25 February 2019

Competition and Consumer Policy
Ministry of Business, Innovation and Employment
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WELLINGTON 6140

Email: competition.policy@mbie.govt.nz

Dear Sir/Madam

Attached are the comments that the New Zealand Food & Grocery Council wishes to present on the ***Discussion Paper: Protecting businesses and consumers from unfair commercial practices***.

Yours sincerely

Katherine Rich
Chief Executive

Discussion Paper – Protecting businesses and consumers from unfair commercial practices

Submission by the New Zealand Food & Grocery Council

25 February 2019

NEW ZEALAND FOOD & GROCERY COUNCIL

1. The New Zealand Food & Grocery Council (**NZFGC**) welcomes the opportunity to submit to the Ministry of Business, Innovation and Employment (**MBIE**) on the issues raised in the *Discussion Paper: Protecting businesses and consumers from unfair commercial practices* (**Discussion Paper**).

2. The NZFGC is an industry association which represents the major manufacturers and suppliers of food, beverage and grocery products in New Zealand. This sector generates over $34 billion in the domestic retail food, beverage and grocery products market, and over $31 billion in export revenue from exports to 195 countries – some 72% of total merchandise exports. Food and beverage manufacturing is the largest manufacturing sector in New Zealand, representing 44% of total manufacturing income. Our members directly or indirectly employ more than 400,000 people – one in five of the workforce.

OVERARCHING COMMENTS – OUR SUBMISSION

3. The NZFGC supports Options Package 4 as described on page 8 of the Discussion Paper, which is comprised of (a) a prohibition of unconscionable business-to-consumer conduct; (b) a prohibition of unconscionable business-to-business conduct; and (c) a prohibition on unfair contract terms (**UCT**s) in business-to-business contracts (**the proposed measures**).

4. The proposed measures present a unique opportunity to strengthen New Zealand's statutory regime in its capacity to address abuses of buyer power, not only in the grocery retail sector but in many other concentrated markets in New Zealand. It is also an opportunity for New Zealand's government to send a definitive message to businesses about what kind of behaviour is acceptable in our trading environment, and to bring New Zealand's consumer and competition law regime into closer alignment with Australia's. More broadly New Zealand would be following international best practice.

5. The comments in this submission relate to business-to-business conduct in the grocery retail market, and include:

    a. Background to this inquiry and our submission.

    b. Challenges with these types of submissions in the New Zealand context.

    c. International context – growing concern regarding demand-side buyer power.

    d. New Zealand competition laws are ineffective.

    e. New Zealand's grocery retail market & examples of harmful conduct by supermarkets.

    f. Specific answers to Discussion Paper questions.

6. We would like to make clear that some of the behaviours given as examples are historic, i.e. last reported in 2014. Current efforts by supermarket management have made a positive difference to the supermarket trading environment and we appreciate the efforts made, but New Zealand law continues to allow certain sorts of behaviours which can easily be reverted to once again, hence it is important to reflect and address the overall market reality as experienced by suppliers.

DETAILED COMMENTS

A. Background to this inquiry and our submission

7. The proposed measures are necessary but unremarkable. Indeed, New Zealand is arguably an outlier in the absence of the measures set out in the Discussion Paper. Many other jurisdictions have comparable measures in place – recognising that there can be a range of conduct not captured by other laws (e.g. generic competition laws) that needs to be addressed.

8. MBIE's review should be seen in the context of:

    a. international norms;

    b. growing concerns about demand-side buyer power;

    c. specific concerns about supermarket buyer power; and

    d. New Zealand's existing market structure, which would be (and was) prohibited under the current competition law test.

9. Much is made in these types of debates in New Zealand about "chilling effects" and uncertainty. However, the proposed business-to-business measures should only impact entities with significant market power, or those conducting themselves in a particularly egregious manner – and would only require these entities to act in accordance with commercial norms in competitive markets.

10. The measures proposed in the discussion document are unremarkable internationally and should be non-controversial in that they would simply impose rules that most would expect to be set down in law (and often are in other jurisdictions). There is nothing to suggest that New Zealand is unique in not needing the same measures. If anything, many of the issues caused by demand-side buyer power are more acute in New Zealand due to our concentrated market structure and behaviour that can result as a consequence.

11. As with any law change, the proposed measures (if enacted) could well have some associated compliance costs. These are expected to be relatively low, and have to be weighed against the potentially very significant harms – the extent of which can only be estimated.

B. Challenges with these types of submissions in the New Zealand context

12. The NZFGC actively encouraged industry leaders across the grocery retail sector to submit in response to the Discussion Paper. However, understandably because of the professional and commercial risks involved, the fear of commercial retribution and the potential impact this could have on a business, has prevented many suppliers from feeling comfortable about making a submission directly. The fact that any submission would be subject to the Official Information Act 1982 is a contributing factor to this. The reality is that raising concerns regarding supermarkets' conduct is not a viable option where confidentially cannot be guaranteed. This can also be prohibitive to suppliers bringing causes of action or raising concerns when unfair conduct occurs.

13. In New Zealand's relatively small, tight-knit trading environment, even the risk of gossip or hearsay is enough to prevent suppliers from raising concerns. Suppliers cannot risk losing a commercial relationship with a supermarket - losing one customer when two

supermarket chains control approximately 95% of the grocery trade can often be a matter of commercial survival.

14. These challenges were demonstrated by the fact that the Commerce Commission (**Commission**) had to compel submissions in relation to its investigation of Progressive Enterprises, now known as Woolworths NZ, during its investigation. The reluctance of suppliers to speak out against supermarkets or minimising their evidence, would have resulted in incomplete information for the review. MBIE will face similar issues in its current review due to the impediments described above.

C. International context – growing concern regarding demand-side buyer power

15. The issue of control of buyer power (and abuses of this power), and how this may be addressed by policy and legal measures, is a growing global concern.[1] The result of this is that other jurisdictions are already considering adopting, or have adopted, measures which seek to control abuses of buyer power. Australian competition law has included some form of prohibition on "unconscionable conduct" since 1986.[2] The Australian UCT regime was expanded to protect small businesses in 2016.

16. Abuse of demand-side buyer power in the supermarket supply chain has increasingly been a specific concern internationally over the last decade – the result of which in many jurisdictions has been the adoption or use of measures analogous to those contemplated in the Discussion Paper.

    a. For example, both Australia and the United Kingdom (**UK**) have introduced grocery retail sector codes of conduct since 2009. The table below identifies where particular conduct by New Zealand supermarkets is expressly prohibited under the Australian Food & Grocery Code of Conduct (**FGCC**).

    b. The Australian Competition and Consumer Commission (**ACCC**) has taken legal action against both Woolworths and Coles in relation to alleged unconscionable conduct. In *ACCC v Coles Supermarkets Australia,* the Australian Federal Court found that "*Coles treated its suppliers in a manner not consistent with acceptable business and social standards which apply to commercial dealings. Coles demanded payments from suppliers to which it was not entitled by threatening harm to the suppliers that did not comply with the demand. Coles withheld money from suppliers it had no right to withhold*."[3]

    c. In 2014 the European Commission (**EC**) adopted a Communication on tackling "unfair trading practices" in the business-to-business food supply chain.[4] Unfair trading practices are practices that deviate from good commercial conduct, are contrary to good faith and fair dealing and are unilaterally imposed by one trading partner on another. A subsequent 2016 Report from the EC on the same issue stated that, "*many Member States… have recently introduced legislative and enforcement measures that broadly meet the criteria for effective frameworks against unfair trading practices. In total, more than 20 Member States have introduced legislation or are planning to do so in the near future*."[5] These legislative /enforcement measures vary between Member States.[6]

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[1] See Peter C. Carstensen's *Competition Policy and the Control of Buyer Power* (2017).
[2] Julie Clarke, *Unconscionable conduct: An evolving moral judgement* (October 2011). Can be accessed at: http://classic.austlii.edu.au/au/journals/PrecedentAULA/2011/71.pdf
[3] *ACCC v Coles Supermarkets Australia Pty Ltd* [2014] FCA 1405 at [1].
[4] See: http://ec.europa.eu/internal_market/retail/docs/140715-communication_en.pdf
[5] See: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2016%3A32%3AFIN, page 2.
[6] See: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2016%3A32%3AFIN, page 5.

17. The reality is that currently New Zealand lacks many of the regulatory safeguards that are available in other jurisdictions. Some unfair commercial practices that would be likely be illegal overseas frequently go unreported and unpunished in New Zealand.

D. New Zealand competition laws are ineffective in managing business-to-business conduct

18. It is well accepted that there are significant shortcomings in New Zealand's competition law regime.[7] While the NZFGC sees benefits in improving section 36 of the Commerce Act (and will expand on this issue in our submission in response to MBIE's *Discussion Paper: Review of Section 36 of the Commerce Act and other matters*), there would remain significant impediments to relying solely on that, because

    a. Parties with market power in a position to abuse that power may argue that they do not have "substantial market power" for the purposes of the Commerce Act. For example, supermarkets may argue that they do not have "substantial market power" because they constrain each other. This can be seen by the fact that the Commission did not make a finding on "substantial market power" in its Progressive Enterprises investigation.[8]

    b. There would still have to be (likely) "substantial lessening of competition" in a relevant market - there may be issues with market definition and demand-side market power can be challenging in this respect (e.g. it can be hard to demonstrate the anti-competitive effects of downward pricing).

    c. There are related issues, such as confidentiality/retribution concerns (discussed in paragraphs 12-13 above), costs of enforcement and the burden of proof.

19. While traditional competition law theory assumes downward pricing to be good (i.e. the lower prices are passed on to consumers) or neutral (i.e. a simple wealth transfer from manufacturers to retailers), significant buyer power (particularly abuses of that buyer power) may inhibit New Zealand suppliers' ability to invest, expand and innovate. All these activities are important for firms to grow to a size large enough to have the capacity to succeed in export markets. Abuses of supermarket buyer power make it difficult for suppliers to generate a normal profit (the minimum level of profit needed to remain competitive in a market) which may then be invested in product development, innovation and exports. A good example from Australia would be the impacts on the dairy industry as a result of "$1 milk", which impacted the industry so badly that some farmers have stopped the production of milk and there is now a shortage of milk, pushing prices to the highest level. Supermarkets have recently raised prices of milk, but the effects on the industry will take some time to repair.

20. This in turn poses a long-term detriment to consumers - a decrease in investment, expansion and innovation by suppliers can result in lower competition between suppliers and higher prices, more limited choice and reduced product quality.[9] Many of these harms may be unknown, and difficult to quantify – this does not negate the need to have balanced protections in place. Furthermore, in many instances the benefit of downward pricing pressure is not passed on to consumers but instead is used to increase businesses' profits. When the ambition is to add value to goods and maintain a strong

[7] See the Commission's submission to the Minister of Commerce and Consumer Affairs, accessed at: https://www.mbie.govt.nz/have-your-say/targeted-commerce-act-review/
[8] The investigation report can be found here: https://www.comcom.govt.nz/dmsdocument/12714
[9] Caron Beaton-Wells & Jo Paul-Taylor, *Codifying Supermarket-Supplier Relations – A Report on Australia's Food and Grocery Code of Conduct* (September 2017), para. 11 (*Codifying Supermarket-Supplier Relations*). Can be accessed at: http://law.unimelb.edu.au/__data/assets/pdf_file/0006/2463135/Deidentified-draft-Code-Report-with-chapter-breaks_LATEST_010917.pdf

manufacturing base, New Zealand has seen the retrenchment or exit of many fast moving consumer goods companies linked to increased retail concentration.

E. The New Zealand grocery retail market

21. New Zealand grocery retailing is characterised by a supermarket duopsony comprised of two large-scale grocery retailers, Woolworths NZ and Foodstuffs (**supermarkets**). This duopsony was the result of a series of supermarket acquisitions in the late 90's and early 2000's, culminating in the acquisition of Woolworths (New Zealand) Limited by Progressive Enterprises Limited, which reduced the number of supermarkets in New Zealand from three to two. This merger occurred in 2001, while the current "substantial lessening of competition" merger test (found in section 27 of the Commerce Act 1986) was in the process of being introduced. The merger was actually declined by the Commission under the new "substantial lessening of competition" test[10] but ultimately allowed to proceed under the old "dominance" test[11] pursuant to a ruling by the Privy Council.[12] In other words, the Commission was not satisfied that the merger would not substantially lessen competition in the relevant markets in New Zealand.

22. New Zealand's two supermarket chains wield significant buyer power in their dealings with grocery suppliers, the majority of which rely on supermarkets to access end consumers. This imbalance exists despite the fact that many suppliers are relatively large, sophisticated companies.[13] In a duopsony, this level of demand-side buyer power goes beyond control of access to consumers - commentators have noted that "*because of the power [supermarkets] wield in the marketplace, they have a strong influence over what consumers buy, and how and where they buy it. Supermarkets can be seen as gatekeepers rather than passive transmitters of consumers' wishes, and their gate-keeping role can work to the detriment of consumers and suppliers alike*."[14]

23. At the outset NZFGC would like to make clear that work is being done by both supermarkets to improve and support positive supplier relationships. Progress has been made since 2014 when issues relating to the treatment of food and grocery suppliers and growers were considered by the Commerce Commission and debated in Parliament. New leadership has also meant a greater desire to work constructively on these issues.

24. NZFGC supports and appreciates this work, but in order to accurately make a submission on the subject of this consultation, it is important not to forget past instances. While not currently an issue, they remain in the negotiation 'toolbox' to be employed at a later stage. Primarily examples are given of activities which have occurred here but are explicitly ruled out in Australia or other jurisdictions.

25. Over the last 5 years NZFGC has received first hand reports of a number of clearly harmful practices. Some are historic issues last reported in 2014 but not since (marked with a (H)) and some are currently performed by New Zealand supermarkets either with head office direction or mandated by some individual store owners (in the case of supermarket chains which are cooperatives) which are not addressed by the existing regulatory regime, including:

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[10] See: https://comcom.govt.nz/__data/assets/pdf_file/0016/73123/448.pdf
[11] See: https://comcom.govt.nz/__data/assets/pdf_file/0020/73073/438.pdf
[12] *Progressive Enterprises Ltd v Foodstuffs (Auckland) Ltd* [2002] UKPC 25.
[13] Catherine Nicholson, Consumers International & Bob Young, Europe Economics, *The relationship between supermarkets and suppliers: What are the implications?* (September 2012), page 2. Can be accessed at: https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf
[14] Catherine Nicholson, Consumers International & Bob Young, Europe Economics, *The relationship between supermarkets and suppliers: What are the implications?* (September 2012), page 2. Can be accessed at: https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf

a. requesting retrospective payments to preserve margins (H);

b. retrospective variations to agreements and ongoing renegotiation of agreements in place.

c. refusing to accept price increases despite rising supplier costs;

d. requiring increased contribution to supermarket promotions to offset any price increases undermining the effect of the price increase.

e. margin expansion: denying a genuine price increase to a supplier while increasing the price to the consumer;

f. penalising suppliers for promotions run with other retailers e.g. The Warehouse or for supplying certain products to other retailers . Likewise demanding compensation for perceived losses from other retailers' promotions and deducting it from payments to suppliers (H)

g. cancelling scheduled supplier promotion programmes as a penalty thereby denying consumers the opportunity to buy those brands at the reduced price;

h. unilaterally imposing additional costs (often promotional costs) or discounting items without prior agreement;

i. refusing to pay agreed costs to suppliers (H);

j. seeking payments for shelf space or shelf positioning not linked to promotions

k. seeking payment for store theft, shrinkage or waste generally seen as retailer costs;

l. individual stores making unreasonable demands for suppliers to supply merchandisers or to pay store staff to work in their stores;

m. requiring free product over and above fair amounts for new product launches (H)

n. requiring suppliers to use third party services e.g. transport companies where the company is owned or linked to the supermarket; (H)

o. requiring suppliers to use a supermarkets distribution network and supply to distribution centres which is more expensive for suppliers delivering direct to store.

p. unreasonable payment delays;

q. taking prompt payment discounts as of right although paying late (this has become the industry norm)

r. unilateral deductions from payments to suppliers (H);

s. delisting products with unreasonably short notice; particularly difficult when a product is imported in significant quantities. In some cases this has meant large quantities of packaging waste and write offs for suppliers. (H);

t. over-ordering or cancelling an order at short notice (H);

u. unreasonable demands to contribute to retailer marketing costs on threat of deletion (H);

v. requests for a suppliers' intellectual property e.g. product information when supermarkets are in competition with homebrand goods; potentially infringing on the intellectual property rights held by a supplier e.g. recipes;

w. unreasonable demands by stores for credits sometimes dating back years;

x. threatening or penalising suppliers (eg by de-listing products, re-allocating shelf space or cancelation of promotions) as a "negotiation" tactic; and

y. a minority of large owner-operated stores have a general culture of bullying, intimidation, or penalising suppliers for non-cooperation. Reports of mistreatment of merchandisers (low paid, mainly women), sales representatives and other company representatives is an ongoing concern. In extreme circumstances suppliers have had to move their staff due to concerns that poor treatment and its potential effects on mental health is a health and safety issue.

26. These behaviours are caused by a lack of competitive pressure on "powerful purchasers" which would normally constrain their conduct. This behaviour manifests in one-sided contracts (or no contracts at all), but also in related (and/or unrelated) abuses of highly asymmetric bargaining power. The table below:

a. sets out some examples of harmful conduct which have been practised by New Zealand supermarkets - these examples have been identified from patterns of behaviour that the NZFGC has observed over the past two decades (a notable rise in such behaviour occurred following the creation of the supermarket duopsony in 2001);

b. describes the resulting harm to suppliers and consumers; and

c. indicates where this conduct is expressly prohibited by the FGCC.[15]

1.	**Requesting retrospective cash payments**
Description of behaviour	• Supermarkets have asked suppliers for retrospective cash payments. These are often presented as compensation for "benefits" received by suppliers in the previous trading year that were not included in the agreed terms of supply between the parties. • Suppliers have reported feeling shocked and intimidated as a result of these requests, which are often raised verbally in meetings, with little to no prior warning and no scope for discussion or negotiation. • These requests for retrospective cash payments also sometimes relate to product "wastage" or "shrinkage" that occurs in-store or are the result of claims that historic invoices remain unpaid. The historical claims are particularly hard for suppliers to refute, due to personnel turnover or lost/destroyed files. • Clause 10 of the FGCC prohibits a retailer from varying a grocery supply agreement with retrospective effect. Clause 14 specifically prevents retailers from requiring a supplier to make any payment to cover wastage of groceries incurred at the retailer's premises.

[15] Can be accessed at: https://www.legislation.gov.au/Details/F2015L00242

Harm to businesses & consumers	• These requests often leave suppliers fearful of retribution if the money is not paid. • Unexpected costs can lead to lower than expected income for suppliers, and increased uncertainty regarding future costs which may be requested in the future inhibit suppliers' ability to plan or invest in product development, innovation and exports.
Examples	• A supermarket invited a supplier to a meeting and stated it was disappointed that in the previous trading year it had lost sales volume due to not pricing as competitively as its competitors. It further stated that as a result it required compensation of $1.8 million for "benefits" delivered to the manufacturer in the previous trading year. This sum was said to reflect money "owed" to the supermarket due to the supplier's product being below category average GP%. The supplier requested to view the supermarket's analysis but was denied. This request was never put into writing and, following debate in Parliament regarding "retrospective payments", was not pursued any further. • A similar meeting was held around the same time with a different supplier, who was asked for $2 million to compensate for benefits (including shelf facing, aisle ends allocated and other estimated costs incurred) received by the supplier in the previous trading year. These benefits were not part of the terms of supply originally agreed to. Again, the supermarket stated it was disappointed that it had not been as competitive in price as its competitors in this product category. Again, this request was never put into writing and, following debate in Parliament regarding "retrospective payments", was not pursued any further. • Suppliers have also reported being asked to make retrospective payments for losses incurred in-store, such as product wastage and theft. In one case the wastage cost constituted total losses for an entire category, then divided amongst all suppliers (meaning some suppliers may have been charged for wastage that did not relate to product supplied by them). • Suppliers have reported being routinely sent claims for promotion contributions (in the thousands of dollars) relating to promotions run up to 4 years in the past.
2.	**Refusing to accept price increases despite rising supplier costs**
Description of behaviour	• Many suppliers report that legitimate price increases requested are routinely refused, with little scope for negotiation. These price increases are often the result of rising input costs, and if not accepted frequently lead to suppliers operating at a loss. • Some suppliers report not having a price increase for up to 7 years.
Harm to businesses & consumers	• Where costs increase but price increases are refused, many suppliers are forced to supply products at a loss. This can often mean operating long-term is not viable.

	• When faced with increasing costs, suppliers may be forced to cut production costs (leading to reduced quality) or cease production (leading to reduced choice for consumers). • Suppliers have observed that prices are often raised to consumers despite the suppliers' price increases being rejected – leading to margin fattening by the supermarkets while the suppliers' businesses suffer.
Examples	• A supplier reported a supermarket refused price increases despite material increases in input costs – as this company supplies both supermarket chains at the same price, it was unable to raise its price with the other supermarket chain either, resulting in 40% - 80% of its total business being affected. In one product category the supermarket's refusal resulted in the supplier making a loss for each unit sold. • A supermarket refused a price increase request from a supplier, despite the supplier facing significant price increases in commodity ingredients for its product. The supermarket later increased the price of 18 of the supplier's products to consumers by up to 6%. • One supplier reported it had to consider halting supply to a supermarket after facing 20% cost increases. The supermarket originally agreed to but then reneged on a price increase, meaning that the supplier was making a loss on products supplied.
3.	**Unilaterally imposing additional costs (often promotional costs) or discounting items without prior agreement**
Description of behaviour	• Supermarkets frequently charge suppliers for costs that have not been agreed to in the terms of supply. These costs are often deducted from payments without prior discussion or negotiation with the supplier impacted. • Suppliers also often report that their products have been discounted heavily by supermarkets without prior agreement. • Clause 9 of the FGCC prohibits a retailer from unilaterally varying a grocery supply agreement without the consent of the supplier concerned. Clause 18 provides that a retailer must not (directly or indirectly) require a supplier to fund part or all of the costs of a promotion.
Harm to businesses & consumers	• Unexpected costs can lead to cash-flow issues for suppliers and can impact profits. This in turn can inhibit suppliers' ability to invest in growth or new product development. Again, ultimately the range of choices available to consumers can be impacted. • In cases where suppliers' products are continually and/or heavily discounted, consumers' perception of the value of products can be warped and consumer expectations of what a fair price is may change. This can be detrimental to suppliers where consumers' perception of value is disproportionate to the supplier's costs.

	• As with example 2 above, in the instances where costs are raised for suppliers but prices (to suppliers) paid by supermarkets are not increased, supermarkets are merely fattening their profit margin at the expense of the suppliers, with little to no discernible benefit for consumers.
Examples	• Due to underperformance of a certain product, a supplier agreed to a 50c discount for a supermarket so that the product could be put on promotion for customers. The supermarket decided not to run the promotion but kept the 50c reduction on all sales. The product continued to underperform and was ultimately delisted. • One supplier reported that all the products across a category were put on special by a supermarket and each supplier in the category was billed back their share of the discount, despite the suppliers not agreeing to this. No breakdown of sales was provided to suppliers and the cost was deducted from the suppliers' payment without agreement. • In one instance a supplier's product was continually put on "deep cut" promotions by a supermarket, which the supplier was forced to fund. The terms of supply between the parties stated that the supermarket did not have the right to unilaterally adjust or amend any part of the deal sheet submitted by the supplier. The supplier reported that the additional payments were crippling its business. The supermarket refused to relent and informed the supplier that it would not accept any new products unless further deep cut discounts were accepted. • Suppliers have reported a supermarket requiring that they use an Electronic Data Interchange, and later charging suppliers approximately $1000 per month for their use of it.
4.	**Refusing to pay agreed costs to suppliers**
Description of behaviour	• The terms of supply between suppliers and supermarkets frequently account for costs which the supermarket may owe the supplier. However, suppliers have reported that these agreed costs are often disputed by supermarkets or go unpaid.
Harm to businesses & consumers	• Non-payment of agreed costs can lead to cash flow issues when a supplier expected to receive payment but did not. There can be associated costs to a supplier relating to pursuing the unpaid amounts. This can often lead to greater uncertainty for suppliers who do not know when/if they will receive agreed payments.
Examples	• One supplier delivers to a supermarket daily. The supermarket would routinely claim that, as it had no physical proof of delivery (a "POD" form) that it did not have to pay for the products. This supplier at one stage had to write off approximately $5 million of payments after the supermarket claimed these products had not been delivered (due to lack of POD), even though they had. • Suppliers have reported that supermarkets often pay late but still take the early payment discount agreed in the terms.

5.	Threatening or exacting "retribution" as a "negotiation" tactic
Description of behaviour	• Suppliers have reported that supermarkets routinely threaten repercussions, including the cancelation of promotions, delistings, favouring competing suppliers, or using these measures as retribution for certain behaviour or responses, if the suppliers do not behave a certain way. • Often supermarkets follow through on these threats if the supplier attempts to negotiate or refuses to adhere with the supermarket's wishes. • Clause 16 of the FGCC prohibits retailers from requiring payment for better shelf space positioning. Clause 19 provides rules as to when retailers may de-list a product, and expressly states that "delisting as a punishment for a complaint, concern or dispute raised by a supplier is not a genuine commercial reason." Clause 26 provides that retailers must not threaten a supplier with business disruption without reasonable grounds.
Harm to businesses & consumers	• When threats such as these can be used by supermarkets at will, suppliers' bargaining power is significantly weakened. Such threats can carry real consequences for suppliers – for example, over 60% of all sales in New Zealand are made while products are on promotion; exclusion from promotions or catalogues can have a major impact on sales. • Threats to de-list also create uncertainty and impact on businesses' ability to plan for the future, including new product development. • When the supermarkets follow through on these threats, there can be a flow-on harm to consumers in the form of reduced choice, reduced innovation and new product development, and the missed opportunity of lower prices when products are not promoted.
Examples	• A supplier of food grocery products was told by a supermarket that, unless prices were lowered in one category, all of its products in another category would be moved to the bottom shelf. This threat was eventually followed through and the supplier lost a significant volume of sales. • A supplier was told by supermarket staff that it would face "repercussions" if it continued to pursue a price increase (which was needed in light of increased input costs), including suggestions it could affect ranging or lead to the supplier being dropped from some stores. • A supermarket demanded a price decrease from a supplier, citing a competing supermarket supplying the supplier's products at a lower price. The supplier explained that this was because the competing supermarket was willing to accept a lower margin, and that it could not control the competing supermarket's prices. When the supplier refused the price decrease, the supermarket responded by reducing

	shelf facings and decreasing catalogue exposure for all of the supplier's products, rejecting new product development and excluding the supplier's products from promotions.
6.	**A general culture of bullying, intimidation and retribution**
Description of behaviour	• Many suppliers express a fear of dealing with supermarkets, due to the far reaching and material potential repercussions of negotiating or raising concerns regarding supermarkets.
Harm to businesses & consumers	• Suppliers are extremely fearful of damaging their relationship with supermarkets due to the impact that this could have on their business. • This concern is even more material for businesses that deal with supermarkets operating in both New Zealand and Australia. The benefits of raising concerns with or resisting such supermarkets must be weighed with the real risk of having their business affected both in New Zealand and Australian markets.
Examples	• One supplier reported that, in the course of a negotiation, a supermarket staff member threw a pen that hit the supplier's staff member. • One supplier reported that, in the course of a negotiation, it was chastised by a supermarket for attempting to elevate issues to senior management level. • Many suppliers have described their interactions with supermarkets as "bullying" and "intimidating."

F. Specific answers to Discussion Paper questions

1. What types of unfair business-to-business contract terms are you aware of, if any? How common are these?
We refer to the examples given in our table above.
2. What impact, if any, do these unfair contract terms have?
We refer to the examples given in our table above.
3. Is government intervention to address unfair business-to-business contract terms justified? Why/why not?
Yes - we refer to the examples given in our table above, as well as paragraphs 18-26 above.
4. What types of unfair business-to-business conduct are you aware of, if any? How common is this type of conduct?
We refer to the examples given in our table above.
5. What impact, if any, does this conduct have?
We refer to the examples given in our table above.

6. Is government intervention to address unfair business-to-business conduct beyond existing legislative protections justified? Why/why not?
Yes – refer to paragraphs 18-26 above.
7. What types of unfair business-to-consumer conduct are you aware of, if any? How common is this type of conduct?
We note that this submission focuses on business-to-business conduct.
8. What impact, if any, does this conduct have?
See answer to Question 7.
9. Is government intervention to address unfair business-to-consumer conduct beyond existing legislative protections justified? Why/why not?
See answer to Question 7.
10. Do you agree with our proposed high-level objectives and criteria for assessing any potential changes to the regulatory framework governing unfair practices? If not, why not?
We agree with the high-level objectives but note that Criterion 3 needs to recognise accepted competition rules as well as the reality of the market structure in New Zealand. The proposed measures are not particularly prescriptive regulation and do not propose a departure from commercial norms.
11. Should a high-level prohibition against unfair conduct be introduced? Why/why not?
Yes – refer to our discussion above.
12. What are the advantages and disadvantages of Options 1A, 1B, and 1C (Refer to Annex 1 for more information)? Which option, if any, do you support?
The NZFGC also submitted in favour of adopting a prohibition on unconscionable conduct in 2016 in response to MBIE's *Targeted Review of the Commerce Act 1986* (attached as **Appendix A**). In that submission our position was (and remains) that a prohibition on unfair conduct should align with the analogous prohibition in the Australian Consumer law (ie Option 1A). Given that many of our laws are based on the Australian laws and the desire for Single Economic Market harmonisation, this option is attractive. In addition, we note that: • Option 1A was considered in 2012 for inclusion in the *Consumer Law Reform Bill*. The Commerce Committee decided, "it is prudent to wait until Australia has developed a body of authoritative case law on the matter before following suit."[16] As there is now Australian case law, there are grounds to revisit this. • The Commission can send "warning letters" regarding compliance with the FTA. The threat of these letters, including the possible associated reputational damage, can deter prohibited behaviour. • The test may still be hard to prove – "unconscionability" is a high standard. If the Australian approach of not defining "unconscionable" was followed, we would likely adopt the Australian interpretation ie "unconscionable" conduct is more than "unfair" and must be "against conscience as judged against the norms of society."[17]

[16] See Explanatory Note of the Consumer Law Reform Bill: http://www.legislation.govt.nz/bill/government/2011/0287/21.0/DLM4777800.html
[17] See: https://www.accc.gov.au/business/anti-competitive-behaviour/unconscionable-conduct

- For example, in 2016 the Federal Court ruled that Woolworths' requests for urgent payments ranging from $4,291 to $1.4 million from suppliers were not "unconscionable." The Court found that, in the context of a retailer / supplier relationship where similar requests had been made before, that Woolworths' conduct was not "unconscionable."[18]

- While it still may be difficult to prove a breach, the existence of the prohibition alone might impact business behaviour. Over time the NZFGC has noted a marked improvement in supermarket/supplier relations in the period following instances where abuses of supermarket buyer power have been raised by NZ politicians (eg Shane Jones MP's 2014 speech in the House of Representatives) or investigated by the Commission (eg the Commission's 2014 investigation into whether Progressive Enterprises may have breached the Fair Trading Act 1986 or Commerce Act 1986).

13. If unconscionable conduct were prohibited (Option 1A), should a definition of unconscionability be included in statute, and if so, how should it be defined?

See answer to question 12.

14. Is it appropriate to require businesses to act in good faith (as per Option 1C – see Annex 1)? Are there situations in which doing so could have negative economic outcomes?

See answer to question 12.

15. Are there any other variations on Option 1 that we should consider?

No.

16. If a version of Option 1 is selected, should it also extend to matters relating to the contract itself?

See answer to question 12.

17. Should any protection against unfair conduct apply to consumers only, consumers and some businesses (and if so, which ones?), or all consumers and businesses?

All consumers and businesses. See paragraph 20 above – in many contexts imbalance in bargaining power can exist between two sophisticated, similarly sized businesses.

18. If the UCT protections are extended to businesses, do you agree that the current consumer UCT provisions should be carried over without major changes? If not, why not?

Yes.

19. If the UCT protections are extended to businesses, should the FTA's 'grey list' for consumer UCTs be carried over 'as is'? Are there any existing examples of unfair terms that should be removed from the list, or any new examples that should be added?

The current FTA 'grey list' is largely analogous (except for one provision) to the corresponding 'grey list' in Australian Consumer Law, which was not changed when the Australian UCT regime was expanded in November 2016. In our view, carrying the 'grey list' over as is provides a useful starting point for determining if a term is a UCT, but is not exhaustive (ie a term that is not on the 'grey list' may still be declared a UCT)

[18] *Australian Competition and Consumer Commission v Woolworths Limited* [2016] FCA 1472

20. Should the protections against UCTs apply to consumers only (as at present), consumers and some businesses (and if so, which ones?), or all consumers and businesses?

The NZFGC considers that protections against UCTs should apply to all consumers and some businesses. We note that:

- This option has the benefit of harmonisation with Australia and could build on New Zealand's existing UCT regime.
- This option could help prevent prohibitive or unbalanced terms of trade being imposed on suppliers.
- Under the current UCT regime the CC undertakes industry "reviews" of SFCCs in different sectors. These reviews have arguably been effective in compelling businesses to change terms in gym contracts, telecommunications contracts and energy retail contracts. A review of B2B contracts in the grocery retail sector could have a similar effect.

21. If the protections against UCTs are extended to businesses, should a transaction value threshold be introduced, above which the protections do not apply? If so, what should the threshold be?

Yes, A transaction value threshold would be analogous with the Australian regime where the "upfront price payable" under the contract is no more than $300,000, or $1 million if the contract is for more than 12 months.

22. Should there be penalties for breaching any new provisions regarding UCTs, and should there be civil remedies available, even if unfair terms have not previously been declared by a court to be unfair? How should any penalties and remedies be designed?

Yes, there should be penalties for breaching any new provisions regarding UCTs and civil remedies should be available. The penalties and remedies should be analogous with the Australian regime.

23. Are there other options to address unfair conduct or unfair contracts that we should consider? If so, what are these?

No.

24. Do you have a preferred options package? If so, which is your preferred package, and why?

The NZFGC supports Options Package 4 because there is no "one size fits all" solution to reducing the harm caused by abuses of buyer power - the best solution is a suite of complementary measures. The measures put forward in Options Package 4, if enacted, would strengthen New Zealand's competition and consumer law regime in that regard. For this reason the NZFGC also intends to submit in favour of amending section 36 of the Commerce Act in response to the Section 36 Discussion Paper.

A commentator recently made this point in relation to the introduction of the FGCC, stating the FGCC *"was not seen as a complete solution to the problem of asymmetric bargaining power and the conduct to which it gives rise or that is, as a response to the exclusion of other possible responses and remedies."* Instead, the FGCC was intended, *"to supplement and possibly bolster other relevant avenues under the Competition and*

Consumer Act 2010, specifically the provisions relating to misuse of market power, unconscionability and unfair contract terms."[19]

The NZFGC submits that the enactment of the measures in Options Package 4 would represent a definitive statement from the New Zealand Government about what kind of behaviour is acceptable, with the potential to improve our trading environment permanently. It may also embolden suppliers to raise concerns, complain or bring causes of actions regarding supermarket conduct where previously they may not have considered this a viable option.

25. Do you agree with our assessment of the impact of each package against the criteria? If not, why not? Do you have any further evidence on the costs and benefits of this option?

The NZFGC is aware of multiple multinational food manufacturers which have ceased production (or are contemplating ceasing production) in New Zealand. While factors such as globalisation and rising minimum wages have also contributed to this, the difficulties suppliers encounter when dealing with New Zealand's supermarkets have undoubtedly also played a part. The prevailing attitude is increasingly that New Zealand is not a place where fast-moving consumer goods can be profitably manufactured.

[19] *Codifying Supermarket-Supplier Relations,* para. 11.

APPENDIX A

NZFGC submission on the Targeted Review of the Commerce Act 1986 (dated 10 February 2016)[20]

10 February 2016

Targeted Commerce Act Review
Competition and Consumer Policy
Ministry of Business, Innovation and Employment
PO Box 1473
WELLINGTON

Email: commerceact@mbie.govt.nz

Dear Sir/Madam

Please find attached the submission that the New Zealand Food & Grocery Council wishes to present on the MBIE Issues paper *Targeted Review of the Commerce Act 1986* dated November 2015.

In summary we are in favour of the Commerce Commission having the same legal powers as the ACCC to give it greater ability to address potential future abuses should they arise and to ensure greater trans-Tasman alignment.

Please let me know if you have any questions.

Yours sincerely

[20] Can be accessed at: https://www.mbie.govt.nz/dmsdocument/2318-food-grocery-council-redacted-targeted-review-commerce-act-phase-one-submission-pdf

Targeted Review of the Commerce Act 1986: Issues Paper

Submission by the New Zealand Food and Grocery Council

10 February 2016

NEW ZEALAND FOOD & GROCERY COUNCIL

1. The New Zealand Food & Grocery Council (FGC) welcomes the opportunity to comment on the Ministry's *Targeted Review of the Commerce Act 1986: Issues Paper* of November 2015.

2. The FGC represents the major manufacturers and suppliers of food, beverage and grocery products in New Zealand. This sector generates over $34 billion in the New Zealand domestic retail food, beverage and grocery products market, and over $26 billion in export revenue from exports to 185 countries – some 61% of total merchandise exports. Food and beverage manufacturing is the largest manufacturing sector in New Zealand, representing 46% of total manufacturing income and 34% of all manufacturing salaries and wages. Our members directly or indirectly employ 370,000 people – one in five of the workforce.

OVERARCHING COMMENTS

3. The FGC wishes to focus its comments in this submission solely on the supermarket sector. Supermarkets are the main customers of our suppliers.

4. New Zealand has one of the most concentrated supermarket sectors in the world. Supermarkets wield substantial bargaining power over their suppliers. The FGC is concerned that in some instances supermarkets are using their bargaining power in a way that has the potential to harm the viability of a vibrant and competitive supplier market to the detriment of consumers.

5. Given:

   (a) the fact that there are only, effectively, two supermarket chains in New Zealand;

   (b) the behaviour exhibited by supermarkets towards suppliers in other parts of the world – where the market concentration is less than New Zealand; and

   (c) the admissions and allegations by and against the two major supermarket players in Australia (see paras 17-19),

   it is not unreasonable to conclude either that such conduct takes place in New Zealand (which goes unreported because of fear of consequences) or that there is fertile ground for such conduct in the future.

6. Supermarket conduct of this nature towards suppliers is against the long-term interests of consumers. Supermarkets' constant demands for lower supplier prices, coupled with supermarkets passing excessive risk and unexpected costs on to their suppliers, means that suppliers have no incentive to invest or to innovate. In the long term, consumers will face higher prices and less choice.

7. Under the status quo, s 36 of the Commerce Act is not operating to address abuses of market power in the supermarket sector. Such abuses by supermarkets have recently been referred to by the Australian Federal Court as "contrary to conscience", and significant penalties of A$10m have been imposed for that conduct in Australia already against Coles. In those proceedings, the ACCC chose to base its claim on a breach of Australia's unconscionability standard, rather than a breach of the Australian equivalent of s 46. The ACCC has recently initiated proceedings against Woolworths in relation to its treatment of suppliers under this unconscionability standard.

8. The FGC supports a move to an "effects test" and the removal of the "taking advantage" element in s 36, as well as the proposal to grant the Commerce Commission the power

to undertake market studies. The FGC is neutral on the alternative enforcement mechanisms identified in the Issues Paper.

9. However, the FGC is concerned that the proposals put forward by the Ministry in its Issues Paper do not go far enough to address potential abuses of market power in the supermarket sector. In response to Q20 of the Issues Paper, the FGC recommends that the Ministry also considers the introduction of an unconscionability provision and a supermarket code of conduct – both of which exist in other countries, including Australia. This would further harmonise the Trans-Tasman business environment, bring the powers of the Commerce Commission closer to those of the ACCC and provide more certainty for all involved in business trans-Tasman. Giving the Commerce Commission the same legal powers as the ACCC would give the regulator greater powers to address potential future abuses should they arise.

10. These overarching comments are expanded upon below. Answers to relevant questions posed in the Issues Paper are detailed in the attached **Appendix 1**.

SPECIFIC COMMENTS

New Zealand supermarket sector is highly concentrated

11. Around the world, consumers buy the vast majority of their groceries at supermarkets. In most countries the number of large supermarket chains can be counted on one hand. As a result, food suppliers are reliant on sales agreements with a handful of supermarket chains to get their produce into the pantries and onto the tables of consumers.

12. The New Zealand supermarket industry is among the most concentrated in the world. The two supermarket giants, Progressive Enterprises Limited (**PEL**) and Foodstuffs, collectively hold 98% of the supermarket retail market in New Zealand. By comparison:

    (a) In Australia, Coles and Woolworths hold a combined market share of 70%;[1]

    (b) In the United Kingdom, the top four supermarkets hold a combined market share of 72%;[2] and

    (c) In Canada, the top three supermarkets hold a combined market share of 63.4%.[3]

Supermarket conduct towards suppliers causes concern around the world

13. Because suppliers rely on selling their produce through supermarkets, there is a substantial imbalance of bargaining power between suppliers and supermarkets. Suppliers cannot risk losing a commercial relationship with a supermarket chain, given the high concentration of the supermarket industry in this country. Losing one customer can often be a matter of commercial survival.

14. Supermarkets can and do take advantage of their bargaining power. Supermarket supply chain practices have attracted the attention of competition regulators in New Zealand and internationally.

New Zealand

15. In New Zealand, the FGC has for many years fielded complaints and expressions of concern from its supplier-members about the behaviour of New Zealand supermarkets

1 Roy Morgan Single Source (Australia), April 2006 - March 2015.
2 Market share of grocery stores in Great Britain for the 12 weeks ending October 11th, 2015 <www.statista.com>.
3 Distribution of the supermarket and grocery store industry in Canada from 2010 to 2015, by market share <www.statista.com>.

that goes beyond usual robust business dealings. This behaviour mirrors that experienced in the other jurisdictions referred to in this submission.

Australia

15. In Australia the ACCC has been very active on these matters. It investigated and prosecuted allegations of unconscionable conduct by supermarket giant Coles. The conduct investigated was very similar to the complaints received in the past by the FGC. The Australian investigation led to Coles paying penalties of A$10 million in 2014 for unconscionable conduct towards its suppliers.[4] That conduct by Coles included the following:

    (a) Coles implemented an Active Retail Collaboration (ARC) program. When suppliers declined to pay the ARC rebate, Coles threatened that this would impact on Coles' decision about the ranging of the supplier's products; that Coles would not acquire new products from the supplier; that Coles would not provide the supplier with information it had previously been supplied with; and that it risked losing Coles' promotional activity for that supplier's products.

    (b) Coles demanded payments for purported profit gaps where this had not been previously agreed between suppliers and Coles.

    (c) Coles demanded retrospective payments for waste.

    (d) Coles required payment for late delivery where this had not been previously agreed with the supplier.

    (e) Coles imposed penalties for short deliveries of a supplier's product without prior agreement.

17. At the heart of the proceedings against Coles was a finding by the Court that Coles had a substantially stronger bargaining position relative to its suppliers; that Coles did not disclose sufficient information to suppliers; and that Coles exerted undue pressure and unfair tactics on suppliers.[5] Justice Gordon of the Federal Court noted:

> "Coles' misconduct was serious, deliberate and repeated. Coles misused its bargaining power. Its conduct was 'not done in good conscience'. **It was contrary to conscience. Coles treated its suppliers in a manner not consistent with acceptable business and social standards which apply to commercial dealings.** Coles demanded payments from suppliers to which it was not entitled by threatening harm to the suppliers that did not comply with the demand. Coles withheld money from suppliers it had no right to withhold."[6]
>
> "Coles' practices, demands and threats were **deliberate, orchestrated and relentless.**"[7]
>
> "Coles' conduct was of a kind which merits severe penalty. But for Coles making the admissions it has now made and acknowledging the gravity of its contravening conduct, the conduct and circumstances in which it was committed would have warranted imposing penalties at or close to the maximum the law permits".[8] [emphasis added]

18. In December 2015, the ACCC initiated proceedings against Woolworths for unconscionable conduct towards its suppliers. The ACCC alleges that Woolworths had developed a strategy to increase its profit performance by requiring "Mind the Gap" payments from suppliers.

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4 *ACCC v Coles Supermarkets Australia Pty Ltd* [2014] FCA 1405.
5 See for example *ACCC v Coles* at [44], [50], [56], [62].
6 At [1].
7 At [201].
8 At [2].

> "The ACCC alleges that Woolworths had been seeking to urgently reduce what it anticipated would be a substantial profit shortfall by demanding payments from suppliers in its management-backed "Mind the Gap" programme.
>
> *"The ACCC alleges that, in accordance with the Mind the Gap scheme, Woolworths's category managers and buyers contacted a large number of the Tier B suppliers and asked for payments from those suppliers for amounts which included payments that range from A$4291 to A$1.4 million to "support" Woolworths.*
>
> *"Not agreeing to a payment would be seen as not "supporting" Woolworths"*, the watchdog said in a statement. It claimed that Woolworths sought approximately A$60.2 million from 921 suppliers through the scheme and ultimately netted A$18.1 million.
>
> *"The ACCC alleges that Woolworth's conduct in requesting the Mind the Gap payments was unconscionable in all the circumstances"* [ACCC chairman Rod Sims] said.
>
> *"A common concern raised by suppliers relates to arbitrary claims for payments outside of trading terms by major supermarket retailers. It is difficult for suppliers to plan and budget for the operation of their businesses if they are subject to such ad hoc requests".*[9]

The ACCC alleges that these requests were made in circumstances where Woolworths had a substantially stronger bargaining position to the suppliers, did not have a pre-existing contractual entitlement to seek the payments and **either knew it did not have or was indifferent to whether it had a legitimate basis for requesting a Mind the Gap payment from the targeted suppliers.**[10]

United Kingdom

19. In the United Kingdom, supermarket conduct towards suppliers has been reviewed in two reports by the Competition Commission, one in 2000 and one in 2008.[11] In the 2008 report, the Commission concluded that:

> Our review of emails between two grocery retailers (Asda and Tesco) and their suppliers during summer 2007, particularly our observations of their negotiating tactics, give the impression that Asda and Tesco have a strong position when negotiating with their suppliers. ... This may explain, for example, observations such as a supplier providing product at below cost or paying for promotions proposed by a retailer that would otherwise be difficult to explain.[12]

20. Over the course of their investigation, the Commission found that one-third to one-half of suppliers experience practices from supermarkets such as payment delays, excessive payments for customer complaints, and retrospective price adjustments.[13]

21. The Commission found that:

> Competition at the retail level leads grocery retailers to seek the best terms and conditions from their suppliers. The possession of buyer power by a grocery retailer allows grocery retailers to extract lower prices from suppliers than would otherwise be the case, and consumers benefit as a result of these lower wholesale prices being reflected in lower retail prices. **However, when, in the hope of gaining a competitive advantage, grocery retailers transfer excessive risks or unexpected costs to their suppliers through practices involving retrospective adjustments to supply agreements or giving rise to moral hazard on the part of the grocery retailer, this is likely to lessen suppliers' incentives to invest in new capacity, products and production processes. If unchecked, these practices, which are essentially a side-effect of competition between grocery retailers with buyer power, will be detrimental to the interests of consumers.**[14] [emphasis added]

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9 Food Navigator Asia "Woolworths repeats 'Mind the Gap' demand while drawing heat from ACCC" <www.foodnavigator-asia.com> (16 December 2015).
10 "ACCC takes action against Woolworths for alleged unconscionable conduct towards supermarket suppliers" <www.accc.gov.au> (10 December 2015).
11 Competition Commission *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom* (2000); Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008).
12 Competition Commission *The supply of groceries in the UK market investigation* at [9.20]
13 At [9.60].
14 At [9.41].

Canada

22. Supermarket conduct towards suppliers came to the attention of the Canadian Competition Bureau in the context of a proposed acquisition. Loblaw, Canada's largest grocery chain, proposed to acquire Shoppers Drug Mart Corporation, Canada's largest drugstore chain. The Bureau took the view that the acquisition would increase Loblaw's market power vis-à-vis suppliers. According to the Bureau, this would lead to a substantial lessening or prevention of competition, higher wholesale prices for other retailers, and potentially higher prices for consumers.

In March 2014 the Competition Bureau reached a Consent Agreement with Loblaw to preserve competition in the market for the retail sale of pharmacy products and drugstore-type merchandise in Canada.[15] The Consent Agreement prohibited certain conduct by Loblaw towards its suppliers that the Bureau considered would reduce competition. This included agreements with suppliers that required suppliers to compensate Loblaw for a pre-determined profit margin; charging penalties related to short deliveries; and charging new supply chain penalties and fees to suppliers that supplied less than $4 million of products to Loblaw. The Agreement additionally required that Loblaw ensure that supply agreements are provided to suppliers in writing.

Section 36 currently inadequately addresses this conduct

23. Section 36 of the Commerce Act as it currently stands is not working to prevent supply chain practices by supermarkets of the kind referred to above that will have a long-term negative impact on prices and consumer choice. It is no coincidence that the ACCC relied on Australia's unconscionability provisions, and not the Australian equivalent to s 36, when bringing proceedings against Coles and Woolworths.

24. This is primarily because of the "purpose" element of s 36. Supermarkets' key driver is maximising revenue and profit. In the event that a supplier is treated badly, in most cases supermarkets will not have a purpose of restricting entry by individual suppliers, preventing or deterring suppliers from engaging in competitive conduct, or eliminating them. But that does not mean this sort of conduct by supermarkets is appropriate – as the Australian Federal Court has noted, such conduct is still "contrary to conscience".

Section 36, even if amended, will not address this conduct

25. While the FGC believes that amending s 36 so as to remove the "taking advantage" element and to include an effects test will go some way to improving the efficacy of s 36 generally, the FGC does not consider it will address the conduct of concern by supermarkets.

26. Removing the "taking advantage" element on its own will not address these concerns, as the "purpose" element is still problematic as set out above. Nor will the introduction of an effects test provide a panacea. If the supermarkets treat all suppliers in a market equally (badly), there will not likely be a substantial lessening of competition in the market in which these suppliers operate since all suppliers will be impacted similarly.

Supermarket conduct towards suppliers is against the long-term interests of consumers

27. Supermarket conduct towards suppliers as detailed above is detrimental to the long-term interests of consumers.

28. The extra payments demanded by supermarkets, coupled with the supermarkets' drive for ever lower prices, place significant pressure on supplier businesses.[16] If suppliers

15 "Competition Bureau review of the Proposed Acquisition of Shoppers Drug Mart Corporation by Loblaw Companies Limited: Position Statement" <www.competitionbureau.gc.ca>

16 See Consumers International "The relationship between supermarkets and suppliers: What are the implications for consumers?" (September 2012) at 10.

cannot continue in business as a result, consumers will suffer from less product choice and higher prices in the longer term."[17]

29. When excessive risks and unexpected costs are passed from supermarkets to suppliers, suppliers are less likely to invest in new capacity or production or to develop new products."[18]

30. In some instances, where supermarkets control the likelihood of a risk eventuating, transferring risk to suppliers creates a "moral hazard": shrinkage, for example, can be reduced by better supermarket security and accounting policies."[19] Passing that risk to the supplier means there is no incentive on the supermarket to minimise that risk. This prevents the development of most efficient practices. Another example of minimising risk might be requiring suppliers to essentially guarantee the margin for the retailer.

The Ministry should consider a broader range of remedies

31. The FGC notes at section 1.2 of the Issues Paper and at Q20 that the Ministry remains open to submissions on the scope of the Issues Paper and other potential options. The FGC submits that the Ministry should consider a broader range of remedies to address the abuse of buyer power by supermarkets – in particular the introduction of an unconscionability provision, and the adoption of a supermarket code of conduct. The FGC also supports a market studies power for the Commerce Commission as already identified in the Issues Paper.

The FGC supports the adoption of an unconscionability standard

32. The FGC supports the introduction of an unconscionability standard as an avenue for addressing conduct that is unfair but that may not be caught within the current and proposed drafting of section 36 of the Commerce Act.

33. In Australia, sections 20-22 of the Australian Consumer Law[20] prohibit unconscionable conduct in trade or commerce. Those provisions are provided in the attached **Appendix 2**. Introducing a similar unconscionability standard into New Zealand law would bring us into closer alignment with Australia.

34. The Australian experience has shown that a statutory prohibition on unconscionable conduct is a greatly more effective way to control abuses of market power by supermarkets. It was successfully invoked by the ACCC against Coles and has subsequently been invoked against Woolworths.

35. An unconscionable conduct provision would ensure that those who benefit from an imbalance in bargaining power, would not be able to take advantage of that imbalance in a way that is contrary to conscience. It would provide a legal avenue for redress for suppliers who suffer as a result of such practices.

The FGC supports the adoption of a supermarket code of conduct

36. A supermarket code of conduct would help ensure that supermarkets treat their suppliers fairly. It would be a proactive and holistic approach to abuses of market power in the supermarket sector.

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17 At 13 – 14.
18 The UK Competition Commission concluded that investment and innovation by suppliers had been negatively impacted by supermarkets' supply chain practices: Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008) at [9.65]; Consumers International "The relationship between supermarkets and suppliers: What are the implications for consumers?" (September 2012) at 14.
19 Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008) at [9.47].
20 Competition and Consumer Act 2010 (Cth), Schedule 2.

37. In drafting and implementing a code of conduct, examples of codes of conduct that are already in place include the Australian Food and Grocery Code of Conduct and the United Kingdom's Groceries Supply Code of Practice. Both the Australian and UK Codes:

(a) Require grocery retailers to deal with suppliers fairly and lawfully;[21]

(b) Set out minimum obligations on grocery retailers when varying supply agreements;[22]

(c) Establish minimum standards of conduct by grocery retailers when dealing with suppliers, such as for payment, de-listing, and allocation of shelf space;[23]

(d) Require grocery retailers to provide staff training on Code compliance;[24] and

(e) Set out a dispute resolution mechanism.[25]

38. The FGC notes that the Australian Code has come under some criticism by suppliers.[26] Key criticisms include that it is voluntary; it does not include penalties for breach; it does not include any investigatory powers or the ability for suppliers to make an anonymous complaint; and it allows retailers to ask suppliers to agree to things that would otherwise be prohibited. The ACCC has already expressed concerns that supermarkets in Australia have not been complying with the Code.[27]

39. In light of this, the FGC submits that the United Kingdom approach to the Supermarket Code is the preferable way to go. Learning from the United Kingdom approach, a New Zealand code of conduct could:

(a) Apply mandatorily to large supermarkets, as determined by annual turnover;[28]

(b) Require supermarkets to appoint in-house code compliance officers and run code compliance programmes, including an annual compliance audit;[29]

(c) Establish an independent Ombudsman with responsibility for monitoring and enforcing the Code, including powers to receive anonymous complaints and investigate alleged breaches, and to initiate investigations itself to determine whether supermarkets are complying with the Code either generally or in respect of particular grocery items;[30] and

(d) Introduce penalties imposable by an Ombudsman for breach of the Code, alongside compensation orders.[31]

40. The FGC believes that the establishment of an independent Ombudsman is particularly important. In its 2008 report, the UK Competition Commission recognised that enforcement of the code could not rely on suppliers coming forward with complaints.

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21 Food and Grocery Code of Conduct (Aus), para 28; Groceries Supply Code of Conduct (UK), para 2.
22 Food and Grocery Code of Conduct (Aus), para 7-10; Groceries Supply Code of Conduct (UK), para 3.
23 Food and Grocery Code of Conduct (Aus), Part 3; Groceries Supply Code of Conduct (UK), para 5.
24 Food and Grocery Code of Conduct (Aus), para 28; The Groceries (Supply Chain Practices) Market Investigation Order 2009 (UK).
25 Food and Grocery Code of Conduct (Aus), Part 5; The Groceries (Supply Chain Practices) Market Investigation Order 2009 (UK).
26 Farm Weekly "Grocery Code faces its critics" (6 March 2015); Business Spectator "Why the ACCC is hounding Coles" (21 October 2014).
27 "ACCC concerned over implementation of the Food and Grocery Code" <www.accc.gov.au> (24 September 2015)
28 See Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008) at [11.278] – [11.280].
29 At [11.322] – [11.328].
30 At [11.332] – [11.376].
31 At [11.370] – [11.371]

Suppliers were not willing to identify themselves to the regulator for fear of consequences for their relationship with supermarkets.[32]

41. The same considerations apply in New Zealand. The Ombudsman should be able to receive anonymous complaints, as a form of information-gathering; and should be given powers to enable it to gain access to necessary information from affected parties.

The FGC also supports a market studies power for the Commerce Commission

42. A market studies power would have significant advantages over the current competition law enforcement mechanisms in the supermarket sector. It would allow the Commerce Commission to proactively investigate the supermarket industry (and other industries) when it becomes aware of concerns about practices in that industry.

43. Market studies are a common feature of competition authorities' toolkits internationally.[33] Notably, a number of jurisdictions have undertaken market studies into the grocery retail sector.[34]

44. The Commission's mandatory investigation powers under s 98 and s 98A should be available to the Commission when conducting market studies. This is particularly important in the supermarket sector, as the imbalance of bargaining power between suppliers and supermarkets means that suppliers are unwilling to bring a complaint to the Commission, or to give evidence to the Commission under a voluntary process. It will also allow the collection of evidence from other parties, such as the supermarkets themselves.

45. The Commission should be given the power to fashion a remedy to address any current or emergent competition concerns, and to that end should be able to make a broad range of recommendations at the end of a market studies investigation. We note, for instance, that at the end of its 2008 investigation into supermarkets the UK Competition Commission recommended a suite of remedies ranging from changes to planning regulations to the implementation of the Groceries Supply Code of Practice.[35]

46. The Government should be required to respond to any recommendations the Commission makes in the course of undertaking market studies.

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32 At [11.350].
33 International Competition Network *Market Studies Project Report* June 2009.
34 In the United Kingdom: Competition Commission *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom* (2000); Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008).
In the United States: Federal Trade Commission *Slotting Allowances in the Retail Grocery Industry* (1 November 2003).
In Australia: Australian Competition and Consumer Commission *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries* (July 2008).
In Norway: Nordic Competition Authorities *Nordic Food markets: A Taste for Competition* (November 2005); Norwegian Inquiry Commission for the Power Relations in the Food Supply Chain *The powerful and the powerless in the food supply chain* (April 2011).
In Italy: Competition Authority *Report on the Distribution of Fruit and Vegetables* (June 2007).
In Austria: *Report on Food Distribution Sector* (June 2007).
35 Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008).

APPENDIX 1 – RESPONSES TO SPECIFIC QUESTIONS IN THE ISSUES PAPER

Q20 Are there any other potential options that the Ministry should consider?

1. The Ministry should consider the introduction of a statutory prohibition on unconscionable conduct, as discussed above at [32] to [35].

2. The Ministry should consider the introduction of a compulsory Supermarket Code of Conduct, as discussed above at [36] to [41].

Q45 Do the approaches to market studies described in the Issues Paper align with a gap in New Zealand's institutional settings for promoting competition?

3. As discussed above at [42] to [46], the FGC believes that there is a need for a market studies power as described in the Issues Paper.

Q46 What procedural settings for a market studies power would best fit the identified gap, in terms of:

a. Who may initiate a market study;

4. The FGC believes that market studies should be able to be initiated by the body conducting the market study (the Commerce Commission), or at the request of the Government.

b. Who should conduct market studies;

5. Market studies should be conducted by the Commerce Commission. This is consistent with international practice.

c. Whether mandatory information-gathering powers would apply;

6. As discussed above at [44], the Commission's mandatory information-gathering powers should apply to market studies.

d. The nature of recommendations the market studies body could make; and

7. The Commission should be given the power to make broad and wide-ranging recommendations, so that the Commission is effectively able to design a remedy to any identified problems. This is discussed above at [45].

e. Whether the government should be required to respond.

8. The Government should be required to respond to any recommendations made by the Commerce Commission as a result of a market study.

APPENDIX 2 – UNCONSCIONABILITY PROVISIONS IN AUSTRALIAN CONSUMER LAW

20 Unconscionable conduct within the meaning of the unwritten law

(1) A person must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law from time to time.

Note: A pecuniary penalty may be imposed for a contravention of this subsection.

(2) This section does not apply to conduct that is prohibited by section 21.

21 Unconscionable conduct in connection with goods or services

(1) A person must not, in trade or commerce, in connection with:
  (a) the supply or possible supply of goods or services to a person (other than a listed public company); or
  (b) the acquisition or possible acquisition of goods or services from a person (other than a listed public company);
engage in conduct that is, in all the circumstances, unconscionable.

(2) This section does not apply to conduct that is engaged in only because the person engaging in the conduct:
  (a) institutes legal proceedings in relation to the supply or possible supply, or in relation to the acquisition or possible acquisition; or
  (b) refers to arbitration a dispute or claim in relation to the supply or possible supply, or in relation to the acquisition or possible acquisition.

(3) For the purpose of determining whether a person has contravened subsection (1):
  (a) the court must not have regard to any circumstances that were not reasonably foreseeable at the time of the alleged contravention; and
  (b) the court may have regard to conduct engaged in, or circumstances existing, before the commencement of this section.

(4) It is the intention of the Parliament that:
  (a) this section is not limited by the unwritten law relating to unconscionable conduct; and
  (b) this section is capable of applying to a system of conduct or pattern of behaviour, whether or not a particular individual is identified as having been disadvantaged by the conduct or behaviour; and
  (c) in considering whether conduct to which a contract relates is unconscionable, a court's consideration of the contract may include consideration of:
    (i) the terms of the contract; and
    (ii) the manner in which and the extent to which the contract is carried out;
and is not limited to consideration of the circumstances relating to formation of the contract.

22 Matters the court may have regard to for the purposes of section 21

(1) Without limiting the matters to which the court may have regard for the purpose of determining whether a person (the ***supplier***) has contravened section 21 in connection with the supply or possible supply of goods or services to a person (the ***customer***), the court may have regard to:
  (a) the relative strengths of the bargaining positions of the supplier and the customer; and
  (b) whether, as a result of conduct engaged in by the supplier, the customer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; and

(c) whether the customer was able to understand any documents relating to the supply or possible supply of the goods or services; and
(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the customer or a person acting on behalf of the customer by the supplier or a person acting on behalf of the supplier in relation to the supply or possible supply of the goods or services; and
(e) the amount for which, and the circumstances under which, the customer could have acquired identical or equivalent goods or services from a person other than the supplier; and
(f) the extent to which the supplier's conduct towards the customer was consistent with the supplier's conduct in similar transactions between the supplier and other like customers; and
(g) the requirements of any applicable industry code; and
(h) the requirements of any other industry code, if the customer acted on the reasonable belief that the supplier would comply with that code; and
(i) the extent to which the supplier unreasonably failed to disclose to the customer:
    (I). any intended conduct of the supplier that might affect the interests of the customer; and
    (II). any risks to the customer arising from the supplier's intended conduct (being risks that the supplier should have foreseen would not be apparent to the customer); and
(j) if there is a contract between the supplier and the customer for the supply of the goods or services:
    (I). the extent to which the supplier was willing to negotiate the terms and conditions of the contract with the customer; and
    (II). the terms and conditions of the contract; and
    (III). the conduct of the supplier and the customer in complying with the terms and conditions of the contract; and
    (IV). any conduct that the supplier or the customer engaged in, in connection with their commercial relationship, after they entered into the contract; and
(k) without limiting paragraph (j), whether the supplier has a contractual right to vary unilaterally a term or condition of a contract between the supplier and the customer for the supply of the goods or services; and
(l) the extent to which the supplier and the customer acted in good faith.

(2) Without limiting the matters to which the court may have regard for the purpose of determining whether a person (the ***acquirer***) has contravened section 21 in connection with the acquisition or possible acquisition of goods or services from a person (the ***supplier***), the court may have regard to:
(a) the relative strengths of the bargaining positions of the acquirer and the supplier; and
(b) whether, as a result of conduct engaged in by the acquirer, the supplier was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the acquirer; and
(c) whether the supplier was able to understand any documents relating to the acquisition or possible acquisition of the goods or services; and
(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the supplier or a person acting on behalf of the supplier by the acquirer or a person acting on behalf of the acquirer in relation to the acquisition or possible acquisition of the goods or services; and
(e) the amount for which, and the circumstances in which, the supplier could have supplied identical or equivalent goods or services to a person other than the acquirer; and
(f) the extent to which the acquirer's conduct towards the supplier was consistent with the acquirer's conduct in similar transactions between the acquirer and other like suppliers; and
(g) the requirements of any applicable industry code; and

(h) the requirements of any other industry code, if the supplier acted on the reasonable belief that the acquirer would comply with that code; and
(i) the extent to which the acquirer unreasonably failed to disclose to the supplier:
    (i). any intended conduct of the acquirer that might affect the interests of the supplier; and
    (ii). any risks to the supplier arising from the acquirer's intended conduct (being risks that the acquirer should have foreseen would not be apparent to the supplier); and
(j) if there is a contract between the acquirer and the supplier for the acquisition of the goods or services:
    (i). the extent to which the acquirer was willing to negotiate the terms and conditions of the contract with the supplier; and
    (ii). the terms and conditions of the contract; and
    (iii). the conduct of the acquirer and the supplier in complying with the terms and conditions of the contract; and
    (iv). any conduct that the acquirer or the supplier engaged in, in connection with their commercial relationship, after they entered into the contract; and
(k) without limiting paragraph (j), whether the acquirer has a contractual right to vary unilaterally a term or condition of a contract between the acquirer and the supplier for the acquisition of the goods or services; and
(l) the extent to which the acquirer and the supplier acted in good faith.