

Commerce (Grocery Sector Covenants) Amendment Bill

Government Bill

Explanatory note

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 2 major grocery retailers that operate as a duopoly, and competitors wanting to enter the retail grocery market face significant challenges.

One of those 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 by exclusivity covenants in leases of sites. Those 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 *new 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 of the Bill, 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 20 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 will include—

- Foodstuffs North Island Limited, Foodstuffs South Island Limited, and Woolworths New Zealand Limited, together with a person who is a franchisee, transacting shareholder, or successor of one of those 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 or 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 designated grocery retailer if the Commerce Commission has made such a recommendation, and if 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 were 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 matters relating to enforcement, remedies, and appeals. Using the existing competition regime will ensure that the grocery sector is already familiar with the framework. It will also mitigate against unintended consequences, in particular there are 2 features that are useful in this respect—

- businesses can apply to the Commerce 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 of the Act provides for court-imposed variations of contracts or covenants and compensation for losses where a contract or covenant is in contravention of the Act. This will allow, for example, for exclusive leases that include a premium for that exclusivity to be renegotiated.

Departmental disclosure statement

The Ministry of Business, Innovation, and Employment is required to prepare a disclosure statement to assist with the scrutiny of this Bill. The disclosure statement provides access to information about the policy development of the Bill and identifies any significant or unusual legislative features of the Bill.

A copy of the statement can be found at <http://legislation.govt.nz/disclosure.aspx?type=bill&subtype=government&year=2022&no=122>

Clause by clause analysis

Clause 1 is the Title clause.

Clause 2 provides for the Bill to commence on the day after it receives the Royal assent.

Clause 3 provides that the Bill amends the Commerce Act 1986 (the Act).

Part 1

Amendment to Part 2 of Act (which relates to restrictive trade practices)

Clause 4 relates to certain covenants and other provisions that impede the development of retail grocery stores (**covenants**). The covenants affected are those described in the Commerce Commission's 8 March 2022 report entitled *Market study into the retail grocery sector* as follows:

- restrictive covenants are promises not to do something that are registered against land and impose restrictions on how that land can be developed or used. Restrictive covenants are attached to or run with land, meaning that they bind any third parties who subsequently acquire (or lease) that land. Examples of how and when restrictive covenants can be lodged include, first, on sale of land by a grocery retailer to a third party and, second, where a site is acquired by a grocery retailer from a third party, and in consideration for that purchase the vendor agrees to register a covenant against other land in the area that the vendor is retaining (*see* paragraphs 6.78 and 9.57 of the report);
- exclusivity covenants are provisions contained in leases that restrict competitors from operating in the same shopping centre. The exclusivity covenants the Commission identified generally have durations of 20 or more years (after taking into account rights of renewal). Exclusivity covenants are contained in leases between the designated grocery retailers and landlords. In general, they would not be binding on subsequent tenants or landlords unless a subsequent tenant assumes possession as a consequence of an assignment of an existing lease during its term (rather than entry into a new lease) (*see* paragraphs 6.81 and 9.57 of the report).

Sections 27 and 28 of the Act already apply to exclusivity covenants and restrictive covenants, respectively, and the covenants may breach those sections of the Act. Section 27 prohibits entering into or giving effect to a contract, arrangement, or understanding containing a provision that has the purpose, effect, or likely effect of substantially lessening competition in a market. Section 28 prohibits requiring, giving, or enforcing a covenant that has the purpose, effect, or likely effect of substantially lessening competition in a market. Such covenants are unenforceable (*see* paragraph 6.98 of the report).

However, the Commission report says that establishing a breach of the Act requires an assessment of local competition conditions on a case-by-case basis in each relevant geographic market (*see* paragraph 9.63 of the report).

Clause 4 inserts *new sections 28A and 28B* into the Act. *New section 28A* removes the need for a person alleging a breach of the Act to prove the test in section 27 or 28, which is that the covenant has the purpose, or has or is likely to have the effect, of substantially lessening competition in a market. Instead, a covenant will fail that test if the covenant impedes the development of retail grocery stores.

A further effect is that all of the provisions of the Act that already apply to sections 27 and 28 will apply to a covenant that is deemed by *new section 28A* to breach that section, including the provisions about the following matters:

- authorisations (*see* Part 5). Those provisions will enable a person that considers that a covenant has a public benefit that outweighs any lessening of competition to apply to the Commission for the covenant to be exempted from the new provisions:
- information-gathering powers (*see*, for example, section 98):
- undertakings (*see* sections 74A to 74C):
- injunctions (*see* section 81):
- the powers under sections 88 to 90 (for example, to renegotiate any agreements that are affected by the Bill):
- other matters relating to enforcement, remedies, and appeals (*see* Part 6).

New section 28B provides for the designation of persons as designated grocery retailers.

Part 2

Transitional and savings provisions

Clause 5 and the Schedule provide for transitional and savings provisions.

Hon Dr David Clark

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The Parliament of New Zealand enacts as follows:

1 Title

This Act is the Commerce (Grocery Sector Covenants) Amendment Act **2022**.

2 Commencement

This Act comes into force on the day after the date on which it receives the Royal assent. 5

3 Principal Act

This Act amends the Commerce Act 1986.

Part 1

Amendment to Part 2 of Act (which relates to restrictive trade practices)

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4 New sections 28A and 28B inserted

After section 28, insert:

28A Certain grocery-related covenants are treated as prohibited and unenforceable

- (1) A covenant to which this section applies must be treated, for the purpose of section 27 or 28 (as the case may be), as having the purpose, or as having or being likely to have the effect, of substantially lessening competition in the relevant market. 10
- (2) This section applies to any of the following in which a designated grocery retailer has an interest: 15
- (a) a restrictive covenant that has the purpose, or has or is likely to have the effect, of impeding the development or use of land or a site as a retail grocery store:
- (b) an exclusivity covenant or other provision in a lease that has the purpose, or has or is likely to have the effect, of impeding another person at the same site (for example, a mall or a shopping centre) from operating a retail grocery store. 20
- (3) However, this section does not apply to—
- (a) a covenant entered into for environmental impact reasons connected with a retail fuel site within the meaning of the Fuel Industry Act 2020; or 25
- (b) a covenant in respect of which the Commission has granted an authorisation under section 58 or given a clearance under section 65A.
- (4) In this section, unless the context otherwise requires,— 30
- covenant** means any covenant or other provision referred to in **subsection (2)**
- designated grocery retailer** means all of the following:
- (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**; 35
- (c) a person that is a successor to a person referred to in **paragraph (a)**:

<p>(d) a person that is a franchisee, or a transacting shareholder (within the meaning of the Co-operative Companies Act 1996), of a person referred to in paragraph (a), (b), or (c):</p> <p>(e) a person that is an interconnected body corporate or associated person (within the meaning of section 47) of a person referred to in paragraph (a), (b), (c), or (d)</p> <p>grocery product means goods in any of the following product categories: bread, dairy products, eggs or egg products, fruit, vegetables, meat, fish, rice, sugar, manufacturer-packaged food, and medicine other than prescription medicine</p> <p>retail grocery store means a place at which a material part of the business being carried on is the business of supplying 1 or more categories of grocery products to consumers (for example, a butchery, fishmonger, bakery, or pharmacy).</p> <p>(5) A designated grocery retailer has an interest in a covenant—</p> <p style="padding-left: 20px;">(a) if the person is or was a party to the covenant; or</p> <p style="padding-left: 20px;">(b) if the person is or was a party to any contract, arrangement, or understanding that resulted in the giving of the covenant or to the inclusion of the covenant in a lease; or</p> <p style="padding-left: 20px;">(c) if the person is a person or an associated person referred to in section 27 or 28.</p> <p>(6) Subsection (1) does not limit any other provision of this Part.</p> <p>(7) If this section applies, the reference in section 61(6) to any lessening in competition that would result, or would be likely to result, includes any lessening that this section provides must be treated as resulting.</p> <p>28B Process for designations for purpose of section 28A</p> <p>(1) The Governor-General may, on the recommendation of the Minister, make an Order in Council designating a person as a designated grocery retailer for the purpose of section 28A.</p> <p>(2) The Minister may recommend to the Governor-General that a person be designated as a designated grocery retailer only after receiving a recommendation from the Commission.</p> <p>(3) The Commission may recommend to the Minister that a person be designated as a designated grocery retailer only—</p> <p style="padding-left: 20px;">(a) after consulting the person about the proposed designation (including the Commission’s reasons for proposing to recommend the designation); and</p> <p style="padding-left: 20px;">(b) if the Commission has taken into account the following criteria:</p>	<p>5</p> <p>10</p> <p>15</p> <p>20</p> <p>25</p> <p>30</p> <p>35</p>
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| (i) | whether the person carries on, or is likely to carry on, a business of supplying all or a majority of categories of grocery products to consumers; and | |
| (ii) | whether designation of the person as a designated grocery retailer would be likely to promote competition or competitive neutrality (that is, a level playing field), having regard to the extent to which the person supplies, or is likely to supply, groceries in competition with 1 or more designated grocery retailers. | 5 |
| (4) | The Commission's recommendation must advise the Minister whether the Commission considers that those criteria are met. | 10 |
| (5) | In deciding whether to make a recommendation, the Minister may do any of the following: | |
| (a) | accept the Commission's recommendation if the Minister is satisfied that those criteria are met: | |
| (b) | reject the Commission's recommendation: | 15 |
| (c) | request that the Commission reconsider any matter (such as an error, an oversight, or competing policy interests): | |
| (d) | make any other decision that the Minister considers is in the public interest. | |
| (6) | The Commission must make the recommendation publicly available as soon as practicable after making it, including a statement of its reasons for making the recommendation. | 20 |
| (7) | An order made under this section is secondary legislation (<i>see</i> Part 3 of the Legislation Act 2019 for publication requirements). | |

Part 2

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Transitional and savings provisions

5 Schedule 1AA amended

In Schedule 1AA,—

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| (a) | insert the Part set out in the Schedule of this Act as the last Part; and | |
| (b) | make all necessary consequential amendments. | 30 |

Schedule
New Part 4 inserted into Schedule 1AA

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Part 4		
Provisions relating to Commerce (Grocery Sector Covenants) Amendment Act 2022		5
13	Interpretation	
	In this Part, unless the context otherwise requires,—	
	Amendment Act means the Commerce (Grocery Sector Covenants) Amendment Act 2022	10
	commencement date means the day after the date on which the Amendment Act receives the Royal assent	
	covenant has the same meaning as in section 28A .	
14	Amendment Act applies to existing covenants	
	Section 28A applies in relation to any action referred to in section 27 or 28 that is taken on or after the commencement date, whether the covenant was given before, on, or after the commencement date.	15