



COVERSHEET

Minister	Hon Dr David Clark	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	Grocery sector reform: regulation of access to grocery wholesale and collective bargaining exemption	Date to be published	Tuesday 1 November

List of documents that have been proactively released

Date	Title	Author
August 2022	Regulatory Impact Statement Addendum: grocery sector regulatory backstop to the quasi-regulated wholesale access regime	MBIE

Information redacted

YES

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

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

Some information has been withheld for the reasons of active consideration by government.

Regulatory Impact Statement: grocery sector regulatory backstop to the quasi-regulated wholesale access regime

Coversheet

Purpose of Document	
Decision sought:	Analysis produced for the purpose of informing final Cabinet decisions.
Advising agencies:	Ministry of Business, Innovation and Employment
Proposing Ministers:	Minister of Commerce and Consumer Affairs
Date finalised:	28 July 2022
Problem Definition	
The Government is developing a Grocery Industry Competition Bill to improve competition in the grocery sector for the long-term benefits of consumers. Cabinet agreed to include a quasi-regulatory wholesale access regime in this Bill to address the lack of wholesale supply options. Under this quasi-regulatory regime, major grocery retailers will be required to consider all requests for wholesale supply in good faith. Any wholesale supply arrangements will be commercially negotiated subject to some transparency and conduct obligations. The expectation is that the wholesale supply arrangements negotiated are consistent with what would be expected in a workably competitive wholesale market. There is currently no basis for doubting this expectation will be met by commercial wholesale supply arrangements negotiated under the quasi-regulatory regime. However, this quasi-regulatory regime places no legal obligation on major grocery retailers to provide wholesale offerings consistent with what would be expected in a workably competitive wholesale market. Cabinet has already agreed to develop a mandatory wholesale access regime that would require major grocery retailers to provide wholesale supply at certain terms and conditions to act as 'regulatory backstop'. Cabinet intends the regulatory backstop to serve as an explicit threat of additional regulation, therefore further incentivising major grocery retailers to provide competitive wholesale offerings under the quasi-regulatory regime. Cabinet also intends it to serve as a signal to wholesale customers, or prospective customers, that they can expect reliable wholesale supply.	
Executive Summary	
This RIS supplements MBIE's 6 May 2022 RIS, <i>Regulatory Impact Statement – Government response to the retail grocery sector market study</i> (the original RIS). As set out in that RIS: • Competition in the grocery sector is not working well for consumers. The retail grocery sector is characterised by a duopoly of two major grocery retailers (Foodstuffs and Woolworths), who are each other's closest competitors. Entry and expansion conditions are not conducive to competition.	

- A key barrier to entry and expansion of competitors is that there is currently a limited wholesale market in New Zealand for fresh produce, meat, and some international groceries but little wholesale offerings for other products. There does not appear to be any likelihood of a new entrant into the wholesale market in the near future.

The Commerce Commission and original RIS recommended, and Cabinet has agreed to implement, a monitored or 'quasi-regulatory' wholesale access regime.

This will require major grocery retailers to establish wholesale supply operations and consider all requests for commercial wholesale supply in good faith. Any wholesale supply arrangement will be commercially negotiated, but all requests would be notified to the grocery regulator. Major grocery retailers will also be required to publish rules and terms and conditions of wholesale supply, and there will be a formal dispute resolution mechanism for wholesale supply disputes. The expectation is that the wholesale supply arrangements negotiated are consistent with what would be expected in a workably competitive wholesale market.

There is currently no basis for doubting that the quasi-regulatory regime will facilitate this outcome.

However, Cabinet considered that the credible threat of further intervention may be necessary. Cabinet agreed to develop a mandatory wholesale grocery access regime to provide a 'regulatory backstop' to the quasi-regulatory access regime.

The problem Cabinet wishes to address by way of a regulatory backstop is a risk that under the quasi-regulatory regime major grocery retailers' wholesale offerings are provided on terms that are not consistent with what would be expected in competitive wholesale market. Major grocery retailers may have commercial incentives to avoid providing wholesale supply that would reduce their competitive advantages in the market. In the absence of further action, there would be monitoring of major grocery retailer's wholesale offerings, and the Government could review the quasi-regulatory regime and eventually pass further legislation if necessary – however, it may be 2-3 years before further legislative changes could be introduced and implemented.

A mandatory wholesale access regime was one of the options assessed by the Commerce Commission and the original RIS but was not recommended at that stage. We assessed that option as a disproportionate intervention with highly uncertain consequences, including the risk of disrupting significant efficiencies and introducing costs that could be passed onto consumers, but as an intervention that could be revisited in future.

Two options are considered for a 'regulatory backstop' that would provide stronger incentives for major grocery retailers to provide competitive wholesale offerings:

- Option 1 (preferred): A flexible toolkit to allow for a timely and proportionate regulatory response if a competitive wholesale offering is not provided and if certain milestones under the quasi-regulatory regime are not met.
- Option 2: The automatic imposition of wholesale access at regulated prices if a competitive wholesale offering is not provided within 12 months.

Option 1, by more clearly indicating an intention to further regulate wholesale supply under certain circumstances, is expected to slightly increase incentives on major grocery retailers to provide wholesale access on competitive terms under the quasi-regulatory regime. If this does not happen, there are advantages in being able to select from a range of possible regulatory responses (i.e. tools) and having the empowering provisions already established so that the preferred response (or combination of responses) can be deployed in a proportionate and relatively timely manner. Providing the means to impose further wholesale supply obligations by regulation is also expected to

improve the confidence of wholesale customers that access to the major grocery retailers' scale and efficiencies will be stable over time.

The use of a regulatory backstop under Option 1 does not have any costs or risks that are not also associated with the counterfactual given the Government could be expected to develop a similar regulatory response if wholesale arrangements under the quasi-regulatory regime later prove unsatisfactory.

In relation to Option 2, we agree with the Commerce Commission's characterisation of that mandatory wholesale access regulation as significant, unprecedented, and exposed to considerable risks, including possible harm to consumers from disrupting vertical supply efficiencies. We also note that access regulation is typically reserved for markets with an essential facility or natural monopoly characteristic.

We have consulted the Commission throughout the development of Option 1 and the Commission has raised no significant concerns with that option.

The views of other stakeholders on the preferred option have not been meaningfully tested. We have tested some aspects of the preferred option with major grocery retailers and a very limited number of prospective wholesale customers and suppliers. While providing different perspectives, stakeholders have raised concerns about the unintended consequences of a mandatory wholesale access regime and stressed the importance of any additional regulation being workable.

Limitations and Constraints on Analysis

Scope of analysis

This RIS is an addendum to (and intended to be read together with) MBIE's 6 May 2022 RIS, *Regulatory Impact Statement – Government response to the retail grocery sector market study* (the **original RIS**). It is subject to the limitations and constraints noted in that RIS.

The scope of options considered is limited by the fact Cabinet has already agreed to develop a quasi-regulatory regime to improve access to groceries by other retailers (referred to as 'wholesale customers') and to a mandatory wholesale access regime to provide a regulatory backstop to that quasi-regulatory regime.

This RIS considers options for developing a regulatory backstop that further incentivises major grocery retailers to provide wholesale offerings under the quasi-regulatory regime that are consistent with what could be expected in a workably competitive market.

Because of the significant time constraints and the lack of public consultation on the proposals, MBIE is not confident it has identified all regulatory tools that might be suitable for inclusion in the preferred option. MBIE has selected regulatory tools for this option based on its understanding of similar tools that have been put to effective use in other regulatory systems. However, there is a lack of regulated grocery wholesale regimes in other countries to draw from.

The costs and benefits of the particular regulatory responses (i.e., the tools) that the preferred option makes available as a 'backstop' are considered at a high-level only. This is because their final design and impacts of each response will depend on the state of the grocery sector market at the time. Any form of 'mandatory wholesale access' regulation would be subject to further regulatory impact analysis in future to inform decisions on whether to implement them.

An important assumption

The options considered in this RIS do not include compulsory divestment of the major grocery retailers' wholesale arms or any form of structural separation, as these options are being explored

separately. Accordingly, the options considered all assume that it is possible to induce major grocery retailers to offer wholesale access to their competitors on terms that could be expected in a competitive wholesale market. Although wholesale offerings that are induced by regulation may *resemble* those that could be expected from an independent (not vertically integrated) wholesaler, regulatory incentives might never be a perfect substitute for market incentives.¹ Furthermore, we also understand that independent (not-vertically integrated) grocery wholesaling is uncommon internationally. The lack of market incentives may ultimately reduce the confidence of any large competitors that they can benefit from the wholesale offerings of major grocery retailers.

Consultation and testing

This RIS has been prepared under significant time constraints. MBIE has not publicly consulted or tested its analysis with interested parties. There has been limited targeted consultation with major grocery retailers, and a very limited number of wholesale customers and suppliers following the announcements of Cabinet's 23 May 2022 decisions relating to wholesale access. We intend to further refine the proposals and our analysis as we carry out further work on the details and consult following decisions by Cabinet on the preferred option.

Responsible Manager

Glen Hildreth
Manager
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Ministry of Business, Innovation and Employment

28 July 2022

Quality Assurance (completed by QA panel)

Reviewing Agency:	MBIE
Panel Assessment & Comment:	MBIE's Regulatory Impact Analysis Review Panel has reviewed this <i>Regulatory Impact Statement: grocery sector regulatory backstop to the quasi-regulated wholesale access regime</i>, as supplementary to the Regulatory Impact Statement: <i>Government Response to the Commerce Commission Grocery Sector Market Study – Policy decisions</i> (the original RIS), both prepared by MBIE. The Panel considers that, given the combination of content in the original RIS and the supplementary RIS, and the enabling nature of the regulatory options, the information and analysis summarised in this supplementary Regulatory Impact Statement meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

¹ For example, a wholesaler acting only to comply with regulatory obligations might not invest in improving their order processing functionality when an independent wholesaler might.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

The entry and expansion of grocery retailers is constrained by lack of access to a full range of grocery wholesale options

1. This RIS supplements MBIE's 6 May 2022 RIS, Regulatory Impact Statement – Government response to the retail grocery sector market study (**the original RIS**). As set out in that RIS, and based on the Commerce Commission's (the Commission) final report on competition in New Zealand's retail grocery sector:
 - a. Competition in the grocery sector is not working well for consumers. The retail grocery sector is characterised by a duopoly of two major grocery retailers (Foodstuffs and Woolworths), who are each other's closest competitors. Competition is muted and this contributes to a limited retail grocery offering to consumers with impacts on the price, quality, range, and service of grocery offerings to consumers.
 - b. Entry and expansion conditions are not conducive to competition. One reason for this is that major grocery retailers enjoy scale and efficiency advantages accessing grocery supply due to the efficiencies of vertical integration and economies of scale both in terms of buying volume and spreading costs across a large retail network.
 - c. To compete with major grocery retailers, a larger new entrant or retailer looking to expand will need to overcome these disadvantages and try to better meet consumer preferences for convenience and price. One way to achieve this would be to access a comprehensive range of groceries more cost-effectively through established wholesale networks until they are able to achieve sufficient scale (and vertically integrate themselves).
 - d. Smaller retailers (e.g., independent dairies or smaller chains) may also want access to established wholesale networks in the long-term to provide a wider selection of products at prices that are more attractive to consumers.
 - e. The Commission found that there is currently a limited wholesale market in New Zealand for fresh produce, meat, and some international groceries but little wholesale offerings for other products. There does not appear to be any likelihood of a new entrant into the wholesale market in the near future.

The Bill will include a quasi-regulatory wholesale access regime

2. On 23 May 2022, Cabinet agreed to develop a Grocery Industry Competition Bill (the Bill) to improve competition in the grocery sector for the long-term benefits of consumers. The Commission and original RIS recommended, and Cabinet has agreed to implement, a monitored or 'quasi-regulatory' wholesale access regime. The three main elements of the quasi-regulatory regime are to:
 - a. Require the major grocery retailers to consider all requests for commercial wholesale supply in good faith. There is no obligation to supply, but all requests would be notified to the grocery regulator, along with the outcome of any requests and, if declined, a summary of the retailers' reasons for declining to provide supply.
 - b. Require the major grocery retailers to put in place and disclose rules and terms and conditions of wholesale supply, and to make these available to potential wholesale customers and to provide the principles, terms, and conditions, and outcomes of any requests for supply, to the regulator.

- c. Establish a formal dispute resolution mechanism for wholesale supply disputes.
3. Major grocery retailers are currently developing wholesale offerings in anticipation of the quasi-regulatory regime coming into effect. The development of these offerings is ongoing and subject to change. However, we have some early indications of the key features so far:

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The Bill will also include a 'regulatory backstop', including the possibility of mandatory wholesale access regulation

5. Cabinet considered that the credible threat of further regulatory intervention may be necessary to incentivise commercial wholesale arrangements under the quasi-regulatory regime consistent with its expectations. It agreed to develop a mandatory wholesale grocery access regime to provide a 'regulatory backstop' to the quasi-regulatory access regime.
6. This would be different to the option explored by the Commerce Commission in its final report and that was assessed in the original RIS, which would have involved mandatory wholesale access regulation as a direct solution to the problems identified with wholesale access (rather than as a 'backstop'). Our reasons for not recommending that option were based on the following concerns the Commission considered in deciding not to recommend mandatory wholesale access regulation:
 - a. The lack of any 'essential facility' or 'natural monopoly' characteristic means that grocery wholesaling is not the type of industry ordinarily regarded as potentially amenable to access regulation. For example, warehousing and distribution logistics are duplicable or available from third parties. This would make such access regulation novel and unprecedented, with a high risk of unintended consequences.
 - b. Principles that might be necessary to implement a full regulatory access regime, such as non-discrimination and equivalence, assume that the needs of the independent grocery retailers are similar to those of the major grocery retailers themselves, and that the service is to a degree "one-size-fits-all".
 - c. Significant intervention could disrupt existing efficient vertical integration efficiencies, operational efficiencies, efficiencies of scale and scope, dynamic efficiency, and introduce significant additional costs. It may also reduce retail competition on price. It would require significant monitoring and regulatory oversight.

What is the policy problem or opportunity?

7. Competition for grocery retail may be improved if other existing or new grocery retailers are better able to leverage the scale and efficiency advantages of major grocery retailers.
8. Smaller wholesale customers (such as independent dairies or smaller chains) provide some limited competitive constraint on the major grocery retailers, which could potentially be increased if they can access wholesale supply in the long-term to provide a wider selection of products at prices that are more attractive to consumers. Larger grocery retailers (such as national or regional retail chains diversifying into groceries) may view wholesale access as a springboard to grow volume and customers while they invest to build their own relationships with suppliers.
9. In the long-term consumers would benefit by having more choices of where to buy groceries because there are more grocery retailers that can provide the convenience of a comprehensive range of groceries at competitive pricing. For example, rurally-based consumers, including Māori, may have shorter travel times if more stores in rural areas provide a grocery offering. Price-focused consumers in urban and peri-urban areas may benefit if existing at-scale retailers expand their offering into groceries.
10. The Government's expectation is that the wholesale offering by major grocery retailers – in terms of range and price – should be consistent with what would be expected in a workably competitive wholesale market.
11. The quasi-regulatory regime allows major grocery retailers the flexibility to design competitive and innovative wholesale offerings. Penalties associated with obligations under the quasi-regulatory regime are likely to incentivise compliance.
12. Our understanding of Cabinet's decision to pre-emptively make further regulatory responses possible is that it was motivated by the risk that incentives to negotiate the kind of wholesale arrangements Cabinet is seeking under the quasi-regulatory regime will be limited in the absence of this threat.
13. Major grocery retailers do not currently have commercial incentives to provide wholesale supply, as evidenced by the fact this has not occurred voluntarily. It is possible that the major grocery retailer may, in good faith, decline to offer commercial wholesale supply to a wholesale customer, or the commercial wholesale offering may be provided on terms that make them unattractive to competitors.
14. However, there is currently no basis for doubting that the quasi-regulatory regime would facilitate the wholesale outcomes sought.
15. Under the quasi-regulatory regime the regulator would closely monitor the major grocery retailers' wholesale offerings. The Government could review the quasi-regulatory regime and develop further legislation if necessary. However, Cabinet has already agreed to develop a mandatory wholesale access regime as a regulatory backstop to be included in the Bill.

What objectives are sought in relation to the policy problem?

16. The original RIS was based on the objective of promoting competition in grocery markets (both the retail market, and the supply of goods to the retail market) for the long-term benefit of consumers within New Zealand. This RIS is concerned with designing a regulatory backstop that further incentivises the development of wholesale offerings by major grocery retailers that are consistent with what would be expected in a workably competitive wholesale market.

17. The Commerce Act uses the word ‘competition’ to mean ‘workable or effective competition’. This distinguishes it from a theoretical state of perfect competition. It would be for the Commerce Commission to apply the concept of workable competition to the wholesale market (under the preferred option). For the purposes of this RIS, we have in mind the kind of wholesale offerings that could be expected in a scenario where wholesalers compete to pass on their cost and scale advantages to customers across three dimensions:
 - a. the range of groceries they can make available;
 - b. the wholesale prices they can offer; and
 - c. other terms of supply which are likely to influence the choice of wholesale customers.
18. Ultimately, the usefulness of this concept to our policy analysis is confined to the long-term benefit of consumers recognised by the original RIS and by the purpose of the Grocery Sector Competition Bill agreed by Cabinet. This requires emphasis to be placed on the significant efficiencies created by the major grocery retailers’ scale and vertical integration (which influences the prices consumers pay for their groceries), and their likelihood of passing these benefits on to wholesale customers on appropriate commercial terms.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

19. The criteria from the original RIS will be used:

Figure 1: Criteria used in this RIS

1. Enabling competitive markets	•Enabling a competitive retail grocery markets, at both local and national levels. •Enabling a competitive grocery sector, including the market for the acquisition of grocery produce from primary producers, manufacturers, and suppliers .
2. Ability to support economic growth / efficiency	•Encouraging innovation within the grocery sector. •Encouraging investment and initiatives that will enhance productivity and enable economic growth across New Zealand. •Ensuring that the sector operates efficiently.
3. Proportionality	•Regulation is proportionate given costs and benefits and provide a proportionate impact on consumers, retailers and suppliers in relation to levels of benefit or cost.
4. Durablilty	•Regulation is up-to-date with current industry and regulatory practice, and are cognisant of expected future context. •Changes are flexible over time and improve in response to feedback received.
5. Certainty	•Intervention is predictable and understandable for government and market players to minimise uncertainty and manage risks. •Consistency with other regulatory regimes. •Any decision-making criteria are clear and provide certainty of process.
6. Timeliness	•Changes or regulations can be implemented in a timely manner.

What scope will options be considered within?

20. The options in this RIS build on Cabinet’s 23 May 2022 decisions to:

- a. establish an initial ‘quasi-regulatory’ access regime for wholesale grocery supply; and

- b. develop a mandatory wholesale grocery access regime to provide a ‘regulatory backstop’ to the quasi-regulatory access regime.
- 21. This direction has informed the development of options in this RIS, which focus on alternative designs of a regulatory backstop.

What options are being considered?

- 22. This RIS considers possible options for the design of the regulatory backstop sought by Cabinet. The options must include the prospect of mandatory wholesale access regulation. We have considered two such options:
 - a. Option 1 (preferred): Flexible toolkit to allow for a timely and proportional regulatory response and provide a credible threat of further regulation if certain milestones or criteria for a wholesale offering are not met.
 - b. Option 2: The automatic imposition of wholesale access at regulated prices if a competitive wholesale offering is not provided within a defined period (e.g., 12 months).
- 23. We compare these options with a counterfactual already dismissed by Cabinet in which a monitored quasi-regulatory regime is established and further changes to primary legislation can be developed in future as necessary or desirable to secure the intended outcomes.

Option One – A flexible toolkit of potential regulatory responses available to the Commission or the Minister

- 24. This option would build on the monitoring quasi-regulatory regime by providing the Commission and Government with a flexible ‘tool-kit’ to place additional forms of regulation on major grocery retailers if certain grounds are met. These additional regulatory responses and the outcomes would be specified in empowering provisions, including:
 - a. the Commission would be able to require a major grocery retailer to put in place, and modify as appropriate, a framework for commercial wholesale supply of a comprehensive range of grocery products at competitive prices (the **Framework**); or make a Grocery Wholesale Industry Participation Code that applies to all designated grocery retailers, and to all retailers that sought access to wholesale groceries (the **Wholesale Code**).
 - b. the Minister could, after considering a recommendation by the Commission, seek an Order in Council to require major grocery retailers to supply wholesale customers with a range of products at regulated prices by either requiring **supply on non-discriminatory terms** or putting in place **price-quality regulation**.
- 25. The intent is to provide an escalating level of intervention without a formal hierarchy. The grounds for activating the empowering provisions, the tools that can be activated, and the processes that would need to be followed are further discussed below.
- 26. However, we have not attempted to fully analyse the likely consequences of implementing the specific tools in this RIS. This is because their final design and the impacts of each regulatory response will depend on the state of the grocery sector market at the time. Any form of ‘mandatory wholesale access’ regulation would be subject to further regulatory impact analysis in future to inform decisions on whether to implement them.

Power for the Commission to impose additional forms of regulation

Activation grounds

27. The Commission could impose additional forms of regulation on major grocery retailers if the purpose of the Bill (to improve competition in the grocery retail sector for the long-term benefit of consumers) would be better met by the additional requirements, and any of the following grounds are met:
- a. after three months from commencement of the Bill, a major grocery retailer has not put in place the formalized rules, criteria and procedures, or the standard terms and conditions, required by the quasi-regulatory regime;
 - b. after six months from the Bill being passed, a major grocery retailer has not put in place the systems necessary (e.g., ordering, billing, delivery, and confidentiality management) to provide wholesale groceries to prospective customers;
 - c. after twelve months from the Bill being passed, prospective customers have sought access, good faith negotiations have concluded, and no substantial agreements have been reached; or
 - d. the wholesale offerings provided by major grocery retailers are not consistent with what would be expected in a workably competitive wholesale market.

Tools

28. In that event, the Commission could:
- a. require a major grocery retailer to put in place, and require changes to, a framework for commercial wholesale supply of a comprehensive range of grocery products at competitive prices (the **Framework**); or
 - b. make a Grocery Wholesale Industry Participation Code that applies to all designated grocery retailers, and to all retailers that sought access to wholesale groceries (the **Wholesale Code**).
29. Both these regulatory tools have been put to effective use in other markets subject to economic regulation (e.g., the Electricity Code and Farmgate Milk Price Manual). They are intended to give the regulator the independence and flexibility to guide the emerging behaviours of market participants towards public interest outcomes, with the least interference with commercial arrangements and least regulatory costs necessary.
30. The Framework would be a manual or rule book that sets out how pricing and ranging decisions will be made by the executives responsible for the wholesale offering. This would include the basis for all costs that they are including in their wholesale prices and any servicing costs that are charged. There would be some analogy to Fonterra's Milk Price Manual. This requirement would create additional transparency for all parties and increase the incentives for major grocery retailers to develop and offer competitive wholesale supply arrangements.
31. The Wholesale Code could be broad and allow provisions that were necessary or desirable to achieve the overall purpose. In practice, it could set out regulatory provisions to improve the operation of the wholesale regime. This could focus on the range of products included in wholesale supply, or the pricing of wholesale, expectations (but not requirements) on wholesale customers, or any other factors that arose.

Process

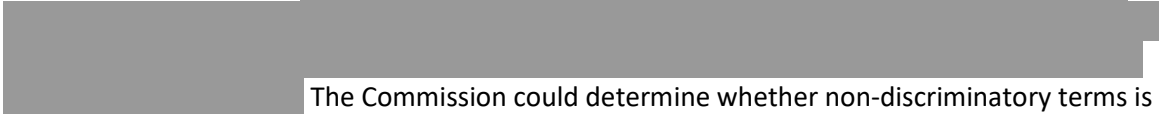
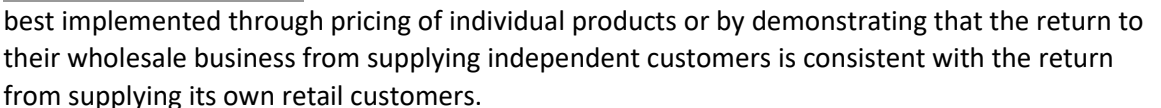
32. A requirement on a major retailer to put a framework in place, or to change the framework, would be secondary legislation in the form of a direction made by the Commission. A comparable direction-making power can be seen in section 24 (Commission may give directions about network rules) of the Retail Payment System Act 2022, for example.
33. A Wholesale Code would also be secondary legislation made by the Commission. It would be similar to the standard-issuing power provided by section 17 (Network standards for designated networks) of the Retail Payment System Act 2022, for example. While the Commission would be responsible for making and amending the Wholesale Code, it could request the industry propose a draft Wholesale Code.
34. The Commission would have the discretion to impose either of these additional forms of regulation on its own initiative, or at the request of the Minister, but using its expertise to assess whether the grounds specified in paragraph 27 are met. However, the Commission would not be able to exercise either of these powers without first consulting affected parties.

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

Activation grounds

35. The Minister, following a recommendation from the Commission, could seek an Order in Council to require major grocery retailers to supply wholesale customers if the wholesale offerings are not consistent with what would be expected in a workably competitive wholesale market and the overall purpose of the Bill could be better delivered by the regulatory tools under the regulatory backstop.

Tools

36. There would be broadly two types of tools provided:
 - a. a requirement to **supply at non-discriminatory terms**; or
 - b. **price-quality regulation** set by the Commission.
37. A requirement to supply at non-discriminatory terms envisages terms that are no less favourable to wholesale customers as the terms on which the major grocery retailer supplies its own retail business. The major grocery retailer would be required to provide a comprehensive range of products it stocks, unless an independent supplier has chosen to opt out of the regime. It would also be required to ensure that it sells to all wholesale customers (including its own retail operations or store operator members) on non-discriminatory terms. The major grocery retailers would be able to prepare a supply proposal as a starting point, to be considered by the Commission and amended if required.
38. The requirement to supply at non-discriminatory terms would have significant impact on the current operating model of major grocery retailers. The incumbent major grocery retailers are vertically integrated and **Confidential information entrusted to the Government**

The Commission could determine whether non-discriminatory terms is best implemented through pricing of individual products or by demonstrating that the return to their wholesale business from supplying independent customers is consistent with the return from supplying its own retail customers.

39. The Commission may impose obligations and directions on the major grocery retailer as necessary to have confidence that the non-discriminatory terms will be met. This could include to require accounting or operational separation. There are no restrictions stopping an independent supplier from opting out. However, the Commission could impose any obligations on wholesale customers it considers are reasonable and necessary for the operation of the regime, such as meet minimum standards of demand forecasting, duration of purchases and minimum orders.
40. Price-quality regulation would be a range of specific obligations set by the Commission and could include:
 - a. pricing methodology (as determined by the Commission);
 - b. performance standards (e.g., delivery timeframes, 'out-of-stock' frequency);
 - c. access terms, such as payment terms and credit, minimum purchase quantities (including pick types) and purchase amounts, and demand forecasting;
 - d. infrastructure and ancillary service requirements including logistics capability and services, IT functions; and
 - e. duration of the regulatory access regime.
41. A major grocery retailer would be required to provide the range of products it stocks, unless an independent supplier has chosen to opt-out of the regime. The Commission could vary the components of price-quality regulation based on factors such as wholesale customer type, different product lines, or wholesale offerings, and geographic location. The Commission may impose any obligations on wholesale customers it considers are reasonable and necessary for the operation of the regime.

Process and recommendations the Commission may make

42. Both these tools would be latent in primary legislation, with either able to be activated by Order in Council on the recommendation of the Minister (following a recommendation from the Commission) specifying its scope (e.g., the major grocery retailers it applies to), and the nature of supply obligations imposed.
43. The Commission may at the same time consider whether to require a Framework or make a Wholesale Code. It may also recommend any other forms of regulatory intervention that have not been contemplated by the Bill (notwithstanding the fact they would require changes to primary legislation). It would have to consult on any recommendation before making it to the Minister. The Minister would not be bound by the Commission's recommendation but would need to be satisfied that the grounds for such an Order in Council are met.

Review, potential deactivation of regulatory responses and repeal of the regulatory backstop

44. Any regulatory response that is implemented under this option would be subject to formal review by the Commission and potential deactivation, having regard to the costs and benefits of regulation and whether it remains necessary to achieve the long-term benefit of consumers.
45. There would also be a formal review of the wholesale access regulatory regime triggered by market concentration levels and a requirement for the Government to respond to advice from the Commission on whether aspects of the regime should be repealed.

Does this option meet the policy objectives?

46. It is generally accepted that commercial contractual arrangements negotiated without economic regulation will be less costly overall.² The best-case scenario under any option is therefore that the quasi-regulatory regime will produce competitive wholesale offers. We think that outcome is slightly more likely under this option because it strengthens incentives to avoid further regulation. This is expected to increase the likelihood of competitive wholesale offerings being available in the short to medium term compared to the counterfactual. This is not to say current incentives are insufficient, but rather that strengthening them can only increase the likelihood of securing the outcome that is sought.
47. We agree with the Commerce Commission's characterisation of that mandatory wholesale access regulation as significant, unprecedented and exposed to considerable risks, including possible harm to consumers from disrupting vertical supply efficiencies. We note that access regulation is typically reserved for markets where there is an essential facility or natural monopoly.
48. The application of price-quality regulation to a diverse and dynamic range of grocery products is complex, notwithstanding the Commission's expertise in price-quality regulation of other industries, including electricity, gas distribution and airports. Supply on non-discriminatory terms is likely to be more beneficial, as it does not involve the regulator directly specifying the range, pricing and access terms
49. There is flexibility under this option to manage these risks and ensure the response is proportionate both in the choice of regulatory response and how the chosen response is designed. Giving the Commission certain tools (the Framework and the Wholesale Code) it can impose on its own initiative, and the incentives of parties to comply with those tools, could significantly reduce the likelihood of recourse to mandatory wholesale access regulation.
50. We also note that a decision to develop regulation for supply on non-discriminatory terms or price-quality regulation would be made by the Executive and informed by further regulatory impact analysis and in view of developments in the wholesale market in the interim.

Option Two – The automatic imposition of wholesale access at regulated prices if a competitive wholesale offering is not provided within 12 months

51. Under this option the only backstop would be the kind of price-quality regulation described under Option 1. Empowering provisions would be established by the Grocery Industry Competition Bill, with the specific obligations on major grocery retailers set by the Commission.
52. The activation grounds for this regulatory backstop would be the same as that for Option 1, except that:
 - a. As well as the time-sensitive criteria described in paragraph 27, there would be a deadline for the Commission to assess whether the wholesale offerings provided by major grocery retailers are consistent with what would be expected in a workably competitive wholesale market.
 - b. If either criteria are met, the major grocery retailers would automatically be required to provide access on terms specified in price-quality regulations set by the Commission after 12 months. There would be no discretion (including for Cabinet) to avoid price-quality regulation if the Commission determines that the criteria are met.

² The Commerce Commission's final report: Market Study into the Retail Grocery Sector, March 2022, paragraph 9.95

- 53. The Commission's assessment against the criteria would be repeated at regular intervals to either activate price-quality regulation or sunset it.
- 54. In summary, both the nature of the regulatory backstop provided by this option and the circumstances in which it kicks in would be almost completely pre-determined.

Does this option meet the policy objectives?

- 55. Overall, it is unclear whether this option would increase the likelihood of wholesale access being provided on competitive terms under the quasi-regulatory regime. On one hand, it could more strongly incentivise competitive wholesale offers given the regulatory consequences are clearer and more unattractive to the major grocery retailers.
- 56. On the other hand, it might increase the likelihood of a backstop being activated/necessary (and reduce the likelihood of competitive outcomes being negotiated under the quasi-regulatory regime). This is because it is likely to create perverse incentives for prospective wholesale customers, who may expect to be advantaged by price-quality regulation. This increases the importance of making the activation ground immune from influence by wholesale customers. Together with the fact that activation would be automatic rather than discretionary, the incentives of wholesale customers appear to elevate the likelihood of a regulatory response being activated.
- 57. Although the public interest in price-quality regulation (in these circumstances) is difficult to judge in advance, the original RIS acknowledged some significant risks and costs associated with such regulation if it were to be activated under this option. We also note the novel and unprecedented nature of this option, given the lack of any essential facility or natural monopoly characteristic, and the diverse range of grocery products.

How do the options compare to the counterfactual?

	Counterfactual: monitored quasi-regulatory regime (with the general possibility of legislative change in future)	Option 1 – Flexible toolkit to allow for a timely and proportionate regulatory response	Option 2 - Automatic price-quality regulation of wholesale if competitive offerings are not provided within a certain timeframe
Enabling competitive markets	0 Wholesale access is negotiated on commercial terms. However, the incentives on major grocery retailers to negotiate wholesale offerings consistent with what would be expected in a competitive market are provided only by a combination of transparency obligations, conduct obligations, penalties attached to these obligations and the possibility of further, unspecified regulatory intervention. If the quasi-regulatory regime under-performs, the benefits of greater competition would be slightly delayed by the need to amend primary legislation to strengthen parties' incentives.	+ Wholesale access is negotiated on commercial terms with stronger incentives for major grocery retailers provided by the more specific threat of a tool kit of possible regulatory responses (according to transparent criteria). The range of regulatory responses available increases the credibility of this threat. We believe this combination of factors makes the quasi-regulatory regime marginally more likely to result in competitive wholesale offerings. If the quasi-regulatory regime under-performs, regulatory responses to improve competition would be implemented sooner than under the counterfactual.	– Stronger incentives for major grocery retailers but weak, and potentially perverse, incentives for wholesale customers to negotiate competitive terms under the quasi-regulatory regime. This has the potential to undermine the success of the quasi-regulatory regime. If the quasi-regulatory regime under-performs, the Government will have committed itself to a form of regulatory response that may not improve competition or promote the long-term interests of consumers.
Ability to support economic growth / efficiency	0 Wholesale access on commercial terms under the quasi-regulatory regime is considered the most likely to facilitate innovation in wholesale access, the enjoyment of efficiencies, and investment and growth by (existing or new) independent grocery retailers. If the quasi-regulatory regime under-performs, further intervention could be developed to support economic growth/efficiency (among other factors).	0 Wholesale access on commercial terms under the quasi-regulatory regime is considered the most likely to facilitate innovation in wholesale access, the enjoyment of efficiencies, and investment and growth by (existing or new) independent grocery retailers. As above, we consider that result marginally more likely under this option (due to stronger incentives). If the quasi-regulatory regime under-performs, a regulatory response would be selected based on its ability to support economic growth/efficiency (among other factors).	– If the quasi-regulatory regime under-performs the lack of regulatory choice may make it difficult to effectively manage the potential to create long-term inefficiencies in the wholesale market. Under-performance of the quasi-regulatory regime is also defined in advance (by the design of the activation grounds) rather than able to be assessed based on all the circumstances, which elevates the risk of an inappropriate regulatory response.
Proportionality	0 Low-cost form of regulation is sufficient if wholesale offerings are consistent with what would be expected	0 If the quasi-regulatory regime under-performs, the flexibility to choose from a range of tools (that also	-- If the quasi-regulatory regime under-performs, the lack of flexibility to choose whether to intervene

	in a competitive market. If the quasi-regulatory regime under-performs, the Government can develop a proportionate regulatory response.	range in the degree of intervention) helps to recognise the dynamic nature of the sector and ensures that regulation is proportionate given the benefits and costs.	and with what tool creates the potential for the costs of the regulatory response to exceed the benefits. There are circumstances in which price-quality regulation would be disproportionate to the problems associated with wholesale access under the quasi-regulatory regime and not result in long-term benefits to consumers.
Durability	0 Ability to negotiate wholesale access on commercial terms is likely to result in durable and flexible arrangements, but any further intervention would require legislative change.	0 Ability to negotiate wholesale access on commercial terms is likely to result in durable and flexible arrangements, and the government already has a range of tools available to intervene if needed. However, these tools are developed without advance knowledge of which regulatory response will be the most appropriate in the circumstances.	– Requiring wholesale supply under price-quality regulation would introduce rigidity in an otherwise dynamic sector (in which both supply and demand is, for example, seasonable).
Certainty	0 Ability to negotiate wholesale access on commercial terms is the default regulation. The possibility of further intervention is indicated but not specified.	+ Specifying in legislation under what circumstances further regulation would be introduced and what possible forms that would take somewhat increases certainty for parties acting under the quasi-regulatory regime. However, flexibility over the nature of regulatory response means regulated parties still face uncertainty.	0 This would increase certainty for regulated parties in terms of the nature of the regulatory response and when it is activated. However, much would be left to the development of price-quality supply obligations, which would be novel and unprecedented with high risk of unforeseen consequences.
Timeliness	0 Wholesale access can be negotiated on commercial terms at any time, but further changes to primary legislation would be required if Government wanted to intervene after a period of assessing performance under the quasi-regulatory regime.	+ If the quasi-regulatory regime under-performs, a suitable regulatory response could be developed sooner than under the counterfactual.	+ If the quasi-regulatory regime under-performs, a suitable regulatory response could be developed sooner than under the counterfactual.
Overall assessment	0	+3	– 4

Key for qualitative judgements in tables:

- ++** much better than the counterfactual
- +** better than the counterfactual
- 0** about the same as the counterfactual
- worse than the counterfactual
- much worse than the counterfactual

What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

58. We have assessed Option 1 (Flexible toolkit to allow for a timely and proportionate regulatory response) as slightly improving on the counterfactual and as preferable to a more restrictive regulatory backstop (assessed as Option 2). The main reasons for this are two-fold.
59. Firstly, we consider wholesale access on competitive terms without further regulation is the optimal outcome, and the incentives of major grocery retailers to facilitate that outcome (to the extent this is within their control) are slightly increased by specifying a range of potential regulatory responses in advance.³ This sends a clear signal to major grocery retailers that the Government is prepared and will have the means to secure the wholesale outcomes it expects by further regulation if they are not secured voluntarily.
60. Secondly, if a further regulatory response is warranted despite this, having a range of responses to choose from means flexibility is not sacrificed at that point in time. Decision-makers will be able to deploy the form of regulation (or regulations) that is/are the most effective, proportionate and best suited to address the particular wholesale access issues that emerge from arrangements under the quasi-regulatory regime.
61. We acknowledge, however, that the benefits of the preferred option may diminish over time. The Commission took the view in its final report that the lack of commercial incentives for the major grocery retailers to supply potential rivals is likely related to the fact they currently face limited competition.⁴ The value of regulation designed to adjust these incentives may therefore weaken to the extent competition in the grocery retailer sector increases over time. This is reflected in deactivation and review mechanisms under the preferred option.
62. Another limitation of all forms of wholesale regulation we have considered is that the range of groceries they make available to wholesale customers (and therefore the extent to which they can enjoy the major grocery retailers' cost advantages) depends on the choices of suppliers. There would appear to be three choices available to the supplier under Option 1 (whatever the degree of regulation involved in facilitating wholesale access):
- a. allow the promotional funding they have negotiated with the major grocery retailer to be passed through to wholesale customers,
 - b. enter into promotional funding relationships with the wholesale customer directly and remove this from the component of the wholesale price, or
 - c. opt out of the wholesale access arrangements and rely solely on their relationship(s) with the major grocery retailer(s).
63. We understand from the Commission's final report⁵ that supplier preferences vary but suppliers exhibit a general willingness to consider either of the first two outcomes (which would not erode the benefits of the option in promoting competition). The risk of suppliers being coerced or contractually obliged by the major grocery retailers to opt out of wholesale access arrangements would be managed as part of other reforms being developed (such as development of a Grocery Code of Conduct).

³ Though we continue to note that whether stronger incentives are in fact required is not clear.

⁴ The Commerce Commission's final report: *Mart Study into the Retail Grocery Sector*, March 2022, paragraph 9.97.1

⁵ Paragraph 9.92.2

What are the marginal costs and benefits of the option?

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Regulated groups	Major grocery retailers are entitled to recover efficient costs (including investments they are required to make) under the quasi-regulatory regime. If further regulation is activated, it is possible some of the regulator's costs would be recovered from participants. Inefficient outcomes largely avoidable through activation test, choice and design of regulatory response.	None identified	Medium. This assessment would benefit from consultation with stakeholders on the design of the option.
Regulators	Costs accounted for in previous Cabinet decision if the backstop is not activated. Greater costs incurred if the backstop is activated, with the possibility of partial or full cost-recovery.	None identified	
Others (e.g., wider govt, consumers, etc.)	Any inefficient outcomes or unintended consequences could affect consumers (e.g., the retail price of groceries). However, as above, we consider these risks manageable.	Small potential for negative impacts on consumers.	Medium. This assessment would benefit from consultation with stakeholders on the design of the option.
Total monetised costs	N/A	None identified with any confidence	
Non-monetised costs	N/A	Low	Medium
Additional benefits of the preferred option compared to taking no action			
Regulated groups	Better access to groceries for retail	Potential benefits for wholesale customers (increased profitability /opportunity to expand).	Medium. This assessment would benefit from consultation with stakeholders on the design of the option.
Regulators		None identified	

Others (e.g., wider govt, consumers, etc.) ⁶	Potential benefits for consumers through greater competition in the grocery retail sector (to the extent this option is more effective than the counterfactual). This could include incidental savings, for example, reduced commuting/delivery costs for consumers in rural areas. The illustration of consumer savings is based on a statistic used by the Commission that consumers spend \$22 billion at supermarkets and other grocery stores a year.	If the retail price of groceries were to decrease on average by 1% because of greater price competition would deliver savings to consumers of \$220,000,000 per year.	Low. It is difficult to assess both to what extent this option would improve wholesale supply than under the counterfactual and to what extent that improvement (alone) would induce competing retailers to enter the market or expand.
Total monetised benefits	N/A	N/A	
Non-monetised benefits		Medium	Low

64. We note that the preferred option defers a proper assessment of the costs and benefits of two of the available regulatory responses to if/when they are recommended by the Commission as a result of unsatisfactory outcomes under the quasi-regulatory regime. These possible responses are:

- a. require a major grocery retailer to supply at non-discriminatory terms; or
- b. regulate a major grocery retailer through price-quality regulation set by the Commission

65. Although we cannot meaningfully assess these in advance, this uncertainty is a significant factor we have considered in favour of a regulatory backstop proposal that includes a reasonable degree of flexibility (including for the Commission). Those two regulatory tools would be subject to regulatory impact analysis if/when they are considered in future, and with better information about the state of the wholesale market under the quasi-regulatory regime (and any other regulatory responses by the Commerce Commission).

Views of stakeholders on the preferred option

66. We have consulted the Commission on the preferred option. The Commission's overall view is that it presents a feasible way to implement Cabinet's May 2022 decisions relating to wholesale access.

67. There has not been public consultation of on the options set out in this RIS. Through the Commerce Commission's market study process, the major grocery retailers raised strong concerns about the workability and effectiveness of mandatory wholesale access regulation. They expressed a willingness to develop commercial wholesale arrangements voluntarily. We have had a number of targeted engagements with major grocery retailers since the announcement of Cabinet's May decisions on wholesale access regulation.

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⁶ The costs of implementing this option are considered neutral when compared with those under the counterfactual.

68. We have had only very limited engagement with other grocery retailers and suppliers.

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Section 3: Delivering an option

How will the new arrangements be implemented?

69. All elements of these proposals would be established or delegated by the Grocery Industry Competition Bill, which the Government intends to introduce by the end of 2022.

Confidential advice to Government Some further policy development and consulted will be required before that bill is introduced.

70. The Bill will also appoint the Commerce Commission as the regulator of the grocery sector. The Commission's powers and functions will include monitoring wholesale supply arrangements under the quasi-regulatory regime, enforcement and making determinations as to whether the milestones and/or criteria are met for a regulatory response. Cabinet has approved budget to support the Commerce Commission in establishing and performing these functions in the 2022/23 financial year. Cabinet also agreed that decisions on funding for the Commission from 2023/24 onward will be sought at Cabinet later in 2022, along with decisions on cost recovery [CAB-22-MIN-0259 refers] If further regulation is activated, further budget is likely to be necessary for the Commission to develop and/or administer that further regulation.

How will the new arrangements be monitored, evaluated, and reviewed?

71. The Commerce Commission will be given statutory functions and powers that include monitoring the process of parties negotiating wholesale arrangements under the quasi-regulatory regime. This has been the subject of earlier Cabinet decisions [CAB-22-MIN-0259 refers]. This will replace a current undertaking by the major grocery retailers to provide regular reports to the Minister of Commerce and Consumer Affairs.
72. The policy objectives would be enshrined in legislation under the preferred option as the activation grounds for developing further regulatory responses, along with prescribed timeframes for these reviews.