

LAW NEWS

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COMPETITION LAW

Grocery competition 'muted' but so are the outcomes

Gary Hughes

The final report confirms what many consumers intuitively feel when they visit the store – only weak incentives exist for Woolworths and Foodstuffs to compete head-on to deliver the right pricing, quality and range of items to satisfy consumers' diverse preferences.

While dominating small growers and suppliers' negotiations, end-customers tend to receive glossy promotions and confusing loyalty schemes, not the long-term cheaper prices that a third player could impel.

Rather than any knock-out blow to the duopoly, the commission recommended a nuanced range of tweaks to improve market dynamics over time. If fully and firmly implemented, some should make a difference. But the impact will be gradual.

Key suggestions were to:

- urge wholesale supply to be offered to other grocery retailers on a voluntary basis, subject to monitoring and limited regulatory measures;
- address imbalances in bargaining power between the two majors and their suppliers via a mandatory grocery code of conduct, Commerce Act exceptions to permit collective bargaining by supplier groups, and strengthening Fair Trading Act unfair contract terms rules for small business;
- help consumers make better-informed purchasing decisions and improve price transparency at retail stores by introducing mandatory unit pricing, as well as asking the majors to co-operate with price comparison websites and ensure their pricing/promotional practices and loyalty card programme terms and conditions (and data harvesting processes) are clear and simple to understand;
- free more land for supermarket development by changes to planning laws, ban restrictive covenants on land and exclusivity covenants in leases and closely monitor strategic conduct

The Commerce Commission's final report into New Zealand's retail grocery duopoly landed on 8 March 2022. Chair Anna Rawlings describes competition between the two leading supermarkets as muted and ineffective. But only a slow gradual path to better market outcomes emerges from the commission's recommendations

such as misusing most-favoured-nation (MFN) clauses or exclusive supply contracts.

That last set of issues, to improve entry and expansion conditions, is the focus of this short article.

The commission's most telling conclusion was:

"Under current market conditions, we see little prospect of new or expanding rivals being able to achieve the scale and geographic coverage required to compete effectively with the major grocery retailers. Competitors wanting to enter the market or expand face significant challenges."

Little has changed since the short-lived Warehouse Extra foray into groceries in 2007-09. As the Court of Appeal observed in *Commerce Commission v Woolworths Limited & Ors* [2008] NZCA 276:

"[the commission] also concluded, uncontroversially, that there were high barriers to entry into the relevant markets (for reasons associated with access to suitable sites, requirements for resource consents and economies of scale) and that there is no likely new entrant into the relevant markets other than the Warehouse." [166]

Lack of sites

Suitable sites are critical for successful entry and expansion of supermarket chains. But there are few available sites for large retail footprint developments, especially in urban areas. The commission highlighted

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planning laws and their implementation by local councils as limiting the availability of land.

It also found problems with planning applications taking into account the positive effects of stores bringing trade competition as a beneficial factor. Take, for example, the Supreme Court's difficulty interpreting whether trade competition was a positive or negative factor in lengthy planning appeals over the Discount Brands outlet mall, in *Westfield (NZ) Ltd v Northcote Mainstreet Inc & Ors* [2005] NZSC 17.

Beyond inherent restraints where suitable land is not geographically/physically available, the commission identified three specific market conduct items affecting site availability and development:

- lodging restrictive covenants (including encumbrances) to stop future supermarket development;
- inserting exclusivity covenants in leases to prevent competing supermarkets or retail grocery firms (especially around malls or shopping centres); and
- land banking – buying and holding sites for future use without any specific plans for development.

The commission noted (p212) that wilfully adding restrictive covenants to reduce the scope of activities which can be conducted on a piece of land is counter-intuitive, as it may significantly reduce the value of

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land so encumbered. This suggests the owner at least expects the benefits of lodging restrictive covenants (increased sales and profits as a result of less competition) will outweigh foregone asset value.

During the course of the inquiry, progress was made. Under media and regulator pressure, the duopolists offered to remove many land covenants, potentially freeing up 90 more sites over time that would have been locked away by restrictive title conditions for up to 20 years.

A key recommendation now for government is to improve availability of sites under planning law, as that largely sets conditions of entry and expansion. It affects the market in multiple ways:

- zoning rules significantly reduce the number of suitable sites available for retail;
- firms can game the consent process to hinder competitors' access to or ability to develop suitable development sites; and
- rule-setting, notification and consenting processes cause delay, cost, uncertainty in setting up retail stores and supporting distribution facilities.

How the government weaves that into its current triple-headed legislative reforms of the Resource Management Act will be intriguing.

Wholesale supply

Another major impediment to market entry or expansion is accessing wholesale supply of a decent range of grocery items on reasonably competitive terms.

Fringe grocery retailers like Supie or Farro need to compete more effectively on range and price if they are to attract mainstream customers. Otherwise they stay on the fringe. Wholesale supply could also be a stepping-stone for new entrants to grow and develop their own direct relationships with growers/processors.

The commission looked at two categories of conduct having an impact:

- suppliers refusing to supply other retailers, out of fear of delisting or retaliation by Foodstuffs or Woolworths; and
- supply arrangements with the two majors affecting the basis on which suppliers can deal with other parties.

Refusals to supply have long been an issue in competition law, typically dealt with under misuse of market power provisions of the Commerce Act. But the evidential threshold is so high, and caselaw interpretation of the s 36 tests now so troublesome,

The key is creating a range of commercial conditions that might entice an Aldi, Asda, Lidl or Walmart into New Zealand

that the commission has largely given up taking market power prosecutions. Instead, that awaits statutory reform of s 36 with an 'effects test'.

And some forms of subtle pressure by established firms might not be clearly actionable, such as the example (p249) of suppliers cajoled into limiting access to products by new online provider, The Honest Grocer. After first agreeing to supply, many suppliers later withdrew products due to genuine fear that they risk other parts of their business. And the commission found examples of suppliers willing to supply only if that retailer did not undercut the prices set by big supermarkets for the same products.

Use of this buyer side (duopsony) power to demand contractual understandings can come in various forms, such as best price clauses, MFN clauses or terms requiring suppliers to give certain items or brands exclusively to a particular retailer if it wants promotional and premium shelf space.

There is no silver bullet here, because such clauses may be mutually negotiated for pro-competitive reasons too. Market dynamic and negotiation factors need to be weighed up. But the commission is signalling to suppliers (and their lawyers) there will be more scrutiny of such contract clauses.

Innovation and investment

The commission backed away from its draft report findings of excess profits being made by big supermarkets.

But it kept up pressure on findings around innovation and technology, concluding that the pace and scale of innovation in New Zealand appears to be less than might be seen overseas or expected in a 'workably competitive' market (see Commerce Act s 3(1)).

That included apparent slowness to take up innovations aimed at improving consumers' in-store shopping experience, such as contactless, trolley or hand-held 'scan & go' trials or investing to create efficiencies through the supply chain or introducing new products and private label brands.

Both supermarkets argued they regularly monitor and introduce new technology and cost-saving devices. But in benchmarking levels of innovation to overseas, the commission found we are often delayed in getting digital, flexible or innovative offerings here:

"The scale and pace of innovation is important because it impacts the prices, choice and options available to consumers over the longer term.

Where competition is weak, retailers may have little incentive to innovate." [95]

Roads not taken

The commission backed away from forceful interventions such as divestiture of land sites or supermarket locations to new entrants, or breaking open access to existing wholesale supply chains controlled by Foodstuffs and Woolworths.

Those options would be complex, a major intrusion into private property rights and likely to be hotly contested through the court system.

Was that just sabre-rattling in the draft report? We'll never know. It certainly got the duopoly's advisors and expert economists submitting forcefully in the final consult round. This has left many commentators underwhelmed by the set of outcomes. At the press conference, the commission faced accusations it had 'bottled it' with the final report.

However, it made a fair point that even those steps might fall flat and not sustain a true independent player over the medium term. The key is creating a range of commercial conditions that might entice an Aldi, Asda, Lidl or Walmart into New Zealand.

Next steps

This Inquiry began in November 2020, took 15 months, engaged with more than 12,000 consumers and interested parties and cost a lot of money. The minister had already set the commission its next market study, into residential building supplies, before the grocery inquiry was even finished.

He will need to move just as swiftly to implement the commission's recommendations, including planning law changes, since they may take years to show an impact on the market. Otherwise, market studies may come to be seen as just a more expensive version of Productivity Commission reports, rather than firm regulatory intervention. ■

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