

Regulatory Impact Statement: Grocery Supply Code of Conduct Requirements

Coversheet

Purpose of Document	
Decision sought:	<i>Approval of Grocery Supply Code of Conduct requirements</i>
Advising agency:	<i>Ministry of Business, Innovation and Employment</i>
Proposing Minister:	<i>Minister of Commerce and Consumer Affairs</i>
Date finalised:	<i>29 March 2023</i>

Problem Definition	
<p>The retail grocery sector has three major retailers: Woolworths New Zealand Limited, Foodstuffs North Island Limited and Foodstuffs South Island Limited (the major grocery retailers). The collective retail grocery market share enjoyed by the major grocery retailers is approximately 80-90%. The Commerce Commission’s (the Commission) market study into the retail grocery sector found that competition is not working well for consumers and the profitability of the major grocery retailers appears higher than expected under workable competition.¹</p> <p>One of the contributing causes found by the Commission includes the imbalance in bargaining power between product suppliers and the major grocery retailers. As a result of the major grocery retailers having superior bargaining power, some suppliers can experience a lack of certainty and transparency about their terms and conditions of supply. The major grocery retailers can also use their buying power to move costs and risks onto suppliers. For example, suppliers can be:</p> <ol style="list-style-type: none">1. charged costs for in-store wastage or damage of products in the hands of the major grocery retailer2. exposed to time delays of up to 60 days in having their invoices paid3. expected to meet a disproportionate share of the costs and risks of promotional discounts4. expected to cover merchandising costs (for instance, from stocking products on the shelves and preparing product displays) which the major grocery retailer also benefits from at no cost to itself.	

¹ The Commission’s final report can be accessed at: https://comcom.govt.nz/__data/assets/pdf_file/0024/278403/Market-Study-into-the-retail-grocery-sector-Final-report-8-March-2022.pdf.

Primary sector producers that supply perishable fresh produce to the major grocery retailers are particularly vulnerable to the imbalance in bargaining power.

This imbalance in bargaining power can lessen suppliers' ability and incentives to innovate and invest in new grocery products, contributing to higher prices and limited grocery offerings for consumers.

Executive Summary

On the Commerce Commission's recommendation, a mandatory Code of Conduct has been agreed

In May 2022, Cabinet agreed to implement a suite of regulatory reforms in the grocery sector in response to the Commission's market study into the retail grocery sector in New Zealand (**the market study**). This included agreeing to introduce a mandatory Code of Conduct (**Code**) to govern relationships between major grocery retailers and their suppliers.² The Code will be secondary legislation. The Commission will have powers to monitor and enforce the Code and make amendments to any of its provisions. The Code will initially only apply to the major grocery retailers, including all franchises and bodies connected with these entities. However, there will be scope to include other retailers, if required in future.

... for better supplier and consumer outcomes

In line with the aims of the Government's overall response to the market study, the broad objectives of the Code are to promote competition and efficiency in the grocery sector for the long-term benefit of consumers, and to contribute to a trading environment in which businesses can participate confidently. This is expected to benefit both consumers and suppliers by creating better incentives for suppliers to innovate and invest in new grocery products, which will contribute to better prices, range and quality of products on supermarket shelves. The Code will also help create a more sustainable supply chain.

The Code aims to improve transparency for suppliers and to reduce inefficient transfers of costs and risks

There are two broad problems which the Code aims to address, both arising from imbalances in bargaining power between the major grocery retailers and suppliers:

1. The major grocery retailers are able to impose costs and risks on suppliers that are too high or that the major grocery retailers are best placed to manage.
2. Poor transparency and certainty of terms and conditions of supply for suppliers.

These two issues give rise to a number of additional related problems, as described in detail in this Regulatory Impact Statement.

² [Regulatory Impact Statement: Government response to the Commerce Commission Grocery Sector Market Study – Policy decisions \(mbie.govt.nz\)](https://www.mbie.govt.nz/regulatory-impact-statement/government-response-to-the-commerce-commission-grocery-sector-market-study-policy-decisions).

We have consulted on a number of options based on United Kingdom and Australian approaches

Through July-August 2022, the Ministry of Business, Innovation and Employment (**MBIE**) consulted on policy proposals for addressing these problems by implementing a Code. Broadly, the options consulted on involved designing the Code consistent with the approaches implemented in the United Kingdom (**UK**) or Australia, or alternatively to adapt the Australian Code.³ We received 20 submissions from a range of stakeholders, including the major grocery retailers, other grocery retailers, suppliers and supplier organisations, not-for-profit organisations and logistics and transport services.

MBIE's recommended requirements for the Code broadly align with the Australian Code

MBIE's recommended requirements for the Code broadly align with the Australian Code. The main requirements are:

- **General good faith obligations.** We recommend that these obligations include, for example, that grocery retailers be responsive and communicative with suppliers and not put suppliers under duress.
- **Requiring supply agreements to be written and to contain minimum content as recommended by the Commission in the market study.** The minimum content includes quality standards, quantity standards, delivery requirements, when products supplied may be rejected, the maximum period for payment and the circumstances where payment may be withheld or deductions made. It would also require the supply agreement to be retained by the grocery retailer for up to seven years after it has expired.
- **Restrictions on the ability of grocery retailers that are subject to the Code to impose unilateral or retrospective variations to supply agreements.** We recommend that the Code should allow unilateral variations only where the variation is for a valid reason (as set out in the supply agreement) and reasonable in the circumstances. In addition, retrospective variations should be prohibited. We also recommend that the Code prevent grocery retailers that are subject to the Code from requiring suppliers to use a particular logistics service to transport goods.
- **Requiring grocery retailers to pay a supplier's invoice within a reasonable time.** This will require grocery retailers to pay a supplier's invoice in accordance with the supply agreement and will require the timeframe set out in the supply agreement to be reasonable.
- **Restrictions on the ability of grocery retailers to set off any money owed by the supplier when paying invoices.** This will require set offs to be provided for in the supply agreement and to be reasonable, as well as require the supplier's written approval for any set offs.

³ The UK's Grocery Supply Code of Practice (**the UK Code**) and the Australian Food and Grocery Code (**the Australian Code**) formed the basis for the options we consulted on. The UK Code is principles-based, while the Australian Code is more prescriptive

- **Restrictions on the ability of grocery retailers to pass on costs involved with shrinkage, wastage, merchandising and promotional activities to suppliers.** The restrictions include a requirement for grocery retailers to make any claims for wastage within six months of receiving the produce.
- **Requiring grocery retailers to have standards for accepting or rejecting fresh produce and to apply these standards without discrimination.** The standards will include requirements for grocery retailers to accept or reject fresh produce within 24 hours of receiving it and to notify the supplier within 48 hours if the produce is rejected.
- **Requiring grocery retailers to have policies for product ranging, shelf allocation, range reviews and delisting produce and to apply these policies without discrimination.** This will include a requirement for grocery retailers to give six months' notice prior to delisting fresh produce.
- **Price increases from suppliers:** We recommended requiring grocery retailers to respond to requests from suppliers for price increases within 30 days of receiving a request.
- **Providing protections for a supplier's confidential information and intellectual property and recognition of taonga.** We recommend the Code include protections regarding suppliers' confidential information. We also recommend that the Code should recognise that, for some Māori suppliers, the knowledge of production processes underpinning intellectual property is a taonga.
- **Prohibiting grocery retailers from threatening suppliers with business disruption or engaging in any conduct for the purpose of pressuring suppliers into opting out of any wholesale access regime.** Prohibiting this behaviour is expected to make the grocery sector reforms more successful overall and will ensure that grocery retailers cannot use the Code to undermine the effectiveness of any Wholesale Access Code.

Adopting an approach to the Code that broadly aligns with the Australian Code means that much of the Code will be based on tried and tested interventions. This helps mitigate some of the risks of unintended consequences involved with creating the Code. We also consider that there are significant efficiency benefits with aligning the Code with the Australian Code, due to the close economic relationship between New Zealand and Australia, as well as the number of businesses that will be affected by the Code operating in both countries.

We anticipate overall benefits for consumers with some transitory costs and risks

The Code will involve some upfront and ongoing costs both for grocery retailers that are subject to the Code and suppliers. However, our assessment is that overall the Code will lead to consumer benefits in the long-run that outweigh any costs. The Code will provide more certainty and improve the way costs and risks are managed between grocery retailers and suppliers.

We anticipate additional costs initially both for grocery retailers and, to a lesser extent, suppliers. This may include both transitional costs (e.g. costs to grocery retailers in preparing new supply agreements) as well as ongoing costs (e.g. costs incurred in monitoring the Code).

We anticipate that most costs will fall on grocery retailers that are subject to the Code. However, suppliers may also incur modest costs in negotiating new supply agreements. Where disputes relating to the Code arise, there may be incremental costs incurred by both grocery retailers and suppliers. The costs incurred by suppliers as a result of the Code will be offset against the benefits to suppliers from the Code. The costs incurred by grocery retailers will be mitigated by transitional

provisions that provide a six-month time period for grocery retailers to issue new supply agreements that comply with the Code. In most cases, the code also sets procedural-based (rather than highly prescriptive) requirements.

We consider the key potential risks are:

- **Higher prices for consumers.** The Code could result in higher prices for consumers due to grocery retailers seeking to recoup the costs of the Code. We expect, however, that these costs will be transitory and moderated by the Commission's ongoing monitoring of the grocery sector. Furthermore, better conditions of supply for suppliers will eventually benefit consumers through better quality products, greater choice and lower prices. There are also significant consumer risks involved with not implementing the Code. Submitters have reported instances where poor conditions have forced some suppliers to exit the market. This ultimately reduces consumer choice and leads to higher grocery prices.
- **Distributional shifts in the balance of bargaining power.** The Code is expected to shift the balance of bargaining power away from the major grocery retailers to suppliers. If the balance is shifted too far, this may reduce the extent of competition between suppliers and as a result lead to higher grocery prices and reduced offerings to consumers. However, we consider that any risk of creating a distributional shift is relatively low, based on the procedural nature of the requirements we are recommending for the Code.

These risks have been mitigated in a number of ways

We consider these risks to be relatively low and are moderated in the following ways.

- The proposals are based mostly on the Australian code, which has proved beneficial.
- The proposals will be refined through further consultation on an exposure draft of the Code. This will help ensure the provisions are effective and workable.
- The Bill requires that the Code be reviewed by the Commission within two years of the Code coming into force. This provides an opportunity to assess its effectiveness and test for unintended consequences.
- The Commission is able to amend the Code at any time after it comes into force, allowing it to address issues which may arise.

Further information on these mitigations are described throughout this RIA.

Submissions on the policy proposal for the Code generally supported our preferred options

Many submissions on the policy proposals for the Code supported our preferred options. However, some submitters were concerned that the Code would not go far enough on certain matters to address the problems identified. We have discounted proposals made by some submitters to include a 'fair-dealings' obligation, and to require 'prompt payments' to suppliers. Feedback received from the major grocery retailers and some suppliers indicated that adopting these options could be costly or difficult to implement and would deviate significantly from the Australian Code.

We will release an exposure draft of the Code and the Commission will review the Code after two years

The Code will:

- complement broader grocery sector reforms underway, including establishing an independent dispute resolution scheme that will be able to investigate and rule on disputes relating to the Code
- apply to the major grocery retailers initially, and to any other grocery retailers that are subject to the Code in future
- be required to be reviewed by the Commission within two years of the Code coming into force.

Approval of the recommended options for the Code will be sought from Cabinet. With Cabinet approval, we will consult on an exposure draft of the Code. Doing so will allow interested parties to comment on the proposed Code and its contents. This will help ensure that the Code is effective and workable.

The Grocery Industry Competition Bill (which will empower the making of the Code) requires the Commission to review the Code within two years of the Code coming into force. The review will provide an opportunity to assess the Code's effectiveness, test for any unintended consequences and make any necessary changes to ensure the Code is achieving the intended benefits.

Limitations and Constraints on Analysis

Our focus is on the details of the Code

On 23 May 2022, Cabinet agreed to establish a mandatory code of conduct and dispute resolution scheme for the grocery sector[CAB-22-MIN-0186 refers]. This decision was based on the Commission's recommendation and analysis from the market study. The accompanying regulatory impact assessment (RIA) analysed options for creating a voluntary, non-enforceable Code.

In this RIA, we are only focused on the detailed requirements to be included in the mandatory code of conduct agreed by Cabinet.

Our proposals for the Code have been developed at the same time as other proposed grocery sector regulatory initiatives

Policy proposals in relation to the Code have been developed at the same time as other proposed grocery sector regulatory initiatives following the market study.

The other proposed regulatory initiatives will significantly influence the shape of the grocery sector in New Zealand. This means there is no stable status quo to compare options for the Code and defining the counterfactual is challenging.

For the purposes of our analysis, we consider that the counterfactual should be based on how the grocery sector reforms likely will evolve if the Code is not implemented. This approach takes into consideration proposed grocery sector regulatory initiatives (e.g. establishing the Commission as the grocery regulator, unit pricing, collective bargaining, unfair contract terms and the quasi-

regulatory wholesale access regime), as well as the enactment of legislation in 2022 to prohibit restrictive and exclusive covenants that restrict the development of competing retail stores.

It may not be possible to consider the interplay between all aspects of these regulatory initiatives or analyse all the unintended consequences of the proposals. Where possible, these have been flagged as risks.

Some of the costs involved are difficult to quantify

Some of the options discussed in this RIA will impose costs on grocery retailers that are subject to the Code (e.g. costs involved in drafting new supply agreements that comply with the Code) and costs to government (e.g. costs involved in monitoring and enforcing compliance of the Code). While we can anticipate where these costs will fall, their monetary value is difficult to quantify.

We have based our options on UK and Australian approaches

The range of options considered in this RIA for the Code is based on the UK Code and the Australian Code.

The New Zealand grocery sector has unique aspects that are not mirrored overseas. These include the extent of imbalances in bargaining power between the major grocery retailers and suppliers and the need to consider the Crown's obligations under Te Tiriti. Our analysis of how tikanga/te ao Māori can be incorporated has been informed by our engagement with iwi and other Māori stakeholders (including Māori producers and suppliers).

Evidence of the specific problems identified have been informed by the Commerce Commission's market study

Most of the problems identified in this RIA have been informed by Commission's market study into the retail grocery sector. This study was comprehensive and included a survey of 126 suppliers in a range of different sectors. This provides a good evidence base for the analysis set out in this RIA.

MBIE's and the Commission's assessments illustrate that there is an imbalance in bargaining power between suppliers and retailers, and that this is leading to poor outcomes. However, in many cases it is difficult to accurately quantify the scale of the individual problems described. The Commission described how some suppliers are reluctant to raise complaints or enforce their rights, due to fear of retribution from the retailer. This makes it difficult to track historic trends in the sector and specifically quantify how widespread these issues are.

Consultation and analysis challenges

Our consultation and analysis has been done in a compressed timeframe. A public consultation document on the Code was released on 6 July 2022 with five weeks provided for submissions. The relatively tight timeframe together with the complexity of the policy proposals for the Code means that some interested parties may not have had sufficient time to make comprehensive submissions. To manage this, we proactively reached out to several stakeholders, including iwi that submitted on the market study, to invite them to make a submission. Several submitters requested and were granted time extensions due to staffing issues and disruptions caused by COVID-19.

Stakeholders that did not get an opportunity to provide comprehensive feedback in 2022 will have a further opportunity to do so during consultation on the exposure draft of the Code.

Nonetheless, we consider that our current analysis gives a reasonable basis for decisions

We are comfortable our current analysis is sufficient for informed decisions to be made on the detailed requirements of the Code.

We consider that our consultations to date, alongside earlier detailed work and consultation done by the Commission as part of the market study, has provided appropriate testing of key details of our proposals for the Code. The proposals for the Code we are recommending have been adapted from tried and tested approaches for grocery supply codes of conduct adopted in similar countries overseas (namely, the UK and Australia). This gives us added confidence that our proposals are proportionate and workable. Though the interplay with other grocery sector reforms is not observable at this time, we have confidence from our and the Commission’s assessments that the new arrangements will effectively complement any other reforms. The Commission will be required to monitor the Code and its interactions with other regulatory reforms in preparation for reviewing the arrangements in two years’ time.

Responsible Manager(s) (completed by relevant manager)

Matthew Mitchell
Manager, Market Performance
Ministry of Business, Innovation and Employment



29 March 2023

Quality Assurance (completed by QA panel)

Reviewing Agency:	The Ministry of Business Innovation and Employment (MBIE)
Panel Assessment & Comment:	<p>The Ministry of Business, Innovation and Employment’s Quality Assurance panel has reviewed the Regulatory Impact Assessment (RIA) <i>Grocery Supply Code of Conduct</i> prepared by the Ministry of Business, Innovation and Employment in March 2023. The Panel considered that the RIA partially meets the quality assurance criteria.</p> <p>The RIA provides a clear understanding of the likely root causes and features giving rise to the problem with the status quo and a clear set of criteria against which to assess a good range of options for the content of the Code of Conduct. Although timeframes for stakeholders to contribute through consultation were limited, the Panel did not consider them notably inconsistent with other government consultation timeframes. The Panel has also been assured that there will be further opportunities for stakeholder input, including through the issuance of an exposure draft.</p> <p>However, a thorough understanding of the scale of the main issues and the impact of the options is limited by the lack of quantifiable information, particularly regarding the incidence and scale of costs and</p>

benefits. This constraint is partially, but not completely, mitigated by drawing on overseas experiences with broadly similar codes in Australia and the United Kingdom. The Panel also noted that further mitigations are proposed to avoid or limit unintended consequences, including the issuing of an exposure draft and a review of the Code of Conduct after two years. The Commerce Commission may, subject to its future consideration, review the effectiveness of the Code in providing fairer negotiation conditions for suppliers and retailers, and whether those conditions have led to better long-term outcomes for consumers in terms of product range, quality and price, and the retail market competition.

Section 1: Diagnosing the policy problem

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

The nature and structure of the market

1. New Zealand's grocery sector includes:
 - 1.1 The three largest grocery retailers, namely, Woolworths New Zealand Limited, Foodstuffs North Island Limited and Foodstuffs South Island Limited (**the major grocery retailers**). The collective retail grocery market share enjoyed by the major grocery retailers is approximately 80-90%. As vertically-integrated businesses, the major grocery retailers have integrated acquisition, distribution and retail operations. They usually purchase directly from suppliers (e.g. primary producers, manufacturers), rather than through independent wholesalers, and operate their own distribution centres and supply-chain infrastructure such as warehousing.
 - 1.2 Other grocery retailers which includes convenience stores (e.g. dairies and petrol stations), international food supermarkets (e.g. Tai Ping and Japan Mart), other supermarkets (e.g. Moore Wilson's, Bin Inn, Costco), food box and meal kit operators (e.g. Hello Fresh, My Food Bag), online only supermarkets (e.g. Supie) and general merchandisers (e.g. the Warehouse and Kmart).
 - 1.3 Suppliers, most of which are small and number in the thousands, that tend to supply the major grocery retailers nearly exclusively, because of the high market saturation commanded by these retailers.⁴
2. In general, suppliers to the grocery sector want their products to be available to as many consumers as possible. The best way of achieving this is to have their products stocked by the major grocery retailers. For most suppliers, alternative supply channels (such as other grocery retailers) are unlikely to generate sufficient sales volumes to be profitable. While some suppliers (e.g. suppliers of red meat) have access to export markets – which provides them with an alternative avenue to sell their products and affords them greater bargaining power in dealing with the major grocery retailers – those markets are not a viable option for most smaller suppliers.
3. The major grocery retailers have limited shelf space and therefore must decide what products to stock in order to maximise their profits. These decisions are made centrally at the head office level or, in some cases, by individual retail stores.

⁴ Woolworths NZ has over 1,400 suppliers, Foodstuffs North Island approximately 1,850 suppliers and Foodstuffs South Island a little over 1,800 suppliers.

4. The process for deciding to stock a supplier's product begins with negotiation between the supplier and the grocery retailer. If the negotiation is successful, the two parties will reach an agreement on:
 - 4.1 payment or settlement terms
 - 4.2 how the products will be delivered (i.e. direct to store or to a distribution centre)
 - 4.3 the 'list price' of the product and rebates or discounts the supplier agrees to deduct from this list price.

We are responding to the Commerce Commission's market study into the retail grocery sector

5. Competition is a key driver of the price, range and quality of grocery products and services offered to consumers but is currently limited in New Zealand.
6. On 8 March 2022, the Commerce Commission (**the Commission**) released its final report (**the Final Report**) on the market study into the retail grocery sector in New Zealand (**the market study**).⁵ As part of the market study, the Commission consulted widely with industry, consumers, and other stakeholders. It received feedback through 80 written submissions, meetings held with 89 parties, and a survey of 126 grocery suppliers. The Commission stated in the Final Report that:
 - 6.1 the major grocery retailers enjoy high levels of profitability, over and above what would be expected under workable competition
 - 6.2 grocery prices in New Zealand appear high by international standards
 - 6.3 innovation in New Zealand's retail grocery sector is low compared to overseas
 - 6.4 there has been no major new entrant into the retail grocery sector recently.
7. The Ministry of Business, Innovation and Employment (**MBIE**) completed a series of regulatory impact analysis to support proposals for specific regulatory initiatives in the grocery sector as a result of the findings from the market study.⁶ This Regulatory Impact Analysis (**RIA**) in relation to the grocery supply code of conduct (**the Code**) adds to the earlier analyses.

The agreed changes give added depth to the existing regulatory system and will be progressively phased in

8. The proposed regulatory initiatives for the grocery sector complement the existing regulatory system as provided by:
 - 8.1 The Commerce Act 1986, which has as its central purpose the promotion of competition in markets for the long-term benefit of consumers within New Zealand. The Commerce Act protects the process of competition, or if competition is limited, provides for regulation for outcomes that are consistent with competition. It sets

⁵ [Market-Study-into-the-retail-grocery-sector-Final-report-8-March-2022.pdf \(comcom.govt.nz\)](https://www.comcom.govt.nz/Market-Study-into-the-retail-grocery-sector-Final-report-8-March-2022.pdf).

various prohibitions, including around anticompetitive conduct involving the use of substantial market power.

- 8.2 The Fair Trading Act 1986, which includes protecting vulnerable businesses against unconscionable conduct and unfair contract terms for eligible business-to-business contracts. For eligibility, contracts must, however, have an aggregate annual value of under \$250,000. The Code will build on these existing protections, where applicable, with clearer specifics on acceptable conduct.

The Grocery Industry Competition Bill includes other changes, mostly in line with the Commission's recommendations from the market study, and are complementary to the proposed Code:

- **Strengthened oversight, monitoring and reporting arrangements.** The Bill adopts new oversight arrangements for the retail grocery sector. The changes give the Commission new responsibilities for general oversight, monitoring and reporting on the performance of the retail grocery sector, as well as specific enforcement responsibilities, including for breaches of the Code. The Bill also sets a programme of review work for the Commission, as a check on particular changes, including a scheduled review of the Code within two years of it coming into force.
- **New wholesale market access arrangements.** The Bill includes changes setting procedural requirements for regulated grocery retailers to negotiate agreements to supply other grocery retailers with wholesale products in good faith. The changes also include a backstop option for regulated wholesale access, if particular conditions are not met.
- **New dispute resolution arrangements.** The changes will set up a low-cost, independent disputes scheme to investigate and rule on disputes relating to the Code or conduct in relation to negotiations for wholesale supply access. The dispute resolution scheme may make binding decisions on particular conduct, for claims under \$5 million.
- **Requiring the consistent display of unit pricing.** Regulated grocery retailers will be required to meet uniform standards for unit pricing information to enable easier cross-comparisons of grocery prices by consumers.
- **Collective bargaining exemptions.** The Bill sets a new exemptions pathway to allow suppliers the ability to collectively negotiate with grocery retailers in certain circumstances, without breaching prohibitions under the Commerce Act.
- **Strengthened business-business unfair contract terms protections.** The Bill includes adjustments to broaden protections against unfair contract terms to include higher value contracts (up to \$1 million in aggregate, an increase from \$250,000 previously). The changes will also allow grocery businesses to take private action and for the grocery regulator to take proceedings in relation to unfair contract terms.

We anticipate the Bill will be passed in mid-2023.

What is the policy problem or opportunity?

The root cause of the problem is the imbalance in negotiating power between grocery retailers and suppliers

9. The imbalance in negotiating power between the major grocery retailers and their suppliers is causing:
 - 9.1 suppliers to accept unfavourable supply terms and conditions, including costs and risks that the major grocery retailers are best placed to manage
 - 9.2 inadequate transparency and certainty for suppliers about the terms and conditions of supply.
10. This is evidenced by the majority of suppliers who submitted on MBIE's discussion document, who outlined a number of specific costs and risks that they are frequently forced to accept and the effects that the lack of transparency and certainty has on their businesses. This impacts suppliers' ability to innovate and develop new grocery products. It also limits their ability to provide competitive supply terms to other grocery retailers. Ultimately, poor supply terms and conditions has resulted in some suppliers being forced to exit the market, as attested to by some submitters on our consultation document relating to proposals for the Code. This contributes to higher grocery prices and limits the range of products available to consumers.

Pronounced effects for Māori and fresh food suppliers

11. Suppliers of fresh produce are particularly vulnerable to the misuse of market power by the major grocery retailers. Fresh produce is highly perishable – suppliers cannot pause production because demand is low or prices are considered to be too low. Therefore, fresh produce suppliers are limited in their ability to delay or withhold supply while seeking to negotiate better supply terms. They are also more vulnerable when grocery retailers make decisions to delist produce and may also be more vulnerable to any retaliatory measures that retailers may take.
12. Māori have a prominent role in the primary sector both as growers and suppliers of produce, owning 50% of the fishing quota and a significant proportion of beef, lamb, sheep, dairy and kiwifruit production. The National Māori Authority noted the the grocery sector is not working well for Māori suppliers as retailers are able to use their buyer power in negotiations to the detriment of all suppliers, including Māori. It also noted that there are very few people with Māori heritage who have senior roles in the governance and management of supermarkets, and therefore, Māori interests may not be protected. In addition, the knowledge of production processes that underpins Māori suppliers' products may be a taonga or cultural treasure. Despite this, the information may not be legally classified as intellectual property and therefore may not receive protection under intellectual property laws.

Symptoms of the problem

13. In this RIA we consider options to address specific issues related to both parts of the problem definition (costs and risks imposed on suppliers and a lack of certainty about supply terms and conditions). As a result of imbalances in bargaining power, the Commission identified a number of specific problems in the market study.

- 13.1 **Supply terms are not always clear.** Currently, there is no legal requirement for supply agreements to be in writing or contain any minimum content. Some arrangements between suppliers and grocery retailers can be relatively informal and lack clear documentation setting out the terms and conditions of supply. This risks suppliers not having adequate transparency and certainty about the terms and conditions of supply. It also leaves suppliers vulnerable to renegotiation of supply contracts, which may involve the unreasonable transfer of costs and risks to suppliers. As grocery sector regulatory reforms progress, it may also make dispute resolution less effective, as suppliers may not be able to raise disputes related to breaches of supply agreements.
- 13.2 **Unilateral and retrospective variations to supply agreements are causing uncertainty and added costs and risks for suppliers.** Unilateral and retrospective variations can be used by one party to a supply agreement to the detriment of the other party. Because of the imbalance in negotiating power, unilateral and retrospective variations are more frequently made by the major grocery retailers. Such variations provide the retailers with an avenue to transfer costs and risks to suppliers and can create uncertainty for suppliers.
- 13.3 **Suppliers may be required to use the grocery retailer's logistics and transport services to deliver goods.** Requiring a supplier to use those services can increase the grocery retailer's profits, at the expense of the supplier. It may also make the supply chain less flexible.
- 13.4 **Suppliers frequently face extended timeframes for invoices to be paid.** Receiving prompt payment is critical to the cash flow of businesses and the timing of payments impacts the ability of a business to invest and grow. The Commission heard that some suppliers wait for up to 60 days for invoices to be paid by grocery retailers. Some supply agreements may include terms with more prompt payments, but these involve accepting a greater settlement discount, which can be in the order of 10%. Many small suppliers reported spending time chasing late payments and searching for alternative sources of funds.
- 13.5 **Set offs against payments create unpredictability and can be perceived as unfair.** Set offs are when a grocery retailer deducts any amount it is owed by a supplier before paying the supplier's invoice. The Commission heard that some suppliers considered set-off practices are unjustified or unclear and result in them receiving smaller payments than expected. However, set offs may have administrative efficiencies since they reduce the number of payments between a supplier and retailer.
- 13.6 **Suppliers can face added costs from retailer charges for shrinkage and wastage.** Shrinkage is the loss of products due to theft or accounting error that occurs after the grocery retailer has taken possession of them. Wastage refers to products that are unfit for sale due to damage or rotting. Suppliers are often expected to meet at least part of the cost of shrinkage and wastage that occurred after the retailer has taken possession of the products, through either a fixed deduction off invoices referred to as a minor damage allowance (MPA) or damaged product allowance (DPA). Despite these payments, the Commission heard of grocery retailers requesting payments for stock not located during a stock count (shrinkage) or stock that was damaged or spoiled (wastage) despite having no evidence that the damage

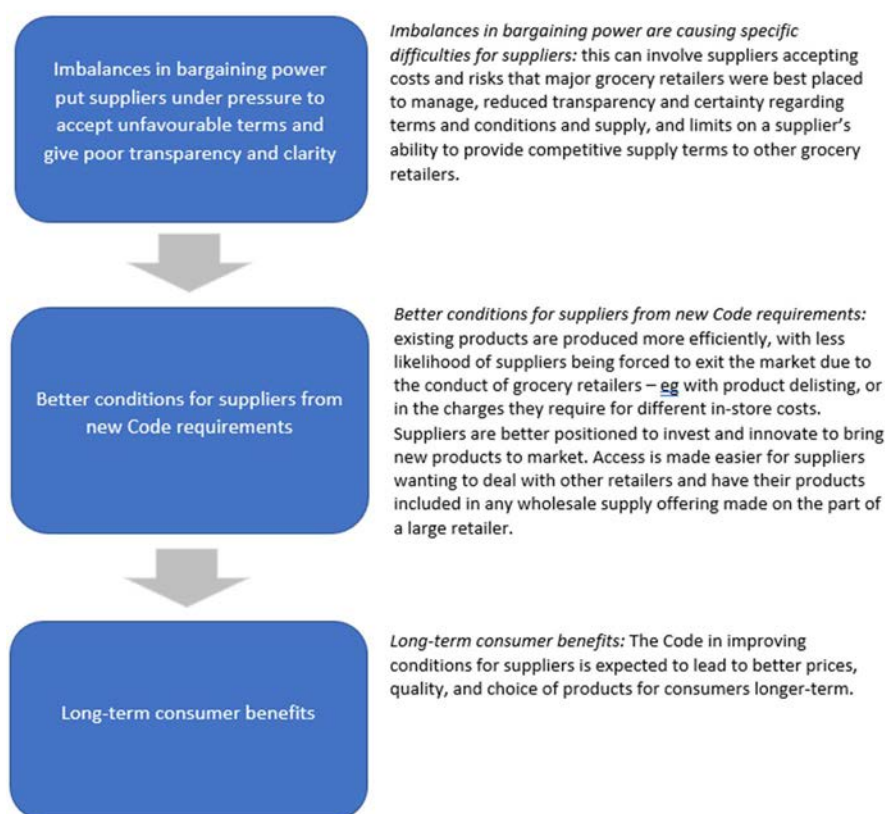
occurred during the supply process. As grocery retailers are likely best placed to manage the risk of shrinkage (in all circumstances) and wastage (in most circumstances), placing the burden on suppliers creates an inefficient transfer of costs and risks.

- 13.7 **Suppliers may face added costs from retailer charges for merchandising and promotional activities, or may be charged as a condition of being a supplier.** Promotional buying is when a grocery retailer and supplier agree to a number of promotions over a period of time, or on a case-by-case basis. The retailer may purchase stock from the supplier at a reduced price in order to pass the saving on to consumers during a promotion. The Commission heard that the costs involved in running such promotions fall disproportionately on suppliers, despite both retailers and suppliers benefitting from such promotions.
- 13.8 **Product ranging and shelf allocation, range reviews and delisting can create added costs and uncertainty for suppliers.** ‘Product ranging’ refers to decisions made by grocery retailers about which products to stock. ‘Shelf allocation’ is about where stock is placed in a retail store. ‘Delisting’ refers to the decision by a grocery retailer to stop stocking certain products. These decisions are critical issues for suppliers, however the Commission heard that such decisions can be made with little or no notice and without clear justification. This creates a lack of certainty that ultimately reduces efficiency in the supply of groceries.
- 13.9 **Suppliers of fresh produce face particular challenges.** The Commission found that fresh produce suppliers are particularly vulnerable to the major grocery retailers using their superior bargaining power. Fresh produce is highly perishable. Once grown, the supplier has little ability to hold supply while seeking to negotiate better terms or find alternative buyers if the major grocery retailer decides to delist their product. Due to this, some growers (and former growers) indicated they could no longer sustain the uncertainties and costs involved in growing fresh produce and were forced to leave crops unharvested.
- 13.10 **Suppliers often face significant delays when renegotiating prices with retailers.** Suppliers have raised concerns about the process for re-negotiating prices they charge grocery retailers. The Commission heard that there can be significant delays between requesting a price increase and the retailer responding, with the process sometimes taking months. This can cause difficulties for the supplier, particularly where the supplier is unable to negotiate an increase in their prices to reflect legitimate cost increases. In turn, this can drive suppliers to lower the quality of the products offered, for example by reducing the package size or using lower quality inputs. In other cases, it may put the viability of the business at risk.
- 13.11 **A supplier’s confidential information, intellectual property, freedom of association may not always be protected.** Some suppliers told the Commission of their concerns that grocery retailers have shared, or may share, confidential information or intellectual property with their own private labels. This potentially reduces incentives for suppliers to invest and innovate in new grocery products. For some Māori suppliers, the knowledge around production processes that underpins their products may be a taonga or cultural treasure. Despite this, the information may not be legally classified as intellectual property and therefore not protected under existing intellectual property laws.

Without a Code, we anticipate that conditions for suppliers would not improve, leading to poorer outcomes for consumers than if a Code was imposed.

14. Other regulatory initiatives included in the Grocery Industry Competition Bill, including establishing the Commission as the new grocery regulator, the wholesale access regime, enabling collective bargaining between suppliers, and addressing unfair contract terms, will progress independently of the Code. There is also work underway on mandatory unit pricing, which will be enacted as regulations provided for under the Fair Trading Act 1986. Most of these regulatory initiatives are focused on New Zealand consumers, with the aim of achieving lower grocery prices and a better quality and range of product offerings. The Code is unique among these reforms as it focuses primarily on the relationship between grocery retailers that are subject to the Code and suppliers, however, with the overall aim of promoting the long-term interests of consumers.
15. In June 2022, Parliament passed the Commerce (Grocery Sector Covenants) Amendment Act. This new law bans restrictive land covenants and exclusive covenants in leases used by grocery retailers to impede the development of land or use of a site for a competing retail store.
16. Due to the pace of the regulatory work currently underway, defining the counterfactual is challenging. For the purposes of this RIA, we consider the counterfactual to be the scenario where other regulatory initiatives underway progress as intended, but a Code is not implemented. We expect the other initiatives will improve competition in the retail grocery sector (for example, by enabling grocery retailers to acquire products at wholesale under the wholesale access regime) and require the Commission to regulate the grocery sector. Mandatory unit pricing will also increase price transparency, and thus, allow consumers to make informed purchasing decisions.
17. However, aside from the Code, the regulatory initiatives do not primarily focus on improving conditions for suppliers. As a result, the counterfactual will not address the effects on suppliers of imbalances in bargaining power between them and grocery retailers. Although some regulatory initiatives (e.g. collective bargaining between suppliers and addressing unfair contract terms) may provide some protections, we consider that these may be inadequate, and suppliers will continue to experience uncertainty about the terms and conditions of supply. As previously noted, we have heard of instances where poor supply conditions have threatened the business viability of suppliers with some even being forced to exit the market.
18. Poor supply conditions for suppliers ultimately affect grocery consumers. They reduce the incentive for suppliers to innovate and invest in new grocery products, resulting in poorer quality and a smaller range of products offered at supermarkets. In the longer term, poor conditions for suppliers may lead to supply shortages as suppliers are forced to exit the market, which can lead to higher prices at the checkout.
19. Figure 1 below summarises how we expect consumers and suppliers will gain from the new Code.

Figure 1: Intervention logic for developing a Code



Objectives of the Code:

20. The broad aims of the Code align with the overall aims of the Government's response to the market study, which is to promote competition and efficiency in grocery markets for the long-term benefit of consumers, and to contribute to a trading environment in which businesses can participate confidently.
21. The Code has two supporting objectives to achieve these dual aims of better trading conditions and improved pricing, quality and choices for consumers:
 - 21.1 **Objective A:** Preventing retailers from passing on costs and risks to suppliers that they are better-placed to manage.
 - 21.2 **Objective B:** Creating more transparency and certainty for suppliers about the terms and conditions of supply.

Trade-offs between objectives

22. There are, however, trade-offs between the specific objectives that the Code seeks to address and the overall aims of the Government's response to the market study.
23. The regulatory initiatives underway for the grocery sector aim to improve the prices, quality and range of groceries offered to New Zealanders, and ultimately to ensure that New Zealanders get a fairer deal at the checkout. While the objectives of the Code are to improve conditions for suppliers, achieving these objectives may come with unintended consequences.

24. For instance, the Code may directly increase costs for regulated grocery retailers due to them needing to renegotiate supply agreements. There is a risk that these costs may be passed on to consumers, contributing to higher grocery prices. There is also a risk that high compliance costs could disincentivise grocery retailers from creating new relationships with suppliers.
25. However, if the Code's intended objectives are achieved, the Code will support better conditions for suppliers which will enable more innovation and create incentives for suppliers to invest in new and better products for supermarket shelves. While we expect this will improve the quality and range of products on offer to consumers, the link between the Code and lower grocery prices is less clear.
26. Where options discussed in this RIA are likely to create additional costs to grocery retailers, we have flagged the risk that these costs may be passed on. We have also considered the interplay between the Code and other regulatory initiatives underway for the grocery sector. Progressing the other initiatives may help mitigate some of these risks.

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

Focus of this regulatory impact assessment

27. This RIA discusses options for what a Code could require, considers how prescriptive the Code should be and assesses whether there are any risks of unintended consequences involved with the preferred options. The aim of the analysis is to ensure that the Code is as effective as possible in addressing the specific issues resulting from the imbalances in bargaining power between suppliers and regulated grocery retailers, while minimising costs and unintended consequences.

Criteria used to compare options to the status quo

28. We have used the following criteria to compare the different options. The criteria are weighted equally.
 - 28.1 **Effectiveness (Objective A)** – the ability of the option to prevent the major grocery retailers from passing costs and risks to suppliers that they are better-placed to manage
 - 28.2 **Certainty (Objective B)** – the ability of the option to provide the major grocery retailers and suppliers with certainty about what conduct is required of them, what costs are involved and what remedies are available
 - 28.3 **Durability** – the flexibility of the option to adapt to changes in grocery markets over time, including consideration of whether the option reflects best regulatory practice
 - 28.4 **Costs** – the potential of the option to impose additional costs on the major grocery retailers, suppliers, or others (see also the combined cost benefit analysis at page 56).
 - 28.5 **Risks** – the potential of the option to result in unintended consequences.
29. For clarity and conciseness, these criteria are kept focussed on effectiveness and certainty as initial steps to better longer-term consumer outcomes. We expand on consumer-level impacts in our overall assessments.

What scope will options be considered within?

30. In considering options for the Code, we have looked closely at relevant Codes in the United Kingdom and in Australia. We have also considered how a Code here could reflect conditions that are unique to New Zealand, including how it could reflect tikanga Māori.
31. The UK Code was put in place in 2009, following a market study and is mandatory for grocery retailers whose annual revenue is greater than £1 billion.
32. The Australian Code was implemented in 2015 and its design was developed in light of the UK Code. Unlike the UK Code, the Australian Code is voluntary. However, the Australian Government has indicated that grocery retailers with an annual revenue of \$5 billion or more or that have a market share of 5% of grocery sales in Australia should sign up for the Australian Code.

The Australian Code has been reviewed and found to be beneficial

33. The Australian Code was independently reviewed in 2018. The review found that the Australian Code has made a positive contribution to improving the relationship between retailers and has been effective in addressing harmful behaviours that had previously been reported by suppliers in the past. While the Australian Code was initially co-designed by government and the grocery industry, it was revised in 2020.

What options are being considered?

Broad options for developing a Code:

34. Four broad options for the Code have been identified:
 - 34.1 **Option A:** Maintaining the status quo/counterfactual. This base-case for our assessments builds in broader new reforms and a new Code of some form, as agreed changes. For consistency with these decisions, our assessments in certain instances (ie in assessing overarching obligations for a Code) consider different options for change rather than a continuation of the status quo.
 - 34.2 **Option B:** A high-level, principle-based code similar to the UK Code.
 - 34.3 **Option C:** A prescriptive code, which uses the Australian Code as a starting point and contains some provisions from the UK Code.
 - 34.4 **Option D:** An alternative code which builds on Option C but includes other provisions which may be of relevance to New Zealand's circumstances.
35. The analysis in this RIA discusses details of the options above across different component elements, targeting the specific problems we are aiming to address (as set out in paragraphs 13.1-13.11 above). These different component elements are:
 - 35.1 overarching obligations of the Code
 - 35.2 requirements for supply agreement contents and requirements which limit unilateral and retrospective variations to supply agreements

- 35.3 requirements to limit the ability of grocery retailers to require suppliers to use a particular transport or logistics service
- 35.4 requirements prescribing timeframes for payments and limiting set offs against payments
- 35.5 requirements to limit the ability of grocery retailers to pass on certain costs (shrinkage, wastage and merchandising/promotion costs) to suppliers
- 35.6 requirements for minimum standards for fresh produce, product ranging, shelf allocation and delisting of produce, and to apply these standards without discrimination
- 35.7 requirements to protect suppliers' confidential information and intellectual property, including recognition of taonga.

Component 1 – Overarching obligations of the Code

Context

- 36. An overarching obligation translates the intent of the Code into an expectation on the conduct of grocery retailers that are subject to the Code. We considered overarching obligations which are linked to concepts of 'good faith' and 'fair dealings'.

Good faith

- 37. Good faith is best known in relation to employment matters and has four elements:
 - 37.1 Must not act in a misleading or deceptive way.
 - 37.2 Must be responsive and communicative.
 - 37.3 Must give the affected parties sufficient information when they need it and a proper opportunity to comment.
 - 37.4 Must treat others fairly using common sense.

Fair dealings

- 38. Fair dealings is a less commonly used term and may be harder to implement. It is used in New Zealand copyright law, but we consider this usage is not highly transferrable to the Code.
- 39. The Australian Code includes a fair dealings concept in disputes (section 35(9)). The scope of this concept requires consideration to be given to the characteristics of the supplier that were, or should have been, known.
- 40. The UK Code relies primarily on fair dealings, and includes two key elements:
 - 40.1 Fairness between the designated grocery retailer and supplier, recognising the supplier's need for certainty in relation to the risks and costs of trading
 - 40.2 Fair treatment of different suppliers by the designated grocery retailer, where the designated retailer must avoid discrimination or distinction between different suppliers.

41. The UK Code also explicitly states that fair dealings includes a requirement to act in good faith, which highlights the overlap between the two terms.

Issues

42. Good faith is an overarching obligation in the Australian Code⁷. A 2018 review of the Australian Code suggested that good faith has more connotations of ‘fairness of process’ (i.e. the behaviour of the parties in a transaction), while fair dealings may have more scope to consider ‘fairness of outcomes’ (including the results of a transaction).
43. From an operational perspective, a good faith principle should be understood and easier to implement. However, the definition used in the Australian Code is more detailed than the definition used in the New Zealand Employment Relations Act 2000. The Australian Code describes a range of specific conduct that is not considered to comply within the good faith principle.

Commission’s recommendation

44. The Commission recommended in the market study an overarching principle-based obligation of good faith, similar to the Australian Code. But it recognised that the UK Code has a principle of fair dealing, and that the two concepts have some overlap.

Options around overarching obligations:

Option 1– Counterfactual

45. Under the counterfactual, the Code would have an overarching obligation of good faith, however, the concept of good faith would not be further defined. Such a Code would rely on the broad definition of good faith as it is commonly used in New Zealand employment law and collective bargaining.

Option 2 – Principle-based Code with good faith obligation only

46. Under Option 2, the Code would include an obligation for grocery retailers to act in good faith. Good faith is defined in the Australian Code and includes a range of conduct that is not considered good faith.
47. Under this option, a grocery retailer that is subject to the Code must:
 - 47.1 not put the supplier under duress
 - 47.2 not retaliate against the supplier
 - 47.3 be responsive and communicative
 - 47.4 provide information in time for suppliers to respond
 - 47.5 generally engage in the trading relationship in good faith.

⁷ <https://www.accc.gov.au/business/industry-codes/food-and-grocery-code-of-conduct/acting-in-good-faith-under-the-food-and-grocery-code#about-the-obligation-to-act-in-good-faith> provides more information about how good faith is defined and used in the Australian Code.

48. Suppliers could also be required to act in good faith. Although suppliers would not be bound by obligations under the Code, supplier conduct could be taken into consideration when determining whether a grocery retailer had acted in good faith.

Option 3 – Prescriptive Code with broader good faith obligation (MBIE preferred option)

49. Option 3 would include an obligation to act in good faith and would include certain elements of fair dealings. In addition to the requirements listed in paragraphs 47.1-47.5 above and described in Option 2 above, the grocery retailer would be required to:

- 49.1 avoid discrimination or distinction between suppliers
- 49.2 recognise the supplier's need for certainty around the risks and costs of trading.

50. Suppliers could also be required to act in good faith, and this would be a consideration when determining whether a grocery retailer had engaged in good faith.

Option 4 – Code with both good faith and fair dealings obligations

51. Option 4 would include an obligation to act in good faith and engage in fair dealings. In addition to Option 3 above, the grocery retailer would be required to:

- 51.1 consider the nature of the relationship between the retailer and supplier
- 51.2 consider the individual characteristics of the supplier that are, or should be, known.

Stakeholder views

52. Both major grocery retailers stated that they preferred a good faith obligation only. They also stated that suppliers should be required to act in good faith. Foodstuffs considered that good faith was a well understood term and created minimal risks. Woolworths NZ considered that 'fair dealings' would be unworkable as 'fairness' is inherently subjective. Furthermore, that a fair dealings obligation would not align with the objective to improve dealings between grocery retailers and suppliers or protect the interests of consumers. However, many other stakeholders that made submissions (particularly growers of fresh produce) were concerned that good faith obligations do not go far enough and have not served growers well in the past. These stakeholders considered that any good faith obligation would need to be specifically defined in the Code and should include any dispute resolution mechanisms available.
53. Two parties (both suppliers) submitted that they preferred that the Code set an overarching good faith obligation with some elements of fair dealings, as they considered that this mirrors most closely the Australian Code.
54. Almost two thirds of suppliers that submitted would prefer that the Code sets an overarching fair dealings obligation. These suppliers considered that this would be most effective in addressing the problems caused by the existing imbalances in bargaining power between suppliers and grocery retailers and is aligned with supporting the long-term interests of consumers. Stakeholders also provided feedback that this option is most suited to consider factors unique to New Zealand's economy, such as Māori economic development priorities, and that avoiding discrimination between suppliers is key to the Code's effectiveness.

Overarching obligations of the Code – how do the options compare to the status quo/counterfactual?

Criteria	Option 1 – Counterfactual (good faith principle not defined)	Option 2 – Principle-based code, good faith obligation only	Option 3 – Prescriptive code, good faith obligation with some elements of fair dealings (preferred option)	Option 4 – Good faith and fair dealings obligations code
Effectiveness	0 ‘Good faith’ as it is defined in New Zealand employment law is unlikely to prohibit the range of behaviour that we seek to address. Suppliers would be reliant on other aspects of grocery regulatory initiatives underway, such as collective bargaining and extension of unfair contract terms.	+	++ This option has a stronger good faith obligation than Option two and is therefore likely to be more effective in prohibiting a range of conduct that the Code seeks to address.	++ This option would require grocery retailers to consider the nature of the relationship between the retailer and supplier and the individual characteristics of the supplier that are or should be known. While it is likely to be effective in prohibiting a range of conduct, it is not clear whether it is more effective than Option 3.
Certainty	0 This option will not improve transparency or certainty for suppliers as it does not define what conduct is considered to be in good faith.	0/+ Does not significantly improve certainty or transparency as it will not prohibit a range of conduct that the Code seeks to address.	++ This option specifically includes non-discrimination and distinction between suppliers and requires grocery retailers to recognise suppliers’ need for certainty. It aims to bring additional certainty benefits to suppliers, compared to Options 1 and 2.	+ This option is likely to create more certainty for suppliers compared to Options 1 and 2. Due to the additional complexity of this option and the risk of test cases, it is likely to create less certainty than Option 3.
Costs	0 This option is simpler than the other options and will not impose costs on retailers. As now, suppliers will continue to face inefficient transfers of costs and risk.	0 This option is simpler than the other options and will not impose more costs on retailers than the counterfactual. A good faith obligation is easy to implement and may be less costly over time. Supplier costs are likely to be reduced at the margins.	0 Compliance with non-discrimination obligations may create minor costs to grocery retailers but also lower costs for suppliers.	- More detailed provisions may add extra costs to grocery retailers to set up and monitor the changes, and meet the costs of potentially greater disputes. Could also create short-term costs to suppliers if test cases are brought to the dispute resolution scheme, however in the long term, this option is likely to result in more efficient cost sharing overall between suppliers and retailers.

Criteria	Option 1 – Counterfactual (good faith principle not defined)	Option 2 – Principle-based code, good faith obligation only	Option 3 – Prescriptive code, good faith obligation with some elements of fair dealings (preferred option)	Option 4 – Good faith and fair dealings obligations code
Risks	0 Not defining good faith may make dispute resolution less effective.	+	-	--
Overall assessment	0 Unlikely to be effective in protecting suppliers from unfavourable terms or increasing certainty, relies on other aspects of grocery regulatory initiatives underway. This option is only marginally effective at addressing the problems identified, and therefore would only have limited benefits to suppliers and limited flow-on benefits to consumers.	+	++	0/+

Key for qualitative judgements in tables:

- ++ much better than doing nothing/the status quo/counterfactual
- + better than doing nothing/the status quo/counterfactual
- 0 about the same as doing nothing/the status quo/counterfactual
- worse than doing nothing/the status quo/counterfactual
- much worse than doing nothing/the status quo/counterfactual

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

55. Option 3 (good faith obligation and selected elements of fair dealings) is likely to best meet the criteria. The option:
- 55.1 has an overarching good faith obligation, which is relatively well-understood and should be easy to implement
 - 55.2 defines what factors should be considered when determining whether a grocery retailer has acted in good faith, similar to the Australian Code. By adopting this definition, the option will help ensure that the Code addresses conduct that has been identified as problematic in Australia
 - 55.3 includes limited aspects of fair dealings, as defined in the Australian Code
 - 55.4 provides protections to suppliers, while not undermining the objective of promoting competition in markets for the long-term benefit of consumers
 - 55.5 comes with a relatively low risk of inappropriately rebalancing the negotiating power in a way which results in poorer outcomes.

Component 2 – Content of supply agreements and unilateral and retrospective variations

Context

56. Supply agreements in the grocery sector are agreements that set out the terms and conditions of trade between grocery retailers and suppliers. While some supply agreements are well documented with clear terms and conditions, others may be informal and unwritten.
57. A unilateral variation is a change made to a supply agreement that does not require the consent of the other party. Requiring suppliers to use a particular logistics service (such as an inhouse logistics service or another service that provides a payment to the retailer) is an example of a unilateral variation that major grocery retailers may impose on suppliers.
58. A retrospective variation is a unilateral change that modifies something in the past. Both unilateral and retrospective variations can be made by one party to the supply agreement to the detriment of the other party. Because of the imbalances in the bargaining power between suppliers and the major grocery retailers, such variations are more frequently made by the retailers.
59. Both the UK Code and the Australian Code limit the use of unilateral and retrospective variations. The UK Code requires parties to give reasonable notice before making a unilateral variation and prohibits retrospective variations, except where they are specifically provided for in supply agreements. In contrast, the Australian Code prohibits all retrospective variations. It also prohibits unilateral variations, except where the relevant provisions are set out in supply agreements with sufficient detail.

Commission's recommendation

60. The Commission recommended in the market study that all supply agreements should be in writing, provided to the supplier and kept by the grocery retailer for as long as the agreement is active. It also recommended that all supply agreements should, at a minimum, contain the following information:

- 60.1 any quantity standards (such as minimum supply volumes)
 - 60.2 any quality standards
 - 60.3 any delivery requirements set by the grocery retailer
 - 60.4 when groceries may be rejected
 - 60.5 the maximum period for payment
 - 60.6 circumstances when payment may be withheld, or deductions made.
61. The Commission further recommended that if unilateral variations were to be permitted, they should only be permitted in certain limited circumstances. The Commission also indicated that retrospective variations are unlikely to be justifiable.

Options around the content of supply agreements, unilateral and retrospective variations and pressure to use a particular logistics service

Option 1– Counterfactual (no requirement for written supply agreements)

62. Under the counterfactual, supply agreements could continue to be either verbal or written. The content of the supply agreement would be negotiated between the parties and no minimum content would be required. Unilateral and retrospective variations would be allowed if the supply agreement permitted them.

Option 2 – Requirement for agreements to be written, no limitation on content of agreement

63. Option 2 builds on the Commission’s recommendations for supply agreements to be written in plain English and provided to the supplier. Under this option, the supply agreement would need to be held by the grocery retailer for up to a year after it expires (this is in line with the UK Code). The contents of the supply agreement would be negotiated between the supplier and grocery retailer and could allow for unilateral and retrospective variations.

Option 3 (Principle-based Code) – Requirement for agreements to be written, retrospective variations to agreements prohibited

64. Option 3 incorporates the Commission’s recommendations for supply agreements to be written in plain English, provided to the supplier, and held by the grocery retailer for at least a year after the agreement expires. In addition, the Code would contain high-level principles which supply agreements must align with. Retrospective variations would be prohibited, and retailers would be required to give reasonable notice before unilateral variations are made. Dispute resolution mechanisms would be available to determine breaches of supply agreements and supply agreements that do not align with the principles of the Code.

Option 4 (Prescriptive Code) – Requirement for agreements to be written and contain minimum content, retrospective variations to agreements prohibited, unilateral variations limited

65. Option 4 incorporates the Commission’s recommendations for supply agreements to be written in plain English and provided to the supplier. This option would require the agreement to be held by the grocery retailer for up to seven years after it expires (the Australian Code requires supply agreements to be held for six years, however, seven years broadly aligns with New Zealand’s tax law). Supply agreements would need to contain the minimum content recommended by the Commission as well as details of the duration of the agreement and termination process.

66. In line with the Australian Code, unilateral variations would be prohibited except where:
- 66.1 the ability to unilaterally vary the arrangement is specifically set out in the supply agreement with sufficient detail; and
 - 66.2 the variation is reasonable given the circumstances; and
 - 66.3 sufficient notice of the unilateral variation is given to the other party.
67. Retrospective variations would be prohibited in all circumstances.

Option 5 (Alternative Code) – Option 4 plus retailers prohibited from pressuring a supplier to use a particular logistics service (MBIE preferred option)

68. Option 5 is similar to Option 4 and incorporates all of the Commission’s recommendations. In addition, this option would also prohibit a grocery retailer from pressuring or requiring a supplier to use their own logistics services or a third party’s service, unless the service is lower cost than the supplier’s preferred service provider or the supplier’s preferred service provider does not meet service standards.

Stakeholder views

69. All parties that made submissions on the Code consultation document supported requiring supply agreements to be written in plain English and most considered that all supply agreements should contain the minimum content recommended by the Commission. Woolworths NZ expressed some general reservations about the Commission’s recommendations. It noted that the grocery industry is fast-paced and stated that the Code needs flexibility to respond to ‘ever-changing customer needs, external factors such as inflation, logistical challenges and opportunities, and therefore ‘New Zealand would not be best served by an industry constrained by overly prescriptive protocols’.
70. All submissions supported prohibiting retrospective variations in all circumstances and limiting unilateral variations. One supplier considered that unilateral variations should be prohibited in all circumstances.
71. Almost all submissions supported prohibiting grocery retailers from requiring or pressuring suppliers to use a particular logistics service. Only Foodstuffs expressed concerns about this proposal. It considered that retailers should retain the ability to operate an efficient supply chain, and that in-house logistics services are crucial to this.

Content of supply agreements – how do the options compare to the status quo/counterfactual?

Criteria	Option 1 (Counterfactual) – No requirement for written supply agreements	Option 2 – Written agreements, no minimum content	Option 3 – Supply agreements must be written and contain minimum content, retrospective variations prohibited	Option 4 – Option 3 plus more prescriptive minimum content, unilateral variations limited	Option 5 – Option 4 plus grocery retailers prohibited from requiring suppliers to use a particular logistics service (preferred option)
Effectiveness	<p>0</p> <p>Work underway on unfair contract terms may provide some protections for suppliers, though does not enable dispute resolution.</p>	<p>0</p> <p>Does not reduce costs and risks to suppliers from unilateral or retrospective variations. Enables some dispute resolution.</p>	<p>+</p> <p>Will reduce the likelihood that suppliers face unexpected costs and risks due to retrospective variations. Enables dispute resolution.</p>	<p>++</p> <p>Will provide suppliers with protection from unreasonable unilateral variations that impose costs and risks. Enables dispute resolution.</p>	<p>++</p> <p>Will provide suppliers with protection from unreasonable unilateral variations that impose added costs and risks. In addition, prohibits grocery retailers from requiring suppliers to use, for example, a particular logistics service. Enables dispute resolution.</p>
Certainty	<p>0</p> <p>Will not increase certainty for suppliers. Relies on suppliers having knowledge and understanding of other grocery sector regulatory reforms.</p>	<p>0/+</p> <p>Requiring supply agreements to be written will result in more certainty for suppliers. However, without requiring minimum content, some of these written agreements may not materially increase certainty in trading relationships between suppliers and retailers.</p>	<p>+</p> <p>Minimum content in grocery supply agreements will give suppliers upfront certainty about the terms of supply.</p>	<p>++</p> <p>Clear minimum content in grocery supply agreements will give suppliers upfront certainty about the terms of supply. Limiting unilateral and retrospective variations will provide additional certainty.</p>	<p>++</p> <p>Clear minimum content in grocery supply agreements will give suppliers upfront certainty about the terms of supply. Limiting unilateral and retrospective variations and restrictions that requiring the use of, for example, particular logistics services will provide additional certainty.</p>

Criteria	Option 1 (Counterfactual) – No requirement for written supply agreements	Option 2 – Written agreements, no minimum content	Option 3 – Supply agreements must be written and contain minimum content, retrospective variations prohibited	Option 4 – Option 3 plus more prescriptive minimum content, unilateral variations limited	Option 5 – Option 4 plus grocery retailers prohibited from requiring suppliers to use a particular logistics service (preferred option)
Costs	0 No direct costs to regulated grocery retailers. Costs unchanged for suppliers.	0/- Minimal direct costs to regulated grocery retailers as contracts may only require minimal redrafting. Broadly similar costs to now for suppliers.	0/- Will involve transitional and minor long-term costs to regulated grocery retailers. May be costlier for regulated retailers than other options as there will be additional costs with working out the content of supply agreements. Marginally reduced costs for suppliers.	0/+ Will involve transitional and minor long-term costs for regulated grocery retailers. Reduced costs for suppliers.	+ The greater protections in this option may come with marginally higher compliance costs, than Option 4, but costs for suppliers will likely be further reduced.
Risks	0/- No direct risks. May make grocery sector regulatory reforms and dispute resolution less effective.	0 No direct risks	- Risk that costs to regulated grocery retailers could be passed on to consumers.	- - The more extensive protections under this option mean slightly higher risks that costs to regulated grocery retailers could be passed on to consumers.	- - The more extensive protections under this option mean slightly higher risks that costs to regulated grocery retailers could be passed on to consumers
Durability	0 Counterfactual may be less durable over time in the context of other grocery sector regulatory reforms.	+ Provisions are durable over time.	0 Provisions are adaptable over time where mutually agreed between grocery retailer and supplier.	- Marginally less flexible than other options.	- Marginally less flexible than other options.

Criteria	Option 1 (Counterfactual) – No requirement for written supply agreements	Option 2 – Written agreements, no minimum content	Option 3 – Supply agreements must be written and contain minimum content, retrospective variations prohibited	Option 4 – Option 3 plus more prescriptive minimum content, unilateral variations limited	Option 5 – Option 4 plus grocery retailers prohibited from requiring suppliers to use a particular logistics service (preferred option)
Overall assessment	<p>0</p> <p>Though this option comes with minimal costs and risks, it does not address the problems identified.</p>	<p>0/+</p> <p>Requiring written agreements does not fully address issues regarding certainty. Anticipated to have minimal benefits for suppliers and consumers.</p>	<p>0/+</p> <p>This option is likely to be somewhat effective at addressing the problems identified, leading to modest gains for suppliers, with flow-on benefits for consumers. However, it does not address issues relating to unilateral variation of agreements and the use of preferred logistic services and could be costlier than other options.</p>	<p>+</p> <p>This option will be effective in addressing the problems identified. Consumers and suppliers are likely to be better off under this option. However, this option will not address the issue identified regarding the use of preferred logistics services and is therefore not as effective as Option 5.</p>	<p>++</p> <p>This option is the most effective for increasing supplier certainty and ensuring costs and risks are not unduly passed on to suppliers. It does, however, come with greater costs to regulated grocery retailers as a result of having to comply with the requirements. However, these costs are likely to be relatively minor and off-set by long-term benefits to consumers and suppliers.</p>

Key for qualitative judgements in tables:

- ++** much better than doing nothing/the status quo/counterfactual
- +** better than doing nothing/the status quo/counterfactual
- 0** about the same as doing nothing/the status quo/counterfactual
- worse than doing nothing/the status quo/counterfactual
- much worse than doing nothing/the status quo/counterfactual

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

72. Option 5 is likely to be most effective in preventing grocery retailers from passing on costs and risks. It also creates more transparency and certainty for suppliers. This is the only option which addresses all of the problems identified under this component. This option:
- 72.1 prohibits retrospective variations to supply agreements in all circumstances
 - 72.2 significantly limits the circumstances where grocery retailers may make unilateral variations to supply agreements, thereby providing a high level of certainty to suppliers
 - 72.3 prohibits grocery retailers from requiring suppliers to, for example, use a particular logistics service unless the cost of the retailer's preferred service is lower than the cost of the supplier's preferred service or the supplier's preferred service does not meet reasonable service standards
73. This option does come with greater costs to regulated grocery retailers. However, these costs are likely to be relatively minor and off-set by long-term benefits to consumers.

Component 3 – Payment terms and set offs

Context:

74. Payment terms describes the terms by which invoices are settled, including timeframes for payments. Set offs are where a grocery retailer deducts any amount it is owed by a supplier when paying a supplier's invoice. More context on these terms is provided in paragraphs 13.4 and 13.5 above.

Commission's recommendation

75. The Commission heard in the market study that some suppliers consider set off practices to be unfair or unjustified. It noted that the approach to set offs in the New Zealand grocery sector is relatively unusual compared to other industries (where set-offs are relatively uncommon), and that this likely reflects imbalances in negotiating power between the major grocery retailers and suppliers. However, the Commission did not form a firm view about whether set offs should be permitted.

Options around payment terms and set offs

Option 1– status quo

76. Under the status quo, suppliers would continue to be paid according to their supply agreement and grocery retailers would retain the ability to deduct any money owed by suppliers when paying invoices. This would allow retailers to continue passing on costs to suppliers, creating cash flow issues for suppliers that can threaten the viability of small businesses.

Option 2 – (Principle-based Code) Requirement for payments to be made within a reasonable time

77. Under Option 2, retailers would be required to pay invoices in accordance with the grocery supply agreement and invoices would need to be paid within a reasonable time. Retailers would remain able to set off against payments if provided for in the supply agreement.

Option 3– (Prescriptive Code) Set offs prohibited, requirement for payments to be made within a reasonable time (MBIE preferred option)

78. Under Option 3, grocery retailers would be required to pay invoices in accordance with the supply agreement and within a reasonable time. Set offs against payments would be prohibited, except with the written approval of the supplier and where provided for in the supply agreement. These set offs would need to be reasonable in the circumstances.

Option 4 – Set offs prohibited, prompt payments required

79. Under Option 4, grocery retailers would be required to make prompt payments no later than specified in the supply agreement. Set offs against payments would be prohibited, except with the written approval of the supplier and where the set off is provided for in the supply agreement. These set offs would need to be reasonable in the circumstances.

Stakeholder views

80. All parties that made submissions on the Code consultation document supported limiting set offs, except where the set off is specifically provided for in the supply agreement, is reasonable in the circumstances and the supplier has given their written permission to the set off.
81. Except for Foodstuffs, Woolworths NZ and T & G Fresh, all submissions favoured our proposed option to require grocery retailers to make ‘prompt’ payments to suppliers no later than a date specified in the supply agreement. Some suppliers referred to the difficulties they experienced in chasing payments from grocery retailers and the detrimental effects late payments had on their businesses. Foodstuffs, on the other hand, were concerned that a ‘one-size fits all’ approach would not be sufficiently flexible. They noted that the Australian Code does not require ‘prompt’ payments and expressed a preference for the Code to mirror the Australian Code where possible. Woolworths NZ submitted that requiring retailers to pay invoices ‘within a reasonable time’ should provide adequate protections to suppliers while preserving the ability of both parties to negotiate terms.

Payment terms and set offs – How do the options compare to the status quo/counterfactual?

Criteria	Option 1 – Status quo (payment according to supply agreement)	Option 2 – Requirement for invoices to be paid within a reasonable time	Option 3 – requirement for invoices to be paid within a reasonable time and set offs prohibited (preferred option)	Option 4 –set offs prohibited, prompt payments required
Effectiveness	<p>0</p> <p>Other aspects of the Code, (such as requiring supply agreements to be written and contain certain terms) as well as work on unfair contract terms currently underway, may provide some protections for suppliers under the status quo. However, it is not clear how much of an impact these will have.</p>	<p>0/+</p> <p>More effective than the status quo due to requirement to pay invoices within a reasonable time.</p>	<p>++</p> <p>Prohibiting set offs means that retailers cannot unreasonably reduce payments to suppliers. As a result, this option is likely to be more effective than Options one and two.</p>	<p>++</p> <p>Likely to be the most effective option in ensuring suppliers are paid promptly.</p>
Certainty	<p>0</p> <p>Unlikely to provide certainty to suppliers.</p>	<p>0/+</p> <p>Provides limited certainty to suppliers by requiring invoices to be paid within a reasonable time, though doesn't require a time to be set out in the agreement.</p>	<p>++</p> <p>Requiring payment times to be set out in the agreement, and prohibiting set offs creates more certainty for suppliers about what and when they will be paid.</p>	<p>++</p> <p>Requirement for prompt payments does not necessarily create more certainty than Option 3.</p>
Costs	<p>0</p> <p>No additional costs to grocery retailers.</p>	<p>0/+</p> <p>May involve some additional costs to grocery retailers as supply agreements may need to be renegotiated. However, these costs are unlikely to be substantial. Receiving payment within a reasonable timeframe will mean reduced costs for suppliers.</p>	<p>0/+</p> <p>Limiting set offs may mean higher administrative costs for grocery retailers, due to efficiency losses, but reduced costs for suppliers.</p>	<p>0/-</p> <p>Requiring prompt payments could mean higher costs to retailers. Reduced costs for suppliers are likely.</p>

Criteria	Option 1 – Status quo (payment according to supply agreement)	Option 2 – Requirement for invoices to be paid within a reasonable time	Option 3 – Requirement for invoices to be paid within a reasonable time and set offs prohibited (preferred option)	Option 4 –Set offs prohibited, prompt payments required
Risks	0 Few risks involved	0 Few risks involved.	0 Risk that prohibiting set offs could have flow-on effects. However, this option is closely aligned with the Australian Code and is unlikely to be risky overall.	- Requiring prompt payments to suppliers could come with a small risk of unintended consequences, with even slight delays in payments being in breach of the Code. This approach deviates from the Australian Code, and therefore comes with more uncertainty about how it may play out.
Durability	0	0 Allows payments to be negotiated between grocery retailers and suppliers, increasing flexibility.	- Allows for payments to be negotiated between grocery retailers and suppliers via the supply agreement. However, limiting set offs makes this option less flexible.	-- Requirement for prompt payments means that this option is less flexible than the other options. Smaller franchises (e.g. a Four Square ⁸) who could be more susceptible to cash-flow issues, and may find it difficult to comply with strict, prompt payment requirements

⁸ Smaller retailers, such as Four Square, will be captured as franchises of Foodstuffs.

Overall assessment	0	+	++	0/+
	Does not address the issues identified.	Likely to be more effective than the status quo with few costs and risks. However, this option provides limited certainty to suppliers.	Likely to be effective in reducing costs and risks and creating more certainty for suppliers. Creates some additional costs for grocery retailers. However, these costs are off-set by higher benefits to suppliers, and the flow-on benefits to consumers. This option is unlikely to be risky overall.	Likely to be effective in reducing costs and risks and creating more certainty for suppliers. However, this option is less flexible compared to the other options. It is also slightly riskier as it deviates from the Australian Code. The risk of costs flowing through to consumers are slightly higher under this option than Option 3.

Key for qualitative judgements in tables:

- ++ much better than doing nothing/the status quo/counterfactual
- + better than doing nothing/the status quo/counterfactual
- 0 about the same as doing nothing/the status quo/counterfactual
- worse than doing nothing/the status quo/counterfactual
- much worse than doing nothing/the status quo/counterfactual

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

82. Option 3 (requiring payments within reasonable timeframes and prohibiting set-offs) best meets the criteria set out in this RIS. This option:
- 82.1 effectively reduces the costs and risks to suppliers by requiring payments to be made according to the supply agreement and within a reasonable time, thus aligning with the objectives of the Code
 - 82.2 increases certainty for suppliers by prohibiting set offs against payments without the written approval of the supplier
 - 82.3 adopts a similar approach to the Australian Code, thus minimising significant unintended consequences. Because of the close relationship between the New Zealand and Australian economies and the number of entities trading in both countries, we consider that aligning the Code with the Australian Code is likely to make the grocery sector regulatory reforms more effective overall.

Component 4 – Shrinkage, wastage and payments for marketing and promotional activities

Context

83. This section discusses options for how the Code could prevent grocery retailers passing on costs and risks to suppliers and canvasses several of the issues described in the problem definition. The options include limiting the ability of grocery retailers to require suppliers to pay:
- 83.1 for shrinkage and wastage
 - 83.2 for costs incurred by the retailer relating to product placements and marketing costs
 - 83.3 as a condition of supply
 - 83.4 for promotional activities and investment buying.

Payments for shrinkage and wastage

84. Shrinkage is the loss of grocery products due to theft, accounting errors or other losses. Wastage is grocery products that are unfit for sale due to damage or other deterioration. There are existing processes to deal with wastage, including 'standard damage allowances' for damage that occurred prior to the product being received by the grocery retailer and where the damage was not visible at the time they were received.
85. Overseas experience suggests that costs associated with shrinkage can be large. Research⁹ has shown that in the UK, in 2014, shoplifting accounted for 26% of all stock loss, while retailers saw £770m stolen by employees and an additional £300m lost as a result of supplier errors. In the UK 40% of all shrinkage came as a result of internal errors, such as mistakes with pricing.

⁹ <https://www.rgisinv.co.nz/tips-insights/how-to-reduce-shrinkage-in-retail>

86. Both the UK Code and the Australian Code prohibit supply agreements that include provisions for shrinkage payments. Both Codes also prohibit payments for wastage except where they are specifically provided for in the supply agreement, the wastage is due to the supplier's negligence and the payments are reasonable in the circumstances.

Payments for grocery retailer's marketing and promotional activities

87. New Zealand, retailer's and suppliers share in the retailer's activities relating to marketing and promotion of products. These activities potentially benefit both the retailer and supplier by generating higher sales. However, some suppliers do not want to be involved in the marketing and promotion of products or would prefer to control the in-store stocking and promotion of their products. Regardless of who does the product promotion and marketing work, most costs are met by the suppliers. In addition, there are also reports of retailers not providing merchandising activities paid for by suppliers.

Payments as a condition of supply:

88. Both the Australian Code and the UK Code limit payments by suppliers to grocery retailers as a condition of being a supplier, with some exceptions. The UK Code provides an exception for new suppliers and the Australian Code requires any payment to be specified in the supply agreement and reasonable having regard to the costs and risks to the retailer of stocking the product.

Payments for promotional activities and investment buying

89. Any restrictions on suppliers funding product promotions by grocery retailers must be carefully framed to manage any undesirable impact on consumers if the restrictions result in reducing the frequency of promotions or price discounts inherent in product promotions. Prohibiting the payment by suppliers for promotional activities outright may result in suppliers being paid a lower list price for their products.
90. Investment buying is where grocery retailers stockpile products purchased from suppliers at reduced prices during a promotional period. Retailers can then earn extra margin on sales of these products after the promotion has ended. However, the benefits to the supplier of increased sales volumes generated by the promotion are no longer available.

Commission's recommendation

91. The Commission recommended in the market study that payments for shrinkage should be prohibited outright and that payments for wastage also should be prohibited except where the supplier is responsible for the wastage.
92. The Commission also recommended that payments for promotional activities should only be permitted where they are reasonable in the circumstances, having regard to the benefits and costs to suppliers and grocery retailers. The Commission noted that investment buying may enable retailers to offer lower prices outside of promotional periods, and did not suggest any limits around any form of investment buying.

Options for preventing retailers from passing on costs and risks to suppliers

Option 1 – Counterfactual (rely on existing supply agreements)

93. Under the counterfactual, no limits around payments for shrinkage, wastage, marketing and promotional activities, or promotional payments are proposed. Such payments would be permitted if provided for in the supply agreement. Existing remedies under the Fair Trading Act 1986 would be available to suppliers.

Option 2 – Principle-based Code

94. Option 2 is the least restrictive option likely to be effective in addressing the problem identified. At a minimum, we consider that a principle-based Code should prohibit payments for the following:
- 94.1 shrinkage in all circumstances
 - 94.2 wastage, unless payment is provided for in the supply agreement and where the wastage is due to the supplier's negligence. The supply agreement must also outline the basis for any payments
 - 94.3 marketing and merchandising, except where payment for these is provided for in the supply agreement
 - 94.4 product placements, except in relation to promotions
 - 94.5 as a condition of supply, except in relation to a promotion or new product, and where the grocery retailer runs a risk in stocking the product.
 - 94.6 payments for promotions, except where reasonable notice is provided.
95. Investment buying would not be prohibited under this option, and reimbursement would only be paid by the grocery retailer to the supplier if products purchased at a promotional price were sold at a price higher than what was agreed with the supplier.
96. This option is likely to be effective in seeking to ensure any payments (for marketing costs, promotional activities and product placement) reflect the relative costs and benefits to grocery retailers and suppliers. However, this option may be less effective and durable than Options 3 and 4 below.

Option 3 – Prescriptive Code

97. Like Option 2, Option 3 would prohibit payments for shrinkage in all circumstances. It would also limit payments for wastage, merchandising, product placement and as a condition of supply.
98. These payments would need to be provided for in the supply agreement and reasonable in the circumstances. Whether or not a payment is 'reasonable in the circumstances' should consider the likely benefits, costs and risks of providing for a payment.
99. A prescriptive Code would prohibit payments for the following:
- 99.1 shrinkage in all circumstances
 - 99.2 wastage, except where provided for in the supply agreement and where the payment is reasonable in the circumstances

- 99.3 marketing and merchandising, except where provided for in the supply agreement and where payment is reasonable in the circumstances
 - 99.4 as a condition of supply, except in relation to a promotion or new product, and where the grocery retailer runs a risk in stocking the product and the payment is reasonable in the circumstances
 - 99.5 payments for promotions, except where the payment is provided for in the supply agreement and is reasonable in the circumstances.
100. Investment buying would not be prohibited, and reimbursement would only be paid if products purchased at a promotional price were sold at a price higher than agreed with the supplier.
101. Payments for product placement or shelf allocation would be permitted if agreed between the supplier and grocery retailer, provided such payments are negotiated in good faith.

Option 4 – Alternative Code (preferred option)

102. Option 4 builds on Option 3. In addition to Option 3, Option 4 would prohibit payments that are not linked to specific activities and require grocery retailers to refund suppliers where they have not completed the relevant activity. This option could also include a sunset clause which would require grocery retailers to submit any claim for wastage within six months of the date on which the goods were received.
103. Option 4 also would prohibit payments for promotions except where provided for in the supply agreement and the payment is reasonable in the circumstances after considering the relative benefits of the promotion to the supplier and grocery retailer.
104. Investment buying would not be prohibited under this option, as long as it is provided for in the supply agreement and is reasonable in the circumstances.

Stakeholder views

105. Submissions on the Code consultation document agreed with prohibiting payments for shrinkage in all circumstances. Most submissions also considered that payments for wastage should be prohibited, except where the wastage is the responsibility of the supplier. Woolworths NZ was the only stakeholder that considered suppliers paying for wastage should be permitted, if provided for in the supply agreement.
106. All parties that made submissions supported a limiting clause to prevent grocery retailers from seeking payments for wastage more than six months after the goods were received. However, there were differing views on the length of time within which payment for wastage could be claimed and stakeholders did not give a detailed view about any risks or benefits in relation to their preferred length of time. To come to an informed view on this issue, we intend to consult on a time period of six months in the exposure draft of the Code.
107. All stakeholders that made submissions considered that payments for promotions and promotional buying should be prohibited except where the payment is provided for in the supply agreement and is reasonable in the circumstances. Most stakeholders also considered that the costs of promotions should be shared fairly between suppliers and grocery retailers, and that the Code should prevent suppliers from fully funding the costs of promotions. The New Zealand Food and Grocery Council indicated that this is an issue of particular importance to suppliers because often suppliers have no choice but to accept the costs involved with promotions.

108. All stakeholders agreed that the Code should prohibit payment as a condition of supply, except in relation to a new product and where the payment is reasonable given the circumstances. 'Reasonable' would have regard to the likely benefits, costs and risks both to the grocery retailer and supplier. This approach is consistent with the Australian Code.

Shrinkage, wastage and marketing costs - How do the options compare to the status quo/counterfactual?

Criteria	Option 1 – Counterfactual (rely on existing supply agreements)	Option 2 – Principle-based Code	Option 3 – Prescriptive Code	Option 4 – Alternative Code (preferred option)
Effectiveness	0 Existing remedies under the Fair Trading Act 1986 are unlikely to prevent costs and risks being passed to suppliers.	+	+	++ Likely to be more effective than the other options due to limiting clause.
Certainty	0 Will not create additional certainty for suppliers.	++	+	++ Provides more certainty about terms of supply than status quo. Sunset clause adds additional certainty.
Costs	0 No additional compliance costs for grocery retailers or suppliers.	0 Compliance costs for grocery retailers will likely be minimal but higher than the counterfactual (Option 1). Marginally reduced costs for suppliers.	0/+ Additional costs for grocery retailers due to stronger obligations in relation to set-offs, shrinkage and wastage . Over time, we anticipate lower costs for retailers as their management of costs improves. Reduced costs for suppliers.	0/+ Additional costs for grocery retailers due to stronger obligations in relation to set-offs, shrinkage and wastage . Over time, we anticipate lower costs for retailers as their management of costs improves. Reduced costs for suppliers.
Risks	0 No additional risks.	- Some compliance costs may create minor risks.	- Compliance costs create risks of unintended consequences, but contracting out provisions should help mitigate some risks.	- Risks are not materially different to those under Options 2 and 3 and are overall relatively low.

Criteria	Option 1 – Counterfactual (rely on existing supply agreements)	Option 2 – Principle-based Code	Option 3 – Prescriptive Code	Option 4 – Alternative Code (preferred option)
Flexibility/Durability	0	+ More limited contracting out provisions for product placement and marketing/merchandising.	++ Contracting out provisions (via supply agreements) adds durability.	++ Contracting out provisions (via supply agreements) adds durability.
Overall assessment	0 Unlikely to be effective in protecting suppliers from unfavourable terms or in improving certainty. Relies on other aspects of the grocery sector regulatory reforms underway.	0/+ More certainty for suppliers but reduced specificity limits effectiveness, flexibility and durability. Limited long-term benefits for consumers and suppliers.	+ Though likely to be somewhat effective, supplier certainty is reduced by the ‘reasonable in the circumstances’ test. There is likely to be some benefit to suppliers and consumers under this option, however these benefits are likely to be less than Option 4.	++ This option is the most effective at increasing supplier certainty and at ensuring costs and risks are not unduly passed on to suppliers. This option does, however, come with greater risks that the costs incurred by retailers flow-through to consumers. However, in the long term, we consider that this risk is offset by the predicted benefits for both suppliers and consumers.

Key for qualitative judgements in tables:

- ++** much better than doing nothing/the status quo/counterfactual
- +** better than doing nothing/the status quo/counterfactual
- 0** about the same as doing nothing/the status quo/counterfactual
- worse than doing nothing/the status quo/counterfactual
- much worse than doing nothing/the status quo/counterfactual

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

109. Option 4 (Alternative Code) is likely to be the most effective. It aligns with the objective of preventing grocery retailers passing on costs and risks to suppliers by:
 - 109.1 prohibiting payments for shrinkage in all circumstances
 - 109.2 limiting payments for wastage, marketing and merchandising, product placement, promotions, and as a condition of being a supplier.
110. Option 4 also contains contracting out provisions (via supply agreements) where reasonable in the circumstances, which adds flexibility to this option.
111. The addition of a limiting clause that requires grocery retailers to submit any claim for wastage within, say, six months of receiving goods creates more certainty and transparency about the terms of supply.
112. Option 4 does not require reimbursement related to investment buying. We consider that mandatory reimbursement may risk disincentivising investment buying, which could impact on prices paid by consumers for their groceries.

Component 5 – Standards for fresh produce, product ranging, shelf allocations and delisting

113. This section discusses options for how the Code could create more transparency and certainty for suppliers by considering several of the issues described in paragraphs 13.8–13.9 above. These include:
 - 113.1 standards for fresh produce
 - 113.2 product ranging and shelf allocations
 - 113.3 processes for delisting products
 - 113.4 responses to price increases from suppliers.

Standards for fresh produce

114. The Australian Code outlines detailed processes for the acceptance or rejection of fresh produce. It provides that a grocery retailer has 24 hours to accept or reject fresh produce and must notify the supplier within 48 hours if produce is rejected. A retailer has up to 30 days to lodge a claim against a supplier for damaged produce or shortfalls.

Product ranging, range reviews and shelf allocations:

115. ‘Product ranging’ refers to decisions made by grocery retailers about which products to stock. Different retailers have different approaches to product ranging to provide the best competitive offering to consumers. ‘*Shelf allocation*’ is about where stock is placed in a retail store. The position of a product affects turnover as some positions are more appealing to consumers. A ‘range review’ is a review of products a grocery retailer stocks to evaluate how successful they are.

Delisting of products

116. 'Delisting' is where a grocery retailer chooses to no longer stock a particular product. Delisting can lead to significant consequences for suppliers but at the same time is a commercial reality in any market. Retailers have limited shelf space for displaying products and the reality is that bringing in new products sometimes means removing existing product items. To be effective, the Code should balance on the one hand the needs of suppliers while on the other not impede retailers from meeting consumer demands (including by delisting exiting products items when necessary to do so).

Price increases from suppliers

117. Suppliers will, from time to time, need to request price increases from grocery retailers. This may be part of supply agreement negotiations or could be done independently of the supply agreement.

Commission's recommendation

118. The Commission recommended in the market study non-discrimination on product ranging and shelf allocation to prevent grocery retailers from using different approaches that advantage their own private label products. It also recommended addressing the circumstances where delisting might occur and the process which should be followed.
119. The Commission also recommended that consideration be given to protections relating to fresh produce to deal with the specific problems experienced by such suppliers, although it did not suggest any specific protections.

Options for product ranging, shelf allocation, delisting, price increase requests and standards for fresh produce

Option 1 – Counterfactual

120. Under the counterfactual, no new provisions would be made for suppliers of fresh produce and no additional guidance or rules would be made about any of the issues described above (product ranging, range reviews, delisting and requests for price increases from suppliers). Suppliers would be reliant on existing provisions relating to unfair contract terms contained in the Fair Trading Act 1986.

Option 2 – Principle-based Code

121. *Product ranging and shelf allocation* – Option 2 would require grocery retailers to have established principles for product ranging and shelf allocation and to apply these principles consistently for all suppliers.
122. *Delisting* – Under Option 2, delisting may only occur for genuine commercial reasons. A grocery retailer looking to delist a supplier must provide the supplier with written notice of the decision, including reasons for the decision and also must provide sufficient time to engage in dispute resolution if the supplier requests this.
123. *Fresh produce* – Option 2 would not have any specific provisions for fresh produce standards. Negotiations around accepting or rejecting fresh produce would rely on the overarching principle of good faith and/or fair dealings. Dispute resolution would be available to suppliers.
124. *Response to price-increase requests* – Option 2 would not have any specific provisions or timeframes in which grocery retailers must respond to price increase requests, but would rely on good faith. Dispute resolution would be available to suppliers if they were not satisfied that the supplier had acted in good faith.

Option 3 – Prescriptive Code

125. *Product ranging and shelf allocation* – Option 3 would require grocery retailers to have established principles for product ranging and shelf allocation and to apply these principles consistently for all suppliers. In addition, retailers would be required to provide advance notice of any range reviews and necessary information to suppliers.
126. *Delisting* – Under Option 3, delisting may only occur in accordance with the supply agreement and for genuine commercial reasons (as per the Australian Code). As with Option 2, the grocery retailer looking to delist the supplier must provide reasonable written notice of the decision, including reasons for the decision, and provide sufficient time to engage in dispute resolution if the supplier requests this.
127. *Fresh produce* – Grocery retailers would be required to have fresh produce standards or quality specifications and use them without discrimination under this option. Retailers would have processes and timeframes to accept or reject fresh produce, be required to accept produce if it meets the standards and not be able to reject produce after accepting it. Retailers also would be required to accept or reject produce within 24 hours of receiving it. If produce is rejected, the retailer would be required to provide written notice to the supplier within 48 hours. Any claims for damaged grocery products, shortfalls or any similar claim would need to be lodged within 30 days of delivery. Dispute resolution would be available to suppliers for any breaches of the Code.
128. *Response to price-increase requests* – In line with the Australian Code, under Option 3 grocery retailers would be required to respond (accept, decline or partially accept) to a request for a price increase within 30 days of receiving the request. If a supplier was not satisfied with the outcome, they may enter negotiations with the retailer. Negotiations would need to be conducted in good faith and without delay, and any information relating to negotiations for price increases would be treated as commercially-sensitive information (discussed in paragraph 142 below). If negotiations are unsuccessful, dispute resolution tools would be available to suppliers.

Option 4 – Alternative Code (preferred option)

129. *Product ranging, shelf allocation and delisting* – option four contains the same requirements as option three for product ranging, shelf allocation and delisting. In addition, a retailer may not initiate delisting prior to a range review.
130. *Fresh produce* – Option 4 would contain all the provisions included in Option 3 for fresh produce standards. In addition to Option 3, grocery retailers would need to give six months' notice if fresh produce was delisted prior to a range review. Dispute resolution would be available to suppliers for any breaches of the Code.
131. *Response to price-increase requests* – Option 4 would also require grocery retailers to respond to a request for a price increase within 30 days. However, retailers would have the ability to request more information about the price increase requested before making a decision. This would enable retailers to make more informed decisions about complicated requests. Requests for price increases must be conducted in good faith and not used to delay consideration of requests. If the supplier was not satisfied with the outcome, dispute resolution would be an option available to suppliers.

What we have heard from submitters:

132. Most submissions on the Code consultation document considered that the Code should require grocery retailers to have standards for fresh produce, in line with the Australian Code.

Several submissions considered that the timeframes for accepting or rejecting produce should be shortened to between 6–18 hours. One submission considered that the time period should be lengthened. Most submissions were broadly supportive of the Code containing specific provisions around fresh produce, similar to the Australian Code. Foodstuffs in their submission cautioned that care would be needed around the specific provisions of the Code, including relevant timeframes for accepting and rejecting fresh produce.

133. Prices for fresh produce was a key issue in several of the submissions. Some suppliers considered that price margins on fresh produce were too high. One supplier stated that the cost of growing produce had increased around 30% over the past year and that despite this, they had not been successful in negotiating a price increase for 10 years. Another submitter considered that brokers and marketing companies contributed to the problem by forcing suppliers to compete with each other to get the best prices. Foodstuffs noted in its submission that it is receiving record numbers of price increase requests from suppliers. It supported a Code that reflected the provisions of the Australian Code but believed that the Code should allow grocery retailers to request more information from the supplier where retailers are not in a position to accept, partially accept or decline a request.
134. All submitters considered that the Code should require grocery retailers to have established principles for product ranging, shelf allocations and delisting and apply these principles without discrimination. Delisting was a key issue for many submitters. All submitters agreed that delisting should be permitted only for genuine commercial reasons, in line both with the UK Code and the Australian Code, and that grocery retailers should be required to give advance notice before conducting range reviews.
135. Several submitters also considered that grocery retailers should be required to undertake a range review process before delisting a suppliers produce. The New Zealand Food and Grocery Council expressed concerns that retailers use the range review process to request higher margins on products, to the detriment of suppliers. It considered that retailers should be required to have genuine commercial reasons for requesting higher margins.
136. Consumer NZ considered that private labels were problematic for consumers as these products tend to set price floors and consequently prevent the introduction of lower price goods. This results in less choice for consumers, and lessens competition overall.
137. T & G Fresh considered that grocery retailers should be required to give a longer notice period prior to delisting fresh produce. Fresh produce takes time to grow and if delisted, can lead to food wastage and significant costs to growers.
138. We agree with T & G Fresh's submission that suppliers of fresh produce face particular challenges when their produce is delisted, and consider that the uncertainty that these suppliers face does not align with the long-term interests of consumers. This issue was not discussed in the Code consultation document and as a result stakeholders did not comment on the issue.. However, we intend to consult on the issue at the time an exposure draft of the Code is released.
139. While almost all submitters agreed that grocery retailers should be required to accept or reject fresh produce within timeframes, there were a variety of opinions about how much time retailers should have. We have not proposed any changes to the 24-hour timeframe recommended in the Code consultation document in the options presented below. We do, however, intend to consult on this in the exposure draft of the Code. This will help us to come to an informed view before the Code is implemented.

Fresh produce, product ranging, shelf allocation and delisting – How do the options compare to the status quo/counterfactual?

Criteria	Option 1 – Counterfactual	Option 2 – Principle-based Code	Option 3 – Prescriptive Code	Option 4 – Alternative Code (preferred option)
Effectiveness	<p>0</p> <p>Recent amendments to the Fair Trading Act 1986 (which came into force on 16 August 2022) extended unfair contract term protections to cover small trade contracts. An ‘unfair’ contract provision includes one that would cause a significant imbalance in the parties’ rights and obligations under the contract. Although this may provide an avenue for suppliers facing a lack of transparency around a dispute, it will not enable dispute resolution.</p>	<p>0/+</p> <p>More effective than the counterfactual due to requirements for product ranging, shelf allocation, and delisting. Enables dispute resolution on unfair contracts.</p>	<p>+</p> <p>Effectiveness is improved by specific, broad-based protections.</p>	<p>++</p> <p>Likely to be more effective than other options in reducing costs and risks, from added notice requirements for fresh produce delisting and turn-around of pricing increase responses.</p>
Certainty	<p>0</p> <p>As above, the recent amendments to the Fair Trading Act 1986 may provide increased certainty. However, suppliers will need to go through the courts.</p>	<p>0/+</p> <p>Will provide more certainty for suppliers than the counterfactual.</p>	<p>+</p> <p>Likely to provide a good amount of certainty for suppliers, particularly for suppliers of fresh produce and suppliers that may be affected by range reviews.</p>	<p>++</p> <p>Likely to provide the most certainty for suppliers, particularly for suppliers of fresh produce and suppliers that may be affected by range reviews.</p>
Costs	<p>0</p> <p>No additional compliance costs. Supplier costs are unchanged.</p>	<p>0/-</p> <p>Some compliance costs around principles for product ranging. These are likely to be marginally higher than the counterfactual. Marginally reduced supplier costs.</p>	<p>0/+</p> <p>Slightly higher compliance costs than for the other options. These costs will mostly fall on grocery retailers, with suppliers expected to gain overall from lower costs.</p>	<p>0/+</p> <p>Similar compliance costs to Option 3. Fresh produce suppliers in particular are likely to benefit in terms of reduced costs.</p>

Criteria	Option 1 – Counterfactual	Option 2 – Principle-based Code	Option 3 – Prescriptive Code	Option 4 – Alternative Code (preferred option)
Risks	0 Few risks of unintended consequences.	0 Fewer risks of unintended consequences compared to the counterfactual.	- Provisions around fresh produce in particular carry risks that price increases will be passed on to consumers.	- Provisions around fresh produce in particular carry risks that price increases will be passed on to consumers. Unclear if this option is riskier than Option 3.
Flexibility/Durability	0	0 Likely to be flexible over time.	- Prescriptive nature means the Code is less flexible than in the counterfactual.	-- Least flexible of all options.
Overall assessment	0 Unlikely to be effective in protecting suppliers from unfavourable terms and conditions or in improving certainty. Relies on other aspects of the grocery sector regulatory reforms underway. Limited long-term benefits to consumers and suppliers	+ Provide increased effectiveness and certainty, but otherwise no material improvement on the counterfactual. Limited long-term benefits to consumers and suppliers	+ Gives lesser protections for suppliers relative to Option 4, thus reducing overall effectiveness. This option will result in some benefits to suppliers, and flow-on consumer benefits, though they will be limited when compared with Option 4.	++ Though flexibility is reduced due to greater prescription, effectiveness and certainty are significantly improved compared to the other options. This will likely have the greatest flow-on benefits for consumers. This option is likely to have similar compliance costs and risks to those under Option 3. However, these costs and risks are offset by benefits anticipated under this option.

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

140. Option 4 (Alternative Code) is likely to be the most effective in creating certainty and transparency about the conditions of supply. It requires grocery retailers to:
- 140.1 have established principles for product ranging and shelf allocation and apply these principles without discrimination (in line with a fair-dealings obligation)
 - 140.2 have specific standards for fresh produce and to apply these standards without discrimination (retailers would be required to accept produce if it meets these standards)
 - 140.3 give six months' notice before delisting fresh produce prior to a range review, in recognition of the fact that this produce takes time to grow
 - 140.4 respond promptly to supplier price increase requests, while retailers would have the ability to request further information.

Component 6 - Confidential information, intellectual property and whistle-blower protections

141. This section discusses options for how the Code could create more transparency and certainty for suppliers and considers several of the issues described in paragraph 13.11 above. These include:
- 141.1 confidential information, intellectual property, business disruption and freedom of association
 - 141.2 whistle-blower protections
 - 141.3 recognition that for some suppliers, the knowledge of their production processes is a taonga (or cultural treasure).

Context

Confidential information, intellectual property, business disruption and freedom of association

142. During the Commission's consultation with stakeholders on the market study, some suppliers raised concerns that grocery retailers have, or may in the future, share confidential information and intellectual property with their own private label brands. This can reduce incentives for suppliers to innovate and invest in new grocery products. For some Māori suppliers, some knowledge that underpins the intellectual property is a taonga and should be respected as such.
143. The Australian Code has provisions relating to the protection of confidential information, intellectual property rights, the transfer of intellectual property, business disruption and freedom of association. These provisions require the grocery retailer to respect the supplier's data or information and hold it in confidence.

Pressure to opt out of commercial wholesale supply arrangements

144. The Government's response to the Market study involved developing a quasi-regulatory wholesale access regime. The regime imposes regulatory requirements on the major grocery retailers to facilitate commercial supply of groceries. If certain conditions are not met, the Commission or Governor-General (on recommendation of the Minister) may impose additional forms of regulation to promote better wholesale outcomes. Major grocery retailers may have incentives to pressure suppliers into opting out of the wholesale access supply, which could reduce the effectiveness of the regime. There is an opportunity for the Code to limit such conduct.

Commission's recommendation

145. The Commission recommended in the market study that the Code should incorporate protections for the confidential information and intellectual property of suppliers.

Options around confidential information, intellectual property, whistle-blower protections, business disruption and freedom of association

Option 1 – Status quo

146. Under the status quo, no additional guidance would be made about how grocery retailers should treat confidential information, intellectual property or taonga. Suppliers would rely on existing contract law in order to settle any disputes about misuse of confidential information and no additional whistle-blower protections would be made.

Option 2 – Code to contain protections for supplier's confidential information and intellectual property

147. Option 2 would require grocery retailers to hold supplier information in confidence and not use it beyond its intended purpose. It would not contain any additional guidance around taonga or any whistle-blower protections.

Option 3 – Option 2 plus prohibit retailers threatening suppliers with business disruption and recognise taonga.

148. Option 3 would require grocery retailers to hold supplier information in confidence and not use it beyond its intended purpose. In addition, the Code would provide protection for whistle-blowers, recognise that some knowledge of production processes may be a taonga and needs to be recognised as such. This option would also prohibit grocery retailers from threatening suppliers with business disruption or hindering any lawful association of suppliers (such as by discriminating or retaliating against them).

Option 4 – Option 3 plus prohibit retailers from pressuring suppliers to opt out of any wholesale access regime

149. Option 4 contains all the provisions in Option 3 and in addition prohibits any conduct to encourage suppliers to opt out of any wholesale access regime.

Stakeholder views

150. All submissions on the Code consultation document supported including in the Code protections for a supplier's confidential information and intellectual property, in line with the protections in the Australian Code. Most also supported taonga protections for the knowledge of supply processes.
151. One submission suggested that protections against retaliatory conduct could be broadened to include 'not acting in a manner contrary to Māori principles, not acting in bad faith with regard to information and not acting in a manner that would be prejudicial to supplier decision options'.
152. The majority of submitters (including Foodstuffs and Woolworths NZ) suggested that the Code should include protections against retaliatory conduct and for taonga, as well as prohibit grocery retailers from threatening suppliers with business disruption. Several submissions considered that this would most closely align with the Australian Code.
153. In addition, almost a third of submitters considered that the Code should prohibit any conduct by grocery retailers that are subject to the Code from pressuring suppliers into opting out of any wholesale access regime.

Changes following consultation:

154. In the Code consultation document, we asked for feedback on whether specific whistle-blower protections should be included in the Code. As a result of the feedback received, we have refined our view on the types of protections that should be included in the Code. We consider that suppliers need:
 - 154.1 an avenue for lodging confidential complaints, such as the grocery sector regulator
 - 154.2 protections against retaliatory conduct by grocery retailers if the retailer discovers that the supplier has lodged a complaint against them.
155. While we consider that measures to address any retaliatory conduct by grocery retailers should be included in the Code, we do not consider that specific whistle-blower protections are needed, over and above those available in the Protected Disclosures (Protection of Whistleblowers) Act 2022. The options below reflect this.

Commercial information and intellectual property: how do the options compare to the status quo/counterfactual?

Criteria	Option 1 – Status quo	Option 2 – Protections for suppliers’ confidential information and intellectual property	Option 3 – Option 2 plus protections against business disruption and recognition of taonga	Option 4 – Option 3 plus prohibiting grocery retailers from pressuring suppliers into opting out of any wholesale access regime
Effectiveness	0	0 Addresses issues separate to the inefficient pass-through of costs and risks.	0 Addresses issues separate to the inefficient pass-through of costs and risks.	0 Addresses issues separate to the inefficient pass-through of costs and risks.
Certainty	0 Suppliers are reliant on existing contract law to settle disputes over confidential information and intellectual property.	+ Provides more certainty for suppliers than the status quo about how confidential information and intellectual property should be protected.	++ Provides additional certainty for Māori suppliers compared to Option 2.	++ Provides a similar level of certainty for suppliers as Option 3. However, Option 4 may make grocery sector regulatory reforms underway more effective overall as a result of added prohibitions on discouraging participation in the wholesale access regime.
Costs	0	0/+ May have some additional compliance costs compared to the status quo. However, these costs are likely to be small and met by gains for suppliers from better protection of sensitive information.	0/+ Recognition and protection of taonga may be difficult to operationalise, resulting in compliance costs to grocery retailers. Suppliers benefit from wider protections for sensitive information.	+ Costs are likely to be similar to Option 3. Suppliers receive additional incremental benefit from more flexibility to make commercial decisions.

	Option 1 – Status quo	Option 2 – Protections for suppliers’ confidential information and intellectual property	Option 3 – Option 2 plus protections against business disruption and recognition of taonga	Option 4 – Option 3 plus prohibiting grocery retailers from pressuring suppliers into opting out of any wholesale access regime
Flexibility/Durability	0	0 As this option is principle-based, it maintains flexibility.	0/- Flexibility and durability is marginally reduced due to more detailed, specific requirements.	0/- Flexibility and durability is marginally reduced due to more detailed, specific requirements.
Risks	0	0 Unlikely to have significant risks.	0/- Larger compliance costs could create additional risks.	0/- Unlikely to be significantly riskier than Option 3.
Overall assessment	0 Without specific protections, suppliers remain vulnerable to poor standards of conduct and misuse of sensitive information by grocery retailers. No flow-on benefits to consumers.	0/+ Overall impacts are moderated by minimal specificity in the Code. Suppliers benefit from improved confidence that sensitive information will be protected and that they will benefit fairly from their own R&D, with flow-on benefits to consumers.	0/+ Improves clarity for suppliers with some modest costs. Marginally higher benefits for consumers.	+ Gives clear accountability standards, and provides improved clarity for suppliers and enhanced overall effectiveness of wider grocery sector regulatory reforms underway. This option will come with small compliance costs for grocery retailers. However, these costs are likely to be offset by the overall benefits to suppliers and consumers.

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

156. Option 4 (Alternative Code) is likely to be the most effective option. It:

- 156.1 requires supplier information to be held in confidence and used only for the purpose for which it was provided
- 156.2 provides protections for suppliers' intellectual property
- 156.3 recognises that for some Māori suppliers, knowledge of their production processes is a taonga
- 156.4 prohibits grocery retailers threatening suppliers with business disruption or hindering any lawful association of suppliers (for example, by applying discriminatory or retaliatory measures)
- 156.5 prohibits any conduct to encourage suppliers to opt out of the regulated wholesale access regime.

157. We consider that prohibiting conduct that encourages suppliers to opt out of the regulated wholesale access regime is likely to make the grocery sector regulatory reforms more effective overall and therefore is worth including in the Code. We acknowledge that this option diverges from the precedent set by the Australian Code.

What are the marginal costs and benefits of the preferred approach?

158. We provide below our analysis of overall expected benefits and costs. Due to the difficulties of valuing specific impacts due to the sparse quantified information received in submissions on the Code consultation document, we have used a qualitative approach to the analysis. The analysis indicates that while some of the options attract costs for retailers and suppliers in particular, in most cases these are modest, and positive benefits overall are anticipated from the options recommended in this RIS.

Affected groups <i>(Identify)</i>	Comment <i>Nature of cost or benefit (e.g. ongoing, one-off), evidence and assumption (e.g. compliance rates), risks.</i>	Impact <i>\$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.</i>	Evidence Certainty <i>High, medium, or low, and explain reasoning in comment column.</i>
Additional costs of the preferred option compared to taking no action			
Regulated parties (grocery retailers that are subject to the Code)	Some initial costs for grocery retailers to set up new agreements with suppliers, particularly legal costs. Also involves ongoing costs for retailers to monitor compliance and,	Medium	Medium

	<p>where applicable, to meet the costs of disputes.</p> <p>Specific changes to limit set-off payment deductions may have added ongoing costs, from higher payment processing volumes. These costs are uncertain and likely to be marginal.</p> <p>We have medium evidence certainty on these impacts from consultation feedback, overseas experience and the Commission’s market study.</p>		
Suppliers	<p>Some initial costs for suppliers to engage with grocery retailers on the new agreements. However, these will be limited, as retailers will be responsible for drawing up their agreements with suppliers.</p> <p>We have medium evidence certainty on these impacts from feedback received on the Code consultation document, experiences overseas experience and the Commission’s market study.</p>	Low	Medium
Regulator	<p>Some costs incurred by the Commission as the grocery sector regulator responsible for monitoring of the Code.</p> <p>We have medium evidence certainty of these impacts from the Commission’s market study and overseas experience.</p>	Medium	Medium
Dispute resolution scheme	<p>Some possible periodic costs from dispute claims, as they arise.</p> <p>We anticipate that the cost of running the dispute resolution scheme will be met by grocery retailers that are subject to the Code.</p> <p>We have low evidence certainty of the impacts, as costs are difficult to assess at this time and feedback received on the Code consultation document provided limited insight.</p>	Medium	Low

Others (e.g. wider government, consumers, etc.)	<p>There is a risk of marginal cost increases for consumers initially due to additional costs being passed-through to them in grocery prices.</p> <p>We have low evidence certainty for these impacts, which are difficult to assess at this time and feedback received on the Code consultation document provided limited insight.</p>	Low	Low
Total monetised costs			
Non-monetised costs		Low-Medium initially, falling to low over time.	Low-Medium

Affected groups (Identify)	Comment Nature of benefit (ongoing, one-off), evidence and assumption (e.g. compliance rates), risks.	Impact \$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.	Evidence Certainty High, medium, or low, and explain reasoning in comment column.
Additional benefits of the preferred option compared to taking no action			
Regulated parties (grocery retailers that are subject to the Code)	Grocery retailers will have greater certainty about expectations for good conduct. We have high evidence certainty of these impacts from the submissions made to the market study and on the Code consultation document.	Low	Medium
Other grocery retailers (i.e. retailers that are not subject to the Code)	May benefit from strengthened protections prohibiting conduct to opt out of the regulated wholesale access regime. We have medium evidence certainty over these impacts from feedback received on the Code consultation document and our own assessments.	Medium	Medium
Suppliers	Reduces costs to suppliers and provides more certainty about the terms of supply. We have high evidence certainty of these impacts from feedback received on the Code consultation document, overseas experience and the Commission's market study.	High	Medium/High
Regulator	Implementing the Code will potentially reduce the amount of monitoring work and enforcement action	Medium	Medium

	<p>required of the grocery sector regulator.</p> <p>We have medium evidence certainty of these impacts from feedback received on the Code consultation document, the Commission’s market study and our assessments.</p>		
Dispute resolution scheme	<p>New standards in the Code are likely to provide for a smoother, more transparent dispute resolution process.</p> <p>We have medium evidence certainty of these impacts from submissions feedback received on the Code consultation document, the Commission’s market study and our assessments.</p>	High	Medium
Others (e.g. wider government, consumers, etc.)	<p>We expect this option to create more and better grocery offerings for consumers in the longer term.</p> <p>The wider horticulture sector may benefit from additional transparency about standards in the Code for fresh produce.</p> <p>We have medium evidence certainty of these impacts from feedback received on the Code consultation document, experiences overseas experience, the Commission’s market study and our assessments.</p>	Medium	Medium
Total monetised benefits			
Non-monetised benefits		Medium-high	Medium

Section 3: Delivering an option

How will the new arrangements be implemented?

159. The Grocery Industry Competition Bill (the Bill) contains powers to make the Code. The intent is that the first Code be made, or approved, through Order in Council. After this, the Commerce Commission will be responsible for the Code, and have powers to make amendments through determination.

The Code will be secondary legislation and civil penalties will apply to breaches of the Code (discussed below). The Code will initially only apply to large grocery retailers

160. The Bill requires that the Code apply to the major grocery retailers (Woolworths New Zealand Limited, Foodstuffs North Island Limited and Foodstuffs South Island Limited) and to all franchises and interconnected bodies connected with these entities. It also allows other parties to be designated as being subject to the Code through an Order in Council. The responsible Minister may recommend that another party be designated if its annual grocery revenue exceeds \$750 million, or if the Commission deems that designation is appropriate, based on the competition benefits of designating the retailer.

161. We have not recommended applying the Code to additional grocery retailers at this time. Applying the Code across smaller retailers may disproportionately increase the regulatory burden for them. Additionally, this could create barriers for new retailers seeking to enter the retail grocery sector, reducing the possibility of increased competition.

The Code will provide a transition period

162. Once in force, grocery retailers that are subject to the Code will need to amend some of their existing supply agreements with suppliers to ensure they are compliant with the obligations and prohibitions set out in the Code. We intend for the Code to provide a six-month transition period from the date it comes into force to give grocery retailers time to provide amended supply agreements to their suppliers.

163. Some provisions of the Code will not require grocery retailers to amend their supply agreements. We intend for such provisions to come into force 28 days after the regulations are notified, as per normal regulation making processes.

We intend to consult on an exposure draft of the Code

164. MBIE will consult on an exposure draft of the Code before Cabinet makes final decisions relating to the necessary regulations to implement the Code. This will provide industry, and other interested stakeholders (including iwi), with an opportunity to provide their views on the detailed requirements of the Code. The feedback received will help to ensure that the Code is both workable and effective.

Implementation risks

165. The major grocery retailers raised concerns that there would not be sufficient time to draft new supply agreements which comply with the Code. This risk is somewhat mitigated by the six-month transitional period described above. The risk is also mitigated by the fact that the Code does not require suppliers to sign the amended agreements.

166. Other stakeholders (including the New Zealand Food and Grocery Council) were concerned that the major grocery retailers would use the transitional period to pressure suppliers into contracting out of some of the more prescriptive provisions of the Code. While we acknowledge this risk, we consider that the grocery commissioner provided for in the Bill will have the necessary powers and functions to investigate any misuse of market power and to investigate any supply contracts that may not have been negotiated in good faith once the Act comes into force.

Ongoing costs associated with the Code may give rise to additional risks

167. The Code will incur some upfront and ongoing costs to grocery retailers that are subject to the Code and, to a lesser extent, suppliers (for example, legal costs). These include both transitional costs (such as costs to retailers involved with issuing new supply agreements) as well as ongoing costs (such as the costs involved with monitoring the Code). Where disputes relating to the Code arise, there may be further costs to both retailers and suppliers. The additional costs to grocery retailers are offset by the benefits that the Code will provide to suppliers. The additional costs to retailers are mitigated by the proposed transitional arrangements which will provide a six-month time period for retailers to issue new supply agreements which comply with the Code and by setting procedural-based (rather than highly prescriptive) requirements for the Code. Other specific risks involved with the Code include:

Risk that the Code will result in higher prices for consumers: The overall objectives of the Code align with that of the Bill – to promote workable competition in grocery markets for the long-term interests of consumers. However, the Code may result in costs to retailers. There is a risk that these costs could be passed on to consumers, resulting in higher grocery prices.

We expect that these costs will be transitory and that better conditions for suppliers will also result in benefits to consumers in the long term. The Code aims to create better incentives for suppliers to innovate and invest in new grocery products, ultimately leading to better quality and a greater range of products available to consumers. There are also significant consumer risks involved with not creating the Code. Several submitters stated that poor conditions were causing their businesses to fail, and that they were forced to leave the industry as a result. This ultimately reduces consumer choices and leads to higher grocery prices.

Risk of creating a distributional shift in the balance of bargaining power: Another key risk is that the Code could cause a distributional shift in the balance of bargaining power from the major grocery retailers to suppliers. Such a shift potentially would reduce competition between suppliers and could result in higher prices and reduced offerings to consumers.

We consider that the risk of creating a distributional shift is relatively low. Most of the recommended requirements for the Code are principles-based and prescribe minimum standards for conduct.

The code will be reviewed two-years after implementation

168. The Bill requires the Commission to review the Code within two years of it first coming into force and report to the Minister on the review as soon as practicable. The purpose of this review is to assess the operation and effectiveness of the Code and determine whether it should be amended, revoked or replaced. This will help mitigate against any risks of unintended consequences.

169. Some of the key factors that the Commission may look at as part of this review include:
- 169.1 whether the provisions have been effective in providing better conditions for suppliers to innovate and invest
 - 169.2 whether these conditions are leading to better outcomes for consumers, in terms of both cost, quality and range of goods supplied
 - 169.3 whether the code has led to any unintended consequences, or greater than expected costs
 - 169.4 whether the effects of the Code align with its purpose, as outlined in the Bill.
170. As discussed below, the Bill provides powers to the Commission, and the new Grocery Commissioner, to provide oversight of the sector. This includes monitoring and reporting on the sector's performance, and ensuring compliance with the regulatory regime (including compliance with the Code).
171. Information collected through this role will be valuable in assessing the effectiveness of the Code and informing any subsequent reviews. The Commission will be able to make amendments to the Code at any time, which will allow the Code to be amended quite quickly, if immediate issues arise.
172. In addition, the Bill provides for subsequent reviews either on the direction of the Minister, on the Commission's own initiative, or through the Commission's annual report on the grocery industry required through the Bill. These regular reviews will support good regulatory stewardship, as they provide for the regular review and adaptation of the regulatory system.

The Commission will be responsible for monitoring and enforcing compliance with the Code

173. The Bill provides for the appointment of a Grocery Commissioner within the Commerce Commission and provides new regulatory powers and functions to the Grocery Commissioner. These include monitoring powers similar to those provided in the Commerce Act 1986 and requirements to conduct annual inquiries into the state of competition in the grocery industry.
174. The powers are broad, so that the Grocery Commissioner may look into various aspects of the grocery industry, including the retail grocery market, any wholesale market and the supply market (including the supply margins of grocery retailers over time).

Civil penalties apply to breaches of the Code

175. The Bill provides four different tiers of civil penalty levels for breaches of the legislation. The Bill allows for the Code to set out which of Tiers 1, 2 or 4 may apply for breaches of the Code (Tier 3 does not apply to the Code).
- 175.1 Tier 1 – the maximum is \$500,000 for an individual. In any other case it is the greater of \$10 million, or three times the value of any commercial gain, or 10% of annual turnover.
 - 175.2 Tier 2 - the maximum penalty is \$200,000 for an individual. In any other case it is the greater of \$3 million, or the value of any commercial gain, or 3% of annual turnover.
 - 175.3 Tier 4 – the maximum penalty under this Tier is \$30,000 for an individual or \$300,000 in any other case.

176. We intend for Tier 2 penalties to apply to contraventions of the Code. Tier 2 penalties will provide sufficient deterrent to ensure compliance with the Code, while remaining proportionate to the seriousness of the contraventions. However, this is something we intend seek feedback on through an exposure draft of the Code.

A disputes resolution scheme will be available to suppliers

177. The Bill provides for a dispute resolution scheme to resolve disputes related to the Code. The scheme may hear disputes from suppliers (related to the Code) and is able to employ both consensual dispute resolution processes that result in an agreement (such as mediation) and determinative processes (such as adjudication).

178. The Minister for Commerce and Consumer Affairs may appoint the scheme and must approve the scheme rules.