

Submission on the Commerce (Grocery Sector Covenants) Amendment Bill

Submitted to:

Economic Development, Science and Innovation Committee

27 May 2022



Commerce Commission submission on the Commerce (Grocery Sector Covenants) Amendment Bill

Introduction

1. The Commerce Commission (the Commission) appreciates the opportunity to make a submission to the Economic Development, Science and Innovation Committee (the Committee) on the Commerce (Grocery Sector Covenants) Amendment Bill (the Bill).
2. The Commission is an independent Crown entity and is New Zealand's primary competition, fair trading, consumer credit, and economic regulatory agency. Our vision is to make New Zealanders better off. We work to ensure markets work well and that consumers and businesses are confident market participants.
3. The Commission is submitting on the Bill on the basis of:
 - 3.1 our recently completed retail grocery market study, of which the Bill forms part of the Government response; and
 - 3.2 the Commission's role as the enforcement body for the Commerce Act 1986, which the Bill amends.

Executive Summary

4. The Commission supports the passage of the Commerce (Grocery Sector Covenants) Amendment Bill, which gives effect to one of the recommendations made as part of our retail grocery market study.
5. We consider that the Bill, if passed, will effectively prohibit major grocery retailers¹ from introducing or relying on the types of restrictive and exclusive covenants that we identified in our study as being problematic. We consider that the Bill will significantly streamline enforcement relating to the use of covenants in the retail grocery sector, compared to the existing sections 27 and 28 of the Commerce Act 1986.
6. Our submission makes the following points:
 - 6.1 the Commission will undertake enforcement in line with our enforcement response guidelines;
 - 6.2 the Bill will be most effective if implemented alongside reforms to planning laws, to ensure sufficient land is available for new supermarkets to be built;
 - 6.3 there may be benefit in the major grocery retailers continuing to remove covenants from land titles;
 - 6.4 the scope of the Bill could be expanded in future; and

¹ Foodstuffs North Island, Foodstuffs South Island, Woolworths New Zealand and related parties.

6.5 we suggest minor changes to the language of the process for designations.

Background on our retail grocery market study

7. On 17 November 2020, the Hon Dr David Clark, Minister of Commerce and Consumer Affairs, published a notice under section 51(1) of the Commerce Act, requiring the Commission to undertake a study into any factors that may affect competition for the supply or acquisition of groceries by retailers in New Zealand.
8. On 8 March 2022, we published our final report into the retail grocery sector. In it, we explained that we had identified a large number of restrictive covenants² on sites, and exclusivity covenants³ in lease agreements, that could be used to prevent parties from selling groceries.
9. We noted that such covenants are likely to reduce market participants' ability to access suitable sites and may hinder and raise the cost of entry and expansion, particularly in situations when planning law is relatively restrictive. Overall, we considered that the use of these covenants was likely to unduly restrict retail competition in the retail grocery sector, and that changes to the practice of lodging covenants restricting the development of supermarket or other grocery retailers would improve the conditions for entry and expansion.
10. In our report, we noted that the major grocery retailers had indicated that they were generally supportive of improving site availability by addressing restrictive covenants and exclusivity covenants in leases. However, there can be practical difficulties in removing existing restrictive covenants on a voluntary basis.
11. Our report noted that sections 27 and 28 of the Commerce Act 1986 already apply to exclusivity clauses in leases and restrictive covenants, respectively. However, establishing a breach requires an assessment of local competition conditions on a case-by-case basis, in each relevant geographic market. A new entrant attempting to achieve scale would need access to sites for grocery retailing in multiple locations, and undertaking legal proceedings in an attempt to obtain appropriate sites would add significant cost, delay and uncertainty.
12. Accordingly, to address the practical barriers to the voluntary removal of covenants, provide an enduring solution to the issue, and address the barriers to enforcement associated with sections 27 and 28 described above, we recommended:
 - 12.1 that the Government prohibit the use of restrictive covenants that relate to the development of retail grocery stores (including specialist retailers such as greengrocers or butchers). In particular, we stated that:

² A restrictive covenant is a promise not to do something that is registered against land and imposes 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.

³ Exclusivity covenants are provisions contained in lease agreements that restrict competitors from operating in the same shopping centre.

12.1.1 restrictive covenants that explicitly and directly impede the development of retail grocery stores should be prohibited, regardless of the purpose of the covenant or the person lodging the covenant;

12.1.2 restrictive covenants that indirectly impede retail grocery store development (such as by saying that only certain (non-grocery-retail) activities may take place on the premises) should be prohibited if they:

- (a) have a purpose of impeding retail grocery store development; or
- (b) are lodged by a grocery retailer, or a person interconnected, associated with, or otherwise assisted by a grocery retailer (regardless of the purpose or likely effect of the covenant); and

12.2 that the Government prohibit the use of exclusive covenants in leases that relate to the operation of retail grocery stores.

Commission comment on the Commerce (Grocery Sector Covenants) Amendment Bill

13. The Commerce (Grocery Sector Covenants) Amendment Bill forms part of the Government response to our market study, and is intended to respond to our recommendations set out above.
14. The Commission supports the passage of the Bill. We consider that the Bill, if passed, will effectively prohibit major grocery retailers from introducing or relying on the types of restrictive and exclusive covenants that we identified in our study as being problematic. The Bill will significantly streamline enforcement relating to the use of covenants in the retail grocery sector, compared to the existing section 27 and 28 of the Commerce Act.
15. The Bill envisages the following roles for the Commission:
 - 15.1 to enforce compliance with the new prohibition on restrictive and exclusive grocery covenants;
 - 15.2 to provide recommendations to the Minister on whether grocery retailers, other than the major grocery retailers, should be designated as subject to the Bill's prohibition on the use of restrictive and exclusive grocery covenants, and to publish any recommendations made; and
 - 15.3 to consider requests for authorisation by businesses for the use of contracts or covenants that would contravene the Bill's prohibitions, but which might be justified by public interest considerations.
16. We make the following comments:
 - 16.1 the Commission will undertake enforcement in line with our enforcement response guidelines;

- 16.2 the Bill will be most effective if implemented alongside reforms to planning laws;
- 16.3 there may be benefit in the major grocery retailers continuing to remove covenants from land titles;
- 16.4 the scope of the Bill could be expanded in future; and
- 16.5 we suggest minor changes to the language of the process for designations.

The Commission will undertake enforcement in line with our enforcement response guidelines

- 17. If passed, the provisions of the Bill will come into force on the day after the date on which it receives Royal assent. At this point, all covenants within scope of the Bill will be treated as having breached sections 27 or 28 of the Commerce Act, whether the covenant was given before, on, or after the commencement date.
- 18. We note that, in responding to these deemed breaches, the Commission will enforce the provisions in accordance with our enforcement response guidelines.⁴ In particular, we will prioritise our limited enforcement resources to focus on matters where the greatest harm exists or may occur. In doing so, we will have regard to the extent of harm, the seriousness of the conduct, and the public interest in the Commission taking enforcement action.

The Bill will be most effective if implemented alongside reforms to planning laws

- 19. While outside of the direct remit of the Committee's consideration of this Bill, we consider that the Bill will be most effective if implemented alongside reforms to planning laws. While covenants impose some barriers to the use of land for supermarket development, most restrictions on land use are a result of planning law made under the Resource Management Act 1991.
- 20. As part of our market study, we recommended that the government make a range of amendments to planning laws and instruments to ensure sufficient land is available for new supermarkets to be built, increase certainty for those seeking to develop new retail grocery stores, and limit the grounds on which new developments can be declined. We are aware of the forthcoming resource management legislative reforms, and encourage the implementation of our recommendations as part of this process.

There may be benefit in the major grocery retailers continuing to remove covenants from land titles

- 21. The Bill would render restrictive covenants that fall within its scope as unenforceable. However, it does not, in itself, have the effect of removing covenants that are registered against land titles.

⁴ Available at: https://comcom.govt.nz/_data/assets/pdf_file/0030/62589/Enforcement-Response-Guidelines-October-2013.pdf

22. While these covenants will no longer have any effect, we note that there is a residual risk that the registration of covenants against land titles could nevertheless deter entry or expansion by potential competitors. This could be the case if, for example, a potential competitor is not aware of the fact that the covenant will be unenforceable under this legislation.
23. This suggests that, notwithstanding the passage of this Bill, there may be benefit in the major grocery retailers voluntarily removing covenants from land titles – we note that some appear to have already made significant progress in this regard. Alternatively, legislative provisions to require the removal of covenants from land titles could be beneficial.

The scope of the Bill could be expanded in future

24. As introduced, the Bill will apply principally to Foodstuffs North Island, Foodstuffs South Island and Woolworths New Zealand.⁵ The Bill also provides a process for the Governor-General to designate additional grocery retailers as subject to the prohibitions.
25. As noted above, our study recommended that restrictive covenants that explicitly and directly impede the development of retail grocery stores, as well as indirect restrictive covenants that nevertheless have a purpose of impeding retail grocery store development, should be prohibited, regardless of the person lodging the covenant. We also recommended that exclusive covenants in leases that relate to the operation of retail grocery stores be prohibited, regardless of the party to them.
26. While the covenants put in place by major grocery retailers were the focus of our market study, and are likely to be the key source of covenant-related barriers to grocery store development, they are not the only potential covenant-related barriers. For example, covenants that inhibit grocery store development would not be captured by the legislation as introduced, if imposed by the following parties:
 - 26.1 new or smaller existing grocery retailers;
 - 26.2 other types of non-grocery retailers; and
 - 26.3 parties other than retailers.
27. While the first of these categories could be brought within the scope of the new prohibitions via the Bill's designation process, the others could not.

We suggest minor changes to the language of the process for designations

28. As introduced, the Bill provides that the Commission may recommend to the Minister that a person be designated as a designated grocery retailer only if the Commission has taken into account the following criteria:

⁵ As well as successors, franchisees, transacting shareholders, interconnected and associated persons, and persons 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.

- 28.1 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
 - 28.2 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.
29. While we support the intent of the second limb of the test, we think the language could be simplified. In particular, we think there could be some uncertainty and disagreement as to when competitive neutrality or a level playing field is achieved. We think this uncertainty could be addressed by replacing the second limb of the test with the following:
- 29.1 whether designation of the person as a designated grocery retailer would be likely to promote competition, 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.

Conclusion

30. We thank the Committee for this opportunity to make a submission and would be pleased to provide any further assistance that the Committee may require. If the Committee has any specific questions on this submission please contact Cam Vannisselroy, Principal Policy Analyst, at [REDACTED]