



COVERSHEET

Minister	Hon Dr David Clark	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	Grocery sector reform: regulation of access to grocery wholesale and collective bargaining exemption	Date to be published	Friday 2 September

List of documents that have been proactively released

Date	Title	Author
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Information redacted

YES

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Some information has been withheld for the reasons of confidential information entrusted to the Government.

Some information has been withheld for the reasons of confidential advice to government.

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Cabinet Economic Development Committee

Grocery sector reform: regulation of access to grocery wholesale and collective bargaining exemption

Proposal

1. This paper seeks agreement to:
 - 1.1. further proposals for the regulation of access to grocery wholesale (Part One); and
 - 1.2. modify the approach to the collective bargaining exemption by certain suppliers (Part Two).

Relation to government priorities

2. This paper relates to the priority of supporting New Zealanders in response to increasing costs of living (including increasing grocery prices) by improving competition in the retail grocery sector.

Executive Summary

3. In May 2022 Cabinet agreed to develop a Grocery Industry Competition Bill (the Bill) to be introduced ^{Confidential advice to} _{Government} [CAB-22-MIN-0186 refers]. The Bill responds to the Commerce Commission's (the Commission's) report on competition in New Zealand's retail grocery sector.
4. The Bill's overall purpose is to improve competition in the retail grocery sector for the long-term benefit of consumers. In July Cabinet agreed to appoint a Grocery Commissioner (the Commissioner) as the grocery sector regulator, and to the monitoring, information disclosure and other functions for the Commissioner [CAB-22-MIN-0259 refers].
5. In this paper I seek agreement to proposals relating to the regulation of access to grocery wholesale.
6. The Commission found that the entry and expansion of grocery retailers was constrained by lack of access to a full range of grocery wholesale options.
7. In May Cabinet agreed to regulate access to grocery wholesale by establishing a 'quasi-regulatory' regime under which major grocery retailers would be required to consider all wholesale access requests in good faith, and a mandatory access regime under which major grocery retailers would be required to provide wholesale access at certain terms as a 'regulatory backstop'. This goes beyond the Commerce Commission's recommendation for a voluntary wholesale access regime.

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8. Through the regulation of access to grocery wholesale I want to enable other grocery retailers (also referred to as wholesale customers) to take advantage of the major grocery retailers' scale and efficiencies in purchasing and distributing groceries, and as a result provide more competitive offerings to consumers.
9. This means ensuring the major grocery retailers develop wholesale offerings that are consistent with what would be expected in a workably competitive wholesale market.
10. Under the quasi-regulatory regime major grocery retailers would negotiate wholesale offerings on commercial terms. There is no basis for doubting that these offerings would be competitive. However, the incentives on major grocery retailers to negotiate competitive wholesale offerings are limited to transparency and conduct obligations.
11. The purpose of a regulatory backstop is to strengthen these incentives by providing for additional regulation if wholesale offerings by major grocery retailers are not consistent with what would be expected in a workably competitive wholesale market and further regulation would be in the long-term benefit of consumers.
12. Regulation of access to grocery wholesale is unprecedented and requires a novel approach. I propose a flexible 'toolkit' of additional forms of regulation. An overview is provided in Annex One.
13. Specifically, I propose to provide powers to the Commissioner to impose additional transparency and conduct obligations. The tools the Commissioner could use include an ability to require a major grocery retailer to put in place a framework for range, price and access terms, and to develop a binding Grocery Wholesale Industry Participation Code.
14. I also propose to provide powers for the Minister of Commerce and Consumer Affairs to step-in, after considering recommendations of the Commissioner, and seek an Order in Council to require major grocery retailers to supply wholesale customers with a range of products at regulated prices and terms. The tools the Commissioner could consider in making their recommendations to the Minister could include a requirement to supply wholesale customers either on non-discriminatory terms, or in accordance with price-quality regulation set by the Commissioner.
15. This toolkit approach provides for an escalating level of intervention without a formal hierarchy between the proposed tools. I consider that this will allow for a timely and proportional regulatory response that provides a credible threat.
16. However, given the dynamic nature of the grocery sector, at the time in which the regulatory backstop may need to be activated it is possible that other forms of regulation may be more appropriate than the tools provided for in this paper - in particular non-discriminatory terms and price quality regulation. That is why I am also proposing that the Commissioner will be able to recommend any other form of regulation that, at that time, is likely to better achieve the long-term benefit of consumers.
17. I acknowledge that the proposals in this paper create some risks. I consider that the long-term benefits to consumers warrant the novel approach proposed, and that the risks can be managed.

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18. In May Cabinet also agreed to introduce an exception to the Commerce Act 1986 for grocery suppliers to collectively bargain with retailers [CAB-22-MIN-0186 refers].
19. Following further policy development, I propose that some of the parameters for collective bargaining be set by regulations. Using regulations to specify, for example the class or classes of suppliers able to make use of the exemption and some of the constraints on the conduct permitted by the exemption, is considered more appropriate and allows flexibility to adapt the exemption as market dynamics or other circumstances change over time.

Part One: Regulation of access to grocery wholesale

Background

20. On 8 March 2022, the Commerce Commission (the Commission) released its final report on competition in New Zealand's retail grocery sector. It concluded that competition is not working well for consumers in the retail grocery sector and made fourteen recommendations. On 23 May 2022, Cabinet accepted most of the Commission's recommendations, and agreed to develop a Grocery Industry Competition Bill (the Bill) to be introduced later this year [CAB-22-MIN-0186 refers].
21. Amongst other findings, the Commission found that the entry and expansion of grocery retailers was constrained by lack of access to a full range of grocery wholesale options. It recommended a voluntary, commercial, wholesale access offering by the major grocery retailers, supported by some limited regulatory measures.
22. Cabinet considered that implementing this recommendation was necessary, but not sufficient. It agreed to regulate access to grocery wholesale through a:
 - 22.1. monitored or 'quasi-regulatory' wholesale access regime to be implemented by the major grocery retailers (the quasi-regulatory regime); and
 - 22.2. regulated wholesale access regime to act as a 'regulatory backstop' (the regulatory backstop).
23. In this paper I seek agreement to further proposals for the regulation of access to grocery wholesale in the Bill.
24. On 4 July 2022 Cabinet agreed to appoint a Grocery Commissioner (the Commissioner) as the grocery sector regulator, and the monitoring, information disclosure and other functions for the Commissioner [CAB-22-MIN-0259 refers].
25. While I refer to 'the Commissioner' throughout this paper, the legislation may require the Commissioner to involve two or more other members of the Commerce Commission when making a decision (similar to the approach taken in respect of the Telecommunications Commissioner). As noted in July, I will specify arrangements for the Commissioner in more detail as part of the drafting process for the Bill.

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Purpose and proposed approach to the regulation of access to grocery wholesale

I want to improve competition in the wholesale grocery sector by incentivising the development of competitive wholesale supply offerings by major grocery retailers

26. The overall purpose of the Government's response to the Commission's recommendations, and of the Bill, is to improve competition in the retail grocery sector for the long-term benefits of consumers.
27. The intention behind regulating access to grocery wholesale is to support this purpose by enabling other grocery retailers (also referred to as wholesale customers) to enjoy the benefits of the major grocery retailer's scale and efficiency so that they are better able to provide a competitive offering to consumers.
28. Smaller wholesale customers (e.g., independent dairies or smaller chains) may want wholesale supply in the long-term to provide a wider selection of products at prices that are more attractive to consumers. Larger grocery retailers (e.g., national or regional retail chains diversifying into groceries, or a new entrant) may view it as a springboard to grow volume and customers while they invest to build their own relationships with suppliers.
29. In the long-term consumers would benefit by having more choices of where to buy groceries because there are more grocery retailers that can provide the convenience of a comprehensive range of groceries at competitive pricing. For example, rurally based consumers, including rurally based Māori, may have shorter travel times if more stores in rural areas provide an improved grocery offering. Price-focused consumers in urban and peri-urban areas may benefit if existing at-scale retailers expand their offering into groceries.

My expectation is that the wholesale offerings by major grocery retailers will be consistent with what would be observed in a workably competitive wholesale market

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31. I want to give major grocery retailers and wholesale customers, and independent suppliers and wholesalers, a degree of certainty of what is expected of them when negotiating commercial wholesale arrangements under the quasi-regulatory regime.
32. Improved access to wholesale options can be either through the major grocery retailers or other channels. I expect the wholesale offering by major grocery retailers to be consistent – in relation to price, range and terms – with what would be observed in a workably competitive wholesale market.
33. The offering should provide a comprehensive range of products. This should reflect the major grocery retailer's own retail range, what suppliers have allowed to be sold to wholesale customer, and what the major grocery retailers could efficiently supply having regard for other sources of supply available (such as direct from the supplier or other wholesalers and distributors). If private label products are sought after by

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wholesale customers under the quasi-regulatory regime, I expect a major grocery retailer to consider these requests in good faith.

34. The wholesale prices should allow the wholesale customer to enjoy the benefits of the major grocery retailer's volume and efficiency-based discounts from suppliers. The payment terms, any costs to serve, and any product margins should be transparent and consistent with a wholesaler operating in a workably competitive wholesale sector.
35. I recognise that retail prices at some major grocery stores may be lower than their wholesale offering prices due to the impact of retail-focused promotional and marketing discounts which are funded by suppliers.
36. It would not be reasonable to expect major grocery retailers to pass on these supplier funded discounts to wholesale customers without supplier agreement. Instead, I expect that generally suppliers will want to negotiate retail-focused promotional and marketing discounts directly with the wholesale customer. This could result in positive competition between retailers and benefits to consumers in the long-term. In either case, it should be the suppliers' choice.

I propose a novel approach to the regulation of access to grocery wholesale

37. The regulation of access to grocery wholesale is unprecedented and requires a novel approach.
38. Under the quasi-regulatory regime agreed to by Cabinet in May, major grocery retailers would negotiate wholesale offerings on commercial terms.
39. There is currently no suggestion that the quasi-regulatory regime would not result in commercially negotiated wholesale supply arrangements that are consistent with what would be expected in a workably competitive wholesale market.
40. However, the incentives on major grocery retailers to negotiate wholesale offerings consistent with what would be expected in a competitive market are provided only by a combination of transparency and conduct obligations.
41. The quasi-regulatory regime therefore may not be sufficient to achieve the overall purpose. This is why in May Cabinet also agreed to the development of a regulatory backstop. The inclusion of a regulatory backstop in the Bill would provide further incentive by articulating clearly the potential significant further regulatory interventions that may occur if a workably competitive wholesale market does not develop.
42. I propose that the regulatory backstop would provide the Government and the Commissioner with a flexible set of regulatory tools, ranging from requiring greater transparency to imposing specific wholesale supply obligations. The intent is to provide an escalating level of intervention without a formal hierarchy. I consider that this approach will allow for a timely and proportionate regulatory response that provides a credible threat.
43. The proposed tools, and grounds and process for activation, are further described in detail in the sections below. An overview is provided in Annex One.

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44. There are some risks associated with the regulation of access to grocery wholesale, and the novel approach proposed. I consider that the long-term benefits to consumers warrant the regulation of grocery wholesale and the proposed approach, and that the risks can be managed as set out further below.

Proposed set of operationally-focused principles to shape decision making by the regulator and the regulated parties

45. I am now also seeking agreement to include in the Bill a set of operationally-focused principles.
46. These principles would firstly ensure that the Government's expectations are clear to market participants and can inform commercial decision-making under the quasi-regulatory regime. They would also help to guide the Commissioner in monitoring and reviewing arrangements under the quasi-regulatory regime, enforcing that regime, and in the event the Commissioner has cause to develop further regulatory responses or advice for the Minister under the regulatory backstop regime.
47. Specifically, I propose principles along the following lines:
- 47.1. wholesale customers seeking to operate as grocery retailers in the New Zealand market have access to a comprehensive range of wholesale product offerings, either through the major grocery retailers or other channels;
 - 47.2. major grocery retailers and wholesale customers have sufficient certainty to make efficient investments, including credible demand and supply for wholesale products, respectively;
 - 47.3. major grocery retailers can reasonably expect to recover efficient costs, including investments they are required to make;
 - 47.4. the wholesale offering by major grocery retailers – in terms of access terms and conditions, range and price – is consistent with what would be expected in a workably competitive wholesale market;
 - 47.5. the prices provided under the wholesale offering by major grocery retailers are transparent to wholesale customers;
 - 47.6. retail-focused promotional and marketing is generally to be negotiated between suppliers and retailers, unless the supplier wants to make them available through wholesale;
 - 47.7. independent suppliers retain control over the channels for the retail sale of their products and brands; and
 - 47.8. wholesale customers, and other major grocery retailers, are not hindered from developing their own trading relationships with suppliers (e.g., by exclusivity arrangements and/or restrictive clauses in trading arrangements between major grocery retailers and wholesale customers).

Proposed designation process

48. I propose that only those major grocery retailers that are also subject to the quasi-regulatory regime can be subject to the regulatory backstop regime.
49. Cabinet has already agreed that initially the quasi-regulatory regime will apply to Foodstuffs North Island, Foodstuffs South Island and Woolworths New Zealand.
50. To allow for additional grocery retailers to be designated, I propose that the Bill contain a similar designation process to that adopted in the Commerce (Grocery Sector Covenants) Amendment Act 2022. This provides that additional grocery retailers may be designated by the Minister by Order in Council, after considering a recommendation from the Commissioner.
51. The Commissioner would be required to consult the grocery retailer about a proposed designation and, in making such a recommendation to the Minister, have regard to:
 - 51.1. whether the grocery retailer supplies the major categories of grocery products¹;
 - 51.2. whether a designation would promote competition in the grocery sector (including the competitive neutrality of any regulation); and
 - 51.3. any other matters it considers relevant.
52. The Minister may accept or reject the Commissioner's recommendation or make any other decision that the Minister considers is in the public interest. The Minister may also request that the Commissioner reconsider any matter, including an error, or an oversight.
53. To provide certainty for potential new entrants or existing grocery retailers looking to expand, I propose that there be a 'regulatory holiday', so that no grocery retailer other than Foodstuffs North Island, Foodstuffs South Island and Woolworths New Zealand will be designated in the first five years of its trading in New Zealand grocery sectors.
54. I expect that the Commissioner be required to produce guidance on the matters it will consider when making a recommendation to designate.

Proposed regulatory backstop tools, activation grounds and processes

55. As set out above I propose a regulatory backstop would provide the Government and the Commissioner with a flexible set of regulatory tools that provide an escalating level of intervention without a formal hierarchy.

¹ Consistently with what will be used in other provisions in the Bill, the major categories of grocery products have been defined as: bread, dairy products, eggs or egg products, fruit, vegetables, meat, fish, rice, sugar, manufacturer-packaged food, and medicine other than prescription medicine.

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I propose to provide the Commissioner with powers to impose additional transparency and conduct obligations

56. I consider it important that in order for the regulatory backstop to provide a credible threat it should provide for a timely and proportional regulatory response.

Activation grounds:

57. I propose that the Commissioner could impose additional transparency and conduct obligations if doing so would better meet the overall purpose of the Bill (namely, to improve competition in the retail grocery sector for the long-term benefit of consumers) and any of the following grounds are met:
- 57.1. after three months from the quasi-regulatory regime provisions in the Bill coming into force, a major grocery retailer has not put in place the formalised rules, criteria and procedures, or the standard terms and conditions, required by the quasi-regulatory regime;
- 57.2. after six months from the quasi-regulatory regime provisions in the Bill coming into force, a major grocery retailer has not put in place the systems necessary (e.g. ordering, billing, and confidentiality management) to provide wholesale groceries to wholesale customers;
- 57.3. after twelve months from the quasi-regulatory regime provisions in the Bill, prospective wholesale customers have sought access, good faith negotiations have concluded, and no substantial agreements have been reached; **or**
- 57.4. the wholesale offerings – in relation to price, range, and terms – provided by major grocery retailers are not consistent with what would be expected in a workably competitive wholesale market.

Proposed tools:

58. Specifically, I propose that the Commissioner could:
- 58.1. require a major grocery retailer to put in place a framework for commercial wholesale supply of a comprehensive range of grocery products at competitive prices (**the Framework**); or
- 58.2. make a Grocery Wholesale Industry Participation Code that applies to all designated grocery retailers, and to all other grocery retailers that sought access to wholesale groceries (**the Wholesale Code**).
59. The **Framework** would be a manual or rule book that sets out how pricing and ranging decisions will be made by the executives responsible for the wholesale offering. This would include the basis for all costs that they used to arrive at their wholesale prices and any servicing costs that are charged. There would be some analogy to Fonterra's Milk Price Manual.
60. I consider that this requirement will create additional transparency for all parties and increase the incentives for major grocery retailers to develop and offer competitive wholesale supply arrangements.

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61. I also propose that the Commissioner be provided with the power to direct a major grocery retailer to adopt or amend specific inputs, assumptions, or processes used in its Framework. This power could be exercised, after appropriate consultation, where the Commissioner considers its directions would be consistent with, or better achieve, the purpose and the principles of the legislation.
62. The **Wholesale Code** could be broad and allow provisions that were necessary or desirable to achieve the overall purpose. In practice, it could set out regulatory provisions elaborating on the principles above to improve the operation of the wholesale regime. This could focus on the range of products included in wholesale supply, or the pricing of wholesale, expectations (but not requirements) on wholesale customers, or any other factors that arise.
63. While the Commissioner would be responsible for making and amending the Wholesale Code, they could request the industry propose a draft Wholesale Code. The Wholesale Code will be enforceable by the Commissioner or by industry participants, including through the imposition of civil pecuniary penalties and orders for compensation.
64. Both these regulatory tools have been put to effective use in other markets subject to economic regulation (e.g., the Electricity Code and Farmgate Milk Price manual). They are intended to give the Commissioner the independence and flexibility to guide the emerging behaviours of market participants towards public interest outcomes, with the least interference with commercial arrangements and least regulatory costs necessary.

Process for activation:

65. From a process perspective the Commissioner:
 - 65.1. may determine whether to require a Framework or make a Wholesale Code of its own initiative, or at the request of the Minister, or as part of its annual reporting function;
 - 65.2. must consult prior to making a decision on whether to require a Framework or make a Wholesale Code;
 - 65.3. must use its expertise to consider the grounds referred to in paragraph 57, which of the available additional regulatory tools to apply, and which major grocery retailer or retailers to apply the tools to; and
 - 65.4. may take into account other matters it considers to be relevant.
66. The Commission could at the same time, or separately, consult on and determine the requirements of the Framework or the content of the Wholesale Code.
67. When making or amending the Wholesale Code, the Commissioner would be required to publish and consult on a draft Wholesale Code, together with a statement of its reasons for the proposed decision. As secondary legislation, the Wholesale Code would be presented to the House of Representatives, and subject to disallowance.

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Powers for the Minister to step in to require major grocery retailers to supply wholesale customers with a range of products at regulated prices

68. I am proposing to make clear that the Government is prepared to step in with potential significant further regulatory interventions if commercial offerings do not deliver a workably competitive wholesale market.

Activation grounds:

69. I propose that the Minister of Commerce and Consumer Affairs, as the responsible Minister, may after considering a recommendation from the Commissioner seek an Order in Council to require major grocery retailers to supply wholesale customers if satisfied that the wholesale offerings are not consistent with what would be expected in a workably competitive wholesale market and the long-term benefit of consumers could be better delivered by greater regulatory intervention.

Proposed tools:

70. Without limiting the forms of regulation the Commissioner could recommend to the Minister in these circumstances, I propose two regulatory tools be provided for in the Bill:

70.1. require a major grocery retailer to **supply at non-discriminatory terms** (undertaking any actions the Commissioner considers necessary to achieve this); or

70.2. regulate a major grocery retailer through a form of **price-quality regulation** set by the Commissioner.

71. If required to **supply at non-discriminatory terms**, a major grocery retailer would be required to provide a comprehensive range of products. It would also be required to ensure that it sells to all wholesale customers (including its own retail operations or store operator members) on non-discriminatory terms. The major grocery retailers would be able to prepare a supply proposal as a starting point, to be considered by the Commissioner and amended if required.

72. The requirement to supply at non-discriminatory terms would have significant impacts on the current operating models of the major grocery retailers. The incumbent major grocery retailers are vertically integrated

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The Commissioner could determine whether non-discriminatory terms is best implemented through pricing of individual product categories or by demonstrating that the revenue to the wholesale business from supplying independent customers is like the revenue from supplying its own retail customers.

73. The Commissioner may impose obligations and directions on the major grocery retailer as necessary to have confidence that the non-discriminatory terms will be met. This could include imposition of accounting or operational separation

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requirements. There are no restrictions stopping an independent supplier from opting out.

74. The particular obligations of **price-quality regulation** set by the Commissioner could relate to:
- 74.1. pricing methodology (as determined by the Commissioner);
 - 74.2. performance standards (e.g., delivery timeframes, 'out-of-stock' frequency);
 - 74.3. access terms, such as payment terms and credit, minimum purchase quantities (including pick types) and purchase amounts, and demand forecasting;
 - 74.4. infrastructure and ancillary service requirements including logistics capability and services, IT functions; and
 - 74.5. duration of the regulatory access regime.
75. The Commissioner could vary the components of price-quality regulation based on factors such as wholesale customer type, different product categories or wholesale offerings, and geographic location.
76. The Government stepping in to require major grocery retailers to supply wholesale customers is a significant and unprecedented regulatory intervention. Supply on non-discriminatory terms is likely the more beneficial of the two tools, as it does not involve the regulator setting the range, pricing and access terms. The application of price-quality regulation to a diverse and dynamic range of grocery products is complex, notwithstanding the Commission's expertise in price-quality regulation of other industries, including electricity, gas distribution and airports.

Process for activation and recommendations the Commissioner may make:

77. In terms of the process for recommending either of these tools, or other form of regulation they think may better achieve the purpose of the Bill and the principles set out above, the Commissioner:
- 77.1. may make a recommendation of its own initiative, or at the request of the Minister, or as part of its annual reporting function;
 - 77.2. may, at the same time, consider whether to require a Framework or make a Wholesale Code;
 - 77.3. must consult prior to making a recommendation;
 - 77.4. must recommend which major grocery retailer(s) to apply the recommended regulation to;
 - 77.5. may take into account other matters it considers to be relevant when considering whether to make a recommendation to the Minister.

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78. I propose that the Commissioner may consider imposing requirements (such as minimum standards of demand forecasting, duration of purchases, health and safety, and minimum orders) on wholesale customers it considers are reasonable and necessary for the operation of the tools.
79. I also propose that the Commissioner may consider requiring a major grocery retailer to include private label products if it determines that doing so is consistent with the purpose of the Bill. Given the major grocery retailers are in a sense suppliers of these products, a requirement for these products to be included would run contrary to the principle of allowing suppliers to opt out. I also understand that major grocery retailers have made significant investments in the development of these products.
80. However, there could be significant advantages for wholesale customers in having access to these products and allowing the major grocery retailers to opt out could provide strong incentives to increase or expand their private label product offerings at the expense of suppliers and consumer choice. The Commissioner is best placed to carefully compare the potential consequences for competition and the long-term interests of consumers.
81. The Minister may accept or reject the Commissioner's recommendation in relation to supply at non-discretionary terms and price-quality regulation or make any other decision that the Minister considers is in the public interest. The Minister may also request that the Commissioner reconsider any matter.
82. A decision to impose an obligation to supply on non-discriminatory terms or price-quality regulation would be implemented by Order in Council. The order would specify the scope and type of obligations imposed. The Commission would then be responsible for developing secondary legislation that establishes the details of either supply at non-discriminatory terms or price-quality regulation and other matters that are desirable or necessary for their administration.
83. The Commissioner could defer obligations of the quasi-regulatory regime if they are not necessary while the regulatory backstop is in force.

Proposed grounds for deactivating the regulatory backstop

84. If a regulatory backstop tool is activated, then I consider it important that the Commissioner should consider when the tool may be deactivated having regard to the costs and benefits of regulation and whether it remains necessary to achieve the long-term benefit of consumers.
85. I propose that the Commissioner may set out a process for reviewing any regulatory backstop tool that was implemented. This could be done by fixing a period for regular review, or by using a market concentration threshold similar to the wider review provisions proposed below.
86. The Commission would then review the additional regulation against the purpose and principles of the legislation. Where it was in the long-term interest of consumers to do so, the Commission could:

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- 86.1. in the case of the **Framework** or **Wholesale Code** regulatory requirements, decide to continue, provide direction or amend, or deactivate them; or
 - 86.2. in the case of **supply on non-discriminatory terms** or **price-quality regulation** requirements, recommend that the Minister continue, amend or deactivate them. Either tool would be deactivated by Order in Council, on the recommendation of the Minister.
87. If the additional regulatory requirements were removed, the quasi-regulatory regime would automatically continue to apply. The additional regulatory requirements could also be re-activated at a future time if the ground for activation was met.

Proposed review of the regulation of access to grocery wholesale

88. The purpose of the Bill is to improve competition in the retail grocery sector for the long-term benefit of consumers. It is possible that either the quasi-regulatory regime or regulatory backstop regime may in the future become unnecessary following the entry of additional competitors in the retail grocery sector.
89. Any significant change to that regulatory regime must be signalled in advance, to allow sufficient time for all parties in the grocery industry to adjust.
90. I propose that the Bill includes provisions that:
- 90.1. provide for a comprehensive competition review of the New Zealand grocery sector at that time, enabling the Government of the day to make informed policy decisions relating to deregulation, including further legislative amendments if required; and
 - 90.2. provide for the Minister to set, by Order in Council, market concentration thresholds that trigger that review;² and
 - 90.3. provide certainty in the sector through clear thresholds, advance notice of any regulatory change, and notification of the Minister's response to the competition review, which will signal the Government's policy direction.
91. I propose that the review be triggered if the Commissioner's monitoring of New Zealand retail grocery sector reveals that the market concentration has likely been at or below the threshold for two consecutive years. The review could be conducted as part of annual competition reports by the Commissioner, which Cabinet already agreed to in July.
92. The Commissioner would then be required to notify the Minister and to provide the Minister, within a further one year, with a report covering:
- 92.1. the state of competition that exists in New Zealand grocery sectors, including retail and wholesale sectors;

² For example, the Herfindahl-Hirschman Index (HHI) provides a generally accepted measure of market concentration that is frequently used by competition regulators as a screening tool. HHI is calculated by squaring the market share of each participant and adding these together. The maximum possible score (one firm with 100% market share) is 10,000, while three players of equal share would have an HHI of 3,333. Internationally an HHI of above 2500 is generally considered to be highly concentrated.

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92.2. whether the Commissioner considers that:

92.2.1. the regulatory backstop regime should be repealed;

92.2.2. the quasi-regulatory regime should continue; and

92.2.3. if so, what changes, if any, should be made.

93. The report could also be part of the annual competition reports by the Commissioner. The Minister would be required to publish, within three months of receiving the Commissioner's report, the Government's response to the Commissioner's report outlining its intentions in relation to the quasi-regulatory access regime.

Proposed compliance and enforcement for the regulation of grocery wholesale

I propose a flexible and graduated set of compliance and enforcement tools

94. Cabinet has already agreed to provide for civil penalties (including penalties based on percentage of turnover) and remedies (including injunctions, undertakings and damages) for failure to comply with the obligations imposed under the Bill [CAB-22-MIN- 0186 refers], where this is modelled off the compliance provisions in the Commerce Act 1986.

95. I am now clarifying in more detail the compliance and enforcement powers that are sought in relation to the quasi-regulatory regime and regulatory backstop regime. I propose that the Bill include a flexible and graduated suite of penalties and remedies to support appropriate enforcement of each regime.

I propose that the Commissioner be empowered to issue a notice to take corrective action and to make directions in relation to a major retailer's Framework

96. If satisfied of non-compliance or likely non-compliance with the obligations under any of the components of the regulation of grocery wholesale access, the Commissioner will be able to require, by written notice, the non-compliant major grocery retailer to take specified steps to remedy the non-compliance or ensure the non-compliance is not continued.

97. Failure to comply with a notice should be subject to a pecuniary penalty, with a significantly higher penalty for repeated failures to comply.

98. This provision is broadly in line with sections 35 and 42 of the Retail Payment System Act 2022, and will provide a timely and cost effective means to incentivise compliance.

99. Where a major grocery retailer has failed to comply with a direction of the kind proposed in paragraph 61. (relating to a Framework they have been required to develop), this could be a more serious contravention, with higher penalties available. I consider this comparable to a failure to comply with a direction under section 24 of the Retail Payment System Act 2022 relating to network rules.

I also propose a full suite of other remedies including warnings, enforceable undertakings, injunctions, and compensation

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100. I also propose that the Commissioner be provided with additional enforcement tools when carrying out its functions:
- 100.1. the Commissioner should be able to accept enforceable undertakings in connection with any matter relating to ensuring compliance with the regulatory regimes. The process for accepting and enforcing undertakings should draw on sections 74A to 74C of the Commerce Act 1986;
 - 100.2. the Bill should provide for the Commissioner or a private party to be able to seek injunctions, issue warnings, seek compensation and damages through the courts. These should draw on other legislation such as the Commerce Act 1986 and Retail Payment System Act 2022; and
 - 100.3. the Bill should provide for the Commissioner to be able to seek Court orders to enforce the price-quality regulation and supply at non-discriminatory terms . These should draw on other legislation regulating wholesale access, such as Part 4 of the Commerce Act 1986 and the Telecommunications Act 2001.
101. This is consistent with the prior Government decisions in relation to the Bill [CAB-22-MIN-0186 and CAB-22-MIN-0259 refers].

Finally, I propose penalties if the requirements and obligations under the quasi-regulatory regime and the regulatory backstop regime are not met

102. Penalties would be available where a major grocery retailer failed to:
- 102.1. have in place within one month from the quasi-regulatory regime provisions in the Bill coming into force:
 - 102.1.1. formalised rules, criteria, and procedures for considering requests for commercial wholesale supply; and
 - 102.1.2. standard terms and conditions for commercial wholesale supply, or principles for determining how such terms and conditions will be agreed with wholesale customers;
 - 102.2. provide this information to a person who requests them for the purpose of considering or making a request for commercial wholesale supply;
 - 102.3. consider, in good faith, a request for commercial wholesale supply made in accordance with the rules, criteria and procedures set;
 - 102.4. comply with a notice to take corrective action;
 - 102.5. have in place a framework for commercial wholesale supply of a comprehensive range of grocery products at competitive prices within one month of a requirement to develop such a framework coming into force;
 - 102.6. comply with a direction relating to a Framework;
 - 102.7. comply with a Wholesale Code produced under the regulatory regime; and

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102.8. comply with supply at non-discriminatory terms or price-quality regulation.

103. These obligations on major grocery retailers are aligned, where appropriate, with the grounds for activating the regulatory backstop regime. While enforcement will be a separate decision from any decision to regulate, the level of compliance with the existing regulatory regime may be relevant to any decision to activate or de-activate regulation.

104. The proposed maximum penalties are outlined in Annex Two.

Risks and mitigations

105. As noted earlier, there are some risks associated with the regulation of access to grocery wholesale and the novel approach proposed.

There is a risk of disincentivising another large-scale competitor from entering the grocery sector

106. Additional regulatory obligations (both as part of the quasi-regulatory regime and regulatory regime) can disincentivise another large-scale competitor from entering the grocery sector. I consider that this is mitigated by:

106.1. the range of considerations that the Commissioner would need to make before recommending that a grocery retailer is designated under the quasi-regulatory regime, the regulatory holiday, and the grounds for recommending that a backstop tool be activated; and,

106.2. the review for the regulation of access to grocery wholesale itself, which is linked to a third party entering and getting established.

There is a risk of pricing being adjusted

107. There is a risk that under the quasi-regulatory regime the retail-focussed promotional and marketing discounts for major grocery retailers increase, while other volume and efficiency-based discounts decrease. This risk will be mitigated through:

107.1. monitoring and information gathering powers provided to the Commissioner under the Bill;

107.2. setting expectations that this conduct is not consistent with a workably competitive wholesale market and may therefore result in a regulatory backstop tool being activated; and

107.3. the regulatory tools available would afford some control over pricing methodologies.

There is a risk of further entrenching the duopoly position for major grocery retailers

108. There is also a risk that the regulation of access to grocery wholesale strengthens the position of the major grocery retailers as a key logistical conduit to connect suppliers with retailers, effectively reinforcing the duopoly. I consider that this is mitigated by:

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- 108.1. monitoring and information gathering powers provided to the Commissioner under the Bill as agreed to by Cabinet in July;
 - 108.2. the ability for the Commissioner to make recommendations in terms of the application of the regulatory backstop tools; and
 - 108.3. by allowing suppliers to retain control over the supply of their products so that they can use direct supply channels where efficient and are encouraged to develop direct relationships with wholesale customers (who might themselves develop wholesale networks).
109. Related to the above, suppliers have (on average) less negotiating power than the major grocery retailers. This negotiating power has been used by the major grocery retailers to secure suppliers' acceptance of terms and conditions of supply that push costs and risks down onto suppliers. This will be addressed through the development of the Grocery Industry Code of Conduct currently out for public consultation.

There is a risk that the regulatory backstop tools proposed create perverse incentives for some wholesale customers

110. There is a risk that the regulatory backstop tools proposed may look appealing to some wholesale customers, particularly those that may want to rely on it in the longer-term, and that this could create unintended incentives to not engage in the wholesale offering that the major grocery retailers are required to develop under the quasi-regulatory regime.
111. This risk has been factored into the design of the activation grounds and the proposed operationally-focussed principles.

There is a risk that additional regulation could create inefficiencies which could ultimately result in higher prices for consumers.

112. Finally, there is also a risk that given the dynamic nature of the grocery sector and diversity of goods affected, the tools provided for in this paper, in particular non-discriminatory terms and price quality regulation may not be workable.
113. Both tools are novel in a market without any 'essential facility' or 'natural monopoly' characteristic and, if executed poorly, have the potential to disrupt efficiencies currently arising from vertical integration, which could ultimately result in higher prices for consumers. Requiring supply on non-discriminatory terms may involve degrees of separation that erode the benefits of vertical integration. Price-quality regulation is likely to be particularly complex to develop without unintended consequences, such as gaming by wholesale customers, and without introducing significant additional costs.
114. The intention of establishing both tools is to incentivise commercially negotiated access arrangements under the quasi-regulatory regime by making the threat of regulation more transparent. In the event that either of these tools was being considered, decisions would be supported by expert advice from the Commissioner, as well as regulatory impact analysis, in order to provide assurance that the intervention would be workable and in the long-term interests of consumers.

Next steps

115. On 23 May Cabinet authorised targeted consultation on exposure drafts of specific parts of the Bill before introduction. I consider that there would be merit in doing so for parts of the Bill that provide for the regulation of access to grocery wholesale given the novelty of the approach and the pace at which the proposals have developed.
116. I also intend to conduct targeted engagement with iwi and Māori, in particular with Māori suppliers and businesses that there are no unforeseen implications for Māori.

Part Two: Implementing an exemption to facilitate greater collective bargaining by certain suppliers

Background

117. The Commission recommended the Government consider enabling collective bargaining by suppliers as one of the measures to address imbalances in their bargaining power with major grocery retailers.
118. On 23 May 2022, accepting this recommendation, the Government agreed to “introduce an exception from prohibitions in Part 2 (restrictive trade practices) of the Commerce Act 1986 for collective bargaining by grocery suppliers, with provisions included in the Bill to set out:
 - 118.1. which grocery suppliers the exemption applies to;
 - 118.2. the scope of activities that are permitted by the exemption (and certain activities that are not so permitted); and
 - 118.3. any disclosure obligations necessary for transparency” [CAB-22-MIN-0186 refers].
119. The decision presumed that the appropriate bounds of the exemption would be established wholly in the Commerce Act. I am now asking Cabinet to revise that view for reasons provided below.

The exemption presents benefits and some risks

120. An exemption would remove legal and cost barriers (i.e., authorisation by the Commission) for certain suppliers to collectively negotiate terms of supply with grocery retailers.
121. Together with other reforms benefiting grocery suppliers, this is expected to improve the confidence of suppliers to innovate and invest in the development of new and better products, with attendant benefits to consumers. Greater scope for collective bargaining has the potential to result in:
 - 121.1. smaller suppliers securing more favourable or efficient contractual outcomes (as opposed to standard terms many suppliers passively accept) than they could independently of one another, including because they are better

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informed of their own interests and have greater resources available to negotiate effectively;

121.2. smaller suppliers more effectively responding to efforts by grocery retailers to modify terms of supply;

121.3. reduced bargaining costs for suppliers (if not also for retailers).

122. There are also certain risks to competition and the interests of consumers to manage carefully in allowing competing suppliers to work together under the exemption.

123. Officials have undertaken further policy development to assess the exemption parameters that would best facilitate desirable conduct by suppliers while minimising the risks to competition.

I propose to build a regulation-making power into the exemption

124. Although Cabinet's previous decisions envisaged that the scope of the exemption would be set in primarily legislation, it has become apparent that a number of aspects of the exemption involve a degree of detail and complexity that is not appropriate for primary legislation. It is challenging to appropriately circumscribe what suppliers could do under the exemption, and an inflexible exemption may not be used by suppliers. There is also a need to be responsive to changes in sector dynamics that are expected to result from other reforms in the grocery sector.

125. Primary legislation would continue to exclude certain provisions of agreements between the participating suppliers, like collective boycott, and set out disclosure obligations.

126. However, I propose that further conditions and constraints on use of the exemption be set by regulations. Regulations made under the Act would specify:

126.1. the class or classes of grocery suppliers to which the exemption applies (for example, limiting the size of eligible suppliers);

126.2. the class of grocery retailers with whom those suppliers may collectively bargain;

126.3. on what conditions suppliers may enter into collective bargaining arrangements; and

126.4. limits and/or exclusions on the particular conduct suppliers in a bargaining group may undertake in reliance on the exemption (for example, on the exchange of commercially sensitive information) or on provisions they can seek to negotiate collectively (e.g., an upfront price for their goods).

127. Grocery retailers would be under no obligation to negotiate with any bargaining group that is formed in reliance on the exemption. I note that that on 4 July 2022, Cabinet agreed that the Commerce Commission's powers and functions as grocery sector regulator will include monitoring, among other things, use of best price clauses and exclusive supply agreements, and grocery supplier margins over time,

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and compare these to benchmarks and international comparisons [CAB-22-MIN-0259].

128. I propose regulations could only be made on recommendation by the Minister of Commerce and Consumer Affairs following consultation with interested parties and after having regard to the purpose of the Commerce Act (to promote competition in sectors for the long-term benefit of consumers within New Zealand).

Financial Implications

129. In July Cabinet agreed to provide \$4.790 million in funding to the Commission to establish and carry-out the grocery sector regulation functions in financial year 2022/23. Confidential advice to Government

This funding would also support the functions needed to monitor the implementation of the quasi-regulatory regime and assess if there are grounds to activate the regulatory backstop.

Legislative Implications

130. Confidential advice to Government

This Bill will bind the Crown.

Regulatory Impact Analysis

131. Regulatory Impact Analysis requirements apply to the policy proposals in this Cabinet paper.
132. The Ministry of Business, Innovation and Employment's Regulatory Impact Analysis Review Panel has reviewed the attached *Regulatory Impact Statement: grocery sector regulatory backstop to the quasi-regulated wholesale access regime* (the supplementary RIS), as supplementary to the Regulatory Impact Statement *Government Response to the Commerce Commission Grocery Sector Market Study – Policy decisions* (the original RIS), both prepared by MBIE.
133. The Panel considers that, given the combination of content in the original RIS and the supplementary RIS, and the enabling nature of the regulatory options, the information and analysis summarised in this supplementary Regulatory Impact Statement **meets** the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

Climate Implications of Policy Assessment

134. The Ministry for the Environment Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

135. There are no specific population-specific implications from the proposals in this paper. However, improving competition in the grocery sector will be of greatest benefit to lower socio-economic groups who may spend a greater proportion of their incomes on groceries on average.
136. Changes will impact on Māori both as grocery suppliers and consumers. Māori whanau on average spend a higher proportion of their income on grocery products, so would disproportionately enjoy any price benefits of increased competition.

Human Rights

137. The proposals in this paper are consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

138. The Treasury, Ministry of Justice, Commerce Commission, Ministry for the Environment, Ministry for Primary Industries, Te Arawhiti, and Land Information New Zealand have been consulted. The Department of Prime Minister and Cabinet and Parliamentary Counsel Office have been informed.
139. The Legislation Design and Advisory Committee has provided advice on key aspects of the proposals in this paper, and their advice has been considered and taken into account.
140. Through the Commerce Commission's market study process, the major grocery retailers raised strong concerns about the workability and effectiveness of mandatory wholesale access regulation. Since the announcement of Cabinet's May decisions to develop a mandatory wholesale access regime as backstop, officials had a number of targeted engagements with major grocery retailers. Confidential information entrusted to the Government

Confidential information entrusted to the Government

Communications

142. I intend to publicly announce these policy decisions. In timing the announcement I will take into consideration that one of the major grocery retailers (Woolworths) is a publicly listed company in Australia.

Proactive Release

143. I propose to proactively release this Cabinet paper and minute within 30 business days. This Cabinet paper and minute will be published on MBIE's website, subject to any information withheld as appropriate under the Official Information Act 1982.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

Part One: Regulation of access to grocery wholesale

1. **note** that on 23 May 2022, the Cabinet Economic Development Committee agreed to [CAB-22-MIN-0186]:
 - 1.1. establish an initial 'quasi-regulatory' regime for wholesale grocery supply to be implemented by the major grocery retailers; and
 - 1.2. a regulated wholesale access regime to act as a 'regulatory backstop';
2. **note** that while I refer to 'the Commissioner' throughout this paper, and in the following recommendations, the powers and functions relating to wholesale regulation would be given to the Commission and the Commissioner will have the authority to carry out the powers and functions, either alone or with two other members of the Commission;

Purpose and proposed approach to regulation of access to grocery wholesale

3. **note** that the regulation of access to grocery wholesale is intended to improve competition in the retail grocery sector for the long-term benefits of consumers;
4. **note** that the regulatory backstop is intended to further incentivise competitive wholesale offerings by enabling the Government to place additional regulation on major grocery retailers, and that I propose a flexible toolkit of additional forms of regulation that provides for an escalating level of intervention without a formal hierarchy;

Proposed set of operationally-focused principles

5. **agree** that the Bill sets out principles intended to guide decision-making both under the quasi-regulatory regime and in the development of any further regulation as a backstop, which are likely to be along the following lines:
 - 5.1. wholesale customers seeking to operate as grocery retailers in the New Zealand market have access to a comprehensive range of wholesale product offerings, either through the major grocery retailers or other channels;
 - 5.2. major grocery retailers and wholesale customers have sufficient certainty to make efficient investments, including credible demand and supply for wholesale products, respectively;

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- 5.3. major grocery retailers can reasonably expect to recover efficient costs, including investments they are required to make;
- 5.4. the wholesale offering by major grocery retailers – in terms of access terms and conditions, range and price – is consistent with what would be expected in a workably competitive wholesale market;
- 5.5. the prices provided under the wholesale offering by major grocery retailers are transparent to wholesale customers;
- 5.6. retail-focused promotional and marketing is generally to be negotiated between suppliers and retailers, unless the supplier wants to make them available through wholesale;
- 5.7. independent suppliers retain control over the channels for the retail sale of their products and brands; and
- 5.8. wholesale customers, and other major grocery retailers, are not hindered from developing their own trading relationships with suppliers (e.g., by exclusivity arrangements and/or restrictive clauses in trading arrangements between major grocery retailers and wholesale customers);

Proposed designation process

6. **agree** only those major grocery retailers who are also subject to the quasi-regulatory regime can be subject to the regulatory backstop regime;
7. **agree** that the quasi-regulatory regime have a similar designation process to that adopted in the Commerce (Grocery Sector Covenants) Amendment Act 2022, with modifications to suit the quasi-regulatory regime as appropriate (including a regulatory holiday for the first five years of trading in New Zealand);

Proposals relating to the regulatory backstop regime

8. **agree** that the Commissioner may impose additional regulatory requirements on major grocery retailers if they would better meet the purpose of the Bill and any of the following grounds are met:
 - 8.1. after three months from the quasi-regulatory regime provisions in the Bill coming into force, a major grocery retailer has not put in place the formalized rules, criteria and procedures, or the standard terms and conditions, required by the quasi-regulatory regime;
 - 8.2. after six months from the quasi-regulatory regime provisions in the Bill coming into force, a major grocery retailer has not put in place the systems necessary (e.g., ordering, billing, and confidentiality management) to provide wholesale groceries to wholesale customers;
 - 8.3. after twelve months from the quasi-regulatory regime provisions in the Bill coming into force, prospective wholesale customers have sought access, good faith negotiations have concluded, and no substantial agreements have been reached; **or**

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- 8.4. the wholesale offerings – in relation to price, range, and terms - are not consistent with what may be expected in a workably competitive wholesale market;
9. **agree** that if the above grounds are met the Commissioner can impose additional regulation by publishing a determination:
 - 9.1. requiring a major grocery retailer to put in place an enforceable framework for commercial wholesale supply of a comprehensive range of grocery products at competitive prices and make directions relating to a framework; and/or
 - 9.2. making an enforceable Grocery Wholesale Industry Participation Code that applies to major grocery retailers, and to all retailers that seek access to wholesale groceries;
10. **agree** that the Minister may, after considering a recommendation of the Commissioner, seek an Order in Council that requires major grocery retailers to supply wholesale customers if the wholesale offerings are not consistent with what may be expected in a workably competitive wholesale market, and the overall purpose of the Bill could be better delivered by additional regulatory intervention;
11. **agree** that the additional regulatory intervention referred to above include the two following regulatory tools:
 - 11.1. require (one or more) major grocery retailers to supply at non-discriminatory terms;
 - 11.2. price-quality regulation;
12. **agree** that when considering either of the tools in recommendation 11, the Commissioner may recommend any other form of regulation that it thinks, in the circumstances, would best meet the purpose of the Bill;
13. **agree** that in terms of the process for recommending either of the tools in recommendation 11, or other form of regulation they think may better achieve the purpose of the Bill, the Commissioner:
 - 13.1. may make a recommendation of its own initiative, or at the request of the Minister, or as part of its annual reporting function;
 - 13.2. may, at the same time, consider whether to require a Framework or make a Wholesale Code;
 - 13.3. must consult prior to making a recommendation;
 - 13.4. must recommend which major grocery retailer(s) to apply the recommended regulation to; and
 - 13.5. may take into account other matters it considers to be relevant when considering whether to make a recommendation to the Minister.

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14. **agree** that any requirements on a major grocery retailer to provide products under the regulated wholesale access regime may also place requirements on wholesale customers that are necessary to ensure the effective operation of the regulated wholesale access regime;
15. **agree** that any requirements on a major grocery retailer to provide products under the regulated wholesale access regime may allow for a supplier to opt-out of the wholesale offering;
16. **agree** that in the event additional intervention is implemented by Order in Council, the Commissioner may require a major grocery retailer to include private label products under that regime if it determines that doing so is consistent with the purpose of the Bill;
17. **agree** that if a regulatory backstop tool is implemented:
 - 17.1. it would be reviewed by the Commissioner in circumstances and using a process as may be specified by the Commissioner (for example, by using a market concentration threshold);
 - 17.2. any additional regulatory requirements imposed by the Commissioner can be amended or deactivated by the Commissioner after reviewing them against the purpose of the Bill;
 - 17.3. regulation of supply on non-discriminatory terms or price-quality regulation could be amended or deactivated by Order in Council, following a recommendation by the Commissioner;

Proposed review of the regulation of access to grocery wholesale

18. **agree** that a review of the regulation of access to grocery wholesale is triggered if the Commissioner's monitoring of New Zealand grocery sectors reveals that the market concentration has likely been at or below the threshold for two consecutive years;
19. **agree** that the Minister can, on their own volition or following a recommendation made by the Commissioner, seek an Order in Council setting market concentration thresholds that trigger that review;
20. **agree** that the Commissioner then be required to notify the Minister and to provide the Minister, within a further one year, with a report covering:
 - 20.1. the state of competition that exists in New Zealand grocery sectors, including retail and wholesale sectors;
 - 20.2. whether the Commissioner considers that:
 - 20.2.1. the regulatory backstop regime should be repealed;
 - 20.2.2. the quasi-regulatory regime should continue; and
 - 20.2.3. if so, what changes, if any, should be made.

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21. **agree** that within three months of receiving the Commissioner's report, the Government must publish its response to the Commissioner's report outlining its intentions in relation to the wholesale regulatory regime;

Proposed compliance and enforcement for the regulation of access to grocery wholesale

22. **agree** to the proposed range of compliance and enforcement provisions for quasi-regulatory regime and regulatory backstop regime including the use of notices to take corrective actions, court orders, enforceable undertakings and pecuniary penalties as set out in Annex Two;

Part Two: Implementing an exemption to facilitate greater collective bargaining by certain suppliers


23. **note** that on 23 May 2022, Cabinet agreed to introduce an exception to the Commerce Act for grocery suppliers to collectively bargain with retailers [CAB-22-MIN-0186 refers];
24. **agree** to rescind the part of that decision that implied the provisions of this exemption would be wholly set out in the Bill;
25. **agree** that this be an exemption by way of secondary legislation to sections 27 and 30 of the Commerce Act;
26. **agree** that certain conduct or provisions be excluded from the exemption, including collective boycott and any other conduct or provisions specified in regulations;
27. **agree** that regulations may also be made specifying:
 - 27.1. the class or classes of suppliers who can make use of the exemption;
 - 27.2. which class or classes of grocery retailer they may collectively negotiate with;
 - 27.3. any conditions on suppliers entering into collective bargaining arrangements.
28. **agree** that suppliers intending to make use of the exception be required to disclose certain information in the manner prescribed by the Commerce Commission before the exemption takes effect and within 15 working days of entering into the arrangement and that these disclosures be published by the Commission;
29. **agree** that the power to make any regulations referred to above be on recommendation by the responsible Minister following consultation with the Commerce Commission and affected parties, and only if considered consistent with the purpose of the Commerce Act (to promote competition in sectors for the long-term benefit of consumers within New Zealand);
30. **note** that on 4 July 2022, Cabinet agreed that the Commerce Commission's powers and functions as grocery sector regulator will include monitoring, among other things, use of best price clauses and exclusive supply agreements, and grocery supplier margins over time, and compare these to benchmarks and international comparisons [CAB-22-MIN-0259];

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31. **agree** that the consequences of any supplier failing to act in accordance with the exemption is that they, and any other supplier participating in that collective bargaining process who knows or ought reasonably to know of the failure, would lose the benefit of the exemption and exposed to potential liability under section 27 and/or 30 of the Commerce Act;

Financial recommendations

32. **note** that the wholesale access regime has financial costs on the Commerce Commission that are not funded beyond financial year 2022/23;

33. Confidential advice to Government
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Development of legislation

34. **invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to the above paragraphs;
35. **authorise** the Minister of Commerce and Consumer Affairs to make additional policy decisions and minor or technical changes to the policy decisions in this paper, consistent with the general policy intent, on issues that arise in drafting and passage through the House;
36. **note** that this Cabinet paper and minute will be proactively released subject to any redactions required within 30 business days of final Cabinet decisions.

Authorised for lodgement

Hon Dr David Clark

Minister of Commerce and Consumer Affairs

Annex One: Overview of proposed regulation of access to grocery wholesale

Regulation of access to grocery wholesale

Increasing level of intervention without a formal hierarchy:

Quasi-regulatory regime

Wholesale supply is commercially negotiated, but major grocery retailers are subject to some transparency and conduct obligations

Major grocery retailers are required to:

- **consider all requests** in good faith and in a timely fashion,
- **notify all requests to the Commissioner**, along with the outcome of any requests
- **put in place formalised rules, criteria, and procedures** for considering requests for wholesale supply
- **put in place standardised terms and conditions of wholesale supply**, or principles for
- **provide a copy of their standardised terms and conditions** to the Commissioner and to any person who requests.

Regulatory backstop

Wholesale supply is commercially negotiated but the Commissioner can impose additional transparency and conduct obligations

Major grocery retailers are required to put in place a **framework for range and price.**

The Commissioner puts in place a **Grocery Wholesale Industry Participation Code.**

Wholesale supply is regulated as the Minister steps-in, on recommendation of the Commissioner:

Major grocery retailers are required to **supply at non-discriminatory terms.**

Major grocery retailers regulated through a form of **price-quality regulation** set by the Commissioner.

Grounds to activate:

The purpose of the regulatory regime would be better met by additional requirements on major grocery retailers where:

- **after three months** of the regime being in place a major grocery retailer has not put in place the formalized rules, criteria and procedures, or the standard terms and conditions, required by the quasi-regulatory regime; or
- **after six months** of the regime being in place a major grocery retailer has not put in place the systems necessary to provide wholesale groceries to wholesale customers; or
- **after twelve months** of the regime being in place a major grocery retailer, prospective wholesale customers have sought access, good faith negotiations have concluded, and no substantial agreements have been reached.

The wholesale offerings are not consistent with what may be expected in a workably competitive wholesale market and the purpose could be better delivered by the tools available under the regulatory backstop.

Enforcement and compliance

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Annex Two: Proposed maximum penalties

	Individual Maximum	Corporate Fixed Maximum	Commercial Gain?	Turnover maximum?	Additional Daily Penalty	Notes
Quasi-regulatory						
Breach of obligation	200,000	3,000,000	1x Commercial Gain ³	3%	30,000	1/3 of Backstop penalties.
Failure to comply with notice to take corrective action	10,000	100,000	No	No	10,000	1/3 of penalty for failure to comply with orders under the Financial Markets Conduct Act, but with additional daily penalty.
Regulatory Backstop						
Breach of obligation or regulatory direction	500,000	10,000,000	3x Commercial Gain	10%	100,000	Commerce Act, Part 2/3 penalties, but with additional daily penalty.
Failure to comply with notice to take corrective action	30,000	300,000	No	No	100,000	Same as FMCA orders, but with additional daily penalty.
Failure to provide information to the Commission	30,000	300,000	No	No	100,000	Same as FMCA orders, but with additional daily penalty.
Failure to notify the Commissioner of events	30,000	300,000	No	No	100,000	Same as FMCA orders, but with additional daily penalty.
Breach of code obligation	30,000	300,000	No	No	100,000	Same as Telecommunication Act 2001, but with additional daily penalty.
Failure to comply with Price/Quality or Information Disclosure ⁴	500,000	5,000,000	No	5%	No	Commerce Act, Part 4 penalties / Fuel Industry Act 2020 level penalties
Failure to Comply with non-discriminatory supply obligations	500,000	10,000,000	3x Commercial Gain	10%	100,000	Commerce Act Part 2/3 penalties, plus additional daily penalty.

³ While a gain-based maximum is important for deterrence, in practice the turnover-based maximum is likely to be used in most cases as commercial gain will rarely be readily ascertainable. In the 21 years since a gain-based maximum was inserted in the Commerce Act, no penalties have been set based on the gain-based maximum. The High Court has held that: “a defendant’s commercial gain cannot be “readily ascertained” ... unless it can be quantified in a timely, efficient and relatively straightforward manner and with reasonable precision and specificity”, see *Commerce Commission v Telecom Corporation of New Zealand Ltd* (2011) 13 TCLR 270 at [45].\

⁴ The Commerce Act also provides a criminal offence for a knowing failure to comply.