DISMANTLING THE GROCERY DUOPOLY: THE CASE FOR PROHIBITING GROCERY COVENANTS VIA ENFORCEMENT ACTION

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New Zealand's retail grocery sector is dominated by a duopoly that impedes opportunities for new entry by lodging restrictive covenants on strategic sites and exclusive covenants in lease agreements. This enables the duopoly to limit competition and artificially raise grocery prices, harming consumers and society as a whole. In response, the Government has recently passed legislation prohibiting the duopoly's covenants. This article applauds action against anti-competitive grocery covenants. However, it argues that enforcement action, rather than legislation, would have been the more appropriate avenue for four reasons. First, under the new legislation, grocery retailers can apply for an exemption so that certain covenants remain in force, the outcome of which can be appealed. This means cases concerning grocery covenants will likely appear before the courts anyway. Secondly, enforcement action under existing legislation would have captured a key distinction that the new legislation overlooks. That is, while the duopoly's restrictive covenants are overwhelmingly anti-competitive and should all be unenforceable, in limited circumstances exclusive covenants are arguably net pro-competitive and should remain in force. Thirdly, and flowing from this, establishing via the courts that grocery covenants are in fact anti-competitive would have provided a more legitimate basis for prohibiting them. Finally, the Government's position that litigation is inefficient as each covenant must be individually analysed overlooks both the ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd *collective covenants approach under s 28 and the s 30 cartel provisions in the existing Commerce Act 1986. To this end, this article argues that all of the duopoly's restrictive covenants and the great majority of their exclusive covenants breach existing competition laws, namely ss 28 and 30 of the Commerce Act.*

* Submitted for the LLB (Honours) Degree, Faculty of Law, Victoria University of Wellington | Te Herenga Waka, 2022. Thank you to my supervisor, Paul Scott, for his invaluable guidance, advice and wisdom. Thank you also to my family for their unwavering support.

I INTRODUCTION

Amid concerns that New Zealand's grocery duopoly is charging unfairly high retail prices,[1] the Commerce Commission (NZCC) released a critical report, illuminating the anti-competitive practices within the industry.[2] A duopoly is where two sellers possess all or almost all of the market shares in a sector.[3] The firms' combined market share enables them to exert control over the industry.[4] This contrasts with a competitive market, which is characterised by a large number of independent sellers.[5]

In the New Zealand grocery sector, the two firms with duopoly control are Foodstuffs and Woolworths NZ.[6] Foodstuffs operates New World, PAK'nSAVE and Four Square stores as well as two other brands in the South Island.[7] Woolworths owns Countdown, SuperValue and FreshChoice.[8] Together, these major grocery retailers (MGRs) account for over 90 per cent of consumers' main weekly grocery shop.[9] Through their combined market dominance, the MGRs can unilaterally raise their prices above competitive levels and restrict new entry at the expense of consumers and society as a whole.[10]

One practice that helps the MGRs to maintain their dominance is the lodging of restrictive covenants and exclusive covenants. The MGRs' restrictive covenants are lodged on strategic sites purchased by the supermarkets.[11] Restrictive covenants run with the land. They prevent all future

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1 Health Coalition Aotearoa *Submission on Market Study into Grocery Sector Draft Report* (2 September 2021) at 1; and Cate Broughton "Supermarket duopoly, high prices 'locking people out of nutrition', health group says" *Stuff* (online ed, New Zealand, 18 April 2022), citing Lisa Te Morenga.

2 Commerce Commission *Market study into the retail grocery sector: Final report* (8 March 2022).

3 *Citizens Telecommunications Company of Minnesota, LLC v Federal Communications Commission* 901 F 3d 991 (8th Cir 2018) at 1010.

4 Erwin A Blackstone, Larry F Darby and Joseph P Fuhr "The Case of Duopoly: Industry structure is not a sufficient basis for imposing regulation" (2012) 34 Regulation 12 at 12.

5 Herbert Hovenkamp *Federal Antitrust Policy: The Laws of Competition and Its Practice* (West Publishing, Minnesota, 1994) at 2; and Roger G Noll "'Buyer Power' and Economic Policy" (2005) 72 Antitrust LJ 589 at 589.

6 Commerce Commission, above n 2, at [2.11].

7 At [2.11].

8 At [2.11].

9 At 99.

10 At [6.16], [6.213], [6.84] and [9.26]; and *Steves & Sons, Inc v Jeld-Wen, Inc* 988 F 3d 690 (4th Cir 2021) at 701.

11 Commerce Commission, above n 2, at [6.78].

owners or lessees from opening a competing grocery retailer on that land.[12] Exclusive covenants are exclusivity clauses in leases between the MGRs as anchor tenants and shopping centre developers, which prevent a competitor from leasing any other site in the centre.[13] These covenants make it difficult for a new entrant or fringe player to expand and disrupt the duopoly.[14]

In response to public dissatisfaction surrounding the duopoly's prices and anti-competitive practices, the Government asked the NZCC to launch an inquiry into the grocery sector in November 2020.[15] The NZCC is an independent Crown entity responsible for enforcing competition laws. It also undertakes market studies to investigate what factors, if any, are impeding competition within a particular market.[16] On 8 March 2022, the NZCC released its final report.[17] It expressed concerns that, due to the duopoly structure, competition in the grocery sector is "muted" and "not working well".[18] Crucially, the NZCC believes the New Zealand market could support at least one additional large-scale competitor.[19] It proposed 14 recommendations for increasing competition, including prohibiting grocery covenants.[20] Subsequently, the Government passed the Commerce (Grocery Sector Covenants) Amendment Act 2022 (the Amendment Act), outlawing all existing and new grocery covenants.

This article applauds action being taken against grocery covenants. However, NZCC enforcement action, rather than new legislation, would have been the more appropriate avenue for doing so. First, the Amendment Act allows the MGRs to apply to the NZCC for an exemption so that a grocery covenant can remain in force, the outcome of which can be appealed.[21] Therefore, cases concerning grocery covenants will likely appear before the courts anyway. Secondly, establishing that grocery covenants breached existing competition laws[22] (ie that they are anti-competitive) would have provided a more legitimate basis for rendering them ineffective. Thirdly, enforcement action would have been preferable as the new legislation fails to capture a key distinction between restrictive and

12 At [9.57.1].

13 At [9.57.2].

14 At [6.82] and [6.83].

15 At [1.2].

16 Commerce Act 1986, pt 3A.

17 Commerce Commission, above n 2.

18 At 146 and 324.

19 At [6.42].

20 At 378.

21 Commerce Act, ss 28A(3)(b) and 91(2); and Commerce Commission *Authorisation Guidelines* (July 2019) at [200].

22 Commerce Act, ss 28 and 30.

exclusive covenants. That is, while the MGRs' restrictive covenants are overwhelmingly anti-competitive and should all be unenforceable, in limited circumstances exclusive covenants are arguably net pro-competitive and should remain in force.[23] Finally, this article rejects the Government's position that enforcement action is inefficient as each covenant must be addressed *individually.*[24] Instead, it proposes that *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd*[25] leaves the door open for the grocery covenants to be assessed as *collectively* resulting in a substantial lessening of competition[26] and/or constituting an output limitation cartel.[27]

As background, Part II discusses the reasons why the NZCC found that competition in the grocery sector is not working well. Part III reviews the NZCC's 14 recommendations and the Government's response.[28] It proposes that the recommendations aimed at increasing the number of suitable retail sites are the strongest, as they address the root issue: high barriers to competitive entry.[29] Part IV analyses whether the covenants breach s 28 of the Commerce Act 1986 in that they substantially lessen competition collectively and/or individually.[30] Finally, Part V examines whether the covenants constitute an output limitation cartel, thereby breaching s 30 of the Commerce Act.[31] This article concludes that, under existing competition laws, all restrictive covenants and the great majority of exclusive covenants should be unenforceable, other than in rare exceptions where the exclusive covenants may be net pro-competitive and should remain in force.

II REASONS WHY COMPETITION IS MUTED IN NEW ZEALAND'S GROCERY SECTOR

Consumers' preferences have driven the growth and dominance of New Zealand's MGRs. The NZCC's consumer survey reveals that 84 per cent of respondents choose to do at least one main shop

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23 Eric Crampton "Why it's hard to open a supermarket in NZ" *Business Desk* (online ed, New Zealand, 30 July 2021).

24 Commerce (Grocery Sector Covenants) Amendment Bill 2022 (122-2) (commentary), citing Commerce Commission, above n 2, at [9.63].

25 *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd* [2006] 3 NZLR 351 (CA) at [158] and [289].

26 Commerce Act, s 28.

27 Section 30A(3).

28 Commerce Commission, above n 2, at 378.

29 Eric Crampton *Submission by the New Zealand Initiative to the Commerce Commission on Issues raised at the Consultation Conference on the Commission's Market study into the retail grocery sector draft report* (18 November 2021) at [1.3(d)]–[1.3(f)].

30 Commerce Act, s 28.

31 Section 30A(3) and (4).

per week at a large grocery retailer.[32] The remaining 16 per cent of consumers prefer multiple shops at smaller retailers.[33] The majority of New Zealanders prefer visiting one large grocery retailer for four key reasons:

(a) they are a "one-stop-shop" with a wide product range, which makes shopping there more efficient than travelling to multiple smaller stores;[34]
(b) they are conveniently located in urban areas and provide parking;[35]
(c) consumers are drawn to the familiarity of a nationally branded chain of supermarkets;[36] and
(d) the MGRs' large market share enables them to obtain goods from suppliers at lower prices due to volume discounts.[37] This, alongside the MGRs' internal economies of scale in warehousing and distribution, increases their efficiencies and reduces their overall costs.[38] In turn, this allows the MGRs to offer consumers generally lower prices compared to smaller grocery stores.

As a result, the MGRs now have a combined estimated share of over 90 per cent of consumers' main grocery shop.[39] This substantial market share and the sector's duopoly structure mean that, even though their prices are generally lower than small retailers, the MGRs are able to maintain higher prices and profits than the NZCC believes would be the case in a workably competitive market.[40] The MGRs' profits, measured by return on average capital employed, averaged between 12.7 per cent to 13.1 per cent across 2015 to 2019.[41] This is over double the 5.5 per cent which the NZCC estimates is a normal rate of return.[42] One firm enjoying temporary high profits characterises a competitive

32 Commerce Commission, above n 2, at [4.30].

33 At [4.30].

34 At [4.27].

35 At [4.68].

36 At [4.27].

37 Commerce Commission *Market study into the retail grocery sector: Final report – Executive summary* (8 March 2022) at 5.

38 Commerce Commission, above n 2, at [6.115]; and Robert H Bork *The Antitrust Paradox: A Policy at War with Itself* (The Free Press, New York, 1993) at 195.

39 Commerce Commission, above n 2, at 99.

40 At 99.

41 At [3.7].

42 At [3.7].

market. However, sustained superprofits across the MGRs are evidence of muted competition and a duopoly premium.[43]

Thus, the first reason why competition is muted is the MGRs' large market share at the retail level, which harms consumers in the form of higher prices than in a competitive market.[44] Woolworths and Foodstuffs both benefit from artificially high returns. There is little incentive to lower prices, improve the quality of goods or diversify their product range.[45] Many grocery items are viewed as necessities, meaning that demand for them is relatively insensitive to price increases.[46] As a result, the demand for grocery products and the MGRs' respective market shares have remained relatively stable.[47] This helps the MGRs to sustain superprofits year after year.

Secondly, competition is muted because new entry and expansion by small retailers is difficult due to the lack of suitable sites.[48] The Overseas Investment Act 2005 (OIA), Resource Management Act 1991 (RMA) and restrictive zoning laws all reduce the number of suitable sites.[49] Similarly, OIA, RMA and council consent processes are lengthy, with unpredictable outcomes.[50] They result in substantial sunk (unrecoverable) costs even before a new supermarket is approved. These legislative hurdles create high barriers to entry. That is, they prevent and deter firms from entering or expanding in the grocery market.[51]

Further, the MGRs restrict the number of sites available by lodging restrictive covenants and exclusive covenants. As discussed above, the MGRs have a history of purchasing land, lodging restrictive covenants to prevent the site being used for grocery retailing and then selling the land on.[52] The NZCC identified over 90 restrictive covenants lodged by the MGRs.[53] Exclusive lease covenants arise where an MGR agrees to be an anchor tenant for a new shopping centre. In exchange, the

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43 At [3.16]–[3.18].

44 Commerce Commission, above n 37, at 8.

45 At 6; Bork, above n 38, at 101; and Mark Jephcott *Law of Cartels* (2nd ed, Jordans Publishing, Bristol, 2011) at 11.

46 Richard A Posner *Antitrust Law* (2nd ed, University of Chicago Press, Chicago, 2001) at 71.

47 Commerce Commission, above n 2, at 160.

48 Commerce Commission, above n 37, at 6.

49 Commerce Commission, above n 2, at [9.24]–[9.27].

50 At [6.63], [6.65] and [9.126].

51 At [6.20]; and Office of Fair Trading *Land Agreements: The application of competition law following the revocation of the Land Agreements Exclusion Order* (March 2011) at [1.9].

52 Commerce Commission, above n 2, at [6.78].

53 At [6.77].

developer covenants not to lease any space to the MGR's competitors.[54] The MGRs have entered into over 100 exclusive covenants. The majority of them were still in force as at March 2022.[55]

Overall, the grocery covenants and the OIA and RMA create high barriers to entry. When combined with the MGRs' large market share, it is extremely difficult for a third player to establish itself and disrupt the duopoly.

Thirdy, competition is muted in the purchase of groceries from suppliers. This is because the MGRs possess oligopsony power.[56] While an oligopoly involves a small number of *sellers* with disproportionate control over a market, an oligopsony is where there are a small number of *purchasers* who disproportionately exert control over a large number of suppliers.[57] The grocery sector is an oligopsony, as there are a large number of suppliers but few purchasers (ie wholesalers and retailers).[58] Indeed, the MGRs are New Zealand's only major retailers. To achieve meaningful market share for their products, suppliers must sell to the MGRs as there are no other large parties competing to buy their products.[59] Conversely, the MGRs generally have multiple suppliers to choose between in each product category. This leads to an imbalance in bargaining power.[60] As is characteristic of an oligopsony, the MGRs often force suppliers to sell their goods at lower prices than in a competitive market.[61] Suppliers maintain that, as a result, their margins are being increasingly squeezed.[62] The MGRs can also insist on uncertain terms of supply, prevent suppliers from dealing with other grocery retailers and threaten to remove suppliers' products from their shelves.[63]

The fourth reason for muted competition is a lack of alternative wholesale supply options.[64] This affects the extent to which smaller retailers can expand and compete with the MGRs for a consumer's

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54 At [6.79].

55 At [6.80].

56 At [8.2] and [8.5].

57 *National Collegiate Athletic Assoc v Board of Regents of the University of Oklahoma* 468 US 85 (1984) at 109; Hovenkamp, above n 5, at 14–15; and James Murphy Bowd "Oligopsony Power: Antitrust Injury and Collusive Buyer Practices in Input Markets" (1996) 76 BU L Rev 1075 at 1084.

58 Commerce Commission, above n 2, at [8.67].

59 At [8.2].

60 At [8.2].

61 Herbert Hovenkamp "Is Antitrust's Consumer Welfare Principle Imperiled?" (2019) 45 JCL 102 at 114.

62 Vegetables New Zealand and Horticulture New Zealand *Submission on Retail Grocery Market Study Preliminary Issues Paper* (9 February 2021) at 2.

63 Commerce Commission, above n 2, at [8.32.2].

64 Commerce Commission, above n 37, at 7.

main shop.[65] Any new large-scale retailer would need to source products from numerous different suppliers. It is time-consuming and costly to develop relationships with these suppliers and establish the necessary warehousing and distribution networks, including for temperature-controlled goods.[66] Additionally, new entrants and fringe players would not benefit from volume discounts due to their small market share. Thus, the MGRs' dominance at the wholesale level stifles new entry.

In summary, the NZCC found that competition in the grocery sector was muted in four main ways: the duopoly structure facilitates artificially high prices and returns at the retail level; the lack of suitable sites restricts new entry and expansion; the MGRs have oligopsony power over suppliers; and there is a lack of alternative wholesale supply options. Part III discusses the NZCC's recommendations to address these issues.[67] It argues that solutions aimed at freeing up land have the potential to increase competition substantially by addressing the root issue: high barriers to entry.[68] While the Government has responded positively to the NZCC's recommendations in this area, it could have gone further in relation to the OIA and RMA.

III THE NZCC'S RECOMMENDATIONS AND THE GOVERNMENT'S RESPONSE

The NZCC proposed 14 recommendations to address muted competition in the grocery sector, which can be summarised as follows:[69]

- Improve conditions for entry and expansion:
  - (1) Increase the availability of retail sites under the RMA.
  - (2) Prohibit grocery covenants.
  - (3) Require the MGRs to consider wholesale supply requests in good faith.
  - (4) When next reviewing the OIA and Sale and Supply of Alcohol Act 2012, consider whether they unduly restrict competition.
  - (5) Monitor strategic conduct that affects entry or expansion.
- Improve competition for the acquisition of groceries from suppliers:
  - (6) Implement a mandatory code of conduct governing relationships between the MGRs and suppliers.
  - (7) Consider a statutory authorisation for grocery supplier collective bargaining.
  - (8) Strengthen the Fair Trading Act 1986 business-to-business unfair contract terms regime.

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65 At 7.

66 Commerce Commission, above n 2, at [6.177].

67 At [7.378].

68 Crampton, above n 29, at [1.3(f)].

69 Commerce Commission, above n 2, at 378.

- Other recommendations:
  (9) Ensure that pricing and promotional practices are easily understandable.
  (10) Mandate the consistent display of unit pricing.
  (11) Ensure that disclosure relating to loyalty programmes and data collection practices is transparent.
  (12) Encourage the MGRs' cooperation with price comparison services.
  (13) Establish a grocery regulator and dispute resolution scheme.
  (14) Review competition levels in the grocery sector every three years.

Recommendations six to eight aim to address the imbalance of power between the MGRs and suppliers.[70] While positive, unless competition is also increased at the retail level, there is a risk that measures to strengthen suppliers' positions will result in the MGRs passing on their increased costs to consumers, resulting in even higher retail prices.[71] Recommendations nine to 12 represent moves towards industry best practice. However, they are unlikely to meaningfully increase competition levels.

Indeed, the NZCC believes that increasing the number of competing retailers is the best way to improve competition.[72] It follows that their recommendations in that area, particularly recommendations one through to four, are the most important and are discussed further below. These recommendations address the root problem: the existing duopoly structure and high barriers to entry.[73]

The Government accepted the NZCC's third recommendation of creating a quasi-regulatory regime where the MGRs are required to "consider requests for wholesale supply in good faith".[74] This measure aims to provide new entrants with access to groceries on similar terms to those the MGRs themselves negotiated with suppliers, before new entrants gain the requisite economies of scale to establish their own relationships with suppliers and distribution networks.[75] Recently, the Government introduced the Grocery Industry Competition Bill 2022 (191) to give effect to this recommendation.

However, the Bill goes one step further than the NZCC's recommendations. Concerned that the MGRs would fail to reach fair commercial agreements with their wholesale customers, the

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70 At 378.

71 At [8.30]; and Hovenkamp, above n 5, at 14–15.

72 Commerce Commission, above n 2, at [9.10]; and Commerce Commission, above n 37, at 2.

73 Crampton, above n 29, at [1.3(f)].

74 Ministry of Business, Innovation and Employment *Regulatory Impact Statement: Government response to the Commerce Commission Grocery Sector Market Study – Policy decisions* (8 June 2022) at 75.

75 Commerce Commission, above n 2, at [9.83], [9.86], [9.88] and [9.91].

Government has proposed a mandatory wholesale supply regime as a backstop.[76] That is, the NZCC can forcibly require one or more MGRs to make certain groceries available to wholesale customers, without the need for these parties to reach an agreement.[77] The NZCC can also determine the price and minimum quantities of groceries to be supplied as well as quality standards such as delivery time frames.[78]

While mandatory wholesale supply is sound in principle, in practice the regime risks being unworkable. Indeed, the NZCC rejected this solution, as regulated sectors typically involve *one* homogenous product.[79] Under the proposed regime, the NZCC would be required to determine a fair wholesale price for potentially *hundreds* of different products.[80] If the price of sugar increases around the world, for example, then the NZCC would have to repeat its analysis not just for sugar, but for all regulated products that contain sugar as an ingredient. A mandatory wholesale access regime would not only be unprecedented; it would also be extremely costly, time-consuming and complex.[81] For these reasons, it is possible the Government will re-evaluate its position and choose to implement only the NZCC's proposed quasi-regulatory regime.

If the quasi-regulatory regime is effective, then it will help new entrants and small retailers access groceries. However, regardless of how much the Government regulates, there will be no meaningful increase in competition unless there is sufficient land for a large, third player to establish itself,[82] hence the importance of recommendations one, two and four.

The NZCC has focused on three ways to increase the number of suitable sites: amending the OIA, amending the RMA and outlawing covenants.[83] Short of a forced break-up of the duopoly, which the NZCC rejected at this stage as being too extreme,[84] increasing the number of sites is the fastest way to increase competition.[85] Thus, it is disappointing that the Government has declined to advance easy yet effective changes to the OIA and RMA. These could include issuing a Ministerial Directive Letter

76 Ministry of Business, Innovation and Employment, above n 74, at 2.

77 Grocery Industry Competition Bill 2022 (191-3), cls 90–92.

78 Clause 92.

79 Commerce Commission, above n 2, at [9.118.1].

80 At [9.118.1.3].

81 At [9.118.1.1] and [9.118.1.3].

82 Commerce Commission, above n 37, at 12.

83 Commerce Commission, above n 2, at [9.21.1], [9.21.2] and [9.21.4].

84 At [9.256].

85 Crampton, above n 29, at [1.3(f)].

(MDL) outlining how the Overseas Investment Office (OIO) should approach applications to open a grocery store and amending the RMA to increase land zoned for supermarkets.[86]

The Government has declined to amend the OIA, maintaining that, due to the 2021 amendments,[87] the Act "now strikes the right balance between managing risks posed by foreign investment while supporting productive, sustainable … investment".[88] Granted, the 2021 reforms are positive. There are now mandatory time frames for OIO decisions,[89] and investors generally only have to pass character and capability tests once.[90]

While these changes may help speed up the OIA process, high barriers to entry remain. The OIO still has considerable discretionary power, leading to unpredictable outcomes.[91] The Government could address this by issuing an MDL outlining its policy approach to overseas investment in the grocery sector.[92] The MDL could state:

> Our starting presumption is that OIA applications for grocery retail stores should be approved unless the site is next to a reserve or marine and coastal area or is a site of significance to mana whenua.

The former is unlikely, as supermarkets are predominantly built in metropolitan areas. An MDL would have been an easy yet effective way of signalling to potential international competitors that they are welcome in New Zealand.[93]

Regarding the NZCC's proposed amendments to the RMA, the Office of the Minister of Commerce and Consumer Affairs has stated that these will be *considered* by the Ministry for the Environment.[94] Yet, in media reports, the Hon Dr David Clark asserted that the Government has accepted 12 of the NZCC's recommendations and taken stronger action on the other two.[95] It is misleading for the Government to maintain they have accepted the NZCC's proposed changes to the

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86 Susie Kilty "Supermarket reforms: beware legislative fatigue" *Business Desk* (online ed, New Zealand, 2 May 2022).

87 Overseas Investment Amendment Act 2021.

88 Office of the Minister of Commerce and Consumer Affairs *Response to the Commerce Commission's retail grocery sector market study* (May 2022) at [55.1].

89 Commerce Commission, above n 2, at [6.212.2].

90 Overseas Investment Act 2005, s 29A, inserted by Overseas Investment Amendment Act 2021, s 19.

91 Commerce Commission, above n 2, at [6.211].

92 Kilty, above n 86.

93 Eric Crampton "Kiwigrocer is a Classic Catch-22" (3 August 2021) NZ Initiative <www.nzinitiative.org.nz>.

94 Office of the Minister of Commerce and Consumer Affairs, above n 88, at [52].

95 David Clark "Government acts on supermarket duopoly" (press release, 30 May 2022).

RMA, when ministerial documents indicate that there is no guarantee these changes will be implemented.

Ultimately, there will be no meaningful increase in the number of suitable sites unless the Government requires planning decision-makers to: consider the consumer benefits of increased competition;[96] increase land zoned for new grocery stores;[97] and facilitate the building of supermarkets in residential areas.[98]

Given the shortcomings in the Government's response regarding the RMA and OIA as means of freeing up land, its decision to prohibit grocery covenants assumes even greater significance.[99] The Amendment Act outlaws all restrictive and exclusive covenants that the MGRs have an interest in, and which have the purpose, effect or likely effect of impeding the development of a retail grocery store.[100]

A strength of the Amendment Act is that the prohibition of grocery covenants is explicit. Also, a legislative approach could be more time- and cost-effective than enforcement action. However, deeper examination reveals that enforcement action is the more legally and economically sound option, for the following four reasons.

First, the Amendment Act provides a mechanism whereby grocery retailers can apply to the NZCC for an exemption.[101] That is, grocery covenants can remain in force where it is established that their pro-competitive effects outweigh their anti-competitive effects. However, if the NZCC declines an exemption application, then the grocery retailer can appeal.[102] Likewise, the public or a competing supermarket can appeal granted exemptions.[103] Despite the Amendment Act, cases concerning grocery covenants are likely to appear before the courts anyway. Enforcement action would have been the most appropriate way to test whether these covenants breach existing competition laws before deciding what, if any, legislative change is required.

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96 Commerce Commission, above n 2, at [9.29].

97 At [9.38].

98 At [9.53].

99 Commerce Act, s 28A, inserted by Commerce (Grocery Sector Covenants) Amendment Act 2022, s 4.

100 Commerce Act, s 28A(2).

101 Section 28A(3)(b).

102 Section 91(2); and Commerce Commission, above n 21, at [200].

103 At [200].

Secondly, lawyers have maintained for years that the MGRs' covenants breach the Commerce Act.[104] Yet only recently, when the Government was facing criticism for a cost of living crisis,[105] has legislation been passed under urgency outlawing grocery covenants.[106] This suggests that the Amendment Act is perhaps a politically motivated response. In turn, this strengthens the proposition that, if covenants are to be prohibited, it should be via the courts. Were the courts to find that these covenants breach existing laws, then this would be a more legitimate basis for prohibiting them. Conversely, were the courts to find that at least some covenants do not breach existing competition laws (for instance, if there are genuine pro-competitive effects and there is no loss),[107] then this would indicate that Parliament's legislative response was rushed and ill-conceived.

Thirdly, the Amendment Act fails to recognise a fundamental difference between restrictive and exclusive covenants. As discussed in Parts IV and V, the MGRs' restrictive covenants are overwhelmingly anti-competitive and should always be prohibited.[108] However, in limited circumstances, exclusive covenants can be pro-competitive. Enforcement action would have ensured that any pro-competitive exclusive covenants were not captured, as they are by the new legislation.

Finally, there are alternative avenues under our existing laws that allow for an efficient approach to litigation. In the commentary to the Amendment Act, the Government adopted the NZCC's position that grocery covenants may breach existing laws, namely ss 27 and 28 of the Commerce Act.[109] The Government stated, however, that "courts must assess, on a case-by-case basis, the extent that competition might be lessened in a relevant geographic market", which is time-consuming and costly.[110] However, the NZCC and Government seem to have overlooked how *ANZCO Foods* provides a route for courts to assess covenants collectively.[111] This overcomes the barrier of individual assessments in localised geographic markets.[112] Also, the grocery covenants likely breach

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104 Craig Fredrickson *Land Covenants in Auckland and Their Effect on Urban Development* (Auckland Council, Technical Report 2018/013, July 2018) at [2.4.4].

105 Jamie Ensor "Cost of living crisis: OECD warns Government actions to fight inflation should be 'more targeted' as further COVID, Ukraine impacts could spell trouble" *Newshub* (online ed, New Zealand, 9 June 2022).

106 Commerce (Grocery Sector Covenants) Amendment Act.

107 *Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees' Union* (1979) 27 ALR 367 (FCAFC) at 382.

108 *ANZCO Foods*, above n 25, at [154].

109 Commerce (Grocery Sector Covenants) Amendment Bill 2022 (122-2) (commentary), citing Commerce Commission, above n 2, at [9.63].

110 Commerce Commission, above n 2, at [9.63].

111 *ANZCO Foods*, above n 25, at [158] and [289].

112 At [158] and [289].

the s 30 cartel provisions.[113] Section 30 does not require geographic market analysis, allowing for a blanket ban of grocery covenants.

Increasing the availability of suitable sites is a vital prerequisite for enabling a large third player to establish and compete against the MGRs.[114] It is therefore important that the process of removing grocery covenants be legally and commercially sound. For these reasons, Part IV will analyse whether the MGRs' covenants breach s 28 of the Commerce Act. Part V will examine whether the grocery covenants breach s 30. After canvassing key legal issues, I conclude that the MGRs' restrictive covenants always breach ss 28 and 30. The MGRs' exclusive covenants almost always breach ss 28 and 30, with limited exceptions.

IV WHETHER THE GROCERY COVENANTS BREACH SECTION 28

A Legislation

Sections 27 and 28 of the Commerce Act are the general prohibition sections,[115] relating to anti-competitive agreements and covenants respectively.[116] For a covenant to be unenforceable it must first have the purpose, effect or likely effect of substantially lessening competition. Secondly, the substantial lessening of competition must occur in a relevant market.[117]

Regarding the first limb, an arrangement or covenant that lessens competition is one which hinders or prevents competition.[118] For this lessening to be substantial, it must reduce competition in a way that is "real or of substance".[119] A lessening of competition is equivalent to an increase in the market power of one or more parties.[120] Market power is the ability for a firm to increase and sustain prices

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113 Commerce Act, ss 30 and 30A.

114 Commerce Commission, above n 37, at 11.

115 Matthew Barber (ed) *Commercial Law in New Zealand* (online ed, LexisNexis) at [33.1].

116 *Ceda Drycleaners Ltd v Doonan* [1998] 1 NZLR 224 (HC) at 243. For a discussion of the equivalent Australian provision, see SG Corones *Competition Law in Australia* (3rd ed, Lawbook Co, Sydney, 2004) at 209–224; and Peter Armitage "The evolution of the 'substantial lessening of competition' test: A review of case law" (2016) 44 ABLR 74. For a discussion of the United States approach, see Oliver Black *Conceptual Foundations of Antitrust* (Cambridge University Press, New York, 2005) at 62–70 and 73–93.

117 Commerce Act, s 28; and *Howick Parklands Building Co Ltd v Howick Parklands Ltd* [1993] 1 NZLR 749 (HC) at 763–764.

118 Commerce Act, s 3(2); and *ANZCO Foods*, above n 25, at [127].

119 Commerce Act, s 2(1) definition of "substantial".

120 *Woolworths Ltd v Commerce Commission* [2008] NZCCLR 10 (HC) at 127; and Commerce Commission *The Commerce Act: Agreements that substantially lessen competition* (July 2018) at 2.

above competitive levels and/or decrease total output, thereby exerting control over that industry.[121] While market share is not the same as market power, a high level of the former is often a prerequisite for the latter.

This article argues that the grocery covenants indirectly increase the MGRs' market share by decreasing the land available to rivals, hindering their ability to enter and expand.[122] In turn, this helps the MGRs to increase and sustain prices above competitive levels, thereby exerting market control. There is little concern that consumers will switch to a rival, as no significant third player competes for consumers' main shop.

In determining whether there is a substantial lessening of competition, courts compare competition levels with the MGRs' covenants remaining in force (the factual or status quo) and competition levels had the covenants never been lodged (the counterfactual).[123] Only where the anti-competitive (competition decreasing) effects outweigh the pro-competitive (competition enhancing) effects will there be a substantial lessening of competition.[124] Thus, courts look at the "net" or aggregate effect on competition.[125]

As for the second limb, the NZCC and the Government maintain that, under s 28, a grocery covenant must substantially lessen competition in a localised geographic market.[126] This means courts would have to assess the grocery covenants individually, bringing numerous proceedings. However, *ANZCO Foods* provides an alternative, more efficient option.

B ANZCO Foods*'s Collective Approach*

ANZCO Foods concerned a meat processing company, AFFCO.[127] As part of an industry rationalisation plan, AFFCO gained authorisation from the NZCC to register restrictive covenants on several processing plants, including at Waitara.[128] These covenants prohibited future owners from

121 Hovenkamp, above n 5, at 80; and Louis Kaplow "On the Relevance of Market Power" (2017) 130 Harv L Rev 1303 at 1304–1305.

122 Commerce Commission, above n 120, at 2; and *Ceda Drycleaners*, above n 116, at 247.

123 *Commerce Commission v Woolworths Ltd* [2008] NZCA 276, [2009] NZCCLR 12 at [63]; and *ANZCO Foods*, above n 25, at [150].

124 *Fisher & Paykel Ltd v Commerce Commission* [1990] 2 NZLR 731 (HC) at 740–741; and *ANZCO Foods*, above n 25, at [249].

125 Barber, above n 115, at [33.14].

126 Commerce (Grocery Sector Covenants) Amendment Bill 2022 (122-2) (commentary), citing Commerce Commission, above n 2, at [9.63].

127 *ANZCO Foods*, above n 25, at [1].

128 At [8]–[9].

using the plants for meat processing.[129] Eventually, ANZCO purchased Waitara. It sought to use the factory for meat processing, but the restrictive covenant barred this.[130] ANZCO sued AFFCO, alleging that the covenant breached s 28 of the Commerce Act.[131] The central issue before the Court of Appeal was whether the covenant had the purpose of substantially lessening competition in the North Island market.[132]

The majority held that the defendant's restrictive covenant did not have the purpose of *substantially* lessening competition, as the Waitara plant only comprised two per cent of the relevant market.[133] William Young J dissented, stating that covenants which have anti-competitive purposes should be prohibited regardless of whether these purposes can be achieved.[134]

More importantly, William Young J stated he would have been prepared to find that the numerous restrictive covenants AFFCO lodged *collectively* resulted in a substantial lessening of competition, had counsel run this argument.[135] He relied on s 3(6) of the Act, which states that, where a party is entitled to the benefits of multiple covenants, these can be taken together as having the effect of substantially lessening competition under s 28.[136] AFFCO had lodged six other restrictive covenants on plants which were "broadly similar".[137] The covenant on the Waitara plant could therefore be considered as part of a broader anti-competitive purpose advanced by AFFCO.[138]

Glazebrook J for the majority stated that the collective covenant issue was not determinative, as ANZCO did not argue this.[139] However, she did not rule out the collective approach.[140] Combined, Glazebrook and William Young JJ constitute a majority for the proposition that, collectively, covenants *can* substantially lessen competition.[141] This has left the door open for the NZCC to argue

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129 At [8].

130 At [11] and [30].

131 Commerce Act, s 28; and *ANZCO Foods*, above n 25, at [21].

132 *ANZCO Foods*, above n 25, at [41]. The High Court found no substantial lessening of competition: see *AFFCO New Zealand Ltd v ANZCO Foods Waitara Ltd* HC Wellington CIV-2004-485-499, 23 August 2004 at [79].

133 *ANZCO Foods*, above n 25, at [278] per Glazebrook J, citing Mellsop's evidence at [187].

134 At [154].

135 At [158].

136 At [158]; and Commerce Act, s 3(6).

137 At [158].

138 At [158].

139 At [288].

140 At [289].

141 At [158] and [289].

that the MGRs' covenants collectively meet the threshold of substantially lessening competition. Such an approach is efficient and avoids the Government's concern that s 28 requires the covenants to be analysed individually, in localised geographic markets.[142]

Further, as in *ANZCO Foods*, the MGRs' restrictive covenants are "broadly similar".[143] In all instances, the MGRs purchased land, lodged a restrictive covenant preventing the site from being used for grocery retailing and sold the property with this condition. This consistent pattern of behaviour makes the MGRs' restrictive covenants highly suitable for the collective approach.

Finally, support for the collective approach can be found in other jurisdictions.[144] The Court of Justice of the European Union prohibited land agreements in the beef processing[145] and beer[146] industries because they had the cumulative impact of restricting new entry and reducing competition.

Using the collective approach, the remaining question is whether the MGRs' restrictive and exclusive covenants substantially lessen competition.

1 Restrictive covenants

Glazebrook J's judgment strongly indicates that the MGRs' restrictive covenants collectively constitute a substantial lessening of competition.[147] She stated that, even if ANZCO ran the collective covenants argument, she would have found no substantial lessening of competition.[148] However, her view reflected the meat processing industry's position at the time: there was existing overcapacity, barriers to entry were low and the detriments arising from the lessening of competition were minor compared to the benefits such as increased productive efficiencies.[149] The industry was highly competitive despite the covenants. Conversely, in the grocery sector, no overcapacity exists, barriers to entry are high and competition is muted.[150] Taking Glazebrook J's reasoning to its logical

142 Commerce (Grocery Sector Covenants) Amendment Bill 2022 (122-2) (commentary), citing Commerce Commission, above n 2, at [9.63].

143 *ANZCO Foods*, above n 25, at [158].

144 Office of Fair Trading, above n 51, at [4.27].

145 Case C-209/07 *Competition Authority v Beef Industry Development Society Ltd* [2008] ECR I-8637 at [38] and [40].

146 Case C-234/89 *Stergios Delimitis v Henninger Bräu AG* [1991] ECR I-935 at 995.

147 *ANZCO Foods*, above n 25, [289].

148 At [289].

149 At [289] and [293].

150 *Commerce Commission v Woolworths Ltd*, above n 123, at [166]; and Commerce Commission, above n 2, at [5.85] and [6.9].

conclusion, the grocery sector is the perfect industry for finding that the restrictive covenants collectively substantially lessen competition.

Additionally, William Young J's analysis applies because the MGRs' restrictive covenants are entirely anti-competitive.[151] Their sole purpose is to prevent competitors opening grocery stores on strategic sites.[152] They do not result in increased efficiencies, lower prices or superior services.[153] Their only "benefits" are creating high barriers to entry which increase the MGRs' market power and profits.[154] These are private benefits. They do not increase competition in any way.[155] Thus, the only purpose of the restrictive covenants is to "injure competitors and thereby injure the competitive process itself".[156]

For these reasons, courts would likely find that the MGRs' restrictive covenants are net anti-competitive and therefore unenforceable. Contrary to the NZCC's and Government's statements, only one case is needed to establish this in case law.

2 *Exclusive covenants*

Whether the MGRs' exclusive covenants collectively substantially lessen competition is more finely balanced. Like the restrictive covenants, the exclusive covenants block new entrants, result in higher prices and help the MGRs reap superprofits.[157] These factors point towards exclusive covenants substantially lessening competition. However, unlike the restrictive covenants, they can have the pro-competitive effect of facilitating new supermarkets.

Where a developer wishes to build a new shopping centre, they usually need a large anchor tenant to gain the necessary funding to proceed.[158] It is common commercial practice for a supermarket anchor tenant to pay higher rent than they otherwise would and/or cover a greater part of the development cost in exchange for the developer agreeing not to grant a lease to a grocery

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151 *ANZCO Foods*, above n 25, at [156].

152 At [156]; Paul G Scott "The Purpose of Substantially Lessening Competition: The Divergence of New Zealand and Australian Law" (2011) 19 Wai L Rev 168 at 190; and Commerce Commission, above n 2, at [6.75].

153 Scott, above n 152, at 190.

154 *ANZCO Foods*, above n 25, at [139]; Scott, above n 152, at 190; and Commerce Commission, above n 2, at [6.82], [6.83] and [6.93.1].

155 Scott, above n 152, at 190, citing *National Society of Engineers v United States* 435 US 679 (1978).

156 Scott, above n 152, at 190, citing Robert H Bork "The Rule of Reason and the Per Se Concept: Price Fixing and Market Division Part 1" (1965) 74 Yale LJ 775 at 775.

157 Commerce Commission, above n 2, at [6.82], [6.83] and [6.93.1].

158 Crampton, above n 23.

competitor.[159] This arrangement is mutually beneficial. The MGR gains greater certainty that it will recover its sunk costs invested in the store/centre without the threat of customer traffic being reduced by a second supermarket.[160] The developer shares the higher margins earned by the supermarket in the form of higher rent.

The NZCC criticises this outcome as a sharing of the benefits arising from an anti-competitive exclusivity arrangement.[161] However, the pro-competitive aspect arises where, without such an arrangement, the shopping centre development would not proceed. This is a real possibility considering the South African Competition Commission's finding that supermarkets are crucial in attracting the necessary number of customers in a shopping centre.[162]

Further, with the development proceeding, consumers benefit from an additional supermarket, which still adds to grocery competition in the surrounding area. The Australian Competition and Consumer Commission accepted these arguments, albeit with caveats regarding the exclusive covenant's length and whether such arrangements should be allowed for future stores.[163]

Nevertheless, exclusive covenants collectively restrict new entrants' or fringe players' ability to compete with the MGRs.[164] This enables the MGRs to increase their prices and yield superprofits. Put another way, the only reason the MGRs lodge exclusive covenants is *because* they are effective.[165] Additionally, out of the 100 exclusive covenants the NZCC identified, approximately 90 guaranteed exclusivity for 20 years or more.[166] This period is likely significantly longer than necessary for the MGR to recoup its sunk costs.

Thus, the anti-competitive effects of exclusive covenants blocking competitors for decades and raising consumer prices outweigh the pro-competitive benefits of facilitating a shopping centre development.[167] It is highly likely that the MGRs' exclusive covenants collectively have the purpose of substantially lessening competition.

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159 Commerce Commission, above n 2, at [6.93.2].

160 At [6.93].

161 At [6.93.1]–[6.93.2].

162 Competition Commission South Africa *The Grocery Retail Market Inquiry Final Report* (25 November 2019) at [308] and [316].

163 Australian Competition and Consumer Commission *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries* (July 2008) at 187–189.

164 Commerce Commission, above n 2, at [6.89].

165 At [9.60].

166 At [6.80].

167 At [6.83].

C Case-by-Case Approach

Courts also have the option of analysing covenants individually, defining the relevant market as geographically localised.[168] This article argues that, under the case-by-case approach, the MGRs' restrictive covenants always have the purpose of substantially lessening competition. The MGRs' exclusive covenants are often net anti-competitive, with limited exceptions.

The MGRs' restrictive covenants substantially lessen competition for all of the reasons discussed under the collective approach. Further, the restrictive covenants are anti-competitive because supermarkets do not only supply *goods*, but also the *service* of being conveniently located close to their customers.[169] Grocery covenants are highly effective because consumers prefer to travel short distances for their main shop.[170] By restricting entry within their confined geographic zone, the MGRs know they are more likely to increase their own patronage than lose customers to stores further afield. This enables the MGRs to sustain higher prices and returns than the NZCC believes would result from workable competition.[171]

The MGRs could argue that there are competing retailers like greengrocers and butchers only a few kilometres away. However, 84 per cent of consumers shop at supermarkets rather than multiple smaller stores due to supermarkets' convenience.[172] It is irrelevant whether greengrocers and butchers are close by, as the covenants substantially lessen the number of competing *supermarkets*. Besides, the MGRs would not lodge these covenants if they were ineffective.[173] They have an anti-competitive purpose and effect. Under both the collective and individual approach, restrictive covenants substantially lessen competition.

Regarding individual exclusive covenants, in metropolitan areas these will also be anti-competitive for the same reasons as restrictive covenants. However, in limited circumstances, individual exclusive covenants in rural areas may be net pro-competitive.

The MGRs would likely see expansion to small towns that can only sustain one supermarket as too risky an investment without the promise of exclusivity. While prices may be higher with only one MGR in the town rather than two, they would still be lower than the existing situation where there are

168 Commerce (Grocery Sector Covenants) Amendment Bill 2022 (122-2) (commentary), citing Commerce Commission, above n 2, at [9.63].

169 Commerce Commission, above n 2, at [4.27] and [4.68].

170 At [4.27] and [4.68].

171 At [6.93.1].

172 At [4.30].

173 At [9.60].

only smaller stores that lack economies of scale.[174] In these circumstances, the MGRs' exclusive covenants would on balance likely be pro-competitive. They would not breach s 28.

Overall, the MGRs' restrictive covenants and exclusive covenants would likely breach s 28 under the collective approach. Restrictive covenants will also breach s 28 under the case-by-case approach. Exclusive covenants would predominantly breach s 28 under the case-by-case approach. However, in small rural towns that can only sustain one supermarket, exclusive covenants may be net pro-competitive and would remain in force.

It is also open to the courts to find that the grocery covenants breach s 30 of the Commerce Act.

V WHETHER THE GROCERY COVENANTS BREACH SECTION 30

A Legislation

Sections 30 and 30A of the Commerce Act prohibit contracts, arrangements, understandings and covenants that contain or give effect to a cartel provision.[175] Three types of cartel conduct are prohibited in New Zealand.[176] These are price fixing, output restriction and market allocation.[177] Price fixing involves agreements or covenants between two or more parties in competition with one another that fix, control or maintain the price of goods or services.[178] Output restriction cartels are agreements or covenants between two or more parties in competition with each other that prevent, restrict or limit the production, capacity, supply or acquisition of goods or services.[179] Market allocation cartels are agreements or covenants whereby the market is divided between competing parties, often by geographic area.[180]

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174 Commerce Commission, above n 37, at 5; and Commerce Commission *Day 7 – Transcript of Grocery Market Study Conference* (2 November 2021) at 11.

175 For a discussion of the equivalent Australian provision, see Corones, above n 116, at 230–249; Caron Beaton-Wells and Brent Fisse *Australian Cartel Regulation: Law, Policy and Practice in an International Context* (Cambridge University Press, Melbourne, 2011) at 89–117; and Russell Miller *Miller's Australian Competition and Consumer Law Annotated* (37th ed, Thomson Reuters, Sydney, 2015) at 310–350. For a discussion of the equivalent United States provision, see Hovenkamp, above n 5, at 140–150; Bork, above n 38; and Black, above n 116, at 70–72. For United Kingdom and European Union law, see Jephcott, above n 45, at 83–96; and Maher M Dabbah *EC and UK Competition Law: Commentary, Cases and Materials* (Cambridge University Press, Cambridge, 2004) at ch 7.

176 Commerce Act, s 30A(1).

177 Section 30A(1).

178 Section 30A(2).

179 Section 30A(3).

180 Section 30A(4).

Parliament has decided that cartel conduct is per se illegal.[181] That is, agreements and covenants which contravene s 30 are illegal on their face. Unlike ss 27 and 28, the plaintiff does not need to define the relevant market or establish that the covenant substantially lessens competition.[182]

The reasons for per se liability are grounded in economic reliability.[183] Courts and economists have determined that fixing prices, restricting output and allocating markets lack any redeeming features.[184] This conduct is so egregious and overwhelmingly anti-competitive because it almost always limits competition, decreases output and increases prices.[185] It enables cartelists to reap artificially high returns while consumers suffer from unnecessarily expensive products.[186] This threatens "the central nervous system of the economy".[187] For these reasons, cartel conduct is deemed illegal without a full ss 27 or 28 inquiry.

This Part will examine whether the MGRs' covenants constitute an output limitation cartel and are therefore per se illegal. First, it is necessary to address whether the covenants represent an arrangement between two or more parties.

B Are the Covenants an Arrangement Between Two or More Parties?

In seeking to avoid liability under s 30, the MGRs would likely argue that an arrangement between two or more parties in competition (ie in the same industry) is required.[188] Lodgement of a restrictive covenant is a unilateral action taken by one supermarket. Therefore, restrictive covenants are not covered by s 30.

Similarly, the MGRs would argue that exclusive covenants are contained in leases between a shopping centre developer and a supermarket, so while there is an arrangement it is not between two parties in the same *industry*.[189] The centre developer is not competing in the grocery industry. Thus, exclusive covenants do not come under s 30.

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181 *Commerce Commission v Emirates* [2012] NZHC 1858 at [10]. See also *United States v Socony-Vacuum Oil Co* 310 US 150 (1940); and *Northern Pacific Railways Co v United States* 356 US 1 (1958) at 5.

182 Paul G Scott "Price Fixing and the Doctrine of Ancillary Restraints" (1999) 7 Canta LR 403 at 413.

183 FW Taussig "Price-Fixing as Seen by a Price-Fixer" (1919) 33 Q J Econ 205 at 222.

184 *Northern Pacific Railways Co*, above n 181, at 5.

185 At 5; *Broadcast Music, Inc v Columbia Broadcasting System, Inc* 441 US 1 (1979) at 19–20*; National Society of Engineers*, above n 155, at 692; and Beaton-Wells and Fisse, above n 175, at 77–78.

186 Miller, above n 175, at 318.

187 *Socony-Vacuum*, above n 181, at 226.

188 Commerce Act, s 30A.

189 Section 30A.

Conversely, the NZCC would likely argue that restrictive covenants are expressly included in the cartel provisions. In 2017, Parliament inadvertently removed covenants from s 30.[190] Recently, the Commerce Amendment Act 2022 rectified this issue.[191] Covenants now fall within the scope of s 30. While the language of "between two or more parties" remains,[192] Parliament likely intended this phrase only to cover contracts, arrangements and understandings. This is because restrictive covenants are by their very nature unilateral actions.[193]

Parliamentary debates support this conclusion. Anna Lorck MP in the first reading of the Commerce Amendment Bill 2021 (9) and the Hon Andrew Little in the third reading both suggested that the MGRs' restrictive covenants may contravene s 30.[194] This strongly indicates that s 30 covers the restrictive covenants.

A further argument is that s 30B(c)(ii) applies. Section 30B(c)(ii) states that s 30A covers "persons who, but for a cartel provision … would, or would be likely to, be in competition with each other".[195] "[B]ut for" the restrictive covenants, a fringe player or new entrant would be able to purchase or lease the land necessary to expand and compete against the MGRs. Thus, the MGRs' restrictive covenants function as "negative arrangements". They force future owners or lessees to agree not to use the land as a retail grocery store.[196] Arguably, there is an arrangement between two or more competing parties.

Some uncertainty remains as to whether exclusivity provisions in leases constitute a covenant under s 30. These agreements are not strictly covenants which run with the land.[197] However, s 30B(c)(ii) arguably also applies here. "[B]ut for" the exclusive covenant, other sites in the shopping centre could be occupied by a competing grocery retailer.[198] The covenant therefore has the practical effect of being an arrangement between the MGR and any current or potential centre tenant, preventing them from opening a retail grocery store. Thus, exclusive covenants are likely also covered by s 30.[199]

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190 Commerce (Cartels and Other Matters) Amendment Act 2017.

191 Commerce Act, ss 30 and 30A, as amended by the Commerce Amendment Act 2022.

192 Section 30A.

193 Commerce Commission, above n 2, at [9.57.1].

194 (16 March 2021) 750 NZPD (Commerce Amendment Bill – First Reading, Anna Lorck); and (17 March 2022) 750 NZPD (Commerce Amendment Bill – Third Reading, Hon Andrew Little).

195 Commerce Act, s 30B(c)(ii).

196 *Ceda Drycleaners*, above n 116, at 235.

197 Commerce Commission, above n 2, at [9.57.2].

198 Commerce Act, s 30B(c)(ii).

199 Commerce Commission, above n 2, at [9.57.2].

C Are the MGRs' Covenants an Output Limitation Cartel?

Output limitation cartels are agreements or covenants which restrict the volume of goods or services.[200] This enables the cartelists to raise their prices, harming consumers.[201] A leading precedent in establishing that output limitation warrants per se liability is *United States v Socony-Vacuum Oil Co*.[202] The United States Supreme Court's determination that an agreement to restrict the supply of gasoline constituted a cartel provides strong justification for the finding that the MGRs' covenants also constitute output limitation.

1 Socony-Vacuum *facts and analysis*

In the 1930s, prices in the mid-Western United States oil market were depressed due to excess supply relative to demand.[203] Many small independent refineries had limited storage capacity, forcing them to sell their gasoline at the prevailing low prices.[204] In 1935 and 1936, multiple major oil companies (MOCs) informally agreed to purchase gasoline from the independent refiners.[205] Due to their greater storage capacity and distribution networks, the MOCs were able to store a significant portion of the independent companies' output, thereby withholding it from the market.[206] This artificially raised the price of gasoline. It allowed the MOCs eventually to sell greater volumes of gasoline at higher prices.[207]

The Government sued the MOCs, alleging their conduct constituted price fixing and breached § 1 of the Sherman Act 15 USC of 1890. This was the only avenue available, as output limitation was yet to attract per se liability.

The Supreme Court dismissed the defendants' arguments that they were not raising gasoline prices above market levels, but were merely stabilising the market.[208] Instead, Douglas J observed that "to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces".[209] By purchasing "a part of the supply of the commodity for the purpose

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200 Commerce Act, s 30A(3).

201 William M Landes "Harm to Competition: Cartels, Mergers and Joint Ventures" (1983) 52 Antitrust LJ 625 at 625.

202 *Socony-Vacuum*, above n 181.

203 At 170.

204 At 171.

205 At 206.

206 At 169 and 210.

207 At 167 and 221.

208 At 222.

209 At 221.

of keeping it from having a depressive effect on the markets", Douglas J continued, the group exerted "effective influence over the market".[210] For these reasons, the Court found that withholding volumes of oil, with the consequential indirect impact of raising prices, is just as abhorrent as a direct price-fixing cartel.[211] Output limitation and price fixing are two sides of the same coin.

The Supreme Court's reasoning in *Socony-Vacuum* also applies to the MGRs' covenants. The lodging of grocery covenants, with the effect of significantly restricting the number of suitable sites available to competitors, constitutes an output limitation cartel. It reduces the number and variety of supermarkets in competition, harming potential new entrants and fringe grocery retailers.[212] In turn, this reduces competition and enables the MGRs to increase their prices.[213] Like in *Socony-Vacuum*, the covenants result, albeit indirectly, in artificially higher prices. This interferes with "the free play of market forces".[214]

2 *Is there truly a volume reduction?*

The MGRs might argue that *Socony-Vacuum* is distinguishable because it involved the actual withdrawal of volumes of a commodity.[215] Conversely, the grocery covenants do not constitute an output limitation because the MGRs seek to maximise volumes and sales, rather than withhold the supply of goods.

It is true that supermarkets seek to maximise sales. However, relying on this proposition to conclude there is no output limitation cartel would be interpreting the *Socony-Vacuum* principles too narrowly.

First, the covenants restrict the supply of suitable grocery retail sites available to competitors.[216] They restrict the *opportunity* for competitors to enter. Secondly, the covenants restrict the *service* to consumers of proximity to increased shopping locations.[217] Thirdly, the MGRs' covenants, by

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210 At 224.

211 At 223 and 224.

212 Commerce Commission, above n 2, at [6.82]–[6.83].

213 At [6.93.1].

214 *Socony-Vacuum*, above n 181, at 221.

215 At 210.

216 Commerce Commission, above n 2, at [6.82].

217 At [4.68].

restricting new entry, help maintain the duopoly's market dominance and muted competition levels.[218] This reduces the volume of food supplied at competitive prices.[219]

As the Second Circuit Court of Appeals in *Todd v Exxon Corp* explained, citing Areeda and others, cartels work most effectively for essential goods that are difficult for consumers to substitute like oil or staple foods.[220] Despite the duopoly's higher prices, demand for essential food items remains relatively inelastic (ie stable).[221] The MGRs can restrict the supply of suitable sites, increase their prices and be confident that demand will remain high, enabling them to reap higher returns than in a competitive market.[222]

Finally, the same dynamic applies in the MGRs' relationships with their suppliers.[223] Due to the MGRs' oligopsony power and large market share, New Zealand suppliers have very few options regarding whom they can sell to besides the MGRs, as discussed in Part I.[224] As a result, the NZCC believes many suppliers are selling their goods at below competitive prices. The MGRs' covenants contribute to this price inelasticity of supply.[225] These covenants prevent new entrants from opening, expanding and competing against the MGRs for suppliers' goods. This new entry would increase suppliers' choice and enable them to charge more competitive prices.[226]

In summary, the grocery covenants' restrictions on the number of suitable sites decrease competition at both the supply and retail ends of the market. They enable the MGRs to pay lower prices to suppliers and charge consumers higher prices than would prevail in a competitive market. Both consumers and suppliers are left worse off by this interference with the competitive process. Thus, the covenants constitute output limitation and warrant per se liability.

3 Is the impact on price too indirect to warrant per se liability?

Alternatively, the MGRs would likely argue that, even if the covenants reduce the number of supermarkets, any alleged impact on price is so indirect and difficult to calculate that the per se

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218 At [6.93.2].

219 At [6.93.2].

220 *Todd v Exxon Corp* 275 F 3d 191 (2d Cir 2001) at 202, citing Phillip E Areeda and others *Antitrust Law: An Analysis of Antitrust Principles and Their Application* (Aspen Law & Business, New York, 1995) at 562.

221 *Todd v Exxon Corp*, above n 220, at 202.

222 Commerce Commission, above n 2, at [6.82] and [6.93.1].

223 *Todd v Exxon Corp*, above n 220, at 202, citing Areeda and others, above n 220, at 574.

224 Commerce Commission, above n 2, at [8.2].

225 At [8.26]; and *Todd v Exxon Corp*, above n 220, at 211.

226 Commerce Commission, above n 2, at [8.2].

provisions are inappropriate.[227] In *Todd Pohokura Ltd v Shell Exploration NZ Ltd*, the Court of Appeal stated, obiter, that it would be difficult to establish, on the face of it, that an agreement to limit supply had the direct impact of raising prices.[228] It would therefore "be inappropriate to apply a per se provision" to such conduct; a full s 27 analysis is needed.[229]

Applying this argument, the MGRs may say that difficulties in finding suitable land are not only due to covenants. The RMA and OIA also reduce the number of suitable sites available.[230] It is arguably unfair to place the burden and blame on the MGRs when the Government also contributes to muted competition. Further, it would likely be difficult to establish that higher prices are the result of the covenants rather than the RMA and OIA.[231]

However, this reasoning is unlikely to be accepted by courts nowadays. Since *Todd Pohokura*, Parliament extended s 30 from only covering price fixing to also cover output limitation.[232] Parliament's express inclusion of output limitation takes supremacy.

Further, cartelists should not avoid liability simply because their output limitation scheme has an indirect rather than a direct impact on price.[233] This conduct is just as egregious and anti-competitive as cartels that directly raise prices. The end result of artificially high prices remains the same.

Finally, the reasoning in *Australian Competition and Consumer Commission v Liquorland (Australia) Pty Ltd* applies.[234] Liquorland and Woolworths pressured potential new entrants in the liquor market into agreeing to restrictions on their liquor licences.[235] In exchange, Woolworths agreed to withdraw its objections to the potential new entrants' licence application.[236] The Federal Court of Australia held that the purpose of these agreements was to prevent new entrants from acquiring restrictionless liquor licences.[237] Even if other factors like court-imposed conditions resulted in

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227 *Todd Pohokura Ltd v Shell Exploration NZ Ltd* [2015] NZCA 71; and Chris Noonan *Competition Law in New Zealand* (Thomson Reuters, Wellington, 2017) at 393.

228 *Todd Pohokura*, above n 227, at [272]–[278].

229 At [276].

230 Commerce Commission, above n 2, at [9.21.1], [9.21.2] and [9.21.4].

231 *Todd Pohokura*, above n 227, at [276].

232 Commerce Act, s 30A, inserted by Commerce (Cartels and Other Matters) Amendment Act, s 8.

233 *Socony-Vacuum*, above n 181, at 224.

234 *Australian Competition and Consumer Commission v Liquorland (Australia) Pty Ltd* [2006] FCA 826, (2006) ATPR 42-123.

235 At [3].

236 At [3].

237 At [831].

restrictions on their licences, the agreements remained plainly anti-competitive.[238] Likewise, even if other factors such as the RMA contribute to a lack of suitable sites in New Zealand, the grocery covenants remain anti-competitive and in breach of s 30.

Importantly, the Federal Court held that these agreements had the *purpose* of substantially lessening competition under s 45, the Australian equivalent to New Zealand's ss 27 and 28.[239] There had in fact been no *effect* of substantially lessening competition, in that such effects had not materialised. Contrary to *Todd Pohokura*, under this approach, the exact extent to which the grocery covenants raise prices would not need to be established under ss 28 *or* 30. It is sufficient that the MGRs' purpose in lodging the covenants was anti-competitive in that they sought to restrict the number of supermarkets, thereby artificially increasing prices.[240]

4 Does the joint venture exemption apply?

One final point from *Todd Pohokura* warrants consideration. That is, joint ventures are an exception to per se liability.[241] Joint ventures are where two or more parties develop a project together, sharing both the risks and benefits.[242] Section 31 establishes that joint ventures are exempt from per se liability, provided they do not have the dominant purpose of lessening competition.[243] The MGRs could argue that an agreement to pay higher rent in exchange for a developer's promise of exclusivity constitutes a joint venture.

The United States' distinction between naked and ancillary restraints is useful in determining whether the joint venture exception should apply in New Zealand. Naked restraints are per se illegal[244] because they do nothing more than restrict output and/or raise prices.[245] The MGRs' restrictive covenants fall into this category for the same reasons William Young J articulated in

238 At [834].

239 Competition and Consumer Act 2010 (Cth), s 45.

240 Note, however, that there is a divergence between Australian and New Zealand case law regarding the test for purpose under ss 27 and 28: see Noonan, above n 227, at 312–323.

241 Commerce Act, s 31; and *Todd Pohokura*, above n 227, at [168] and [276].

242 Dabbah, above n 175, at 492.

243 Commerce Act, s 31(4).

244 Corones, above n 116, at 79.

245 Bork, above n 38, at 264, citing *United States v Addyston Pipe & Steel Co* 85 F 271 (6th Cir 1898) and *Board of Trade of the City of Chicago v United States* 246 US 231 (1918). See also Hovenkamp, above 5, at 140; and Phillip Areeda "The Changing Contours of the Per Se Rule" (1985) 54 Antitrust LJ 27 at 30.

ANZCO Foods. These covenants are manifestly anti-competitive as their *only* purpose is to prevent rivals from using the land, which reduces the output of supermarkets and therefore competition.[246]

Conversely, ancillary restraints are "subordinate and collateral" to a legitimate commercial transaction[247] and are no broader than necessary to achieve the transaction.[248] Ancillary restraints are justified because they preserve socially valuable commercial relationships, increase efficiencies and/or decrease prices.[249]

Therefore, one must consider whether the MGRs' exclusive covenants are subordinate to the legitimate purpose of building a shopping centre. In almost all circumstances, exclusivity for over 20 years is substantially "wider than necessary to achieve the legitimate purpose" of facilitating a new shopping centre.[250] It is far longer than necessary for the supermarket to recover its sunk costs.[251] This suggests reducing competition is the central, rather than subordinate, purpose. In these circumstances, the covenants are naked restraints. The joint venture exception does not apply.

However, it is possible that an exclusive covenant is subordinate to the legitimate business rationale of building a new shopping centre where: the covenant is for a shorter period;[252] in a small rural town where demand could not support two supermarkets; and where the alternative is a town with no supermarket.[253] Here, the exclusive covenant arguably increases competition.[254] Consumers reap a fair share of the covenant's benefits in the form of increased output and decreased prices. This is a key factor that points towards granting an exception in the United Kingdom and European Union equivalents to s 31.[255] Thus, on balance, these exclusive covenants are net pro-competitive.

D Conclusion on s 30

In summary, the MGRs' restrictive covenants always restrict output and increase prices. They are overwhelmingly anti-competitive, a breach of s 30 and therefore unenforceable. The MGRs' exclusive covenants in urban areas also restrict output and breach s 30. They are unlikely to be ancillary because

246 *ANZCO Foods*, above n 25, at [149] and [156].

247 Bork, above n 156, at 797–798.

248 Bork, above n 38, at 266–267.

249 At 266–267; and Beaton-Wells and Fisse, above n 175, at 79–80.

250 Scott, above n 152, at 191.

251 Commerce Commission, above n 2, at [6.85.1].

252 Australian Competition and Consumer Commission, above n 163, at 187–189.

253 Commerce Commission, above n 37, at 5; and Commerce Commission, above n 174, at 11.

254 Beaton-Wells and Fisse, above n 175, at 267.

255 Office of Fair Trading, above n 51, at [5.16]. Curiously, the NZCC did not refer to the Office's paper in its grocery sector report.

20 years' exclusivity is excessive and demand is high in metropolitan areas. However, exclusive covenants for shorter periods in small rural towns are arguably an ancillary restraint, meaning the joint venture exception applies. These covenants can remain in force. In all other situations, the covenants raise barriers to entry, decrease competition and enable the duopoly to raise their prices artificially. These covenants warrant per se liability.

VI CONCLUSION

The NZCC's market report illuminates how the MGRs' large market share at the retail level and oligopsony power over suppliers, when combined with high barriers to entry, lead to artificially high retail prices and muted competition. Solutions aimed at encouraging competitive entry by increasing the number of suitable sites – namely amending the OIA and RMA, and removing grocery covenants – are therefore the most effective. They strike at the heart of the issue. With limited suitable sites available, it is difficult for a fringe player or new entrant to expand and compete against the MGRs. It is therefore disappointing that the Government did not further amend the OIA and RMA. Nevertheless, the weak response in these areas heightens the importance of removing grocery covenants in an appropriate and effective way.

Enforcement action, rather than legislation, is the most appropriate avenue, as it provides a strong case law basis for deeming the covenants unenforceable. Additionally, litigation is not as time-consuming as the Government suggests. The *ANZCO Foods* approach under s 28 and the s 30 cartel provisions are two avenues for collectively prohibiting the grocery duopoly's covenants. At least in relation to restrictive covenants, only one proceeding is needed to establish this position in case law.

Further, enforcement action is especially preferable for exclusive covenants. The majority of exclusive covenants are likely net anti-competitive and breach both ss 28 and 30. However, exclusive covenants may actually increase competition in limited circumstances, namely small rural towns that can only sustain one supermarket. Correspondingly, these particular exclusive covenants will not breach s 28. They will remain in force. These exclusive covenants will likely also constitute a joint venture, meaning they are exempt from per se liability. Enforcement action is more appropriate as, in these circumstances, exclusive covenants should not be captured by the Amendment Act.

In all other situations, the grocery covenants are overwhelmingly anti-competitive. By restricting new entry, they limit the supply of groceries at competitive prices. This enables the MGRs to sustain artificially high prices and returns, which is the hallmark of an output limitation cartel. The impact on price may be indirect, but the result is just as egregious.