Russell McVeagh

Submission to the Ministry of Business, Innovation and Employment
Russell McVeagh

Review of Anti-competitive Land Agreements

25 August 2023

INTRODUCTION

1. Russell McVeagh is grateful for the opportunity to submit to the Ministry of Business, Innovation and Employment ("**MBIE**") on the July 2023 "Review of Anti-Competitive Land Agreements" Discussion Document ("**Discussion Document**").

2. Our submission ("**Submission**") is designed to assist MBIE to make recommendations that achieve the best policy outcomes for all New Zealanders, and reflect that we act for a range of businesses, both large and small.

EXECUTIVE SUMMARY

3. We recognise that there are some instances of land covenants being used in ways that can lessen competition in New Zealand markets.[1] However, there are also many examples of covenants being used for efficient and pro-competitive purposes.

4. We consider that the current prohibition contained in section 30 of the Commerce Act 1986 ("**Commerce Act**") is overly restrictive as it prevents businesses from using land covenants that do not have an anticompetitive purpose and which are demonstrably justified to protect their legitimate business interests. We consider that this has had the unintended consequences of:

   (a) stifling investment and innovation, as firms are unwilling to undertake projects where they require the confidence that a land covenant provides that the adjacent land will not be used in ways that detrimentally impact the productive use of their own land. This has the flow-on effect of preventing competition from developing in certain industries, such as the electricity sector, which we will discuss further in this Submission; and

   (b) encouraging landowners to bank land to avoid the risk that it will be used in ways that may be disruptive to their own operations, rather than selling or leasing it to be used for productive purposes.

5. Our Submission addresses:

   (a) that we consider that the current sections 27 and 28 are fit for purpose, and any perceived "gap" in the law is more accurately characterised as a deficiency in broad understanding of the law.

[1] MBIE's Discussion Paper refers to "land agreements" as meaning "any legal agreements (including covenants and restrictive leases) that a party can enter into to either restrict the way land can be used or require it to be used in a certain way." However, we note that the Commerce Act 1986 ("Commerce Act") defines a covenant as a covenant (including a promise not under seal) annexed to or running with an estate or interest in land (whether at law or in equity and whether or not for the benefit of other land).

(b) our concerns that the expansion of the section 30 cartel prohibition to include covenants has had the unintended consequence of stifling innovation by preventing the legitimate use of covenants;

(c) our concerns that the authorisation regime is not a practical option for most businesses, and is therefore insufficient to mitigate the unintended consequences stemming from the expansion of section 30 to include covenants; and

(d) how section 28A has similarly led to the over-capturing of covenants.

SECTIONS 27 AND 28 ARE FIT FOR PURPOSE

6. No compelling case has been put forward that demonstrates why section 27 and 28 are not fit for purpose – in particular, no compelling reason why the test for anti-competitive land covenants should depart from the test for anti-competitive contracts, arrangements, or understandings.

7. To the extent there are any deficiencies in the current regime, we consider that they would be more accurately characterised as a deficiency in understanding of the law rather than any "gap" in the law. These issues in understanding are better remedied through increased public awareness of the rules regarding anti-competitive covenants, alongside greater government oversight of the registration process. We therefore support MBIE's proposals to implement guidance on the LINZ website, amending agreement templates, and introducing checkpoints into the registration process.[2]

8. We do not consider that it would be a proportionate response to introduce further deeming provisions (for example, in the manner of section 28A) to deem certain types of covenants as being presumptively illegal as the risk with deeming provisions is that, by definition, they are overinclusive and are almost always likely to result in unintended consequences.

OVER-REACH OF THE CARTEL PROHIBITION

9. In its Discussion Document, MBIE poses the question of whether the current rules under section 30 are at risk of over-capturing covenants, and whether the introduction of an exception should be considered in relation to covenants with certain purposes.

10. As of April 2023, section 30 of the Commerce Act prohibits covenants that have the purpose, effect or likely effect of fixing prices, restricting output or allocating markets between competitors. A covenant that meets these conditions is prohibited regardless of whether there is any impact on competition in a market. The combination of the strict '*per se*' application and lack of effective exceptions for covenants means that many legitimate covenants are now captured by the cartel prohibition.

11. We have seen evidence, in our engagement with clients, that the amendments have led to a chilling effect on certain productive projects due to the cartel risk and inability for businesses to protect their legitimate interests that have absolutely nothing to do with competition and would not substantially lessen competition in any relevant market. This results in undesirable outcomes, and may be detrimental to consumers, as it is preventing the development of competitive offerings. In some instances, this may also be counter to government policy and goals.

[2] Discussion Document, pages 36 and 37.

12. In particular, we are concerned that the current legislative framework is making it materially more difficult for electricity generators to develop sustainable forms of generation (in particular wind farms) without being able to restrict the use of neighbouring land that may adversely impact on their ability to generate electricity from natural resources.

13. To take a worked example:

    (a) An electricity generator purchases a site to develop into a wind farm and has spare adjoining land that they wish to sell.

    (b) In order for a wind farm to function effectively, it requires an undisturbed flow of air. It is therefore imperative that the surrounding area is free from any nearby obstructions, such as buildings and trees over a certain height which may impede on the air flow and therefore ability to generate.

    (c) The electricity generator wishes to ensure that the land adjacent to the development site is not used in ways that may be detrimental to its own use of the retained land (for example, by restricting structures over a certain height being placed on the land as doing so would adversely impact the wind farm's ability to function).

14. In the event that the adjacent land ends up being owned by a competitor, there is a real risk that enforcing the covenant may amount to an output restriction as it would prevent the competitor from installing structures which may adversely impact the use of the retained land (which would effectively prevent the installation of wind turbines given that these would likely exceed the height restrictions), or a market allocation as it would effectively allocate the geographic areas in which competing electricity generators could operate wind farms. This breach is irrespective of whether there are any other alternative available sites for a competitor to develop their own wind farm (for which there are likely to be many in the context of a national market for electricity generation).

15. MBIE has suggested that instead of an absolute ban on competing activities the covenant could instead focus on restricting the adverse effects, which therefore still allows competition subject to complying with these parameters.[3] Although this may be possible in some cases, it does not work for all cases. In the windfarm scenario above the adverse effects result from having any structures over a certain height within a certain radius of the wind turbine. The likely effect of an adverse effects restriction is that no wind turbines are built on the adjacent land. This would still be caught by the cartel provision.

16. An electricity generator in this scenario would be unable to protect its legitimate business interests given the risk of breaching the cartel prohibition. As a result, they would not be able to obtain sufficient certainty that any adjacent land would not be used in a way that may cause detriment to the effective functioning of their proposed windfarm, and may therefore be reluctant to pursue the investment.

17. Given the legitimate need to protect one's investment from being detrimentally impacted by the activities of others, and the public benefits of such covenants which give firms the confidence necessary to pursue investment in renewable energy generation, it is not appropriate to impose strict liability on the enforcement of such covenants. In the counterfactual, the electricity generator may decide not to develop the windfarm, or will not dispose of the land that is surplus to its requirements. This outcome is inconsistent with the purpose of the Commerce Act, as it would stifle the development of renewable energy

[3] Discussion Document, page 20.

generation, which is essential for New Zealand to meet its emissions reduction targets. It would also lead to an inefficient allocation of land, which is not in the long-term interests of New Zealand.

18. In its Discussion Document, MBIE identifies a number of rationales for businesses using covenants.[4] While the above falls within the "protecting ongoing operations" category, another key rationale that MBIE identified was to recoup an initial investment. MBIE expressed concerns that a long-term covenant may go beyond what is reasonably necessary to recoup an initial investment, and so suggested the less-restrictive alternative of a time-limited agreement. While we agree that, theoretically, a time-restricted agreement would be sufficient to recoup an initial investment, under the current laws, this would still be regarded as prohibited cartel conduct. This is because a limited duration output restriction or market allocation would still be captured by section 30, and therefore any attempt to enforce it would be prohibited. Therefore, amendments to the Commerce Act would still be necessary to allow a covenant which both MBIE and ourselves agree is legitimate.

EXCEPTIONS TO THE CARTEL PROHIBITION UNLIKELY TO APPLY

19. We consider that it is necessary to introduce a new exception into the Commerce Act that acknowledges that covenants which do not have any anticompetitive purpose or effect may be necessary to protect the legitimate interests of businesses.

20. The only exception to the cartel prohibition for covenants is the collaborative activities exception, which was designed for ongoing cooperative ventures entered into through contracts, arrangements and understandings, and is wholly deficient for land covenants. For example, in the above wind farm scenario, despite that an electricity generator may be seeking to rely on a covenant purely to protect their legitimate business interests, rather than having an anti-competitive purpose, the collaborative activities exception is unlikely to apply. This is because to benefit from the "collaborative activity" exception, two or more parties must carry on, in co-operation, an enterprise, venture, or other activity, in trade. In the wind farm example (and as in most plausible scenarios where a covenant is used to protect legitimate business interests), there is no ongoing relationship between the covenantor and those who take possession of the land (especially after the land is sold to a new purchaser).

21. As demonstrated above, under the current legislative framework, there are no exceptions that those who seek to use covenants to protect their legitimate business interests can rely on to avoid breaching the cartel prohibition. Rather, the only legal method of obtaining this protection is through the Commission's authorisation regime.

AUTHORISATION REGIME IS COMMERCIALLY IMPRACTICAL

22. Under section 58 of the Commerce Act, the Commission may authorise covenants that contain a cartel provision. While authorisation is theoretically available to those who seek to use covenants to protect their legitimate business interests, our experience is that this is unlikely to be a practical option for most firms. In particular, this is because:

    (a) the authorisation process is costly for businesses. In addition to the Commission's filing fee (NZ$36,800), businesses will typically need to engage a lawyer who has the requisite experience and knowledge to assist them in drafting an application, and to advise on various matters up until the Commission makes its decision, as well as

[4] Discussion Document, page 19.

an economist to assist on quantification of public benefits. Authorisation should be reserved for exceptional cases, not day-to-day business cases;

(b) as the Commission targets 120 working days to make a decision (ie over six months), this timeline is commercially impractical when investment decisions will typically need to be made in a more timely manner. Although the Commission can grant interim authorisation, that does not give parties the necessary comfort to make significant investment decisions;

(c) the authorisation process is public in nature, and third parties are given the opportunity to submit their views, which is not practical for commercially sensitive initiatives; and

(d) given that the Commission has a wide discretion as to what they are permitted to take into account when making their decision, and can depart from their own guidelines, the authorisation process is unpredictable. Thus, despite investing money, time and other resources into the application process, businesses do not have any certainty that authorisation will be granted.

23. Further, authorisation would be required for each future covenant, given that the Commission would likely be unwilling to prospectively authorise all future covenants of a business. Each new covenant would have to be assessed on its merits and the competitive conditions in place at the time of implementation, meaning that the same costly, time-consuming and unpredictable process would need to be repeated.

24. Given the above, we consider that the current authorisation regime is insufficient to mitigate the risk that the cartel prohibition over-captures covenants, as it is simply not workable from a commercial perspective. It is important to note that there is no alternative or "work-around" to the authorisation process. Therefore, businesses that seek to require or enforce a covenant that contains a cartel provision in order to protect their legitimate business interests have no alternative avenues of legal protection.

PROPOSED SOLUTION

25. We submit that, in order to remedy the concerns outlined above, and prevent the unintended consequence of stifling business innovation and investment, a new exception to section 30 should be introduced:

> **Legitimate covenants exception**
>
> Nothing in section 30 applies to a person in relation to a cartel provision included in a covenant that is not for the dominant purpose of lessening competition provided that the covenant is reasonably necessary for the protection of a legitimate business interest that relates to the use of the land that benefits from the covenant.

26. The advantage of this proposed test is that it incorporates both the dominant purpose and reasonable necessity limbs of the collaborative activities exception. This would mean that the exception is not available where either:

(a) the dominant purpose is to simply prevent competition; or

(b) there is another practical way to protect the legitimate interest (eg an adverse effects restriction); or

(c) the covenant goes beyond what is reasonably necessary to protect the legitimate interest (eg if the covenant's rationale is to recoup an initial investment, the duration of the covenant should be limited to what is considered reasonably necessary to recoup that investment).

27. As with the other exceptions to the cartel prohibition, the covenant would still need to not have the purpose, effect or likely effect of substantially lessening competition in a market. We consider that this strikes a better balance between allowing anti-competitive covenants and minimising the unintended consequences of resorting to a blanket deeming provision.

28. Such an exception has precedent in New Zealand law, for example when assessing "unconscionable conduct" and "unfair contract terms" under the Fair Trading Act 1986, the Court is required to consider whether the conduct / contractual terms are "reasonably necessary for the protection of the trader's legitimate interests".[5]

29. The drafting of the exception could usefully include a non-exhaustive list of examples describing covenants that are not for the dominant purpose of lessening competition and are reasonably necessary for the protection of a legitimate business interest. Any such list should include covenants that restrict uses of land near renewable electricity generation, where the restricted land uses would affect the efficient operation of the renewable generation. An explicit example in respect of renewable generation would help to increase investment confidence and would be consistent with the Government's emissions reduction targets and the aspirational goal of 100 percent renewable electricity generation by 2030.

OVERREACH OF SECTION 28A

30. In addition to our concerns regarding the over-reach of the amended section 30, we also consider that section 28A has similarly resulted in significant unintended consequences which impact upon businesses' ability to protect their legitimate business interests for the benefit of consumers. We therefore urge MBIE to revisit the inclusion of section 28A and avoid the use of similar language in any new legislation in future.

31. The language that is currently used in section 28A results in a very broad range of covenants being treated as prohibited and unenforceable. This includes "restrictive covenants" that have the effect or likely effect of *impeding* the development or use of land or a site as a retail grocery store or any other retail store that is likely to complete with a retail grocery store operated by the designated grocery retailer (a "competing business"), or "exclusivity covenants" that have the effect or likely effect of *impeding* another person from operating a competing business.

32. The use of the term "impeding" is not defined, creating uncertainty as to when the prohibition could be triggered. As drafted, there is a risk section 28A could (improperly) be argued to capture a broad range of legitimate property arrangements which require land to be used for a particular purpose, or protect certain features of the land, including access routes or loading zones designed to preserve operational efficiency, carparks, and other services infrastructure that provide amenity and other benefits to lessees and their customers.

[5] Fair Trading Act 1986, ss 8(2)(f) and 46L(1)(b)

CONCLUDING COMMENTS

33. As noted, Russell McVeagh is grateful for the opportunity to submit to MBIE on its Discussion Document. Our submissions are designed to assist MBIE to make recommendations that achieve the best policy outcomes for all New Zealanders.