commerce Act 1986 and be unenforceable. |
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3.4.1. Was the Ministry of Justice consulted about these provisions?	YES
MBIE consulted the Ministry of Justice as part of the policy development process on these provisions, and on the final Bill.	

Privacy issues

3.5. Does this Bill create, amend or remove any provisions relating to the collection, storage, access to, correction of, use or disclosure of personal information?	NO

3.5.1. Was the Privacy Commissioner consulted about these provisions?	NO

External consultation

3.6. Has there been any external consultation on the policy to be given effect by this Bill, or on a draft of this Bill?	YES
<p>The policy to be given effect by this Bill was the subject of consultations by the Commerce Commission as part of its market study into the grocery sector during 2021. In addition, MBIE has undertaken some targeted consultation on the policy. There was general support among major grocery retailers for the Commerce Commission's recommendations to improve the conditions for entry and expansion, which includes the policy relating to prohibitions on restrictive covenants. For other participants in the grocery sector, the recommendations in respect of restrictive covenants were not emphasised as part of the overall solution to the competition problems the Commission identified.</p> <p>See Commerce Commission - Market study into the grocery sector (comcom.govt.nz)</p>	

Other testing of proposals

3.7. Have the policy details to be given effect by this Bill been otherwise tested or assessed in any way to ensure the Bill's provisions are workable and complete?	YES
<p>These changes were developed in consultation with the Commerce Commission (the regulator under the Commerce Act 1986) with the aim of ensuring they are workable.</p>	

Part Four: Significant Legislative Features

Compulsory acquisition of private property

4.1. Does this Bill contain any provisions that could result in the compulsory acquisition of private property?	NO

Charges in the nature of a tax

4.2. Does this Bill create or amend a power to impose a fee, levy or charge in the nature of a tax?	NO

Retrospective effect

4.3. Does this Bill affect rights, freedoms, or impose obligations, retrospectively?	YES
See Appendix One.	

Strict liability or reversal of the usual burden of proof for offences

4.4. Does this Bill:	
(a) create or amend a strict or absolute liability offence?	NO
(b) reverse or modify the usual burden of proof for an offence or a civil pecuniary penalty proceeding?	NO

Civil or criminal immunity

4.5. Does this Bill create or amend a civil or criminal immunity for any person?	NO

Significant decision-making powers

4.6. Does this Bill create or amend a decision-making power to make a determination about a person's rights, obligations, or interests protected or recognised by law, and that could have a significant impact on those rights, obligations, or interests?	YES
The Bill amends the Commerce Commission's authorisation powers under section 61 of the Commerce Act. In particular the reference in section 61(6) to any lessening in competition includes any lessening in competition that is treated as resulting from the covenants falling within the scope of the Bill.	

Powers to make delegated legislation

4.7. Does this Bill create or amend a power to make delegated legislation that could amend an Act, define the meaning of a term in an Act, or grant an exemption from an Act or delegated legislation?	YES
<p>The Bill's provisions only apply to designated grocery retailers. Designated grocery retailers are defined as:</p> <ul style="list-style-type: none">(a) Foodstuffs North Island Limited, Foodstuffs South Island Limited, and Woolworths New Zealand Limited;(b) a person that is designated as a designated grocery retailer by the Governor-General by Order in Council made under section 28B;(c) a person that is a franchisee, or a transacting shareholder of a person referred to in paragraphs (a) and (b). <p>A person may be designated by the Governor-General on the recommendation of the Minister. The Minister may make a recommendation if the Commerce Commission has made a recommendation after consultation with the person, and the Minister is satisfied:</p> <ul style="list-style-type: none">(i) that the person is in business to supply all or a majority of categories of grocery products (as defined in the Bill) to consumers.(ii) The designation of that person would promote competition or competitive neutrality (i.e. a "level playing field") with regard to the extent to which the person competes with 1 or more other designated grocery retailers.	

4.8. Does this Bill create or amend any other powers to make delegated legislation?	NO

Any other unusual provisions or features

4.9. Does this Bill contain any provisions (other than those noted above) that are unusual or call for special comment?	NO

Appendix One: Further Information Relating to Part Four

4.3 Retrospective effect

The Bill amends the Commerce Act 1986 to deem certain restrictive land covenants, and exclusivity covenants in leases obtained by major grocery retailers to be unenforceable. This amendment is retrospective in the weak sense that it will affect arrangements previously negotiated on the basis they include the giving of a covenant. This approach is aligned with the approach recommended by the Commerce Commission in its report¹. It is not retrospective in the strong sense of penalising any person for past conduct.

The covenants affected by the Bill are covenants in which a designated grocery retailer has an interest.

Where such covenants have the purpose, or have, or are likely to have the effect, of impeding the development of or use of land or a site (for example in a mall or shopping centre), they are deemed, for the purposes of sections 27 or 28, as having the purpose, or as having or being likely to have the effect, or substantially lessening competition in the relevant market.

These types of covenants, when obtained by an existing grocery retailer, effectively prevent rival grocery retailers from opening stores that would compete with the existing grocery retailer. This was identified by the Commerce Commission as reducing effective competition in the retail grocery market and contributing to higher grocery prices for consumers.

This problem identified by the Commerce Commission relates to existing covenants. It is therefore not possible to effectively address this problem without proposals that affect these covenants.

Many of the covenants involving grocery retailers identified by the Commerce Commission have long terms (e.g. more than twenty years, in the case of exclusive leases, when the right of renewal is taken into account). Extending the prohibition to existing covenants has the potential to provide an immediate improvement in competition in retail grocery market. It will make it easier for grocery retailers looking to enter the market or for existing retailers looking to expand their operations.

In respect of land covenants, there is unlikely to be any adverse effect from applying the prohibition to existing covenants. It is possible that making existing land covenants unenforceable will enhance the value of the land concerned by enabling a wider range of activities to be carried out on that land. If the other party to this transaction believes they have been materially disadvantaged by the amendments, there is a process of restitution provided by section 89 of the Commerce Act 1986.

In the case of exclusive leases, applying the prohibition to existing leases may have an adverse impact on the commercial position of the lessor and the grocery retailer. The arrangement with the lessor is likely to have involved the grocery retailer acting as an “anchor tenant” to attract other retailers. This might enable a store development that might not otherwise have been worthwhile. Section 89 of the Commerce Act 1986 contemplates judicial intervention if necessary to renegotiate agreements affected in this way. This avenue will be available to major grocery retailers if they believe they need to be compensated by the land owner for the loss of exclusivity in their tenancy.

¹ See Recommendation 2, p390 of the Commerce Commission report.