



12 April 2021

Project Lead (Grocery Market Study)  
Commerce Commission  
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Dear Sir/Madam

Attached are the comments that the New Zealand Food & Grocery Council wishes to present on the submissions to the *Market study into the retail grocery sector: Preliminary issues paper*.

Yours sincerely

Katherine Rich  
**Chief Executive**



## **Market study into the retail grocery sector: Preliminary issues paper submissions**

**Cross-submission by the New Zealand Food &  
Grocery Council**

**12 April 2021**

## NZFGC Comments on points in submissions on the Preliminary Issues Paper

### 1. INTRODUCTION

- 1.1 New Zealand Food & Grocery Council Inc (**NZFGC**) thanks the Commerce Commission (**Commission**) for this opportunity to provide comments on the submissions to the Preliminary Issues Paper (**PIP**).

#### ***The limited submissions highlight the issues, need for deep enquiry by the Commission & remedies***

- 1.2 **Suppliers are limited in their ability to respond:** The absence of material submissions from suppliers is no surprise. Most suppliers are unwilling to express their views given the risk of retaliation (most obviously the threat of “delisting”). Even offers of sections 98 and / or 100 protections is generally insufficient. This is valid evidence of significant structural issues that must be addressed.
- 1.3 **Consumers are unable to meaningfully respond:** It is unrealistic to expect consumers to submit given their lack of resources, industry knowledge and experience with a more competitive counterfactual. We endorse Consumer NZ’s useful submission.
- 1.4 **The Commission’s surveys may assist but there are still major impediments:** We commend the Commission for its surveys of suppliers and customers. We are encouraged by the “...*extremely positive response to the surveys, with many consumers and suppliers submitting their feedback...*” and hope the Commission’s statement that the “... *feedback was both valuable and important ... and will contribute...*”<sup>1</sup> proves correct. However, we are mindful of the limitations. Suppliers are generally unwilling and/or unable to contribute fully and freely when so dependent on channels which may often account for 70-90% of their volumes. (These channels are irreplaceable despite retailers putting forward arguments to the contrary.)
- 1.5 **NZFGC survey:** Given these limitations, NZFGC commissioned Blackmarket Research, an independent Australian research firm, to undertake research seeking members’ views on issues relating the Market Study.<sup>2</sup> That feedback speaks for itself. One standout result is that 64% agree that anti-competitive behaviour exists in the New Zealand food and grocery industry.<sup>3</sup> Further, it is quite clear we have an issue with certain behaviours and practices within our industry that are only possible due to significant market power.

#### ***High level comments on the submissions of the “Major Grocery Retailers”<sup>4</sup> (Retailers):***

- 1.6 **They incorrectly describe competition & competitive constraints:** They (perhaps deliberately) ignore demand-side and supply-side realities, incorrectly suggesting they are materially/sufficiently constrained from non-substitutes and “missions”. At its

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<sup>1</sup> We refer to the Commission’s 26 March 2021 email to stakeholders

<sup>2</sup> This was provided to the Commission on 11 March 2021. Blackmarket was chosen due to its experience conducting similar research for recent Australian inquiries and due to the highly sensitive nature of the research to assure members of absolute confidentiality in their responses. Given its relevant expertise, consultancy Hexis Quadrant assisted with question design to ensure they were appropriately tailored to the industry. We also commissioned consultancy firm Hexis Quadrant to assist with detailed knowledge to ensure the questions were appropriately tailored to our industry.

<sup>3</sup> This is significant given most of our members receive training on competition law and responsibilities, so they recognise the issues when they see them.

<sup>4</sup> Correctly defined by in the PIP (p3) as comprising Woolworths NZ Limited and the Foodstuffs Group (**Retailers**).

simplest, they do not focus on competition in the market (unsurprising as there is so little) They essentially argue that they are “in competition” for the “consumer dollar”.

- 1.7 **Relatedly, they mischaracterise the level of retail competitiveness, incorrectly treating “intragroup” and different tiers/branding as competitive constraints:** Retailers constitute a duopsony on the buy-side, and a duopoly on the sell-side. (The two Foodstuffs’ submissions are unsurprisingly much the same and should be treated as one.)
- 1.8 **They use incomplete and incorrect data to suggest competitiveness:** The arguments are not supported by data. It is incumbent on Retailers to provide a full set of data that is transparent and can be tested.
- 1.9 **Mentioning charters highlights existing gaps and shows the need for a proper Code of Conduct:** Even if past behaviour has improved, (1) it is the counterfactual which is relevant, and (2) the market structure means no guarantees against a reversion. The fact supermarkets have their own “charters” recognises something is needed. But the mechanism must be fit for purpose and seen as a genuine option for suppliers to raise issues with Retailers. This process gives the opportunity to adopt international best practice, building on UK and Australian experiences. **The Commission may wish to ask the Retailers how often the “charters” have been tested and we believe they have been rarely used by suppliers to resolve issues.**
- 1.10 **The potential harms of private label products, particularly in the context of NZ market structure, are ignored:** This is consistent with the one-sided nature of the Retailers’ submissions.

### ***Format of this submission***

- 1.11 This submission has the following Sections:

- Introduction.
- Scope and focus of the study - the Importance of market definition & evidence.
- The true nature of competition & constraints
- Brief comments on issues with private label - conflicts & potential distortions.
- Possible remedies to address market structure issues.
- Specific comments on “charters” & codes of conduct.

## 2. SCOPE AND FOCUS OF THE STUDY - THE IMPORTANCE OF MARKET DEFINITION & EVIDENCE

### ***Introduction***

- 2.1 The Retailers' submissions argue that alternative sources of food and beverage (eg meal bags, cafés) are such strong competitive constraints that there are no real competition concerns. These "options", quite obviously, cannot be given anything remotely like "equal weight", if indeed they deserve *any* weight. No real evidence has been given supporting these arguments.
- 2.2 It is necessary to consider substitutability from the demand and supply-sides. Also, to consider the materiality and level of any such alleged constraint. Yet the Retailers' do the opposite, aggregating almost everything and attributing even weight. This approach:
- a. Ignores the terms of reference and purpose of the study.
  - b. Ignores orthodoxy, ie defining markets from the demand and supply-sides.
  - c. Ignores the approach of competition agencies, both domestically and internationally.

### ***The Retailers' approach ignores the terms of reference & purpose of the retail grocery sector study***

- 2.3 The Retailers argue a wide range of fringe providers must be considered to assess retail grocery competition. However, the Government clearly intended the focus of the study to be supermarkets. Its media release announcing the study refers to a "*study into supermarkets*" and indicates the purpose of the study is to "*make sure we're not paying more than we should during the weekly shop*" – exactly what differentiates the function supermarkets fulfil as compared to other food providers like restaurants or meal bag providers.<sup>5</sup>
- 2.4 This is consistent with the terms of reference which mandate consideration of the pricing and grocery procurement practices of the Retailers. Suggesting the study focus must be widened to the food industry at large and anything that can fulfil a consumer's need to eat appears to be a deliberate attempt to distract from the true concern the study is trying to address.

### ***The Retailers ignore the necessity for a market definition exercise & related analytical discipline***

- 2.5 Market definition is the tool used to identify and assess competitive constraints. It is insufficient to point to any alternative source of food and beverage and equate them to a relevant "constraint", as the Retailers' submissions have done, otherwise all businesses are conflated into competitors for the consumer dollar.

### ***Demand-side substitutes posited are not alternatives for the grocery "weekly shop"***

- 2.6 The phrase "weekly shop" is shorthand to represent the regular, traditionally weekly, shop for a bundle of products that can only be obtained all in one place from a

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<sup>5</sup> New Zealand Government media release *Supermarkets announced as Government's second market study* (17 November 2020): <https://www.beehive.govt.nz/release/supermarkets-announced-government%E2%80%99s-second-market-study>

supermarket. The Retailers' submissions attempt to deny the significance of the "weekly shop" by claiming there has been a decline in "one stop-shop" behaviour and/or that there are a series of "missions", presumably providing greater opportunities for substitution.

*Retailer arguments about increased missions etc miss the point; suggest higher market power*

- 2.7 We understand that at least some consumers may now shop on a more regular basis than traditionally was the case. (It is not clear whether this is across-the-board or for particular segments as the Retailers have not specified this or provided relevant data.) However, we also understand that this is reflective of greater availability of supermarkets – they are open longer hours, more days of the week, and stocking a greater range of products than was previously the case (most notably alcohol). The Retailers' footprints may also be better than was previously the case.
- 2.8 If anything, this may suggest that supermarkets are – or have long ago become – far greater substitutes for traditional convenience outlets (service stations, dairies and alcohol retailers). On that basis, supermarkets may represent a strong substitute (with a better range and lower pricing) for those alternatives, but the reverse seems far less likely. Particularly when supermarkets, which are vertically integrated as wholesalers, will be the suppliers to many of those convenience outlets. On the buy-side this suggests even greater purchasing power for the Retailers when dealing with suppliers.
- 2.9 Even if there has been a decline, this does not change the fact that there is, and will continue to be, a significant portion of consumers who buy groceries in the weekly shop. Given its purpose, the whole premise of the study is exactly the prevalence of the weekly shop or an aggregated number of visits for groceries that is the equivalent.
- 2.10 Relatedly, it is not overly relevant whether shopping is weekly or more frequent. We believe that the introduction of the marketing theory of "missions", as an attempt to argue that supermarkets therefore compete with many other retailers, is not supported as a strong economic argument. The key issue is whether consumers are doing a bundled shop – ie buying a range of products at each shop that would be inconvenient to source from different specialist shops.

*Unsubstantiated assertion without quantification*

- 2.11 Significantly, the Retailers fail to give relevant evidence supporting their claims (eg data on the proportion of supply from other sources or cross elasticity or win/loss ratios).
- 2.12 We could only see (redacted) data on the prevalence of missions or the size of substitutes. This alludes to them being a material constraint, but provides no actual relevant evidence.
- 2.13 We comment further on this in Section 3 – The true nature of competition & constraints.

*It is necessary to consider the consumers*

- 2.14 In order for the Retailers' arguments to be taken seriously, not only would they need to provide appropriate quantification, they would first need to assess the relevant consumer groups. As previously submitted the Commission has considered grocery retail markets from the demand-side looking at consumer travel distances. But given the attempts to relitigate these issues and raise new points, and if the marketing theory relating to "missions" is entertained, it would be necessary to look at who were the consumers of

meal bags, cafés etc, which parties were conducting missions (and for what purposes), and what they saw as the alternatives. This would require a more granular analysis. It is hard to see a less affluent consumer considering a meal bag or café, or more expensive convenience options, to be substitutes for the weekly (regular grocery) shop.

*Other channels are not a substitute for suppliers either*

2.15 The Retailers suggest that suppliers can “band together” and/or switch to alternative channels. These assertions are highly flawed:

- a. We estimate Retailers represent around 70% to 90% of suppliers’ New Zealand volume and in some cases it may be higher. It is obviously unrealistic to expect that volume could simply be switched. In terms of the volumes taken by supermarkets, there are no competing channels which can take such volumes in a timely manner. This is why we reject somewhat glib statements in the Retailers’ submissions that suppliers can simply choose to supply others. This is not the reality for New Zealand suppliers.
- b. Those alternative channels would not have the demand or logistical ability. If the Retailers had properly analysed the posited alternatives, this would have highlighted the demand characteristics of the customers of those channels. There is not the demand from those retailers/outlets at anywhere near the same volume.
- c. While fresh food suppliers may have more options, any benefit derived from this is offset by the fact that their products are more perishable and so require a timely sale. For example the Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries (**ACCC Report**) considered there may be competitive pressures in perishable goods.<sup>6</sup>
- d. Suppliers cannot “band together” to negotiate. This is not realistic and may even be illegal. Suppliers may be members of an industry association, but an association is not a union and cannot negotiate of members behalf on matters relating to commercial terms. Suppliers have competing interests and profiles. For competition law reasons many will be unwilling or unable to cooperate together and even if they did, given the market duopsony it is doubtful that the result would mean greater negotiation power. Relatedly, and importantly, they face the more pressing issue of trying to “stay onside” with Retailers for their commercial survival. The Retailer response should suppliers attempt to collectively bargain is predictable which makes their suggestion appear disingenuous.
- e. When suggesting that suppliers could “band together” Foodstuffs North Island in its submission went as far as noting that Selling Agents “*can improve suppliers’ bargaining power...*”.<sup>7</sup> This statement has been the subject of mirth within the supplier community because although agents can represent many firms and products there is no opportunity to leverage that in a negotiation which is done for those individual firms.

2.16 Again the Retailers’ claims suppliers have alternative channels to reach the market are not supported with evidence of this claim with relevant data. For example, if the Retailers delisted a particular product, would additional supply to all other channels be able to make up for that loss in volume? If not how can alternative and niche channels be argued

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<sup>6</sup> ACCC Report at page 120 <https://www.accc.gov.au/publications/report-of-the-accc-inquiry-into-the-competitiveness-of-retail-prices-for-standard-groceries-july-2008>

<sup>7</sup> Foodstuffs North Island’s submission at page 14

to be viable substitutes? Where has this happened in practice and to what extent? One or two isolated examples of these products would be insufficient.

- 2.17 Instead, the ability of supermarkets to “negotiate robustly” with suppliers is best explained by supermarkets being the only channel through which most suppliers can reach most consumers. There is no substitute for the level of volume (and geographic spread) supermarkets represent to suppliers. We estimate this to be around 70-90% of all sales volume for smaller suppliers but this is the sort of data the Retailers should be providing.

### **Supply-side substitutes**

- 2.18 Self-evidently the suggested constraints cannot provide the range or “marketplace” that a supermarket offers. Nor does this appear to be claimed by the Retailers. A channel that can substitute *one* product, or even a selection of products, is not necessarily able to substitute the *bundle* of products and services supermarkets provide. They do not offer the “bundle” for the essential or main weekly shop (or other relevant period). They may, as noted, be a poor substitute for supermarkets for other “missions”. This may be why we see fewer convenience stores.
- 2.19 To truly see the weakness of those submissions one need only consider the requirements to be a full competitor on the supply-side.

*Conditions of entry and/or expansion need to be considered*

- 2.20 A competitor would need:

- a. Thousands of SKUs covering a sufficient range of products so as to enable customers to pick up everything they need in one stop. The Health Star Rating review estimated over 15,000 SKUs of packaged food in New Zealand alone, excluding non-food products and fresh products.
- b. To be price competitive and price at the same price points.
- c. Increasingly, offer an online channel (Retailers have highlighted the significance of this).
- d. A national footprint, distribution network and sufficient volume to reach the scale needed to efficiently buy from suppliers.
- e. Favourable trading terms with suppliers to be price competitive on the consumer side – this is precluded by current contracts in place with the Retailers who can negotiate one-sided terms like most-favoured nation clauses.
- f. As Foodstuffs’ submissions recognised,<sup>8</sup> desirable land and store locations to attract customer traffic and to offer convenience for consumers.

- 2.21 As noted, the alternatives put forward by the Retailers do not provide the functional characteristics required to be substitutes. Nor has any evidence been presented that this marginal competition is a material competitive constraint on the market power of the Retailers.

- 2.22 Supply-side substitution seems unrealistic despite the Retailers’ assertions. Supply-side substitution refers to when a supplier of one product can substitute its production

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<sup>8</sup> For example Foodstuffs North Island’s submission at [31]

capacity to quickly supply an alternative product in response to an increase in price by a hypothetical monopolist of that alternative product.

2.23 There is not any obvious supply-side substitution potential.

- a. The Warehouse, Kmart etc may be the most likely candidates but would fail to satisfy the usual hypothetical monopolist test because it would take time and investment for those stores to provide the full range of groceries.
- b. The Warehouse has already tried. The Warehouse has submitted accurately on these points and we endorse its submission.
- c. It is telling that Aldi, which might seem an obvious near entrant, has been unwilling or unable to do so. Even if it did it would be necessary to consider the nature and extent of any constraint that it offered. This is hypothetical.
- d. Similarly, references to Costco, which may or may not start supplying in New Zealand, seem misplaced. It would be necessary to understand the nature and extent of its market entry. If, for example, it was a dry goods operator with one premises in Auckland, supplying only selected and private label brands, it is hard to see what its impact would be on the broader grocery markets in New Zealand. It seems implausible that Costco would meet a LET test.

***The Retailers' approach is inconsistent with competition agencies' market definitions***

2.24 The Retailers' analytical approach is inconsistent with how competition/antitrust agencies have approached the assessment of competition in the market and broader competitive constraints.

2.25 Most obviously the Commission's approach, which was used by the Court of Appeal in the *Woolworths* judgment, considered "*markets for the retailing of grocery items in supermarkets*" within a certain distance to account for demand- side substitutability.<sup>9</sup> We refer also to paragraphs 56 to 57 of our submission which quotes, and agrees with, the Commission in previous decisions explaining why other providers are only fringe competitors.

2.26 In the United States also, the degree of constraint that alternatives pose is fundamental to their exclusion or inclusion from consideration.

- a. In *Von's Grocery* the relevant market was the *grocery market in the Los Angeles area*.<sup>10</sup>
- b. In *American Stores Inc* the relevant product market was "*supermarkets*". This was defined as full line grocery stores with more than 10,000 square feet because "*realistically, only such supermarkets compete for the consumers' weekly or periodic grocery shopping needs and other outlets which also sell groceries, such as convenience stores, etc., serve consumers' needs in a distinctly separate market ...* ***The Court is not persuaded that the relevant product market in this case contains food purchases from the broad range of outlets contended by defendants, nor that grocery shoppers seriously consider, for example, gasoline service stations or department stores as competing sources with supermarkets for their grocery needs. Even if convenience stores competitively***

<sup>9</sup> *Commerce Commission v Woolworths Limited* [2008] NZCA 276 at [5]

<sup>10</sup> *United States v Von's Grocery Co* 384 US 270 (1966)

*price a few food items, such as bread and milk, in direct competition with supermarkets, such is not sufficient to justify inclusion of all retail grocery sales from whatever outlet in the relevant product market”.*<sup>11</sup>

- c. In *Whole Foods Market Inc* the relevant product market was *premium natural and organic supermarket chains (PNOS)* because only such supermarkets “*compete for core consumers within a PNOS market, even if they also compete on individual products for marginal consumers in the broader market*”.<sup>12</sup> The court further explained “[w]hat motivates antitrust concern for such customers is the possibility that “*fringe competition*” for individual products within a package may not protect consumers who need the whole package from market power exercised by [suppliers] of the package”.<sup>13</sup>

2.27 In none of these cases have restaurants, meal bags etc formed part of the relevant market because they simply do not form a sufficiently material constraint. In fact the opposite is the case. Federal Trade Commissioner Christine S Wilson recently observed how product markets in relation to grocery have been narrowing.<sup>14</sup>

***The Retailers’ approach is also inconsistent with that of competition agencies in market studies***

2.28 Market studies into retail grocery undertaken in other jurisdictions also focus on supermarket competition.

2.29 For example, the ACCC Report recognised:

- a. “*Larger supermarkets primarily aim to attract consumers completing their weekly shopping, ... Supermarkets face competition from specialist retailers such as butchers and greengrocers in relation to meat and fresh fruit and vegetables; however, their closest competitors are usually other supermarkets with broadly similar retail offers*”.<sup>15</sup>
- b. “[S]upermarkets offer a joint product, which consists of retailing a broad range of products from the same location”.<sup>16</sup> Other food providers cannot fully substitute this offering.

***Summary***

2.30 Even if there is an increase in, for example, meal bag sales, (1) the Retailers have not provided any evidence to suggest that this has reduced their sales or impacted them in any way (ie no evidence of a correlation); (2) even if they had, correlation is not causation; (3) further they would need to demonstrate which particular customer/segments they are competing with (we suspect that from a competition

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<sup>11</sup> *California v American Stores Inc* 697 F Sup 1125, 1129 (CD Cal 1988)

<sup>12</sup> *Federal Trade Commission v Whole Foods Market Inc* 548 F 3d 1028, 1043-49 (DC Cir 2008) at page 1037

<sup>13</sup> *Federal Trade Commission v Whole Foods Market Inc* 548 F 3d 1028, 1043-49 (DC Cir 2008) at page 1038

<sup>14</sup> See *From Von’s Grocery to Whole Foods: How Narrowing Product Markets Have Quietly Changed Antitrust* Commissioner Christine S Wilson, US Federal Trade Commission (5 March 2021, Seventh Annual Berkeley Spring Forum on M&A and Governance)

<sup>15</sup> ACCC Report at 70

<sup>16</sup> ACCC Report at 72

perspective it may be more likely that these compete with convenience foods/takeaways etc)<sup>17</sup>.

- 2.31 The Retailers' submissions are not founded on appropriate analysis or supported by appropriate evidence. We expect that there is extensive information asymmetry and they could provide relevant information with a high level of granularity. Without proper foundation their assertions must be rejected.

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<sup>17</sup> Normally, if such data is provided, care would need to be taken to adjust for any short term COVID-19 distortions.

### 3. THE TRUE NATURE OF COMPETITION & CONSTRAINTS

#### ***There is a duopsony on the buy-side and duopoly on the sell-side***

- 3.1 After defining an appropriate market with constraints properly weighted relative to their significance, it is clear that the grocery retail market is dominated by an upstream (buy-side) duopsony and a downstream (sell-side) duopoly of Foodstuffs and Woolworths. Conditions of entry and expansion are onerous. Structural issues are exacerbated by behavioural factors as we have previously submitted. As the Warehouse and New Zealand Horticultures' submissions recognise, the level of competition that can exist in a duopoly with high barriers is limited.

#### ***Conditions of entry & expansion - consideration of the LET test***

- 3.2 The Retailers' submissions fail to identify any examples of successful full-scale entry. Costco's success with its planned single store is yet to be determined, as United Fresh's submission recognised,<sup>18</sup> and in any case it had to overcome high barriers of entry, having to search for suitable sites and rely on its significant international supply chain.
- 3.3 As noted above, many of the suggested competitive constraints are yet to materialise and/or may be imaginary.
- a. Examples like Sephora, Zara, H&M are beauty and apparel stores which are not even in the same industry and are completely irrelevant.
  - b. The Warehouse is cited as an example of entry even though its attempt to expand to grocery failed – demonstrating a clear market line between supermarkets and other retailers and providers.
  - c. The growing significance of online supply only highlights a further “condition of entry” needed to compete as a full-service grocer.

#### ***Retailers' meaningless aggregation to the point of including all stores is extreme and ignores geographic markets***

##### **All stores & intragroup competition**

- 3.4 Woolworths' submission attempts to characterise individual stores as separate competitors.
- a. Characterising each of the Retailers as hundreds of individual stores is incorrect when stores are geographically spread out to compete for different local catchments and secure for the Retailer a complete geographic offering.
  - b. Characterising each banner as separate competitors is also incorrect when banners cater to different points in the market, again to secure for the Retailer a complete offering.
- 3.5 Foodstuffs seems to make similar arguments when it suits. We submit that the Commission has taken the correct approach treating it as “one head”. We are not aware of evidence to suggest that its individual banners are anything other than directed at different segments in the market, or that individual store owners consider themselves to be in direct competition with each other.

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<sup>18</sup> At page 17

- 3.6 Provisions in the Commerce Act, which treat interconnected bodies corporate as one person, recognise the commercial reality that each Retailer group only acts as a single constraint on one another. It is for good reason that when conducting a merger control assessment, the Commission treats interconnected and associated persons as “one head”. It does not place weight on internal competition. Taking such arguments to an extreme would permit mergers to monopolies, if they operated multiple brands.

### ***Accommodating behaviour***

- 3.7 We consider it is important not to create a “straw person” or hurdle around accommodating behaviour although we do think there is evidence that this occurs. The broader point is that there is an unusual level of market concentration with very high barriers to entry and expansion. This has facilitated Retailer behaviour which has exacerbated barriers to entry. This has the adverse upstream impacts on supply, including on innovation, investment and employment as set out in our earlier submission. That means less competitive markets downstream, also to the detriment of consumers.
- 3.8 That said, there are examples of accommodating behaviour as outlined in various submissions. The problems are not new. For example, on 16 May 2014 Hon Clayton Cosgrove wrote to Dr Berry expressing concerns *“held by a number of suppliers in the supermarket sector about being required to disclose information pertaining to their pricing, contracts and other arrangements with competing retailers in order to maintain access to retail shelves.”* He went on to give the *“specific example. I am concerned by reports that a large supermarket chain has recently demanded that some suppliers inform them about the promotional activity of other competing retailers.”*

### ***No countervailing supplier power***

- 3.9 The Retailers’ submissions argue suppliers have countervailing supplier power. Simply because a party is larger multinational does not give it countervailing market power. We understand that over the past 15 years the share of dollar sales for larger manufacturers has dropped about 25%, from just over 50% to just over 40% of overall supermarket sales, which does not seem to support assertions of countervailing supplier power. Cases of equal bargaining power will be rare in practice. In virtually all other cases there is a significant imbalance.
- 3.10 Other submissions recognise the imbalance of power in favour of the Retailers<sup>19</sup>. Coordination by suppliers is unrealistic for the reasons noted in Section 2. For this reason, there is no evidence of aggregation on the supply side which comprises of many different parties and interests. We understand that the evidence shows that larger suppliers now account for a significantly lower percentage of supply to supermarkets than was previously the case.
- 3.11 On the retail side however, there are only two major Retailers. As noted, suppliers are dependent on the Retailers as their primary channel to consumers. Even international suppliers need to rely on the Retailers for access to the New Zealand market. The Retailer-supplier dynamic is further skewed by the fact that Retailers can directly supply products through private labels and so are also competitors with incentive to give preference to their own products to maximise their profits. We discuss private label issues further in Section 4.

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<sup>19</sup> See for example Consumer NZ’s submission at [38]-[41], Turner & Growth Fresh’s submission’s answer to question 39 and 40, and New Zealand Horticulture’s submission

### ***Retailers' incentives are profit maximisation***

- 3.12 The Retailers' actions and behaviours are consistent with that of a duopoly. They frame themselves as consumer focused, however like any rational business they act to maximise profits. Consumers should benefit from competition not Retailer generosity. Two recent examples where being consumer focused or "customer driven" was secondary to retailer margin demands were the deletions of San Remo Pasta and Orchard Gold Frozen Berries (New Zealand grown) from North Island New Worlds. Both ranges were the clear market leaders in their categories and therefore the most preferred by New Zealand consumers at the time of their deletion on margin grounds.
- 3.13 Arguments that their conduct is all in the best interests of consumers must be subject to appropriate scepticism and viewed through that lens. Increasingly decisions are about margin above all else so that even the most popular products (as indicated by consumer preferences and sales) can vanish from the shelf reducing access and consumer choice.

### ***The Retailers' submissions lack the necessary evidence to support their claims***

- 3.14 As noted above, the Retailers' submissions do not evidence their claims. They are the ones in the position to collect and provide this data at the granular level needed to properly evaluate it. Instead, their submissions have provided at best only glimpses of part of the picture and contain inconsistent generalisations to hide issues by conflating categories. They lump all competition together and aggregate it to give a greater appearance of competition.
- 3.15 For example, Foodstuffs North Island's submission states "*there is no single grocery product that is truly necessary to purchase ... The high degree of product substitutability enables a wider range of retailers to compete for the same customers*"<sup>20</sup> yet "*there are a number of suppliers with significant market share and relatively unique products (ie low substitutability)*"<sup>21</sup>.
- 3.16 Thus, we see comments along the lines of "*In relation to these missions FSNI competes against meal kits, specialist grocers, pre-made meal retailers and quick service restaurants, which are able to win material sales and constrain FSNI by focusing on particular missions*"<sup>22</sup> and "*Meal kit providers are direct competitors to supermarkets*"<sup>23</sup>. But we did not see quantification or relevant evidence for this.
- 3.17 Page 16 of Woolworths' submission states that consumers will go on to shop at other food providers after shopping at Countdown. This does not necessarily reinforce close competition. Those other shopping expeditions may be complementary or irrelevant. That comment strongly suggests that from the demand-side consumers may see those as separate markets. So, for example, it seems that on their own interpretation consumers do not shop at those other retailers *instead* of Countdown but in addition to it. It is impossible to know given that the Retailers did not provide evidence on this.
- 3.18 If data is provided for one segment, then it should be provided for all segments to show the full picture and not just the most competitive parts of the market because in a sector as large as retail grocery, that leaves many areas for anticompetitive behaviour to hide. For example, Woolworths' submission<sup>24</sup> cites a New Zealand Horticulture press release to state independent fresh fruit and vegetable retailers account for 60% of sales in

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<sup>20</sup> At [16]-[17]

<sup>21</sup> At [25.1]

<sup>22</sup> Foodstuffs North Island's submission at page 4

<sup>23</sup> Woolworths' submission at page 22

<sup>24</sup> At page 45

Auckland, but fails to mention that the same press release states independent fresh fruit and vegetable only account for 20% of sales overall.<sup>25</sup>

- 3.19 Their arguments need to clearly identify which products, consumers, and geographic locations, they apply to, and need to provide evidence of the degree of constraint. For example, Foodstuffs North Island's submission claims suppliers can supply direct to consumer.<sup>26</sup> This may be true for some products, but not all. It fails to identify which products, and does not provide context of the degree of direct supply which may be very little especially compared to the volume supermarkets represent. It may also have been limited to the time during COVID-19 lockdowns.
- 3.20 The ACCC Report recognised this problem of unsupported generalisations. "*In scrutinising the information before the inquiry, it has become clear that some industry participants, representative groups and commentators have made unsupported claims to the inquiry and in the media. **These claims were based on generalisations and there was a failure to provide facts to support the claims***" [emphasis added].<sup>27</sup>

### ***Profitability and price comparisons have limitations & argument / data again opaque***

- 3.21 While EBIT may be one measure to look at, other factors and evidence may be worthwhile. For example, assessing the tax returns of individual store owners. International comparisons of prices and profitability may also have limitations.
- 3.22 We were concerned that a number of the assertions and the economist's report provided by Woolworths.
- 3.23 We were perplexed that an economists' report would be based on poor data, particularly when the provider of that data expressly required a disclaimer on every page with the following text:

***"All information contained herein is provided for reference only, and is not intended to provide professional advice and shall not be relied upon in that regard. The Economist Intelligence Unit, NA, Inc. and its affiliates do not make any warranty or representation as to the accuracy, completeness or reliability of any of the information contained herein"***.

- 3.24 Accordingly, the so-called "Grocery price benchmarking" report (**NERA report**) prepared by NERA Economic Consulting must be ignored as having zero evidential value. It is based on EIU data subject to a disclaimer that it should not be relied upon. (Interestingly Foodstuffs seems to disclaim international comparisons.)

### ***Economic evidence on substitution, profitability, international price comparisons and private labels***

- 3.25 This clear unsuitability in the underlying data should be the end of the matter. However, given the importance of this study and submissions made by the Retailers, it was necessary to seek independent expert economic evidence.
- 3.26 Accordingly, we commissioned Castalia Advisors (**Castalia**) to provide an economic report commenting on the Retailers' arguments about substitution, profitability, international price comparisons and private labels. As part of this exercise we asked

<sup>25</sup> <https://www.scoop.co.nz/stories/BU2008/S00204/open-letter-horticulture-recognise-independent-fruit-vegetable-retailers-as-essential-services.htm>

<sup>26</sup> See for example Foodstuffs North Island's submission at [20]

<sup>27</sup> ACCC Report at xiii

them to view review NERA's Report. A copy of the Castalia Report accompanies this submission.

3.27 Castalia concludes:

- a. Close substitutes are most relevant when assessing competition.
- b. Economic profits, rather than accounting profits, are relevant to competition assessment.
- c. International price comparisons must be carefully constructed and interpreted.
- d. The likely effect of private labels must be assessed in the specific context of the NZ's grocery market structure and the organisational context of the NZ retailers

**Close substitutes are most relevant when assessing competition**

3.28 Castalia finds that:

- a. Value-added food and beverage retail (eg takeaway retailers, cafes, restaurants) are different services. They are not close substitutes. Prices reflect additional inputs.
- b. Convenience stores are also unlikely to represent a significant competitive constraint due to the higher prices and more limited range.
- c. Meal kits are unlikely to be in the same market because consumers are unlikely to shift consumption at sufficient scale applying a SSNIP test.
- d. Purchase of individual grocery types from specialists is unlikely to be a sufficiently close substitute for full-service supermarkets. (There are potentially some exceptions, but the Commission would need significant additional information to place appropriate weight on any such constraints.)

**Economic profits, rather than accounting profits, are relevant to competition assessment**

3.29 Castalia confirms that economic profits are the relevant measure. Accounting profitability measures, which is what the Retailers cite, is not relevant to examining market power. The focus should be on whether risk-adjusted returns on capital are higher than reasonable expectations.

3.30 Relevant NZ data is not available, but looking at Woolworths Australia's return on capital employed (ROCE) returns seem to greatly exceed what would be expected for Woolworths (a defensive company with a low asset beta) from a CAPM perspective, and do not indicate a strongly competitive market. NZ retail grocery supply is likely less competitive, so returns on capital for NZ grocery retailers also seem likely to be excessive.

3.31 Castalia recommends that the Commission collects financial information from Woolworths NZ, at least a sample of Foodstuffs' member supermarkets (across brands, locations and size), and the Foodstuff cooperatives.

### **International price comparisons must be carefully constructed and interpreted**

- 3.32 Castalia were not able to fully comment on the methodology used to collect the data NERA Report used, due to the lack of clarity and information on how it was collected. It observed that it was unclear if NERA was fully aware of the methodology used. However, based on the available information, Castalia found a number of problems with the dataset.
- 3.33 Castalia concluded that the results of the NERA price comparison analysis **should not be relied upon**. At best, it considered that the report raised some of the methodological issues the Commission would need to consider if it undertook a price comparison.

### **The likely effect of private labels must be assessed in the specific context of the NZ's grocery market structure and the organisational context of the NZ retailers**

- 3.34 Castalia confirms the potential for anticompetitive detriments from private labels.
- 3.35 As we note elsewhere in this submission Castalia considers it important that the Commission assesses their impact in the specific context of the relevant markets in NZ, given:
- a. The structure, concentration and degree of market power in the relevant retail grocery markets.
  - b. The extent of buyer power that the supermarkets hold for each of the relevant upstream markets for the supply of grocery goods.
  - c. The incentives on grocery retailers in NZ, given their ownership and operating structures.
- 3.36 As noted we consider that the price point of private label products should be a significant feature of the analysis. The proportion of supermarket private label sales will be significant as well. We understand that these could on average be up to nearly 15% by value. These figures will necessarily vary – so in some geographic and product markets the numbers could be significantly higher. Similarly, where private label products are lower value – error volume will be higher.
- 3.37 Woolworths' submission relies on measures of competition which do not show the full picture.
- a. **Low margins:** As indicated above, economic profit, rather than accounting profit, is the relevant measure of profitability. We query how Woolworths' return on capital compares with a reasonably required return in the NZ context, and how it compares worldwide.
  - b. **International benchmarks:** Benchmarks as simple as [interest.co.nz's grocery price monitor](https://www.interest.co.nz/grocery-price-monitor) (screenshot attached as **Figure 1**) show how New Zealand prices are historically higher than Australia's.<sup>28</sup> We refer also to paragraphs 22 to 24 of our submission which provided data showing how New Zealand's retail grocery sector is one of the most concentrated with food expenditure among the highest in the world and recommended the Commission to conduct a similar analysis with more recent data. Competition may also be able to be improved significantly more

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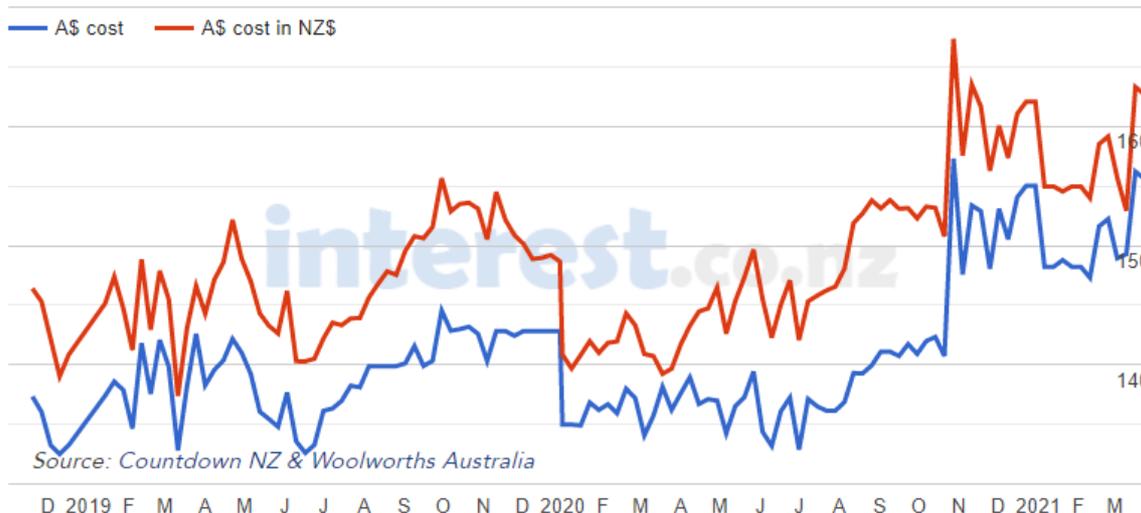
<sup>28</sup> Prices after the study commenced obviously cannot be taken into account

than benchmarking suggests considering many other jurisdictions have also had competition concerns in relation to retail grocery.

### NZ\$ basket



### A\$ basket in NZ\$



**Figure 1: Interest.co.nz's grocery price monitor comparing Countdown NZ and Woolworths Australia prices.** The biggest differential in the time period captured appears to be 1 January 2020 where NZ prices were NZ\$177.68 while Australia prices were almost NZ\$35 lower at NZ\$142.83. More generally, NZ prices are usually higher, with the NZ graph even using a higher scale (prices after the grocery study commenced obviously cannot be taken into account).

- c. **Investment and innovation:** Woolworths' market power enables it to invest into its own business, but suppliers are not afforded the same luxury. We believe that some of the Retailers' cost cutting is simply shifting costs to suppliers, for example requiring suppliers to pay for store theft, which is usually a genuine retail cost. We endorse New Zealand Horticulture's submission which recognises how this harms competition in the long term because suppliers are unable to invest in improving efficiency and innovation. Woolworths' submission identifies a handful of New Zealand's most successful local suppliers, but that is the bare minimum level of innovation we would expect to see and does not preclude structural issues in the

supply chain which will have long term effects in the years to come if change does not occur. We cannot see how smaller local suppliers can innovate when their margins are being squeezed by the Retailers to further their own business.

#### 4. BRIEF COMMENTS ON ISSUES WITH PRIVATE LABEL - CONFLICTS & POTENTIAL DISTORTIONS

##### *Private labels - Retailer comments*

- 4.1 Woolworths' submission considers their private label offerings "*have a positive effect on competition at the supplier level and in turn deliver lower prices and increased choice for New Zealand consumers*".<sup>29</sup>
- 4.2 Foodstuffs North Island's submission similarly considers "*[t]he supply of private label products is an important way in which FSNi responds to the market power of major global and domestic suppliers*".<sup>30</sup>
- 4.3 We acknowledge that, in the context of the Australian market, over a decade ago, the ACCC concluded that the introduction of private labels **at a lower price point** offer consumers additional choice and was on balance pro-competitive in that market "*all other things being constant*". And that "*as a whole*" consumers were not worse off.<sup>31</sup> Those limitations are worth noting.
- 4.4 The Retailers do not address the vertical theories of harm which arise from their involvement on the supplier level and the related inherent conflicts on interests that arise from being at the same time retailer and competitor with suppliers. It is also worth noting that while retailers point out in their submissions that the New Zealand supply community is innovative, there are examples of innovative suppliers being required to allow the use of their "innovation" in the form of the retailers' private label offering.
- 4.5 The Retailers' assertions are not a substitute for an analysis of New Zealand market structure and conduct and potential adverse anti-competitive effects.

##### ***There can be procompetitive and anti-competitive impacts of private labels***

- 4.6 As noted, private labels are not unequivocally good.
- 4.7 Even in 2011, in the quite different EU marketplace, the position was put as follows:

*"Private labels influence both the competition within food supply chains and the range of food products that are available to consumers. Private labels increase the range of available products and thus increase inter-brand (price) competition. On the other hand, private labels change the relation between retailers and their suppliers. **Suppliers of branded products face not only vertical competition from retailers but also horizontal competition**, since retailers start 'producing' their own products. Retailers may replace industrial brands by private labels. When retailers do so, they **reduce consumer choice**. Suppliers of private labels may benefit from this development, but they may also lose. They get access to the customer base of the large retailers, but they **may also become more dependent on specific retailers**. Therefore, suppliers of private labels become more dependent on retailers, and independent suppliers of branded and non-branded products face more intensive competition. **Both developments may enable retailers to exploit possible buyer power and to***

<sup>29</sup> Woolworths' submission's answer to question 37.

<sup>30</sup> Foodstuffs North Island's answer to question 37.

<sup>31</sup> ACCC report private labels section at 16.3 (page 360)

***squeeze suppliers' profits. In the end, this may hurt consumers if consumer prices rise, consumer choice is limited and the innovation rate falls.***<sup>32</sup>[Emphasis added]

- 4.8 We also note the abstract for ***The impact of the rise in private label brands on supplier-retailer relationships***<sup>33</sup> which reads:

*“The Australian supermarket industry has long been dominated by two players- Coles and Woolworths. In recent years this dominance has increased significantly and the ‘Big 2’ have been utilizing their power more effectively, resulting in record growth and financial performance. One of the main changes in recent years has been the ever increasing number of ‘private label’ products on supermarket shelves. This study has investigated the wide-reaching implications of these products on the relationship between Australian supermarkets and their suppliers. This qualitative study used indepth, high engagement interviews with a range of suppliers. The findings indicate a highly uncertain future for Australian food suppliers, with the situation likely to continue to worsen further as the supermarkets continue to exercise their power. This research has implications for suppliers, marketers, policy makers, and its main contribution lies in providing a greater understanding of the significance of the impact of private labels on the industry.”*

***The potential concerns highlight the need for a proper substantive analysis – not assertion***

- 4.9 New Zealand’s unique market structure and an increased focus over recent years on vertical/horizontal overlap and issues means close scrutiny is required.

***Retailers have various potential conflicts of interest***

- 4.10 Earlier we noted that Retailers are profit-maximising. They will opt for the bundle that maximises their profits, not what is best for consumers or suppliers. As mentioned earlier the deletion of consumers’ most popular and regularly chosen brands are good examples where it is difficult to reconcile the rhetoric of being “customer driven” with what actually occurs. If North Island New World were truly “customer driven” why delete the most popular brands consumers choose to put in their trolleys? The New Zealand market structure lends itself to greater manipulation than might otherwise be the case in another market with genuine competition.

- 4.11 We also noted the growing interest in vertical/horizontal issues. Notably when a party operates a marketplace for suppliers, but it then becomes a supplier in its own marketplace, competing with its own customers. Amazon<sup>34</sup> and others are examples of this growing scrutiny.

- 4.12 There are a number of conflicts of interest here:

- a. *Conflict of interest 1 – Retailers get significant inside information from suppliers:* Parties do not normally supply competitors with volume, cost/price and promotional information. Indeed as of 8 April this year cartel conduct is now a criminal offence.

<sup>32</sup> The impact of private labels on the competitiveness of the European food supply chain – study carried out by LEI, Reference No ENTR/ 2009/031 [The-impact-of-private-labels-in-SME-competitiveness-of-the-European-food-supply-chain.pdf](https://www.researchgate.net/publication/32968296) (researchgate.net)

<sup>33</sup> [8296.pdf](https://www.impgroup.org/research/8296.pdf) (impgroup.org)

<sup>34</sup> See for example Dana Mattioli *Amazon Scooped Up Data From Its Own Sellers to Launch Competing Products* (23 April 2020) [https://www.wsj.com/articles/amazon-scooped-up-data-from-its-own-sellers-to-launch-competing-products-11587650015?mod=hp\\_lead\\_pos7](https://www.wsj.com/articles/amazon-scooped-up-data-from-its-own-sellers-to-launch-competing-products-11587650015?mod=hp_lead_pos7)

As far as we know there are no measures to protect that information being misused for anti-competitive purposes.

- b. *Conflict of interest 2 – Price relativities at retail.* Retailers may not want competing, strongly branded goods, to be priced below their private labels and in some cases will reject deals for higher quality product because the branded product would be cheaper for consumers than the retailer's private label. Private labels might then set a price floor and reduce price competition. Conversely if the private label goods were regarded as better quality, then the ACCC's comments about the then-applicable level of comfort it was able to reach would not seem relevant (as, putting aside the other distinctions, they appear to have been in relation to lower price point private labels).
- c. *Conflict of interest 3 – quantitative issues – Retailers become competitors for vital shelf space.* Not only could this impact the viability of suppliers, consumers may miss out on the variety and innovation, particularly as quantities of private label increase.
- d. *Conflict of interest 4 – there may also be concerns about use of know-how and/or intellectual property belonging to the supplier.* It may unknowingly or unwillingly be forced to effectively gift this information and intellectual property to the Retailer. Suppliers have reported this to the NZFGC over the years.

**Summary – conflict-of-interest as competitors – market distortions possible & scrutiny required**

**Retailers competing as suppliers**

- 4.13 Retailers have different incentives when they also compete on the supplier level. First, Retailers receive sensitive commercial information from suppliers and have a conflicting interest to use this information to improve their own competing private label or even force suppliers to become their manufacturers (ie, requiring the supplier to also manufacture the Retailers' home brands as a condition of supply). Second, private labels are typically understood as a low-cost option, as the Retailers' own submissions suggest<sup>35</sup>. Retailers therefore have a conflicting interest to ensure competing products are priced higher than this implicit price floor. Third, suppliers compete for limited supermarket shelf space. Retailers have a conflicting interest to favour the placement of their own private label products. There may be related IP issues.

**Market distortions**

- 4.14 Retailers have an interest in continuing to supply other products to provide consumers with a range of goods – but only to a degree. Market distortions can occur because it is Retailers who have the power to decide how many competitors and which competitors it will allow to compete to maximise the Retailers' overall profits, rather than consumer choice deciding which products should prevail and rewarding such products accordingly.

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<sup>35</sup> See Woolworths' submission's answer to question 37 and Foodstuffs North Island's submission at [27.2].

## 5. POSSIBLE REMEDIES TO ADDRESS MARKET STRUCTURE ISSUES

### *Introduction*

- 5.1 Earlier we took the perspective that it was appropriate for the Commission to issue its draft report, confirming the structural issues, before we proceeded to submit on possible measures to address the issues.
- 5.2 Having seen the attempts to obfuscate the issues, and being given this opportunity, it now seems appropriate to raise these so that they can be considered in the Commission's draft report.

### *The problem*

- 5.3 Per our initial submission there is a structural issue. The downstream (retailing) market power is used to squeeze margins from the rest of the supply chain and create barriers to entry by engaging in exclusionary conduct, further reinforcing the lack of competition.
- 5.4 We refer to paragraphs 11 to 17 of our submission which outlines the harms of buyer power exhibited by supermarkets in New Zealand.
- 5.5 These points are reinforced and further supported by our recent survey and presumably, the Commission's own results.
- 5.6 **It is worth repeating paragraph 174 of our submission which read as follows:**

The table below identifies types of harmful procurement practices, supported by examples.

	<b>Type of behaviour</b>	<b>Who benefits</b>
<b>1</b>	<b>Shifting risk and cost from the supermarket to the supplier</b>	
1.1	Requiring a supplier to guarantee a retailer's margin regardless of price.	Retailer
1.2	Margin expansion – the practice of extracting higher margins from suppliers and at the same time increasing the on-shelf price.	Retailer
1.3	Tender processes where double and triple the trading margin is expected from suppliers.	Retailer
1.4	Demands for payments from suppliers for costs which are instead genuine retail costs e.g. staff costs for placing products on the retailer's shelf.	Retailer
1.5	Demands to pay for store theft, shrinkage and waste.	Retailer
1.6	Demands to pay for product damage not the fault of the supplier or risk deletion.	Retailer
1.7	Demands for retrospective payments from suppliers for previous financial years for perceived gaps in margin or other vague benefits the supplier is deemed to have received.	Retailer
1.8	Over-ordering and cancelling; overordering due to retailer forecasting errors and then returning the stock.	Retailer
1.9	One-sided contracts e.g. having no exit clause for suppliers; prohibiting suppliers from seeking legal or professional advice on tender documents without approval from the retailer.	Retailer
1.10	Retrospective variations to contracts to favour the retailer.	Retailer
<b>2</b>	<b>Extracting additional payments/fees from suppliers</b>	

2.1	Demands to pay a percentage of sales as a “display” payment when the product has not, and most likely will not, be displayed. Some larger suppliers extract agreements for displays in return, but most signed agreements are without any guaranteed activity from the retailer at all.	Retailer
2.2	Demands to pay for shelf space or floor space or risk deletion.	Retailer
2.3	Listing and ranging fees.	Retailer
2.4	“Auctions” and tenders for shelf space.	Retailer
2.5	Unreasonable claims for payment of services or credits dating back more than two years following “forensic audits”.	Retailer
2.6	Demands for payment of a % of sales for waste or damage which is over and above actual waste or damage.	Retailer
2.7	Introducing new and unbudgeted costs e.g. a product “neck tag” fee, a product recall fee or some other new cost	Retailer
2.8.	Negotiating a discount from the supplier for a consumer promotion and then not running the consumer promotion. While price is not discussed the negotiation takes place with the supplier intention and expectation that there will be activity in the market of some kind which benefits consumers.	Retailer, Consumer loss
2.9	Demands that a supplier uses the retailer’s transport system which is often more expensive, less efficient and less accountable. Threats of punitive action should a supplier wish to leave the retailer’s primary freight service.	Retailer
2.9	Demands to purchase retailer data eg. dunnhumby	Retailer
<b>3</b>	<b>Reducing or delaying payment to suppliers</b>	
3.1	Deducting a settlement or prompt payment discount despite making late payments.	Retailer
3.2	Slow and extended payment terms for goods; payments made months after the retailer has sold the goods; unreasonable payment delays. irrespective of undertakings as to timeliness in contracts.	Retailer
3.3	Unreasonably long payment terms for high volume goods. For example, a supplier sells product to retailer on 1 December and it sells on 2 December. The retailer pays the supplier 20 January and often later.	Retailer
3.4	A practice by some stores of regularly and significant claiming for short delivery of shipments (signed as received) when the supplier has no doubt the product has been delivered.	Retailer
3.5	Arbitrary deductions of large sums from remittance without consultation. There is little most suppliers can do to get disputed claims back.	Retailer
<b>4</b>	<b>Product deletion threats and other retribution</b>	
4.1	Constant threats of deletion as a default and “negotiation” shortcut.	Retailer
4.2	Threatening to move supplier’s product to a lower shelf to make it harder for consumers to secure other retailer benefits.	Retailer
4.3	Banning a supplier from promotional activity as a punitive measure for not complying with some other demand or activity.	Retailer, Consumer loss as there are fewer opportunities to buy those brands at a reduced price.
4.4	Rejection of all new product development as a punitive measure for not complying with some other demand reducing consumer access to products and innovation	Retailer, Consumer loss.

<b>5</b>	<b>Inducing supplier to refuse to deal with competitive retailers</b>	
5.1	Demands not to supply competitors with exclusive packs or other product variants.	Retailer
5.2	Threatening deletion of a product or applying other pressure if a supplier supplies products to another new entrant in the New Zealand market.	Retailer
<b>6</b>	<b>Requirements to participate in uneconomic promotions</b>	
6.1	Requiring suppliers to participate in promotions where the ROI is unclear or unlikely. See 2.9 regarding the purchasing of retailer data.	Retailer, in some cases consumer.
6.2	Demands that suppliers move to a “6 week on, 2 weeks off” promotional rotation which would mean in effect that all stock is purchased from the supplier at the promotional price.	Retailer, Consumers benefit only during the promotion “on weeks” when the lower price is passed on.
<b>7</b>	<b>Requirements to provide free products or perks</b>	
7.1	Demands for significant amounts of free product at store before accepting what should be, according to head office decision, a compulsory stocked line and on the shelf.	Retailer
7.2	Requests for petrol vouchers, restaurant meals, free product and other personal gifts either personally or for staff	Retailer, Personal
7.3	Free overseas travel and accommodation	Retailer, Personal
7.4	Demanding suppliers credit all stock after a punitive deletion.	Retailer
<b>8</b>	<b>Buyer-induced bundling</b>	
8.1	Requiring suppliers to use retailer-owned or affiliated services eg transport, distribution centres – even when this is a more expensive route to market.	Retailer
8.2	Requiring or pressuring a supplier to purchase retailer data and insights at significant cost.	Retailer
<b>9</b>	<b>Requiring collusive behaviour in supplier market</b>	
9.1	Rejecting offers from suppliers for lower priced goods for consumers because the offers would be cheaper than the retailer's private label product.	Retailer
9.2	Demands to know from a supplier information or details about retail competitor's promotional programme or pricing	Retailer
<b>10</b>	<b>Appropriating IP for supermarket's own brands</b>	
10.1	Copying or demanding the use of supplier's intellectual property for private label products and in some cases subsequently deleting the supplier's product.	Retailer
<b>11</b>	<b>Inadequate health and safety measures</b>	
11.1	Bullying of sales representatives, poor treatment of merchandisers leading to mental health concerns.	No one benefits.
11.2	Poor health and safety practices in store	No one benefits

5.7 Our paragraphs 175 and 176 read:

175. In some countries, a Grocery Code of Conduct is in place [to address] these types of behaviour, ultimately to the benefit of consumers through increased access to products, innovation, lower prices and choice.

176. Some, though not all, of the behaviours described above may be addressed by the “Unconscionable Behaviour” provisions, which are currently before the House, but that on its own is not sufficient to address the extreme imbalance of bargaining power between large supermarkets and their suppliers
- 5.8 Recent feedback has evidenced and reinforced the above table. In fact, it has served to highlight the depth of the issues. The lack of acknowledgement of the issues and any meaningful attempt to address them by the Retailers in their submissions causes even greater concern.
- 5.9 We also want to clarify that our reference to Codes of Conduct and potential legislation is simply to reinforce that these are necessary, but not sufficient, conditions.
- 5.10 As noted, it is now necessary to consider possible solutions to the above problems.

### **Possible solutions**

- 5.11 Any solution should seek to mimic or recreate a workably competitive market as much as possible. It should enable consumers to benefit from the full range of competitive outcomes, including retailing competition and flourishing upstream supply.
- 5.12 There are a range of possible options to be considered to address the distortions and market structure and behaviour. These are briefly noted in Table A below.
- 5.13 **Table A: Possible remedies to address grocery retailing competition problems**

POSSIBLE ACTION	EXPLANATION	WHAT IT MIGHT ACHIEVE
<b>Structural separation</b>	<ul style="list-style-type: none"> <li>• Full or partial structural separation.</li> <li>• Perhaps divesting brands or stores and/or stores to create a third player.</li> <li>• There is precedent for this. For example: the structural separation of NZ Telecom to Spark &amp; Chorus; AT&amp;T Corporation in 1982 was ordered by agreed consent decree to divest of several companies in order to break up a monopoly in US telecommunications; the US lawsuit against <a href="#">Google</a> sought structural relief</li> </ul>	<ul style="list-style-type: none"> <li>• Effectively unwind the merger c. 20 years ago</li> <li>• Divest sites to assist new entry</li> <li>• Divest brands</li> <li>• Divest upstream wholesale purchasing / distribution</li> <li>• Eliminate / reduce buyer power</li> <li>• Greater competition for the benefit of consumers</li> </ul>
<b>EOI / open access</b>	<ul style="list-style-type: none"> <li>• Creating an equivalence of inputs or open access model (as has been done in relation to telecommunications in the past),</li> <li>• This would for example require Retailers to treat all parties, including competing businesses, in the same way (eg supermarkets would charge themselves for private labels the same amount as what is charged to suppliers)</li> </ul>	<ul style="list-style-type: none"> <li>• Increased transparency of process and information.</li> <li>• Fairer wholesale procurement (eg private label) and distribution processes</li> </ul>
<b>Operational separation</b>	<ul style="list-style-type: none"> <li>• Require arm’s-length operation/transparency <ul style="list-style-type: none"> <li>○ Openreach</li> <li>○ Perhaps for house brand</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Transparency and, ideally, more competitive outcomes</li> </ul>
<b>Financial disclosure</b>	<ul style="list-style-type: none"> <li>• No separation but full financial disclosure eg airports</li> </ul>	<ul style="list-style-type: none"> <li>• Better for identifying the basis for future regulation or</li> </ul>

		as a complement to a new regulatory regime
<b>Return regulation</b>	<ul style="list-style-type: none"> <li>• WACC / building blocks eg lines companies, new telco</li> <li>• So CC already does / can do</li> </ul>	<ul style="list-style-type: none"> <li>• Might be seen as keeping prices lower but could carry risks and not deliver</li> </ul>
<b>Prohibited lines of business</b>	<ul style="list-style-type: none"> <li>• No housebrands – pure reseller – avoid conflicts</li> <li>• Prohibition on new sites? Approval required.</li> <li>• Divestment of unused sites</li> </ul>	<ul style="list-style-type: none"> <li>• Would avoid leveraging market power and adverse foreclosure effects</li> </ul>
<b>Code of conduct / related matters</b>	<ul style="list-style-type: none"> <li>• A mandatory Grocery Code of Conduct for supermarkets to address potential abuses of market power towards food and grocery manufacturers arising from NZ's highly concentrated grocery retail market.</li> </ul>	<ul style="list-style-type: none"> <li>• Many things in a code of conduct could (should) be legislatively mandated e.g. access/supply terms, prohibition on charges for non-existent services (eg. display fees unless displays received, compulsory mediation/arbitration, independent reviewer, shifting of burden – have to prove relevant costs to pass on et cetera; also the blanket removal of deductions and payments from a bygone era eg. Settlement payments, prompt payment discounts, long payment terms, and no payments for retail costs such as theft and store damage</li> </ul>

5.14 **Status of reforms:** We have previously submitted on necessary reforms, as attached in our initial submission, to create a productive environment for fair competition, in all New Zealand markets. We understand some of these reforms are already underway but emphasise that all these measures are necessary due to their individual limitations. However, those submissions should not detract from our submission now that it is appropriate to consider the full range of potential remedies as identified in Table A (Possible remedies to address grocery retailing competition problems).

5.15 For completeness, we reproduce those earlier comments on regulatory reform. We reiterate that these two are necessary, but not necessarily sufficient, measures.

#### 5.16 **Table B: Previous submissions on regulatory reforms & comments**

POSSIBLE REFORMS	STATUS	WHAT IT MIGHT ACHIEVE	LIMITATIONS
<b>Replace 36 abuse of market power test with an “effects” test</b>	<ul style="list-style-type: none"> <li>• Part of the Commerce Amendment Bill currently open for submissions</li> </ul>	<ul style="list-style-type: none"> <li>• Allow a wider range of conduct to be caught by the prohibition by considering effects, not just purpose, and removing the “normal</li> </ul>	<ul style="list-style-type: none"> <li>• Litigation is costly and uncertain</li> <li>• Proving a SLC requires a market analysis and Retailers are in a better</li> </ul>

		commercial conduct” defence	position to know the market
<b>Empower the CC to undertake market studies</b>	<ul style="list-style-type: none"> <li>• Already implemented by Commerce Amendment Act 2018</li> <li>• Grocery study currently underway</li> </ul>	<ul style="list-style-type: none"> <li>• Allow the Commission to assess the state of competition between supermarkets and make recommendations on how to improve the state of competition</li> </ul>	<ul style="list-style-type: none"> <li>• Information intensive exercise. Retailers will have the most information, while suppliers may be hesitant to speak of their experience in fear of retaliation.</li> </ul>
<b>Introduce a prohibition against unconscionable conduct”</b>	<ul style="list-style-type: none"> <li>• Part of the Fair Trading Amendment Bill currently before Parliament</li> </ul>	<ul style="list-style-type: none"> <li>• Prohibit conduct “<i>against the conscience as judged against the norms of a society</i>”</li> <li>• Commission can send warning letters to deter prohibited behaviour</li> </ul>	<ul style="list-style-type: none"> <li>• Unconscionable is a high and uncertain standard</li> </ul>
<b>Extend the Unfair Contract Terms (UCT) regime to business-to-business (B2B) contracts</b>	<ul style="list-style-type: none"> <li>• Part of the Fair Trading Amendment Bill currently before Parliament (for “small” businesses only)</li> </ul>	<ul style="list-style-type: none"> <li>• Help prevent prohibitive or unbalanced terms of trade being imposed on suppliers</li> <li>• Under the current UCT regime the Commission undertakes industry “reviews” of standard form consumer contracts in different sectors, may do the same for retail grocery</li> </ul>	<ul style="list-style-type: none"> <li>• Covers “small trade contracts” only</li> <li>• Does not address all unfair conduct (for example pricing concerns)</li> <li>• Only the Commission can seek a declaration under the existing UCT regime so less accessible for suppliers</li> </ul>
<b>Introduce a Code of Conduct</b>	<ul style="list-style-type: none"> <li>• Not implemented yet</li> </ul>	<ul style="list-style-type: none"> <li>• Regulate supermarket behaviour</li> </ul>	<ul style="list-style-type: none"> <li>• Depends on how it is drafted, concerns include if it is not mandatory, clauses can be contracted out of, no pecuniary sanctions, ineffective dispute resolution process, no independent enforcement</li> </ul>

<b>Empower the Commission to accept enforceable undertakings</b>	<ul style="list-style-type: none"> <li>• Already implemented by Commerce Amendment Act 2018</li> </ul>	<ul style="list-style-type: none"> <li>• Enforceable undertakings could be used to prohibit specific abuses of buyer power</li> </ul>	<ul style="list-style-type: none"> <li>• Requires a Commission investigation first, used at the Commission's discretion</li> </ul>
<b>Introduce an exemptions regime</b>	<ul style="list-style-type: none"> <li>• Not implemented yet</li> </ul>	<ul style="list-style-type: none"> <li>• Exempt suppliers from competition laws when negotiating with supermarkets to help correct imbalances of bargaining power with supermarkets</li> <li>• More accessible than the costly and time consuming authorisation regime (eg Australia has a notification regime under which immunity automatically begins a set time period after notification)</li> </ul>	<ul style="list-style-type: none"> <li>• Unclear whether exemption would be granted</li> <li>• Given market duopsony, may not result in significantly greater negotiation power</li> </ul>
<b>Introduce non-discrimination rules</b>	<ul style="list-style-type: none"> <li>• Not implemented yet</li> </ul>	<ul style="list-style-type: none"> <li>• Address vertical competition issues eg where supermarkets give preference to private label products over branded products or where supermarkets use their knowledge as a customer of a supplier to help supermarkets compete with the supplier</li> </ul>	<ul style="list-style-type: none"> <li>• Only addresses one specific issue</li> </ul>

## 6. SPECIFIC COMMENTS ON “CHARTERS” & CODES OF CONDUCT

### *Codes of conduct*

- 6.1 The United Kingdom and Australia have legislated codes of conduct after undergoing similar market study exercises. In Canada, a draft code of conduct has also been submitted to a working group set up to address competition issues in retail grocery. We also endorse a legislated and independently enforced grocery code of conduct in New Zealand, and offer our assistance in drafting such a code with the Commission and industry.
- 6.2 There is considerable recognition of the need for a code:
- a. On 2 April 2014 it was reported that the Green Party had prepared a Member’s Bill which would set up an independent supermarkets adjudicator and a compulsory code of conduct.<sup>36</sup>
  - b. Similar concerns were noted by Labour and the Caucus supported Clayton Cosgrove MP in his desire to put forward a Private Members Bill. On 20 November 2014 a statement was issued (see **Annex A**). In the House for the Commerce (Supermarket Adjudicator and Code of Conduct) Amendment Bill, at its First Reading, Clayton Cosgrove noted that Labour MPs would support the Bill in the first reading and had already “drafted below the last election what we consider a pretty robust and tailor-made piece of legislation”. In the Labour Party’s policy of the time Mr Cosgrove noted his party had “set out in our Code of Conduct – and we already have a Code of Conduct already drafted in a piece of legislation – a penalties regime where an arbitrator should have the power to investigate, publicise and also render penalties.”
  - c. A copy of that Bill is separately attached. It was based on the then applicable Australia Code, which has since been tightened. New Zealand would need something more contemporary and suited to the needs of the New Zealand market. But it provides a base example for development.
- 6.3 In line with the United Kingdom and Australia’s experience, we consider the code of conduct would need:
- a. **To be mandatory and binding** on Woolworths and Foodstuffs. Unlike the Australian Code which was introduced on a voluntary basis and negotiated between the Australian Food and Grocery Council, Coles and Woolworths, the NZFGC does not have the resources or ability to conduct this with any hope of a strong and binding Code. The Commission or MBIE must hold the pen and engage with stakeholders, but to leave it to the supermarkets will result in a weak Code and the status quo.
  - b. **A clear obligation of good faith** which explains how good faith is breached. The Australian Code has recently been strengthened to ensure that the spirit of the Code remains paramount not pedantic interpretations which allowed retailers to find loopholes around provisions that were clearly outside the intention of parts of the Code.
  - c. **Prohibitions against** unilateral or retrospective variations of agreements, unconsented off-sets against a supplier’s invoice, requiring payments from

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<sup>36</sup> [Greens bill aimed at supermarket regulator | Newshub](#)

suppliers for shrinkage, wastage or better positioning, demands for significant quantities of free product, percentage payments that are not linked to specific services (eg. percentage display payments but no displays), prompt payment discounts taken when payments are late, outdated settlement deductions for the privilege of being paid by retailers, and other misconduct.

- d. **Limited ability to contract out of code obligations** given buyer power undermines the ability of contracts to be negotiated fairly in the first place. A recent example was a Foodstuff North Island contract which had exit provisions for the Retailer, but no exit provisions for the supplier.
- e. **Compliance obligations** on Retailers to maximise the effectiveness of the code.
- f. **An independent adjudicator** to enforce the code and for dispute resolution processes to be easily accessible for suppliers who may have less resources to defend themselves than the Retailers.
- g. **Meaningful consequences** for breaching the code, such as significant pecuniary penalties proportionate to any commercial gain or severity of the conduct.
- h. **Review processes** to monitor whether the code is effective and to facilitate any improvements needed.

### ***Private charters***

- 6.4 The Retailers already each have their own supplier charters. The existence of such charters recognises that the Retailers hold vast power that may be abused without some form of code of practice in place. Clearly there has been some dominant or oppressive behaviour in the market which led to the need for charters.
- 6.5 Unfortunately, while the Retailers have an incentive to create a charter to present themselves in the best light, they have no incentive to truly even the playing field with suppliers, nor even follow the charter given the lack of independent dispute resolution processes. **Both charters are largely symbolic. The supplier community does not view the charters as living documents providing robust frameworks to deal with business relationships. This can only come from an independent mandatory code across all supermarkets.** Overall, the private charters have little substantive effect and are very rarely used by suppliers.
- 6.6 The charters are not seen to be honoured or carried out in practice. Suppliers do not feel able to use them or have faith that even if they do it will result in a fair outcome. For example, in the case of Foodstuffs suppliers are expected to contact the CEOs or the Foodstuffs lawyer. This is a daunting prospect for particularly small suppliers who will never have had the opportunity to meet them before and then be expected to make contact about a complaint.
- 6.7 The NZFGC was consulted in the development of the Foodstuffs Charter and while some of our stylistic changes were accepted, none of our substantive suggestions on behalf of suppliers (for example only deleting products based on commercial grounds) were accepted. The Countdown charter had no meaningful input opportunity from NZFGC into its development although NZFGC was sent a copy prior to its launch. NZFGC has never received a final copy of the Countdown charter.

## Supply terms

### One-sided terms

- 6.8 Contracts which supermarkets enter into with suppliers are often “templates” prepared by supermarkets which contain terms in favour of supermarkets or otherwise do not provide for clear reciprocal obligations. For example, a standard dispute resolution provision allows the supermarket to appoint an “independent third-party” mediator – but the supplier gets no say. This is recognised by Consumer NZ’s submission: *“[s]upermarkets have the power to set the terms of supply. If a supplier considers those terms unfair, there’s often no practical option to challenge them without risking the agreement being terminated and product being removed from the store”*.<sup>37</sup>

### Vague terms

- 6.9 Often, they are vaguely drafted and inconsistent – just enough in a preamble to give a basis for the obligation on suppliers to pay for supermarket-related services (for example aisle ranging or display). It is often unclear what the obligations of supermarkets are and who/how this is to be policed. Also, there is often no clear link between payment and the “deliverables” (which are often undefined in the contracts). There are no “price signals” between the “service” and the “fee”. Suppliers should at the minimum have a right to withhold payments for supermarkets’ non-compliance or failure to deliver – but clearly these are not provided in the vaguely drafted contracts.

### Retailers’ behaviour

- 6.10 Suppliers who are in a weak position to bargain are susceptible to supermarkets taking advantage of ambiguous supply terms to entrench their market position. Suppliers either accept the supermarkets position or be delisted. Foodstuffs North Island’s rollout of a Minor Damage Allowance (**MDA**) deduction is a good recent example. The aim of the MDA was to reduce claims for credits made by stores. MDA was not to cover damage caused in the store or by store staff or theft. In practice, stores put through claims for all sorts of reasons that are beyond the responsibility of suppliers. In cases, reports to NZFGC when suppliers challenge these claims which can be many thousands of dollars stores will demand payment or threaten deletion of the suppliers’ products.
- 6.11 There is a degree of pressure and coercion on suppliers where supermarkets transfer costs onto suppliers, and suppliers are required to make investment but this is not reflected at the shelf in the form of lower prices to consumers. The regular requirement for large quantities of free stock or the payment for displays are two good examples. Supermarkets’ reviews of categories often lack transparency leading to imbalanced negotiations. Suppliers face pricing challenges which are centered around supermarkets refusal and/or inability to implement justified price increases and ongoing margin creep. Supermarkets also refuse to recognise pricing fluctuations eg commodity items or foreign exchange rates. Suppliers are often coerced into terms of trade and other customer margin and support funds. Supermarkets are not committed to compliance – for example, where customers have agreed and supermarkets have accepted payment for activity - but there is no recourse of funds reimbursement when compliance is not delivered. Adherence to a change in Foodstuffs North Island commercial model led to coercive behaviours, not reflecting ‘consumer driven’ behaviour as advertised and which resulted in a significant increase in supplier risk.

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<sup>37</sup> Consumer NZ’s submission at [40]

### **Bid process**

- 6.12 The fact that there is a process for suppliers to bid for their products to be supplied to a supermarket is also clearly indicative of a supermarket's dominant position in the grocery industry. Some suppliers may be left out of the process due to request for terms the supermarkets deem as less favourable. Under the terms of a bid or request for tender a supermarket is entitled to exclude any bidder or respondent from the bid or tender for **any reason**.

### **Foreclosure effects**

- 6.13 The terms in the supply contracts allow supermarkets to easily de-list suppliers without regard to commercial grounds or taking into account that in many cases suppliers have imported stock or stock on the water. This causes a foreclosure of access by consumers to the suppliers' products, as it is not available for suppliers to continue their supply chain via smaller retailers who cannot support the volume suppliers require to sustain their business. In other words, there is no substitutable retail channel through which a supplier can sell their products to consumers. This is often the reason why many small to medium brands – especially those that are locally based – are unable to survive and consumers lose out on getting these products.
- 6.14 Supermarkets also often bind suppliers to terms which make it unfavourable for them to supply another retailer. This is recognised by Consumer NZ's submission: "*...Terms and conditions imposed in the contracts supermarkets have with their suppliers may also create de facto barriers by effectively preventing suppliers offering more favourable terms to others*".<sup>38</sup> Customers' access to the suppliers' products are therefore foreclosed by such unfavourable terms.

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<sup>38</sup> Consumer NZ's submission at [37]



Commerce Spokesperson

20 November 2014

MEDIA STATEMENT

## **Mandatory code of conduct needed for supermarkets**

Labour has drafted legislation to establish a mandatory code of conduct for supermarkets to ensure New Zealand suppliers are not affected by anti-competitive behaviour.

“Even though the Commerce Commission found no technical breaches of the law through some of Countdown’s business practices when dealing with suppliers, 90 complaints would indicate there are serious issues which need to be dealt with,” says Labour’s Commerce spokesperson Clayton Cosgrove.

“The Commission was only able to look at the letter of the law. In Labour’s view the law is not strong enough. In Australia the ACCC is currently prosecuting Coles for anti-competitive behaviour and has a code of practice.

“The UK has an independent adjudicator with a mandatory code of practice. In that country there are ten dominant supermarket players who effectively control 85 per cent of the market and that has been judged to be too much concentrated market power. In New Zealand there are two dominant players, with 95 per cent market share.

“It is time the law was changed. Labour has worked on this issue for some time and has the solutions.

“Labour has a bill ready to go that would create a mandatory code of conduct for supermarkets, overseen by an independent adjudicator with real teeth. We will release it next week and offer it John Key’s Government as a solution to these issues.

“Last year Labour also lodged an amendment to make changes to s36 of the Commerce Act to give the Commerce Commission more power to act on damaging anti-competitive behaviour.

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<sup>39</sup> [Mandatory code of conduct needed for supermarkets | Scoop News](#)

“So far National has refused to support our amendment. They should reconsider,” says Clayton Cosgrove.

**Contact: Clayton Cosgrove 021 829 562**