Wholesale Supply Inquiry:

Preliminary Issues Paper

Woolworths New Zealand Limited Submission

8 November 2024

Part 1: Introduction and Executive Summary

(1A): Introduction

1.1 The Commerce Commission (the **Commission**) is carrying out an inquiry (the **Inquiry**) under section 55 of the Grocery Industry Competition Act 2023 (the **GICA**) to consider whether the regulatory grocery retailers' (**RGRs**) wholesale supply of groceries and any ancillary services should be subject to additional regulation and, if so, what additional regulation should apply.

1.2 The Commission has published:

(a) terms of reference (the **ToR**) (published on 4 September 2024); and

(b) a preliminary issues paper (the **PIP**) (published on 24 September 2024).

1.3 This submission (**Submission**) provides Woolworths New Zealand Limited's (**WWNZ**) feedback on the ToR and the PIP.[1]

(1B): Executive summary

1.4 We consider that the approach to the Inquiry as set out in the ToR and the PIP should be re-considered, from both a process and substantive perspective.

1.5 We raise these issues as we wish to assist the Commission to ensure the process and findings of the Inquiry:

(a) are robust and fair;

(b) are compliant with the remit conferred on the Commission by the GICA;

(c) meet the natural justice and consultation requirements of common law; and

(d) meet the expectations for best practice regulation.

1.6 Our specific concerns are as follows:

(a) ***Insufficient consultation on the ToR***: Despite inviting submissions on the ToR, the Commission truncated the period for the provision of those submissions without notice, and proceeded to publish its PIP

[1] This Submission also refers to the Commission's first Annual Grocery Report published on 4 September 2024 (referred to as **Annual Report**).

within the timeframe which it had previously advised would be available for submissions on the ToR.[2]

Given WWNZ is one of the stakeholders most affected by the Inquiry, in light of the natural justice and consultation requirements of common law, the Commission should have allowed time for WWNZ to provide its submission on the ToR prior to the Commission publishing its PIP (and should not have changed that consultation period without notice). That is because both the ToR and PIP are fundamental for setting the overall scope and direction of the Inquiry, which means if those are not framed appropriately, the whole Inquiry risks non-compliance with the GICA framework. Accordingly, WWNZ:

(i) includes its views on the ToR as part of this Submission; and

(ii) records its view that the requirements of the GICA, as well as the natural justice and consultation requirements of common law, mean the Commission needs to reconsider (and re-issue) its ToR (and then its PIP) in light of this Submission.[3]

See further at Part 2 below.

(b) ***Inappropriate reliance on the analysis and views set out in the Annual Report***: The Inquiry appears underpinned by the views published in the Annual Report that "[w]holesale offerings by RGRs do not appear to be consistent with a competitive wholesale market."[4]

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[2] From WWNZ's perspective, the Commission's decision to truncate the period for submissions without notice is consistent with an emerging pattern of the Commission seemingly prioritising haste without providing consultation, and in ways that risk undermining the Commission's ability to make accurate evidence-based findings about the sector and the impact of the GICA - for example:

- the Commission did not consult with WWNZ on its Annual Report before it was published (which meant WWNZ did not have an opportunity to comment on the number of inaccuracies in the Annual Report before it was published);
- the Commission's decision to publish its Annual Report within an expedited timeframe, which meant that it was based on observations from outside the period it was supposed to consider, and that the Commission had not allowed a reasonable time to assess the impacts of the new regulatory regime established by the GICA; and
- the Commission announced its review of the Grocery Supply Code before some key aspects of the Grocery Supply Code were even operational (and only five months after the rest came into full operation), which meant the Commission had not allowed a reasonable time to assess the impacts of the new Grocery Supply Code.

[3] We note that the PIP and accompanying media release from the Commission state that the Commission may decide to take action before the Inquiry is complete, using its powers under the GICA to establish a wholesale code and / or require RGRs to prepare a wholesale framework. While the GICA allows these forms of additional regulation to be implemented without a Commission Inquiry, the GICA still requires the Commission to consult on any draft determinations that propose to implement these forms of additional regulation. Furthermore, in light of the consultation requirements of common law, the Commission must properly consult with WWNZ and other affected stakeholders before it takes such action.

[4] Annual Report. Page 103.

WWNZ has a number of significant concerns with the Commission's approach to that issue, namely that:

(i) The Commission has not allowed reasonable time for the impacts of the new wholesale regime to bed in before making such an assessment.

(ii) That assessment as set out in the Annual Report appears to lack sufficient depth, and did not reflect mandatory considerations under the GICA, and so there is an insufficient basis for such a conclusion.

(iii) Such views pre-empt this Inquiry, with the Inquiry being a process:

- that is not supposed to start with a presumptive conclusion; and
- that the GICA requires is only conducted with full consultation with affected parties.

See further at Part 3 below.

(c) ***<u>WWNZ's wholesale business has achieved significant growth in a short period of time</u>***: WWNZ does not agree that the number or diversity of its customers[5] or the level of its wholesale sales[6], after just 15 months of the regulatory regime being in force, are lower than what would be expected in a competitive market. In that short space of time, WWNZ's wholesale business, New Zealand Grocery Wholesalers (**NZGW**), has been created from scratch and has achieved significant growth in relation to the number of suppliers it has, the range it carries, and the number of retail customers it works with. See further at Part 4 below.

(d) ***<u>WWNZ should not be regulated due to any lack of progress by other RGRs</u>***: The PIP reflects that NZGW's progress in developing a scale wholesale business is more advanced than that of other RGRs.[7] This is important, as the GICA provides for findings or

[5] As suggested at paragraph 40 of the PIP.
[6] As suggested at paragraph 42 of the PIP.
[7] For example:
- Paragraph 39.1 of the PIP states that: "WWNZ has the largest number of wholesale customers and by far the highest sales through its wholesale offering".
- Paragraph 41.3 of the PIP states that: "Compared to FSNI and WWNZ, the volume of FSSI's wholesale sales was very low."

recommendations to be made in respect of just one RGR (rather than all RGRs),[8] and requires any recommendations of additional regulation to "be the most cost-effective… in the circumstances".[9]

Taken together, these provisions require the Commission to take the most cost-effective (i.e. targeted) approach to making any recommendations of further regulation. That means, for example, it would be inconsistent with the GICA framework for any recommendations of further regulation to be made in relation to WWNZ's wholesale business based on concerns about the progress of the wholesale business of Foodstuffs North Island (**FSNI**) or Foodstuffs South Island (**FSSI**), unless that could be established as the most cost-effective regulatory response.[10] It is difficult to see how regulation of one entity, due to concerns about another entity, could be the "most cost-effective in the circumstances."

The approach to the Inquiry suggested in the PIP (and the ToR) needs to be updated to reflect these obligations. See further at Part 5 below.

(e) ***Failure to reflect mandatory requirements under the GICA***: WWNZ is also concerned that the approach to the Inquiry outlined in the ToR and the PIP fails to reflect other considerations that must be taken into account in the manner directed by the GICA, including:

(i) the desirability of wholesale pricing taking into account the efficiency of an RGR's wholesale operations;[11]

(ii) the desirability of wholesale pricing taking into account an RGR's "reasonable expectation of recovering its efficient costs, including a reasonable return on investments made in connection with a wholesale offering";[12] and

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[8] For example:

- Section 65(1)(b)(ii) of the GICA requires the Commission to consider whether "the wholesale offerings of groceries provided by **1 or more** regulated grocery retailers (in relation to any 1 or more of price, range, quantity, frequency, or any terms and conditions) are not consistent with wholesale offerings provided in a competitive wholesale market". Emphasis added.
- Section 66(2) of the GICA states that "the Commission may make a determination under this subpart that applies to **1, some, or all** regulated grocery retailers". Emphasis added.

[9] Section 57(3)(b). Emphasis added.

[10] The mandatory requirement in s 57(3)(b) that the Commission must consider the most cost-effective additional regulation in the circumstances overrides any other provision in the GICA stating that the Commission (or the Minister) may act in relation to a RGR even if it has complied with the GICA (e.g. ss 66(2), 82(3)).

[11] GICA s 24(1)(a)(ii).

[12] GICA s 24(1)(a)(iii).

(iii) the desirability of RGRs "being able to invest and innovate for the long-term benefit of consumers".[13]

For the Inquiry to be legitimate and complete, the Commission must take these factors into account in the manner directed by the GICA before making any findings or recommendations. The approach suggested in the ToR and the PIP needs to be updated accordingly. See further at Part 6 below.

(f) ***<u>It is necessary for any decisions / recommendations to be subject to full and rigorous cost-benefit analysis</u>***: The approach to the Inquiry outlined in the ToR and the PIP does not indicate that the Commission will conduct a rigorous cost-benefit analysis before making any decisions / recommendations on further regulation. However, the GICA requires such analysis before any recommendations of further regulation may be made - including to ensure that recommendations are in the long-term interests of consumers, that recommendations result in a net benefit, and that any regulation would be the "most cost-effective".[14] That is particularly the case given the conclusions in the Commission's final report issued on 8 March 2022 (**Final Report**) in its *'Market study into the retail grocery sector'* (**Grocery Market Study**), that further intervention of the nature being considered in the Inquiry was not warranted or in the interests of New Zealand consumers - and its statement that "careful cost-benefit analysis would be desirable"[15] before any such intervention should be considered. See further at Part 7 below.

(g) ***<u>Approach to considering RGRs' incentives is unclear</u>***: The proposed ToR notes the Commission's intention to assess whether RGRs have incentives to "to create a compelling wholesale offer and support the entry or expansion of retail competitors". If that aspect of the ToR is intended to consider whether RGRs have incentives to develop their wholesale businesses, then it is necessary for the Commission's ToR and PIP to reflect that RGRs (in the manner directed in the GICA) need to be able to achieve a "reasonable return on investments made in connection with a wholesale offering"[16] and be "able to invest and innovate".[17] If that aspect of the ToR is intended to consider whether RGRs have incentives to support the entry or expansion of other retail competitors, then that is inconsistent with the

[13] GICA s 24(1)(f).
[14] GICA ss 57(2)(b), 57(3)(a), and 57(3)(b).
[15] (8 March 2022). Commission. Grocery Market Study, Final Report. [9.119].
[16] GICA s 24(1)(a)(iii).
[17] GICA s 24(1)(f).

Commission's usual approach to considering competition. Ordinarily, a competition regulator (including the Commission in other contexts)[18] would not expect a competitor to have incentives to support the entry or expansion of competitors. The GICA defines competition as "workable competition" (being a concept that does not contemplate one competitor having incentives to support another). This aspect of the ToR needs to be clarified to ensure it is compliant with the GICA. See further at Part 8 below.

(h) ***Consideration of downstream retailers' costs is inappropriate***: The PIP suggests an approach of assessing the RGRs' wholesale prices based on the "additional costs to wholesale customers of retailing the products… which could be equivalent to at least 15% of the price of the goods".[19] That is not an approach provided for by the GICA, which requires wholesale grocery prices to reflect efficient wholesale costs (as established by the purpose of Part 3 of the GICA and the wholesale pricing principles). If the Commission wishes to make findings as to prices, it must carry out further consultation and analysis to establish appropriate cost models, which would also require consideration of how suppliers' discretionary Retail Scan Funding[20] should be appropriately treated under the GICA. See further at Part 9 below.

(i) ***The ToR and PIP need to properly address provision of suppliers' Retail Scan Funding to wholesale customers***: As noted by the Commission previously, grocery retailing / wholesaling does not involve any essential facility or natural monopoly characteristics[21] - there are many channels to retailers for suppliers' products, including direct supply and via other wholesalers. Given that, there is an appearance that what the Commission primarily wants to achieve through its Inquiry is to enable third party retailers (wholesale customers) to have access to broadly the same input costs that suppliers charge RGRs. Currently WWNZ cannot provide those input costs (or sometimes even supply products at all) to wholesale customers due to the decisions of suppliers - namely, either:

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[18] (20 August 2024). Commission. Personal banking services: Final report. [2.49].

[19] PIP. [47].

[20] In this Submission, WWNZ uses the term "Retail Scan Funding" to refer to what the Commission referred to in its Annual Report as "trade spend" - i.e. "any discretionary rebates, discounts and payments for improving sales or encouraging retailers to support products" (Annual Report. Page 49.). For the purpose of this Submission, and the Commission's Inquiry, it is important that the Commission analyses and assesses Retail Scan Funding discretely from other supply rebates, discounts, or payments (**RDPs**) given the different ways in which they are applied by suppliers - in particular, because Retail Scan Funding arrangements are contingent on retailer activities (i.e. typically on activating a retail promotion, and typically only calculated / paid when goods are "scanned out" at retail).

[21] Grocery market Study Final report. [9.118.1].

(i) deciding to "opt out" of having their goods supplied at wholesale by WWNZ; or

(ii) deciding to have a significant proportion of the overall cost of their goods determined by suppliers' discretionary Retail Scan Funding - being discounts that WWNZ cannot pass on to wholesale customers as they are contingent on retail promotional activity, are only paid when products are scanned-out at retail, and due to WWNZ's obligations under the Grocery Supply Code.[22]

If this is the Commission's fundamental concern, then ultimately the Inquiry (including the ToR and the PIP) should be transparent that the Commission's focus will be on considering recommendations in relation to suppliers (under section 58(2) of the GICA), not RGRs, and on assessing the costs and benefits of regulating suppliers in that way. In particular, due to the issues outlined at (i) and (ii) above, unless the Commission addresses this issue by making recommendations relating to suppliers, the only other way to achieve the same outcome would be to require wholesale pricing at a level at which RGRs effectively fund / subsidise other retailers' promotions. Such an approach would be inconsistent with the GICA requirements of achieving outcomes that are consistent with a competitive wholesale market, and the desirability of RGRs achieving a reasonable return on investment in connection with their wholesale offerings, and being able to invest and innovate for the long-term benefit of customers. See further at Part 10 below.

1.7 We hope that this Submission assists the Commission. We regard the Commission's ToR and PIP as fundamental to setting the scope and direction for the rest of the Inquiry. This means that unless the ToR and PIP are re-considered in light of the matters raised in this submission, we would have concerns that the Commission's process and ultimate decision-making in the Inquiry would not reflect the requirements under the GICA (including the need to conduct a rigorous cost-benefit analysis), and the need to give all submissions a fair and open minded hearing. The abbreviated consultation process and very short timeframes for completion of the Inquiry as set out in the PIP give us additional concerns in this respect.

1.8 We further specifically request that the Commission:

[22] Clause 17, Grocery Supply Code, requires that supplier promotional funding must be reasonable having regard to the benefits to the supplier from a retail promotion.

(a) reconsider (and re-issue) the ToR and the PIP to reflect the points made in this Submission;

(b) give full and rigorous consideration to the matters raised in this Submission, when making any findings or recommendations in the Inquiry (noting WWNZ's view that a failure to do so will lead to a procedurally flawed and manifestly incorrect outcome); and

(c) re-consider the timeframes for the Inquiry to allow for all mandatory obligations to be completed to the required standard.

1.9 Given their relevance to the Commission's Inquiry, we also **enclose** with this Submission Henry Ergas AO's paper entitled "Comments on the Recommendations for Third Party Access by the Commerce Commission New Zealand" and Peter Harris AO's paper entitled "Views on the Commerce Commission Draft Market Study Report on Grocery Retailing in New Zealand", which were originally provided to the Commission on 23 November 2021 during its Grocery Market Study. The Commission cited both the Ergas and Harris economic analysis and commentary in its Grocery Market Study Final Report, including to underpin that Final Report's statements that:

(a) "The sector is more dynamic than many regulated sectors, and certainly more diverse in its product offerings, increasing the cost and difficulty of regulation";[23]

(b) "Significant intervention could disrupt existing efficient vertical integration efficiencies, operational efficiencies, efficiencies of scale and scope, dynamic efficiency, and introduce significant additional costs";[24]

(c) "As there is no 'monopoly asset' involved, it is likely to be more difficult to identify the precise boundaries of the regulated wholesale service, and what assets would be required to provide that service";[25] and

(d) Significant wholesale regulatory intervention risked "reduc[ing] retail competition on price" and would "require significant monitoring and regulatory oversight".[26]

1.10 Both those papers remain pertinent to this Inquiry. We consider that the ToR and PIP need to be updated to reflect the economic analysis in those papers.

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[23] Grocery Market Study Final Report. [9.118.1.3], citing the Ergas paper.
[24] Grocery Market Study Final Report. [9.118.3], citing the Ergas paper.
[25] Grocery Market Study Final Report. [9.118.1.3], citing the Harris paper.
[26] Grocery Market Study Final Report. [9.118.3], citing the Harris paper.

1.11 WWNZ's detailed submissions are set out below.

2. No opportunity for consultation on the ToR

2.1 Despite inviting submissions on the ToR, the Commission truncated the period for consultation on the ToR without notice, and published its PIP within the timeframe which had previously been advised would be available for submissions on the ToR. As the Commission has noted itself, it would have been preferable for stakeholders to have been informed of the new timeline when it was changed.[27]

2.2 Given that WWNZ is one of the stakeholders most affected by the Inquiry, in light of the natural justice and consultation requirements of common law,[28] the Commission should have provided notice of its decision to truncate the timeframe for submissions on the ToR prior to the Commission publishing its PIP (and not only advised it of that after the fact). [ ], WWNZ notes that the Commission has advised that it "welcome[s] views from WWNZ on the scope of the Inquiry… as part of its submissions on the PIP, including on any matters covered in the ToR".[29]

2.3 Accordingly, WWNZ includes its views on the ToR as part of this Submission and records its view that to reflect the natural justice and consultation requirements of common law,[30] the Commission needs to reconsider (and re-issue) its ToR (and then its PIP) in light of this Submission. That is particularly the case given that both the ToR and PIP are fundamental for setting the overall scope and direction of the Inquiry, which means if those are not framed

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[27] [ ]

[28] The Commission is under a duty to observe natural justice in conducting any process (*In re Pergamon Press Ltd* [1971] Ch. 388 (CA) at 399, *Stininato v Auckland Boxing Association (Inc) and Others* [1978] 1 NZLR 1 at 13), noting that:

- it is well established that a public authority that makes adverse public statements in respect of a person must first comply with the requirements of natural justice. Such statements may greatly influence public and government opinion and can have a devastating effect on a person's reputation, and a person's interest in their reputation is an interest protected by law, which should not be adversely affected without basic procedural protections (*Re Erebus Royal Commission; Air New Zealand Ltd v Mahon (No 2)* [1981] 1 NZLR 618 at 651 and 653);
- the courts have declined to take a technical approach to the question of what amounts to an adverse finding against a person, focusing instead on the overall "sting" of the words used (*O'Regan v Lousich* [1995] 2 NZLR 620 Tipping J); and
- WWNZ is one of the parties most impacted by the Inquiry, and as Crown Law has advised, "[t]he greater the potential impact on a person or group, the greater the requirements of fairness" (Crown Law. The Judge Over Your Shoulder – A guide to good decision-making and the law in New Zealand. At page 27. https://www.crownlaw.govt.nz/assets/Uploads/JOYS-for-web.pdf.).

[29] [.]

[30] Reinforced by the expectation created by the Commission's statement that it welcomes submissions on the ToR as part of this Submission.

appropriately, the whole Inquiry risks not being compliant with the GICA.

3. Inappropriate reliance on the Annual Report's analysis and views regarding wholesale

3.1 The Inquiry appears to be premised on the analysis and views outlined in the Annual Report regarding the wholesale offerings of the RGRs. WWNZ considers this to be inappropriate, for the following reasons.

(3A) The Commission has not allowed reasonable time for the impacts of the new wholesale regime to bed in

3.2 The Commission brought forward its first Annual Report to "1 year earlier than required"[31] under the GICA.[32] That is notable given:

(a) in providing for the annual reports, the Regulatory Impact Statement (**RIS**) said that their purpose was to see "if the benefits of competition are not emerging in reasonable time";[33] and

(b) the GICA's identification of the period ending 30 June 2025 for the first mandatory report reflects that Parliament (and the Ministry of Business, Innovation and Employment (**MBIE**)) considered that at least one more year was necessary to provide an assessment of whether benefits are emerging in a "reasonable time" as a result of the recent regulatory changes in the grocery sector.

3.3 Despite that clear direction from Parliament (and MBIE), the PIP states that the scale of the RGRs' wholesale businesses "do not reflect the level of activity we would expect to see in a competitive wholesale market."[34] We do not consider that allowing a timeframe of just over one year is sufficient to assess whether the current quasi-regulatory regime is progressing towards achieving the objectives of the GICA. For example, WWNZ's wholesale business, NZGW, has achieved significant growth in a very short period of time - as detailed further at Part 4 below.[35] Further, elsewhere (for example, its written reasons

[31] (4 September 2024). Commission. Commerce Commission Annual Grocery Report - Media and Stakeholder Presentation. Page 2. https://comcom.govt.nz/__data/assets/pdf_file/0026/362357/Grocery-Annual-Report-media-and-stakeholder-presentation.pdf

[32] GICA, s 178(3).

[33] (6 May 2022). MBIE. Regulatory Impact Statement: Government response to the Commerce Commission Grocery Sector Market Study - Policy decisions. Page 4.

[34] PIP. [42].

[35] In this respect we note that the while the statutory tests for additional regulation (in the form of a wholesale code or framework) arising from specific RGR failures to comply with the GICA include time markers of 3 months, 6 months and 12 months since the enforcement of the wholesale regime, the trigger of inconsistency with offerings in a competitive wholesale market does not specify a time marker. This absence of a specific time marker implies that the

on the FSNI / FSSI merger) the Commission has expressly noted "that some of the changes and outcomes (from the GICA) will take time".[36]

(3B) The Annual Report's assessment lacked sufficient depth, and did not reflect mandatory considerations under the GICA

3.4 Even setting aside our concerns that the Commission has not allowed reasonable time for the impacts of the new wholesale regime to become evident, we consider that the Annual Report's assessment of NZGW's wholesale offering lacked sufficient detailed analysis to enable the Commission to reach the view that the "[w]holesale offerings by RGRs do not appear to be consistent with a competitive wholesale market."[37]

3.5 We have significant concerns in this respect, including the Commission not speaking to NZGW to understand the reasons for how it operates, making inaccurate comparisons with the wholesaling environment in Australia, and failing to take into account mandatory considerations under the GICA.

3.6 Of particular concern are the following:

(a) The Commission's summary of the factors it would "expect" to see in a "competitive wholesale market"[38] are not grounded in evidence. For example, WWNZ does not consider there is evidence for the Commission to state that, in a "competitive wholesale market", independent third party wholesale customers would "obtain goods on similar non-price terms" to a vertically-integrated retailer's own retail stores. There are reasons that all major supermarket chains across the OECD are vertically integrated. This reflects, as Henry Ergas AO has outlined, that:[39]

> *There are a number of circumstances where vertical integration is an efficient way of organising the activities of a firm, and where, conversely, enforcing vertical separation can be very costly. Firms have the option of sourcing the inputs they require in markets via arms-length contracts, or, alternatively, of producing these inputs themselves, i.e., 'internalising' their procurement. The efficiency rationale for vertical integration lies in the operational and investment interdependencies between organisational functions.*

GICA contemplated that more time (than the 15 months allowed by the Commission) would be required to make an assessment of whether the RGRs' wholesale offerings are consistent with what would be seen in a competitive wholesale market.

[36] Foodstuffs North Island Limited and Foodstuffs South Island Limited [2024] NZCC 22 at [43].

[37] Annual Report. Page 103.

[38] Annual Report. Page 93.

[39] (23 November 2021). Henry Ergas AO. Comments on the Recommendations for Third Party Access by the Commerce Commission New Zealand. [4].

These efficiencies and interdependencies of vertical integration necessarily mean that even in competitive wholesale markets there will be differences in non-price terms between arms-length contractual terms and "internalised" procurement.

(b) Section 24(2) of the GICA states that when the Commission is considering whether the RGRs' wholesale offerings provide "reliable and cost-effective access to the range of wholesale groceries, at the quantity and frequency, that are or are likely to be demanded by wholesale customers", the Commission "must have regard to other reasonably available channels of supply of groceries to wholesale customers (for example, wholesale customers directly arranging supply from suppliers)".[40] While a mandatory consideration, it was not apparent in the Annual Report that the Commission undertook appropriately detailed enquiries with other wholesalers or suppliers in relation to their wholesale offerings,[41] or other retailers in relation to their own distribution networks, for example with:

(i) suppliers that also offer their own "direct store delivery" wholesale supply. This is notable, given that in its written reasons on the FSNI / FSSI merger, the Commission expressly noted that "the merged entity would face competitive constraint in wholesale markets from other wholesalers, and wholesale customers buying direct from grocery suppliers";[42]

(ii) other wholesalers, such as T&G Fresh, MG Marketing, Fresh Direct, Bidfood, JR Wholesale Meats, Wholesale Meats Direct, etc. Again this is notable given the Commission's findings in

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[40] Emphasis added.

[41] While:

- page 97 states that "[w]hen assessing the range in the RGRs' wholesale offerings, we have considered whether wholesale customers can purchase substitute items and the availability of alternative channels of supply, including direct supply arrangements with suppliers";
- page 100 states "[p]roducts in fresh categories are often available through specialty wholesalers (eg, T&G Fresh) and other alternative channels of supply";
- page 100 states that "[s]maller and specialty retailers who stock fresh categories generally preferred their current channels of supply";
- page 101 states "in general there appears to be little change to the benefits these alternative channels provide since the Market Study"; and
- page 101 states that "wholesale customers also identified some benefits in direct supply" from suppliers,

it was not apparent that any detailed analysis / assessment had been undertaken with other wholesalers / suppliers of their specific offerings (price, range, or service), nor any detailed analysis / assessment of why a number of retailers "generally preferred their current channels of supply" for fresh categories or see "benefits in direct supply". Or alternatively, even if the Commission did undertake enquiries with other wholesalers or suppliers about their wholesale offerings, or other retailers in relation to with their own distribution networks, the Annual Report's views did not reflect the extent of those other alternatives.

[42] Foodstuffs North Island Limited and Foodstuffs South Island Limited [2024] NZCC 22. [X22].

its Grocery Market Study that "wholesale options exist for sourcing some product categories in New Zealand such as fresh produce (eg, T&G Fresh and MG Marketing) and meat"[43] and its findings in its written reasons on the FSNI / FSSI merger (referred to above);

(iii) Costco - which is notable given:

- economic analysis prepared on behalf of Costco has estimated that "sales to business customers are in the order of 30% of [its] total sales" in Australia and "include a high share of the following: Independent restaurants and take-away food outlets, Small supermarkets and convenience stores…"[44]
- in the UK Competition Markets Authority's (**CMA**) 2017 consideration of the *Tesco / Booker* merger, it referred to Costco among the key wholesalers in the UK.[45]

(iv) The Warehouse in relation to its own logistics capabilities. This is notable given our understanding that The Warehouse distributes its dry grocery goods from a distribution centre in Wiri (a part of Auckland) that is almost the size of WWNZ's Auckland National Distribution Centre. The Warehouse also has a significantly sized distribution centre in the South Island (which has been described as "the biggest single-level building in the South Island").[46]

(c) The Annual Report[47] (and then the PIP)[48] raises the concern that "the conversion rate from enquiries to orders is low". In relation to WWNZ, the Commission has information demonstrating that of the total [ ][49] enquiries received by NZGW that have not proceeded, the vast majority were because the enquirer:

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[43] Grocery Market Study Final Report. [6.134].

[44] (10 November 2020). Costco Boolaroo. Economic Impact Assessment. Ethos Urban. On behalf of Costco Wholesale Australia Pty Ltd.

[45] Noting that "in cash and carry grocery wholesale, Booker and Bestway are the largest wholesalers in the UK, followed by Dhamecha, Blakemore, Parfetts and Costco". See: CMA. "A report on the anticipated acquisition by Tesco PLC of Booker Group plc". (20 December 2017). [7.66].

[46] (6 May 2016). "Giant $13 million expansion for The Warehouse's distribution centre". Stuff. https://www.stuff.co.nz/business/industries/79654004/giant-13-million-expansion-for-the-warehouses-distribution-centre

[47] Annual Report. Page 95.

[48] PIP. [41.1].

[49] Figures are as of 10 October 2024.

(i) did not respond to follow-up correspondence with NZGW, suggesting they did not have a genuine intention to transact ([ ]);

(ii) was not within the scope of the GICA's wholesale regime (e.g. the enquirer was based overseas or only wanted alcoholic products, ([ ]); or

(iii) did not have an operational retail business ([ ]).

We do not consider it accurate to calculate a "conversion rate" based on such enquiries. Further, while the Annual Report raised a concern that NZGW does "not currently offer fresh produce at wholesale", the Commission has been provided information demonstrating that, of all its enquiries that did not proceed, only [ ] potential customers confirmed that was because NZGW did not have a fresh produce offering.

(d) The Annual Report raised a concern that the RGRs "appear to have limited the range of products they offer via wholesale to products that go through their distribution centres, and to suppliers who have agreed to participate / 'opt in'". This suggests that RGRs have deliberately restricted their wholesale range in this way. However:

(i) in relation to "direct store delivery" products (such as milk and bread), it is difficult to see what value WWNZ could add from a delivery or efficiency perspective by seeking to "wholesale" those products. Suppliers deliver such products to WWNZ's supermarkets (and other grocery retailers) directly given the products' perishable nature. Section 24(2) requires the Commission to have regard to suppliers' direct supply capabilities in considering the range of products offered by the RGRs;[50] and

(ii) NZGW does not have the right to wholesale products when suppliers have not agreed to participate in WWNZ's wholesale offering:

○ section 24(1)(h) of the GICA expressly states that a principle of the wholesale regime is "the desirability of suppliers retaining reasonable control over the

[50] Including in assessing whether range is a factor relevant to whether it should perform or exercise its Part 3 functions, powers or duties.

channels for the retail sale of their own products and brands"; and

- ○ (even setting aside contractual law) it would be a breach of WWNZ's obligations under the Grocery Supply Code to resell suppliers' products without permission.

It is not appropriate for the Commission to draw an adverse inference against RGRs for not doing something that they cannot legally do (including under the GICA).

(e) The Annual Report expressed adverse views in relation to the New Zealand wholesale grocery market by making comparisons with Australia's wholesale grocery market,[51] without acknowledging that there are a great number of similarities between how WWNZ's NZGW and Woolworths' Australian Grocery Wholesalers (**AGW**) operate their respective wholesale businesses in New Zealand and Australia, as well as other similarities between New Zealand and Australia. For example:

(i) The Annual Report said that in a "competitive grocery wholesale market" it would expect wholesale pricing to be based on "RGRs' actual costs to provide products to wholesale customers".[52] [ ][53]

(ii) The Annual Report states that the Commission considers that "[o]ther retailers' access to RDPs"[54] may be an issue with the wholesale offerings. We assume by this reference the Commission is referring to suppliers' "Retail Scan Funding" (as NZGW already passes on to wholesale customers, in effect, all other discounts made available by suppliers,[55] given its pricing is based on its cost of goods sold plus fixed margin).[56] However, in relation to Retail Scan Funding, [ ]

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[51] For example: Annual Report. Page 100.

[52] Annual Report. Page 93.

[53] [ ]

[54] Annual Report. Page 103. The Commission uses the term "RDPs" to generically refer to "Supplier rebates, discounts or payments". As WWNZ outlines in this Submission, it is important to distinguish suppliers' Retail Scan Funding from other supplier RDPs.

[55] [ ]

[56] WWNZ. NZGW Rules, Criteria and Procedures for Considering Wholesale Supply Requests & Principles for Wholesale Supply. https://www.nzgrocerywholesalers.co.nz/rules_and_principles.pdf

(iii) The Annual Report noted a concern that NZGW only sells a "limited range of private label products, and notably excludes all Woolworths branded products."[57] By contrast it said that "private label products make up a substantial proportion of the top-selling retail products and are offered by grocery wholesalers, such as Metcash in Australia, and by food service providers."[58] These statements are inconsistent with the Australian dynamics:

- [ ]
- While Metcash has private label products:
  - Metcash does not wholesale its IGA-only private label products (branded "Community Co") to other third party grocery retailers (they are only supplied to its IGA franchise stores, which is in effect the same approach as NZGW and AGW in relation to Woolworths branded private label products); and
  - the private label products that Metcash does wholesale to other third party grocery retailers are not branded with Metcash's own retail brand (i.e. IGA or even "Community Co"), but rather are branded with a non-retailer specific brand ("Black & Gold") and, therefore, are more similar to a "fantasy" brand than a retailer branded private label range.

(iv) The Annual Report, as noted above, raised a concern that NZGW does "not currently offer fresh produce at wholesale".[59] However, had the Commission made enquiries with WWNZ it would have understood that AGW also does not offer fresh produce at wholesale.

(v) The Annual Report raised a concern that RGRs set "minimum order requirements and delivery requirements [that] are reducing the viability of the offerings for smaller retailers".[60] Any wholesaler would need to have minimum order and

[57] Annual Report. Page 100.
[58] Page 100.
[59] Page 100.
[60] Page 102.

delivery requirements in order to enable a viable delivered wholesale offering - that is a feature which distinguishes a wholesale offering from a retail offering. As the Commission noted during the Grocery Market Study, trying to develop a wholesale offering for [ ].[61] Furthermore, NZGW's minimum order quantity (of 60 cartons, which makes up a pallet), [ ]. We also have developed our "wholesale card" offering for wholesale customers looking to purchase very small volumes that cannot be viably delivered.

3.7 Given the limited analysis set out in the Annual Report and its failure to take into account mandatory considerations (as set out in section 3.4 above), WWNZ considers that there is an insufficient basis for the Annual Report's views that "in its current form the wholesale regime is not working well for the broader grocery industry and is unlikely to be promoting the purpose of the Act".[62] It is, therefore, also wholly inappropriate for the analysis and views referred to in the Annual Report to be used as a basis or starting point for the Inquiry.

(3C) The Annual Report's views pre-empt the Inquiry, without the required procedural safeguards

3.8 Those concerns are magnified further when the ToR and the PIP suggest that the Commission's views in the Annual Report may have already influenced (or even pre-empted) the Commission's findings of the Inquiry, which risks undermining the Inquiry process more broadly. For example, there are a number of statements in the ToR and the PIP that suggest some level of predetermination, such as:

(a) "there are some fundamental issues in the wholesale market that cannot be addressed under the regime's current settings";[63]

(b) "in its current form the wholesale regime is not helping to improve competition and efficiency in the New Zealand grocery sector, or benefitting New Zealand consumers, and seems unlikely to do so in its current form";[64] and

(c) "why the current regime is not achieving its purpose".[65]

[61] [ ]
[62] Annual Report. Page 103.
[63] PIP. Page 1.
[64] ToR. [7].
[65] ToR. [10.1].

3.9 This is of particular concern given:

(a) s 56(1) of the GICA states that the purpose of a wholesale inquiry is to "consider whether the wholesale supply of groceries and any ancillary services should be subject to additional regulation …";

(b) s 57(1) of GICA requires the Commission, in carrying out a wholesale inquiry, to consider whether any of the tests for regulation are satisfied. A key test is whether wholesale offerings are not consistent with wholesale offerings provided in a competitive market. The Commission appears to have already determined that this test is satisfied, despite it being a matter it must consider with an open mind as part of the Inquiry;

(c) the GICA specifically provides for rights of consultation in a wholesale inquiry (including publication of a draft report and "allow[ing] a reasonable time for comments on the draft");[66] and

(d) the Grocery Commissioner has made statements to the media indicating that the Commission is undertaking the Inquiry so that it can "unlock" additional regulation from the Minister[67] - rather than reflecting that the purpose of an Inquiry is "*whether* the wholesale supply of groceries and ancillary services *should* be subject to additional regulation".[68]

3.10 WWNZ would like the Commission to address these concerns - both to:

(a) provide reassurance that the Inquiry's outcome is not a foregone conclusion and to address that appearance; and

(b) ensure that its findings in relation to wholesale are only made in light of the requirements of the GICA (including the mandatory consultation rights).

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[66] GICA, s 59.

[67] For example, the Grocery Commissioner stated: "We also doing a section 55 and 56 inquiry to see what else can be unlocked because in the Grocery Industry Competition Act there are backstops, those backstops though require us to actually do an inquiry first then give a report to the Minister and say 'here you are, we've got backstops in here that can be unlocked, this is our recommendation on the backstops'. Those backstops could be non-discriminatory pricing, so in other words I am supplying, I am the supermarket and I am supplying my own stores at X price, I've got to be able to supply other retailers at the same price." (4 September 2024). New Zealand Herald. Grocery Commissioner Pierre van Heerden is working ahead of schedule to drive sector change. https://www.nzherald.co.nz/business/grocery-commissioner-pierre-van-heerden-is-working-ahead-of-schedule-to-drive-sector-change

[68] Section 56(1). Emphasis added.

4. Part 4: WWNZ's wholesale business has achieved significant growth in a short period of time

4.1 WWNZ does not agree that the number or diversity of its customers[69] or the level of its wholesale sales[70] are lower than what would be expected in a competitive market after just 15 months. In that short space of time, NZGW:

(a) has expanded the number of employees in its team to [ ];

(b) as of 28 October 2024, has engaged with [ ] suppliers, of which [ ] have agreed to allow NZGW to wholesale some or all of their products. NZGW now has a range encompassing more than [ ] products; and

(c) now has [ ] wholesale customers,[71] with NZGW set up to deliver to [ ] domestic retail customer sites.[72] This includes growth in sales to retail customers such as [ ]. NZGW also supplies to distributors who are known to provide stock to the petrol channel, such as [ ] and [ ]. The store said to be "New Zealand's largest independent supermarket" in New Zealand[73] (FIFO Supermarket in Hamilton) is also a NZGW customer,[74] and NZGW has recently [ ] added [ ] as a wholesale customer.

4.2 This reflects significant growth in a very short period of time.

5. WWNZ should not be subject to further regulation due to any lack of progress by other RGRs

5.1 The PIP reflects that NZGW's progress in developing a scale wholesale business is more advanced than that of other RGRs.[75] This is important as the GICA:

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[69] As suggested at [40] of the PIP.

[70] As suggested at [42] of the PIP.

[71] Excluding charity customers.

[72] Excluding charity customers.

[73] (26 April 2024). New Zealand supermarket sector shake-up - independent store in Hamilton set to open. NZ Herald. Retrieved from: https://www.nzherald.co.nz/nz/new-zealand-supermarket-sector-shake-up-independent-store-in-hamilton-set-to-open/R65HFZSIWBE2BHHAFQ527JRRBM/?utm_source=ground.news&utm_medium=referral

[74] (27 April 2024). New Hamilton supermarket 'could be a game changer'. 1 News. Retrieved from: https://www.1news.co.nz/2024/04/27/new-hamilton-supermarket-could-be-a-game-changer/

[75] For example:

- [39.1] of the PIP states that: "WWNZ has the largest number of wholesale customers and by far the highest sales through its wholesale offering".
- [41.3] of the PIP states that: "Compared to FSNI and WWNZ, the volume of FSSI's wholesale sales was very low."

(a) provides for findings or recommendations to be targeted at just one RGR (rather than all RGRs);[76] and

(b) requires the Commission, in making any recommendations, to "consider what would be the most cost-effective… additional regulation in the circumstances".[77]

5.2 Taken together, these provisions require the Commission to take the most cost-effective (i.e. targeted) approach to making recommendations / findings of any further regulation.

5.3 That means, for example, it would be inconsistent with the GICA framework for any recommendations to be made of further regulation in relation to WWNZ's wholesale business based on concerns about the progress of FSNI's or FSSI's wholesale businesses, unless that could be established as the most cost-effective regulatory response.[78] It is difficult to see how regulation of one entity, due to concerns about another entity, could be the "most cost-effective in the circumstances".

5.4 The approach suggested in the ToR and the PIP needs to be updated to reflect these obligations.|

6. The approach to the ToR and the PIP does not reflect the GICA's requirements

6.1 The approach to the Inquiry outlined in the ToR and the PIP does not suggest that the Commission intends to consider other matters that it must take into account under the GICA to the extent they are considered relevant to assessing whether wholesale offerings are consistent with those provided in a competitive wholesale market, including:

(a) the efficiency of an RGR's wholesale operations;[79]

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[76] For example:

- Section 65(1)(b)(ii) of the GICA requires the Commission to consider "the wholesale offerings of groceries provided by **1 or more** regulated grocery retailers (in relation to any 1 or more of price, range, quantity, frequency, or any terms and conditions) are not consistent with wholesale offerings provided in a competitive wholesale market". Emphasis added.
- Section 66(2) of the GICA states that "the Commission may make a determination under this subpart that applies to **1, some, or all** regulated grocery retailers". Emphasis added.

[77] Section 57(3)(b). [Emphasis added]

[78] The mandatory requirement in s 57(3)(b) that the Commission <u>must</u> consider the most cost-effective additional regulation in the circumstances overrides any other provision in the GICA stating that the Commission (or the Minister) <u>may</u> act in relation to a RGR even if it has complied with the GICA (e.g. ss 66(2), 82(3)).

[79] Section 24(1)(a)(ii).

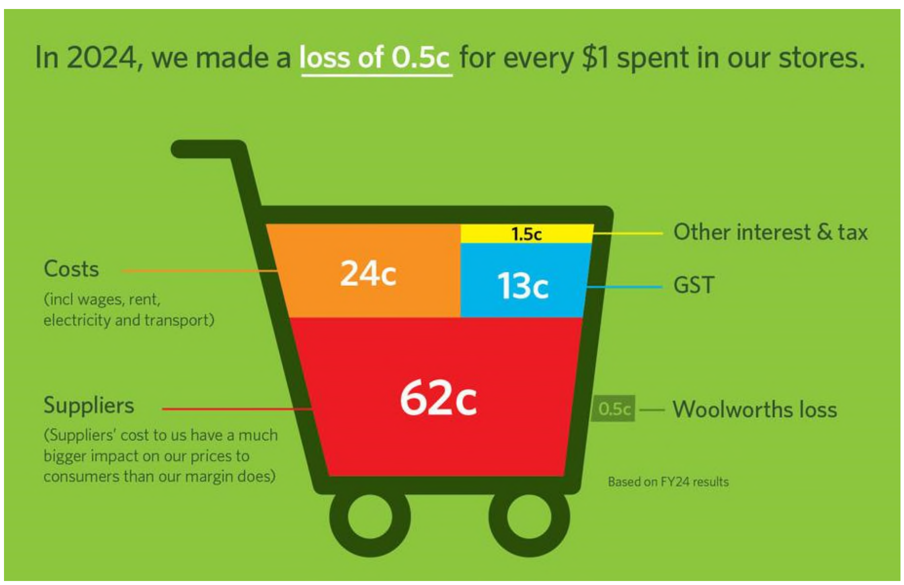
(b) an RGR's "reasonable expectation of recovering its efficient costs, including a reasonable return on investments made in connection with a wholesale offering";[80] and

(c) the desirability of RGRs "being able to invest and innovate for the long-term benefit of consumers".[81]

6.2 Two examples (of many) in the PIP (and the Annual Report) of an approach that overlooks these considerations are:

(a) the comment in relation to WWNZ's "wholesale card" that "given the relatively low value of the wholesale discount (5%) it does not appear to present a cost-effective option for most wholesale customers".[82] Given WWNZ is already losing 0.5c for every dollar spent in its store[83] (see Figure 1 below), the viability for WWNZ of even that 5% discount requires careful consideration, but the PIP indicates an approach that only considers issues from the perspective of wholesale customers (not in light of the considerations noted above in relation to the RGRs); and

Figure 1 - Breakdown of every $1 spent in WWNZ stores



[80] Section 24(1)(a)(iii).
[81] Section 24(1)(f).
[82] PIP. [71].
[83] [ ]

(b) the Annual Report's statement indicating the prospect of the Commission using a wholesale code to mandate "inclusion of private label products".[84] In making that statement the Annual Report did not acknowledge that such a requirement risks undermining the ability of RGRs to be "able to invest and innovate for the long-term benefit of consumers". In particular, such a recommendation would undermine grocery retailers' incentives to invest in private label products (noting that they do so to differentiate their retail offering from other retailers').[85] That risks higher overall prices and fewer choices for consumers given, as the Commission found in its Grocery Market Study, consumers can "benefit from private label products through lower prices and greater choice".[86]

6.3 WWNZ is concerned that this approach, of overlooking the requirements and positions of the RGRs, is manifest throughout the ToR, the PIP, the Annual Report, and more broadly is reflected in the Commission making one of its institutional performance measures that "[t]he national retail grocery market share concentration of regulated grocery retailers reduces over time when measured against the 2023/24 Annual Competition Review baseline",[87] without reflecting that its performance indicator needs to in fact be consistent with the GICA. The GICA does not require reduction in the RGRs' size irrespective of the consequences or the benefits to consumers (as that would be an approach that simply seeks to injure the businesses of the RGRs regardless of the consequences), but rather directs consideration of efficiencies, the ability to innovate and invest, and to achieve reasonable returns on investment - all for the long-term benefits of consumers.

6.4 To put this another way, the "main principle" of Part 3 of the GICA "is the importance of wholesale offerings to wholesale customers (including by regulated grocery retailers) being consistent with wholesale offerings provided in a competitive wholesale market."[88] A wholesale offering that is consistent with a competitive wholesale market is sustainable, and would achieve a reasonable rate of return and enable investment and innovation into the future.

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[84] Annual Report, page 119.

[85] Grocery retailers, such as WWNZ, supply private label products to differentiate their retail offering on price and innovation. This contributes to price competition, both with other retailers and between suppliers (including large multinational suppliers, such as Unilever, Coca-Cola, Nestle, Procter & Gamble, and Mondelez) and therefore puts downward pressure on grocery prices for New Zealand consumers. If RGRs, such as WWNZ, are required to provide their private label products to competing retailers on a wholesale basis then it removes a very significant commercial rationale for producing these products. That may mean that RGRs will no longer invest in private label products, which would risk denying consumers more affordable options and therefore result in higher grocery prices for consumers.

[86] Grocery Market Study Final Report. [8.163].

[87] (2024/25). Commission. Statement of Performance Expectations. Page 30. https://comcom.govt.nz/__data/assets/pdf_file/0021/357213/Statement-of-Performance-Expectations-202425.pdf

[88] Section 23(2).

6.5 For the Inquiry to be complete, the Commission must take these considerations into account in the manner directed by the GICA before making any findings or recommendations. A failure to do so would result in an Inquiry that does not reflect the requirements of the GICA - and would reflect a lens of either:

(a) injuring the RGRs' businesses regardless of the consequences; or

(b) requiring the RGRs to subsidise other retailers to the detriment of both their own businesses and, more importantly, the long-term interests of consumers.

6.6 WWNZ requests that the ToR and the PIP (and its institutional performance measures) be updated to reflect these requirements in the manner directed by the GICA.

7. It is necessary for any decisions / recommendations to be subject to full and rigorous cost-benefit analysis

7.1 As the Commission will be aware, in conducting an Inquiry under the GICA the Commission needs to consider:

(a) whether "any other regulation or action may be necessary or desirable to promote the purpose of this Act"[89] (with the purpose of the GICA being to "promote competition and efficiency in the grocery industry for the long-term benefit of consumers in New Zealand");[90]

(b) "the benefits of applying (or continuing) different types of additional regulation";[91] and

(c) "what would be the most cost-effective type or types of additional regulation in the circumstances".[92]

7.2 The above requires that before making any decision or recommendation in relation to further regulation the Commission must:

(a) conduct a rigorous cost-benefit analysis to ensure that the benefits of such regulation outweigh the costs, including by promoting "workable or effective" competition in a way that does not undermine efficiencies,

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[89] Section 57(2)(b).
[90] Section 3. [Emphasis added]
[91] Section 57(3)(a). [Emphasis added]
[92] Section 57(3)(b). [Emphasis added]

investment or innovation or otherwise act adversely to the long-term interests of consumers;[93] and

(b) if it decides based on that cost-benefit analysis that further regulation is warranted, only recommend the most cost-effective "additional regulation in the circumstances" - which would mean the least costly (least intrusive) option capable of addressing any identified issue.[94]

7.3 In this context, we are concerned that the approach to the Inquiry outlined in the ToR and the PIP does not currently indicate that the Commission will be assessing whether the tests for regulation are satisfied in accordance with the GICA. If it is established that the tests are satisfied, then there is no indication in the ToR or the PIP that the Commission (as required by the GICA) will conduct a rigorous cost-benefit analysis before making any decisions / recommendations on further regulation, nor (if any further regulation is, based on that analysis, considered necessary) that it is obliged to consider the most cost-effective additional regulation.[95] We submit that the ToR and the PIP need to be updated to reflect these requirements.

7.4 That is particularly the case given the Commission has previously concluded that further intervention of the nature being considered in the Inquiry was not warranted or in the interests of New Zealand consumers - and said that "careful cost-benefit analysis would be desirable"[96] before any such intervention should be considered. For example, in the Commission's Grocery Market Study, the Commission concluded:

(a) " … we do not recommend that substantive access regulation be imposed at this time. There are a significant number of issues that would need to be resolved before economic regulation would be feasible. Even if feasible, careful cost-benefit analysis would be desirable".[97]

(b) "Grocery wholesaling requirements are likely to vary significantly, and require different services from the major grocery retailers, meaning non-discrimination and equivalence may not be workable principles for regulation."[98]

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[93] Sections 3 and 57(3)(a).
[94] Section 57(3)(b).
[95] Section 57(3)(b). This obligation to consider the most cost-effective regulatory intervention in the circumstances is consistent with the orthodox "regulatory ladder" approach to regulation - i.e. that the lowest form of regulatory intervention should be considered first, before any more interventionist options.
[96] Grocery Market Study Final Report. [9.119].
[97] Grocery Market Study Final Report. [9.119].
[98] Grocery Market Study Final Report. [9.118.2].

(c) "Significant intervention could disrupt existing efficient vertical integration efficiencies, operational efficiencies, efficiencies of scale and scope, dynamic efficiency, and introduce significant additional costs. It may also reduce retail competition on price. It will require significant monitoring and regulatory oversight."[99]

(d) "The lack of any essential facility or natural monopoly characteristic means that grocery wholesaling is not the type of industry ordinarily regarded as potentially amenable to such [access] intervention."[100]

(e) " … we do not consider operational or structural separation (with or without divestment) of the major grocery retailers' wholesale and retail businesses (ie, vertical separation) to be necessary or desirable....there would be a range of practical challenges and transaction costs associated with operational or structural separation."[101]

7.5 In discharging its obligations under the GICA, prior to making any recommendations as part of this Inquiry the Commission must do the following:

(a) Reach probative evidence-based conclusions,[102] not conclusions based on an intuitive sense of a problem, anecdotal evidence, or a preconceived target that it wants to decrease the "national retail grocery market share concentration of regulated grocery retailers".[103]

(b) Consider the full regulatory and administration costs and complexity of seeking to implement and monitor a regulatory regime that has no global precedent. These costs and complexities have been noted by the Commission, MBIE, and other regulatory experts as follows:

(i) The Commission:

- "Any regulation regime would be novel and unprecedented, increasing the design and implementation cost – and uncertainty – arising from the regulation. It would also increase the risk of unintended consequences."[104]

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[99] Grocery Market Study Final Report. [9.118.3].
[100] Grocery Market Study Final Report. [9.118.1].
[101] Grocery Market Study Final Report. [9.124].
[102] Refer to the probative evidence rule applicable to investigative bodies.
[103] (2024/25). Commission. Statement of Performance Expectations. Page 30.
https://comcom.govt.nz/__data/assets/pdf_file/0021/357213/Statement-of-Performance-Expectations-202425.pdf
[104] Grocery Market Study Final Report. [9.118.1.1].

- "The sector is more dynamic than many regulated sectors, and certainly more diverse in its product offerings, increasing the cost and difficulty of regulation."[105]

(ii) MBIE: "Given the lack of any essential facility or natural monopoly characteristic, and the diverse range of grocery products, such a regulatory regime would be novel and unprecedented. This would increase the design and implementation cost – and uncertainty – arising from the regulation. It would also increase the risk of unintended consequences."[106]

(iii) Peter Harris AO: "The root cause of these complexities is that the asset being separated is a sort of right to a set of prices, not a natural monopoly asset of a physical infrastructure kind, as is commonly the case with separation or access arrangements under competition policy around the world. Because of this, the tool it proposes to use is not designed – and based on the list above could not reliably be redesigned – for this purpose."[107]

(iv) Henry Ergas AO: "the Commission's proposed interventions are entirely unrelated to the conceptual basis for access regulation, either as regards (natural monopoly) utilities regulation or even access to essential (infrastructure) facilities".[108]

(c) Appropriately consider, and reflect in its decision making, the significant efficiencies and other benefits to consumers from the RGRs being able to operate in a vertically-integrated way - for example, to recognise:

[105] Grocery Market Study Final Report. [9.118.1.3].

[106] (5 July 2022). MBIE. Regulatory impact statement https://www.mbie.govt.nz/dmsdocument/22638-regulatory-impact-statement-government-response-to-the-commerce-commission-grocery-sector-market-study-policy-decisions-proactiverelease-pdf

[107] Peter Harris AO "Views on the Commerce Commission Draft Market Study Report on Grocery Retailing in New Zealand" (November 2021).

[108] (23 November 2021). Henry Ergas AO. Comments on the Recommendations for Third Party Access by the Commerce Commission New Zealand. [107].

(i) <u>There are compelling efficiency reasons why the major supermarket chains across the OECD are all vertically integrated</u>.[109] Reflecting this:

- MBIE has observed:[110]

> *There are significant efficiencies from vertical integration. This includes the retailer being able to collaborate with suppliers:*
> - *On merchandising strategies and promotions*
> - *By providing demand forecasting to support alignment with the suppliers' capacity and production*
> - *To curate product range based on the suppliers' brand (e.g. 'green'), customer demand and to support new product offerings*
> - *To support resilience of the supply chain, including during disruptions…*
>
> *Buying arrangements and logistics are optimised to focus on retail product-offerings. The sector is dynamic, involving a large and diverse range of product offerings. Significant intervention could disrupt existing efficient vertical integration efficiencies, operational efficiencies, efficiencies of scale and scope, dynamic efficiency, and introduce significant additional costs which could be passed on to consumers in higher grocery prices.*

- Henry Ergas AO has observed: "the ubiquity of vertical integration in grocery retailing in many countries - including those where grocery markets are undoubtedly strongly competitive is an indication that this model offers significant efficiency benefits that enable these businesses to compete more effectively, to the ultimate benefit of customers."[111]

In other words, the Commission's findings would need to recognise that any regulation that disrupted the efficiencies of vertical integration would make New Zealand an outlier and would risk adverse consequences for New Zealand consumers.

[109] Tesco, Sainsbury's, Asda, Coop and Morrisons in the UK, Coles, Woolworths, Costco and Aldi in Australia, and other major international retailers including Kroger, Walmart, Carrefour, Mercadona and Lidl.

[110] (5 July 2022). MBIE. Regulatory impact statement government response to the Commerce Commission grocery sector market study policy decisions proactive release. https://www.mbie.govt.nz/dmsdocument/22638-regulatory-impact-statement-government-response-to-the-commerce-commission-grocery-sector-market-study-policy-decisions-proactiverelease-pdf

[111] (23 November 2021). Henry Ergas AO. Comments on the Recommendations for Third Party Access by the Commerce Commission New Zealand. [75].

(ii) The Commission's previous findings that vertical integration is necessary for a scale grocery business to successfully operate. As the Commission observed during the Grocery Market Study: "Coriolis has highlighted that Metcash is the only independent grocery wholesaler in peer group countries, and that it is changing its business model. The concept of an independent wholesaler, Coriolis says, has failed and would not work in New Zealand."[112] This means that there would be significant risks to costs, prices, customer-led innovation and stability of supply if any regulation broke apart WWNZ's vertical integration (or inadvertently had a similar effect).[113]

(iii) That there are major risks to stability of food supply if vertically-integrated models are inappropriately disrupted, or impacted by regulatory overreach (see **Appendix One** for information that WWNZ has previously provided the Commission on this point).

(iv) That WWNZ is already a small supermarket retailer by global standards (serving a market with a smaller population than Sydney, but spread across a long, skinny island chain separated by a body of water), and that any steps that further undermined scale economies would have adverse impacts for New Zealand consumers.

(d) Appropriately consider, and reflect in its decision making, that WWNZ's supply chain is already at capacity at certain points of the year (for example, Christmas, Easter, demand shocks (such as COVID-19)), and that WWNZ needs to be able have the returns (and certainty in relation to the regulatory environment) in order to invest in expanding that capacity - including if it needs to expand that capacity to accommodate additional wholesale customers.

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[112] Grocery Sector Market Study Final Report. [9.123.2].

[113] Demonstrating this:

- WWNZ's buyers are focussed on the needs of customers, and by ensuring that their focus is end-to-end, they make us a more efficient retailer overall. An environment where the perspective of buyers is narrowed, for example through some kind of operational separation of buying functions, would significantly increase the risk of low quality decisions, with negative impacts in our supply chain and certainly negative outcomes for customers.
- WWNZ does not buy to hold stock in a warehouse. WWNZ buys to meet constantly changing customer needs, and our supply chain serves to get products from suppliers to customers as efficiently as possible, at a high service level, and just-in-time.
- WWNZ's existing operations are supported by integrated store-connected systems that support high quality demand forecasting, systematised ordering and highly efficient replenishment and end-to-end product flows.

(e) Appropriately consider, and reflect in its decision making, that all the recent larger-scale entrants in the New Zealand grocery sector have achieved that without requiring access to regulated wholesale supply, but rather have formed direct relationships with suppliers (for example, Costco, My Food Bag, HelloFresh, and Farro Fresh) [ ][114] This demonstrates that regulated wholesale supply is not necessary for new entry, and therefore that it is important that regulated wholesale supply is not seen as the only path to new entry and that its benefits are not overstated. It also reflects MBIE's previous observation that: "Most large retailers would seek to develop their own supply chains, meaning any demand for wholesale access would be short term, if used at all"[115] (reflecting that regulated wholesale access is only ever intended, at most, to be a short-term "stepping stone" option for the type of new entrants that it is understood the Commission wishes to see emerge - and not one that Costco, Aldi, or Amazon would likely seek to use even on that short-term interim basis).

(f) Appropriately consider, and reflect in its decision making, the previous WWNZ analysis, supported by [ ] that found that any structural separation with forced divestment is likely to increase grocery sector costs by $440 to $980 million[116] per year, with direct flow-on impacts to customers in the form of higher grocery prices (up to 6% higher) (as well as a number of additional costs and risks).[117] Given those costs and risks, previous Cabinet papers noted that "[t]he Treasury does not consider further work on divestment is warranted at this stage",[118] and the (then) Cabinet itself noting that "divestment comes with significant uncertainties, risks, and limitations."[119]

7.6 Even if further regulatory interventions in relation to the RGRs' wholesale offerings were considered justified, we do not consider that the Commission can make any recommendations of interventions without:

[114] (12 February 2024). NZ Herald. Seventh store for Farro Fresh: New Smales Farm shop opens on Wednesday. https://www.nzherald.co.nz/business/companies/construction/seventh-store-for-farro-fresh-new-smales-farm-shop-opens-on-wednesday/ONZ6DW3GCJBAHIJMSE726IWNX4/

[115] (5 July 2022). MBIE. Regulatory impact statement government response to the Commerce Commission grocery sector market study policy decisions proactive release.

[116] This figure reflects the estimated ongoing annual costs combined with the estimated one-off costs amortised over a three year period.

[117] (22 September 2022). Forced divestment of grocery retail: An indicative look at costs and risks.

[118] (13 July 2023). Title of Cabinet paper: Provisional supermarket divestment cost benefit analysis and proposed next steps. Minister: Hon Dr Duncan Webb.

[119] (13 July 2023). Title of Cabinet paper: Provisional supermarket divestment cost benefit analysis and proposed next steps. Minister: Hon Dr Duncan Webb.

(a) conducting a full and rigorous cost-benefit analysis - including of the costs outlined above; and

(b) establishing that any further regulation is the most cost-effective in the circumstances.

7.7 We would regard any further regulatory interventions without full and rigorous consideration of the factors described above to be procedurally flawed and manifestly incorrect. It is also difficult to see how the Commission could complete its Inquiry within the timeframe indicated in the PIP while carefully assessing the relevant issues to the standard required by the GICA.

8. Approach to considering RGRs' incentives is unclear

8.1 The aspect of the ToR proposing assessment of whether RGRs have incentives to "to create a compelling wholesale offer and support the entry or expansion of retail competitors" is unclear.

8.2 If that aspect of the ToR is intended to consider whether RGRs have incentives to develop their wholesale businesses, then it is necessary for the Commission's ToR and PIP to reflect, in the manner directed by the GICA, the desirability that RGRs are able to achieve a "reasonable return on investments made in connection with a wholesale offering"[120] and "able to invest and innovate".[121]

8.3 If that aspect of the ToR is intended to consider whether RGRs have incentives to support the entry or expansion of other retail competitors, then that is inconsistent with the Commission's usual approach to considering competition. Demonstrating this, the GICA defines "competition" as "workable competition" and in other contexts, the Commission has said that "workable competition is ongoing and inherently injurious. Competitors in such markets are constantly jostling to improve their market share. They do not seek to accommodate with their rivals – they seek to do them harm by winning their customers".[122]

8.4 This aspect of the ToR needs to be clarified to ensure it is consistent with the definition of "workable competition" and, therefore, with the GICA.

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[120] GICA s 24(1)(a)(iii).
[121] GICA s 24(1)(f).
[122] (20 August 2024). Personal banking services. Final competition report. [2.49]

9. Suggestion of wholesale pricing methodologies without consultation or necessary reference to the GICA is inappropriate

9.1 The PIP suggests an approach of assessing the RGRs' wholesale prices based on the "additional costs to wholesale customers of retailing the products … which could be equivalent to at least 15% of the price of the goods".[123]

9.2 If that is intended to suggest that to avoid a presumed "margin squeeze"[124] the Commission may need to regulate the RGRs' wholesale prices based on its assumptions of wholesale customers' retail costs, then that is not an approach provided for by the GICA.

9.3 The GICA requires wholesale prices to reflect efficient wholesale costs. If that condition is met then, from a pricing perspective, wholesale customers can have access to the pricing benefits of the RGR's buying scale. If customers have inefficient retail costs, then they might not successfully compete despite having access to efficient wholesale prices. But that is an issue within the control of those wholesale customers, not the RGRs. It would be wrong to regulate wholesale prices in an effort to allow inefficient retailers to compete. Key provisions in the GICA that establish this position are as follows:

(a) The purpose of Part 3, which is to enable wholesale customers to have reliable and cost-effective wholesale supplies of groceries and to provide reasonable access to the benefits of the scale, and the efficiency, of operations of regulated grocery retailers.[125]

(b) The wholesale pricing principles, which (as noted at [6.1] above) state the desirability of each RGR's wholesale prices reflecting efficient costs, taking into account:

(i) the RGR's costs;

(ii) the RGR's efficiencies; and

(iii) the RGR's reasonable expectation of recovering its efficient costs (including a reasonable return on investments).

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[123] PIP. [47].

[124] With "margin squeeze" meaning the theoretical concern of the setting of wholesale prices at levels that do not allow wholesale customers to profitably operate in the downstream retail market.

[125] GICA, s 21.

9.4 In undertaking its regulatory functions under the GICA, such as conducting the Inquiry, the Commission is required to take both these provisions into account.[126]

9.5 Therefore, in assessing the wholesale prices set by the RGRs (as part of determining whether the wholesale regime is meeting the Part 3 purpose as well as the GICA purpose), the key question for the Commission should be whether the RGRs' wholesale prices reflect efficient wholesale costs. That reflects an internationally standard and orthodox approach to regulatory cost modelling.

9.6 WWNZ acknowledges that it is theoretically possible that retail prices that are lower than wholesale prices could be an indicator that wholesale prices do not reflect efficient costs, but that would at most be a potential indicator and would never be determinative. The Commission would still be required to develop a detailed cost model to estimate a RGR's efficient wholesale costs, efficiencies, and reasonable return on investments.

9.7 It is yet to be determined what models could be appropriately used to assess efficient wholesale costs – the GICA does not contain specific requirements in that respect. Before the Commission develops any positions on an appropriate methodology for wholesale pricing, further consultation on such matters is required. But whatever model is used to assess efficient wholesale costs, wholesale customers' margins and retail costs do not impact the efficiency of the wholesale prices that are offered by the RGRs, so it is inappropriate for the Commission to take these into account when assessing the wholesale offering of the RGRs.[127]

9.8 This means, as the wholesale pricing principles in the GICA indicate (but is not indicated in the PIP), rather than downstream retailers' costs, the Commission would need to consider the costs that a RGR pays to its suppliers, and that RGR's efficiencies and reasonable expectations of recovering its efficient wholesale costs (including a reasonable return).

9.9 Furthermore, any assessment of these factors would need to be conducted on a specific RGR-by-RGR basis - i.e. it would not be appropriate for WWNZ to be assessed on the basis of the costs, efficiencies, or retail prices of, say, FSNI's business model (or vice versa).

[126] GICA, s4(2) and s24(1).

[127] Even if as part of consultation the Commission were to propose a retail-minus approach to determining an RGR's efficient wholesale costs, the retail costs of wholesale customers would remain irrelevant to that assessment (only the retail costs of RGRs would be relevant).

10. The ToR and PIP need to properly address provision of suppliers' Retail Scan Funding to wholesale customers

10.1 Further to Part 9 immediately above, in making an assessment of the costs that WWNZ pays to suppliers, as the Commission will be aware, suppliers' discretionary Retail Scan Funding has a material impact on WWNZ's retail pricing. WWNZ receives supplier Retail Scan Funding because it is vertically integrated - i.e. because WWNZ can activate supplier-led promotional activities at retail. As WWNZ has outlined to the Commission previously:[128]

> *The practice of supplier promotional funding involves suppliers charging higher upfront invoice prices to retailers, with discounts to achieve an overall lower "net price"* ***provided to retailers*** *through promotional funding on a periodic basis. It is not a matter of WWNZ requiring suppliers to provide promotional funding, but rather it is a practice that benefits and is primarily driven by suppliers (not by WWNZ), and is common across the world (it is not unique to New Zealand). This is because it is a practice that* ***allows suppliers to control the timing of a retailer's promotional programme in relation to the supplier's products****. [Emphasis added]*

10.2 Notwithstanding that Retail Scan Funding is provided in the context of WWNZ's retail operations (i.e. activation of promotions at retail), it appears that the Inquiry's primary focus is seeking to have RGRs (or suppliers) pass suppliers' Retail Scan Funding to wholesale customers.[129] That appearance is reinforced by the Commission's previous findings that grocery retailing / wholesaling retailing is not a "natural monopoly" asset (e.g. involving non-replicable monopoly physical infrastructure)[130] - there are many channels to retailers for suppliers' products, including direct supply and via other wholesalers. For example the PIP states that the Commission intends to look at the following:

(a) "why RGRs have extensive access to RDPs but access is limited for wholesale customers."[131]

(b) "how we can incentivise suppliers to provide trade spend to wholesale customers".[132]

(c) "the development of systems and processes that enable wholesale customers to have appropriate access to the RDPs that the RGRs currently benefit from would also be an improvement".[133]

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[128] (16 September 2024). WWNZ. Review of the Grocery Supply Code.

[129] In this context, WWNZ notes that paragraph 62.2 of the PIP misquotes the Commission's Grocery Market Study. The Commission's findings in the Grocery Market Study, as referenced, were not about ability to access products, but about the prices of those products. Page 239. Final Report. Grocery Market Study.

[130] Grocery Sector Market Study Final Report. [9.118.1].

[131] PIP. [81.3].

[132] PIP. [83.2].

[133] PIP. [73].

10.3 NZGW has the systems to enable it to pass standard “on invoice” discounts and rebates to wholesale customers (and, as noted at 3.6(e)(i) above, it does so through its COGS-based pricing model). However, the issue is that currently NZGW cannot provide suppliers’ Retail Scan Funding (or in some instances, cannot provide suppliers’ products at all) to wholesale customers due to the decisions of suppliers - namely, either:

(a) because suppliers “opt out” of having their goods supplied at all to RGRs’ wholesale customers; or

(b) because suppliers’ Retail Scan Funding is:

(i) only provided as goods are “scanned out” at retail (i.e. it is provided in recognition of retail sales); and

(ii) provided by suppliers for the purposes of funding retail promotions (which means both contractually, and due WWNZ’s obligations under the Grocery Supply Code,[134] WWNZ could not pass such funding to wholesale customers).

10.4 The fact that the RGRs’ abilities to pass on suppliers’ discretionary Retail Scan Funding would be the key defining determinant of the attractiveness of the RGRs’ wholesale offerings has long been identified by WWNZ to the Commission. For example, in September 2021 WWNZ outlined the following to the Commission:[135]

> *For WWNZ to provide wholesale supply on terms that would enable other retail customers to be competitive in the market, we would therefore need the support of our suppliers to either:*
>
> - *enable us to pass through suppliers’ discretionary rebates to other retail customers; or*
>
> - *convert discretionary rebates into purchase-based fixed rebates that are embedded into the cost of goods (such a move would require the discontinuation of scan-based discretionary rebates).*

10.5 Reinforcing this, the RIS in relation to the GICA expressly recognised that “[s]uppliers would need to be involved in decisions about whether promotional pricing could be passed on to other retailers”, noting (in its full context):[136]

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[134] Clause 17, Grocery Supply Code.

[135] (10 September 2021). WWNZ’s submission on the New Zealand Commerce Commission’s draft report regarding the market study into the retail grocery sector. Page 52. https://comcom.govt.nz/__data/assets/pdf_file/0024/265812/Woolworths-NZ-Ltd-Submission-on-Market-study-into-grocery-sector-draft-report-10-September-2021.pdf

[136] (5 July 2022). MBIE. Regulatory impact statement government response to the Commerce Commission grocery sector market study policy decisions proactive release. [152]. [Emphasis added].

> *Promotional prices are price reductions borne by suppliers to promote their products in competition with other suppliers in their product category. Promotional pricing arrangements are a significant reason why the major grocery retailers can retail at lower comparative prices.* ***Suppliers would need to be involved in decisions about whether promotional pricing could be passed on to other retailers****. The Commission notes that under this option, suppliers may choose to directly enter promotional funding relationships with independent grocery retailers, or in some cases may permit pass-through by the wholesaler.*

10.6 Accordingly, if the Commission's fundamental concern is the passing on of suppliers' Retail Scan Funding to wholesale customers (as appears to be the case), then ultimately the Inquiry (including the ToR and the PIP) should be transparent that the Commission's focus needs to be on considering recommendations in relation to suppliers (under s 58(2) of the GICA), not RGRs. In considering such recommendations, the Commission would need to carefully consider the costs / benefits of that (including as the ubiquitous nature across the world of supplier-led Retail Scan Funding arrangements suggests it is an efficient market mechanism), whilst recognising that the GICA does expressly contemplate that obligations might be placed on suppliers.[137]

10.7 If this issue is not addressed with suppliers, the only other way to achieve the outcome which is apparently desired by the Commission would be to require RGRs to subsidise other retailers by requiring wholesale pricing at a level by which RGRs effectively fund / subsidise other retailers' promotions (being an outcome that would be inconsistent with the GICA requirements of achieving outcomes that are consistent with a competitive wholesale market, and inconsistent with the GICA's recognition of the desirability of RGRs achieving a reasonable return on investment in connection with their wholesale offerings and RGRs being able to invest and innovate for the long-term benefit of customers).

11. Concluding comments

11.1 We hope that this submission assists the Commission. Our requests in relation to how the Commission addresses this Submission are set out at Section 1B above.

[137] For example, s 76(2), in the context of a wholesale code, provides that a "supplier must comply with the provisions of a wholesale code imposed under section 75(1)(d) to (f)".

Appendix One

Previous WWNZ submission on the risks to supply chain resilience and food security from structural wholesale intervention[138]

<u>Risks to supply chain resilience and food security</u>:

We do not consider that the Commission has considered the significant risks to New Zealand's food and grocery supply chain of seeking to introduce unprecedented and significant structural intervention into the vertical integration of New Zealand's supply chain - an intervention that would make New Zealand an outlier compared to any other modern developed market economy.

There are numerous different risks to New Zealand that are mitigated via a robust, agile, and vertically integrated supply chain delivering food security for New Zealanders. Those risks include pandemics (as currently being seen), earthquake (for example, Christchurch in 2010/11 and Wellington/Kaikoura in 2016), flooding (for example in Canterbury in 2021),[323] and volcanoes (with an eruption in Auckland estimated to require the displacement of 320,000 people).[324]

We have significant concerns regarding how a vertically separated supply chain, or one dominated by contracted or regulated wholesale supply models, would hold up in the face of a crisis, such as COVID-19.[325] WWNZ's vertical integration has been at the heart of how we have kept New Zealand's food supply chain operating over the past two years. For example, through our ability to:

- Respond and pull levers in an all-of-system way;
- Adjust allocation of product to different stores (for example, priority communities);
- Smooth demand to reduce shortfalls (for example, product limits in stores);
- Optimise stock levels and deliveries across our network - including pushing stock to create capacity;
- Alter store opening hours (to allow team time to replenish shelves);
- Move team from one store to another - even closing stores - to maximise capacity while more than 1,000 team were being stood down into self-isolation at home;

[138] (23 November 2021). Woolworths New Zealand Limited's post conference submission to the New Zealand Commerce Commission regarding the market study into the retail grocery sector. Exhibit 18.

- Partner with suppliers to convert products from DC supplied into DSD (to free up DC capacity);
- Have business continuity plans involving rapid redistribution of products across our DCs;
- Quickly open online-only fulfilment centres and stand-up Priority Assistance services for the elderly and vulnerable; and
- Work with suppliers to consolidate production into higher volume lines (for example, mince).

It is not just COVID-19 that the supply chain must be sufficiently resilient to handle, and it is not just vertical integration that provides that supply chain with resilience. It is also the fact that, as a nationwide vertically integrated retailer of scale, WWNZ has multiple distribution centres enabling it to pivot its supply chain as required to ensure the continued supply of foods to New Zealanders. For example, the November 2016 earthquakes required the closure of our Palmerston North distribution centre, however, we were able to ensure that our supermarkets in the lower North Island continued to be stocked (and despite "heavy buying by quake-worried shoppers") by diverting deliveries from our distribution centre in Auckland.[326] Similarly, following the Canterbury floods of June 2021, which closed the key delivery routes through Canterbury, we worked closely with our suppliers, transport partners and our stores to help minimise any impacted to customers.[327]

WWNZ considers that a number of the more extreme interventions outlined in the Draft Report would risk significant impacts to the resilience of food supply.