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Determination

Foodstuffs North Island Limited and Foodstuffs South Island Limited [2024] NZCC 22

The Commission:	Dr John Small Dr Derek Johnston Pierre van Heerden
Summary of application:	An application from Foodstuffs North Island Limited and Foodstuffs South Island Limited to merge.
Determination:	Under section 66(3)(b) of the Commerce Act 1986, the Commerce Commission declines to give clearance for the proposed merger.
Date of determination:	30 September 2024

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Contents

Executive summary

X1. On 15 December 2023, Foodstuffs North Island Limited (FSNI) and Foodstuffs South Island Limited (FSSI) (together, the Parties) sought clearance to merge into a single national grocery entity, potentially also together with the existing Foodstuffs (N.Z.) Limited entity (the Proposed Merger).

X2. The Commerce Commission declines to give clearance for the Proposed Merger.

X3. We are not satisfied that the Proposed Merger would not have, or would not be likely to have, the effect of substantially lessening competition in multiple acquisition and retail grocery markets in New Zealand.

X4. The Parties operate as separate co-operatives that focus on serving the island in which they are located and do not compete in any local retail or wholesale grocery markets. While operating as separate co-operatives, the Parties currently work together in a range of ways and share ownership of several other entities. Although the Parties both procure private label products together, they otherwise currently acquire most grocery products from suppliers independently and represent separate options for suppliers to get their products on the shelves of major grocery retailers in New Zealand.

X5. In assessing the competitive effects of the Proposed Merger, we considered the effects it would have on competition in:

X5.1 acquisition markets: where the Parties acquire grocery products from suppliers;

X5.2 retail grocery markets: where the Parties supply grocery products to New Zealand consumers, largely through their New World, PAK'nSAVE and Four Square banners; and

X5.3 wholesale markets: where the Parties supply grocery products to wholesale customers (both foodservice customers and other grocery retailers).

X6. Although we have considered the competitive effects in each of these markets separately, we have been mindful that there are commercial dependencies between grocery acquisition markets and markets for the retail and wholesale supply of groceries. For example, the market power of the merged entity in markets for the acquisition of grocery products is connected to its scale or market share in retail and wholesale grocery markets.

X7. Competition in grocery markets in New Zealand is already not working well for many suppliers or for consumers. Grocery markets are currently (and have been for many years) highly concentrated and barriers to entry are high. New Zealand's major grocery retailers have maintained significant combined market shares for many years. Suppliers are typically more dependent on major grocery retailers than retailers are on suppliers. The intensity of competition between major grocery retailers is muted, as the Commission has noted in previous work.[1]

[1] Market study final report (8 March 2022) at 324 and [8.50] and first annual grocery report (4 September 2024) at 5, 22 and 104-106.

X8. The Proposed Merger would result in a permanent structural change to the New Zealand grocery industry. We are concerned about the impact this would likely have on competition and New Zealand consumers.

Acquisition markets

X9. The Commerce Act is intended to promote competition for the long-term benefit of consumers. Competition refers to independent rivalry between buyers and between sellers in a market. Such competition is desirable because it ultimately leads to lower consumer prices, higher quality goods and services, greater variety, and more innovation. If a merger reduces the extent of independent rivalry between buyers, it may significantly impede competition in acquisition markets and be harmful to the competitive process in those markets.

X10. We envisage serious risks to competition for the acquisition of grocery products and are not satisfied that the Proposed Merger would not have, or would not be likely to have, the effect of substantially lessening competition in multiple markets for the acquisition of grocery products.

X11. The prices and terms by which the major grocery retailers acquire grocery products are usually determined through negotiations between suppliers and each buyer individually. Outcomes of negotiations depend on the relative bargaining power of the negotiating parties. These outcomes depend on factors such as the alternatives, or “outside options”, available to either party if an agreement is not reached and the risk appetite of the negotiating parties.

X12. We consider that each of FSNI and FSSI currently provide competitive constraint on each other by acting as outside options in negotiations between a supplier and another buyer. This effect operates even when a supplier could satisfy the demand of both of the Parties. It is through the bargaining process that the Parties compete to acquire grocery products from suppliers in acquisition markets. The Proposed Merger would effect a permanent structural change in the grocery industry and eliminate this competition.

X13. We are concerned that the loss of competition with the Proposed Merger would be substantial, because:

X13.1 there is already muted competition in the relevant acquisition markets and high barriers to retail entry and expansion. The Parties and Woolworths New Zealand Limited (Woolworths), as New Zealand’s major grocery retailers, are the three largest buyers of grocery products in New Zealand and a key route to market for many suppliers;

X13.2 the Proposed Merger would reduce the number of major buyers of many categories of grocery products in New Zealand from three to two. It would create the largest single acquirer of groceries in New Zealand, and result in many suppliers selling most of their output to (at most) just two remaining major grocery retailer customers (the merged entity and Woolworths) rather than the existing three (FSNI, FSSI and Woolworths);

X13.3 competition from the remaining competing buyers in relevant acquisition markets is unlikely to be sufficient to constrain the merged entity from exercising increased buyer power. We are not satisfied that Woolworths would have an incentive to constrain the merged entity, and rival grocery retailers other than Woolworths account for only a small portion of grocery retailing and buying in New Zealand; and

X13.4 grocery suppliers would be unlikely to be able to exert countervailing power to the extent that they could constrain an exercise of buyer power by the merged entity.

X14. Our acquisition market concern is with the impact of the Proposed Merger on the process of independent rivalry between buyers in the acquisition markets and on the merged entity's buyer (or market) power. In our view, the Proposed Merger would result in increased buyer power for the merged entity, and materially shift the balance of bargaining power in favour of the merged entity during negotiations with suppliers. This would substantially lessen competition in acquisition markets. In summary, this is because:

X14.1 the Proposed Merger would remove an important alternative option for many suppliers, although the Proposed Merger would affect suppliers differently depending on the strength of their options (alternative outside supply channels);

X14.2 for suppliers who currently only supply one of the Parties (but could supply both or either), the Proposed Merger would remove an important outside option and reduce their bargaining power;

X14.3 for suppliers who currently supply both of the Parties, such as some suppliers in product categories such as dry/ambient and chilled or frozen groceries, the Proposed Merger would raise the stakes and cost of disagreement with the merged entity compared with the Parties individually by removing the option of just selling to one of the Parties. This would reduce their bargaining power in negotiations with the merged entity; and

X14.4 the removal of one of three major buyers of many categories of grocery products with the Proposed Merger would further entrench the bargaining imbalance that is already present between many suppliers and the Parties separately. This would increase the merged entity's buyer power and enable it to extract lower prices and less favourable terms from suppliers than the Parties would be able to obtain separately in the counterfactual (and better than they would have been able to obtain in a competitive market). This includes "cherry picking" the most favourable terms from those currently offered to each of FSNI and FSSI. Indeed, we understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers:
[ ].

X15. For these reasons alone, we cannot grant clearance to the Proposed Merger. In addition to substantially lessening competition in the relevant acquisition markets, we also consider that the Proposed Merger could harm suppliers' ability and incentive to innovate, with consequent harm to consumers. In summary, this is because:

X15.1 each of FSNI and FSSI provide separate opportunities for new grocery products to be listed in New Zealand, and their consolidation with the Proposed Merger would remove one such opportunity. That could slow the pace and development of new product innovation for some suppliers, resulting in reduced consumer choice and/or quality of grocery products; and/or

X15.2 the increased buyer power gained as a result of the Proposed Merger could have a potentially significant effect on margins and profitability of suppliers. This would adversely affect the ability and incentive of suppliers to invest, resulting in effects such as reduced capacity, quality or innovation in the affected acquisition markets.

X16. The Parties submit the Proposed Merger would give rise to cost savings, bring about efficiencies and be good for consumers. We do not accept this submission in making our determination for a mix of legal and evidential reasons. First, the clearance test asks whether we are satisfied that competition would not be substantially lessened in any market, so we are obliged to examine competition in acquisition markets separately from any retail market impact that might affect consumers. Moreover, we are not satisfied that the bulk of any cost savings would be passed through to retail consumers, and, for reasons explained below, we consider that consumers are likely to be worse off overall if the Proposed Merger proceeded. Second, we do not consider that the Proposed Merger is likely to give rise to rivalry-enhancing efficiencies in the relevant acquisition markets that would offset the likely substantial lessening of competition that would otherwise result.

Retail grocery markets

X17. We considered the potential for the Proposed Merger to raise competition concerns in markets for the retail supply of groceries in a number of ways. We considered whether:

X17.1 the Proposed Merger could result in a loss of actual or potential competition at the retail level between the Parties;

X17.2 the increased buyer power of the merged entity in acquisition markets could raise the barriers to entry and expansion for rival grocery retailers; and

X17.3 coordinated effects could arise from the Proposed Merger at the retail level through increasing the potential for the merged entity and Woolworths to reach a tacit agreement on the level of retail prices.

X18. The Parties do not currently compete in any retail grocery markets. Our assessment of the factual evidence before us is that there is not a real chance of a counterfactual scenario where the Parties enter each other's island and compete in any retail grocery markets. Given this, we are satisfied that the Proposed Merger would not result in a loss of actual or potential competition at the retail level between the Parties.

X19. However, we are not satisfied that the Proposed Merger would not increase barriers to entry and expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets. We consider that this would substantially lessen competition, potentially depriving consumers of a more competitive grocery industry in the future.

X20. We are also not satisfied that the Proposed Merger would not increase the likelihood, completeness or sustainability of coordination between the merged entity and Woolworths. In particular, we consider that there is a real chance that the reduction in the number of major grocery retailers from three to two and the creation of a national Foodstuffs entity would make price coordination between the merged entity and Woolworths more likely, more complete or more sustainable.

Wholesale grocery markets

X21. We considered the potential for the Proposed Merger to raise competition concerns in markets for the wholesale supply of groceries, in terms of both wholesale supply to foodservice customers and wholesale supply to grocery retailer customers, and in terms of both commercial and regulated wholesale supply.

X22. We are satisfied that the Proposed Merger is unlikely to substantially lessen competition in any markets for the wholesale supply of groceries. We consider that the merged entity would face competitive constraint in wholesale markets from other wholesalers, and wholesale customers buying direct from grocery suppliers. We do not consider that the Proposed Merger would make coordination in wholesale markets more likely, more complete or more sustainable.

The Application

1. On 15 December 2023, the Commerce Commission (the Commission) registered a clearance application (the Application) from Foodstuffs North Island Limited (FSNI) and Foodstuffs South Island Limited (FSSI) (together, the Parties) seeking clearance to merge into a single national grocery entity, potentially also together with the existing Foodstuffs (N.Z.) Limited (FSNZ) entity (the Proposed Merger).[2]

Our determination

2. We decline to give clearance to the Proposed Merger as we are not satisfied that the Proposed Merger would not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand. This is because we are not satisfied that:

   2.1 the Proposed Merger will not have, or would not be likely to have, the effect of substantially lessening competition due to unilateral effects in markets for the acquisition of grocery products, which could have flow on effects in retail grocery markets;

   2.2 the Proposed Merger would not increase barriers to entry and expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets. We consider that this would substantially lessen competition, potentially depriving consumers of a more competitive grocery industry in the future; and

   2.3 the Proposed Merger would not increase the likelihood, completeness or sustainability of coordination between the merged entity and Woolworths at the retail level. In particular, we consider that there is a real chance that the reduction in the number of major grocery retailers from three to two and the creation of a national Foodstuffs entity would make price coordination between the merged entity and Woolworths more likely, more complete or more sustainable.

Our framework

3. Our approach to analysing the competition effects of mergers is based on the principles set out in our Mergers and Acquisitions Guidelines (Guidelines).[3]

The substantial lessening of competition test

4. As required by the Commerce Act 1986 (the Act), we assess mergers using the substantial lessening of competition test.[4]

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2 A public version of the Application is available on our website at: https://comcom.govt.nz/case-register alongside consultation documents and submissions we published as part of our investigation of the Proposed Merger. As noted in the Application at [12], FSNI and FSSI propose to carry out the Proposed Merger by way of amalgamation under Part 15 of the Companies Act 1993.

3 Commerce Commission, Mergers and Acquisitions Guidelines (May 2022).

4 A substantial lessening of competition includes the "hindering or preventing of competition". The Act s 3(2).

5. We determine whether a merger is likely to substantially lessen competition in a market by comparing the likely state of competition if a merger proceeds (the scenario with a merger, often referred to as the factual), with the likely state of competition if a merger does not proceed (the scenario without a merger, often referred to as the counterfactual).[5]

6. We make a pragmatic and commercial assessment of what is likely to occur in the future, with and without a merger, based on the information we obtain through our investigation and taking into account factors such as market growth and technological changes.[6]

7. The Act is premised on competition (that is, independent rivalry between buyers and sellers) producing the best outcomes for consumers in the long run. A lessening of competition is a loss of independent rivalry or an increase in market power. Market power can be held by (and exercised at the discretion of) both suppliers and buyers of goods and services. Where suppliers have market power, they have the ability to profitably raise price above the price that would exist in a competitive market (the 'competitive price'), or reduce non-price factors such as quality or service below competitive levels.[7] Where buyers have market power, they have the ability to profitably lower prices paid to suppliers, or impose non-price terms to a buyer's advantage. Although evidence of an ability to raise prices above (or lower prices below) the competitive price is a useful indicator of a lessening of competition, it is not the test in itself.

8. Assessment of whether a merger may substantially lessen competition may involve us considering:

    8.1 **unilateral effects:** whereby a merged entity is able to profitably increase the prices at which it supplies goods above the level that would prevail in the absence of a merger without the profitability of that increase being thwarted by customers switching, for example due to the competitive responses of rivals.[8] Such effects could also arise where a merged entity could profitably reduce quality or innovation or worsen an element of service or any other element of competition below the level that would prevail without a merger – such changes leading to an increase in quality-adjusted prices.[9] They could further arise where a reduction in competition among buyers enables a merged entity to reduce input prices or purchase volumes, or impose non-price terms to its advantage;

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5 *Commerce Commission v Woolworths Limited & Ors* (2008) 12 TCLR 194 (CA); [2008] NZCA 276 at [63].

6 Mergers and Acquisitions Guidelines above n3 at [2.35].

7 The Act s 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81]. A reduction in competition among buyers can harm sellers by allowing buyers to use their enhanced market power to extract lower input prices or purchase volumes from sellers, and to impose non-price terms to a buyer's advantage.

8 Mergers and Acquisitions Guidelines above n3 at [3.62]-[3.63].

9 For ease we may refer to the potential effects from a merger simply as "price increases" or "price decreases" as relevant. This should be taken as including equivalent reductions in quality or innovation.

8.2 **coordinated effects:** the potential for a merged entity and all or some of its remaining competitors to coordinate their behaviour in the relevant markets, sustaining prices and profits above competitive levels. Unlike a substantial lessening of competition arising from the merged entity's own conduct, coordinated effects require some or all of the buyers or suppliers in the relevant markets to act in a coordinated way;[10] and

8.3 **vertical effects:** in the case of a merger between suppliers (or buyers) who are not competitors but who operate in related markets, where a merger gives a merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively.[11]

9. Determining the scope of the relevant market or markets can be an important tool in determining whether a substantial lessening of competition is likely.

10. We define markets in the way that we consider best isolates the key competition issues that arise from a merger. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.[12]

When a lessening of competition is substantial

11. Only a lessening of competition that is substantial is prohibited. A lessening of competition will be substantial if it is real, of substance, or more than nominal.[13] Some courts have used the word 'material' to describe a lessening of competition that is substantial.[14]

12. Consequently, there is no bright line that separates a lessening of competition that is substantial from one which is not. What is substantial is a matter of judgement and depends on the facts of each case.[15] It is the degree to which competition may be (or has been) lessened which is critical. A lessening of competition does not need to be felt across an entire market, or relate to all dimensions of competition, for it to be substantial. A lessening of competition that adversely affects a significant section of a market may, depending on the circumstances, be a substantial lessening of competition in a market.[16] One way of assessing whether competition will be substantially lessened is by asking whether suppliers or customers in the relevant market(s) are likely to be affected in a material way.

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10 Mergers and Acquisitions Guidelines above n3 at [3.84].

11 Mergers and Acquisitions Guidelines above n3 at [5.1]-[5.2].

12 Section 3(1A). See also *Brambles v Commerce Commission* above n7 at [81].

13 *Woolworths & Ors v Commerce Commission* (HC), above n13 at [127].

14 Ibid at [129].

15 For example, while a merger that allows a merged entity to raise prices by 5-10% would substantially lessen competition, a lower increase may also be 'substantial' in some markets such as grocery markets. See *Woolworths & Ors v Commerce Commission* (HC) above n13 at [138].

16 *Dandy Power Equipment Pty Ltd v Mercury Marine Pty Ltd* (1982) 64 FLR 238; ATPR 40-315, 43,888.

13. In markets that are already concentrated, a smaller change in competition with a merger may amount to a substantial lessening of competition than would be the case in markets that are less concentrated to begin with.[17] While it will always depend on the circumstances of the particular case, in a concentrated market a merger that results in even a relatively small reduction in rivalry might amount to a *substantial* lessening of competition. This is because there may be few available competitive options and little dynamism left in the market. In such a market, a merger that permanently removed some of the few remaining sources of independent rivalry could well substantially lessen competition.

14. While we commonly assess competition effects of a merger over a two year timeframe, the relevant timeframe for assessment depends on the circumstances in any given case. A longer timeframe will be appropriate if, on the evidence, competition effects are likely to arise in later years.[18] Indeed, some mergers that may produce competitive benefits in the immediate or short term, may give rise to a substantial lessening of competition over a more extended timeframe.

When a substantial lessening of competition is likely

15. A substantial lessening of competition is ‘likely’ if there is a real and substantial risk, or a real chance, that it will occur.[19] This requires that a substantial lessening of competition is more than a possibility but does not mean that the effect needs to be more likely than not to occur.[20]

The clearance test

16. Applying the clearance test always involves assessing matters which are uncertain. Comparisons of what may happen with or without a merger (the factual and counterfactual) both involve making predictions about the future and are therefore “necessarily incapable of accurate assessment”.[21]

17. In *Commerce Commission v Woolworths*, the Court of Appeal found:[22]

> [W]hat constitutes a substantial lessening of competition must in the end be a matter of judgment, although we accept, of course, that such a judgment must be informed by as much practical evidence as possible.

18. A decision to give or decline to give clearance is necessarily made on the basis of all of the evidence. However, not all evidence of past or present conduct or events provides a reliable predictor of future likely impact.[23] In addition, there may be insufficient evidence to justify a conclusion that there is no likelihood of a substantial

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17 M Sumpter, *New Zealand Competition Law and Policy* (CCH, Auckland, 2010) at 186-187, discussing the decision in *Air New Zealand v Commerce Commission* (2004) 11 TCLR 347 (HC).
18 *Woolworths & Ors v Commerce Commission* (HC) above n13 at [131].
19 *Woolworths & Ors v Commerce Commission* (HC) above n13 at [63].
20 Ibid at [111].
21 *Commerce Commission v Woolworths* (CA) above n5 at [75].
22 *Commerce Commission v Woolworths* (CA) above n5 at [191].
23 See for example, ibid at [192].

lessening of competition in any particular case.[24] We will also sometimes have before us conflicting evidence from different market participants and must determine what weight to give the evidence of each party.[25]

19. The Commission must make a reasonable enquiry into a clearance application.[26] However, the burden of proof ultimately lies with an applicant (or the parties to a merger) to satisfy us on the balance of probabilities that a merger is not likely to substantially lessening competition.[27]

20. We must clear a merger if we are satisfied that a merger would not be likely to substantially lessen competition in any market.[28] If we are not satisfied – including if we are left in doubt – we must decline to clear a merger.[29]

Our process and evidential issues raised by the Parties

21. In their submissions on the Statement of Unresolved Issues (SoUI), the Parties raised the following procedural matters relating to the use of evidence by us in our consideration of the Proposed Merger. Namely the Parties submit that:

    21.1 it is procedurally unfair for us to place weight on material referred to in the SoUI that has not been provided to the Parties (as opposed to their advisors) and/or has been extracted from longer interviews or information requests (including where the source of specific material or the product market to which it relates has been redacted).[30] The Parties submit that this is the case because they are better placed than their advisors to respond to evidence that has been given confidentially; and

    21.2 the evidence given by market participants as to what may occur in the future should be considered to be opinion evidence, and by analogy to the Evidence Act 2006, should be considered to have little to no probative value.[31]

22. The Commission's approach to information gathering for the purpose of considering applications before it is longstanding. It is a specialist body with investigative powers. We collected and reviewed a substantial amount of evidence gathered through interviews, information requests and submissions received from the Parties, suppliers, rival grocery retailers, and other industry participants and third parties. We tested issues and specific evidence that we were considering through three separate consultation phases,[32] where the Parties and third parties were invited to

[24] See for example, ibid at [197].
[25] *Brambles New Zealand Ltd v Commerce Commission* above n7 at [64].
[26] *Commerce Commission v Woolworths* (CA) above n5 at [101].
[27] *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA) at [7] and *Commerce Commission v Woolworths* (CA) above n5 at [97].
[28] The Act s 66(1).
[29] *Commerce Commission v Woolworths Limited* (CA) above n5 at [98].
[30] SoUI submission from the Parties (13 August 2024) at 68-69. See also confidential SoUI submission from the Parties' advisors (30 August 2024) at [7]-[8].
[31] SoUI submission from the Parties (13 August 2024) at 68-69.
[32] These were through the publication of a Statement of Preliminary Issues (SoPI) on 18 January 2024, Statement of Issues (SoI) on 4 April 2024 and lastly an SoUI on 16 July 2024.

make written submissions to us, the last of which involved us publishing the SoUI. This determination has been made after due consideration of all the submissions and evidence before us on the Proposed Merger.

23. That the Commission may consider information that is kept confidential (or which has been shared with advisors to parties on an advisor-only basis) is necessary for the effective operation of the merger regime under the Act. Just as we have needed to protect third party information, we have also protected information provided by the Parties. In this case, we have withheld significant amounts of confidential information of the Parties from the public consultation versions of the Application, SoI and SoUI on the basis that it was commercially sensitive.

24. The need for the Commission to protect confidential information has been accepted by the Courts, which have, in appeals of previous determinations under Part 5 of the Act, issued confidentiality orders that impose substantially the same confidentiality restrictions on applicants as were in place during the Commission's investigation of those matters.[33] The need for such an approach is evidenced by the fact that otherwise:

  24.1 the Commission would be unable to place weight on confidential information provided by third parties (but, according to the Parties' apparent position, would be required to take into account the confidential information that they had supplied);

  24.2 an approach that required disclosure of all information received from third parties would significantly impact our ability to gather confidential information from them, since they would be reluctant to engage with us. This in turn would lower the quality of our decision-making and potentially mean that we could not gather the information required to form a view on the competitive effects of a merger; and

  24.3 the Commission would be required to make public (or available to the Parties) commercially sensitive information, which would undermine competitive tension in the relevant markets and ultimately could defeat the purpose of the Act, being to promote competition.

25. The Commission's ability to rely on evidence that is inherently future looking was challenged unsuccessfully in the High Court in *Godfrey Hirst.* Justice Gilbert observed:[34]

> [50] …The information gathered from the interviews was necessarily imperfect and suffered from obvious limitations. However, we are not persuaded that the Commission should have disregarded, or placed little weight on, the merchants' views on the likely price increase. Their

[33] See for example, the confidentiality order recorded on the cover page of *NZME v Commerce Commission* [2017] NZHC 3186 (HC).

[34] *Godfrey Hirst v Commerce Commission* [2016] NZHC 1262 at [50]-[53]. Not raised in the subsequent appeal to the Court of Appeal.

> views, as key market participants, are relevant and will have provided some assistance to the Commission in making its assessment.

26. The Court went on to contrast the Commission's information gathering powers with those that might apply in a court of law:

> [51] It must be kept in mind that the Commission conducts an investigation, not a court process limited by evidential rules. For the purposes of carrying out its functions under the Act, the Commission has been given broad powers to receive any statement, document or information that may assist its determination regardless of whether it would be admissible in a court.[35] Interviews with market participants will be conducted with varying degrees of formality, depending on the circumstances. Almost inevitably, the Commission will receive information during the investigation process of varying quality.

27. The Commission, however, is not a court. It is an expert body charged with regulating markets, and in this case, determining whether we are satisfied the Proposed Merger is not likely to have the effect of substantially lessening competition. To continue the passage cited above from Gilbert J in the High Court in *Godfrey Hirst*:

> [52] The Commission may attribute little or no weight to some of the information it gathers and place greater weight on other information that it considers to be more reliable. However, the Commission does not make its assessment simply by accepting or rejecting the speculative views of market participants or by collating the merchants' responses and determining the range of likely price increases accordingly. Rather, the Commission is required to exercise its own expert judgment. This will be based, not only on information gathered during the investigation, but on its own knowledge of the industry and the dynamics of the particular market or markets. The Commission's assessment need not necessarily coincide with the views expressed by market participants.
>
> [53] The Commission has a good understanding of the relevant markets, not only as a result of its lengthy investigation for the purposes of the present application, but also as a result of its consideration of an earlier similar application in 2011…

28. As in *Godfrey Hirst*, we consider we have a good understanding of the relevant markets in question (as we note at [40]). While we have relied on the evidence obtained during the investigation of the Application in reaching our determination, that understanding has informed the application of our expert judgement to the information we have obtained during our investigation.

The Parties

29. FSNI is owned by 332 co-operative members all based in the North Island and FSSI is owned by 198 members all based in the South Island.[36] The members of FSNI and FSSI operate individual retail and wholesale grocery stores.

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35 The Act s 99.

36 The Application at Figure 1.

30. FSNI members operate under the following retail grocery brands:

    30.1 New World;

    30.2 PAK'nSAVE; and

    30.3 Four Square.

31. FSSI members operate under the following retail grocery brands:

    31.1 New World;

    31.2 PAK'nSAVE;

    31.3 Four Square;

    31.4 Raeward Fresh; and

    31.5 On the Spot.

32. Through their members, the Parties operate retail grocery stores across New Zealand and are major grocery retailers.[37] As well as operating retail grocery stores, the Parties operate wholesale grocery businesses through which they supply grocery products to foodservice customers, route trade customers and other retailers. Specifically:

    32.1 FSNI operates Gilmours Wholesale Limited in the North Island; and

    32.2 FSSI operates Trents Wholesale Limited in the South Island.

33. The Parties are also subject to legal obligations to provide wholesale grocery offerings to rival grocery retailers, as required by the Grocery Industry Competition Act 2023 (GICA).

34. FSNI and FSSI are currently two separate co-operatives that jointly present a national bricks-and-mortar and online retail grocery offering through common retail grocery brands (New World, PAK'nSAVE and Four Square). FSNI and FSSI have a close relationship today, sharing ownership of some trading and non-trading entities (eg, FSNZ and Foodstuffs Own Brands Limited (FOBL)) and work together in a range of ways (eg, in relation to marketing, brand alignment, the acquisition of private label products and other initiatives).[38] Despite the existing interrelationship and close relationship between the Parties, FSNI and FSSI are separate legal entities and are not currently interconnected bodies corporate.

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[37] The Parties are not strictly themselves store operators or retailers and are instead more in the nature of franchisors or wholesalers to their owner operator members. However, for shorthand purposes throughout this determination, we refer to the Parties as grocery retailers.

[38] The Application at [4], [20] and [40]-[45].

Industry background

35. The Proposed Merger relates to the grocery sector in New Zealand.

36. Within the grocery sector, FSNI and FSSI are two of New Zealand's major grocery retailers (and regulated grocery retailers under the GICA), the third being Woolworths New Zealand Limited (Woolworths), whose retail grocery brands currently include Woolworths, Countdown, SuperValue and Fresh Choice. The Parties and Woolworths (as major grocery retailers) are vertically integrated through a number of parts of the grocery sector. The Parties and Woolworths:

    36.1 acquire both private label products (eg, Pams) and branded grocery products from suppliers (eg, farmers, growers, processors and manufacturers), based both domestically and overseas;

    36.2 have distribution centres and infrastructure through which products get from suppliers to individual grocery stores or wholesale customers; and

    36.3 supply grocery products to customers at the retail and wholesale level under different banners/brand names.

37. Due to the vertical integration of the Parties, the Proposed Merger involves three functional levels of the grocery sector – from the acquisition of grocery products from suppliers to the wholesaling and retailing of grocery products. Figure 1 depicts (at a high level) the different functional levels of the grocery sector in New Zealand and where the Parties fit within the sector.[39]

38. Beyond the major grocery retailers, as noted to a large extent in Figure 1, the other industry participants in the grocery sector include:

    38.1 suppliers of grocery products – ranging from large multinational suppliers to small local suppliers;

    38.2 other grocery wholesalers (eg, Bidfood, Service Foods);

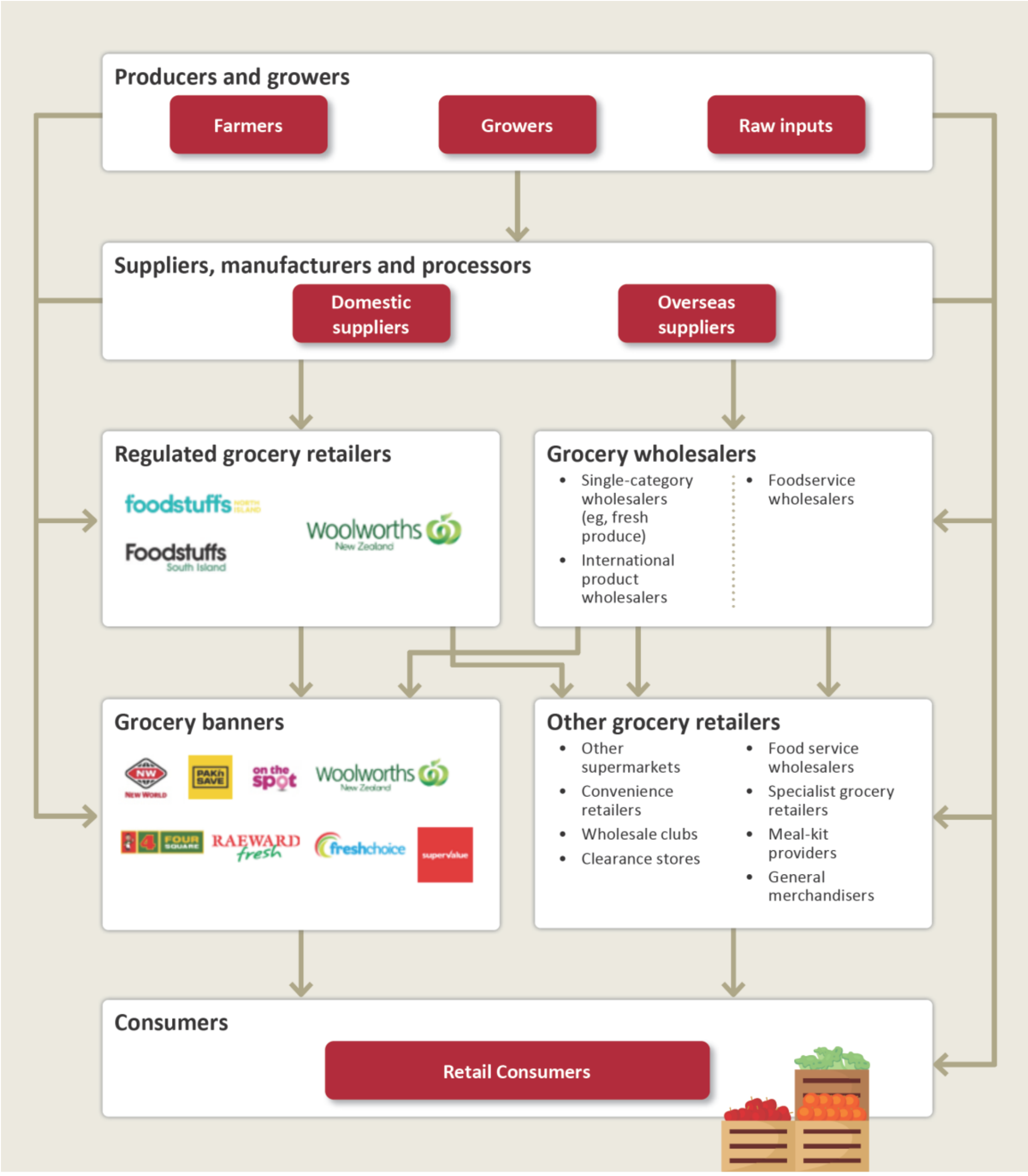
    38.3 other grocery retailers (eg, The Warehouse, Costco, Bin Inn, Reduced to Clear, Commonsense Organics, Farro Fresh, Chemist Warehouse, dairies, petrol stations, specialist, or single category retailers);

    38.4 industry groups or bodies (eg, New Zealand Food and Grocery Council, New Zealand Specialist Cheesemakers Association, Grocery Action Group); and

    38.5 retail and wholesale customers.

[39] This figure is sourced from the Commission's first annual grocery report (4 September 2024) at 16. A similar figure was included in the Commission's market study final report (8 March 2022) at 37.

Figure 1: Functional levels of the New Zealand grocery sector



39. In assessing the competitive effects of the Proposed Merger, we have considered to what extent competition in the relevant markets for the acquisition, retail supply and wholesale supply of groceries would be materially different with the Proposed Merger. In doing so, we have been mindful that there are commercial dependencies between grocery acquisition markets and markets for the retail and wholesale supply of groceries. For example, the market power of the merged entity in markets for the acquisition of grocery products is connected to its scale or market share in retail and wholesale grocery markets. Moreover, we have been cognisant of the fact that the accretion by the merged entity of market power in acquisition markets could have the effect of reducing competition in retail or wholesale grocery markets, if it were to provide the merged entity with such an advantage in the terms on which it procures supplies (eg, as to price or exclusivity) that it became substantially more difficult for rivals to expand or enter into those retail or wholesale grocery markets.

40. The Commission has a good understanding of the relevant markets, from its general functions under the Act and Fair Trading Act 1986 (FTA), but also under the GICA (which was passed in 2023 empowering the Commission to monitor and report on competition and efficiency in the grocery sector for the long-term benefit of consumers). In recent years, the Commission has investigated (or is investigating) numerous aspects of the grocery sector under its various functions and powers. These include:

    40.1 the Commission completing a grocery market study in 2022;

    40.2 ongoing regulation and reporting under the GICA, including the Commission publishing its first annual grocery report in September 2024;

    40.3 the Commission's proceeding against FSNI in relation to historic anti-competitive covenants in breach of s 28 of the Act;[40]

    40.4 ongoing investigations into all three major grocery retailers to determine if their pricing and promotional practices comply with the FTA; and

    40.5 other merger clearance applications involving products sold through major grocery retailers, examples in recent years including Henkel/Earthwise, Life Health Foods/Chalmers, Allied Foods/Dad's Pies and Woolworths/PETstock.

41. It is evident from other work of the Commission and our investigation of the Proposed Merger that:

    41.1 suppliers are often dependent on major grocery retailers as their main route for selling their products to retail consumers, with the major grocery retailers being a significant channel for many suppliers' products to reach consumers. This means that suppliers are typically more dependent on major grocery retailers than retailers are on suppliers, leading to a bargaining power imbalance in many cases. Overall, competition is muted and has not been working well to date for many suppliers to the major grocery retailers;[41]

    41.2 the grocery sector in New Zealand is highly concentrated at the retail level with significant market share being held by the Parties and Woolworths, while other rival grocery retailers make up a small portion of retail grocery markets. The market share of these major grocery retailers has also been relatively stable (on a national basis) since 2005, with limited variation in market share.[42] The trend in national market shares over the last five years

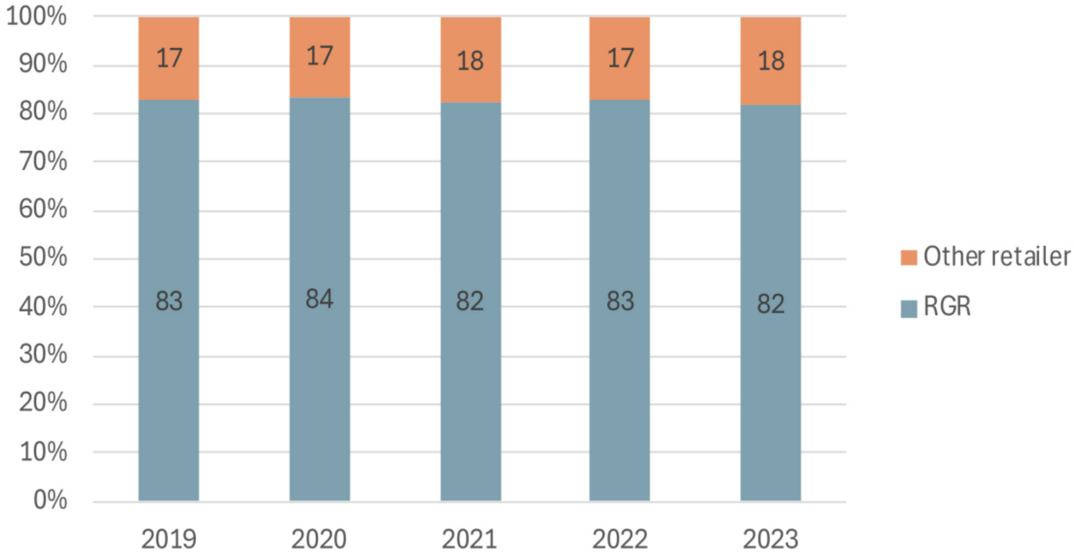
[40] *Commerce Commission v Foodstuffs North Island Ltd* [2024] NZHC 2306. The Commission also investigated other major grocery retailers for similar conduct.

[41] Market study final report (8 March 2022) at 324 and [8.50] and first annual grocery report (4 September 2024) at 5, 22 and 104-106. Our investigation of the Proposed Merger has similarly found this to be the case.

[42] First annual grocery report (4 September 2024) at 14, 19 and 42 and market study final report (8 March 2022) at [5.79].

for major grocery retailers (shown as the part of the bar labelled RGR) compared to other rival grocery retailers is shown in Figure 2;[43] and

Figure 2: Trend in national retail grocery market shares (2019 to 2023)



Source: First annual grocery report (4 September 2024) at Figure 8

41.3 the intensity of competition between the major grocery retailers is muted and competition in retail grocery markets has not been working as well for consumers as it could.[44]

42. At the retail level, the Parties operate a range of different types of stores. They primarily operate supermarkets – large format grocery stores selling a wide variety of foods (such as dry groceries, fresh produce), household goods, non-alcoholic beverages and usually some alcoholic beverages.[45] However, the Parties also operate specialist liquor stores and, in the case of FSSI, convenience stores.[46]

43. The market study findings and work of the Commission under the GICA form part of the background for our consideration of the Proposed Merger. However, the GICA is not intended to, and would not, mitigate the structural loss of competition that would result from the Proposed Merger. In addition, we do not consider that the current and planned regulatory interventions under the GICA would have a material impact in a timeframe that would be relevant to assessing the effects of the Proposed Merger, with the Commission's first annual grocery report noting that

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43 First annual grocery report (4 September 2024) at 42. Figure 2 does not capture other retailers' sales by single category retailers (eg, Chemist Warehouse, Mad Butcher), meal kit providers (eg, Hello Fresh, My Food Bag) or food box operators (eg, Wonky Box) and so may understate slightly the shares of other rival grocery retailers. A similar figure is included in the market study final report (8 March 2022) at 165 covering the period 2015 to 2019.

44 Market study final report (8 March 2022) at 44 and 146 and first annual grocery report (4 September 2024) at 5 and 42.

45 Market Study Final Report (8 March 2022) at 12.

46 The Application at Figure 4.

some of the changes and outcomes (from the GICA) will take time.[47] [48] The Parties agree that the GICA is not intended to, nor would, mitigate any loss of competition arising from the Proposed Merger. Rather, in their view, the Proposed Merger is not likely to result in a substantial lessening of competition, with the GICA forming part of the broader regulatory landscape that would place ongoing pressure on the merged entity.[49]

With and without scenarios

44. Assessing whether a substantial lessening of competition is likely requires us to:[50]

    44.1 compare the likely state of competition if a merger proceeds (the scenario with a merger, often referred to as the factual) with the likely state of competition if it does not (the scenario without a merger, often referred to as the counterfactual); and

    44.2 determine whether competition is likely to be substantially lessened by comparing those scenarios.

45. We make a pragmatic and commercial assessment of what is likely to occur with and without a merger, based on information we obtain through an investigation.[51] The High Court considers that likely means something less than "more likely than not", but something more than only a remote prospect of occurring. To be likely, there must be a real and substantial possibility of a scenario occurring.[52]

With the Proposed Merger

46. The Proposed Merger would give rise to a permanent structural change in the grocery sector in New Zealand. The Proposed Merger would see FSNI and FSSI merge by way of a Court-approved amalgamation under Part 15 of the Companies Act 1993. With the Proposed Merger, the Parties would consolidate within and under the management of a single national grocery entity. FSNZ may also be included in the amalgamation.[53]

47. The Parties submit that the rationale for the Proposed Merger is to create a world-class, customer-driven national food and grocery retailer and wholesaler.[54] The Parties also submit that given the Proposed Merger would not alter competition in any retail grocery markets, the merged entity's incentives would be the same as the Parties' current incentives (which is to maintain competitiveness in supplier markets).[55] They further submit that, by combining the best aspects of both

47 First annual grocery report (4 September 2024) at 5.

48 In general, we consider entry and expansion within two years is sufficiently timely. However, this time may vary depending on the facts of the case. Mergers and Acquisitions Guidelines above n3 at n95.

49 SoUI submission from the Partes (13 August 2024) at [107].

50 Mergers and Acquisitions Guidelines above n3 at [2.29].

51 Mergers and Acquisitions Guidelines above n3 at [2.35].

52 *Woolworths & Ors v Commerce Commission* (HC) above n13.

53 The Application at [12]-[13].

54 The Application at [19].

55 SoUI submission from the Parties (13 August 2024) at [75]-[86].

co-operatives, a single, fully integrated national support centre structure (with supporting supply chain infrastructure) would reduce the complexity, duplication and cost of running two separate co-operatives. As a result, in the Parties' view, the Proposed Merger would:[56]

47.1 lead to cost reductions (including overhead costs and product costs), efficiency gains, increased agility and innovation;

47.2 result in a merged entity that is leaner and more resilient, more efficient, and faster at adapting to customers' changing needs; and

47.3 lead to a more cohesive national offering, which would ultimately deliver better value for customers at the checkout and thus enhance competition.

48. The Parties' expected savings from the Proposed Merger would arise from a combination of cost savings and buying benefits. We understand that more than half of the benefits to the Parties of the Proposed Merger are expected to come from securing better terms from suppliers. [ ].[57]

49. The Parties further submit that increasing retail competition (and the Commission's role under the GICA) should ensure significant pressure on the merged entity to pass through the benefit of savings and efficiencies to retail consumers.[58]

50. In terms of what would change with the Proposed Merger, the Parties submit that:[59]

50.1 the key change would be that a single entity (and management and operational support function of that entity) would become responsible for the acquisition of grocery products for the Parties across New Zealand, although:

50.1.1 there would be no change for private label products and certain other products (eg, [ ]) which the Parties already jointly acquire; and

56 The Application at [6] and [20].

57 [ ]

58 The Application at [7]. The Parties' additional submissions regarding the likelihood that cost-savings and efficiencies would be passed through to consumers are discussed further later starting at [441].

59 The Application at [5] and SoUI submission from the Parties (13 August 2024) at [5], [14]-[16].

50.1.2 there would be no effect on local store ownership, and store-level and local-level acquisition of grocery products would be unaffected (with no change in buying practices);

50.2 the Proposed Merger would not give rise to any change in concentration or the Parties' position in retail and wholesale grocery markets, meaning that any incentives at the retail or wholesale level that drive the acquisition of grocery products or ranging decisions would not change; and

50.3 the potential change that is expected to arise from the Proposed Merger in acquisition markets would be circumscribed by the fact the Parties already share retail brands (and therefore retail brand positioning and initiatives), coordinate certain retail strategy, and have shared national marketing campaigns and customer surveys/insights.

51. Where necessary, we address the Parties' submissions below in considering whether a substantial lessening of competition is likely. With the Proposed Merger, a key change – that we consider would have an impact on market outcomes – is that the number of distinct major grocery buyers would be reduced from three to two (from FSNI, FSSI and Woolworths, to the merged entity and Woolworths) for many categories of grocery products. Importantly, where product ranging, purchase and selling pricing and other decisions are currently taken independently (and often divergently) by each of FSNI and FSSI, as a consequence of the Proposed Merger there would be a loss of this independent (and potentially divergent) decision making with the merged entity as the sole decision maker on such matters.

Without the Proposed Merger

52. We have assessed the Proposed Merger against a counterfactual scenario of the status quo. In this counterfactual scenario:

52.1 FSNI and FSSI would continue to operate independently of each other, each in its own island, with a continued relationship to manage the fact that they are trading under the same brands and present as a single national offering;[60]

52.2 while [ ],[61] and any such changes would not result in a competitively distinct counterfactual to the status quo;

52.3 in acquisition markets, FSNI and FSSI would continue to work together to acquire private label products and some other products (eg, [ ]), but would otherwise continue to separately acquire grocery products from suppliers (ie, continue to be alternative options for suppliers), and each of FSNI and FSSI

[60] The Application at [97].

[61] The Application at [97] and [ ].

would continue to progress their own centralised buying programme;[62]

52.4 in retail grocery markets, FSNI and FSSI would continue to each operate in its own island and not in competition with each other,[63] but would continue to work together in a range of ways (eg, in relation to marketing, brand alignment and other initiatives). While either of the Parties could, [ ], enter the retail grocery market in the island in which it does not currently compete, we are satisfied based on the evidence before us that there is not a real chance of a counterfactual scenario where either of the Parties would do so;[64] and

52.5 at the wholesale level, FSNI and FSSI would likely continue to jointly service national wholesale customers through Gilmours and Trents.

Framework for assessing effects of the Proposed Merger on acquisition markets

53. We discuss below the framework we have adopted for assessing effects of the Proposed Merger on acquisition markets and respond to submissions on this framework.

What we said in the SoUI

54. In the SoUI, we identified that the Proposed Merger gave rise to potential competition issues in both acquisition markets and retail grocery markets.

55. In relation to acquisition markets, we set out our view that a bargaining framework is generally appropriate for assessing the competitive effects of the Proposed Merger.

56. Bargaining power and buyer power are key concepts within a bargaining framework. Bargaining power refers to the ability of parties in a negotiation to exert influence over each other. Buyer power occurs where a buyer has a stronger bargaining position than a seller, allowing them to extract better terms (such as lower prices) than would be expected in a competitive market.[65]

57. We also explained that the Act's prohibition on mergers that would have (or would be likely to have) the effect of substantially lessening competition, applies equally to acquisition markets as it does to selling markets.

58. This is because (emphasis added):

62 SoPI cross submission from the Parties (7 March 2024) at [48].

63 The Application at [99].

64 In reaching this view we have relied on the factual matters raised by the Parties and Houston Kemp. See for example Houston Kemp report on SoI (26 April 2024) from [72]. We have assumed that the present arrangements between the Parties that give rise to these dynamics do not in themselves contravene the Act, but this is not an issue upon which we express any conclusive view.

65 Market study final report (8 March 2022) at [8.24]-[8.26]

58.1 section 66(3)(b) requires us to consider if a merger or acquisition will have, or is likely to have "…the effect of substantially lessening competition in **a** market"; and

58.2 section 3(1A) explains that "Every reference…to the term **market** is a reference to a market in New Zealand for goods or services…".

59. We understand that this position is consistent with the approach taken to the assessment of mergers in other jurisdictions applying the substantial lessening of competition test, including the United States[66] and Australia.[67]

60. It follows from this approach that, if we consider that there is a likely lessening of competition (or strengthening of market power) in acquisition markets then we are not required to inquire whether:

60.1 there are any beneficial effects of the Proposed Merger in retail or wholesale grocery markets that could offset this lessening of competition;[68] or

60.2 consumers are directly harmed or not by the Proposed Merger.[69]

61. That said, we consider there are a number of ways a substantial lessening of competition in relevant markets for the acquisition of grocery products might manifest and could negatively impact on consumers in retail grocery markets over time. This includes a reduction in the choice or quality of groceries, a reduction in the opportunities grocery suppliers have to pitch new ideas or products, and a reduction in grocery suppliers' ability and incentives to invest or innovate.

62. In addition, the merged entity may be able to leverage its increased market power in relevant markets for the acquisition of grocery products to gain such an advantage in the terms on which it procures supply (eg, as to price or exclusivity) that it becomes more difficult for a new grocery retailer to enter, or an existing grocery retailer to expand in, the retail grocery markets.

66 See for example, section 2.10 of the 2023 Merger Guidelines of the US Department of Justice and Federal Trade Commission.

67 See for example, [1.5] of the Australian Competition and Consumer Commission (ACCC) Merger Guidelines and the Public Competition Assessment for *Saputo Dairy Australia/Murray Goulburn* (17 May 2018). See n103 below.

68 In contrast, *within* a market *pro-competitive* effects (including rivalry enhancing efficiencies) are balanced against the anti-competitive effects of a transaction: see *ANZCO Foods Waitara Ltd v AFFCO New Zealand Ltd* (2005) 11 TCLR 278 at [249].

69 The Parties agree that we are not required to establish links between effects in acquisition markets and impacts on retail consumers, submitting that "the Commerce Act protects acquisition markets as well as supply markets" and that it is "[not] necessary to quantify the extent of any harm to consumers". SoUI submission from the Parties (13 August 2024) at [43] and n37. However, for the reasons set out in their submission, the Parties' view is that no substantial lessening of competition would be likely to arise in any market as a result of the Proposed Merger. See for example, SoUI submission from the Parties (13 August 2024) at [11].

Submissions from the Parties

63. Our consideration of the Proposed Merger saw us receive substantive submissions from the Parties and their advisors on the framework we should use to assess the effects of the Proposed Merger on acquisition markets and how the framework should be applied. The Parties and their advisors agree that a bargaining framework is appropriate for assessing the competitive effects of the Proposed Merger on acquisition markets.[70] Houston Kemp (on behalf of the Parties) submits that we should not be concerned about the creation of the largest buyer of groceries in New Zealand or the reduction in the number of major buyers of many categories of grocery products from three to two.[71]

64. We summarise below these submissions and then discuss our view on the appropriate framework and on the submissions from the Parties.

65. The Parties submit that in assessing competitive effects of the Proposed Merger, both the ability and the incentive of the merged entity to cause a substantial lessening of competition must be analysed.[72]

66. The Parties and their advisors further submit that:

    66.1 the merged entity would not have the **ability** to effect a substantial lessening of competition in any acquisition market because:

        66.1.1 the Proposed Merger would not harm the competitive process. Even if some suppliers did exit, this would represent a harm to competitors and not a harm to competition;[73]

        66.1.2 the essential economic harm arising from a substantial lessening of competition from a merger between competing buyers is suppression of prices and output below the competitive level.[74] The expected price reductions in acquisition markets following the Proposed Merger would be modest and within the range of prices that could be expected within the bargaining framework.[75] Even the largest possible effect of the Proposed Merger could not reasonably be described as "substantial".[76] In addition, the relative degree of bargaining power cannot be expected to change the level of output

70 SoPI cross submission from the Parties (7 March 2024) at [4], Houston Kemp report on SoPI (7 March 2024) at [40] and Düsseldorf Competition Economics report on SoUI (13 August 2024) at [25].

71 Houston Kemp report on SoUI (13 August 2024) at [45].

72 SoUI submission from the Parties (13 August 2024) at [23] and [25] and Commerce Commission call with the Parties' advisors (5 September 2024).

73 Houston Kemp report on SoUI (13 August 2024) at [43] and Commerce Commission call with the Parties' advisors (5 September 2024).

74 Houston Kemp report on SoUI (13 August 2024) at [26].

75 SoUI submission from the Parties (13 August 2024) at [63].

76 Houston Kemp report on SoUI (13 August 2024) at [36].

that is agreed to be exchanged by a buyer and seller and therefore a change in prices is only a transfer between the supplier and buyer;[77]

66.1.3 a transfer of surplus from suppliers to the merged entity would not itself be harmful to competition and would not be a substantial lessening of competition.[78] On this point, the Parties also note that the Act recognises that cost savings can be either benign, pro-competitive, or anti-competitive, and as such it is necessary to characterise such changes based on analysis, economic reasoning and evidence;[79]

66.1.4 a reduction in the number of channels to market for suppliers is not harmful because the merged entity would purchase the same or greater quantity than FSNI and FSSI in combination. There would not be any detriment to competition unless it resulted in a reduced quantity of groceries being sold and "thereby below-market prices";[80]

66.1.5 in a bargaining framework, bargaining power and the outcomes of negotiations are influenced by a range of factors, including the relative degree of patience between the buyer and seller, the risk aversion of the negotiating parties, the credibility of a threat to walk away from negotiations, the extent of incomplete information, and the extent of any asymmetry with which information is available to the negotiating parties.[81] Düsseldorf Competition Economics (on behalf of the Parties) submits that the Proposed Merger is not expected to deprive suppliers of their best alternative outside option. As suppliers retain the best alternative outside options there would be no "buyer power effect" from the Proposed Merger and no change in resulting outcomes;[82] and

66.1.6 there would be no reduction in the ability and incentive for suppliers to invest and innovate;[83] and

77 Houston Kemp report on SoPI (7 March 2024) at [9] and Düsseldorf Competition Economics report on SoUI (13 August 2024) at [19].

78 Houston Kemp report on SoUI (13 August 2024) at [29].

79 SoUI submission from the Parties (13 August 2024) at [35]-[39]. Here, the Parties refer to the fact that the Act treats joint buying by competing buyers as benign or pro-competitive unless it substantially lessens competition, that input cost savings that reduce marginal costs of supplying an output market are treated positively in many instances. We do not agree this is correct as a matter of statutory interpretation, see n115 below. We note here though that the Parties acknowledge a reduction in competition among buyers can lead to "artificially suppressed input prices or purchase volume: which can give rise to a substantial lessening of competition".

80 Houston Kemp report on SoUI (13 August 2024) at [45].

81 Düsseldorf Competition Economics Report on SoUI (13 August 2024) at [16] and Houston Kemp Report on SoPI (7 March 2024) at [27].

82 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [16] and [34]-[38].

83 Houston Kemp report on SoUI (13 August 2024) at [46]-[47] and Düsseldorf Competition Economics report on SoUI (13 August 2024) at [46]-[47].

66.2 the merged entity would not have any **incentive** to suppress competition in any acquisition market because:

66.2.1 it is not sufficient to show a theoretical ability to suppress competition in acquisition markets where doing so would be against the merged entity's interests;[84] and

66.2.2 given competition in retail grocery markets, the Parties would be incentivised to maintain competitiveness in acquisition markets. The Parties would not have an incentive to reduce competition among suppliers. Rather they have strong incentives to maintain price, quality, range and service dimensions.[85]

Our view

67. The submissions put forward by the Parties and their advisors above including the focus on the effects on competition between suppliers, transfers of surplus, and the notion that harm to suppliers is merely harm to competitors are based on an incorrect understanding of the statutory test. The fundamental question we need to address is whether we are satisfied that the Proposed Merger is not likely to substantially lessen competition in any market.

68. To explain why we consider the Parties' submissions to be misconceived, in this section we explain our view of competition, why we consider competition in acquisition markets is important, and why a bargaining framework is appropriate here. We then address the specific submissions raised by the Parties and their advisors.

Competition as independent rivalry

69. The Act prohibits mergers or acquisitions that would have, or would be likely to have, the effect of substantially lessening competition in a market.[86]

70. Competition is valued as a mechanism for the allocation of society's resources.[87] Firms are rewarded for innovation and discovering the goods and services that the community wants, and for supplying them as efficiently as possible.[88] Competition is also a regulator of conduct: firms in competitive markets disregard market signals at their peril, with others willing and able to encroach upon their market share.[89]

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84 SoUI submission from the Parties (13 August 2024) at [73].

85 Houston Kemp report on SoUI (13 August 2024) at [38]-[44], Commerce Commission call with the Parties' advisors (5 September 2024) and Düsseldorf Competition Economics report on SoUI (13 August 2024) at [32].

86 The Act s 47.

87 *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352 (CA) at 358 and *Fisher & Paykel Ltd v Commerce Commission* [1990] 2 NZLR 731 (HC) at 756. See also *NZME Ltd v Commerce Commission* [2018] NZCA 389, [2018] 3 NZLR 715 at [74].

88 *Wellington International Airport Ltd v Commerce Commission* [2013] NZHC 3289 at [24(a)]. *Major Energy Users Group v Commerce Commission* [2024] NZHC 959 at [164]-[165].

89 *Re Queensland Co-operative Milling Association* (1976) 8 ALR 481 (Trade Practices Tribunal) (*QCMA*) at 515. See also Heydon, Trade Practices Law (2nd ed, 1989) vol 1 at 1548 and [3.210], cited in *Auckland Regional Authority v Mutual Rental Cars (Auckland Airport) Ltd* [1987] 2 NZLR 647 (HC) at 671 and *Fisher & Paykel Ltd v Commerce Commission* [1990] 2 NZLR 731 (HC) at 757-758.

71. A competitive market also preserves economic opportunities for market participants, avoids the fragility that comes from reliance on a single entity, and provides opportunities for new operating models to emerge and evolve through different interactions between the various market participants. Market participants can compete, contract, and collaborate without coercion, interference, or discrimination.

72. The antithesis of competition is undue market power.[90] That is the power to make choices without being undermined by rivals. This does not mean a particular choice will inevitably be made, rather the essence of market power is "discretionary power".[91]

73. Effective competition requires independent rivalry in all dimensions of price, quality, range and service offerings across a market.[92] "Independent rivalry" refers to the situation where different businesses or entities operate in a market, striving to best meet the needs of customers in order to achieve their own goals (which typically focus on profitability and market share), without colluding or coordinating their strategies with competitors.[93] Each competitor acts independently, making their own decisions about pricing, marketing, production, and other factors that influence success in the market.[94] This process of rivalry creates incentives for efficient investment, for innovation, and for improved efficiency.[95]

74. Whether and how strongly firms compete is in large part determined by market structure.[96] This includes the degree of market concentration and the conditions for entry and expansion.

Competition among buyers in acquisition markets

75. As noted in Chapter 4 of our Guidelines, a merger between competing buyers may harm sellers just as a merger between competing sellers may harm buyers. A merger of competing buyers can substantially lessen competition by reducing the competition between buyers or by increasing the potential for coordination among the buyers who remain in the market.[97]

76. Competition among buyers can have a variety of beneficial effects that are analogous to competition among sellers. For example, buyers may compete by raising the prices offered to sellers, by expanding supply networks through transparent and predictable contracting, procurement and payment practices, or by investing in technology that reduces friction for sellers. In contrast, a reduction in competition among buyers can harm sellers by allowing buyers to use their enhanced market power to extract lower input prices or purchase volumes from

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90 *QCMA* above n89 at 515 and *Woolworths & Ors v Commerce Commission* (HC) above n13 at [127].

91 *QCMA* above n89 at 515. Maureen Brunt *Economic Essays on Australian and New Zealand Competition Law* (Kluwer Law International, 2003) at 194-195.

92 *QCMA* above n89 at 515, cited in *Major Energy Users Group v Commerce Commission* [2024] NZHC 959 at [166].

93 *ANZCO v AFFCO* above n68 at [242].

94 *QCMA* above n89 at 515, approved in *NZME Ltd v Commerce Commission* above n87 at [34].

95 *Wellington International Airport Ltd v Commerce Commission* above n88 at [22].

96 *New Zealand Bus Ltd v Commerce Commission* [2007] NZCA 502, [2008] 3 NZLR 433 at [237], citing *QCMA* at 516. See also *Commerce Commission v Woolworths Ltd* (CA) above n5 at [187], [200] and [206].

97 Mergers and Acquisitions Guidelines above n3 at 33.

sellers, and to impose non-price terms to a buyer's advantage. In turn this may reduce the ability and incentives for sellers to invest in capacity or innovation or lead to exit of suppliers, thereby reducing overall choice and quality.

Competition and a lessening of competition in a bargaining framework

77. We consider – alongside the Parties, Houston Kemp and Düsseldorf Competition Economics – that it is appropriate to analyse the effects of the Proposed Merger for most products using a bargaining framework. A bargaining framework is appropriate where buyers (powerful or not) negotiate bilaterally with individual suppliers. Under the bargaining framework, the buyer and seller will negotiate to share the overall profits that a product generates.[98] The resulting purchase price will fall within the bounds of the minimum price the seller is willing to accept and the maximum price the buyer is willing to pay. A bargaining framework is distinct from a monopsony framework, which would apply in circumstances where a powerful buyer faces a large number of competing suppliers to which it pays a single market price.[99] While a bargaining framework is likely appropriate for most products that suppliers supply to major grocery retailers, there may be some grocery products for which a monopsony framework is more appropriate.

78. Our focus when considering whether there is an effect on competition in acquisition markets using a bargaining framework is on the process of independent rivalry between buyers.[100] To this end, we consider it is important to focus on:

    78.1 the extent to which the Proposed Merger would result in a structural change to the New Zealand grocery industry; and

    78.2 the extent to which the Proposed Merger – and the resulting structural change – would substantially harm the competitive process and the process of independent rivalry between buyers in relevant acquisition markets.

79. In this matter, we consider that competition between the Parties in acquisition markets can be characterised in at least two ways.

    79.1 First, where a supplier is constrained to supply one but not both of FSNI or FSSI, or there is a supply shortage, the Parties compete for supply from those suppliers whose products are in short supply. In those circumstances, the Proposed Merger would result in a loss of an 'outside option' for suppliers.

    79.2 Second, for suppliers that supply both parties, the Proposed Merger would raise the stakes and cost of disagreement with the merged entity compared with either of the Parties individually. Disagreement with one of the Parties separately would mean a supplier would lose the margins and volumes associated with sales to one of them. With the Proposed Merger,

98 Houston Kemp report on SoPI (7 March 2024) at [18].

99 See *Turners and Growers Ltd v Zespri Group Ltd* (2011) 13 TCLR 286 (HC) and *New Zealand Apple and Pear Marketing Board v Apple Fields Ltd* [1991] 1 NZLR 257 (PC).

100 This would also be our focus if we assessed the competitive effects of the Proposed Merger on relevant acquisitions markets using a monopsony framework.

disagreement with the merged entity would risk the margins and sales to both of the Parties combined.

80. Under either characterisation, the loss of competition as a result of the Proposed Merger would increase the merged entity's buyer power and thus lower the prices and worsen the terms of trade negotiated with either of the Parties individually. Neither characterisation of competition relies on the Parties being in competition with each other in retail grocery markets.

81. Many grocery suppliers currently negotiate listings, prices, other terms of trade, and contract renewals with at least three buyers. Each of these dimensions is subject to independent rivalry between buyers because they are distinct parts of the options available to suppliers in their dealings with each buyer individually.

What would change with the Proposed Merger

82. In terms of acquisition markets, the structural change with the Proposed Merger would be a reduction in the number of major buyers of many categories of grocery products from three to two, removing an important third option for many suppliers.[101]

83. It is important to acknowledge that there is already widespread concern about the existing degree of buyer power in the bilateral negotiations between major grocery retailers and suppliers.[102] In bilateral negotiations, the balance of bargaining power between the two parties in the negotiation is particularly important because the price for that transaction is set by negotiation rather than by the market. When considering the bargaining framework, the existing buyer power that major grocery retailers enjoy suggests that current prices are already towards the minimum that suppliers are willing to accept. While our analysis is focused on the change that the Proposed Merger would bring, what we are essentially considering is the extent to which it may exacerbate an existing competition problem.[103]

84. This means the structural change with the Proposed Merger would likely substantially harm the competitive process and the process of independent rivalry in acquisition markets, if it were to substantially:

[101] This is not to suggest a three to two merger would, in every case, result in a substantial lessening of competition. But we place weight on the strong theoretical concerns such a structural change creates and it is for the Parties to satisfy us that those concerns are unfounded: *Commerce Commission v Woolworths Ltd* (CA) above n5 at [200]-[206].

[102] The Commission itself has noted this in its market study final report (8 March 2022) at 324 and [8.50] and first annual grocery report (4 September 2024) at 5, 22 and 104-106.

[103] The ACCC's interim report on its supermarket inquiry (August 2024, released 27 September 2024) at 47 draws a distinction between increases in buyer-side market power which may counteract seller market power and push prices closer to competitive levels and those which move a market further away from a competitive outcome. While we would not adopt the interim report's use of the labels of "bargaining power" and "monopsony power" to make this distinction, we consider that it echoes our concerns with the Proposed Merger given the existing buyer power that major grocery retailers enjoy. In bilateral contexts, competition is stronger the more evenly matched are the participants (eg, in a sports match).

84.1 change the balance of bargaining power between buyers and suppliers, resulting in increased buyer power for the merged entity;

84.2 enable the merged entity to extract lower prices from suppliers than the Parties would have been or be able to obtain separately in the counterfactual (and better than they would have been able to obtain in a competitive market). This includes "cherry picking" the most favourable trading terms from those currently offered to each of FSNI and FSSI; and/or

84.3 have flow-on effects that adversely affect the ability and incentive of suppliers to innovate, or reduce the pace and development of new product innovation by suppliers, compared to that which would occur in the counterfactual by:

84.3.1 reducing the expected profitability of investments in new products; and/or

84.3.2 increasing the riskiness of such investments, as a result of a reduction in the number of major channels through which new products can be introduced.

85. In terms of the prices that the merged entity might be able to extract from suppliers, we consider that these would likely be lower than either FSNI or FSSI would have been able to achieve alone in the counterfactual. Under the bargaining framework, this would further push the negotiated prices towards the minimum price that suppliers are willing to accept. The Parties submit that [ ].[104]

86. In the case of the Proposed Merger, we have identified a number of relevant acquisition markets (as set out in Table 2 starting after [217]). In many of these markets, alternative other sales channels available to suppliers do not appear to be close substitutes for the major grocery retailers,[105] and the Proposed Merger would reduce the number of major grocery buyers from three to two. In some markets where other grocery retailers are significant buyers or products are exported in large volumes, some suppliers may have credible alternative options to the major grocery retailers.

87. As discussed further below, while cost-savings that result from merger efficiencies may be benign or pro-competitive, wealth transfers from weaker competition post-merger are not benign or pro-competitive.[106]

104 SoUI submission from the Parties (13 August 2024) at 78.

105 The evidence gathered through our investigation of the Proposed Merger on this point is discussed further later at [168]. This means that suppers have limited alternative options to the major grocery retailers. The Commission noted this to be the case in its first annual grocery report (4 September 2024) at 106.

106 See [107]-[109] below.

88. Our view is that if the Proposed Merger resulted in a substantial lessening of competition, it would likely be accompanied by:

    88.1 a transfer of surplus from grocery suppliers to the merged entity;

    88.2 exit by suppliers from one or more relevant acquisition markets;

    88.3 a reduction in the number of channels for suppliers, or a reduction in the number of opportunities suppliers have to pitch new ideas or products;

    88.4 a reduction in grocery suppliers' ability and incentives to invest or innovate; and/or

    88.5 a reduction in choice and/or quality of groceries.

89. To be clear, we do not consider that each of the above outcomes is evidence in and of itself of a substantial lessening of competition. Rather, we consider that they are potential *outcomes* of a substantial lessening of competition, resulting from a structural change to the industry that harms the competitive process.

Our concern is with harm to the competitive process, not the fate of individual competitors

90. The Parties submit that the focus of the test is a substantial lessening of competition in a market (or harm to the competitive process) but that "in a number of places the SoUI makes statements and cites evidence that it suggests demonstrate harm, or adverse outcomes, to individual suppliers, which by themselves do not indicate a lessening of competition".[107]

91. This does not accurately reflect our approach. Our acquisition market concern is with the impact of the Proposed Merger on the process of independent rivalry between buyers in the acquisition markets and on the merged entity's buyer (or market) power. In the relevant acquisition markets, the Proposed Merger would reduce the number of major buyers of many categories of grocery products from three to two. This would be a significant structural change in these markets that would impact the process of independent rivalry and the merged entity's buyer power in those acquisition markets.

92. That the Act is concerned with competition not competitors is a longstanding principle first articulated in the seminal Australian case of *QCMA*. We do not understand this proposition to be controversial and would simply note two points.

[107] SoUI submission from the Parties (13 August 2024) at [51] and Commerce Commission interview with the Parties' advisors (5 September 2024).

93. First, protecting competition may have the effect of protecting individual competitors, and conversely a merger which lessens competition may adversely affect individual competitors.[108]

94. Secondly, aside from theoretical or structural evidence, the evidence that we obtain is generally from, and relates to, individual market participants. It is inevitable that the evidence will refer to the potential harm to individual entities that currently benefit from existing competition. Our role is to assess these individual pieces of evidence and consider them in light of, and together with, any theoretical or structural evidence. Having assessed all of the evidence and other information before us, we are required to exercise our judgement and determine whether we are satisfied no substantial lessening of competition is likely.

A substantial lessening of competition does not require a showing of suppressed prices and reductions in output

95. Houston Kemp submits that the orthodox approach for assessing a potential substantial lessening of competition occasioned by a merger between competing buyers is to focus on the essential economic harm being the suppression of prices and output below the competitive level.[109] Unless a merger has this effect, there can be no lessening of competition.

96. The question for us is whether we are satisfied that the Proposed Merger would not be likely to substantially lessen competition (ie, that it would not reduce independent rivalry and increase buyer-side market power in the acquisition market). While prices and output levels are important potential outcomes of a merger that increase market power, this is not itself the test.

97. The submissions of the Parties and their advisors assume a test that is different to the statutory test we must apply.

98. In contrast to the Parties' view, we consider that a substantial lessening of competition may occur whether or not there is a specific or quantifiable reduction in volume or output.

99. Although we do not consider that the statutory test requires a reduction in output, this outcome is possible in a bargaining framework. The view that post-merger changes in bargaining outcomes would reflect a transfer of surplus only assumes that bargaining is efficient in the sense that negotiating parties are able to realise all mutual gains from trade. However, bargaining outcomes can be inefficient if there is information asymmetry between the negotiating parties and/or negotiated contracts are incomplete. In those circumstances inefficiently low output may result.[110] The

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108 *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 at [564]. Noting the caveat to that general principle in McGechan J in *Commerce Commission v Fletcher Challenge Ltd* [1989] 2 NZLR 554 (HC) at 604 and *Union Shipping NZ Ltd v Port Nelson Ltd* [1990] 2 NZLR 662 at 700: individual competitors are protected to the extent that protects competition.

109 Houston Kemp report on SoUI (13 August 2024) at [26].

110 See for example, Jonathan B Baker, Joseph Farrell and Carl Shapiro, "Merger to Monopoly to Service a Single Buyer: Comment", (2008) Vol. 75 Antitrust Law Journal No. 2, at 637-646.

Parties' advisors recognise this possibility but do not account for its likelihood or implications for their views as to potential competitive effects of the Proposed Merger in more than a cursory way.[111] We consider that the potential for bargaining to be inefficient is particularly relevant to competitive outcomes that play out over time such as effects on sellers' investments in innovation and buyers' ability to extract contractual terms that harm rival grocery retailers.

100. We consider that the Parties' approach conflates the question of whether competition has been lessened with the question of whether a lessening of competition would change prices and output to the detriment of consumers.

101. Section 1A states that the purpose of the Act is to "to promote competition in markets for the long-term benefit of consumers within New Zealand".

102. In the long run, it is expected that consumers will benefit from a concerted focus on the protection and preservation of the competitive process, including competition to acquire goods and services. Consumers enjoy benefits from competitive tension at all levels of a supply chain, not just in the level with which they directly interact.

103. In other words, the Act is premised on competition (that is, independent rivalry between buyers and sellers) producing the best outcome for consumers in the long run. When firms have to compete, it leads to competitive prices, higher quality goods and services, greater variety, and more innovation.

104. Accordingly, in assessing whether a substantial lessening of competition arises in acquisition markets for the purposes of determining a s 66 merger clearance application, we do not consider that we are required, for reasons of either law or policy, to quantify the extent of any impact of the Proposed Merger on retail grocery markets in terms of price or quantity or harm to consumers. Requiring us to undertake this quantification would be an inappropriate 'gloss' on the statutory language and involve reading in a restriction on our primary directive of preventing a lessening of competition in any market.[112]

105. Notwithstanding the ultimate purpose being consumer welfare, the relevant provisions in the Act relating to mergers and s 66 merger clearances focus on the

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111 Düsseldorf Competition Economics report on SoUI (13 August 2024) at n14 notes that "In cases of asymmetric information, where the retailer lacks full knowledge of the goods' quality and production costs, the traded quantity often ends up being too small. However, the expertise of large retailers in purchasing helps reduce this information gap, bringing traded quantity closer to an efficient level." Houston Kemp Report on SoPI (7 March 2024) at [27e] "These [bargaining] models provide insight into the factors that influence bargaining power and therefore bargaining outcomes in practice. For example: … (e) the extent of incomplete information about one or both parties' preferences, and the extent of asymmetry in that knowledge – parties that are more informed about their rival's willingness to pay or accept may be able to use that information to gain a better outcome for themselves, or parties may not be able to make a deal at all".

112 The Courts have been unwilling to impose additional gloss to the statutory tests for clearance and authorisation. See for example, *Godfrey Hirst NZ Ltd v Commerce Commission* [2016] NZCA 560 [2017] 2 NZLR 729 at [41] and *Southern Cross Medical Care Society v Commerce Commission* (2001) 10 TCLR 25 (HC) at [32].

impact on competition, not on the impact on consumers as such.[113] The s 67 merger authorisation process allows for a merger to be approved if it results in a net public benefit despite lessening competition (or being likely to).

106. However, the number of ways a substantial lessening of competition in relevant markets for the acquisition of grocery products might manifest (as outlined at [88] above) could negatively impact on consumers in retail grocery markets over time. This includes a reduction in the choice or quality of groceries, a reduction in the opportunities grocery suppliers have to pitch new ideas or products, and a reduction in grocery suppliers' ability and incentives to invest or innovate. These effects are considered in our analysis of acquisition markets (starting at [220]). In addition, the major grocery retailers may be able to leverage their increased market power in relevant markets for the acquisition of grocery products to gain such an advantage in the terms on which they procure supplies, (eg, as to price or exclusivity) that it becomes more difficult for rival grocery retailers to enter or expand in the retail grocery markets. These potential flow-through effects are considered in our analysis of retail grocery markets (starting at [489]).

Relevance of wealth transfers

107. Houston Kemp submits that a transfer of surplus from suppliers to the merged entity is not itself harmful to competition, does not amount to a substantial lessening of competition, and presupposes that grocery markets are currently sharing surplus in the 'correct' proportions whereas the merged entity's increased buyer power may counteract suppliers' market power.[114]

108. These submissions misstate our position. Our concern is that competition would be substantially lessened by the reduction in the number of major buyers of many categories of grocery products from three to two in relevant acquisition markets. Paying lower prices and transferring surplus from suppliers to the merged entity is a potential outcome of an increase in market power. The transfer is relevant as an indicator that a competitive tension between buyers would be removed with the Proposed Merger.[115]

109. Relatedly, all buyers and sellers that engage in bilateral bargaining have some degree of market power, although its strength will vary across buyers and sellers. It is therefore self-evident that an increase in buyer power that lowers prices and

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113 *Commerce Commission v Air New Zealand Ltd* [2011] NZHC 1285 at [58].

114 Houston Kemp report on SoUI (13 August 2024) at [29]-[30].

115 Wealth transfers can be benign or pro-competitive. We do not consider this is the case here because the wealth transfers would arise in conjunction with a substantial lessening of competition. Similarly, we do not consider there is much force in the Parties' submission (set out at n79) that the joint buying exemption to cartel conduct under s 33 means that the Act treats joint buying as benign or pro-competitive. First, s 33 is a narrow exemption which does not permit all acquirer-based cartels. Second, s 30, the cartel prohibition, otherwise prohibits cartel provisions in relation to the supply or *acquisition* of goods or services. Third, the s 33 exemption does not apply to s 27, which assesses the conduct under the substantial lessening of competition test, which we are required to apply here. Plainly, the Act envisaged a different approach to, hypothetically, a scenario where small market participants without market power independently purchased goods at a collectively negotiated price, to a scenario where the largest market participants with a high degree of market power made collective purchases from suppliers.

worsens terms for any seller would countervail that seller's market power to some extent.[116] However, our view is that post-merger cost savings accruing to a merged entity simply from the exploitation of increased market power in acquisition markets that allows it to negotiate prices below those that would apply in the counterfactual should not be treated as relevant efficiencies. Such cost savings reflect a harm to competition.

Reduction in number of channels

110. The Parties submit that the SoUI is incorrect to cite harms arising from a reduction in the number of channels or opportunities to pitch for suppliers because despite the merged entity consolidating two, formerly geographically separate buyers in many grocery acquisition markets, it would purchase the same or a greater quantity than the Parties (in combination) pre-merger. They say it is misconceived to cite a reduction in the number of 'opportunities to pitch' when the value of those channels/opportunities have increased by at least a commensurate, offsetting amount with the ability to offer only one region or island remaining. They also say that unless the increased buyer concentration with the Proposed Merger would be likely to result in a reduced quantity of groceries sold (which it would not) and, thereby below-market prices, it cannot be said there would be any detriment to competition.[117]

111. We have explained above our view that a substantial lessening of competition in acquisition markets does not require showing suppressed prices and reductions in output below competitive levels. Nor do our concerns about harms arising from a reduction in the number of channels for suppliers to bring their grocery products to consumers rely on that outcome. Our view is that each of the three major grocery retailers currently present separate opportunities for suppliers, including new suppliers, or suppliers with new products, to gain a foothold in the market. These separate opportunities create competitive rivalry in acquisition markets as each of the three major grocery retailers act as outside options in negotiations between a supplier and another buyer. A reduction from three to two major channels with the Proposed Merger would reduce that rivalry. This would make it more difficult for suppliers, in particular smaller suppliers, to innovate and introduce new products into New Zealand, or delay the timeframe within which new innovative products are launched. In the context of a concentrated market with high barriers to entry and expansion that loss of rivalry would be substantial. This would ultimately impact on consumers through fewer products, lower quality products, and/or the slower introduction of new products or suppliers on retail grocery shelves for consumers.

Incentive for suppliers to invest and innovate

112. The Parties submit that the contention in the SoUI that the Proposed Merger would lead to a reduction in suppliers' ability and incentive to invest and innovate is not supported

[116] Just as an increase in seller power that raises prices and worsens terms for any buyer would countervail that buyer's market power to some extent.

[117] Houston Kemp report on SoUI (13 August 2024) at [45].

by mainstream economic theory.[118] Düsseldorf Competition Economics goes further and submits that the Proposed Merger could increase supplier incentives to innovate.[119]

113. We disagree that mainstream economic theory does not support our concerns about an increase in buyer power on suppliers' ability and incentive to invest. As we explain below at [384], economic theory is not settled as to the theoretical effects of increased buyer power on suppliers' incentives to invest and innovate so each case will depend on its own facts. In relation to ability, an exercise of buyer power can reduce suppliers' ability to invest if it makes it harder for them to finance innovations they would otherwise have made or reduces profitability to such an extent that suppliers exit. We consider that any increase in buyer power with the Proposed Merger may reduce suppliers' ability and incentives to invest in new and innovative products, due to reduced profitability and increased risk. A transfer of surplus away from suppliers through increased bargaining power of the merged entity could adversely affect the ability and incentive of suppliers to innovate, increase the costs of external financing, or lead to exit.

An incentive to supress competition between suppliers is not relevant

114. We are not satisfied that there would not be a substantial lessening of competition in the acquisition market(s) because the Proposed Merger would eliminate an outside option that prior to the Proposed Merger was contributing competitive constraint to negotiations between suppliers and buyers.

115. Having established in the factual that the merged entity would, for example, exercise its market power by decreasing the price paid to suppliers, the assessment of whether competition is *substantially* lessened does not depend on the merged entity's incentives in the factual. Competition would be harmed in relevant acquisition markets by the structural loss of a major grocery buyer, not by any post-merger conduct that the merged entity may or may not be incentivised to enter into.

116. The Parties submit that we have not sufficiently canvassed the Parties' incentives or likely conduct following the Proposed Merger.[120] The Parties further submit that competition at the retail level means that the merged entity's incentive to ensure competitive supply would be unchanged as a result of the Proposed Merger. This is because the merged entity's ability to maintain and improve its competitive positioning at the retail level is said to depend on it obtaining competitively priced, and new and innovative, grocery products from suppliers.[121] That the Parties' submissions imply that they would have a choice as to the exercise of their market power post-merger merely demonstrates the existence of it.

117. Competition in the retail grocery markets would impact the merged entity's behaviour in acquisition markets. In some circumstances an apparent increase in market power from an increase in concentration might be constrained by the possibility of entry or by

118 Houston Kemp report on SoUI (13 August 2024) at [46].
119 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [46].
120 SoUI submission from the Parties (13 August 2024) at [72]-[73].
121 SoUI submission from the Parties (13 August 2024) at [81].

countervailing market power. But we do not consider any such offsetting factors are operative here. Instead, as we discuss at [491]-[551], we consider that the Proposed Merger would raise barriers to entry and expansion in relevant retail grocery markets and therefore reduce competition in retail grocery markets compared with the counterfactual. To the extent that competition in retail grocery markets is reduced, we consider the merged entity would have a weaker incentive both to maintain competitive acquisition markets and to encourage new and innovative grocery products. Furthermore, we do not consider that suppliers' countervailing power would be sufficient to constrain the merged entity's buyer power.

118. In addition, the Parties' submissions do not address either:

118.1 the reduction in rivalry between buyers in the relevant acquisition markets; nor

118.2 their ability/incentive to exercise market power by lowering prices to suppliers or imposing unfavourable terms.

119. Rather, the Parties' submissions focus on a different issue: whether the merged entity would have an incentive to supress competition *between suppliers* in the acquisition markets.

120. While the merged entity might have an incentive to ensure that the supply chain continues to exist, we consider this to be irrelevant. What matters is whether the Proposed Merger would reduce rivalry between buyers and whether the merged entity would have an incentive to extract economic rent from relevant acquisition markets.

Summary of framework

121. The question we need to answer is whether we are satisfied that the Proposed Merger is not likely to substantially lessen competition in any market.

122. A merger between competing buyers may harm sellers just as a merger between competing sellers may harm consumers.

123. We understand effective competition requires independent rivalry in all dimensions of price, quality, range and service offerings across a market. Whether and how strongly firms compete is in large part determined by market structure.

124. A bargaining framework is generally appropriate to assess the Proposed Merger because buyers negotiate bilaterally with individual suppliers for the acquisition of grocery products in most cases.

125. Impact on price is but one indicia of rivalry. We do not consider that we are required to show that the Proposed Merger would lead to the suppression of prices and output below the competitive level in a relevant acquisition market.

Market definition – acquisition markets

126. Market definition is a tool that helps identify and assess the close competitive constraints a merged entity is likely to face. We define markets in the way that we consider best isolates the key competition issues that arise from a specific merger or acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.[122]

127. This is particularly relevant in this case where there is the potential for a very large number of markets. An overly granular market definition, involving thousands of individual geographic and product markets would require the Parties to satisfy us that there was no substantial lessening of competition in every market. That would be unworkably resource intensive and untimely for market participants, the Parties and us.

128. The relevant markets to assess the impact of the Proposed Merger on the acquisition of grocery products are the wholesale markets in which the Parties and their suppliers interact. Suppliers may be (for example) growers of fresh produce, farmers, manufacturers, or processors. There are thousands of relevant suppliers, which range in size and type from small local growers and niche food producers, through to large multinationals which produce many different types of products.

129. For purposes of assessing the effects of the Proposed Merger, we consider there are separate relevant market categories for:

129.1 the national acquisition of dry/ambient groceries by major grocery retailers;

129.2 the national acquisition of chilled and frozen groceries by major grocery retailers;

129.3 the national acquisition of health and beauty products by major grocery retailers and other customers;

129.4 the national acquisition of beverages by major grocery retailers and other customers;

129.5 the national acquisition of snacks by major grocery retailers and other customers;

129.6 the national and regional acquisition of meat and seafood products by major grocery retailers and other customers;

129.7 the national acquisition of beer and wine by major grocery retailers and other customers; and

129.8 the local, regional and national wholesale acquisition of fresh produce by major grocery retailers and other customers.

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[122] Section 3(1A). See also *Brambles v Commerce Commission* above n7 at [81] and Mergers and Acquisitions Guidelines above n3 at [3.7]-[3.10].

Framework for defining acquisition markets

130. The conceptual framework we use when we define the relevant market in a merger between competing sellers is the 'hypothetical monopolist test'. We ask whether a hypothetical monopolist could profitably impose a small, but significant, non-transitory increase in price (a SSNIP) of at least one of a merged firm's products. This will be case when there are few good substitutes to the product in question. Substitution to alternative products can occur on both the 'demand' and 'supply' side.

130.1 Demand-side substitution is where customers would switch sufficient purchases to alternative products or locations so that a SSNIP is not profitable.

130.2 Supply-side substitution is where rival firms (having observed an increase in price) can easily, profitably and quickly (generally within one year) switch production to supply the products or locations in question without significant cost so that a SSNIP is not profitable.

131. We apply a variation of the hypothetical monopolist test to define relevant markets in mergers between competing buyers. In this case, we define relevant grocery product acquisition markets by asking whether a hypothetical sole grocery buyer could profitably impose a small but significant non-transitory decrease in price (SSNDP).

132. We consider substitution from the perspective of both sellers and buyers by assessing:

132.1 whether sellers of a grocery product could switch sufficient volumes to alternative distribution channels to make a SSNDP unprofitable. It is not just the number of alternative distribution channels that a supplier of grocery products may switch to that is relevant to the SSNDP test. The ease with which the supplier could switch sufficient volumes into those channels is also important; and

132.2 whether other buyers that were not originally purchasing a grocery product (having observed a decrease in price) could make a SSNDP unprofitable by easily, profitably and quickly switching to begin purchasing the grocery product in question.

Submissions from the Parties

133. The Parties submit that "the markets suppliers participate in, and the way they interact with the Parties, vary widely. Put another way, multiple "markets" must be analysed".[123] The Parties also submit that the SoUI took some steps to define potentially-affected acquisition markets, but this analysis is incomplete, with the potential harm from the Proposed Merger not being linked to specific markets (ie, that the SoUI failed to define specific markets in which the Proposed Merger would substantially lessen competition).[124] However, the Parties had previously submitted that "[a]lthough it may be possible to argue that sales of each product could be considered as a separate market, to avoid complexity suppliers can be

123 SoI submission from the Parties (26 April 2024) at [18].

124 SoUI submission from the Parties (13 August 2024) at [8.2].

appropriately categorised according to similarity of their circumstances, and thus the change (or lack of change) they would experience in their bargaining position as a result of the Proposed [Merger]".[125]

134. Further, the Parties also submit that:[126]

134.1 for suppliers in many markets, options of at least the scope and scale of the Parties are available (eg, export) and other grocery retailers of sufficient scope and scale to provide alternatives exist (eg, Chemist Warehouse);

134.2 for suppliers in lower-volume markets, other grocery retailers do not need to be of comparable scope and scale to provide an alternative;

134.3 medium suppliers tend to have realistic options outside the major grocery retailers;

134.4 it is not necessary to conclude on the level of constraint provided by other acquirers of grocery products, because the focus is the change that would arise from the Proposed Merger and the consequences of that change;

134.5 the assumption that other full-service grocery retailers are the only genuine alternative for "most suppliers" (other than some suppliers for fresh produce), is incorrect; and

134.6 the fact that "many suppliers" supply meaningfully only to the Parties and Woolworths, is not, in and of itself, relevant – it is a supplier's competitive position in relation to the market(s) which is important (and the validity of the point that only other grocery retailers can provide an alternative channel to the Parties depends on the market in question).

135. Houston Kemp submits that the assessment of the effects of the Proposed Merger needs to be undertaken in the context of the market in which each supplier operates (ie, by reference to the degree of power held by a supplier) and its other options for selling grocery products (ie, to Woolworths, other grocery retailers and other buyers). Rather than defining or analysing individual markets as the Parties submit we should do, Houston Kemp has itself only analysed the potential effects of the Proposed Merger on four different categories of suppliers (ie, major national suppliers, smaller national suppliers, regional suppliers, small local suppliers).[127]

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125 SoI submission from the Parties (26 April 2024) at [20].

126 SoI submission from the Parties (26 April 2024) at [44.2], SoI cross submission from the Parties (31 May 2024) at 7-8 and SoUI submission from the Parties (13 August 2024) at [90]-[92].

127 Houston Kemp report on SoPI (7 March 2024) as summarised in Houston Kemp report on SoI (26 April 2024) at [40]. Houston Kemp considers that for the [ ]% of suppliers shared by the Parties, the outside option for these suppliers would not change with the Proposed Merger, because if they are already supplying both FSNI and FSSI, their outside option is already, something else. In other words, the outside option cannot change for this proportion of suppliers. In respect of the remaining percentage of suppliers who might experience capacity constraints or have a preference to supply one island or the other based on location, none of these matters would lead to a substantial lessening of competition. Commerce Commission call with the Parties' advisors (5 September 2024).

136. Houston Kemp presented an analysis of the effect of the Proposed Merger on suppliers falling outside of the major national and small local categories (ie, smaller national and regional suppliers) based on those suppliers' outside options.[128] Houston Kemp identified a sample of 500 'middle' suppliers to FSNI, and asked FSNI to "classify these suppliers based on the extent of outside options available for these suppliers to sell their products".[129] Houston Kemp acknowledged that [ ].[130] As Houston Kemp notes, [ ].[131]

137. Houston Kemp submits that most of the suppliers it examined had at least one material option outside of the major grocery retailers.[132] These options included the ability to sell their products into export markets, to foodservice providers, or to other key retailers (such as Chemist Warehouse, The Warehouse, or other independent grocery retailers). In the case where suppliers import their products into New Zealand, Houston Kemp "assume that those suppliers already face significant competition from imports and should not be expected to be materially affected by the merger".[133]

Third party submission

138. The New Zealand Specialist Cheesemakers Association submits that there are unique specification demands from major grocery retailers which make moving the same product to other channels, non-viable. It further submits that there are no other competing routes (outside of the major grocery retailers) to the consumer market with equivalent of substitutable volume in New Zealand. It considers that the merged entity would have such a dominant position that it would not have to respond to market pressure and would essentially become the market itself.[134]

Our view

139. A number of markets for the acquisition of grocery products may be impacted by the Proposed Merger. Given the variety of products that are acquired by the Parties from a large number of different types of suppliers (which is reflected in the large number of products on the shelves of their grocery stores – with a large format store ranging over 10,000 stock keeping units (SKUs)),[135] there will be many relevant

128 Houston Kemp report on SoI (26 April 2024) at [44].
129 Houston Kemp report on SoI (26 April 2024) at [44].
130 RFI response from Houston Kemp (6 June 2024) at 1a
131 RFI response from Houston Kemp (6 June 2024) at 1a.
132 Houston Kemp report on SoI (26 April 2024) at [45] and Figure 2.1.
133 Houston Kemp report on SoI (26 April 2024) at [44].
134 SoUI submission from New Zealand Specialist Cheesemakers Association (12 August 2024) at 6. The Parties response to this submission is that there are many other buyers of speciality cheese beyond the grocery retailers, including speciality retailers, independent grocers, hospitality and wholesalers and that these channels are typically a significant contributor to suppliers' overall sales in this category. SoUI cross submission from the Parties (26 August 2024) at 10.
135 Market study final report (8 March 2022) at Figure 4.5.

acquisition markets with different characteristics, with potentially separate markets for each supplier or even for each supplier-buyer pair.

140. Relevant acquisition markets will vary with the nature of suppliers and their products, how their costs change as they increase or decrease production (including any capacity constraints), the alternative channels they can supply products to, and their strategies (eg, targeting specific types of customers).

141. In this section, we set out the general framework with which we view the product, geographic and customer dimensions of relevant markets for the acquisition of grocery products, before identifying common features of categories of markets.

Product dimensions of the relevant markets

142. We consider that in principle there are separate relevant markets for the acquisition of grocery products based on individual products or types of products. This is because on both the demand-side and the supply-side, products in one category may not be readily substitutable with products in another category. However, for the reasons explained above, we have aggregated across categories for the purposes of our competition analysis.

143. From a supply-side perspective, many suppliers are focussed on particular product categories or on particular products within those categories. There are also suppliers which supply multiple products across multiple categories. While this suggests there are likely to be some complementarities between the production of different types of grocery products, the extent of these complementarities vary by product. As a general proposition, suppliers cannot switch easily from manufacturing one type of grocery product or category, to producing other types of grocery products or categories.

144. On the demand-side, major grocery retailers are (in theory) able to readily divert shelf space between different grocery products and can more easily substitute particular products for other products than suppliers can switch to producing other grocery products or categories. In practice, such substitution is still constrained by the need of major grocery retailers to procure a sufficiently comprehensive range of grocery products across various categories in order to compete in retail grocery markets.

145. The general proposition that the acquisition of grocery products takes place in relatively narrow markets according to product type is consistent with past merger determinations in which the Commission investigated discrete grocery wholesale supply markets.[136] Examples include:

145.1 separate product markets for the supply of laundry detergents, laundry pre-wash aids and toilet cleaner products;[137]

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136 These markets were framed as supply markets due to consolidation at the supplier level, but the assessment of the product dimension still has some relevance for our analysis of the current relevant markets.

137 Henkel New Zealand Limited and Earthwise Group Limited [2023] NZCC 11 at [22].

145.2 a distinct product market for the supply of tofu that was separate from plant-based meat alternatives (excluding tofu);[138]

145.3 separate product markets for savoury pies and sausage rolls;[139]

145.4 separate product markets for each of colony cage, barn and free-range eggs;[140]

145.5 a distinct product market for the supply of Greek yoghurt that was separate from "mainstream yoghurt products";[141] [142]

145.6 separate product markets for each of red sauces (primarily tomato sauce and ketchup), barbecue sauce, steak sauce and Worcestershire sauce;[143] and

145.7 a distinct product market for the supply of primary and secondary processed chicken that was distinct from other animal protein product markets.[144]

146. As noted above, for purposes of assessing the effects of the Proposed Merger, we are aggregating categories of products as a matter of fact and commercial common-sense way of isolating the likely competition issues that may arise from the Proposed Merger, without defining every single individual product market. These categories group together products that are likely to exhibit common dynamics meaning that the product markets within these categories may be impacted by the Proposed Merger in similar ways.

147. These categories, which are set out in more detail later in Table 2, include dry/ambient groceries; chilled and frozen groceries; beverages; snacks; meat and seafood; fresh produce; health and beauty; and beer and wine.

Geographic dimensions of the relevant markets

148. There are local, regional and national dimensions of the Parties' acquisition of grocery products, which vary according to the types of products (or categories of products) acquired by the Parties.

149. It appears that, for most of the relevant product categories identified above, the relevant geographic dimension is national. Due to New Zealand's small market size it makes sense for some national suppliers, where possible, to supply the entire country from the same site (or a small number of sites). For example, we understand that a supplier will typically have a single manufacturing site from which they supply both the North Island and South Island, with some examples of suppliers (usually

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138 Life Health Foods NZ Limited and Chalmers Organics Limited [2022] NZCC 21 at [35].
139 Allied Foods (N.Z.) Limited and Dad's Pies Limited [2021] NZCC 21 at [17].
140 Heyden Farms Limited, Henergy Cage-Free Limited and Rasmusens Poultry Farms Limited [2020] NZCC 19 at [17]. Colony cage eggs are in the process of being phased out by the major grocery retailers.
141 Goodman Fielder New Zealand Limited and Lion – Dairy & Drinks (NZ) Limited [2018] NZCC 12 at [59].
142 The Commission left open the possibility of other yoghurt products constituting their own market, but did not define it more specifically as it was not necessary to assess the competitive effects of that merger.
143 H.J. Heinz Company (New Zealand) Limited and Cerebos Pacific Limited [2018] NZCC 2 at [45].
144 Tegel Foods Limited and Brinks Group of Companies (Commerce Commission Decision 658, 22 October 2008) at [186].

large suppliers) having multiple manufacturing sites.[145] In the case of frozen goods and dry groceries, we understand that suppliers will often supply both FSNI and FSSI from the same physical manufacturing site.[146]

150. There is a high degree of alignment in ranging (ie, overlap in shared large suppliers) between FSNI and FSSI. The Parties advise that [ ]% of FSSI's top [ ] suppliers (representing [ ]% of FSSI's total sales) also supply FSNI. Similarly, [ ]% of FSNI's top [ ] suppliers (representing [ ]% of FSNI's total sales) also supply FSSI.[147] In general, our view is that competition in national acquisition markets with shared suppliers to the Parties is likely to be materially affected by the Proposed Merger, subject to the extent to which other types of channels to market are considered to be sufficiently close substitutes by these suppliers (discussed below).[148]

151. This view is consistent with the Commission's consideration of the previous merger of Progressive Enterprises Limited and Woolworths in 2001, where the Commission concluded that the "assessment of the market power that would be held by buyers in the grocery wholesale market… is undertaken most effectively in the context of a national market". At the time, the Commission determined that "[m]ost suppliers supply nationally and there do not appear to be important differences in the way the market operates in different parts of the country".[149]

152. However, we also consider that there are local and regional dimensions to the supply of some products.

153. The Parties are of the view that for suppliers with the ability to supply in a limited geographic area, "it would not be relevant whether the Parties are two or a single channel to market as they would only deal with one of them",[150] with or without the Proposed Merger. The Parties further submit that for highly perishable fresh products, only local supply is feasible, and transporting these products over the Cook Strait is a material hindrance in terms of time and cost. For such products, supply generally takes place to single grocery stores or, at most, an island, and comes from suppliers in the same island. For such products, the Proposed Merger is not capable of affecting bargaining outcomes as it would not give rise to any change in bargaining dynamics – it is already the case that generally only one of FSNI or FSSI (or one or

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145 Commerce Commission interview with [ ].

146 For example, [ ]. See Commerce Commission interviews with [ ], [ ], [ ] and [ ].

147 The Application at [122].

148 See above, in the section titled "What would change with the Proposed Merger" for an overview of how we consider the Proposed Merger would impact bargaining power in these scenarios.

149 Progressive Enterprises Limited and Woolworths (NZ) Limited (Commerce Commission Decision 448, 14 December 2001) at [72]. This determination was made on the basis of a different legal test to the current law, but the analysis in relation to the market definition still has application.

150 SoI submission from the Parties (26 April 2024) at [32.1].

more of one of their grocery stores) is acquiring from relevant suppliers, and that would not change as a result of the Proposed Merger.[151]

154. Some suppliers of fresh produce or products that are fragile or perishable with a short shelf life (eg, salad greens) may only be able to supply products to customers within a local or regional market on one island, due to relatively high costs associated with transporting such products over longer distances (including across the Cook Strait). In general, competition in local or regional acquisition markets is unlikely to be affected by the Proposed Merger in a material way, as FSNI and FSSI are unlikely to be competing in the same market for the acquisition of these products. However, we note that some fresh produce is supplied nationally and transported between islands, depending on the circumstances.

155. In terms of the scope of regional and local markets for the wholesale supply of fresh produce, we consider there is not a one sized estimation of the approximate size of geographic markets that apply across all fresh produce products. The size of geographic markets for the acquisition of wholesale supply of fresh produce varies depending on product characteristics. We consider cool storage is needed to varying degrees for different types of products (eg, salad greens require cold storage whereas root crops do not), and not all types of produce are fully substitutable for each other (eg, a potato is not a substitute for a kiwifruit). This implies there is a degree of demand-side substitutability between fresh produce products in that grocery retailers vary the type of produce they buy on any given day depending on the quality, price, transportability and availability of produce, and what is being demanded by retail consumers.[152]

156. This is consistent with past merger clearance determinations, in which the Commission identified (or noted) that there were (or could be) distinct geographic markets for the wholesale supply of relevant products:

156.1 in 2020, the Commission considered that at its broadest, the relevant market for the wholesale supply of fresh produce is a national market for the wholesale supply of fresh produce in New Zealand. However, the Commission also noted there was evidence suggesting that there could be narrower markets for the supply of produce in discrete local areas, but did not reach a concluded view;[153]

156.2 in 2020, the Commission noted that, as eggs are relatively low value products, transport costs affect the distance over which egg producers can economically supply their products. The Commission noted that transport costs did not appear to significantly limit the movement of eggs throughout the North Island, but that the additional costs to transport eggs across the Cook Strait

151 SoPI cross submission from the Parties (7 March 2024) at [7.3].

152 Turners & Growers Fresh Limited and Freshmax NZ Limited [2020] NZCC 6 at [33].

153 Turners & Growers Fresh Limited and Freshmax NZ Limited [2020] NZCC 6 at [31].

(and the lack of inter-island volumes) indicated that a North Island market for the production and wholesale supply of eggs was appropriate;[154] and

156.3 in 2008, in relation to the wholesale supply of chicken, the Commission identified that there were separate North Island and South Island markets, for reasons including speed and security of supply when transporting product across the Cook Strait, and shelf life limitations with extended travel time.[155]

Customer dimensions of the relevant markets

157. Suppliers are often dependent on the major grocery retailers as their main channel to market for selling their products to retail consumers.[156] The Commission's first annual grocery report similarly noted that the major grocery retailers are a significant channel for suppliers' products to reach consumers.[157]

158. There are a range of alternative sales channels that suppliers may regard as being substitutable to the major grocery retailers, such as wholesalers, foodservice customers, direct to retail consumers, other domestic grocery retailers, and exports. However, the extent to which suppliers would be able to switch sufficient volume to alternative sale channels to defeat a SSNDP by one or more of the major grocery retailers depends on how easily a supplier can adapt its product for sale to those alternative channels, as well as the nature and extent of demand for its product by those alternative sales channels.

159. Our investigation of the Proposed Merger has found that for many grocery suppliers, the large proportion of demand that is aggregated through the major grocery retailers means alternative sales channels are unlikely to be regarded as close substitutes to the major grocery retailers. This view:

159.1 is based on interviews we have done with more than 50 different grocery suppliers, and responses to requests for information (RFIs) we have received from approximately 30 suppliers (many of whom were also interviewed), of either or both of the Parties as part of our investigation of the Proposed Merger; and

159.2 is consistent with the view expressed by the Food and Grocery Council, and the results of a survey of 70 of its members about the Proposed Merger.[158]

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154 Heyden Farms Limited, Henergy Cage-Free Limited and Rasmusens Poultry Farms Limited [2020] NZCC 19 at [30]-[35].

155 Tegel Foods Limited and Brinks Group of Companies (Commerce Commission Decision 658, 22 October 2008) at [186].

156 Market study final report (8 March 2022) at [8.50]. This statement in the market study report was based on a survey of 126 suppliers, and follow-up interviews with many of these suppliers, which indicated that without selling through the major grocery retailers, "the majority indicated that their business would be unsustainable, and they would be likely to exit the New Zealand market". Market study final report (8 March 2022) at [8.56].

157 First annual grocery report (4 September 2024) at 104.

158 SoPI submission from the Food and Grocery Council (19 February 2024).

160. This view is also informed by responses to voluntary RFIs received from a sample of suppliers as part of our investigation of the Proposed Merger, illustrated in Table 1.[159]

Table 1: Approximate proportion of suppliers' sales (%) by channel[160]

Supplier	Major grocery retailers	Other domestic supply (including other retail channels, foodservice etc)	Export
[ ]	98%	2%	0%
[ ]	96%	0%	4%
[ ][161]	94%	6%	0%
[ ]	88%	12%	0%
[ ]	86%	14%	0%
[ ]	81%	19%	0%
[ ]	79%	14%	7%
[ ]	74%	26%	0%
[ ]	71%	16%	13%
[ ]	62%	38%	0%
[ ]	60%	27%	13%
[ ]	56%	24%	20%
[ ]	55%	34%	11%
[ ]	54%	46%	0%
[ ]	53%	1%	46%
[ ][162]	46%	54%	0%
[ ]	45%	54%	1%
[ ]	43%	37%	20%
[ ]	35%	65%	0%
[ ]	33%	3%	64%
[ ]	32%	6%	62%
[ ]	32%	68%	0%
[ ]	28%	72%	0%
[ ]	26%	74%	0%
[ ]	15%	4%	82%
[ ][163]	5%	1%	94%

161. Table 1 represents the approximate proportion of suppliers' total sales (by percentage) that is supplied into the major grocery retailer channel (FSNI, FSSI and

159 It has not been practically feasible for us to independently verify all of the data in Table 1 by collecting purchase data from all buyers for these suppliers.

160 The percentages in Table 1 are based on recent 12 month periods, but these periods are not the same for all suppliers. All percentages are based on sales, with the exception of [ ] which is based on volume.

161 This supplier does not currently supply both Parties.

162 This supplier does not currently supply both Parties.

163 This supplier does not currently supply both Parties.

Woolworths), other domestic supply channels (other grocery retailers, foodservice, wholesale, direct to consumers) and exported (where relevant). The percentages in Table 1 do not necessarily provide an accurate reflection of the exact portion of a supplier's business that may be at risk with the Proposed Merger. This is because the major grocery retailers' column shows total supply to both Woolworths and the Parties. Further, for some suppliers, the total supply to the major grocery retailers may include both branded and private label supply. As noted below, we do not consider there would be any material change in how the Parties would acquire private label products with the Proposed Merger.

162. Table 1 instead illustrates the relative size of the major grocery retailer channel for these suppliers as compared to alternative sales channels. However, importantly, it does not suggest that the same products supplied by a supplier to one channel are substitutable with products they supply to other channels. As noted by Düsseldorf Competition Economics, the quality of outside alternatives (not just their existence) is important when thinking about bargaining positions and outcomes.[164] The attractiveness of alternative channels will depend on the specifics of the product and the sales channel. Different products may be supplied in domestic versus export markets, including due to differences in packaging/labelling requirements or general consumer preferences. In general, products supplied to foodservice customers are of pack sizes that are substantially larger than those stocked by grocery retailers.[165] Also, as an example, we have been told that the supply of eggs to retail and foodservice is different. Foodservice customers predominantly focus on value and price (the cost of production), whereas in retail quality differences (eg, free-range) is as important as value segments.[166]

163. The general proposition that there are particular wholesale supply markets where supply to different sales channels constitutes separate markets is consistent with past Commission determinations. For example:

163.1 in 2018, we identified distinct markets based on retail, foodservice and quick-service restaurant customers when defining wholesale sauce markets and noted this may arise where requirements for certain customers differ significantly – for example, foodservice typically requires either very large, or very small packaged goods for these sauces;[167]

163.2 in 2015, we identified markets in New Zealand for supply of lubricant to supermarkets, that was separate to the supply of lubricant to pharmacy wholesalers;[168] and

164 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [23].

165 Commerce Commission interviews with [ ] and [ ]. The Commission also noted in the market study that many foodservice wholesaler's products are "sold in formats that are suitable for foodservice but not retail grocery (eg, in bulk as opposed to packaged)". Market study final report (8 March 2022) at [6.140.1].

166 Commerce Commission interview with [ ].

167 H.J. Heinz Company (New Zealand) Limited and Cerebos Pacific Limited [2018] NZCC 2 at [52]-[54].

168 Reckitt Benckiser Group Plc and Johnson and Johnson [2015] NZCC 12 at [X4].

163.3 in 2008, we identified different markets based on discrete customer groups, including independent or smaller grocery retailers (including petrol stations and convenience stores), foodservice customers, and quick-service restaurant customers when dealing with the wholesale supply of chicken. Reasons included the large volumes of chicken products that grocery retailers require, the very precise specifications of products required by quick-service restaurants, and the relative fragmentation of foodservice customers.[169]

164. There are other alternative channels (including through foodservice, export or direct selling online) available for some suppliers. Specifically, there are likely relevant acquisition markets in which alternative types of customers or sales channels are substitutable with supply to the major grocery retailers, such as, for example, for certain types of beverages, or for confectionery products – where convenience stores may account for significant proportions of sales volumes of suppliers (albeit still less than through the major grocery retailers).

165. Other retail customer channels relevant to our assessment include other grocery retailers such as:

165.1 **The Warehouse** – which has recently expanded its grocery range but offers a significantly narrower range of products than the major grocery retailers. The Warehouse has been public about its difficulties accessing the goods it needs to expand and compete at competitive prices.[170] The Food and Grocery Council submits that The Warehouse is too small to have a significant impact or provide a viable alternative for suppliers to the major grocery retailers.[171] Suppliers of different products that we have spoken with noted The Warehouse stocks a more limited range with one of these suppliers also noting that The Warehouse tends to focus on value products;[172]

165.2 **Costco** – Costco offers a narrower range of products than the major grocery retailers, many of which are in large wholesale quantities.[173] The Food and Grocery Council submits that Costco, like The Warehouse, is too small to have a significant impact or provide a viable alternative to major grocery retailers;[174]

165.3 **other grocery retailers** – there are a small number of other grocery retailers in the retail grocery sector. For example, Bin Inn (a bulk and wholefoods

169 Tegel Foods Limited and Brinks Group of Companies (Commerce Commission Decision 658, 22 October 2008) at [113].

170 RNZ "Two major operators still stifling competition in grocery sector, The Warehouse says" (24 March 2023), https://www.rnz.co.nz/news/business/486611/two-major-operators-still-stifling-competition-in-grocery-sector-the-warehouse-says. The Warehouse is part of The Warehouse Group which also owns Warehouse Stationery and Noel Leeming, but it is only The Warehouse stores that sell grocery products.

171 SoI submission from the Food and Grocery Council at [13.4].

172 Commerce Commission interviews with [ ] and [ ].

173 For instance, it has been reported that a typical Costco carries 4,000 stock keeping units compared to the 20,000 stock keeping units found at a store of the Parties. Costco Wholesale "2023 annual report" (7 December 2023) at 5.

174 SoI submission from the Food and Grocery Council (26 April 2024) at [13.4].

grocery retailer), Commonsense Organics (an organic food retailer with five stores in Auckland and Wellington), Reduced to Clear (a clearance/discounter retailer), Farro Fresh, (a premium grocery retailer with seven (soon to be eight)[175] stores in Auckland) and Paddock to Pantry (a primarily online premium grocery store with one store near Auckland).[176] These account for a marginal proportion of grocery acquisitions;

165.4 **convenience retailers** – these are focussed on top-up shopping missions and snacks, drinks and convenience foods, such as dairies and petrol stations; and

165.5 **single category retailers** – retailers that specialise in particular product categories such as greengrocers, butchers, bakeries, pet stores, and pharmacies. For example, Chemist Warehouse, which provides a variety of pharmacy and health and beauty products at over 50 stores nationwide.

166. Other channels include:

166.1 **foodservice wholesalers** – who primarily serve wholesale customers such as cafes, restaurants, hotels, prisons, and charities. These customers often procure products in different pack and quantity sizes to grocery retailers; and

166.2 **export** – we understand that for many domestic manufacturers of meat, fish, dairy products and wine, export markets can represent an important segment of their business. Again, the impact of the Proposed Merger on competition in products supplied by these suppliers would vary according to a supplier's ability to substitute domestic supply with export.

167. However, for the reasons summarised below, these alternative sales channels do not appear to be close substitutes to the major grocery retailers for suppliers in the relevant acquisition market categories we have identified for the purposes of assessing the Proposed Merger (other than for some suppliers of fresh produce).[177]

<u>Evidence received from agencies or bodies that represent suppliers/distributors</u>

168. The New Zealand Specialist Cheesemakers Association submits that there are unique specification demands from grocery retailers which make moving the same products to other channels non-viable.[178]

169. Agencies that represent suppliers and/or distributors of grocery products indicated that although they/their members supply some volume into alternative sales channels such as pharmacies, The Warehouse, Costco, convenience stores, petrol

175 https://www.nzherald.co.nz/lifestyle/farro-fresh-to-open-new-boutique-supermarket-in-aucklands-commercial-bay/ZKQSWSB43ZF6XIQLAQRCY6RS6M/.

176 Other grocery retailers in this sector include Moore Wilson's (also a specialist grocery retailer operating in the Wellington region) and the recently opened Foodie (an Asian supermarket operating in West Auckland) https://www.nzherald.co.nz/business/vast-new-foodie-asian-supermarket-opening-at-aucklands-westgate-this-thursday/USKHIFGATJCCTAH2RI7L5MGSIA/.

177 Many suppliers would cross over different product categories. For simplicity, we have only included such suppliers' views in one place here.

178 SoUI submission from the New Zealand Specialist Cheesemakers Association (12 August 2024) at 6.

stations and export,[179] the major grocery retailers account for the majority of sales volume.[180] This implies that suppliers and distributors of grocery products are unlikely to view alternative sales channels as close substitutes to the major grocery retailers.

170. Specifically, these agencies consider that the importance of scale advantages of the major grocery retailers to suppliers means that it would be difficult to find alternative sales channels with sufficient scale to meet minimum order or volume requirements. For example, one agency noted that when a product is delisted from (for example) FSNI, it would be difficult to recoup that lost volume. It would try to find alternative distribution, but this involves having to create new customers to make up the volume, which is difficult to do in the short term.[181]

171. One agency also told us that a lot of large businesses have the benefit of export to Australia. However smaller businesses without that luxury may end up deleting lines if they cannot get enough scale through the major grocery retailers.[182]

172. Some of these agencies also emphasised the importance of the major grocery retailers to suppliers as a route to market for new products. For example, one distributor noted that it needs Woolworths or FSNI on board with any new products because “that’s where the majority of the volume sits”.[183] Another agency considers that the Proposed Merger removes a “path to the mass market” that suppliers (particularly smaller suppliers) need for their products to become volume-wise affordable to produce.[184]

Evidence from suppliers of dry/ambient products

173. The Parties are of the view that suppliers of products within the dry/ambient goods category have a diversity of sales channels that provides suppliers with viable alternatives if a major grocery retailer attempts to negotiate unfavourable terms. Below we summarise their submissions specific to products in this category.

173.1 **Salad dressing, vinegar, pickles and relishes:** Suppliers in this category have access to various sales channels beyond the major grocery retailers, including

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179 Commerce Commission interviews with [ ], [ ] and [ ].

180 For example, one agency noted that [ ]% of its suppliers’ sales are with the major grocery retailers, with the remainder being sales to The Warehouse and other route trade customers. Commerce Commission interview with [ ]. Another agency noted that the major grocery retailers drive [ ]% of revenue. Commerce Commission interview with [ ].

181 Commerce Commission interview with [ ]. In our view, this shows that it can be difficult for suppliers to quickly and easily divert volume following a delisting, which could be exacerbated by the Proposed Merger if a supplier was delisted on a national basis by the merged entity and had to try to divert that volume elsewhere.

182 Commerce Commission interview with [ ].

183 Commerce Commission interview with [ ].

184 This agency also that advised that large grocery suppliers are looking for alternatives to grow (eg, alternative channels/retailers), but do not want to risk annoying the major grocery retailers (who drive [ ]% of revenue) by supplying other grocery retailers like Costco and The Warehouse, particularly given they are currently minuscule grocery retailers. Commerce Commission interview with [ ].

organised convenience channels, foodservice, other grocery retailers such as Costco and The Warehouse, farmers markets and meal kit providers.[185]

173.2 **Cooking sauces and marinades:** There is a strong presence of multinational suppliers in this category that have numerous alternatives to the Parties.[186] Alternative retail sales channels include Woolworths, SuperValue, other grocery retailers such as Costco and The Warehouse, convenience stores, Asian grocers, foodservice, hospitality, hotels and wholesalers.[187]

173.3 **Mexican:** Alternative sales channels include Woolworths, Fresh Choice, SuperValue, local grocery retailers, The Warehouse, wholesalers and food manufacturers.[188]

173.4 **Breakfast:** Multinational suppliers of breakfast products have numerous alternative buyers of their products in New Zealand, Australia and other export markets in the Asia Pacific.[189] Larger and medium sized national suppliers have various alternative channels in addition to the major grocery retailers, such as The Warehouse, convenience stores, foodservice, Costco, and wholesalers.[190]

173.5 **Cleaning:** Alternative sales channels include other grocery retailers, Bunnings, Mitre 10, Chemist Warehouse, The Warehouse and significant purchasers of cleaning products.[191]

173.6 **Spreads:** Multinational suppliers of spreads such as [ ] have numerous alternative sales channels in New Zealand, Australia and other export markets in the Asia Pacific.[192] Suppliers in this segment also have access to various other sales channels beyond the major grocery retailers, including diaries, service stations, foodservice, food manufacturers, other grocery retailers such as Costco, Farro and The Warehouse, health shops (in relation to honey specifically) and convenience stores.[193]

173.7 **Paper goods:** Alternative sales channels include Woolworths, other grocery retailers such as The Warehouse, Costco, diaries and Farro Fresh, Bargain Chemist, Chemist Warehouse, Mitre 10 and Bunnings.[194]

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185 SoUI submission from the Parties (13 August 2024) at Appendix 2 at [6.4] and SoUI submission from the Parties (13 August 2024) at Appendix 2 at 3.

186 SoUI submission from the Parties (13 August 2024) at Appendix 3 at [15.1].

187 SoUI submission from the Parties (13 August 2024) at Appendix 3 at 8.

188 SoUI submission from the Parties (13 August 2024) at Appendix 4 at 12-13.

189 SoUI submission from the Parties (13 August 2024) at Appendix 5 at [27].

190 SoUI submission from the Parties (13 August 2024) at Appendix 5 at [28] and SoUI submission from the Parties (13 August 2024) at Appendix 5 at 17-18.

191 SoUI submission from the Parties (13 August 2024) at Appendix 6 at 23.

192 SoUI submission from the Parties (13 August 2024) at Appendix 7 at [49].

193 SoUI submission from the Parties (13 August 2024) at Appendix 7 at [50.3] and SoUI submission from the Parties (13 August 2024) at Appendix 7 at 27.

194 SoUI cross submission from the Parties (26 August 2024) at Appendix 3 at 2-3.

173.8 **Dishwashing products:** Alternative sales channels include Woolworths, The Warehouse, Costco, Bargain Chemist, Chemist Warehouse, Mitre 10, Bunnings and other grocery retailers such as dairies and Farro Fresh.[195]

173.9 **Laundry:** Alternative sales channels include Woolworths, the Warehouse, Costco, Bunnings, Mitre 10, pharmacies (including Chemist Warehouse and Bargain Chemist), other grocery retailers such as dairies and specialist retailers (including Bin Inn and Bulk Barn).[196]

174. Several suppliers of dry/ambient grocery products indicated that the major grocery retailers account for the majority of their sales volumes and revenues.[197] Suppliers also indicated that there is limited scope to switch to alternative sales channels, such as foodservice and export.[198] Although one supplier indicated it could divert supply from retail to its commercial arm, this would be dependent on capacity and price.[199] We consider this would not be a viable option for most suppliers of dry/ambient grocery products.

175. For example, one supplier told us that if the merged entity's buyer power led to the Parties wanting better terms, the supplier could look to alternative channels out of survival. However, it noted that foodservice would be unlikely to replace the volume from the merged entity, and neither would export, especially in the time it takes to arrange it (given once delisted, a supplier would have a very short time to survive).[200] Another supplier told us that the "overwhelming majority" of its revenue in New Zealand comes from the major grocery retailers, and a product de-listed by FSNI would often trigger a conversation as to whether [ ].[201]

176. There appears to be some differences between suppliers of dry/ambient products regarding alternative sales channels options to the major grocery retailers, depending on the size of the supplier and grocery product in question. Specifically, some suppliers indicated that export may be a viable alternative to supplying the major grocery retailers.[202] However, one supplier noted that while it considers export to be a relatively large alternative channel, it does not consider it could divert

195 SoUI cross submission from the Parties (26 August 2024) at Appendix 4 at 7.

196 SoUI cross submission from the Parties (26 August 2024) at Appendix 5 at 12.

197 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], and [ ].

198 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ] and [ ].

199 Commerce Commission interview with [ ].

200 Commerce Commission interview with [ ].

201 Commerce Commission interview with [ ]. Another supplier also told us that if a product was de-listed by one of the Parties, it would look to reduce volumes into that island or to divert volumes to other channels in that island. Commerce Commission interview with [ ].

202 Commerce Commission interviews with [ ] and [ ].

volume from the grocery channel to export.[203] Another supplier told us that it supplies its product through three channels: retail, e-commerce and foodservice/hospitality. The supplier said [ ]% went through retail. It noted that it previously lost sales to FSNI but did not notice initially because its foodservice picked up at the same time. That said, it also told us that its volumes in FSSI are also starting to decrease and it is only at [ ]% volume of what it used to be. The supplier believed it could grow online sales.[204]

177. Overall, we consider the evidence suggests that alternative sales channels to the major grocery retailers are not close substitutes to most suppliers of dry/ambient grocery products. It is not the mere existence of alternative sales channels that are relevant to our assessment, but rather whether suppliers to the Parties would be able to quickly and easily switch significant volumes to those alternative channels in order to defeat a SSNDP by the Parties. Whilst export may be a viable alternative to some larger suppliers, sales channels such as foodservice and other grocery retailers are generally perceived to be of insufficient scale to provide a viable alternative to these suppliers.[205]

<u>Evidence from suppliers of chilled or frozen products</u>

178. The Parties are of the view that suppliers of products within the chilled or frozen goods category have numerous alternative sales channels to the Parties. Below we summarise their submissions specific to products in this category.

178.1 **Frozen fish:** Alternative sales channels include Woolworths, Costco, independent retailers, convenience stores and wholesalers.[206]

178.2 **Chilled fresh sauces:** Alternative sales channels include Woolworths, Farro Fresh, Asian stores, wholesalers, convenience stores, foodservice, meal kit providers and hospitality.[207]

178.3 **Frozen berries:** Alternative sales channels include Woolworths, other grocery retailers, specialist retailers, convenience stores, foodservice, hospitality and wholesalers.[208]

178.4 **Ice cream:** Alternative sales channels include other grocery retailers, convenience stores, foodservice, cafes and wholesalers.[209]

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203 It explained that "it's certainly not a case of if it's getting tricky in New Zealand you just divert to Australia, I don't think there's any New Zealand food manufacturers who would say that". It also noted "On the surface, it seems very obvious and simple, but it's not". Commerce Commission interview with [ ].

204 Commerce Commission interview with [ ].

205 Commerce Commission interviews with [ ], [ ], [ ] and [ ].

206 SoUI submission from the Parties (13 August 2024) at Appendix 8 at 32.

207 SoUI submission from the Parties (13 August 2024) at Appendix 9 at 36.

208 SoUI submission from the Parties (13 August 2024) at Appendix 10 at 39.

209 SoUI submission from the Parties (13 August 2024) at Appendix 11 at 43.

178.5 **Frozen poultry:** Alternative sales channels include other grocery retailers, convenience stores, foodservice, hospitality, wholesalers, butcheries and meal kit providers.[210]

178.6 **Speciality cheese:** Alternative sales channels include Woolworths, specialist retailers, independent grocers, delicatessens, foodservice, hospitality and wholesalers.[211]

179. The New Zealand Specialist Cheesemakers Association submits that specialty cheese makers do not have any alternative retail channel with equivalent consumer reach to the major grocery retailers,[212] and for smaller members of The New Zealand Specialist Cheesemakers Association export is not a viable alternative to New Zealand retail (ie, because of the direct logistical and market establishment costs for the volume they produce, and food safety compliance standards required by the Ministry for Primary Industries (MPI) to permit export outside Australia are beyond the resources of most smaller cheesemakers to sustain).[213]

180. Most suppliers of chilled or frozen products indicated that the major grocery retailers account for the majority of domestic sales volumes, with the remaining volume to foodservice or export channels.[214] For example, one supplier told us that if it lost volume with the merged entity, it could not redirect that volume elsewhere in the domestic market – there would be nowhere for that volume to go, and that this scenario would be true for most suppliers that supply FSNI.[215]

181. One supplier indicated that around [ ]% of its turnover was with supermarkets and [ ]% to foodservice. However, it indicated that that the products it supplies foodservice and the Parties are not readily interchangeable, in that the products to foodservice are supplied in bulk, and the products supplied to the Parties have "supermarket retail-ready presentation" which requires a lot of investment.[216] Another supplier told us there may be some difference in the products between channels such as [ ].[217] We consider this implies that substitutability between other sales channels and major grocery retailer channels may not be a viable option for most suppliers of chilled and frozen products.

210 SoUI submission from the Parties (13 August 2024) at Appendix 12 at 48.

211 SoUI cross submission from the Parties (26 August 2024) at Appendix 6 at 18.

212 The Parties have a contrasting view and submit that there are many other buyers of speciality cheese beyond the grocery retailers, including speciality retailers, independent grocery retailers, hospitality and wholesalers. The Parties further state that they understand that these other channels are typically a significant contributor to suppliers' overall sales in this category. SoUI cross-submission from the Parties (26 August 2024) at 10.

213 SoUI submission from the New Zealand Specialist Cheesemakers Association (12 August 2024) at 6.

214 Commerce Commission interviews with [ ], [ ], [ ], and [ ].

215 The supplier further noted that it is "not going to all of a sudden start shipping [ ] to Australia". Commerce Commission interview with [ ].

216 Commerce Commission interview with [ ].

217 Commerce Commission interview with [ ].

182. We note that one supplier told us that it is predominantly an export business and that it considers it could easily divert volume from domestic to export.[218] However, the extent to which export would be considered a close substitute to the major grocery retailer sales channel for most other suppliers of chilled or frozen products is unclear.

183. We consider the evidence suggests that alternative sales channels to the major grocery retailers are not close substitutes to most suppliers of chilled and frozen goods. Whilst foodservice and export may be viable alternatives to some suppliers of chilled or frozen products, the extent to which most suppliers would be able to quickly and easily divert sufficient volumes to these channels in the event of a SSNDP by the Parties appear to vary significantly depending on the nature of the product and supplier size.

<u>Evidence from suppliers of health and beauty products</u>

184. The Parties are of the view that suppliers of products within the health and beauty category have numerous alternative sales channels to the Parties. Below we summarise their submissions specific to products in this category.

   184.1 **Personal wash:** Global suppliers such as [ ] have countless alternatives to the Parties.[219] Alternative sales channels include other grocery retailers (eg, Woolworths and Costco), large pharmacy chains (eg, Chemist Warehouse and Bargain Chemist), other pharmacies, other retailers (eg, The Warehouse, Kmart, Mitre 10), convenience stores, and potentially wholesalers.[220]

   184.2 **Oral care:** There are large number of alternative sales channels to the Parties, including other retailers (eg, The Warehouse, Kmart, Costco), pharmacies, dairies, dental practices, appliance stores (in relation to electric toothbrushes and accessories), Woolworths, other grocery retailers and convenience stores.[221]

185. We consider the evidence from suppliers of health and beauty products on the extent of substitutability between the major grocery retailers and alternative supply channels is mixed.

186. Some suppliers indicated that the major grocery retailers account for the majority of domestic sales.[222] For example, one supplier advised that the major grocery retailers account for [ ]% of its business. While it supplies other retailers such as [ ] in addition to the major grocery retailers, [ ] is still "very small" in terms of sales, with [ ] making up even less of its sales.[223]

218 Commerce Commission interview with [ ].

219 SoUI submission from the Parties (13 August 2024) at Appendix 13 at [89.2].

220 SoUI submission from the Parties (13 August 2024) at Appendix 13 at [52].

221 SoUI cross submission from the Parties (26 August 2024) at Appendix 7 at [38] and SoUI cross submission from the Parties (26 August 2024) at Appendix 7 at 23.

222 Commerce Commission interviews with [ ], [ ] and [ ] and e-mail from [ ] to the Commerce Commission (10 September 2024).

223 Commerce Commission interview with [ ].

Similarly, another supplier told us that supermarkets make up the majority (~[ ]%) of its New Zealand sales, and while it can export to Australia, it is harder to export internationally because of regulations. It noted if its range was impacted as a result of the Proposed Merger, it would have to consider its long-term viability of those products and it would have a huge impact.[224] One supplier also noted that it exports around [ ] of its products to Australia but did not consider there was much opportunity to export outside of that.[225]

187. Other suppliers consider that customers such as Costco and Chemist Warehouse are viable alternatives to the major grocery retailer channel.[226] For example, one supplier advised that all of its product is sold [ ] through the major grocery retailers and pharmacies (with a different product mix in each channel). This supplier considers it could divert volume from grocery segment to the pharmacy segment.[227]

188. We consider it is likely possible for most suppliers of health and beauty products to substitute between the major grocery retailers and other customer channels (including pharmacies such as Chemist Warehouse). However, the extent to which suppliers would be able to quickly and easily switch sufficient volumes to alternative customer channels to defeat a SSNDP is unclear.

<u>Evidence from suppliers of beverages</u>

189. The Parties are of the view that suppliers of cold beverages have numerous alternative sales channels to the Parties, including Woolworths, Fresh Choice, Farro Fresh, convenience stores, Tai Ping, The Warehouse, Kmart, Mitre 10, Bunnings, local retailers, Farmers, foodservice, wholesalers and hospitality.[228]

190. Suppliers of beverages indicated that the major grocery retailers account for the majority of their sales revenue. For example, one supplier explained to us that the Parties are the "primary source" of business for it and the easiest entry point to gain relevance for suppliers. It noted that only once a supplier shows consistent performance in supermarkets would other channels such as petrol stations and convenience stores take interest.[229]

191. The general importance of the grocery retailing channel to beverage suppliers is further illustrated through a supplier indicating that over [ ] of its products are sold through grocery retailers and that the Parties are important customers.[230] Another

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224 As noted elsewhere, this supplier also advised us that it recently had to cut production because it could not afford to sell at FSNI's desired price and also told us that following a ranging decision in FSNI for [ ] in which it participates, it "would have [had] to exit" those categories, had it not been ranged in FSSI. Commerce Commission interview with [ ] and e-mail from [ ] to the Commerce Commission (10 September 2024).

225 The supplier stated that if the merged entity was to seek a better price, it would be inclined to say "yes". Commerce Commission interview with [ ].

226 Commerce Commission interviews with [ ], [ ] and [ ].

227 Commerce Commission interview with [ ].

228 SoUI submission from the Parties (13 August 2024) at Appendix 14 at 58.

229 Commerce Commission interview with [ ].

230 Commerce Commission interview with [ ].

supplier also told us that it would not be feasible to divert supply from grocery retailing to alternative supply channels.[231]

192. We consider it is likely possible for most suppliers of beverages to substitute between the major grocery retailers and other customer channels (including convenience retailers and foodservice). However, the extent to which suppliers would be able to quickly and easily switch sufficient volumes to alternative customer channels to defeat a SSNDP is unclear.[232]

Evidence from suppliers of snack products

193. The Parties are of the view that suppliers of snack products have numerous alternative sales channels to the Parties. Below we summarise their submissions specific to products in this category.

   193.1 **Confectionary:** Global suppliers such as [ ] would have countless alternatives to the Parties.[233] The largest New Zealand supplier [ ] exports products and other domestic suppliers may also export products overseas.[234] Alternative sales channels in addition to the major grocery retailers include convenience stores, service stations, retailers such as Kmart and The Warehouse, independent retailers/gift stores, Mitre 10, Bunnings and wholesalers.[235]

   193.2 **Nuts and snacking food:** The Parties consider that “suppliers have access to more alternative buyers than retailers have access to alternative suppliers”.[236] Alternative sales channels include Woolworths, independent retailers, service stations, non-food retailers and wholesalers.[237]

194. Some suppliers of snack products indicated that although they supply to alternative sales channels such as foodservice, convenience stores and export, the major grocery retailers are key to ensuring their commercial viability in New Zealand.[238] For example, one supplier told us that, while it exports and supplies customers such as petrol stations, it could not survive as a supplier without supermarkets.[239] Another supplier (who also supplies other channels such as other retailers and convenience stores) advised that its product getting de-listed in a major grocery retailer would mean it needs to make a commercial decision whether that product remains viable across the whole of New Zealand.[240]

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231 Commerce Commission interview with [ ].
232 Commerce Commission interview with [ ].
233 SoUI submission from the Parties (13 August 2024) at Appendix 15 at [104.1].
234 SoUI submission from the Parties (13 August 2024) at Appendix 15 at 64.
235 SoUI submission from the Parties (13 August 2024) at Appendix 15 at [104.3(b)].
236 SoUI submission from the Parties (13 August 2024) at Appendix 16 at [109].
237 SoUI submission from the Parties (13 August 2024) at Appendix 16 at 70.
238 Commerce Commission interviews with [ ] and [ ].
239 Commerce Commission interview with [ ].
240 Commerce Commission interview with [ ].

195. Two suppliers consider that increasing export sales would be a viable alternative to the major grocery retailers.[241] For example, one supplier told us that it supplies approximately [ ] between foodservice and retail (with some export). However, it does not consider it could divert any lost volume from the merged entity in New Zealand as it is too small but would to look to Australia for volume.[242]

196. We consider it is likely possible for most suppliers of snack products to substitute between the major grocery retailers and other customer channels (including convenience retailers, foodservice and export). However, the extent to which suppliers would be able to quickly and easily switch sufficient volumes to alternative customer channels to defeat a SSNDP is unclear.[243]

<u>Evidence from suppliers of meat and seafood products</u>

197. The Parties are of the view that suppliers of meat and seafood products have numerous alternative sales channels to the Parties, including butchers, fishmongers, quick service retailers, foodservice, wholesalers, meal kit providers and retail direct to consumers (Including Alliance and Neat Meat).[244] They are also of the view that international importers of pork such as Farmlands Mathesis (a broker) would have "countless alternatives" to the Parties.[245]

198. Suppliers of meat and seafood products indicated that they sell products into multiple domestic sales channels, including the major grocery retailers, foodservice, direct to retail and other grocery retailers.[246]

199. Two suppliers also noted that they export some of their products.[247] However, one of these suppliers indicated that although the majority of its business is export, [ ].[248]

200. One supplier noted that although it is "reasonably" big in foodservice and have options outside of grocery retailers, it "wouldn't like the supermarkets to disappear overnight obviously".[249] Another supplier advised that it supplies a range of retailers (that account for [ ]% of its sales, with the remainder foodservice and export. It advised that it is trying to grow its export business but that its priority is to supply the domestic market, with export being incremental to that. It has

241 Commerce Commission interviews with [ ] and [ ].
242 This supplier also noted it deals with Costco in small volumes, and while it is always open to new players, currently the opportunity is not as big as with the major grocery retailers. Commerce Commission interview with [ ].
243 Commerce Commission interview with [ ].
244 SoUI submission from the Parties (13 August 2024) at Appendix 17 at 75-76.
245 SoUI submission from the Parties (13 August 2024) at Appendix 17 at [119.1].
246 Commerce Commission interviews with [ ], [ ], [ ] and [ ].
247 Commerce Commission interviews with [ ] and [ ].
248 Commerce Commission interview with [ ].
249 Commerce Commission interview with [ ].

[ ].[250]

201. We consider it is likely possible for most suppliers of meat and seafood products to substitute between the major grocery retailers and other customer channels (including other grocery retailers, foodservice and export). However, the extent to which suppliers would be able to quickly and easily switch sufficient volumes to alternative customer channels to defeat a SSNDP is unclear.

Evidence from suppliers of beer and wine products

202. The Parties are of the view that suppliers of beer and wine have numerous alternative sales channels to the Parties. Below we summarise their submissions specific to products in this category.

202.1 **Wine:** International suppliers would have "countless alternatives" to the merged entity.[251] Alternative sales channels for domestic suppliers include other grocery retailers, liquor stores, wholesalers and hospitality.[252]

202.2 **Beer and cider:** Alternative sales channels include other grocery retailers, liquor stores, wholesalers and hospitality.[253]

203. Two suppliers of alcoholic beverages indicated that they sell products into multiple sales channels, including grocery retail, specialist liquor, hospitality and export.[254]

204. One supplier advised that while it does export, it is difficult to move volume from the domestic market to export market and there are not "massive channels to sell additional volumes through" because demand needs to be built up over time. It takes a long time to establish an export market.[255]

205. We consider it is likely possible for most suppliers of beer and wine products to substitute between the major grocery retailers and other customer channels (including hospitality, specialist liquor and export). However, the extent to which suppliers would be able to quickly and easily switch sufficient volumes to alternative customer channels to defeat a SSNDP is unclear.

Evidence from suppliers of fresh produce

206. There is a large variety of fresh produce products in New Zealand. These products have different characteristics, which impacts the extent to which suppliers would consider alternative sales channels as close substitutes to the major grocery retailers. For example, suppliers of perishable or fragile products would likely have

[250] Commerce Commission interview with [ ].
[251] SoUI submission from the Parties (13 August 2024) at Appendix 19 at [135.5].
[252] SoUI submission from the Parties (13 August 2024) at Appendix 19 at 84-85.
[253] SoUI submission from the Parties (13 August 2024) at Appendix 18 at 81.
[254] Commerce Commission interviews with [ ] and [ ].
[255] Commerce Commission interview with [ ].

fewer alternative options than suppliers of fresh produce products that can be transported over longer distances.

207. Woolworths considers (and the Parties agree)[256] that producers and growers of fresh fruit and vegetables have significant options/alternative channels (eg, central markets, direct to customers, export, foodservice, food processors and meal kits), noting that export is the biggest market for many farmers and growers, while local consumer markets constitute a small proportion of their supply.[257] This is consistent with a view shared by one supplier of fresh produce that indicated they tend to go about seeking the best return for their product.[258]

208. However, we have also received information from fresh produce suppliers that the major grocery retailers account for the majority of their domestic sales volume and revenue.[259] For example, one supplier told us that while it does currently supply parties outside of the major grocery retailers (eg, wholesale produce markets), approximately [ ]% of its produce is supplied through the major grocery retailers, and having FSNI and FSSI as separate entities gives suppliers a separate option through which to supply product into.[260]

209. Another supplier noted that it has all of its infrastructure geared up to look after supermarkets, such that the Parties could put them out of business. Further, while also acknowledging the Proposed Merger could make it easier to supply its product, it noted that, if the merged entity decided to only go with two suppliers, then it would be "in trouble". They also indicated that they would not be able to build a relationship with [ ].[261]

210. The foodservice channel appears to be a viable option for some fresh produce suppliers. For example, one supplier told us that it supplies both the major grocery retailers and foodservice customers.[262] Another supplier told us that more than [ ]

256 SoUI submission from the Parties (13 August 2024) at 90 and Appendix 20 at 62.
257 Woolworths RFI response (17 April 2024) at document WW.010.0002 at 1.
258 Commission interview with [ ].
259 Commerce Commission interviews with [ ], [ ], [ ], [ ] and [ ].
260 Commerce Commission interview with [ ]. In particular, this fresh produce supplier indicated that currently, it could, say, not supply FSNI for a period, and instead supply FSSI, depending on what the markets are doing at the time. However, with the Proposed Merger, having only one entity might lead to a "take it or leave it" scenario. This supplier also highlighted the position of fresh produce in the grocery market, noting in categories such as meat, dairy, fish, bread and any other manufactured products, a supplier can "turn off" supply and choose not to sell their product, however this is not the case in fresh produce where growing time and weather have an impact and that produce has to be sold, or ploughed but that essentially, without the major grocery retailers, it would have nowhere to go.
261 Commerce Commission interview with [ ].
262 Commerce Commission interview with [ ].

of its revenue is derived from [ ], with the remainder made up of independent customers, other retailers and foodservice customers.[263]

211. Similarly, export appears to be an alternative option to some fresh produce suppliers.[264] However, one supplier told us that while export is a meaningful channel for it, it is not easy to divert from domestic supply to export because of differences in [ ]. [ ] that cannot be sold are diverted to [ ].[265] Another supplier told us it has not exported much of its product recently, but generally considers export is not lucrative because its product can be produced more cheaply in Australia (due to [ ]).[266]

212. We consider that even for suppliers that could divert some or all of their product to other channels such as export or foodservice, it may be difficult for those suppliers to do so quickly and easily if desired or required (eg, if such suppliers wanted to diversify their customer base or, post-merger, those suppliers were receiving worse terms than previously, or were no longer ranged with the merged entity). For example, one supplier told us that its whole business is catered towards the major grocery retailers, and it would be very difficult to move to foodservice.[267]

<u>Conclusion</u>

213. The viability of alternative sales channels for suppliers across different product categories varies according to the individual supplier's size and type of products produced. The evidence suggest that alternative sales channels are unlikely to be close substitutes to the Parties for many suppliers. It is unlikely that suppliers either can, or would be able to, quickly and easily divert a sufficiently large proportion of their sales volume to alternative sales channels in order to defeat an exercise of buyer power by the merged entity.

Relevant markets to assess the effect of the Proposed Merger

214. As noted above, our view is that, due to the large number of relevant markets for the acquisition of grocery products, in order to assess the competitive effects of the Proposed Merger, it is necessary to aggregate across similar markets, or classes of similar markets. We consider this is a common-sense approach that enables us to isolate the likely competition issues that may arise from the Proposed Merger, without needing to precisely define and analyse every single individual grocery acquisition market that may exist.

215. In this section we set out the categories of relevant markets for the acquisition of grocery products that are likely to be affected by the Proposed Merger. We set out general propositions in relation to the dimensions of markets in each category, but note that due to the diversity of products, there are likely to be exceptions to all

263 Commerce Commission interview with [ ].
264 Commerce Commission interview with [ ].
265 Commerce Commission interview with [ ].
266 Commerce Commission interview with [ ].
267 Commerce Commission interview with [ ].

propositions. We set this out for each category of acquisition markets that we are considering in Table 2, with further detail on fresh produce following Table 2.

216. In formulating the categories of acquisition markets set out in Table 2, we have:

216.1 had regard to the definition of groceries in the GICA, which defines groceries as goods in any of eleven product categories. These product categories being:[268]

216.1.1 fresh produce (eg, fruit, vegetables and mushrooms);

216.1.2 meat, seafood or meat substitutes;

216.1.3 dairy products (eg, milk, cheese and butter);

216.1.4 bakery products;

216.1.5 chilled or frozen food;

216.1.6 pantry or dry goods (eg, eggs);

216.1.7 manufacturer-packaged food;

216.1.8 non-alcoholic drinks;

216.1.9 personal care produces (eg, toiletries and non-prescription medicine);

216.1.10 pet care products (eg, pet food); and

216.1.11 household consumables (eg, cleaning, laundry and stationery products);

216.2 noted that the Commission has in previous work similarly grouped grocery products into product categories, by:[269]

216.2.1 grouping together products sold by grocery retailers that are of a similar type;

216.2.2 assessing dry groceries (non-perishable food products like rice, pasta and canned products, and certain non-food products like toilet paper) separately to perishable products (eg, baked items, dairy, deli, meat, and fresh fruit and vegetables);

216.2.3 referring to distinct product categories (eg, alcohol, dairy, meat, fresh produce, frozen products, health and beauty, baby, household cleaning, confectionary, pet food and general grocery); and

216.2.4 surveying suppliers on specific categories;

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268 The GICA at s 5.

269 Market study final report (8 March 2022) at 10-11, [2.44], [2.57.1], [5.41], [5.43], Figure F1 and 597.

216.3 recognised that, between categories of acquisition markets, there are differences in:

216.3.1 the extent of alternative channels available to suppliers beyond the major grocery retailers; and

216.3.2 other market dynamics that may impact on supply chain logistics and the geographic scope within which products are supplied; and

216.4 the ways in which the Parties themselves categorise grocery products.[270]

217. We have sought to define categories of acquisition markets that would best isolate the competitive effects of the Proposed Merger. For completeness, we note that the categories of acquisition markets set out in Table 2, are not themselves acquisition markets.

270 On the Parties' retail websites for New World and PAK'nSAVE, products are grouped under headings of fresh foods and bakery (which comprises produce, meat, seafood, dairy, eggs, meal kits, delicatessen and bulk/loose foods); chilled, frozen and desserts; pantry; drinks (both hot drinks and cold drinks); beer, cider and wine; personal care (which comprises beauty and grooming, plus health and wellness); baby, toddler and kids; quick and easy meals/meal spot; kitchen, dining and household (which includes cleaning and laundry); and pets.
[
]

Table 2: Categories of acquisition markets

Category of market	Products included	Geographic dimension	Substitutes	Concerns
National markets for the acquisition of dry/ambient groceries by major grocery retailers.	Dry/ambient groceries encompass a very wide range of products including canned goods, breakfast products, rice, pasta, flour, oil, vinegar, condiments, spreads etc.	The geographic dimension of these markets is national, with products generally supplied from single manufacturing sites, or imported, and no shelf-life issues or issues with transportation.	For most suppliers active in these markets, it does not appear that they would be able to substitute meaningful proportions of their supply to other channels in the event of a SSNDP, implying that other customer channels fall outside the scope of the relevant market.	Suppliers active in these markets have raised concerns in relation to the Proposed Merger.[271] We are not satisfied that the Proposed Merger would not substantially lessen competition in such markets.
National markets for the acquisition of chilled and frozen groceries by major grocery retailers.	Chilled and frozen groceries encompass packaged products that are temperature controlled including sauces, dips, fruits, frozen vegetables, ice	The geographic dimension of these markets is national, with products generally supplied from single manufacturing sites, or imported, and no shelf-life issues.	For most suppliers active in these markets, it does not appear that they would be able to substitute meaningful proportions of their supply to other channels in the event of a SSNDP, implying that other customer channels fall	Suppliers active in these markets have raised concerns in relation to the Proposed Merger.[272] We are not satisfied that the Proposed Merger would not substantially

271 For example, [ ] considers itself a medium sized business and expressed concern with the Proposed Merger. Its key concern was that having less "players" increases the risk for it and other medium-sized suppliers, noting that medium-sized suppliers are all "battling away" and that somebody would be a loser as a result. [ ] considers itself a medium sized business and expressed concern with the Proposed Merger that it would be difficult for manufacturers (such as itself), noting that it is already very constraining with a limited number of customers and there has been "such a degradation of manufacturer margin in the past". [ ] noted their pipeline for importing products is [ ] and it expressed a concern that with the Proposed Merger, there would be no option to divert supply to one of the Parties and the volumes that it would supply to the merged entity could not profitably be sold to other channels (eg, smaller grocery retailers or restaurants). [ ] expressed concern with the Proposed Merger that there would be increased pressure on it as a supplier and that there is a low probability that other channels like export, foodservice or hotels could replace volume to the merged entity. See Commerce Commission interviews with [ ], [ ], [ ] and [ ].

272 [ ] considers that smaller suppliers are more restricted to the North Island or South Island and so the risk to them is higher in relation to the outcome of the Proposed Merger with respect to terms and ranging. See Commerce Commission interview with [ ].

Category of market	Products included	Geographic dimension	Substitutes	Concerns
	cream, frozen meats etc.		outside the scope of the relevant market.	lessen competition in such markets.
National markets for the acquisition of health and beauty products by major grocery retailers and other customers	This includes personal care products such as toothpaste, deodorant and shampoo.	The geographic dimension of these markets is national, with products generally supplied from single manufacturing sites, or imported, and generally no shelf-life issues or issues with transportation.	For suppliers in these markets, we consider that it is generally possible to substitute between supplying the major grocery retailers, and other customer channels including pharmacies such as Chemist Warehouse. However, the extent to which suppliers would be able to switch volumes to alternative customer channels to defeat a SSNDP is unclear.	Suppliers active in these markets have raised concerns in relation to the Proposed Merger.[273] We are not satisfied that the Proposed Merger would not substantially lessen competition in such markets.
National markets for the acquisition of beverages by major grocery retailers and other customers.	Beverages encompasses non-alcoholic beverages such as coffee, juices or soft drinks/energy drinks. These can both	The geographic dimension of these markets is national, with products generally supplied from single manufacturing sites, or imported, and generally	For suppliers in these markets, we consider that it is generally possible to substitute between supplying the major grocery retailers, and other customer channels including convenience	Suppliers active in these markets have raised concerns in relation to the Proposed Merger.[274] We are not satisfied that the Proposed Merger

273 For example, [ ] considers itself a big company. It noted its timeframe for importing products is [ ] and expressed concern with the Proposed Merger that it would be cautious about bringing new product to market in New Zealand if not ranged with the merged entity. See Commerce Commission interview with [ ].

274 For example, [ ] expressed concern with the Proposed Merger that the opportunity to have three separate negotiations would be removed and this would be challenging for both small and large suppliers. [ ] expressed concern that the Proposed Merger would increase risk by removing the ability to shift volume from one of the Parties to the other. It also considers that in terms of innovation, it would make it more difficult for a small brand to enter the market and build into a market leader. It considers that national ranging poses a high risk to suppliers that require volume to operate. See Commerce Commission interviews with [ ] and [ ].

Category of market	Products included	Geographic dimension	Substitutes	Concerns
	be refrigerated or non-refrigerated.	no shelf-life issues or issues with transportation.	retailers and foodservice. However, the extent to which they would be able to switch volumes to alternative customer channels to defeat a SSNDP is unclear.	would not substantially lessen competition in such markets.
National markets for the acquisition of snacks by major grocery retailers and other customers.	This category includes chips, chocolate, confectionery, chewing gums, savoury snacks like nuts, etc.	The geographic dimension of these markets is national, with products generally supplied from single manufacturing sites, or imported, and generally no shelf-life issues or issues with transportation.	For suppliers in these markets, we consider that it is generally possible to substitute between supplying the major grocery retailers, and other customer channels including convenience retailers and foodservice customers. However, the extent to which they would be able to switch volumes to alternative customer channels to defeat a SSNDP is unclear.	Suppliers active in these markets have raised concerns in relation to the Proposed Merger.[275] We are not satisfied that the Proposed Merger would not substantially lessen competition in such markets.
National and regional markets for the acquisition of meat and seafood products by major	This category includes the wholesale supply of animal proteins (ie, meat, poultry and seafood).	The geographic dimension of these markets varies according to the product.	For suppliers in these markets, we consider that it may be possible to substitute between supplying the major grocery retailers, specialty retailers and foodservice customers. However, as noted	Suppliers active in these markets have raised concerns in relation to the Proposed Merger.[277]

275 For example, [ ] expressed concern with the Proposed Merger that its market is already small and only being able to sell into one customer would constrain its ability to innovate locally. See Commerce Commission interview with [ ].

277 For example, [ ] considers itself a large supplier with a unique product. [ ] expressed concern with the Proposed Merger that the merged entity might rationalise which could remove smaller suppliers in the market, particularly in the South Island. See Commerce Commission interview with [ ] and [ ].

Category of market	Products included	Geographic dimension	Substitutes	Concerns
grocery retailers and other customers.			above, the Commission has previously identified separate markets according to customer channel for the wholesale supply of chicken. The Parties submit that for meat and seafood, export is a key option and drives bargaining outcomes.[276] The extent to which they would be able to switch volumes to alternative customer channels to defeat a SSNDP is unclear.	We are not satisfied that the Proposed Merger would not substantially lessen competition in such markets.
National markets for the acquisition of beer and wine by major grocery retailers and other customers.	This category includes beer and wine, as well as cider and any other alcoholic beverages commonly available in grocery retailers.	The geographic dimension of these markets is national, with products generally supplied from single manufacturing sites, or imported, and generally no shelf-life issues or issues with transportation.	For suppliers in these markets, we consider that it may be possible to substitute between supplying the major grocery retailers, liquor stores and foodservice. However, the extent to which they would be able to switch volumes to alternative customer channels to defeat a SSNDP is unclear.	Suppliers active in these markets have raised concerns in relation to the Proposed Merger.[278] We are not satisfied that the Proposed Merger would not substantially lessen competition in such markets.

276 SoPI cross submission from the Parties (7 March 2024) at [7.1].

278 For example, [ ] did not have an issue with the Proposed Merger itself however did note that the Parties are and would continue to be present in all three of its main channels (ie, grocery, [ ]). It also considers that the Proposed Merger may be more straightforward for some national suppliers yet pose some risks for some local ones. [ ] expressed concern with the Proposed Merger that for at least one of its products, it would be exposed if it lost volume to the merged entity because it is not a product that it can export easily. See Commerce Commission interviews with [ ] and [ ].

Category of market	Products included	Geographic dimension	Substitutes	Concerns
Local, regional and national[279] markets for the wholesale acquisition of fresh produce by major grocery retailers and other customers.	This category includes fresh fruit and vegetables and eggs. (See further points below)	For most products in this category, the more regional nature of supply means the Parties are less likely to be in competition. However, a notable exception is in times of short supply, where the Parties compete directly for produce which is only grown in one part of the country and can be shipped. Products in this category are susceptible to shelf-life issues or issues with transportation.	We consider that the relevant markets include supply to various types of customers, but note that the major grocery retailers are the largest acquirers of almost all types of fresh produce. For example, the main customers of egg producers are the major grocery retailers which account for about 60% of all eggs produced in New Zealand.[280] The Parties submit that export is a key option for suppliers of some types of fresh produce and drives bargaining outcomes.[281]	We consider that the Proposed Merger may not raise concerns in all markets for the acquisition of most fresh produce, but we are not satisfied that the Proposed Merger would not substantially lessen competition in any such markets, particularly during supply shortages and in instances where supply is or could be national.

279 As noted previously, we consider that some suppliers of fresh produce may only be able to supply products to customers within a local or regional market on one island, due to relatively high costs associated with transporting such products over longer distances (including across the Cook Strait). However, we also note that some fresh produce is supplied nationally and transported between islands, depending on the circumstances and perishability of the product in question. For example, one fresh produce supplier told us that logistics often determine where a product gets placed (for example, how the produce will "hold up" and what the cost will be to ship it). See Commerce Commission interview with [ ]. We were also told that while it may be the case that some produce products are supplied locally, it is common for some fruit and vegetables to be shipped between the North and South Islands, given not all products can be grown everywhere (eg, Kumara in Dargaville can be shipped to the South Island, cherries in Central Otago can be shipped to the North Island, and citrus in Gisborne can be shipped to the South Island). We were also told that if there was (for example) a grower of tomatoes in the South Island that got turned down in FSSI, it could shift its volume to the North Island. See Commerce Commission interview with [ ].

280 Heyden Farms Limited, Henergy Cage-Free Limited and Rasmusens Poultry Farms Limited [2020] NZCC 19 at [22].

281 SoPI cross submission from the Parties (7 March 2024) at [7.1].

218. As outlined above, we define markets in the way that we consider best isolates the key competition issues that arise from a merger. In many cases this may not require us to precisely define the boundaries of a market. What matters is that we consider all relevant competitive constraints, and the extent of those constraints. For that reason, we also consider products and services that fall outside a market, but which would still impose some degree of competitive constraint on a merged entity.

219. In this case, as noted above, we consider that the common-sense approach to defining markets and our analysis of the competitive effects of the Proposed Merger is to aggregate similar markets, or classes of similar markets into categories. There are also high-level effects of the Proposed Merger that span categories. Given this, we do not consider it necessary to undertake a separate, detailed competition analysis for each category.

We are not satisfied that a substantial lessening competition in acquisition markets is not likely

220. We envisage serious risks to competition for the acquisition of grocery products and are not satisfied that the Proposed Merger will not have, or would not be likely to have, the effect of substantially lessening competition in multiple markets for the acquisition of grocery products, which would have flow on effects in retail grocery markets.

221. Our concerns are particularly in relation to product markets where supply is national, where major grocery retailers account for a large proportion of suppliers' output and revenue, and where major grocery retailers face a diverse base of multiple suppliers. These product markets are in general, more likely to fall within categories of dry/ambient groceries, and chilled and frozen groceries. However, we are not satisfied that there would not be a substantial lessening of competition in relevant product markets for the acquisition of grocery products that fall within other categories.

222. The focus of our assessment has been on whether the Proposed Merger would substantially lessen competition in acquisition markets.

223. As we explain at [279] we consider that each of FSNI and FSSI currently provide competitive constraint by acting as outside options in negotiations between a supplier and another buyer. This effect operates even when a supplier could satisfy the demand of both of the Parties. It is through the bargaining process that the Parties compete to acquire grocery products from suppliers in acquisition markets, and the Proposed Merger would effect a permanent structural change in the grocery industry and eliminate this competition and competitive constraint.

224. We are concerned that the loss of competition with the Proposed Merger would be substantial, because:

224.1 there is already muted competition in the relevant acquisition markets (as noted at [41]) and high barriers to retail entry and expansion. The Parties and Woolworths are the largest buyers of grocery products in New Zealand and a key route to market for many suppliers (as noted earlier at [41.1] and discussed later at [320.2]);

224.2 the Proposed Merger would reduce the number of major buyers of many categories of grocery products in New Zealand from three to two. It would create the largest single acquirer of groceries in New Zealand, and result in many suppliers selling most of their output to (at most) just two remaining major grocery retailer customers (the merged entity and Woolworths) rather than the existing three (FSNI, FSSI and Woolworths);

224.3 competition from the remaining competing buyers in relevant acquisition markets is unlikely to be sufficient to constrain the merged entity from exercising increased buyer power. In particular, we are not satisfied that the other remaining major acquirer of grocery products, Woolworths, would have an incentive to constrain the merged entity, and rival grocery retailers other than Woolworths account for only a small portion of grocery retailing and buying in New Zealand; and

224.4 grocery suppliers would be unlikely to be able to exert countervailing power to the extent that they could constrain an exercise of buyer power by the merged entity.

225. As noted at [78], our acquisition market concern is with the effect of the Proposed Merger on the process of independent rivalry between buyers in the acquisition markets and on the merged entity's buyer (or market) power. In our view, the Proposed Merger would result in increased buyer power for the merged entity, and materially shift the balance of bargaining power in favour of the merged entity during negotiations with suppliers. This would substantially lessen competition in relevant acquisition markets. In summary, and as discussed in further detail below:

225.1 the Proposed Merger would remove an important alternative option for many suppliers, although the Proposed Merger would affect suppliers differently depending on the strength of their options (alternative outside supply channels);

225.2 for suppliers who currently only supply one of the Parties (but could supply both or either), the Proposed Merger would remove an important outside option and reduce their bargaining power;

225.3 for suppliers who currently supply both of the Parties, such as some suppliers in product categories such as dry/ambient and chilled or frozen groceries, the Proposed Merger would raise the stakes and cost of disagreement with the merged entity compared with the Parties individually by removing the option of just selling to one of the Parties. This would reduce their bargaining power in negotiations with the merged entity; and

225.4 the removal of one of three major buyers of many categories of grocery products with the Proposed Merger would further entrench the bargaining imbalance that is already present between many suppliers and the Parties separately. This would increase the merged entity's buyer power and enable it to extract lower prices and less favourable terms from suppliers than the Parties would be able to obtain separately in the counterfactual (and better than they would have been able to obtain in a competitive market). This includes "cherry picking" the most favourable terms from those currently offered to each of FSNI and FSSI. Indeed, we understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers: [ ].[282]

226. For these reasons alone, we are not satisfied that the Proposed Merger will not have, or would not be likely to have, the effect of substantially lessening competition due to unilateral effects in markets for the acquisition of grocery products.

227. We consider that the substantial lessening of competition arising in acquisition markets may have a flow on effect on innovation for new grocery products by suppliers. This would in turn harm retail consumers who would miss out on the benefit of the innovation. We discuss our reasons further at [353]-[403] but in summary this is because:

227.1 each of FSNI and FSSI provide separate opportunities for new grocery products to be listed in New Zealand, and their consolidation with the Proposed Merger would remove one such opportunity. That could slow the pace and development of new product innovation for some suppliers, resulting in reduced consumer choice and/or quality of grocery products; and/or

227.2 the increased buyer power as a result of the Proposed Merger could have a potentially significant effect on margins and profitability of suppliers. This would adversely affect the ability and incentive of suppliers to invest, resulting in effects such as reduced capacity, quality or innovation in the affected acquisition markets.

228. Separate to our general consideration of the increased buyer power that would result from the Proposed Merger, we considered the impact that the Proposed Merger would have on centralisation of procurement and private label. This includes the impact it may have negotiations with suppliers.

229. We are satisfied that the Proposed Merger would not make a substantial difference to:

229.1 the extent of centralisation of procurement by each Party. FSNI and FSSI are currently independently (at different speeds) transitioning toward greater centralisation of procurement at their respective head office level, and this is likely to continue absent the Proposed Merger; and

282 [ ]

229.2 the penetration of private label products, or the ability for either FSNI or FSSI to use private label products as a bargaining tool in their negotiations with suppliers. The ability and incentive of the Parties in terms of private label products may be the same both with and without the Proposed Merger.

230. We also assessed whether the Proposed Merger would increase the potential for the merged entity and Woolworths to coordinate their behaviour in acquisition markets to obtain prices and trade terms with suppliers that are less favourable to suppliers. We are satisfied that the Proposed Merger is unlikely to substantially lessen competition in acquisition markets due to coordinated effects. The Proposed Merger would be likely to increase symmetry between the merged entity and Woolworths. However, we consider that there is unlikely to be sufficient transparency in the terms individually negotiated with suppliers for the merged entity and Woolworths to reach agreement over coordinated terms and to monitor compliance with an agreement.[283]

The way negotiations work

231. As described previously, most retailer-supplier relationships within the grocery sector fit within a bargaining framework. Grocery retailers and their suppliers typically enter into bilateral supply agreements, which detail the specific terms on which products will be supplied.[284]

232. Currently, FSNI and FSSI each present separate opportunities for grocery suppliers to negotiate listings, prices, other terms of trade and contract renewals and each form part of the options available to suppliers in their dealings with each buyer individually.

233. A supplier may approach a grocery retailer's relevant category manager, or vice versa, to initiate discussions. If agreement is reached, the supplier will typically enter into a supply contract with the retailer.[285]

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283 As noted at [509], some suppliers have indicated that they charge all grocery retailers the same list price and, if they offered a lower price to one grocery retailers, then other grocery retailers would request a similar change. While grocery retailers therefore may have some notion of the supply price that other grocery retailer obtain, it would nevertheless be much harder to reach and monitor a tacit agreement where prices are not transparent. List prices will not always be the same as the actual price after discounts and rebates which further reduce transparency.

284 These negotiations indicate that [ ].

285 There may be an exception for suppliers of fresh produce (ie, fruit and vegetables). One fresh produce supplier told us that [ ], it might be awarded a percentage share of a category – for example, in respect of [ ], a [ ]% share/allocation, or a slightly higher share for [ ] where it has a better supply base or has products that the Parties want. Commerce Commission interview with [ ].

234. As part of making ranging decisions, grocery retailers also periodically undertake category review programmes. In a category review, a major grocery retailer will consider the mix of products it stocks in a product category. The Parties submit that, while they each operate their programmes independently, factors relevant to a category review include customer "need states",[286] factors that are important to customers in relation to the particular category, whether there are any well-known brands which consumers consider 'must have', customers' tastes, the role of private label, challenges faced by suppliers/the Parties, the level of substitutability between different suppliers/products, the role of innovation, and category health.[287]

235. The Parties further submit that:[288]

235.1 the category insights above heavily influence the category strategy, which considers factors such as whether there are opportunities to increase/decrease share of shelf for products, rationalise/reduce the product range or simplify the shop for customers, and introduce new suppliers/SKUs; and

235.2 a key part of the category review processes is also assessing individual product performance across a set of criteria, namely:[289]

235.2.1 **[**];

235.2.2 **[**];

235.2.3 **[**];

235.2.4 **[**]; and

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286 The Parties define "need states" as referring to core customer needs, or demands, in relation to a product such as [ ]. Products grouped together within a need state are products that fulfil a similar need for customers. Need states are specific to a category, as they depend on how customers shop the category. SoUI submission from the Parties (13 August 2024) at [136].

287 SoUI submission from the Parties (13 August 2024) at [136] and [138].

288 SoUI submission from the Parties (13 August 2024) at [137], [138] and [140].

289 SoUI submission from the Parties (13 August 2024) at [140].

235.2.5 **[ ].**

236. In terms of supply arrangements with the Parties, we understand that suppliers will often have [ ]. For instance, we understand that [ ].[290] Suppliers indicated that, while there are fixed or operational terms which tend to be similar or consistent across both FSNI and FSSI, there are other variable or discretionary terms which may differ.[291]

Submissions from the Parties

237. The Parties submit and have told us that they do not meaningfully compete to acquire groceries. Each of FSNI and FSSI negotiates individually with suppliers and, [ ].[292] This means that supply negotiation is done by each of the Parties without reference to the price or volumes supplied to the other of the Parties. The logical extension of the Parties' position is that there is in practice no competition in markets for the acquisition of grocery products, not just between the Parties, but between the Parties and Woolworths or any other potential buyers. We disagree for the reasons set out from [273].

238. In addition to the Parties' submissions on the framework for assessing competition in acquisition markets that we discussed above, the Parties submit that the Proposed Merger is not capable of lessening competition in any market for the acquisition of grocery products from suppliers because:[293]

238.1 the Parties are not in competition with each other, or do not meaningfully compete, in relation to the acquisition of grocery products. Suppliers treat the Parties as a single national channel to market and it is incorrect to assume

290 RFI response from the Parties (23 May 2024) at [5] and [7], FSNI RFI response (29 February 2024) at [5] and [8] and FSSI RFI response (28 March 2024) at [6] and [8]-[9]. This appears consistent with what suppliers have told us, that there are centralised supply terms (ie, trading terms) which are overlayed with commercial terms at the store level (ie, terms that relate to supply of a product). See Commerce Commission interview with [ ]. However, we also understand arrangements around matters such as promotions, displays, ranging and merchandising for example, are being conducted more frequently at the head office level, particularly in respect of FSNI which has recently moved to the centralised procurement model. See Commerce Commission interviews with [ ], [ ] and [ ].

291 Commerce Commission interviews with [ ] and [ ].

292 The Application at [116], [118], [128.3] and n75.

293 The Application at [8.2], [80], [118] and [131], SoPI cross submission from the Parties (7 March 2024) at [5], [16], [23], [102] and [106] and SoI submission from the Parties (26 April 2024) at [28], [36] and [38].

that FSNI and FSSI can be regarded as entirely separate heads in the market. Furthermore:

238.1.1 describing the Proposed Merger as a three to two merger is not a fact-based characterisation of the way buying occurs; and

238.1.2 there should be no meaningful effect on suppliers' ability to negotiate with the Proposed Merger, with respect to smaller and larger suppliers with and without the Proposed Merger;[294]

238.2 product shortage would not generally give rise to more direct competition between the Parties than would occur at any other time; and

238.3 the merged entity's ability to achieve lower prices would not in and of itself be a lessening of competition.

239. The Parties also submit that although the Proposed Merger would consolidate two, formerly separate buyers in some grocery acquisition markets, there would be no reduction in the number of channels or opportunities as a result of the Proposed Merger:

239.1 the idea that currently and in the counterfactual a supplier can divert supply between the Parties ignores the role of customer demand in ranging decisions. This explains why each of FSNI and FSSI are not simply separate "options" for suppliers, with the Proposed Merger reducing choice. Rather, the overall opportunity, and the drivers of decisions in relation to it, would not be altered by the Proposed Merger,[295] with the starting point for category reviews being customer need states.[296] The Proposed Merger would not result in a higher likelihood that larger suppliers would be ranged in preference to smaller suppliers;[297]

239.2 the merged entity would purchase the same (or a greater) quantity than FSNI and FSSI (in combination) pre-merger and would be driven by the same incentives in the same retail grocery markets. Put another way, the Parties submit that they are channels to different markets, and there would be no reduction in the number of channels or opportunities as a result of the Proposed Merger. This, alongside the evidence regarding incentives and economic reasoning, indicates that a reduction in the number of buyers does

294 While the bargaining position for some suppliers may not result in a material change with the Proposed Merger, we consider that it is not necessarily the size of the supplier that would determine its bargaining position, but rather the impact of the Proposed Merger on a supplier's 'outside options' in any bilateral negotiation. On this basis, the bargaining position for both small and large suppliers could be substantially impacted.

295 SoUI submission from the Parties (13 August 2024) at 70 and 91.

296 SoUI submission from the Parties (13 August 2024) at [52] and [78].

297 SoUI submission from the Parties (13 August 2024) at 71.

not indicate a reduction in competition because the opportunity for suppliers would be unchanged;[298] and

239.3 there would be no change to competition in any local retail grocery market (which presumably drives stores' acquisition conduct), so for suppliers whose markets are small (eg, one or a small number of stores), the Proposed Merger would not be capable of giving rise to any change in competitive conditions.[299]

240. The Parties further submit that the Proposed Merger would not increase the merged entity's buyer power such that it would have the ability or incentive to anti-competitively reduce prices paid to suppliers because this would harm the merged entity – rather it would have incentive to ensure competitive supply.[300] Houston Kemp and Düsseldorf Competition Economics make a similar point.[301] [302]

241. The Parties submit that the buying benefits that they expect to gain from the Proposed Merger are not material in terms of any potential impact on acquisition markets. Rather, the Parties submit that the cumulative savings they expect to make over six financial years is $[ ], a maximum of less than $[ ] in a single year, which is [ ]% of the merged entity's projected total spend on products, and [ ]% of the projected total value of retail sales.[303]

242. The Parties submit that in any event, the merged entity's ability to achieve the more favourable of the terms of each of FSNI and FSSI would depend on the dynamics of specific product markets.[304]

243. Houston Kemp submits that:[305]

243.1 there may be some limited, temporary competition between the Parties during periods where there might be insufficient or limited supply in fresh produce;

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298 SoUI submission from the Parties (13 August 2024) at [87.4].

299 SoUI submission from the Parties (13 August 2024) at 72.

300 SoI submission from the Parties (26 April 2024) at [9]-[10] and SoUI submission from the Parties (13 August 2024) at [80]. While the merged entity would prefer competitive supply because more supply options reduces the bargaining power of suppliers, in the event of disagreement with a supplier, the merged entity would have far more options to acquire alternative supply from than a supplier would have grocery retailers to supply into. As discussed below, suppliers note they have been delisted, or threatened with delisting if they are unable to meet margin expectations – this shows that the Parties generally have multiple sources of supply and have the ability to dictate terms to suppliers.

301 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [32]-[33].

302 Houston Kemp report on SoUI (13 August 2024) at [6]-[7].

303 SoUI submission from the Parties (13 August 2024) at [60]-[62].

304 SoUI submission from the Parties (13 August 2024) at 76.

305 Houston Kemp report on SoPI (7 March 2024) at [43], [78] and [93].

243.2 there is a different market dynamic for fresh products – delineated further to meat, fish and fresh produce – (ie, seasonal influences and supply and demand);[306] and

243.3 the supplier relationship with each of the Parties is likely to differ significantly between suppliers.

244. Houston Kemp further submits that the merged entity may achieve a slight improvement in its relative bargaining position compared to FSNI and FSSI separately, in respect of some national suppliers, but that some other suppliers would be largely unaffected.[307] It notes:[308]

> For those wholesale grocery product markets involving major national suppliers, some of which will supply 'must-have' products for the merged entity, these suppliers are likely to have significant countervailing power. At the other end of the spectrum, very small suppliers are likely to continue to negotiate with one or a small number of stores directly. For both these categories of suppliers, it is difficult to envisage how the merger will give rise to any material change in either the degree of rivalry between buyers, or the intensity of competitive outcomes.

245. Houston Kemp's view is that the Proposed Merger would give rise to an increase in the intensity of competition between suppliers of grocery products with that intensity given effect to by two buyers that were previously three (among others) each competing to acquire a greater quantity of grocery products.[309] Düsseldorf Competition Economics also considers that integrating previously separate markets would lead to more "uniform pricing" by suppliers engaging in price differentiation and a moderate average price reduction would increase procurement volumes.[310]

246. In analysing the effects of the Proposed Merger on acquisition markets, Düsseldorf Competition Economics submits that it is crucial to analyse changes in the outside options of suppliers, and that it is important to take into account the quality, not just the existence, of outside alternatives in shaping bargaining outcomes.[311] In its view,

306 Houston Kemp (for the Parties) further submit that the Proposed Merger is unlikely to cause a lessening of competition in these markets because there remains a high degree of competition between buyers for fresh products (ie, the merged entity, Woolworths, Costco, individual grocery stores and fruit and vegetables stores), exports play an important role in determining the outside options available to suppliers (and buyers), fresh produce wholesalers are also important buyers of produce from suppliers and the merged entity's incentives in wholesale and retail grocery markets would remain unchanged, which implies that it would seek to acquire the same amount of produce. Houston Kemp report on SoUI (13 August 2024) at [78].

307 Houston Kemp report on SoPI (7 March 2024) at [58]-[59], [63] and [66] and Houston Kemp report on SoI (26 April 2024) at [8a] and [40].

308 Houston Kemp report on SoI (26 April 2024) at [43]. In other words, Houston Kemp considers that larger national suppliers are likely to have significant countervailing power, and the Proposed Merger would be unlikely to result in a material change for small suppliers who deal with a small number of grocery stores.

309 Houston Kemp report on SoUI (13 August 2024) at [13(b)].

310 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [32]-[33].

311 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [23]-[24].

if outside options remain (largely) unchanged, the resulting bargaining outcomes are also unlikely to shift.[312]

247. Düsseldorf Competition Economics notes that the Proposed Merger is expected to allow the Parties to secure the better of the prices currently charged to FSNI and FSSI.[313] However, Düsseldorf Competition Economics submits that there would be no reduced competition in the acquisition markets with the Proposed Merger because, in its view:[314]

247.1 suppliers would retain the best alternative outside options. This is because a supplier has likely already optimised its channels to market in the geographic area covered by the other co-operative, and so redirecting the lost volume to the other geographic market is not optimal;

247.2 if a supplier was not able to obtain a supply agreement from FSNI or FSSI, it is unlikely that its best outside option would be to shift any lost volume to the other co-operative. Instead, its best alternative outside option would be to redirect volume to other rival grocery retailers operating within the same geographic market as to the co-operative to which it has lost supply; and

247.3 the geographical separation of the Parties and lack of market overlap means that a supplier's alternatives would remain unchanged with the Proposed Merger (ie, the best alternative outside options would be retained) and there would be no "buyer power effect". Therefore, the Proposed Merger would not reduce competition in acquisition markets, as suppliers retain the best alternative outside options, implying no change in resulting outcomes.

248. Düsseldorf Competition Economics appears to take a stronger view compared to the Parties and Houston Kemp on the effects of the Proposed Merger. Houston Kemp submits that the merged entity's bargaining position would improve "slightly" relative to national suppliers.[315] The Parties have described the change associated with the acquisition markets from the Proposed Merger as "very limited".[316] Düsseldorf Competition Economics on the other hand submits there would be no "buyer power effect" from the Proposed Merger.[317]

Obtaining information from third parties

249. A significant number of suppliers (of all sizes, including large multinationals and smaller local suppliers) declined to participate in our investigation of the Proposed Merger, or felt constrained in the information they provided to us. Many of those who declined to participate did so because they were concerned about their involvement being known to the Parties.

312 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [24].
313 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [13]-[14]
314 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [36]-[38].
315 See for example, Houston Kemp report on SoPI (7 March 2024) at [59].
316 See for example, SoUI submission from the Parties (13 August 2024) at [60].
317 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [37].

250. Suppliers who have made submissions and/or were interviewed also expressed concerns around whether the information they provided to us would be disclosed to the Parties, due to a fear of possible retribution from the Parties for participating in this process.

251. These concerns are consistent with the Commission's experience in the market study in relation to suppliers of all three major grocery retailers, and in 2014 when it investigated under Part 2 of the Act conduct of what was then Progressive Enterprises (now Woolworths).

252. Some suppliers appear to have spoken with the media and cited concerns with speaking about the Proposed Merger because "…using their identity is something of a professional death-wish, fearing they could be deleted from supermarket distribution".[318]

253. Suppliers that have raised concerns with us about information being disclosed to the Parties generally did so due to the importance of continued supply to the Parties to maintain the viability of their business, rather than being based on actual evidence or any threats of retribution.[319] In our experience, such concerns are not unusual where goods are supplied or acquired in highly concentrated markets.

254. We are transparent with parties we engage with as to how we use information we obtain during an investigation. We consider that the processes we have in place to safeguard confidential and commercially sensitive information, including against disclosure to the Parties themselves, should enable suppliers to speak with us without fear of retribution by the Parties. However, some parties still considered the safest course was not to participate in our investigation of the Proposed Merger because they remain concerned:

254.1 disclosure will be required by law;

254.2 about the costs associated with engaging on confidentiality; and/or

254.3 that even the best systems and processes are fallible.[320]

318 https://www.newshub.co.nz/home/new-zealand/2024/06/suppliers-sh-t-scared-about-proposed-foodstuffs-mega-merger-of-north-and-south-island-businesses.html.

319 On this point, the Parties submit that they do not threaten retribution, and that their incentives are to treat suppliers as commercial counterparties that are critical to their success in their business of grocery retailing. As such, in the Parties' view, the concerns are unfounded. SoUI submission from the Parties (13 August 2024) at 72-73 and SoUI cross-submission from the Parties (26 August 2024) at 16-17.

320 We also received eight anonymous third party views through the Anonymous Reporting Tool (ART) which was introduced as part of the Commission's cartel enforcement and work into the grocery industry. The tool provides third parties with a secure channel to report information without disclosing any personal and/or identifying information. Information provided through ART that has been correctly anonymised is anonymous even to Commission staff. However, when giving weight to anonymous information, we must also have regard to the reliability of the information, our ability to test it against other evidence, and the relative weight given to evidence from identifiable parties.

255. The concerns of both those who did engage and those who declined to participate highlight the need for the Commission to be able to safeguard confidential and commercially sensitive information, including after we have made a determination on the Proposed Merger.

Third party submissions and evidence received

256. Submissions and evidence provided by third parties contained a variety of views about the likely effects of the Proposed Merger on competition in acquisition markets.

257. The Grocery Action Group submits that with the Proposed Merger, suppliers would have one less outlet for their products and their already limited negotiating power would be reduced further.[321] The Grocery Action Group further submits that consumers would be materially adversely affected if the Proposed Merger proceeds because it would decrease competition in an already uncompetitive market by consolidating power in the largest supermarket operator.[322]

258. The Food and Grocery Council broadly considers that there would be enhanced buyer power with the Proposed Merger and submits that in response to its survey, suppliers consider that:[323]

258.1 the Proposed Merger would tilt the balance of bargaining power in favour of the merged entity, allowing it to negotiate more favourable terms to the detriment of suppliers. With suppliers having fewer options, suppliers' ability to negotiate would diminish, with the merged entity having more control over pricing and terms of trade leading to a transfer of surplus from suppliers to the merged entity; and

258.2 the merged entity's consolidated power would enable it to negotiate more assertively, resulting in winners and losers among suppliers.

259. The Food and Grocery Council further submits that in response to its survey, suppliers consider that maintaining three separate major grocery retailers reduces the risk by offering more options and spreading the risk.[324]

260. In response to the Food and Grocery Council's survey, the Parties submit that the response rate for the survey has not been provided, nor was the total number of New Zealand Food and Grocery Council members.[325] The New Zealand Food and Grocery Council told us that the total number of members at the time of the survey was [ ] and the response rate was [ ]%.[326]

321 SoUI submission from the Grocery Action Group (16 August 2024) at [8.3].
322 SoUI submission from the Grocery Action Group (16 August 20240 at [2.8a].
323 SoI submission from the Food and Grocery Council (26 April 2024) at [4.19], [10.6] and [11.3].
324 SoI submission from the Food and Grocery Council (26 April 2024) at [13.3].
325 SoUI submission from the Parties (13 August 2024) at 73.
326 E-mail from the New Zealand Food and Grocery Council (12 September 2024).

261. The Warehouse Group submits that the Parties' own economic report (by Houston Kemp) concludes that the Proposed Merger would improve the bargaining position of the merged entity relative to large and small national suppliers to the Parties and that the transfer of a mere surplus as characterised in Houston Kemp's report ignores the real-world implication of that effect.[327] The Warehouse Group also submits that there would be a material reduction in the bargaining power of suppliers with the Proposed Merger and a move to a single national supply contract compared to supply arrangements with FSNI and FSSI separately.[328]

262. Anonymous G's submission agrees with our characterisation that the Proposed Merger would be a three to two reduction in the number of major buyers of grocery products from suppliers, and also that FSNI and FSSI currently present alternative channels to market and separate opportunities for suppliers to have products listed.[329] Anonymous G highlights a concern around the merged entity becoming a de facto 'decider' of what grocery products are listed in New Zealand and submits that it would be difficult for a grocery supplier to continue to sell or launch a product unless it is listed with the merged entity.[330] In response, the Parties do not consider it accurate that the merged entity would have the ability to decide (without reference to consumer demand) which products to range, given products are available at other retailers and suppliers have other channels.[331] However, in our view, irrespective of what drives the Parties' decisions, the merged entity's listing/ranging decisions may indeed impact what products are available in New Zealand given suppliers may decide not to sell or launch a product in New Zealand without the merged entity's support.

263. Pernod Ricard submits that the Proposed Merger would bring size and scale that would unlock efficiencies that would be beneficial for consumers. It submits further that the Proposed Merger would also bring efficiencies to suppliers in engaging with one head office instead of two.[332]

264. Beard Brothers submits that the Proposed Merger would bring significant cost savings to its business as there is currently a lot of duplication in processes which could be streamlined through one entity, saving considerable time and effort. It

327 SoI cross submission from The Warehouse Group (10 May 2024) at [5]-[6]. The Parties' response to this submission is that any change in bargaining outcome, or price, is not in and of itself a competitive harm. The Parties further note that no evidence is provided by The Warehouse Group about the real-world implication of the effect of a "mere" transfer. SoI cross submission from the Parties (31 May 2024) at 2.

328 SoI cross submission from The Warehouse Group (10 May 2024) at [18(a)]. The Parties' response to this submission is that there is no evidence presented by The Warehouse Group on this point. SoI cross submission from the Parties (31 May 2024) at 7.

329 SoI submission from Anonymous G (18 April 2024) at [5]-[8].

330 SoI submission from Anonymous G (18 April 2024) at [6].

331 SoUI submission from the Parties (13 August 2024) at 74.

332 SoUI submission from Pernod Ricard (12 August 2024). The Parties response to this submission is that they agree the Proposed Merger would lead to efficiencies for suppliers. SoUI cross submission from the Parties (26 August 2024) at 7.

submits further that any cost savings that it can get from something so simple, would have a big impact.[333]

265. Anonymous K submits that the Proposed Merger would bring efficiencies and in turn allow suppliers to bring products to market faster, spend less time on category reviews and have consistent ranging possibilities.[334]

266. Ernie Newman submits that the Parties and Woolworths are often the only route to market in viable volumes, and that a reduction from three to two major buyers of grocery products as a result of the Proposed Merger would be a substantial lessening of competition which would cause the closure of many suppliers due to the loss of just one of the two remaining channels. Ernie Newman further submits that the merged entity would cherry pick terms to get the better price and that a supplier would have no option but to accept the lower of the two prices – removing the cross subsidisation that is currently an option for most suppliers.[335]

267. The New Zealand Specialist Cheesemakers Association submits that for specialty cheesemakers, the only access to the New Zealand consumer market, at scale, is through the major grocery retailers. It further considers that there is extreme asymmetry of market power in this space and that the Proposed Merger would create a highly unequal market both to the supply and retail side – with so much market power on the part of the merged entity, it would be able to command monopolistic terms and have low competitive incentives to pass these back to consumers on the retail side.[336]

268. Lisa Asher submits that there are currently three major grocery retailer buyers in New Zealand and three options for suppliers to sell their product into.[337] Lisa Asher also submits that New Zealand is currently at market failure pre-merger, and if the Proposed Merger goes ahead, it would be very hard to reverse due to the

333 SoUI submission from Beard Brothers (9 August 2024). The Parties response to this submission is that they agree the Proposed Merger would lead to efficiencies for suppliers. SoUI cross submission from the Parties (26 August 2024) at 23.

334 SoUI submission from Anonymous K (11 August 2024). The Parties response to this submission is that they agree the Proposed Merger would lead to efficiencies for suppliers. SoUI cross submission from the Parties (26 August 2024) at 18.

335 SoUI submission from Ernie Newman (12 August 2024) at 2. The Parties response to this submission is that the merged entity achieving the terms that one of the co-operatives achieves today (and in the counterfactual) would not be expected to amount to a lessening of competition, and a transfer of surplus without more, is not evidence of a lessening of competition (which is supported by an application of the bargaining framework). The Parties further note that the merged entity would have an incentive to share with customers an improvement in its variable costs (such as product costs). SoUI cross submission from the Parties (26 August 2024) at 20.

336 SoUI submission from New Zealand Specialist Cheesemakers Association (12 August 2024) at 1 and 3. The Parties response to this submission is that the Proposed Merger would result in no material change in competition and the market position of the Parties would not be enhanced by the Proposed Merger. The Parties further note that they do not determine “market access” and that it would be expected the merged entity would have an incentive to share with customers an improvement in its variable costs. SoUI cross submission from the Parties (26 August 2024) at 8.

337 SoI submission from Lisa Asher (25 April 2024) at 5. The Parties response to this submission is that the three to two concern in relation to buying is not supported by the evidence. SoI cross submission from the Parties (6 May 2024) at 27.

concentration of power. Buyer power is prevalent now and with one less player, it would be much more. The Proposed Merger would lead to a further loss of competition.[338]

269. Some industry participants consider that:

269.1 the Parties do not generally compete for volume from grocery suppliers (including due to the geographical separation and/or different territories in which each of FSNI and FSSI operate);[339] but

269.2 there are currently three major grocery retailer customers with which suppliers can have separate trading negotiations, and with the Proposed Merger, this would reduce to two.[340]

270. Further, in contrast to the Parties' submission (set out at [239.1]):

270.1 some industry participants indicated that they view each of the Parties as a separate option to sell product into and consider that the Proposed Merger would remove suppliers' ability to shift volume from one of FSNI/FSSI to the other;[341]

270.2 one supplier (of non-food products) said that it can generally offset the impact of a delisting in FSNI with product to FSSI and Woolworths but is concerned that its offering would reduce over time with the Proposed Merger;[342]

270.3 another supplier (of non-food products) considers that currently, it can balance a delisting in one of the Parties with volume to the other, but that this would no longer be an option post-merger;[343]

270.4 another supplier (of dry/ambient products) indicated that if it has a product listed in both FSNI and FSSI and was delisted in one, it could still sell in the other co-operative and shift some of the volume;[344]

338 SoUI submission from Lisa Asher (15 August 2024) at 1 and 31. The Parties response to this submission is that they disagree and consider the market has become increasingly competitive in recent years. SoUI cross submission from the Parties (26 August 2024) at 24.

339 Commerce Commission interviews with [ ], [ ], [ ], [ ] and [ ].

340 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ] and [ ].

341 Commerce Commission interviews with [ ] and [ ]. In the case of [ ], the Parties' advisors note that [ ]. Confidential SoUI submission from the Parties' advisors (30 August 2024) at [14] and SoUI submission from the Parties (13 August 2024) at Appendix [ ].

342 Commerce Commission interview with [ ].

343 Commerce Commission interview with [ ].

344 Commerce Commission interview with [ ].

270.5 another supplier (of fresh produce) told us that it can and often does switch between supplying FSNI and FSSI;[345] and

270.6 as noted elsewhere, another supplier (of fresh products) noted that the current separation of FSNI and FSSI means that if it lost business with FSNI it could go to FSSI.[346]

271. Industry participants that we spoke with (including suppliers across a range of categories and of all sizes, both large multinationals and smaller local suppliers) also raised various concerns (broadly summarised below) in relation to a potential increase in buyer power of the Parties with the Proposed Merger, including that:

271.1 there would be increased or greater buying power and/or leverage on the part of the merged entity in bargaining with grocery suppliers;[347]

271.2 the risk to grocery suppliers of losing product nationally and the outcome of ranging decisions would be greater with the Proposed Merger;[348]

271.3 the merged entity would seek for grocery suppliers to improve their offers thereby increasing margin expectations and further reducing supplier margin;[349] and

271.4 the merged entity would "cherry pick" the more favourable terms of each of FSNI and FSSI to implement across the supply base.[350]

272. Conversely, some suppliers (in different product categories and of varying sizes) expressed to us a view that there would be no change in the buying power of the Parties and/or in terms of supply with the Proposed Merger.[351]

Our view

273. Based on the evidence received, we envisage serious risks to competition for the acquisition of grocery products and are not satisfied that the Proposed Merger will

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345 Commerce Commission interview with [ ].

346 Commerce Commission interview with [ ].

347 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ] and [ ].

348 Commerce Commission interviews with [ ] and [ ].

349 Commerce Commission interviews with [ ], [ ] and [ ].

350 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ] and [ ].

351 Commerce Commission interviews with [ ], [ ], [ ] and [ ].

not have, or would not be likely to have, the effect of substantially lessening competition in multiple markets for the acquisition of grocery products.

274. Each of FSNI and FSSI currently provide competitive constraint by acting as outside options in negotiations between a supplier and another buyer. Currently, FSNI and FSSI each present separate opportunities for grocery suppliers to supply their products.[352] Outside of grocery products that the Parties already acquire jointly today (eg, private label products), FSNI and FSSI currently acquire groceries separately from suppliers and exist as separate channels to market for suppliers. Suppliers are also currently able to negotiate listings, prices and other terms of trade with each of the Parties individually, and potentially divert volume between the two co-operatives and/or use the outcome of negotiations with one co-operative to influence negotiations with the other. The fact that each of the Parties is a separate opportunity (in addition to Woolworths) may influence the bargaining power of suppliers in negotiations with each co-operative. This effect operates even when a supplier could satisfy the demand of both of the Parties. It is through the bargaining process that the Parties compete to acquire grocery products from suppliers in acquisition markets. The Proposed Merger would effect a permanent structural change in the grocery industry and eliminate this competition and competitive constraint.

275. We are concerned that the loss of competition with the Proposed Merger would be substantial, because:

275.1 there is already muted competition in the relevant acquisition markets (as noted at [41]) and high barriers to retail entry and expansion. The Parties and Woolworths, as New Zealand's major grocery retailers, are the three largest buyers of grocery products in New Zealand and a key route to market for many suppliers;

275.2 the Proposed Merger would reduce the number of major buyers of many categories of grocery products in New Zealand from three to two. It would create the largest single acquirer of groceries in New Zealand, and result in many suppliers selling most of their output to (at most) just two remaining major grocery retailer customers (the merged entity and Woolworths) rather than the existing three (FSNI, FSSI and Woolworths);

275.3 competition from the remaining competing buyers in relevant acquisition markets is unlikely to be sufficient to constrain the merged entity from exercising increased buyer power. We are not satisfied that Woolworths would have an incentive to constrain the merged entity, and rival grocery retailers other than Woolworths account for only a small portion of grocery retailing and buying in New Zealand; and

352 This might not be the case for some suppliers (eg, some suppliers of fresh produce) who supply their product(s) on a local/regional basis and cannot or do not supply outside of their relevant local/regional area.

275.4 grocery suppliers would be unlikely to be able to exert countervailing power to the extent that they could constrain an exercise of buyer power by the merged entity.

276. As noted earlier, our acquisition market concern is with the impact of the Proposed Merger on the process of independent rivalry between buyers in the acquisition markets and on the merged entity's buyer (or market) power. In our view, the Proposed Merger would result in increased buyer power for the merged entity, and materially shift the balance of bargaining power in favour of the merged entity during negotiations with suppliers. This would substantially lessen competition in acquisition markets. In summary, and as discussed in further detail below:

276.1 the Proposed Merger would remove an important alternative option for many suppliers, although the Proposed Merger would affect suppliers differently depending on the strength of their options (alternative outside supply channels);

276.2 for suppliers who currently only supply one of the Parties (but could supply both or either), the Proposed Merger would remove an important outside option and reduce their bargaining power; and

276.3 for suppliers who currently supply both of the Parties, such as some suppliers in product categories such as dry/ambient and chilled or frozen groceries, the Proposed Merger would raise the stakes and cost of disagreement with the merged entity compared with the Parties individually by removing the option of just selling to one of the Parties. This would reduce their bargaining power in negotiations with the merged entity; and

276.4 the removal of one of three major buyers of many categories of grocery products with the Proposed Merger would further entrench the bargaining imbalance that is already present between many suppliers and the Parties separately. This would increase the merged entity's buyer power and enable it to extract lower prices and less favourable terms from suppliers than the Parties would be able to obtain separately in the counterfactual (and better than they would have been able to obtain in a competitive market). This includes "cherry picking" the most favourable terms from those currently offered to each of FSNI and FSSI. Indeed, we understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers: [ ].[353]

277. As we note at [227], and discuss further at [353]-[403], we consider that the substantial lessening of competition arising in acquisition markets may have a flow on effect on innovation for new grocery products by suppliers. This would in turn harm retail consumers who would miss out on the benefit of the innovation.

[353] [ ]

278. The Parties submit (as set out at [49]) that the merged entity would face significant pressure to pass through the cost savings arising from the Proposed Merger. However, we have not been provided with evidence of the likely extent of any pass through. It is possible that the merged entity would pass through some of its cost savings to retail consumers, as economic theory would generally suggest. However, in our view, any pass through is likely to be limited due to the current muted competition in retail grocery markets (as noted at [41]), and the further lessening of competition as a result of the Proposed Merger.[354] Our view accords with Düsseldorf Competition Economics.[355] Further, as we explain elsewhere we are not satisfied that any such pass through would be in the long term interests of consumers. We consider that the Proposed Merger would substantially lessen competition in retail grocery markets by further raising barriers to entry and expansion and increasing the likelihood, completeness or sustainability of coordination between the merged entity and Woolworths. We are therefore of the view that these effects on competition in retail grocery markets, in addition to a likely reduction in range, quality and innovation of grocery products as a result of the increased buyer power of the merged entity, would mean that the Proposed Merger would have an overall adverse effect on retail grocery consumers.

Loss of competition between the Parties

279. We explained at [111] above our views on how competition between the Parties can be characterised. For the reasons set out below we consider that each of FSNI and FSSI currently provide competitive constraint by acting as outside options in negotiations between a supplier and another buyer. This effect operates even when a supplier could satisfy the demand of both of the Parties. It is through the bargaining process that the Parties compete to acquire grocery products from suppliers in acquisition markets. The Proposed Merger would effect a permanent structural change in the grocery industry and eliminate this competition and competitive constraint.

280. Houston Kemp submits that the dynamic market environment that characterises fresh grocery product may lead to occasions where there is insufficient supply on a regional or nationwide basis to satisfy the typical demand in that area for a fresh product (and that in these limited circumstances, there may be some limited, temporary competition between the Parties).[356] This accords with evidence from some suppliers:

280.1 one fresh produce supplier told us that, for example, in relation to [ ] (which is prone to shortages due to weather events), it would likely have

[354] The firm-specific nature of the cost savings would also likely limit pass-through.

[355] Düsseldorf Competition Economics note that the extent of price reductions depends notably on the extent of competition in the relevant retail grocery markets. Düsseldorf Competition Economics report on SoUI (13 August 2024) at n17.

[356] Houston Kemp report on the SoPI (7 March 2024) at [92]-[93].

demand for that product from say both Christchurch and Auckland, in periods of short supply;[357] [358] and

280.2 another fresh produce supplier noted that it supplies [ ] to FSSI, and will only be approached by FSNI for [ ] if it is short.[359]

281. However, the evidence indicates that the Parties also compete for volume from suppliers of other products in periods of short supply (eg, imported products facing shipping problems), not just fresh produce. For example:

281.1 a supplier (of a range of dry/ambient products) told us that it sees competition between the Parties when a product is in short supply (eg, because the supplier's production capacity is less than demand) and the Parties are both pushing to make sure all of their orders are filled;[360] and

281.2 another supplier (of a range of dry/ambient products) told us that the Parties are competing for the same product if there is short supply of a product, and they cannot quickly switch to another supplier's product.[361]

282. Outside of supply shortages, we have also been told of instances where one of the Parties has ranged a product and a supplier might use that as leverage to obtain ranging in the other of the Parties.[362] However, some suppliers that we spoke with (across different categories and of varying sizes) consider that in practice:[363]

282.1 there is no mechanism with which they can directly play the Parties off against each other;[364]

282.2 they do not leverage their position or terms with one to obtain better trading terms with the other;[365] or

282.3 they do not share terms between the Parties.[366]

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357 Commerce Commission interview with [ ].

358 FSSI acknowledges that fresh produce is difficult and that it is most prone to shortages in the market for a number of reasons, including climate situations, biosecurity or market access (import) issues. Commerce Commission interview with FSSI (20 February 2024).

359 Commerce Commission interview with [ ].

360 Commerce Commission interview with [ ].

361 Commerce Commission interview with [ ].

362 Commerce Commission interviews with [ ], [ ] and [ ]. In the SoUI submission from the Parties (13 August 2024) at 84, the Parties note that in general, suppliers do not provide the Parties with information on their supply to other customers.

363 The points made in this paragraph are consistent with the Parties' experiences. SoUI submission from the Parties (13 August 2024) at 84.

364 Commerce Commission interview with [ ].

365 Commerce Commission interviews with [ ], [ ] and [ ].

366 Commerce Commission interview with [ ] and [ ]. FSNI also told us that suppliers [ ]. Commerce Commission interview with FSNI (22 February 2024).

283. Our view is that in many relevant markets for the acquisition of grocery products the Proposed Merger would reduce the number of major grocery retailers with which suppliers can negotiate from three to two and eliminate any competition between the Parties in acquiring groceries.

284. The Parties' submissions (set out earlier at [238]-[239]) disagree with our conception of the Proposed Merger as a reduction from three to two major buyers in acquisition markets. Instead, the Parties submit that the number of channels or opportunities for suppliers would not be reduced as a result of the Proposed Merger. We address some of the elements of these submissions, such as the relevance of the Parties' incentives and the likely effect of the Proposed Merger on competition in relevant retail grocery markets elsewhere.

285. In our view, the Proposed Merger would affect suppliers differently depending on the strength of their options. However, for many national suppliers the major grocery retailers account for such a large proportion of groceries supplied in New Zealand that we consider it unlikely that those suppliers could substitute supply from major grocery retailers to other buyers, particularly in acquisition markets for dry/ambient, chilled, and frozen products. In addition, each of the Parties provide separate opportunities for new grocery products to be listed. The Proposed Merger would consolidate those two opportunities into one. The consolidation of these opportunities as a result of the Proposed Merger would affect not only competition for the acquisition of existing grocery products but also slow the pace and development of new product innovation for some suppliers as we discuss further below.

286. The Proposed Merger would remove the potential for suppliers to use the outcome of negotiations with one co-operative to influence negotiations with the other and raise the stakes and cost of disagreement with the merged entity compared with separate negotiations with the Parties individually.

287. The Parties submit that this view overlooks the upside, or increased opportunity, available to the supplier(s) that would replace a delisted supplier (eg, an innovative new entrant supplier), and that, in the Parties' view, the prospect of a combined negotiation means increased opportunity (not increased risk), in terms of greater potential for increased sales (and margin), which may not arise to the same extent under the counterfactual.[367] However, as discussed elsewhere, we are not satisfied that the structural reduction in the number of major retail grocery buyers with the Proposed Merger would not substantially lessen competition, which cannot be offset

[367] SoUI submission from the Parties (13 August 2024) at [51.1]. The increased "opportunity" with the Proposed Merger was raised to us as part of our investigation. For example, [ ] noted that the volume and opportunity the Parties and Woolworths can offer is incredible, and that a supplier may do brilliantly when they first get listed. However, it also noted that a supplier has to be able to keep listings, continue to innovate and keep up with the major grocery retailers' demands, and that those margins never shift back to a supplier, and a supplier may go brilliantly but be bankrupt a week later if they get delisted because they have nowhere else to go. Commerce Commission interview with [ ].

by any potential upsides for suppliers that obtain national ranging with the merged entity.

288. The Parties submit that, for suppliers who currently supply only one or a small number of stores, the Proposed Merger would not be capable of giving rise to any change in competitive conditions. Our view is that this could be the case if those suppliers are capacity constrained and restricted to supplying a certain geographic area. However, the Proposed Merger would reduce the options for small capacity constrained suppliers that could supply one of either FSNI or FSSI. Further, the Parties' submissions appear to assume that suppliers who currently only supply a small number of stores would remain small in the future. Our view is that for small suppliers that wish to expand, the Proposed Merger would make it more difficult for them to scale-up their businesses. While a small supplier might still be able to seek island-wide supply (or part island-wide supply) post-merger, any ranging decisions would be made by a single entity (the merged entity), rather than suppliers having two separate buyers (ie, FSNI and FSSI) that they could approach in the counterfactual.[368]

289. Some industry participants (including suppliers across a range of categories and of varying sizes) also specifically expressed a view that the consolidation would be detrimental to competition in acquisition markets and/or retail grocery markets, for example:

289.1 one supplier (of dry food products) told us that the Proposed Merger would limit the competitive nature of having three major grocery retailer customers;[369]

289.2 a second supplier (of non-food products) expressed the view that any additional concentration in grocery markets in New Zealand would be detrimental;[370]

289.3 a third supplier (of dry/ambient products) considers the consolidation with the Proposed Merger would reduce competition;[371]

289.4 a fourth supplier (while noting the Proposed Merger may result in efficiencies for it due to the ability for streamlining), noted that it did not consider that the Proposed Merger would increase competition, and would in fact be a step backwards towards increasing competition in the retail sector;[372] and

289.5 a fifth industry participant sees the Proposed Merger as a "huge negative" for competition.[373]

368 See evidence discussed at [172].
369 Commerce Commission interview with [ ].
370 Commerce Commission interview with [ ].
371 Commerce Commission interview with [ ].
372 Commerce Commission interview with [ ].
373 Commerce Commission interview with [ ].

Increased buyer power with the Proposed Merger

290. Our view is that the removal of one of three major buyers of many categories of grocery products with the Proposed Merger would further entrench the bargaining imbalance that is already present between many suppliers and the Parties separately. This would increase the merged entity's buyer power and enable it to extract lower prices and less favourable terms from suppliers than the Parties would be able to obtain separately in the counterfactual (and better than they would have been able to obtain in a competitive market). This includes "cherry picking" the most favourable terms from those currently offered to each of FSNI and FSSI. Indeed, we understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers: [ ].[374]

291. Suppliers are currently able to negotiate different terms of supply with each of FSNI and FSSI.[375] Currently there are three separate opportunities for many suppliers to negotiate and obtain suitable terms of supply for their products through the major grocery retailers (with each of the Parties and Woolworths). The consolidation with the Proposed Merger would remove one of these opportunities, and for local and regional suppliers remove a supply option. For national suppliers, consolidation would increase the risk and cost of disagreement for suppliers compared with negotiating with FSNI and FSSI separately (due to more of a supplier's business being attributed to the merged entity). The loss of these options would increase the merged entity's bargaining power and make it more likely that suppliers would accept lower prices and less favourable terms compared with the counterfactual. A supplier's inability to reach agreement with the merged entity or to negotiate favourable terms with the merged entity could lead a supplier to significantly reduce its offering or exit the market completely.[376]

292. The Parties submit that the Proposed Merger would not materially enhance the merged entity's buyer power.[377] However, a primary reason for the Parties' own rationale for the Proposed Merger is to increase their buying power.[378] In particular, we understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers:

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374 [ ]

375 This is not the case for private label products which have national supply contracts.

376 For example, one supplier told us that it recently had to cut production because it could not afford to sell at FSNI's desired price. Commerce Commission interview with [ ]. Another supplier indicated that it might not be able to bring in some [ ] because in the absence of large customers, it would be harder to bring in volume and to get the right price. Commerce Commission interview with [ ].

377 SoUI submission from the Parties (13 August 2024) at [2.2(a)]. As noted previously, Houston Kemp recognises that there would be a slight improvement in bargaining power for some suppliers while Düsseldorf Competition Economics expects the Proposed Merger to have 'no buyer power' effect.

378 This is evidenced by the Parties' expectation that the Proposed Merger would result in savings from buying benefits [ ]. [ ]

[ ].[379] In our view, the Parties' expectations that the merged entity would be able to 'cherry-pick' in this way is evidence of significantly enhanced buyer power because of the Proposed Merger. Absent such an enhancement, we would expect suppliers to be able to renegotiate contracts with the merged entity so that they would be no worse off than they were before the Proposed Merger.

293. Contrary to the Parties maintained assertion that the Proposed Merger would not materially increase the merged entity's buyer power, some statements from internal documents provided by the Parties include comments around the [ ], that [ ] and being a [ ].[380] However, the Parties submit that [ ]. The Parties also submit that [ ].[381]

294. In support of their view that the Proposed Merger would not materially enhance the merged entity's buyer power, the Parties submit that the Proposed Merger would result in [ ] improvement in the merged entity's bargaining position with some suppliers, and that this would result in estimated buying benefits of $[ ] over a six-year period. This is [ ]% of the merged entity's projected total spend on products, and [ ]% of the projected total value of retail sales.[382]

295. However, we do not find this persuasive for several reasons.

295.1 First, the Parties have estimated the buying benefits by [ ]. In practice, the Application assumes that the [ ]. In other words, the buying benefits of $[ ] appear to be [ ]. As a result, the more valid comparison is between the estimated buying benefits of $[ ] and [ ] expenditure on suppliers (and not the merged entity's expenditure on all suppliers), as it is the suppliers to [ ] that are expected to bear the brunt of the savings [ ].

379 [ ]

380 [ ].

381 SoUI submission from the Parties (13 August 2024) at 77-78.

382 SoUI submission from the Parties (13 August 2024) at [60]-[62].

295.2 Second, the Parties' estimated buying benefits of $[ ] over six years (or an average of approximately $[ ] per year), is likely to represent a more significant proportion of profitability, particularly in a sector with high volumes and relatively low margins. For example, according to FSNI, of each dollar that is spent at its supermarkets, 4 cents is retained as net profit (with 68 cents paid to suppliers, 13 cents on GST, and 15 cents on wages and other costs).[383] Applied to the Parties combined reported revenues for 2024 – approximately $14.4 billion (comprised of $10.8 billion for FSNI[384] and $3.6 billion for FSSI[385]) – a 4% profit margin implies an annual profit of $576 million. The Parties' estimated annual buying benefits of $[ ] million would represent an increase in combined profit of almost just under [ ]% of the combined profit.

295.3 Third, the Parties' estimation of buying benefits is based on [ ], and is therefore likely to mask the effect on individual suppliers due to differences in bargaining power relative to the merged entity. It may also be the case that [ ].

296. We discuss our views on the constraint from suppliers' countervailing power on the merged entity's buyer power later in this section.

297. Industry participants that we spoke with (including suppliers across a range of categories and of all sizes, both large multinationals and smaller local suppliers) expressed concern that the merged entity's buyer power would result in unfavourable terms and reduced margins for suppliers who rely on the volumes acquired by the Parties, including due to the merged entity:[386]

297.1 having increased or national margin expectations;

297.2 being able to extract more margin, or better terms, from suppliers; and/or

[383] Market study conference transcript (21 October 2021) at 12. https://comcom.govt.nz/__data/assets/pdf_file/0032/269951/Day-1-Transcript-of-Grocery-Market-Study-Conference-21-October-2021.pdf.

[384] https://annualreports.foodstuffs.co.nz/leadership-reports/from-our-chair.

[385] FSSI Annual report (2024) at 10. https://www.foodstuffs-si.co.nz/-/media/Project/Sitecore/Corporate/Corporate-South-Island/PDFs-2024/FY24-Annual-Report_final.pdf.

[386] Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ] and [ ].

297.3 putting suppliers under pressure to improve margins or offer it the best terms.

298. The potential “cherry picking” of terms by the merged entity is a concern that was raised with us by suppliers (across a range of categories and of all sizes, both large multinationals and smaller local suppliers),[387] especially given [ ].[388] Industry participants that we spoke with (including suppliers across a range of categories and of all sizes) saw risks or significant impacts to suppliers’ businesses with the Proposed Merger, and are concerned that suppliers may have no choice but to agree to the merged entity’s terms (given the market share that the merged entity would have and the lack of alternative channels that suppliers would have).[389] Some industry participants also expressed a view that the consequences could be severe for suppliers, including for example:

298.1 one industry participant said that because suppliers would have potentially a whole country of volume with the merged entity, suppliers would be “even more desperate” to hold onto their spots on shelves;[390]

298.2 a second industry participant expressed a view that suppliers already feel forced to agree to the Parties’ terms to gain ranging, or they might “lose 60% of [their] business overnight”;[391]

298.3 one supplier (of beverages) told us that the merged entity would represent a lot of value and volume in grocery markets in New Zealand, and that the price to pay to access that scale may be prohibitive for some smaller suppliers;[392]

298.4 a second supplier (of dry food products) noted that smaller suppliers would struggle to stand up to the merged entity;[393]

298.5 a third industry participant told us that the merged entity’s increased buyer power could see some suppliers that win and some that get completely wiped out; and[394]

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387 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ] and [ ].

388 SoPI cross submission from the Parties (7 March 2024) at [148].

389 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ] and [ ].

390 Commerce Commission interview with [ ].

391 Commerce Commission interview with [ ].

392 Commerce Commission interview with [ ].

393 Commerce Commission interview with [ ].

394 Commerce Commission interview with [ ].

298.6 another supplier noted that with the increased buying power the merged entity would have, it could cause [ ] to go out of business, leaving [ ] to control the relevant market and prices going up.[395]

299. We also note that freighting across the Cook Strait is recognised as a significant expense for suppliers.[396] We have been told that it is more costly moving product from the North Island to the South Island compared to the reverse.[397] If the merged entity – by potential "cherry picking" of terms – implemented the better of the terms in a supplier's existing contract with FSNI and FSSI, this could have implications for suppliers in terms of margin and ranging. For example, one industry participant indicated to us that it expects FSNI and FSSI to merge terms, taking the terms that are more favourable to the commercial interests of the merged entity, rather than a fair balance and expressed concerned about this, given there are more costs involved in getting product to the South Island.[398]

300. Houston Kemp submits that as the Parties do not compete in retail grocery markets they would retain the same post-merger incentives to ensure optimal supplier investment, so the merged entity could compete with Woolworths in retail grocery markets.[399] We discuss this proposition further at [383] below. However, we consider that the merged entity, as a profit maximising entity, would have the incentive to use any additional market power it gains as a result of the Proposed Merger to extract better prices and terms from suppliers.

301. The Parties submit that the Proposed Merger would generate efficiencies for suppliers.[400] Some industry participants we spoke with (including suppliers across a range of categories) indicated that the Proposed Merger could create efficiencies or simplification and/or be beneficial in that suppliers would only have to deal with a single merged entity rather than FSNI and FSSI separately.[401] In addition,

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395 Commerce Commission interview with [ ].
396 Commerce Commission interview with [ ].
397 Commerce Commission interview with [ ].
398 Commerce Commission interview with [ ].
399 Houston Kemp report on SoUI (13 August 2024) at [6]-[7] and [14].
400 In the Parties' view, anticipated merger benefits for suppliers include improving the ease of doing business with one relationship (ie, with the merged entity, instead of individually with FSNI and FSSI), the ability to streamline operations and remove cost from customer service, ensuring product plans agreed with suppliers can be executed consistently on a national basis, and increasing the speed to market of product innovation. SoI submission from the Parties (26 April 2024) at [107].
401 Commerce Commission interviews with [ ], and [ ]. We discuss the efficiencies/benefits of the Proposed Merger in more detail later. Despite acknowledging the efficiencies that could arise from the Proposed Merger, many of these industry participants also raised concerns about the Proposed Merger and its potential negative impact.

[ ] considers the Proposed Merger would create ease for suppliers in having to only deal with a single merged entity.[402]

302. Any savings from the Proposed Merger would arise from a combination of cost savings ([ ]) and buying benefits from enhanced buyer power ([ ]). In terms of the latter, the Parties' [ ].[403]

303. We discuss how we consider efficiencies in a s 66 merger clearance context in detail from [422]. In summary, our view is that in a merger clearance context our consideration of any efficiencies should be limited to in-market rivalry-enhancing efficiencies. In the case of the Proposed Merger, there may be some in-market efficiencies associated with lower costs of negotiations (as a result of only having to negotiate with the merged entity rather than the Parties individually). However, our view is that the cost savings accruing to the merged entity simply from exploiting its enhanced buyer power in acquisition markets should not be treated as relevant efficiencies. Instead, such cost savings reflect a harm to competition.

Level of constraint provided by other acquirers of grocery products

304. We have considered the constraint that the merged entity would face from other acquirers of grocery products. Those acquirers may constrain the merged entity's buyer power if they have an incentive to offer higher prices or better trading terms to suppliers and/or suppliers can switch sufficient volumes to other acquirers.

305. For the reasons set out below, competition from the remaining competing buyers in relevant acquisition markets is unlikely to be sufficient to constrain the merged entity from exercising increased buyer power in acquisition markets, including those set out in Table 2 above. In markets where suppliers are often dependent on the major grocery retailers as their major route for selling to retail customers (such as national markets for the acquisition of dry/ambient and chilled or frozen groceries by major grocery retailers), we are not satisfied that Woolworths would have an incentive to constrain the merged entity. Rival grocery retailers other than Woolworths account for only a small portion of grocery retailing and buying in New Zealand. In acquisition markets where there are also buyers in wholesale and/or export channels (such as markets for the acquisition of meat and seafood products by grocery retailers and other customers), we are not satisfied that suppliers would be able to switch sufficient output to those channels such that buyers in those channels would constrain the exercise of the merged entity's buyer power.

402 Commerce Commission interview with [ ].

403 [ ]

Submissions from the Parties

306. The Parties submit that the characterisation of the Proposed Merger as a reduction from three to two major grocery retailers (and major acquirers of groceries) in New Zealand is simplistic, incorrect and inaccurate as it does not account for the varied positions of different suppliers and their other options for selling their products, submitting that:[404]

306.1 for suppliers in many markets, options of at least the scope and scale of the Parties are available (eg, export) and other grocery retailers of sufficient scope and scale provide alternatives (eg, Chemist Warehouse);

306.2 for suppliers in lower-volume markets, other grocery retailers do not need to be of comparable scope and scale to provide an alternative; and

306.3 medium suppliers tend to have realistic options outside the major grocery retailers.

307. The Parties and Houston Kemp further submit that fresh produce suppliers' other options (including exporting, selling to other key retailers, foodservice, food manufacture or meal kit providers) remain a key factor in their willingness to accept particular terms when negotiating with FSNI or FSSI (or any other buyer).[405]

308. In relation to the constraint from Woolworths, the Parties submit that it is implausible that Woolworths would not present a sufficient constraint on the merged entity's buyer power because, in the Parties' view:[406]

308.1 Woolworths is a national business and is a materially larger acquirer than the Parties currently and, on that basis, could already achieve significantly better terms than FSNI and FSSI;

308.2 the change in product prices the Parties aim to achieve is not sufficiently significant to support any material change in their ability to compete with Woolworths (only a small improvement in price competitiveness);

308.3 suppliers' bargaining position relative to Woolworths would not be changed with the Proposed Merger in a way that would allow them to worsen the terms they offer Woolworths; and

308.4 many suppliers have significant channels to market outside of the major grocery retailers such as export markets, speciality retailers, foodservice buyers, wholesalers and food manufacturers.

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404 SoI submission from the Parties (26 April 2024) at [41] and [44.2] and SoI cross submission from the Parties (31 May 2024) at 7-8.

405 SoI submission from the Parties (26 April 2024) at [39.2] and Houston Kemp report on SoPI (7 March 2024) at [81(b)] and [84].

406 SoUI submission from the Parties (13 August 2024) at [91]-[92].

309. Houston Kemp also submits that there are a spectrum of options available to suppliers (other than through export) to supply fresh produce.[407]

310. Finally, by way of specific examples, the advisors for the Parties submit that:[408]

310.1 [ ];[409]

310.2 [ ];

310.3 [ ];

310.4 [ ];[410]

310.5 [ ];

310.6 [ ];[411]

310.7 [

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407 Houston Kemp report on SoPI (7 March 2024) at [85].

408 Confidential SoUI submission from the Parties' advisors (30 August 2024) at [11].

409 [ ]. Commerce Commission interview with [ ].

410 [ ]. Commerce Commission interview with [ ].

411 [ ]. Commerce Commission interview with [ ].

]; [412]

310.8 [

]; [413]

310.9 [

]; [414]

310.10 [

]; [415]

310.11 [

]; [416]

and

310.12 [

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412 [ ], Commerce Commission interview with [ ].

413 [ ]. Commerce Commission interview with [ ].

414 [ ]. Commerce Commission interview with [ ].

415 [ ]. Commerce Commission interview with [ ].

416 [ ]. Commerce Commission interview with [ ].

].[417]

Third party submissions and evidence received

311. The Warehouse Group submits that retailers outside the major grocery retailers are of a different scope and scale and do not provide a true alternative for suppliers.[418]

312. The Grocery Action Group submits that The Warehouse is the only other realistic competitor to the Parties and Woolworths.[419]

313. The Food and Grocery Council submits that in response to its survey, suppliers generally perceive other grocery retailers like The Warehouse and Costco as too small to have an impact or provide a viable alternative to the major grocery retailers, and that these other grocery retailers lack the scale to compete effectively with the major grocery retailers.[420]

314. The New Zealand Specialist Cheesemakers Association submits that there is not sufficient scale or capability in other acquirers of groceries to impact the current major grocery retailers and that rival grocery retailers are either too small (eg, Farro Fresh) or do not sell higher priced discretionary purchases (eg, The Warehouse).[421]

315. Rival grocery retailers (other than Woolworths) that we spoke with consider that they already acquire groceries on different terms to the Parties or may not be able to source brands sold through the Parties. However, one of these rival grocery retailers does not see themselves competing that closely with the Parties or consider that the Proposed Merger would materially impact on it. Specific feedback from rival grocery retailers includes the following:

    315.1 one smaller grocery retailer considers that the Proposed Merger would not have much of an effect on it albeit it does consider the major grocery retailers to be its "number one" competitors. It also considers that it already does not

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417 [ ]. Commerce Commission interview with [ ].

418 SoI cross submission from The Warehouse Group (10 May 2024) at [18(b)]. The Parties' response to this submission is that it is incorrect, simplistic, and inaccurate to characterise the Proposed Merger as a reduction from three to two buyers. The Parties further note that as an example, for suppliers in many markets, options of at least the scope and scale of the Parties are available (eg, exports), for suppliers in many markets other local grocery retailers are easily of sufficient scope and scale to provide an alternative (eg, Chemist Warehouse). For suppliers in lower-volume markets, grocery retailers do not need to be of a comparable scope and scale to provide an alternative. SoI cross submission from the Parties (31 May 2024) at 7-8.
[ ]. Commerce Commission interview with The Warehouse Group (8 February 2024).

419 SoI submission from the Grocery Action Group (24 April 2024) at [3.10].

420 SoI submission from the Food and Grocery Council (26 April 2024) at [13.4].

421 SoUI submission from New Zealand Specialist Cheesemakers Association (12 August 2024) at 7.

acquire groceries on the same supply terms as some of the major grocery retailers;[422] and

315.2 [ ].[423]

316. Industry participants that we spoke with do not appear to see rival grocery retailers (other than Woolworths) as providing significant constraint on the Parties. For example, one party noted that other grocery retailers (such as Costco) tend to sit on the "edges" compared to what the major grocery retailers are providing.[424]

317. Suppliers that we spoke with (across a range of categories and of all sizes) indicated that, for suppliers:

317.1 volume to the major grocery retailers is important and, for some suppliers, it would be difficult to function without them;[425] and

317.2 diverting volume to other channels outside of the major grocery retailers would be challenging.[426]

<u>Our view</u>

318. Competition from the remaining competing buyers in relevant acquisition markets is unlikely to be sufficient to constrain the merged entity from exercising increased buyer power, such that competition would not be substantially lessened with the Proposed Merger.[427]

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[422] Commerce Commission interview with [ ]. While [ ], we do not consider it a direct competitor to the Parties given the differentiated offering and customer base.

[423] Commerce Commission interview with [ ].

[424] Commerce Commission interview with [ ].

[425] Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ] and [ ].

[426] Commerce Commission interviews with [ ], [ ], [ ], [ ] and [ ].

[427] The Parties submit that it is not necessary to conclude on the level of constraint provided by other acquirers of grocery products, because the focus is the change that would arise from the Proposed Merger and the consequences of that change. The Parties further submit that the structure of retail grocery markets, and therefore their competitive incentives, would not change as a result of the Proposed Merger. SoUI submission from the Parties (13 August 2024) at [90]. However, as noted elsewhere, in our view, we are not required to assess the incentives the merged entity may or may not have to harm the competitive process between itself and suppliers, and how these incentives might differ to those of the Parties in the counterfactual. If we were required to assess incentives, we would not be satisfied that the merged entity's incentive to ensure competitive supply of groceries in acquisition markets would outweigh its incentive to maximise its profit by using its enhanced buyer power to reduce acquisition prices and worsen terms for suppliers. As such, we consider it *is* necessary for us to consider the extent to which rival grocery retailers could constrain the merged entity, in case such constraint would be sufficient to mean no substantial lessening of competition would be likely.

319. Our discussion of the acquisition markets that are relevant to our assessment of the Proposed Merger assessed the strength of the alternative channels available to suppliers. In several acquisition markets, the major grocery retailers are suppliers' main route for selling to retail consumers. Based on the evidence received, it appears that for many suppliers in those acquisition markets, the merged entity's only meaningful competitor in the acquisition of grocery products would be Woolworths. While Woolworths would remain as a significant acquirer of grocery products from suppliers in acquisition markets, as noted earlier:

  319.1 with the Proposed Merger, Woolworths would be one of just two remaining major grocery retailer customers to whom many suppliers would sell most of their output to; and

  319.2 we are not satisfied that Woolworths would have an incentive to constrain the merged entity. In our view, we do not consider that Woolworths would have an incentive to offer better terms to suppliers to constrain the merged entity's buyer power.[428] Doing so would likely raise its own costs and reduce its competitiveness with the merged entity unless it reduced its own margins. Instead, we consider that Woolworths (and any other rival grocery retailer) would likely have an incentive to try to also obtain lower prices from suppliers to remain competitive with the merged entity.[429] Regardless, Woolworths would be unlikely to have the capacity to absorb significant additional volumes from suppliers. Woolworths does not currently experience issues in obtaining grocery products from suppliers.

320. There are other grocery retailers who would compete with the merged entity to acquire grocery products, as set out earlier at [38] and [167]. However, evidence indicates that these other grocery retailers account for a small proportion of grocery retail sales in New Zealand, compared to the major grocery retailers (the Parties and Woolworths).

  320.1 In the market study, we assessed that between 2015 and 2019 the major grocery retailers accounted for a combined share of retail supply of between 70% and 90%.[430] The analysis from our first annual grocery report, shown in Figure 2 above, indicates that the major grocery retailers continue to account for a large combined share of retail grocery sales.

  320.2 The major grocery retailers are the largest buyers of grocery products in New Zealand and a key route to market for many suppliers. Data gathered as part of our investigation of the Proposed Merger (set out in Table 1) shows that the major grocery retailers account for a similar percentage of supply for

428 See for example, Buyer Power and Merger Analysis – the need for different metrics, Statement of Peter C Carstensen, prepared for workshop on merger enforcement held by Antitrust Division and the Federal Trade Commission (2004) available at https://www.justice.gov/archives/atr/buyer-power-and-merger-analysis-need-different-metrics.

429 While Woolworths and other grocery retailers are likely to have the incentive to also seek lower prices from grocery suppliers, we are not satisfied that they would have the ability to achieve that outcome.

430 Market study final report (8 March 2022) at [8.50].

some suppliers – although different suppliers may be affected differently by the Proposed Merger.

320.3 Qualitative evidence from suppliers that other grocery retailers account for a small proportion of grocery retailing supports our assessment of the quantitative data, although this may vary by category or supplier. For example, two suppliers (of non-food products) told us that over [ ]% and [ ]% of their revenue/business sits with the major grocery retailers.[431] A third supplier (of a range of grocery products) told us that [ ]% of its products go through the major grocery retailers.[432] A fourth supplier (of beverages) told us that the Parties are the primary source of its business,[433] with a fifth supplier (of dry food products) highlighting the dominant role of the Parties in its category.[434] A supplier (of non-food products) said that the major grocery retailers make up a majority of its business and that its supply to other grocery retailers (ie, The Warehouse and Chemist Warehouse) are less compared to volumes being acquired by the major grocery retailers.[435] Another supplier (of imported food) advised that while it sells into The Warehouse and Costco, this is relatively small business compared to the major grocery retailers.[436] Lastly, another supplier (of dry food products) noted that no other grocery retailers can buy at the volume of the Parties, especially for premium goods.[437]

321. Suppliers that we spoke with (across a range of categories) consider that channel diversity and having multiple channels to sell into, is important for suppliers,[438] and we consider it is important to the competitive process in acquisition markets. One of these suppliers told us that, from a trading environment perspective, the fact that it has the ability to trade with three different major grocery retailers and also other smaller grocery retailers around the edges, balances things out currently.[439] Moreover, other suppliers and industry participants indicated to us that they see risks in supplying other grocery retailers or in offering them better terms than the Parties, currently or post-merger:

321.1 one supplier (of a range of ambient products) said that it is not comfortable taking the risk of being seen by the Parties or Woolworths as cheaper on other shelves. It noted that already, if one grocery retailer promotes its

431 Commerce Commission interviews with [ ] and [ ]. The remaining sales of these suppliers may not solely be to other grocery retailers, as suppliers could also make sales to foodservice wholesalers.
432 Commerce Commission interview with [ ].
433 Commerce Commission interview with [ ].
434 Commerce Commission interview with [ ].
435 Commerce Commission interview with [ ].
436 Commerce Commission interview with [ ].
437 Commerce Commission interview with [ ].
438 Commerce Commission interviews with [ ], [ ], [ ] and [ ].
439 Commerce Commission interview with [ ].

products, it receives calls from other grocery retailers with complaints or expectations (even if it is a retailer-led promotion);[440] and

321.2 an industry participant considers that if Costco (even though it is a small grocery retailer) or The Warehouse are given the same price as the major grocery retailers and emerge with a sharp price (at the retail level), suppliers are called in by the major grocery retailers who seek a lower supply price from suppliers so they can match other grocery retailers, while maintaining existing margins.[441]

322. In some acquisition markets, such as national markets for the acquisition of meat and seafood, national markets for the acquisition of beer and wine, and local, regional and national markets for the acquisition of fresh produce, buyers in wholesale and/or export channels may provide some constraint on the merged entity's buyer power in respect of some suppliers.

323. However, we are not satisfied that in those markets, competition from acquirers in non-retail channels would be sufficient to constrain the merged entity's buyer power. This is because we are not satisfied that suppliers would be able to quickly and easily divert sufficient output to those channels. See [212] for examples showing the difficulty for some suppliers of switching to other channels.

324. Overall, competition from the remaining competing buyers in relevant acquisition markets is unlikely to be sufficient to constrain the merged entity from exercising increased buyer power. This is because:

324.1 there is likely to be a subset of suppliers that have no substantial alternative options of supply outside of the major grocery retailers, and these are particularly likely to be suppliers of products that are dry/ambient, frozen or chilled (as outlined earlier in Table 2). This is consistent with our view that a reduction in major grocery retailer customers from three to two and a single point of negotiation with the merged entity would raise the stakes for such suppliers (ie, the cost of disagreement or risk to the supplier in being delisted and/or losing volume, would be significantly higher than without the Proposed Merger);

324.2 as regards Woolworths, we are not satisfied that Woolworths would have an incentive to constrain the merged entity;

324.3 other buyers of retail groceries do not have sufficient scale to constrain the merged entity; and

440 Commerce Commission interview with [ ]. In the SoUI Submission from the Parties (13 August 2024) at 89, the Parties submit that they do not seek to disrupt supply to their competitors but do seek to ensure they receive supply on competitive terms.

441 Commerce Commission interview with [ ].

324.4 where it is an option, we are not satisfied that suppliers could quickly and easily divert output from the merged entity to buyers in other channels such as wholesale and/or export.

Countervailing power of suppliers

325. We have considered the extent to which any suppliers have countervailing power which they would be able to use to constrain the exercise of buyer power by the merged entity. In the context of a merger between buyers, countervailing power exists when a supplier possesses special characteristics that give that supplier the ability to substantially influence the price a merged firm pays.[442]

326. When we assess countervailing power in a merger between competing buyers, we are generally concerned with the bargaining power that a supplier would have in negotiations with the merged entity. This will depend, among other things, whether suppliers can bypass or threaten to bypass the merged firm by sponsoring new entry at the retail level; or whether they could switch (or credibly threaten to switch) to buyers of grocery products in other geographic markets where competitive conditions are different. It will also depend on the alternatives available to the buyer.

327. There may be some ‘must have’ products for which there are few alternatives and which are so important for a major grocery retailer to stock that the supplier has greater bargaining power in any bilateral negotiations with grocery retailers. However, even suppliers of ‘must have’ products may suffer from a bargaining power imbalance today. Furthermore, any bargaining advantage that suppliers of ‘must have’ products have does not necessarily extend to other products in their range or protect other suppliers from the exercise of buyer power. We discuss this in further detail at [343]. We also note that a merger which removes a buyer that was an important alternative for a seller would be expected to reduce a supplier’s countervailing power compared with the counterfactual.

328. For the reasons set out below, we consider that grocery suppliers would be unlikely to be able to exert countervailing power to the extent that they could constrain an exercise of buyer power by the merged entity.

<u>Submissions from the Parties</u>

329. The Parties submit that suppliers have material countervailing power and that in their view:[443]

329.1 large, multinational suppliers (which make up a significant percentage of the Parties’ total sales):

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442 Mergers and Acquisitions Guidelines above n3 at [3.115] in the context of a merger between sellers.

443 SoI submission from the Parties (26 April 2024) at [47]-[49] and SoUI submission from the Parties (13 August 2024) at [97], [99],[101], [144.3] and 102.

329.1.1 generally have parent companies many times larger than the Parties and, in many cases sell 'must have' items; and

329.1.2 their countervailing power is significant in concentrated acquisition products, and is not diminished based on choices they make about structuring their business in New Zealand or outsourcing aspects of their negotiation or distribution;

329.2 suppliers with popular or 'must have' products or alternative options (eg, exports or alternative countries, for goods imported by multinational suppliers) have countervailing power;

329.3 the Parties are obliged to accept price terms (or cost price increases) from these suppliers or face an inability to supply their customers with well-known brands;

329.4 given the scale and relative size of large multinational suppliers compared to the major grocery retailers in New Zealand, large multinational suppliers may be able to charge even higher prices (and enjoy higher margins) in New Zealand than elsewhere; and

329.5 suppliers leverage the popularity of their 'must have' products into the supply of other products in their portfolio. FSNI notes that, in its experience, leveraging a popular or 'must have' product to gain ground with another product is a key negotiation tool that suppliers use, particularly the larger multinationals (examples including [ ]).

330. The Parties further submit that:[444]

330.1 smaller national suppliers that do not necessarily offer 'must have' products are also very important to the Parties to ensure that the Parties can address particular need states and respond to consumer demands for variety etc. These smaller suppliers already face significant competition from large suppliers and should not be expected by be materially affected by the Proposed Merger. Further, there are many examples of the Parties actively fostering the development of these suppliers [ ]; and

330.2 the relative bargaining position of suppliers would depend on a range of factors that vary by product market, such as supplier concentration, the presence of 'must have' products, and alternative channels available. The Parties consider there are many instances where suppliers have demonstrated a strong bargaining position (eg, [ ]).

444 SoUI submission from the Parties (13 August 2024) at [144.4] and 95.

331. The Parties and Houston Kemp further submit that fresh produce suppliers' other options (including exporting, selling to other key retailers, foodservice, food manufacture or meal kit providers) remain a key factor in their willingness to accept particular terms when negotiating with FSNI or FSSI (or any other buyer).[445]

332. The Parties' advisors also submit that:[446]

332.1 [ ];

332.2 [ ];

332.3 [ ];

332.4 [ ];

332.5 [ ];

[445] SoI submission from the Parties (26 April 2024) at [39.2] and Houston Kemp report on SoPI (7 March 2024) at [81(b)] and [84].

[446] SoUI submission from the Parties (13 August 2024) at Appendix [ ] and confidential SoUI submission from the Parties' advisors (30 August 2024) at [11], [12] and [23].

332.6 [ ];

332.7 [ ]; and

332.8 [ ]:

332.8.1 [ ]; and

332.8.2 [ ].

333. Houston Kemp also submits that strength of brand and market power on the supply-side are due to larger national suppliers having a stronger bargaining position.[447]

334. Houston Kemp further considers that:[448]

334.1 it does not necessarily follow if a supplier has one 'must have' product, that all their other products are 'must have' but that if a supplier has amonopoly

[447] Houston Kemp report on SoPI (7 March 2024) at [56] and Houston Kemp report on SoUI (13 August 2024) at [49].

[448] Commerce Commission calls with the Parties' advisors (12 June 2024) and (5 September 2024).

of a ‘must have’ product, they could attempt to bundle or tie other products with it, when dealing with the Parties;[449]

334.2 alternative channels of supply are those other options/channels that suppliers can flex and are the source of countervailing power in a bargaining arrangement; and

334.3 [

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Third party submissions and evidence received

335. The Food and Grocery Council submits that responses to its survey indicate a shared view among suppliers who perceive themselves as having less negotiating power relative to the major grocery retailers.[450]

336. The New Zealand Specialist Cheesemakers Association submits that there are no individual suppliers or groups of suppliers within its association that could defend themselves from the market power of the Proposed Merger with a defensive retail strategy.[451]

337. As described below, industry participants that we spoke with (including suppliers across a range of categories and of all sizes, both large multinationals and smaller local suppliers) expressed mixed views on the strength of suppliers’ countervailing power.

338. Evidence (as shown by the examples below) indicates that larger suppliers, suppliers of ‘must have’ products and suppliers with alternative options to the Parties may be more likely to have, or be perceived to have, countervailing power.

338.1 A large multinational supplier considers that it has strong bargaining power with the major grocery retailers because it is a big supplier and the major grocery retailers need it (ie, the major grocery retailers’ need for its product creates some leverage).[452] Two other suppliers (in different categories) indicated that smaller local and regional suppliers may have better leverage than other suppliers (with one noting that smaller suppliers potentially get a

449 We have not identified evidence of any supplier attempting to bundle or tie the supply of a ‘must have’ product to other products they supply. Further, it would follow that it should be just as likely that the Parties could attempt to bundle or tie their acquisition of any non-‘must have’ products with getting access to ‘must have’ products.

450 SoI submission from the Food and Grocery Council (26 April 2024) at [10.2].

451 SoUI submission from New Zealand Specialist Cheesemakers Association (12 August 2024) at 8. The Parties response to this submission is that the “market power” or market position of the Parties is not expected to be enhanced by the Proposed Merger and that there is substantial competition in relation to speciality cheeses, including from imported products. SoUI cross submission from the Parties (26 August 2024) at 11.

452 Commerce Commission interview with [ ]. The Parties consider that many multinational suppliers would be in this position (ie, big suppliers that are needed by the Parties). SoUI submission from the Parties (13 August 2024) at 88.

"leg up", and the other noting that planograms allow for local/regional suppliers).[453] A fourth supplier (of dry food products) told us that its strength of brand and propositions are its strength in negotiations, but also noted that "[the Parties] are more important to us than we are to them".[454]

338.2 Two suppliers indicated that they would not supply the Parties on terms that were unacceptable, with one suggesting a supplier might have a degree of power in negotiations where it has a 'must have' product. In particular, one supplier (of a range of products) said that if it cannot get a price that is acceptable, it would not supply product to the Parties, and noted that while it is necessary to "put up with what you can get," if a supplier has a product that the Parties really want, then there is no questions on price.[455] A second supplier into [ ] told us that if the merged entity sought a better deal on one of its products, that it would not supply it and pull the product.[456]

338.3 In terms of evidence from grocery retailers, Woolworths told us that many dry grocery products are considered 'must haves' and these suppliers (of 'must have' dry grocery products) have significant countervailing power.[457] Woolworths considers that a large proportion of suppliers have alternative options to supplying it and therefore exert countervailing power in negotiations.[458]

338.4 However, contrary evidence from other industry participants and suppliers (across a range of categories and of all sizes) is that a number of market leading brands or large suppliers have been de-ranged by the Parties (with some exiting the market or scaling back their business) or have had to reduce their prices/margins to be ranged by the Parties, suggesting that suppliers of such brands may not have countervailing power. For example:

338.4.1 one supplier (of [ ] products) told us that it lost approximately [ ] of its [ ] in FSNI and was forced to [ ]. It explained that, while volume is only one of many variables it looks at when making portfolio decisions, losing as much volume as it did when it was delisted from FSNI was a major contributor to

453 Commerce Commission interviews with [ ] and [ ].

454 Commerce Commission interview with [ ].

455 In this instance, the supplier referred to its [ ]. See Commerce Commission interview with [ ]. The Parties submit that this is consistent with their experience. SoUI submission from the Parties (13 August 2024) at 96.

456 Commerce Commission interview with [ ].

457 Woolworths RFI response (17 April 2024) at document WW.010.0002 at 4.

458 Woolworths RFI response (17 April 2024) at document WW.010.0002 at 1. The Parties submit that this is consistent with their experience and with the market analyses in relation to dry grocery products provided at Appendices 2-20 of their SoUI submission. SoUI submission from the Parties (13 August 2024) at 96-97.

[ ];[459]

338.4.2 another supplier told us that it won a product listing on the basis that [ ], at the expense of a competitor who had some products delisted. It does acknowledge that this meant a reduced margin;[460] and

338.4.3 a third supplier told us that it had recently had to reduce its production because it could not afford to sell at FSNI's desired price.[461]

339. A few other instances of ranging decisions that appear to indicate a lack of countervailing power on the part of suppliers are:

339.1 a supplier (of [ ] products) told us about an instance where it was not able to meet FSNI's margin expectations and so many products were delisted and [ ]. While it was able to divert some of that supply to Woolworths, it was required to reduce its production and offered some margin improvement to keep ranging;[462] and

339.2 another supplier had its [ ] delisted in FSNI following discussions about ongoing supply and noted these scenarios are usually in connection with grocery retailers seeking margin to sustain a retail price point to keep

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459 The product referred is [ ]. Commerce Commission interview with [ ]. We note the Parties' submission that we should not rely on this evidence without substantiation. See SoUI Submission from the Parties (13 August 2024) at 98. This supplier's evidence is consistent with [ ] See [ ] at 43 and [ ] at 18 and 31.

460 Commerce Commission interview with [ ] and e-mail from [ ] to the Commerce Commission (12 September 2024). The Parties' submission is that the evidence does not appear to be validated and we should seek to provide documentary evidence. See SoUI submission from the Parties (13 August 2024) at 100. This suppliers' evidence is consistent with [ ] See [ ] at 5.

461 Commerce Commission interview with [ ]. The Parties' submission is that we should not rely on this evidence without substantiation. See SoUI submission from the Parties (13 August 2024) at 101. This suppliers' evidence is consistent with [ ]. See [ ] at 15.

462 Commerce Commission interview with [ ] and e-mail from [ ] to the Commerce Commission (12 September 2024). This is despite FSNI considering [ ] as a [ ] and accounting for [ ]% of [ ] category. See SoUI submission from the Parties (13 August 2024) at Appendix [ ].

them competitive with other grocery retailers and that this is not specific to FSNI or FSSI.[463]

340. The Parties submit that we should not rely on such information without validation. We do not accept that this is correct. We assess the credibility and reliability of all evidence by reference to a range of matters including the nature of the evidence, if and how it is corroborated, its internal consistency, and its consistency with other evidence. We are not making any determination about these particular ranging decisions. They are simply examples of the issues that have been raised. What they show is the importance of alternative options for suppliers.

<u>Our view</u>

341. We are not satisfied that suppliers would be able to exert countervailing power to the extent that they would constrain an exercise of buyer power by the merged entity. The structural change with the Proposed Merger would remove a buyer that for many suppliers is an important alternative option. We expect that this would materially shift the balance of bargaining power in favour of the merged entity during negotiations with suppliers. It is not realistic that suppliers could sponsor new entry in retail grocery markets.

342. We consider that some suppliers (such as companies with 'must have' products or companies with alternative channels that they can threaten to switch supply to) are more likely to have a degree of countervailing power than other suppliers.

343. However, we have received mixed evidence to support the Parties' submission that leveraging a popular or 'must have" product to gain ground with another product is a key negotiation tool that suppliers use, particularly the larger multinationals.[464] [465] One supplier we spoke with considers that it could leverage the strong brand power of one of its products into negotiations for its other products that are more readily substitutable, but noted that it tends to focus more on how to make that other product/brand non-substitutable instead. It also noted that while there is a clear correlation between strength of brand and profitability, it is not necessarily the case that the strongest brand has the highest margin per unit.[466] Conversely, Anonymous G submits that
[

463 Commerce Commission interview with [ ] and e-mail from [ ] to the Commerce Commission (11 September 2024).

464 SoUI submission from the Parties (13 August 2024) at 102.

465 The Parties appear to use this as a lever, but in the reverse. For example, an instance where FSNI's [ ]. See [ ] at 13. The Parties submit that [ ]. See [ ] at 13 and SoUI submission from the Parties (13 August 2024) at Appendices [ ].

466 Commerce Commission interview with [ ].

].[467]

344. In our view, even suppliers that are in a stronger bargaining position than other suppliers may suffer from a bargaining power imbalance to some extent in the counterfactual, which would be exacerbated by the Proposed Merger.[468] This is because, in many cases, the Parties are two of the largest buyers of these companies' products in New Zealand, and the Parties have many levers that they can utilise in negotiations. For example (using some of the specific suppliers that the Parties' advisors noted would have countervailing power):

344.1 despite being a multinational company, [ ] has raised concern with us about the "clout at the table" the merged entity would have, and the "far more dramatic effect" that pushing back or refusing a request by the merged entity could have.[469] [ ];[470]

344.2 [ ] told us that the "overwhelming majority" (over [ ]%) of its revenue in New Zealand comes from the major grocery retailers, and a product de-listed by FSNI would often trigger a conversation as to whether [ ]. It further noted that concentration in the New Zealand market makes it "less and less attractive" for multinational suppliers. As noted elsewhere, [ ];[471]

344.3 FSNI [ ];[472]

344.4 FSNI [

467 SoI submission from Anonymous G (18 April 2024) at [12b].

468 For example, [ ]. Commerce Commission interview with [ ]. This scenario is consistent with [ ] at 15. FSSI also notably considers [ ] as one of its 'must have' products in this category. See SoUI submission from the Parties (13 August 2024) at Appendix [ ].

469 Commerce Commission interview with [ ].

470 [ ] at 15.

471 Commerce Commission interview with [ ].

472 [ ] at 26.

];[473] and

344.5 [ ],[474] [ ].[475]

345. We have also seen evidence that the Parties' negotiations appear to prioritise margin expectations over strength of brand and ranging.[476] In addition, in the category review documentation provided by the Parties, further details are provided on the negotiations between [ ] and suppliers. For example, [ ].[477] In other words, even when dealing with strong brands in a category, [ ] has a number of strategies and options to deal with suppliers who offer them a better margin. This provides an indication of the strength of the current bargaining position of one of the Parties, even with suppliers with strong brands in a category. The Proposed Merger would give the merged entity enhanced bargaining power that would give it even greater ability to leverage suppliers to increase its profits at their expense.

346. Another example is in the cleaning products category, in which the Parties note multinational suppliers play [ ].[478] In the category review documentation for this category, [ ].[479] [ ].[480]

346.1 [

473 [ ] at 32.

474 Confidential SoUI submission from the Parties' advisors (30 August 2024) at 11.

475 Commerce Commission interview with [ ] and e-mail from [ ] to the Commerce Commission (12 September 2024).

476 FSSI notes [ ]. See e-mails from [ ].

477 [ ] at 2 and 4.

478 SoUI submission from the Parties (13 August 2024) at Appendix 6.

479 [ ] at 5.

480 [ ] at 15.

];[481]

346.2 [ ].[482]

347. [ ].[483] If a supplier provides products to FSNI and FSSI on materially different terms, this may suggest the supplier has greater bargaining power over one of the Parties compared to the other. However, it does not necessarily follow that the supplier has countervailing power in its negotiations with the Parties that would be sufficient to constrain the merged entity from extracting better terms due to its buyer power as a result of the Proposed Merger.

348. We also note that information provided by the Parties as part of their submission on the SoUI and separately includes a breakdown of FSNI sales by supplier by different product categories, which the Parties have analysed in their submissions on the SoUI.[484] These breakdowns provide an indication of the extent to which FSNI currently faces a single or small number of large suppliers in a product category, or alternatively faces a more dispersed supplier base in which FSNI could play multiple suppliers against each other. The 24 categories analysed by the Parties in their submissions on the SoUI each fit within one of the broader aggregated categories of acquisition markets we have defined to assist our assessment of the Proposed Merger (outlined in Table 2).[485]

349. Although the Parties characterise the supply-side as being highly concentrated,[486] with the implication that the Parties are at a bargaining disadvantage, this is not always reflected in the breakdown provided by the Parties. For example, for the category of salad dressings, vinegar, pickles and relishes, the Parties submit that the category [ ].[487] However, the breakdown of FSNI sales by supplier shows [ ].[488] This indicates a fragmented supply, and that FSNI has multiple suppliers and supply options in this category that it can turn to in the

481 [ ] at 2.
482 [ ] at 2 and 5.
483 Commerce Commission interview with the Parties' advisors (5 September 2024).
484 SoUI submission from the Parties (13 August 2024) at Appendices 2-20 and FSNI RFI response (6 September 2024).
485 SoUI submission from the Parties (13 August 2024) at Table 1 and Appendices 2-20 and SoUI cross submission from the Parties (26 August 2024) at Table 1 and Appendices 3-7.
486 The number of sources of supply will differ among product categories, with some categories having more suppliers than others. For example, the Parties consider that categories of [ ] all comprise a high concentration of suppliers. See SoUI submission from the Parties (13 August 2024) at Appendices [ ].
487 SoUI submission from the Parties (13 August 2024) at Appendix 2.
488 SoUI submission from the Parties (13 August 2024) at Appendix 2, Figure 1.

event of disagreement with a supplier in the category.

350. Similarly, FSNI's breakdown of sales by supplier in a number of other product categories indicates that FSNI faces an unconcentrated supply side, in which it deals with a large number of suppliers:

350.1 in 'cooking sauces, stocks, and marinades', the largest supplier is [ ];[489]

350.2 in 'cleaning' products, the largest supplier is [ ];[490]

350.3 in 'personal wash' products, the Parties submit that "while there are lots of suppliers in this category, it is dominated by a handful of large multinational suppliers".[491] The largest supplier to FSNI is [ ];[492] and

350.4 in the 'specialty cheese' category, the Parties note that there is a [ ], with suppliers ranging "from multinationals to small New Zealand owned cheesemakers".[493] [ ].[494]

351. There are other product categories where the bargaining positions of the buyers and suppliers appear to be more balanced. For example, in the 'ice cream' category, the Parties submit that the product category is dominated by [ ], who account for [ ].[495] In the case of FSSI, [ ].[496] FSSI has noted that [

489 SoUI submission from the Parties (13 August 2024) at Appendix 3, Figure 2.
490 FSNI RFI response (6 September 2024), at [6].
491 SoUI submission from the Parties (13 August 2024) at Appendix 13.
492 SoUI submission from the Parties (13 August 2024) at Appendix 13, Figure 5.
493 SoUI cross-submission from the Parties (26 August 2024) at Appendix 6.
494 SoUI cross-submission from the Parties (26 August 2024) at Appendix 6 and FSNI RFI response (6 September 2024) at [17].
495 SoUI submission from the Parties (13 August 2024) at Appendix 11.
496 SoUI submission from the Parties (13 August 2024) at Appendix 11, Figure 4.

].[497]

352. Two other examples where FSNI and FSSI appear to face a small number of suppliers are the ‘chilled fresh sauces’ category and the ‘frozen poultry’ category:

352.1 the Parties submit that in the ‘chilled fresh sauces’ category [ ].[498] This is consistent with the supplier breakdown provided by the Parties, which shows that FSNI source [ ]% of its sales in this category from [ ], with [ ]% from [ ], and [ ]% from others.[499] [ ];[500] and

352.2 the Parties submit that the ‘frozen poultry’ category is [ ].[501] According to information provided by the Parties, [ ].[502] The Parties noted that the Commission has previously found that although grocery retailers represented a significant buyer of chicken processors’ total sales, retailers’ ability to exercise any countervailing power (through the ability to switch volumes between processors) was limited by the need to be able to shift substantial volumes from one supplier to another, and that with few players capable of processing material volumes and long lead times required for processors to increase chicken production, shifting supply was difficult and would dampen the extent of any countervailing power.[503]

Impact on innovation for new grocery products

353. We consider that the substantial lessening of competition arising in acquisition markets from the Proposed Merger (described above) may have a flow on effect on innovation for new grocery products by suppliers. This would in turn harm retail consumers who would miss out on the benefit of the innovation.

354. There are two mechanisms through which the Proposed Merger may impact on innovation, which may arise separately or in combination.

354.1 First, each of FSNI and FSSI provide separate opportunities for new grocery products to be listed in New Zealand, and their consolidation with the Proposed Merger would remove one such opportunity. That could slow the

497 SoUI submission from the Parties (13 August 2024) at Appendix 11 at [72].
498 SoUI submission from the Parties (13 August 2024) at Appendix 9.
499 RFI response from FSNI 4 (6 September 2024) at [9].
500 SoUI submission from the Parties (13 August 2024) at Appendix 9.
501 SoUI submission from the Parties (13 August 2024) at Appendix 12.
502 RFI response from FSNI (6 September 2024) at [11].
503 SoUI submission from the Parties (13 August 2024) at Appendix 17 at [122.1].

pace and development of new product innovation for some suppliers, resulting in reduced consumer choice and/or quality of grocery products.

354.2 Second, the increased buyer power gained as a result of the Proposed Merger could have a potentially significant effect on margins and profitability of suppliers. This would adversely affect the ability and incentive of suppliers to invest, resulting in effects such as reduced capacity, quality or innovation in the affected acquisition markets.

355. In the longer term, impacts on innovation could lead to a reduction in the rate at which new grocery products are available to retail consumers in New Zealand, resulting in reduced consumer choice and/or quality of grocery products. A reduction in choice or quality of grocery products would adversely affect retail consumers.

Submissions from the Parties

356. The Parties submit that they have no incentive to harm innovation (or their supplier base more generally). The Proposed Merger would not cause any change in competitive conditions in retail or wholesale grocery markets and so there would be no change in the merged entity's incentive to support innovation.[504] The merged entity would have the same presence in retail grocery markets as the Parties do currently (and would in the counterfactual).[505]

357. The Parties submit that, as a result, the market opportunity for suppliers would not change, but only (to a limited extent) the method of accessing it.[506] The Parties' relationships with suppliers are driven by the Parties' need to offer products that customers want to buy (with the right mix of quality and price points), together with the logistics and supply chain capability and capacity to deliver them through the supply chain to the customer. In the Parties' view, this is a virtuous cycle: when suppliers are successfully producing quality products and developing new products, the Parties benefit through greater sales; but when the Parties perform well, their suppliers benefit through greater volumes and economies of scale.[507] The Parties submit that as a result they benefit from suppliers' innovation, as this can expand sales for both suppliers and the Parties. Both share incentives to bring better value to consumers.[508]

358. In terms of new product development (NPD), the Parties submit:

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504 SoI submission from the Parties (26 April 2024) at [119] and SoUI submission from the Parties (13 August 2024) at [117].

505 SoUI submission from the Parties (13 August 2024) at 125-126.

506 SoI submission from the Parties (26 April 2024) at [115] and SoUI submission from the Parties (13 August 2024) at [123].

507 SoI submission from the Parties (26 April 2024) at [120].

508 SoI submission from the Parties (26 April 2024) at [120].

358.1 that both of the Parties regard NPD and supplier innovation as key parts to their business, and the Parties' approaches to NPD and innovation are broadly similar with only minor practical differences;[509]

358.2 that in all instances, customer needs and the quality of the innovation are the starting point. [ ];[510] and

358.3 they are not entirely separate heads in the market currently and work together in certain scenarios, which limits the potential change that can arise with the Proposed Merger.[511] They further note that they currently conduct certain supplier innovation/NPD activities together, for example, through the Foodstuffs Emerge competition where the Parties support new smaller suppliers to on-board and scale up.[512] In addition, the Parties submit that [ ].[513]

359. The Parties also submit that their ability to foster small supplier innovation is an important competitive advantage over their (corporate) competitors, as their co-operative model enables the Parties to assist a supplier to work initially with one or two stores (driven by suppliers' cashflow and production capabilities), with the ability to expand the supplier's reach to more stores as its capabilities grow. The Parties submit that they have no incentive to cease a practice they perceive as a key competitive advantage, and where their incentives in retail and wholesale grocery markets would not change as a result of the Proposed Merger.[514] Small suppliers' pathways would be unaffected, with local ranging and the emerging supplier forum still available following the Proposed Merger.[515]

360. The Parties distinguish between three types of suppliers (noting that larger, multinational suppliers and smaller suppliers are the two key supplier groups that drive NPD):[516]

360.1 **large national suppliers, including multinationals**: the Parties submit that these suppliers supply both FSNI and FSSI and have products sold in nearly all retail stores. Some of these suppliers are active across many countries and channels and often have a sophisticated global NPD rollout programme which is driven by offshore teams (and is generally not tailored to the New Zealand market). The Parties submit that they are not significant purchasers for these

509 RFI response from the Parties (18 September 2024) at [3].
510 RFI response from the Parties (18 September 2024) at [5].
511 SoI submission from the Parties (26 April 2024) at [121].
512 RFI response from the Parties (18 September 2024) at [6.3].
513 RFI response from the Parties (18 September 2024) at [6.4].
514 SoI submission from the Parties (26 April 2024) at [123].
515 SoUI submission from the Parties (13 August 2024) at 125-126.
516 SoI submission from the Parties (26 April 2024) at [117] and Houston Kemp report on SoI (26 April 2024) at [28].

suppliers on a global scale and therefore these suppliers' innovation incentives are in no way dependent on sales to the Parties. The Parties submit that the Proposed Merger would not impact these suppliers, which would continue to have significant investment incentives and to spread any innovation costs/risks across a large number of other sales channels.

360.2 **small suppliers**: the Parties submit that these suppliers are considered to bring the most "pure" form of innovation given they need to offer something different in order to get a foot in the door. Given these suppliers generally only supply to a small number of stores, the Parties submit that these suppliers would not be impacted by the Proposed Merger; and

360.3 **medium suppliers**: these are suppliers that supply one or both of FSNI and FSSI and may have products sold at many retail stores. The Parties submit that the Proposed Merger would allow an easier growth trajectory for these suppliers than dealing with each of the Parties separately.

361. The Parties also submit that focusing on a reduction in the number of channels for innovative products does not take into account the potential competition effects of the change that would be brought about by the Proposed Merger,[517] and that for suppliers whose markets are small (ie, a small number of grocery stores), the Proposed Merger would not be capable of giving rise to any change in competitive conditions for innovation because there would be no change to competition in any local grocery market (which presumably drives stores' acquisition conduct).[518]

362. The Parties also submit that the evidence from suppliers (discussed below) regarding whether FSSI is more receptive to innovation compared to FSNI is not a competition issue and is more an issue of supplier perception (and some of which is an incorrect perception). Further to this, the Parties submit that the actual NPD numbers do not suggest a material difference.[519] They further submit that to the extent it is the case that FSSI has more proactive, individualised relationships with suppliers, the Parties would be seeking to incorporate this advantage into the practices of the merged entity in conjunction with FSNI's emerging suppliers forum, given the Parties' focus on fostering new and innovative products. In addition, they submit that the impression that FSSI has more proactive, individualised relationships with suppliers may be because FSSI is not as far along in rolling out its centralised buying programme and there is an (incorrect and inaccurate) perception that centralised buying is less favourable for small suppliers.[520]

363. The Parties further submit that the Proposed Merger would be likely to make it easier for suppliers to innovate. In particular:[521]

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517 SoUI submission from the Parties (13 August 2024) at [123].
518 SoUI submission from the Parties (13 August 2024) at 72.
519 SoUI submission from the Parties (13 August 2024) at [125]-[127].
520 SoUI cross-submission from the Parties (26 August 2024) at 34-35.
521 SoI submission from the Parties (26 April 2024) at [118].

363.1 the merged entity would likely offer one NPD cycle, rather than two separate NPD cycles. This would make it considerably easier for suppliers to launch a new product nationally across the Parties' banners. The Parties submit that the misalignment between the Parties' NPD cycles is a particular pain point for suppliers. Houston Kemp makes a similar submission;[522] and

363.2 the merged entity's national footprint would mean that suppliers would have the potential for an easier growth path from supplying a single store to national supply (ie, from one grocery store to 525 stores). This would incentivise suppliers to work with the merged entity to launch new products. Houston Kemp submits that this process would provide suppliers more certainty regarding (among other things) capital investments that require a national sales strategy in order to provide a sufficient return on investment and allowing for a national sales launch, for which the supplier can also plan a national sales and marketing strategy.[523]

364. In relation to the effect of enhanced buyer power arising from the Proposed Merger on suppliers' ability and incentives to invest in innovation, the Parties submit that the Proposed Merger would not have a material impact on buyer power, and the merged entity would have the incentive to maintain competition in acquisition markets.[524] Further, Houston Kemp submits that:

364.1 there is no economic consensus as to whether the presence of bargaining power (or a change in bargaining power) can be expected to increase or decrease investment in innovation;[525]

364.2 although "it has been posited in the literature that the exercise of buyer power reduces incentives for supplier investment", present levels of supplier profitability are not themselves determinative of either the level or prospect for efficient investment by suppliers; rather, the relevant consideration is the likely effect of investment on future expected profits. In circumstances where firms that have a viable and profitable investment opportunity that cannot be self-financed from existing profits, they will generally be incentivised to seek external funding;[526]

364.3 suppliers facing a reduction in bargaining power have a stronger incentive to invest if that investment would have the effect of reducing buyer bargaining power, including by enabling the firm to gain a competitive advantage over its rivals;[527] and

364.4 under the bargaining framework whereby buyers and sellers engage and are incentivised to maximise their joint surplus (and therefore undertake efficient

522 Houston Kemp report on SoI (26 April 2024) at [27].
523 Houston Kemp report on SoI (26 April 2024) at [27].
524 SoUI cross submission from the Parties (26 August 2024) at 33.
525 Houston Kemp report on SoI (26 April 2024) at [21].
526 Houston Kemp report on SoI (26 April 2024) at [22].
527 Houston Kemp report on SoI (26 April 2024) at [23].

investment), a buyer with increased bargaining power may face an increased incentive to co-finance supplier investment, because:[528]

364.4.1 the buyer can buy more of the product from the supplier and so benefit to a greater extent, enabling it to be a better competitor in retail or wholesale grocery markets; and

364.4.2 the presence of larger buyers may reduce transaction costs and coordination problems between suppliers and buyers (ie, avoiding the 'hold-up' problem).

365. In terms of the overall effects of the Proposed Merger on innovation, Houston Kemp submits that:

365.1 the Proposed Merger would not preclude grocery suppliers from seeking to invest, innovate and test the provision of products initially within one region (ie, it does not remove an option for suppliers), but rather means that the merged entity would have an increased ability to provide national-level investment in suppliers, which would enable it to compete more effectively with Woolworths' national-based strategy (which may also include a trans-Tasman component);[529]

365.2 the ability and incentives for the merged entity to engage in island-based or regional investment would not be reduced (as compared to the Proposed Merger not proceeding), say, if consumer preferences or supply constraints suggested region-specific initiatives would be more effective;[530] and

365.3 notwithstanding "the overarching principle that a transfer of surplus is not consistent with a lessening of competition" (which we disagree with), its view is that the net result of these effects is that incentives for suppliers to invest – in order to, ultimately, provide benefits by means of enhanced output that would benefit retail consumers – are unlikely to be harmed as a result of the Proposed Merger, and may be enhanced.[531]

366. Houston Kemp also submits that a reduction in choice or quality of grocery products, or exit of suppliers, as a result of the Proposed Merger is not necessarily anticompetitive.[532] It considers that retail consumers are unlikely to be harmed if, for example: a reduction in quality is accompanied by a sufficiently large price reduction; or a reduction in choice is supported by sufficiently substitutable products being available or new products introduced, or if the shelf space has been allocated to a better overall consumer offering. Houston Kemp further submits that the merged entity would retain an unchanged incentive to ensure its offering meets consumer

528 Houston Kemp report on SoI (26 April 2024) at [24].
529 Houston Kemp report on SoI (26 April 2024) at [25].
530 Houston Kemp report on SoI (26 April 2024) at [26].
531 Houston Kemp report on SoI (26 April 2024) at [29].
532 Houston Kemp report on SoUI (13 August 2024) at 9 and [40].

needs.[533] Accordingly, even if some suppliers exit due to the Proposed Merger, this would represent harm to suppliers rather than harm to competition. The Parties make a similar point, noting that a reduction in "choice" might be pro-competitive where consumers consider lower prices more attractive than multiple brands of products they perceive to be substitutable, and that suppliers' exit can occur for reasons other than a loss of competition (eg, its products are no longer popular with customers and buyers therefore do not want them).[534]

367. Düsseldorf Competition Economics submits that the Proposed Merger could increase supplier incentives to innovate. It submits that:

367.1 the primary effect of the Proposed Merger appears to be a small improvement in procurement terms on the part of the merged entity. This might induce stronger incentives for suppliers to diversify their product offerings, reduce cost and/or enhance quality;[535] and

367.2 in markets dominated by smaller grocery retailers, suppliers have limited innovation incentives as innovation efforts may not improve their bargaining positions.[536] However, as buyers become fewer and larger, suppliers face a stronger incentive to innovate. This is because losing a large contract in such circumstances can drastically reduce the price and, consequently profit, they can achieve. Without an attractive innovative product, it is difficult for suppliers to make up lost sales elsewhere, making innovation crucial to staying competitive. Further, by investing in innovation, a supplier increases the potential loss a retailer would face if the relationship were to end.[537] Düsseldorf Competition Economics cites several references to academic economics literature to support this framework.[538]

Third party submissions and evidence received

368. We received mixed views from third party submissions and evidence from industry participants we have spoken with on whether the Proposed Merger would have a negative impact on innovation through either or both of the mechanisms discussed above. As a general proposition, suppliers we have spoken with (across a range of categories) indicated that investment in NPD may be impacted by the Proposed Merger.[539] However, some other industry participants consider the Proposed Merger

533 Houston Kemp report on SoI (26 April 2024) at [40] and [42].
534 SoUI submission from the Parties (13 August 2024) at [87.2]-[87.3].
535 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [46].
536 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [42].
537 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [43].
538 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [42] and n26.
539 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ] (although this supplier indicated it is already hard to innovate in a mature category), [ ], [ ], [ ], and [ ] and e-mail from [ ] to the Commerce Commission (11 September 2024).

unlikely to impact their own innovation,[540] with some industry participants also thinking that innovation might increase or become easier or more simple with the Proposed Merger, or that the Proposed Merger would provide suppliers with better insights on which to engage in NPD.[541]

The effects of a reduction in the number of channels on innovation

369. Of submitters who consider that the Proposed Merger would reduce the ability and incentive for suppliers to invest in innovation because of a reduction in the number of channels:

369.1 Anonymous G submits it would become very difficult to continue to sell a product or to launch a product unless the merged entity was to list it, meaning that the merged entity would likely become de facto the "decider" of what products are listed in New Zealand. [ ].[542] It also submits that to support a successful introduction of a new product, it would be necessary [ ]. It submits that while FSNI and FSSI are in the process of centralising their procurement model, in the counterfactual (where FSNI and FSSI remain separate), [ ].[543] Anonymous G further submits that [ ], a failure to secure listing with the merged entity would make it extremely difficult to justify media spend to promote the product;[544]

369.2 the New Zealand Specialist Cheesemakers Association submits that the stakes of presenting NPD to the merged entity would be high (particularly for its members). The investment would need to be weighed against the real risk that a rejection by the merged entity would cut off access to 60% of the New Zealand grocery market;[545] and

540 Commerce Commission interviews with [ ] (however, this supplier noted it that it sticks to its core products, and considers that the Proposed Merger would impact brands trying to get into grocery), [ ] (however, this supplier does not develop innovation just for the New Zealand market), [ ], [ ] (however, as noted elsewhere, this supplier currently offers a [ ]) and told us that if the Proposed Merger reduces competition then retail consumers would not see alternatives to plastic like this), [ ], [ ], [ ], [ ] (however, as noted elsewhere, the Proposed Merger could impact the timing of each individual launch), [ ], [ ], and [ ].

541 Commerce Commission interviews with [ ], [ ], [ ], [ ] and [ ].

542 SoI submission from Anonymous G (18 April 2024) at [6].

543 SoI submission from Anonymous G (18 April 2024) at [17].

544 SoI submission from Anonymous G (18 April 2024) at [19].

545 SoUI submission from the New Zealand Specialist Cheesemakers Association (12 August 2024) at 13.

369.3 the Grocery Action Group submits that suppliers would have one less outlet for products which would further reduce the negotiating power suppliers have. Further, that innovation would be stifled and prices for retail consumers would continue to rise.[546]

370. In contrast, Pernod Ricard submits that in its experience the success of its own innovations and commercial negotiations would not be impacted by whether there are two or three grocery channels, but rather, on the individual merits and strength of a proposal.[547] The Parties agree with this submission and note that the starting point for the Parties' engagement with suppliers is to promote each co-operative's competitiveness at the retail level, including by reference to meeting customer "need states".[548]

371. Table 3 summarises some of the mixed interview evidence from industry participants on the effect of a reduction in the number of major channels to consumers as a result of the Proposed Merger on the ability and incentive for suppliers to invest in innovation.

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546 SoUI submission from the Grocery Action Group (16 August 2024) at [8.3].

547 SoUI submission from Pernod Ricard (12 August 2024).

548 SoUI cross submission from the Parties (26 August 2024) at 7.

Table 3: Evidence from industry participants on effects of reduction in number of channels on ability and incentive for suppliers' innovation

Evidence that reduction in number of channels for innovation would reduce ability and incentive for suppliers' investments in innovation	Evidence that reduction in channels would not make a material difference to innovation
• Some parties indicated that, currently, suppliers have three opportunities for ranging new products in grocery stores (FSNI, FSSI and Woolworths). Ranging in two out of the three would often warrant NPD. With the Proposed Merger, suppliers would only have two options (the merged entity and Woolworths), making it potentially harder to do NPD (unless a supplier is able to get both on board). This increases supplier risk.[549] • Similarly, a supplier told us that the Proposed Merger would likely reduce its preparedness to invest in innovation or take commercial risk with respect to new products as there would be less potential "takers" for these products.[550] • Another supplier (of a range of products) considers that if ranging was nationalised across the merged entity, it would significantly increase its risk as a manufacturer in terms of launching innovation. The same supplier told us that for a small brand the Proposed Merger would make it much harder to build that brand into a market leader or even bring the brand to market if suppliers could no longer go direct to a grocery store, noting that "it would lock them out of the market". It also said that retail media is expensive and required for innovation. It further considers the Proposed Merger could require more investment into retail marketing (ie, if a supplier could no longer execute retail marketing differently in each island), which would make it more expensive/challenging to launch new products.[551]	• A supplier of dry food products considers that the Proposed Merger would not impact NPD, as each product is ranged on its merit.[563] • One supplier said it is always looking to innovate, and that it cannot imagine this changing with Proposed Merger.[564] • A supplier (of dairy products) considers the Proposed Merger would be much better from a marketing launch perspective.[565] • Another supplier of beverages said that, from an innovation perspective, large customers are not prioritised by it as it does a lot of NPD and investment across all its customers, and the Proposed Merger would not change this.[566] • One supplier said that, for innovation done across both Australia and New Zealand, the Proposed Merger would not impact innovation in New Zealand, but concentration would make New Zealand markets less attractive.[567]

549 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ] and [ ].
550 E-mail from [ ] to the Commerce Commission (11 September 2024).
551 Commerce Commission interview with [ ].
563 Commerce Commission interview with [ ].
564 Commerce Commission interview with [ ].
565 Commerce Commission interview with [ ].
566 Commerce Commission interview with [ ].
567 Commerce Commission interview with [ ].

Evidence that reduction in number of channels for innovation would reduce ability and incentive for suppliers' investments in innovation	**Evidence that reduction in channels would not make a material difference to innovation**
• Some parties told us that to get a new product ranged, small suppliers need to prove the concept on a smaller scale before going nationwide. Many brands start off supplying one or few stores and then expand from there. FSSI tends to be more receptive to new products and new suppliers entering. This channel to market would be lost to suppliers with the Proposed Merger.[552] • A supplier said that the Proposed Merger would result in "less niche suppliers".[553] • Another supplier indicated that, with the Proposed Merger, if the merged entity chooses not to range a new product, it would not be worth launching that new product just with Woolworths.[554] • A supplier commented that a channel must have scale to make a new product viable. If the merged entity would not range a new product, then the supplier would only have a couple of other choices of where it could launch the new product.[555] • One multinational supplier said if it was not ranged in the merged entity, it might be more hesitant about trialling new products, or not bring some of its innovation to New Zealand (which might result in more homogenous, less curated product ranges).[556]	• A supplier noted that the Proposed Merger would not have a large impact on investment in innovation, as suppliers need to innovate in order to grow and succeed, but it might impact timing of each individual launch.[568] • One supplier (of beverages) said it innovates with Woolworths as there is no proper process for innovation with FSNI, but noted it looks at whether innovation would work in an international market since New Zealand is a small market.[569] • A supplier (of bakery items) said it innovates a lot now and hopes that the Proposed Merger would make it easier to innovate to bring NPD to market.[570] • A supplier said that if the Proposed Merger allowed for a national ranging approach then it would be easier to bring new products to market (rather than needing to secure supply with both FSNI and FSSI, or one of FSNI/FSSI and Woolworths) and open up more new product opportunities for suppliers.[571]

552 Commerce Commission interviews with [ ], [ ], [ ] [ ]. [ ], [ ], [ ] and [ ].

553 Commerce Commission interview with [ ].
554 Commerce Commission interview with [ ].
555 Commerce Commission interview with [ ].
556 Commerce Commission interview with [ ].
568 Commerce Commission interview with [ ].
569 Commerce Commission interview with [ ].
570 Commerce Commission interview with [ ].
571 Commerce Commission interview with [ ].

Evidence that reduction in number of channels for innovation would reduce ability and incentive for suppliers' investments in innovation	Evidence that reduction in channels would not make a material difference to innovation
• A supplier indicated that the Proposed Merger could mean it is able to have nationwide supply with the merged entity, but could also mean where its products get delisted, this would be more significant for it.[557] • One industry participant (that works with a range of suppliers but is not a supplier itself) told us that New Zealand is a small market, and that a lot of large businesses have the benefit of also selling in Australia which enables them to meet minimum factory run requirements for new products they develop. On the other hand, smaller businesses without that luxury have to take on a lot more risk to meet minimum factory run requirements, and would be disincentivised to do so following the Proposed Merger (and may end up deleting new lines entirely if they can only supply half of the market).[558] • One supplier (of non-food products) considers that small suppliers are often the most innovative, and are the ones that may be impacted the most by the Proposed Merger (given they generally have a higher cost of doing business and may not have scale or capacity to supply nationally).[559] • One industry participant told us that the Proposed Merger would create an access concern for smaller suppliers because there is a lot more at stake.[560]	• One supplier noted that having less people making ranging decisions may mean less chance of it getting a "champion", but that its innovation would happen regardless because of the export market.[572] • A supplier said the Proposed Merger could help it to know whether a piece of innovation is worth producing for 40% or 60% of the market.[573] • One party noted that the Proposed Merger would probably be beneficial for innovation due to how it uses the Parties' insights on sales data, and because the merged entity would have more insights to share.[574] • One supplier (of fresh products) told us that its innovation is unlikely to be affected by the Proposed Merger because of its export activity.[575] • A supplier said that FSSI is more difficult to get on board.[576]

557 Commerce Commission interview with [ ]. The Parties' submission – discussed previously – is not to overlook the upside, or increased opportunity, available to suppliers. See SoUI submission from the Parties (13 August 2024) at [51.1]. The Parties' submission is that the Proposed Merger could provide an easier pathway to national supply than the status quo. See SoUI submission from the Parties (13 August 2024) at 125-126. However, we are not satisfied that the structural reduction in the number of independent major grocery retailer customers with the Proposed Merger would not substantially lessen competition, which cannot be offset by any potential upsides for suppliers that can introduce their innovative products with the merged entity.

558 Commerce Commission interview with [ ].

559 Commerce Commission interview with [ ].

560 Commerce Commission interview with [ ].

572 Commerce Commission interview with [ ].

573 Commerce Commission interview with [ ].

574 Commerce Commission interview with [ ].

575 Commerce Commission interview with [ ].

576 Commerce Commission interview with [ ].

Evidence that reduction in number of channels for innovation would reduce ability and incentive for suppliers' investments in innovation	**Evidence that reduction in channels would not make a material difference to innovation**
• One supplier (of dry food products) told us that the Proposed Merger would limit the competitive nature of dealing with three entities and, given its NPD has a huge upfront cost, means that it might have to make decisions about whether the NPD is worthwhile. It thought that all smaller and medium-sized businesses would be in the same position.[561] • One supplier (of dry food products) considers that established brands that have been supplying the major grocery retailers for a long time would likely not be negatively impacted from the Proposed Merger. However, it considers that the Proposed Merger would affect new brands trying to enter/small businesses that have not yet formed relationships with the major grocery retailers, especially if the merged entity operated similarly to Woolworths with decisions at head office level.[562]	• One supplier (of beverages) told us the Proposed Merger would not impact its innovation as it needs to innovate for the long-term growth of its business.[577]

561 Commerce Commission interview with [ ].
562 Commerce Commission interview with [ ].
577 Commerce Commission interview with [ ].

The effects of enhanced buyer power on innovation

372. The Food and Grocery Council submits that the results of its survey of members raised concerns about potential adverse effects of the Proposed Merger on supply, ranging, quality, and innovation due to tighter margins and reduced pricing flexibility. We understand that Food and Grocery Council members were asked whether the Proposed Merger could impact innovation by suppliers, such as reducing the incentives and/or pace of development, and 68% of suppliers who completed the survey answered yes (and the remainder split between those who were unsure and those who believe that the Proposed Merger may lead to greater investment and efficiency in the innovation process).[578]

373. The Food and Grocery Council also submits that statements from its members suggest that a reduction in acquisition prices resulting from the Proposed Merger would have a negative impact on investment in innovation. In this regard, it submits that tightened margins, squeezed pricing, and increased pressure on profitability with the Proposed Merger may limit resources available for innovation initiatives and hinder the innovation process.[579]

374. The Food and Grocery Council further submits (based on member feedback) that the Proposed Merger would impact innovation in the following ways:[580]

 374.1 **reduced prices or margins:** suppliers expressed concerns about working on tight margins and the erosion of cost pricing, and that increased pressure on margins or a reduction/squeeze in prices with the Proposed Merger could leave little room for investment in innovation. It could reduce suppliers' ability to take risks in new product development, limit resources available for innovation efforts and/or restrict marketing support for new products;

 374.2 **chilling effect:** there are concerns that the Proposed Merger could have a chilling effect on innovation, particularly if ranging decisions are solely based on retailer margin and lowest cost;

 374.3 **change in product mix:** expectations include a greater emphasis on private label products with the Proposed Merger, potentially limiting brand diversity and stifling innovation. There is a consensus that the product mix and ranging strategies would continue to evolve; and

 374.4 **other concerns:** concerns about the Proposed Merger include potentially less choice and innovation, as well as the risk of increased negotiation pressures at the expense of innovation and barriers to entry for small businesses. Additionally, the consolidation of major grocery retailers raises concerns about significant changes in the retail grocery sector and the investment in future innovation.

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578 SoI submission from the Food and Grocery Council (26 April 2024) at [14.2] and [14.4a].
579 SoI submission from the Food and Grocery Council (26 April 2024) at [14.3].
580 SoI submission from the Food and Grocery Council (26 April 2024) at [14.4a]-[14.4j].

375. The Grocery Action Group submits that retail consumers would be materially adversely affected if the Proposed Merger proceeds because it would drive some suppliers out of the market due to the reduced margins, meaning less choice and innovation for retail consumers.[581]

376. The New Zealand Specialist Cheesemaker Association submits that with margin transfer and diminishing supplier profitability, the incentive to invest further in the business would be reduced.[582]

377. Lisa Asher submits that it would be hard for a business to invest and grow when it has minimal security on continued business within such short contracts. This is because there is a high chance a business would lose its branded presence if it is not a multinational supplier as innovation would be impacted.[583]

378. Anonymous K submits that the Proposed Merger would bring efficiencies in terms of communicating and dealing with two companies and in turn allow suppliers to bring products to market faster.[584]

379. In terms of the details of evidence before us from suppliers on how suppliers' post-merger profitability might impact their investment in innovation:

    379.1 one supplier (of a range of grocery products) told us that ultimately any consolidation in the grocery sector which shifts a suppliers' ability to negotiate and moves margin from it to the major grocery retailers, without any benefit to retail consumers, would inhibit its ability to innovate. It further noted that if a supplier does not get volume from the major grocery retailers (who account for 60% of business), a supplier could not range a product;[585]

    379.2 a second supplier (of non-food products) said that if the Proposed Merger resulted a reduction to its margin, this would potentially cause the quality of its products to lessen as it would have less money in its "pot";[586]

    379.3 a third supplier (of dry food products) noted that NPD is costly and higher risk than investing in core range. It considers it is possible that the Proposed Merger would impact its investment in NPD, depending on how the Proposed Merger impacts its leverage and terms;[587]

    379.4 an industry participant (involved with fresh produce) told us that there is significant investment in innovation in the [ ] space, with that investment generally coming from [ ] who have the means to do this through the testing and purchasing of [ ]. It explained that the nature of the supply chain means that if [ ] returns are diminished, they would be

581 SoUI submission from the Grocery Action Group (16 August 20240 at [2.8d].
582 SoUI submission from the New Zealand Specialist Cheesemakers Association (12 August 2024) at 15.
583 SoUI submission from Lisa Asher (15 August 2024) at 10.
584 SoUI submission from Anonymous K (11 August 2024).
585 Commerce Commission interview with [ ].
586 Commerce Commission interview with [ ].
587 Commerce Commission interview with [ ].

"putting less in [ ]", so while there might be no initial impact on innovation as a result of the Proposed Merger, there might be long term impact if there is enough downward pressure on [ ];[588] and

379.5 a fourth supplier (of frozen products) said it would have to consider the resources it puts towards innovation if profitability came down.[589]

380. In addition, two suppliers have specifically told us the Proposed Merger would impact the ability for suppliers to innovate on environmentally friendly packaging. One supplier (of a range of grocery products) said they mainly innovate by launching different product categories and flavours but also by investing in BPA free [ ].[590] Another supplier (of dry food products, which currently offers a [ ]) told us that if the Proposed Merger reduces competition then retail consumers would not see alternatives to plastic like this.[591]

Our view

381. We consider that the substantial lessening of competition arising from the Proposed Merger (described above) would be likely to have a flow on effect on innovation for new grocery products by suppliers.

382. There are two mechanisms through which the Proposed Merger may impact innovation. These may arise separately or in combination.

382.1 **Reduction in the number of channels:** The structural loss of the Parties as two separate opportunities for new grocery products to be listed in New Zealand, and their consolidation with the Proposed Merger, would remove one opportunity for suppliers to supply products to. That could slow the pace and development of new product innovation for some suppliers, resulting in reduced consumer choice and/or quality of grocery products. We consider that this impact on innovation may be felt strongest by smaller suppliers, for which each of FSNI and FSSI are two of the main avenues to be listed. However, the Proposed Merger may also impact on innovation in relation to larger domestic suppliers and multinationals. For multinationals, the Proposed Merger would be unlikely to impact their global product development, but it may result in products not being listed in New Zealand, being delayed in coming to New Zealand, or not being tailored (or being less tailored) to local customer preference.

382.2 **Enhanced buyer power:** The merged entity's increased buyer power as a result of the Proposed Merger could have a potentially significant effect on margins and profitability of suppliers. This would adversely affect the ability and incentive of suppliers to invest, resulting in effects such as reduced

[588] Commerce Commission interview with [ ].
[589] Commerce Commission interview with [ ].
[590] Commerce Commission interview with [ ].
[591] Commerce Commission interview with [ ].

capacity, quality or innovation in the affected acquisition markets. This is of particular concern in categories of products in which the Parties consider innovations are "driven by suppliers", which each fit within one of the broader aggregated categories of acquisition markets we have defined to assist our assessment of the Proposed Merger (outlined in Table 2). Examples include the following categories: [ ]; [ ]; [ ]; [ ]; [ ]; [ ]; [ ][592] and [ ].[593] In at least those cases, suppliers' incentives to invest (or stay in the market) may be reduced if they are unable to capture a sufficient share of the benefits of their sunk investments in product innovation when negotiating with buyers. The increased bargaining power of the merged entity would mean that the merged entity could capture a greater share of the value of the investments increasing the risk of this 'hold-up' concern. Suppliers' ability to invest would be reduced as the worsening of their terms of trade lessens their ability to finance investments that they would otherwise make through retained earnings and may increase the risk, and therefore cost, of external financing. Innovation would also be lessened if suppliers become unprofitable, resulting in their exit.

383. The crux of the Parties’ submissions that there would be no (or an enhanced) effect on innovation flowing from a substantial lessening of competition in acquisition markets is their proposition that they have no incentive to harm innovation and their supplier base more generally. The merged entity would prefer more suppliers and more innovation, all else being equal. However, we understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers: [ ].[594] The resulting lower prices (and less favourable terms) would necessarily harm suppliers and could have a potentially significant effect on their margins and profitability. In turn, these price effects could reduce both the ability and incentive for suppliers to invest in innovation. This would harm retail consumers who would miss out on the benefits of innovation.

384. The Parties’ and their advisors’ submissions have focused mainly on the likely effect of the Proposed Merger on suppliers’ *incentives* to invest in innovation. Düsseldorf Competition Economics and Houston Kemp support their submissions with several references to economics literature. However, economic theory is not settled on the likely effects of a reduction in competition between buyers on sellers’ incentives to innovate. Furthermore, some of the modelling assumptions in the literature cited by the Parties’ advisors do not reflect the realities of New Zealand grocery markets and

592 SoUI submission from the Parties (13 August 2024) at Appendices [ ].
593 SoUI cross-submission from the Parties (26 August 2024) at Appendix [ ].
594 [ ]

therefore generally provide limited guidance for us as to the likely effects of the Proposed Merger on suppliers' incentives to innovate.[595]

The effects of a reduction in the number of channels on innovation

385. In our view, a reduction from three to two major grocery retailers and independent channels to bring new products to market with the Proposed Merger would make it more difficult for existing and new suppliers to innovate and introduce new products into New Zealand, or impact on the timeframe within which new innovative products are launched. This would reduce the incentive for and ability of suppliers to innovate, by reducing the likelihood of a successful launch and therefore the expected returns from innovation.

386. Currently, each of the three major grocery retailers present separate opportunities for new suppliers, or suppliers with new products, to gain a foothold in the market. Each of FSNI, FSSI and Woolworths brings different new products and suppliers to the market, ultimately contributing to the range, and quality of product development in the country. With the Proposed Merger, one independent major grocery retail channel through which suppliers can access the market and introduce new products would be removed.

[595] For example, Düsseldorf Competition Economics report on SoUI (13 August 2024) at n26 cites Chen, Z. (2019), Supplier Innovation in the Presence of Buyer Power, International Economic Review, 60, 329-353 to support its view that the Proposed Merger could have positive innovation effects as suppliers are incentivised to strategically adapt. However, Chen (2019) models the geographic market as consisting of a dominant retailer with a competitive fringe. Chen notes that this suppresses the strategic factors that may exist in a market with an oligopoly of retailers which may lead to a failure in bargaining outcomes. Chen recognises that the modelling results may differ if these strategic factors are incorporated into their models. As the structure of the New Zealand grocery acquisition and retail markets do not fit the assumptions of Chen's model we do not consider that the theoretical results derived from the model are a good indicator of potential outcomes in New Zealand grocery markets. Furthermore, Inderst, R., & Wey, C. (2011), Countervailing Power and Dynamic Efficiency, Journal of the European Economic Association, 9,702-720 note that they endogenized buyer power from buyers' size which generates more valuable supply options. However, the authors note that there may be other sources of buyer power, such as loyalty to retail outlets which make it less likely that customers would switch stores if a supplier's product is delisted. Alternatively, retailers may increase sales of private labels thus capturing some of the revenues that would otherwise be lost when a supplier's branded product is delisted. The authors note that it is an open question how buyer power that originates from these alternative sources could affect supplier incentives . Roman Inderst and Christian Wey (2007), "Buyer power and supplier incentives," 51 European Economic Review 647-667 theorises that suppliers facing fewer and larger buyers will have incentives to invest more in product and process innovation that allows them to accommodate the loss of a large individual order by increasing sales to other buyers. However, Inderst and Wey (2007) note that while their theory applies to incentives for incremental innovation by suppliers faced with buyers with greater bargaining power, the theory does not extend to non-incremental investment. Importantly, Inderst and Wey (2007) note "While the presence of large buyers may stimulate incremental investments, it may stifle non-incremental investments including new product development and entry" at 648-649. Houston Kemp cite Inderst and Wey (2003) to submit that the formation of larger buyers should induce the supplier to choose strategies that increase total output. Inderst, R and Wey, C, *Buyer power and supplier incentives*, WZB discussion paper, No. SP II 2003-05, 2003 at 3. However, in that paper Inderst and Wey do not suggest that effect will occur in all circumstances and in their 2007 version identify the potential negative impact on non-incremental investments.

387. The Parties submit (as set out at [363.2]) that the merged entity's national footprint could create an easier growth path for suppliers which would incentivise suppliers to work with the merged entity to launch new products. Some suppliers agree with this view. However, other suppliers have stressed the importance of having multiple channels to gain a foothold in the market. Our view is that the loss of a channel for suppliers to work with (either of FSNI or FSSI) would reduce the opportunities, and thus ability, for suppliers to work with the merged entity compared with the counterfactual. Furthermore, both the incentives and ability for suppliers to work with the merged entity to bring new products to market would be reduced if they are unable to capture a sufficient share of the expected returns from the investments due to the 'hold-up' problem arising from the merged entity's enhanced buyer power (which we discuss at [391]-[392]).

388. One of the reasons for Düsseldorf Competition Economics' view (set out at [367.2]) that the Proposed Merger would create greater incentives for suppliers to invest in innovation is that, as buyers become fewer and larger, losing a large contract can drastically reduce the price and, consequently profit, that suppliers can achieve. Without an attractive innovative product, it is difficult for suppliers to make up lost sales elsewhere, making innovation crucial to staying competitive.[596] This is how we conceive the potential harm from a consolidation in the number of buyers. We discuss below our views on the both the ability and incentive for suppliers to innovate to overcome this potential harm.

The effects of enhanced buyer power on innovation

389. As we explain elsewhere, we consider that the Proposed Merger is likely to increase the merged entity's buyer power in relevant grocery acquisition markets. We consider that any increase in buyer power with the Proposed Merger may reduce suppliers' ability and incentives to invest in new and innovative products, due to reduced profitability and lower expected returns from investments in innovation.

390. We note Düsseldorf Competition Economics' submission at [367.1] and Houston Kemp's submission at [364.3] that increased buyer power might induce stronger incentives for suppliers to diversify their product offerings, reduce cost and/or enhance quality to counter the otherwise negative effects of the enhanced buyer power. However, in our view any such effect on suppliers' incentives would need to be balanced with the effect on suppliers' incentives (and ability) to invest (or stay in the market) if they are unable to capture a sufficient share of the benefits of their sunk investments when negotiating with buyers.

391. The increased bargaining power of the merged entity would mean that the merged entity could capture a greater share of the value of some suppliers' investments in innovation, reducing the expected profitability of such investments. The Parties sometimes work with suppliers to bring new products to market.[597] This may partly mitigate 'hold-up' concerns for some innovations but does not remove the 'hold-up'

596 Düsseldorf Competition Economics report on SoUI (13 August 2024) at [43].

597 SoUI cross-submission from the Parties (26 August 2024) at Appendix [ ]. [ ]

problem for supplier-led innovations which are common in many grocery categories. For example, according to information provided to us by the Parties, supplier-driven innovation has commonly occurred in at least the following product categories or segments, which each fit within one of the broader aggregated categories of acquisition markets we have defined to assist our assessment of the Proposed Merger (outlined in Table 2):[598]

391.1 [ ];[599]

391.2 [ ];[600]

391.3 [ ];[601]

391.4 [ ];[602]

391.5 [ ];[603]

391.6 [ ];[604]

391.7 [ ];[605] and

391.8 [ ].[606]

392. Increased buyer power and the potential for 'hold-up', are likely to reduce suppliers' ability to invest by the worsening of their terms of trade for all products, thus reducing their profitability and ability to fund investments through retained earnings, making it harder for them to finance investments that they would otherwise make. This may be because they would have reduced profitability to finance those investments internally and it may be harder for them to obtain low cost external financing because less profitable firms with fewer channels to market may be considered to be higher risk.

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598 The list of examples below does not include product categories or segments where the Parties characterise innovation as being low or limited, or driven by both suppliers and retailers.

599 SoUI submission from the Parties (13 August 2024) at Appendix [ ].

600 SoUI submission from the Parties (13 August 2024) at Appendix [ ].

601 SoUI submission from the Parties (13 August 2024) at Appendix [ ].

602 SoUI submission from the Parties (13 August 2024) at Appendix [ ].

603 SoUI submission from the Parties (13 August 2024) at Appendix [ ].

604 SoUI submission from the Parties (13 August 2024) at Appendix [ ].

605 SoUI submission from the Parties (13 August 2024) at Appendix [ ].

606 SoUI cross-submission from the Parties (26 August 2024) at Appendix [ ].

393. Innovation would also be lessened if suppliers become unprofitable, resulting in their exit. We are not satisfied that this could not happen in practice given the short-term gains that the merged entity may achieve from squeezing suppliers, particularly in circumstances where there are other suppliers that offer substitutable products. In addition, squeezing suppliers' margins may inadvertently go too far if there is information asymmetry between the negotiating parties so that a mutually beneficial deal is ultimately not achieved.

394. The Parties submit that there is not a "real chance" that this squeezing effect would happen as they are sophisticated acquirers of grocery products, and while mis-judgements are always theoretically possible in individual instances, there is not a real chance they would systematically play into the merged entity's conduct in a way that could give rise to a real chance it would seek to (or would successfully) reduce competition in acquisition markets.[607] However, the Parties may not be fully aware of the financial position of suppliers such that the buyers misjudge the true ability of suppliers to withstand price reductions or worse terms. Furthermore, even if a supplier does not exit it may not have the ability to fund otherwise profitable innovations with the Proposed Merger to the same extent as in the counterfactual. We therefore do not consider that the Parties would be likely to have sufficient information to ensure that their strong negotiating positions do not push suppliers' actual and expected returns below those necessary to sustain ability and incentives for innovation.

395. The evidence before us suggests that the effect of the Proposed Merger on individual suppliers' incentives to invest in innovation in response to the merged entity's buyer power may vary. Some suppliers faced with buyers with increased bargaining power may have stronger incentives to invest, as the Parties' advisors submit. For example, one supplier noted that it would "probably have to try and invest more to make sure we remain relevant with the supermarket chain" as a result of the Proposed Merger.[608] However, other suppliers and market participants hold the opposite view.

396. We are not satisfied, based on the evidence available to us, that incentives to invest would be stronger for many suppliers or product categories. Nor are we satisfied, based on the evidence before us, that suppliers would have the ability to fund these innovations given the likely negative impact of enhanced buyer power on suppliers' margins even if they had a greater incentive to do so. The loss of an independent channel for bringing new products to market would also reduce the ability of suppliers to do so. We are therefore not satisfied that the Proposed Merger would not result in reduced investment in innovation from grocery suppliers, as well as reduced introduction of innovative products into the New Zealand market.

Impact on smaller vs larger suppliers

397. In relation to the impact on innovation, our concerns are strongest with regard to local and smaller suppliers, for whom each of FSNI and FSSI are two of the main avenues to be listed and who often are the source of 'pure' innovation. These

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607 SoUI submission from the Parties (13 August 2024) at [82].
608 Commerce Commission interview with [ ].

smaller suppliers are also less likely to have countervailing power to constrain the merged entity's increased buyer power because they typically do not supply 'must have' products and often supply products for which substitutes are available.

398. The individual channels for fostering small supplier innovation would consolidate into a larger single merged entity with the Proposed Merger. This is of particular concern given the Parties' submissions (noted above) that small suppliers are key sources of 'pure' innovation which may be stifled by the presence of large buyers.[609]

399. As noted above, we received evidence that some suppliers perceive that FSSI may be more receptive to supporting suppliers' innovation or that it is easier to range a new product in FSSI compared to FSNI. The Parties submit that this is an incorrect perception and not a competition issue.[610] However, we consider that suppliers' perceptions are likely to influence their incentives to invest in innovation by affecting their expectations as to the ease with which new products can be ranged, as well as the expected profitability of their innovation. The loss of a channel that is perceived to be more receptive to new products is thus likely to lessen suppliers' incentives to innovate. Additionally, the Parties submit that the actual NPD numbers and processes between FSSI and FSNI do not materially differ.[611] In any event, ultimately our concern is around the loss of a major channel for launching new products and not the similarities and differences between the consolidating channels.

400. We also have concerns in relation to larger suppliers and multinationals. The Proposed Merger would be unlikely to impact multinationals global product development but may result in products not being listed in New Zealand, being delayed in coming to New Zealand, or not being tailored to local customer preferences. We are not satisfied that the Proposed Merger would not impact the opportunities/incentives that multinational suppliers have to bring new products into New Zealand. This is because failure to secure a listing or ranging with the merged entity (who would account for a large share of potential retail sales) could reduce the expected profitability of a new product launched into New Zealand compared with the expected profitability from failing to secure a listing or ranging with one of the Parties individually.

Ultimate impact on consumers

401. In our view, any potential reduction in innovation by suppliers may lead to fewer products, lower quality products, and/or the slower introduction of new products on retail grocery shelves for consumers, reducing consumers' choice of grocery products. It may also result in fewer efficient suppliers entering the market which

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609 As noted earlier, Inderst and Wey (2007) suggest that the presence of large buyers may stifle non-incremental investments including new product development and entry. Inderst and Wey (2007) above n595 at 648-649. The Parties suggest that small suppliers are sources of 'pure' innovations. If the innovations of small suppliers are non-incremental (that is, are entirely new developments rather than modifying an existing product or process) then they may be at additional risk of being stifled from the Proposed Merger.

610 SoUI submission from the Parties (13 August 2024) at [125].

611 SoUI submission from the Parties (13 August 2024) at [127] and RFI response from the Parties (18 September 2024) at [3].

could also increase retail grocery prices in the long-term. As such, consumers may be worse off as a result of the Proposed Merger.

402. Houston Kemp submits that consumers are unlikely to be harmed if a reduction in quality is accompanied by a sufficiently large price reduction or a reduction in choice is supported by sufficiently substitutable products being available or new products introduced, or if the shelf space has been allocated to a better overall consumer offering.[612] Further, the Parties submit that the starting point for category reviews is customer need states, and where lowest-cost is chosen, it is likely to suggest lower-priced products are considered to be wanted by customers.[613] However, consumers' preferences for grocery products are diverse including their price/quality preferences and trade-offs.[614] Some customers may prefer a lower price/lower quality product and some prefer higher price/higher quality. Given the diversity of consumer preferences, we are not satisfied that overall customers would not be worse off as a result of a reduction in choice flowing from a reduction in product innovation.

403. We have also received feedback from suppliers that we have spoken with (across different product categories) about the impact of less innovation by suppliers on end consumers.

403.1 One supplier (of a range of products) considers that the Proposed Merger (and having only two customers to introduce new products through) not only makes it more challenging, but it might reduce the ability of suppliers of branded products to bring innovation to market, ultimately resulting in less choice for consumers and a lack of offering/variety across brands.[615]

403.2 A second supplier (of a range of grocery products) told us that a reduction in innovation would mean the consumer loses outright because private label would be bigger and there would be less innovation on the shelf.[616]

403.3 A third supplier (of a range of products) considers that while there might be some benefits to retail consumers in the short term (ie, rationalisation and potentially some price savings), it considers that in the longer-term, we would ultimately see some grocery suppliers (such as small suppliers that cannot supply nationwide) dropping out of the market. Further, it considers that in the long-term, it would be higher risk for companies like itself to introduce innovative (ie, sustainable, environmentally friendly, more nutritional) products if there is "nowhere to try them anymore". In this supplier's view,

612 Houston Kemp report on SoUI (13 August 2024) at [40].
613 SoUI submission from the Parties (13 August 2024) at 114.
614 For example, [ ]. See SoUI cross-submission from the Parties (26 August 2024) at Appendices [ ].
615 Commerce Commission interview with [ ].
616 Commerce Commission interview with [ ].

this would result in consumers subsequently having less choice and options for products to buy.[617]

403.4 The New Zealand Specialist Cheesemakers Association submits that the Proposed Merger would also remove the opportunity for a new supplier of an existing product to bring “product excellence, pack formats, brand stories, provenance and of course price pressure to the market”.[618]

Assessment of consumer harm and efficiencies

404. The Parties submit the Proposed Merger would give rise to cost savings, bring about efficiencies and be good for retail consumers.[619]

405. We have considered whether:

405.1 the Proposed Merger should be allowed if it benefits retail consumers even though it would lessen independent rivalry in the relevant acquisition markets; and

405.2 the Proposed Merger should be allowed as it is likely to give rise to rivalry-enhancing efficiencies in the relevant acquisition markets such that there would not be a net substantial lessening of competition in those markets.

406. In summary, our views are that:

406.1 the clearance test asks if we are satisfied that competition would not be substantially lessened in any market, and so it is not relevant to consider whether or not retail consumers in a different market would benefit from the Proposed Merger;

406.2 in the alternative, even if consumer welfare is relevant, we are not satisfied that cost savings from the Proposed Merger would be passed on to retail consumers to a significant degree and we consider that the overall impact for consumers would be negative; and

406.3 it is appropriate to look at the net impact of the Proposed Merger on competition within a particular market but we are not satisfied that there would not be a substantial lessening of competition even taking into account the potential rivalry-enhancing efficiencies in the relevant acquisition markets.

407. In the remainder of this section we summarise the evidence and submissions, and then address the two questions set out above.

617 Commerce Commission interview with [ ].
618 SoUI submission from the New Zealand Specialist Cheesemakers Association (12 August 2024) at 13-14.
619 See for example, the Application at [20].

Submissions from the Parties

408. In publicly announcing the Proposed Merger in 2023, the Parties stated that:[620]

408.1 the Boards of each of the Parties "have been clear it must deliver meaningful benefits for customers and all our Stakeholders";

408.2 the Proposed Merger would "make us more efficient and able to deliver more innovation and better value for New Zealanders";

408.3 a single, merged co-operative would be able to work on initiatives that improve efficiency and competitiveness "better and faster"; and

408.4 the benefits of reducing the complexity, duplication, and cost of running two co-operatives would allow the merged entity to "deliver better value for our customers".

409. A more recent update on the Proposed Merger in May 2024, referred to the Parties realising efficiencies from operating as one national business and stated that it would "deliver benefits to all our stakeholders: customers, Members, teams, suppliers and communities".[621]

410. The Parties' expected savings from the Proposed Merger would arise from a combination of cost savings and buying benefits. We understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers. [

].[622]

411. The Parties submit that the savings and efficiencies expected to arise from the Proposed Merger would be shared with retail consumers in the form of lower checkout prices and to wholesale customers through lower wholesale prices. The Parties also submit that:[623]

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620 FSNI/FSSI Media Release re Proposed Merger (7 November 2023).

621 Foodstuffs Update on Merger Application (20 May 2024).

622 [ ]

623 The Application at [6]-[7], [20] and [119]-[121], SoPI cross submission from the Parties (7 March 2024) at [3], [60]-[62], [66]-[68] and [137], SoI submission from the Parties (26 April 2024) at [5], [70]-[73], [85]-

411.1 the efficiencies expected to arise from the Proposed Merger are of a nature that we can consider in assessing whether the Proposed Merger would be likely to result in a substantial lessening of competition;[624]

411.2 the operation of a single national support centre structure with the Proposed Merger would lead to cost reductions (including overhead costs and product costs), efficiency gains, increased agility and innovation, a more cohesive national offering and enhanced competition;

411.3 there is no question that any better buying terms achieved with the Proposed Merger would be shared with consumers, as in competitive markets, efficiency gains are likely to be passed through to consumers;

411.4 increased retail competition and the GICA (plus other public, regulatory and political pressure) should ensure the benefits of savings and efficiencies are passed on;

411.5 citing examples, that the Parties have a strong track record of passing through cost savings to consumers (even at the expense of their own margins) and [ ];[625]

411.6 citing evidence and analysis from the market study, that lower prices for retail consumers did follow the previous North Island Foodstuffs merger and there was no increase in FSNI margins;

411.7 they face public, supplier and Government scrutiny and failure to stick to public commitments they have made on what the Proposed Merger would deliver would be self-defeating;

411.8 the statutory test for merger clearances is focused on a substantial lessening of competition. A buyer’s ability to achieve input cost savings from a merger in an acquisition market is neutral, or pro-competitive if it results in lower retail or wholesale prices than would otherwise prevail; and

411.9 the Parties publish a comparison of their prices as against supplier cost prices and the Stats NZ Food Price Index. As illustrated in Figure 9 of the Parties’ submission on the SoI, over the last 27 months FSNI and FSSI have been making a concerted effort not to pass through the full amount of increased

[106], Figure 9 and [141]-[146], SoI cross submission from the Parties (6 May 2024) at 18-19, SoI cross submission from the Parties (31 May 2024) at 4-7, SoUI submission from the Parties (13 August 2024) at 76 and [106] and SoUI cross submission from the Parties (26 August 2024) at 22 and 25.

624 However, the Parties also submit that it is not necessary for us to conclude that cost savings would be passed on to retail consumers as the Proposed Merger would not give rise to a substantial lessening of competition. SoI submission from the Parties (26 April 2024) at [87] and SoUI cross submission from the Parties (26 August 2024) at 24.

625 [ ]

supplier costs onto consumers, to ensure that the Parties remain price competitive at the checkout.

412. The [ ] for the Proposed Merger states the following in terms of savings being passed on to customers:[626]

[ ]

413. However, the Parties' [ ]:[627]

413.1 [ ];

413.2 [ ];

413.3 [ ]; and

413.4 [ ].

414. Regarding these comments, FSNI advised us that [ ]. FSNI also told us that:[628]

414.1 the Proposed Merger cannot just produce benefits for FSNI/FSSI members and shareholders, with the Parties believing that they are accountable to New Zealanders in terms of the Proposed Merger showing them value and benefits. The Parties have been very clear that a significant portion of the

626 [ ]
627 [ ]
628 Commerce Commission interview with FSNI (31 May 2024).

value pool generated by the Proposed Merger would pass through to customers;

414.2 it is impossible to pinpoint how much growth the merged entity would earn from customers who see more value:

414.2.1 in buying savings being passed on (ie, better pricing across a merged FSNI/FSSI); and

414.2.2 from buying efficiencies ([ ]) being retained by the merged entity to maintain fair co-operative returns or to head off increases in prices and costs; and

414.3 buying benefits would be shared with customers either through heading off on price increases, lowering prices or investments in innovation (in the things that customers are telling the Parties they want).[629]

415. FSSI advised that [ ].[630]

416. The Parties submit that the Proposed Merger would result in consumer benefits at the retail level, relative to the counterfactual. However, the Parties also submit that they "do not argue that harm upstream is offset by pro-competitive effects downstream, but rather that no substantial lessening of competition would be likely to arise in any market" due to the Proposed Merger. The Parties further submit that consumer benefits at the retail level are consistent with a lack of harm at in

629 [ ]

630 Commerce Commission interview with FSSI (5 June 2024).

acquisition markets[631] and that, at the very least, we should expect to see some cost savings passed through to consumers.[632] In addition:

416.1 Houston Kemp submits that "economic principles show that at least some part of the anticipated reduction in the merged entity's marginal cost of production will always be passed on by a profit maximising under *any* form of downstream competition";[633] and

416.2 Düsseldorf Competition Economics similarly submits that general optimisation principles suggest that "when a company (even a monopolist) secures more favourable procurement terms, a portion of the resulting cost savings is passed on to consumers in the form of lower prices".[634]

417. In terms of the extent to which the Proposed Merger is likely to impact the Parties' product costs, the Parties submit that [ ].[635]

Third party submissions and evidence received

418. Some submissions from interested parties have raised concerns that any benefits or efficiencies achieved by the Parties with the Proposed Merger would not ultimately be passed on to consumers.[636] Moreover, many suppliers/industry participants we have spoken with do not consider the Proposed Merger would benefit consumers or retail prices and/or doubted the extent to which any benefits or efficiencies achieved by the Parties with the Proposed Merger would ultimately be passed on to retail consumers.[637] In response the Parties submit it is not clear to them how other submitters would be in a position to assess this.[638]

419. On the other hand, some suppliers/industry participants told us that they do consider the Proposed Merger could potentially result in lower prices for consumers

631 SoUI submission from the Parties (13 August 2024) at [11] and [43]. See also SoUI cross-submission from the Parties (26 August 2024) at 19.

632 SoUI submission from the Parties (13 August 2024) at [133].

633 Houston Kemp report on SoUI (13 August 2024) at [11].

634 Düsseldorf Competition Economics report on SoUI (26 August 2024) at [29i].

635 RFI response from the Parties (9 September 2024).

636 SoPI submissions from The Warehouse Group (9 February 2024), Anonymous B (23 January 2024) Lisa Asher (9 February 2024), Monopoly Watch (27 February 2024), and the Food and Grocery Council (19 February 2024), and SoI submissions from The Warehouse Group (10 May 2024), Justin Jeans (20 April 2024) and Anonymous F (13 April 2024).

637 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ] and [ ].

638 SoUI submission from the Parties (13 August 2024) at 127.

and/or otherwise be advantageous to consumers.[639] One supplier considers there is a possibility the merged entity might pass through some cost savings to consumers in the short term but that the Proposed Merger would nonetheless have a negative impact in the long-term,[640] with another supplier similarly noting that while consumers might not suffer in the short term, long term they would suffer on choice.[641]

420. The New Zealand Specialist Cheesemakers Association submits that the merged entity would be able to command monopolistic terms and have low competitive incentives to pass these back to consumers on the retail side.[642]

Previous views of the Commission on pass through in grocery markets

421. In the market study, the Commission noted that:

421.1 buyer power can be a driver of efficiency and good outcomes for consumers, including if better wholesale purchasing terms lead to lower retail prices and improved quality or variety (ie, grocery retailers pass though cost savings);[643]

421.2 significant efficiency benefits achieved by grocery retailers (including through economies of scale) can also benefit consumers where they are passed on in the form of lower prices;[644] and

421.3 the extent to which customers may benefit depends on the strength of competition between grocery retailers.[645] A more competitive retail grocery market increases the extent to which benefits grocery retailers obtain from buyer power will be passed through to consumers.[646]

Consumer harm

422. We now consider the question of whether the Proposed Merger should be allowed on the basis that it would be good for consumers, regardless of the lessening of independently rivalry in the relevant acquisition markets.

423. First, we consider that the Act requires us to undertake a competition assessment rather than a consumer welfare assessment for a clearance application.

424. The Act is generally focused on competition as a means to an end, and assumes that preserving competition is in the long-term benefit of consumers.

639 Commerce Commission interviews with [ ], [ ], [ ], and [ ], and SoUI submission from Beard Brothers (9 August 2024).

640 Commerce Commission interview with [ ].

641 Commerce Commission interview with [ ].

642 SoUI submission from New Zealand Specialist Cheesemakers Association (12 August 2024) at 3.

643 Market study final report (8 March 2022) at [8.29]-[8.30].

644 Market study final report (8 March 2022) at [6.122].

645 Market study final report (8 March 2022) at [8.30].

646 Market study final report (8 March 2022) at [8.33].

425. The merger clearance test in the Act is focussed on the effect of a merger on competition in a market or markets in New Zealand. Each market must be assessed separately and regardless of whether it is an acquisition, or a retail or wholesale grocery market.

426. If we are not satisfied that the Proposed Merger would not substantially lessen competition in the relevant acquisition markets (as above), then it is not permissible to ask whether this might be "offset" in some way by gains to consumers in retail grocery markets.

427. We note that this is an important distinction between an application for a clearance (under s 66) and an application for an authorisation (under s 67), as the latter asks whether there is a sufficient public benefit to New Zealand from a merger that it should be permitted notwithstanding that it is likely to lessen competition in a particular market(s).

428. Second, it is not clear to us the extent to which cost savings from the Proposed Merger would be variable costs that are more likely to be passed through to retail consumers. The Parties have publicly stated that the Proposed Merger would enable the merged entity to "deliver better value for our customers" and submit that [ ],[647] However, we are certainly not satisfied that the bulk of cost savings would be passed on to retail consumers.

428.1 We consider that buying benefits are more likely to be passed through if they affect variable costs (such as product costs).[648] In that regard, the Parties submit that the merged entity would have an incentive to share an improvement in its variable costs (such as product costs) with customers.[649]

428.2 In our view muted competition at the retail level (as noted at [41]) and the firm-specific nature of some of the cost benefits would lessen the extent to which savings would pass through to retail prices.[650] Düsseldorf Competition Economics concurs that the extent of price reductions in retail grocery markets would depend on the degree of competition in the relevant markets.[651]

647 FSNI/FSSI Media Release re Proposed Merger (7 November 2023) and [ ]

648 Mergers and Acquisitions Guidelines above n3 at [3.122].

649 SoUI submission from the Parties (13 August 2024) at 76. See also [36.2].

650 Firm-specific cost savings are those that only the merged entity would benefit from. Although a wide range of outcomes is possible in oligopolistic markets, the extent of firm-specific pass through is typically less than pass-through of industry wide cost changes (RBB Economics (February 2014), Cost Pass Through, theory, measurement and potential policy implications, A Report prepared for the Office of Fair Trading, at 5). In addition, the market study found that the pass through of cost changes affecting only one grocery retailer was much lower than when compared against cost changes affecting two grocery retailers. Market study final report (8 March 2022) at Figure D10.

651 Düsseldorf Competition Economics report on SoUI (13 August 2024) at fn 17.

428.3 The Parties have told both consumers and co-operative members that they would benefit from the Proposed Merger, but it is unclear what proportion of efficiencies may be allocated to each group. While we would normally expect some variable cost savings to be passed through, consumers may not benefit in this case if the Proposed Merger also raises barriers to entry and expansion and increases the risk of price coordination.

428.4 It is also not clear that any efficiencies from the Proposed Merger would necessarily be realised in a timely fashion, adding to the uncertainty around cost savings being passed on to consumers. On this point, the Parties' [ ],[652] and it is unclear what this means for the extent to which any efficiencies would flow through to retail consumers within the next two years.

429. Third, we also consider that there a number of ways in which the Proposed Merger could negatively impact on consumers. We consider that:

429.1 it would result in a substantial lessening of competition in the markets in which groceries are acquired from suppliers. The removal of one of three major buyers of many categories of grocery products with the Proposed Merger would further entrench the bargaining imbalance that is already present between many suppliers and the Parties separately. This would increase the merged entity's buyer power and enable it to extract lower prices and less favourable terms from suppliers than the Parties would be able to obtain separately in the counterfactual (and better than they would have been able to obtain in a competitive market). This includes "cherry picking" the most favourable terms from those currently offered to each of FSNI and FSSI. Indeed, we understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers: [ ].[653] This could be harmful for consumers if it caused suppliers to rationalise their operations, stop production, fail or exit, and thereby reduce the product range, quality and innovation that retail consumers might otherwise enjoy;

429.2 each of FSNI and FSSI provide separate opportunities for new grocery products to be listed in New Zealand, and their consolidation with the Proposed Merger would remove one such opportunity. This would mean that there would be less opportunities for new suppliers and new products to get listed and enter the New Zealand market, and less opportunity for multinational suppliers to launch products in New Zealand. That could slow the pace and development of new product innovation, resulting in reduced

652 [ ]

653 [ ]

consumer choice and/or quality of grocery products. The transfer of surplus away from suppliers as a result of increased bargaining power would also adversely affect the ability and incentive of suppliers to innovate;

429.3 as we discuss later, we are not satisfied that the Proposed Merger would not increase barriers to entry and expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets. We consider that this would substantially lessen competition, potentially depriving consumers of a more competitive grocery industry in the future; and

429.4 as we also discuss later, the Proposed Merger could harm consumers by increasing the likelihood, completeness or sustainability of coordination in retail grocery markets between the merged entity and Woolworths. If the merged entity and Woolworths were better able to coordinate on prices, it would mean consumers would pay higher prices for grocery products than if the merged entity and Woolworths set their prices independently.

430. For these reasons, we do not consider that the Proposed Merger should be cleared on the basis of a consumer welfare assessment.

"Efficiencies defence" not available on the facts

431. The substantial lessening of competition test is a "net" test in each relevant market. That is, we must consider any pro-competitive outcomes of a merger and balance these against any anticompetitive outcomes. For example, a merger could make a firm more competitive (through economies of scale, reducing information asymmetries, etc), or more innovative, in such a way that it becomes a more vigorous and effective competitor. In such a scenario, we would net off those pro-competitive outcomes against any lessening of competition arising from the competitive aggregation, and form an overall view on whether competition would be substantially lessened in that market.[654]

432. Our Guidelines refer to the fact that "efficiencies may be relevant to our assessment of whether a merger would be likely to substantially lessen competition in a market"[655], and that they are relevant "when efficiency gains prevent customers from being adversely affected in a material way" (eg, by preventing customers from paying substantially higher prices).[656]

433. However, the Guidelines also note that claims of efficiency gains "are rarely of the required type, magnitude and credibility", and that the burden is on an applicant to satisfy us that they would be realised in a timely fashion, that they would not likely be realised without a merger, and that they would be passed on to buyers sufficiently to prevent a finding of a substantial lessening of competition.[657]

[654] See for example, *ANZCO v Affco* (CA) above n81 at [249] and *Fisher & Paykel* [1990] 2 NZLR at 740.
[655] Mergers and Acquisitions Guidelines above n3 at [3.118].
[656] Mergers and Acquisitions Guidelines above n3 at [3.120].
[657] Mergers and Acquisitions Guidelines above n3 at [3.119].

434. Our Guidelines currently focus to a great degree on pass through of efficiencies to customers, and are not express as to whether efficiencies can be 'out of market'. We consider that there is a distinction to be drawn between efficiencies that prevent a substantial lessening of competition (by making a market more competitive), and efficiencies that would to some extent compensate consumers for a substantial lessening of competition. The latter is akin to what we consider as part of merger authorisation applications.

435. In the context of merger clearance applications, we consider that any assessment of efficiencies is or should be limited to only in-market, rivalry-enhancing efficiencies (found in the market in which they occur) that would prevent a substantial lessening of competition (from occurring in that exact same market) by offsetting any anti-competitive effects. This is because:

435.1 the s 66 clearance test requires us to block mergers if they would, or we are not satisfied that they would not be likely to, substantially lessen competition in any market. A market is the locus of our assessment. There is no reference in this section of the Act to balancing harm in one market against any benefits in another;

435.2 there is another provision of the Act that does permit us to consider out of market efficiencies more holistically – the s 67 merger authorisation test;

435.3 the key case that discusses efficiencies in the context of the substantial lessening of competition test, *ANZCO*, refers to the substantial lessening of competition test being a net test. This logically requires netting off competition losses and gains in the same market to ascertain whether there is a substantial lessening of competition overall; and

435.4 while our Guidelines note that efficiencies "may be relevant to our assessment of whether a merger would be likely to substantially lessen competition",[658] given case law, we do not consider that the substantial lessening of competition test allows us to net off factors that harm and enhance competition across different markets.

436. We also consider that cost savings accruing to a merged entity simply from the exploitation of increased buyer power in acquisition markets should not be treated as relevant efficiencies. Such cost savings reflect a harm to competition.

437. In terms of the Proposed Merger, in our view:

437.1 there may be some in-market efficiencies in relevant acquisition markets arising from reduced transaction costs (eg, fewer negotiations);

437.2 however, cost savings resulting from the exploitation of increased buyer power would not count as an efficiency for these purposes; and

658 Mergers and Acquisitions Guidelines n3 at [3.118].

437.3 we do not consider that any in-market efficiencies accruing to the merged entity in relevant acquisition markets would offset the reduction in rivalry between buyers in these markets.

438. We understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers: [ ].[659] Our view is that these cost savings, which would accrue from the exploitation of increased buyer power in acquisition markets should not be treated as relevant efficiencies. Such cost savings reflect a harm to competition rather than an enhancement of it.

439. Accordingly, we do not consider that an "efficiencies defence" is available to offset the likely lessening of competition in the acquisition markets.

Impact of the previous North Island Foodstuffs merger

440. There is the uncertainty as to the extent to which cost savings from the Proposed Merger might be shared with consumers. We therefore considered the extent to which the previous North Island Foodstuffs merger in 2013 resulted in efficiencies and/or cost savings on the supply-side that were passed through to consumers and if this told us anything about the likelihood of efficiencies being passed through to consumers with the Proposed Merger. This evidence and submissions on the previous North Island Foodstuffs merger (discussed below) do not satisfy us that substantial benefits from the Proposed Merger are likely to pass through to consumers and that this would be sufficient to offset our concerns about harm in acquisition markets (to the extent that we are required to consider 'out of market' efficiencies).

Submissions from the Parties

441. The Parties submit that, in its view, the evidence indicates that the previous North Island Foodstuffs merger:[660]

441.1 resulted in lower prices to retail customers;

441.2 did not result in any material uplift in FSNI's margin;

441.3 did not result in any aggregation in retail grocery markets and therefore suppliers' total opportunity did not change; and

441.4 did not result in any adverse impact of competition in any acquisition markets.

442. Specifically in terms of efficiencies, FSNI told us that [ ]. It considers that with the Proposed Merger, there is an

659 [ ]

660 SoUI submission from the Parties (13 August 2024) at [93] and [95.2(d)].

opportunity to obtain real value for retail consumers through the buying process.[661]

443. The Parties also submit that, [ ] set at the most competitive local level, and that retail consumers nationally could benefit from the Proposed Merger if it increased the prevalence of national pricing.[662]

Third party submissions and evidence received

444. Evidence from interested parties on the previous North Island Foodstuffs merger is mixed, and in some cases contrasts with the information received from the Parties. For example:

444.1 The Food and Grocery Council submits that in response to its survey, suppliers consider that:[663]

444.1.1 they experienced a shift towards centralised decision-making, with the new entity exerting dominance in negotiating better terms. Negotiations often favoured the terms where there was the lowest cost, resulting in reduced profitability for some suppliers;

444.1.2 despite the promise of increased efficiencies and cost savings, the previous North Island Foodstuffs merger failed to deliver tangible benefits to consumers with prices sometimes increasing and ranging opportunities decreasing; and

444.1.3 since the previous North Island Foodstuffs merger, they have experienced resource limitations, negotiation challenges, range consolidation and product deletions, decreased profit and increased reliance on FSNI.

444.2 The Warehouse Group submits, in respect of the previous North Island Foodstuffs merger, that there is a real question about whether the benefits promised by that merger (which it submits were customers benefitting from operations running under one IT system, integration, launch of online grocery delivery, improved efficiencies and savings resulting in better services and lower prices over time) ever or mostly eventuated, and that similar

661 Commerce Commission interview with FSNI (22 February 2024).

662 SoI submission from the Parties (26 April 2024) at [145.3] and SoUI cross-submission from the Parties (26 August 2024) at 18.

663 SoI submission from the Food and Grocery Council (26 April 2024) at [15.2], [15.5] and [15.8]. The Parties' response to this submission is that FSNI disagrees it exerted "dominance" following the previous North Island Foodstuffs merger. The Parties further note that FSNI considers retail grocery prices decreased as a result of the previous North Island Foodstuffs merger and disagrees that retail consumer choice has decreased – rather that FSNI has continued to seek to optimise its offer to consumer demand. SoI cross submission from the Parties (6 May 2024) at 18-19.

statements made by the Parties about the Proposed Merger should be treated with caution.[664]

444.3 Lisa Asher submits that since Foodstuffs Auckland and Foodstuffs Wellington have combined, they have participated in slowing store choice and availability to the detriment of the New Zealand public.[665]

444.4 Pernod Ricard submits that in its experience the previous North Island merger resulted in greater efficiency and more effective operations.[666]

444.5 The Grocery Action Group submits that suppliers have provided feedback that the previous North Island Merger did not result in cost saving or efficiencies for suppliers or cost savings for consumers.[667]

444.6 The New Zealand Specialist Cheesemakers Association submits that although it was more efficient to deal with one entity, there was no discernible efficiency 'dividend' for consumers and that with no change in pricing or margin demands, there was no net positive outcome for suppliers.[668]

444.7 Four suppliers (in different categories) told us that the previous North Island Foodstuffs merger had very little impact on them or resulted in no significant change/difference for them, with one noting that with one point of contact, dealings with FSNI became easier, rationalised, centralised and/or smooth.[669] Three suppliers (across differing categories) said that there was a crossover already between Foodstuffs Auckland and Foodstuffs Wellington prior to that merger or that they worked closely, and operated similarly in terms of their models, culture and policies.[670] However, one supplier (of health and beauty products) expressed the view that Foodstuffs Wellington behaved very differently to Foodstuffs Auckland.[671] One supplier (of fresh products)

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664 SoPI submission from The Warehouse Group (9 February 2024) at [6]-[7], [31]-[36]

665 SoUI submission from Lisa Asher (15 August 2024) at 5.

666 SoUI Submission from Pernod Ricard (12 August 2024). The Parties response to this submission is that they agree and note that the inefficiencies in having separate buying structures (as is currently with FSNI and FSSI) were alleviated at the completion of the previous North Island Foodstuffs merger. SoUI cross submission from the Parties (26 August 2024) at 7-8.

667 SoUI submission from the Grocery Action Group (16 August 2024) at [4]. The Parties response to this submission is that FSNI has seen no evidence that the previous North Island Foodstuffs merger resulted in a lessening of competition in any market involving the acquisition of grocery products and that FSNI considers retail prices decreases as a result of that merger. SoUI cross submission from the Parties (26 August 2024) at 34.

668 SoUI submission from New Zealand Specialist Cheesemakers Association (12 August 2024) at 8. The Parties submit that FSNI has seen no evidence that the previous North Island Foodstuffs merger resulted in a lessening of competition in any market involving the acquisition of grocery products and that prices decreased as a result of that merger. SoUI cross submission from the Parties (26 August 2024) at 11.

669 Commerce Commission interviews with [ ], [ ], [ ], and [ ].

670 Commerce Commission interviews with [ ], [ ] and [ ].

671 Commerce Commission interview with [ ]. This supplier also considers that as a result of previous North Island merger, there became less options for supply, it had less negotiating power and one less fall-back option.

explicitly told us that there were "no instances of increased pressure from Foodstuffs" with the previous North Island Foodstuffs merger.[672] One other supplier (of dry food products) had no insight on how the North Island Foodstuffs merger impacted commercial terms, but considered that as a whole, the North Island Foodstuffs merger brought efficiencies.[673]

444.8 However, three suppliers indicated that there was a change in buyer power, or that suppliers or competition were impacted by, the previous North Island Foodstuffs merger. One supplier (of dry food products) told us that the result of that merger was that there was more of a pressure to keep products listed, and that the power balance had shifted in favour of FSNI.[674] A second supplier (of a range of grocery products) said that the centralised head office with that merger meant FSNI could leverage power over suppliers, impacting small suppliers.[675] A third supplier (of dry food products) noted that following the Proposed Merger, the merged entity would seek to implement the better of the Parties' terms, as was the case with the previous North Island Foodstuffs merger.[676]

444.9 In terms of the insights we could draw from the previous North Island Foodstuffs merger, two suppliers (from different categories) told us that there were more similarities between Foodstuffs Auckland and Foodstuffs Wellington than between FSNI and FSSI,[677] suggesting that the effects of the Proposed Merger would be likely to be greater than the previous North Island Foodstuffs merger. A third supplier (of fresh products) told us that during the time of the North Island Foodstuffs merger, the market was quite different, and the power of the major grocery retailers was not as strong,[678] suggesting that the effects of the Proposed Merger could be different.

Our view

445. The evidence available to us on the extent to which efficiencies and costs savings were realised from previous North Island Foodstuffs merger and shared with consumers is mixed. We are not, therefore, able to draw insight from the effects of that merger on the likelihood and extent of pass through to consumers of any cost savings arising from the Proposed Merger.

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672 Commerce Commission interview with [ ].
[ ].

673 Commerce Commission interview with [ ].

674 Commerce Commission interview with [ ].

675 Commerce Commission interview with [ ].

676 Commerce Commission interview with [ ].

677 Commerce Commission interviews with [ ] and [ ].

678 Commerce Commission interview with [ ].

We are not satisfied that a substantial lessening of competition in retail grocery markets is not likely

446. In relation to retail supply, the Parties submit that the Proposed Merger is not capable of lessening competition in any market for the retail supply of groceries.[679]

447. We are not satisfied that the Proposed Merger will not have, or would not be likely to have, the effect of substantially lessening competition in retail grocery markets.

448. The Proposed Merger would be likely to:

448.1 result in a substantial increase in the buyer power of the merged entity; and

448.2 consolidate the retail offerings (including retail banners and supermarkets) of FSNI and FSSI within and under the management of a single national retail grocery entity, with the effect that the merged entity would operate, and input into the retail pricing and competitive strategies for all New World, PAK'nSAVE and Four Square supermarkets nationally.

449. For the reasons summarised in this section (and expanded on in subsequent sections), we consider that these changes with the Proposed Merger would substantially lessen competition in retail grocery markets in at least two ways:

449.1 by further raising barriers to entry into, and/or expansion within, retail grocery markets; and

449.2 by increasing the likelihood, completeness or sustainability of coordination between the merged entity and Woolworths.

450. We have reached these conclusions notwithstanding the lack of overlap between the Parties in local retail grocery markets. It is not local store aggregation that we think would give rise to the harms to competition we identify in retail grocery markets. Instead, it is:

450.1 the substantially increased buyer power achieved by the merged entity (in the case of the barriers to entry and expansion theory of harm); and

450.2 the permanent structural change to retail grocery markets through the removal of a major grocery retailer and the increased centralisation of price setting post-merger (in the case of the coordinated effects theory of harm).

451. The Parties submit that as there is no overlap or potential overlap between the Parties there is no possible lessening of competition in retail grocery markets.[680] We considered this submission and whether there would be a loss of competition between the Parties in any retail grocery markets. We are satisfied that the Proposed Merger would not result in a loss of actual or potential competition at the retail level between the Parties. The Parties do not currently compete in any retail grocery

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679 The Application at [111].
680 The Application at [73] and SoI submission from the Parties (26 April 2024) at [155].

markets. While either of the Parties could, [ ], enter the island retail grocery market it does not currently compete in, we are satisfied based on the evidence before us that there is not a real chance of a counterfactual scenario where either of the Parties would do so.

Raising barriers to entry into, and/or expansion within, retail grocery markets

452. The Proposed Merger would increase barriers to entry and expansion into and within retail grocery markets. This is because:

452.1 the increased buyer power that the merged entity would achieve through the Proposed Merger would enable it to negotiate more favourable price and non-price terms with suppliers, increasing its margins, further extending its scale advantage against new entrants and smaller grocery retailers, and enhancing its ability to engage in strategic retaliation in response to attempted entry and expansion by rival grocery retailers; and

452.2 the Proposed Merger could increase the likelihood of rival grocery retailers being unable to obtain competitive supply due to the increased buyer power of the merged entity 'raising the stakes' for suppliers, and suppliers not wanting to risk damaging their relationship with the merged entity.

453. The merged entity would not necessarily need to reduce prices to deter entry and expansion by rival grocery retailers. The knowledge that the merged entity would be capable of steep discounts due to favourable terms would be sufficient to deter rival grocery retailers from entering and expanding in retail grocery markets.

Increasing the likelihood, completeness or sustainability of coordination

454. The Proposed Merger could increase the likelihood, completeness or sustainability of coordination between the merged entity and Woolworths.

455. We are of the view that retail grocery markets have some features which make them vulnerable to sustainable coordination, such as the small number of competitors at both a national and regional level; the high degree of price transparency; limited scope for new entry and expansion; and frequent interaction between the Parties and Woolworths over a long period of time.

456. The Proposed Merger would result in the merged entity setting prices centrally rather than in each island. We consider this would make coordination in retail grocery markets more likely, complete or sustainable, as it would make it easier for the merged entity and Woolworths to align their prices to one another. Such alignment could take different forms, including (but not limited to) the merged entity and Woolworths setting a single national (or regional) price for some individual goods (or a basket of goods), or through an increased ability to [ ]. The alignment could also take the form of the merged entity and Woolworths avoiding promotional clashes for some products. Through these means of coordination the merged entity and Woolworths (as the only two major grocery retailers) may be able to raise retail

grocery prices above competitive levels by accommodating each other's behaviour.

457. The higher retail grocery prices as a result of sustainable coordination would in principle increase the incentive for entry and expansion to occur. This would destabilise coordination. However, rival grocery retailers may be deterred from entry and expansion even at those higher prices if they believed they would be ultimately undercut by the merged entity using its lower acquisition prices as a result of its buyer power to engage in strategic retaliation. Rival grocery retailers would also be deterred from entering and expanding if suppliers were reluctant to supply them or provided the merged entity with preferential treatment. In this way, the increase in barriers to entry and expansion would reinforce any price coordination that the merged entity and Woolworths engage in.

Ultimate impact on consumers

458. In addition to the Proposed Merger's potential impacts on retail consumers discussed elsewhere we consider that:

458.1 the Proposed Merger would increase barriers to entry and expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets. We consider that this would substantially lessen competition, potentially depriving consumers of a more competitive grocery industry in the future; and

458.2 the Proposed Merger could harm consumers by increasing the likelihood, completeness or sustainability of coordination in retail grocery markets between the merged entity and Woolworths. If the merged entity and Woolworths were better able to coordinate on prices, it would mean consumers would pay higher prices for grocery products than if the merged entity and Woolworths set their prices independently.

Market definition – retail grocery markets

459. We discuss below the relevant markets for assessing the impact of the Proposed Merger on retail grocery markets. Retail grocery markets are relevant to both our assessment of the likelihood of the merged entity's buyer power impacting entry and expansion by rival grocery retailers and to our assessment of whether the Proposed Merger would increase the potential for the merged entity and Woolworths to coordinate their behaviour.

Framework for defining retail grocery markets

460. Our framework for defining retail grocery markets for the supply of groceries to retail consumers is the same as that discussed earlier at [130].

Submissions from the Parties

461. The Parties submit that the effects of the Proposed Merger at the retail level can be analysed by reference to local, regional and national markets for the retail supply of

groceries (in which retailers sell groceries to consumers).[681] The Parties further submit that:

461.1 it is not necessary to precisely define the geographic dimension of retail grocery markets. Rather, the Parties submit that the Commission's perspective in the previous market study that "grocery retailers typically compete for consumers within small local areas but there are some regional and national dimensions to competition" can be adopted for purposes of analysing the Proposed Merger;[682] and

461.2 in the product dimension of retail grocery markets, they compete with a wide range of market participants across many product categories, and that it is not necessary to precisely define product markets given there is no competition between the Parties (so, no competition can be lost as a result of the Proposed Merger).[683]

462. The Parties further submit that the relevant retail product markets are broader than "one-stop-shop" or at least that the Parties are very materially constrained by grocery retailers that have a narrower or more specialised offerings.[684] However, the Parties say that it is not necessary to conclusively define the relevant retail grocery markets as there is no overlap or potential overlap between the Parties and therefore (in their view) no possible lessening of competition.[685]

Our view

463. For the purposes of our analysis, we have assessed the impact of the Proposed Merger on local, regional and national markets for the retailing of grocery products by retail grocery stores which offer the ability for retail consumers to do a one-stop shop grocery shop.[686]

464. Retail grocery markets are highly differentiated, implying that:

464.1 the major grocery retailers (the Parties and Woolworths) face some degree of constraint from smaller supermarkets (eg, Farro Fresh and Moore Wilson's), as well as other grocery retailers (eg, single category retailers and convenience stores), in some local grocery retail markets; and

464.2 there will be varying degrees of competition between the retail banners of the major grocery retailers in different locations.

465. However, we consider the major grocery retailers are each other's closest competitors for consumer grocery spend. They have a high combined market share

[681] The Application at [75]-[76].
[682] The Application at [75]-[76].
[683] The Application at [77]-[79].
[684] SoI submission from the Parties (26 April 2024) at [155].
[685] The Application at [73] and SoI submission from the Parties (26 April 2024) at [155].
[686] These include the supermarkets operated by the major grocery retailers (ie, the Parties and Woolworths) that are able to offer consumers a one-stop shop option for grocery purchases as they typically sell a wide range of grocery products in one location.

and operate a large number of supermarkets across New Zealand under a variety of retail banners that cater to consumer preferences for a one-stop shopping location.[687]

466. Although grocery retailers typically compete for consumers in small local areas there are also regional and national dimensions to competition between the major grocery retailers. Several important aspects of the retail grocery offer, such as centralised pricing and product acquisition, are set uniformly across the retail banners of the major grocery retailers at either a regional or national level. For the purposes of our assessment, we therefore consider it appropriate to define separate local, regional and national markets for the retailing of grocery products.[688]

Product dimension

467. The starting point for assessing the scope of the relevant product dimension is the products and services supplied by the Parties. We consider the Parties primarily compete against those physical supermarkets which offer the ability for retail consumers to do a one-stop grocery shop. As we identified in the market study, consumers value the convenience of a wide range of groceries at a single location.[689] A sufficiently wide product range that accommodates one-stop shopping is therefore an important element of convenience, as well as the location and accessibility of a supermarket.

468. For the purposes of our assessment, we consider it appropriate to adopt a store level approach for defining the relevant product dimension of the relevant market, due to the difficulty of assessing a large number of separate candidate markets using a product approach.[690] Our approach treats supermarkets as the products. We then use the hypothetical monopolist test to assess substitutes for the supermarkets of the Parties in defining the scope of the product dimension. This is the standard approach adopted in retail merger investigations and is also consistent with the approach previously adopted by the Commission in other grocery retailing investigations.[691]

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687 Market Study Final Report (8 March 2022) at [4.52] and [4.84].

688 Market Study Final Report (8 March 2022) at [4.114].

689 Market study Final Report (8 March 2022) at [2.6] stated that: *"*Consumers value the convenience of a wide range of groceries at a single location. A sufficiently wide range that accommodates one-stop shopping is therefore an important element of convenience, as well as the location and accessibility of a grocery store".

690 If the store approach is adopted it does not necessarily imply that the Parties would face the same degree of competitive constraint across all product categories sold at their supermarkets.

691 For example, see Progressive Enterprises Limited and Woolworths (NZ) Limited (Commerce Commission Decision 438, 13 July 2001) at [23]-[72]; and Commerce Commission Foodstuffs (Auckland) Limited, Foodstuffs (Wellington) Co-operative Society Limited, and Foodstuffs South Island Limited; and (separately) Woolworths Limited (Commerce Commission Decision 606 and 607, 8 June 2007) at [102]-150].

<u>Demand-side substitution</u>

469. Grocery retailing consumers have a diverse range of preferences and needs. The combined set of products and services offered to consumers by grocery retailers to cater to this diverse range of consumer needs is known as the retail grocery offer.

470. Grocery retailers differentiate the retail grocery offer across the spectrum of price, quality, range and service (PQRS). Individual grocery retailers or retail banners use a particular combination of PQRS to attract and retain retail consumers.

471. For example, grocery retailers compete for consumers' grocery spend by differentiating their retail grocery offer in a number of ways, including:

471.1 the prices of products, including regular and one-off promotions;

471.2 loyalty programmes and non-price promotions;

471.3 the quality of products;

471.4 the range of available products;

471.5 location;

471.6 accessibility including ease of access and opening hours; and

471.7 the quality of service and the shopping experience (eg, store layout, number and accessibility of staff to consumers, etc.).

472. Some of these aspects of the retail grocery offer, such as price and quality of service can be adjusted relatively easily by most grocery retailers. However, other aspects valued by some consumers, such as store size, parking facilities and store layout, are less easily changed. Store location is perhaps the aspect of the retail grocery offer which is most difficult to adjust.[692]

473. The Parties and Woolworths tend to compete across the full PQRS spectrum, which allows them to compete for many different combinations of consumer preferences and to make their retail grocery offer attractive to consumers on many different types of shopping missions.[693] In contrast, other grocery retailers tend to compete with the major grocery retailers only over some aspects of the retail grocery offer.[694]

692 Market Study Final report (8 March 2022) at [4.16]-[4.19].

693 A commonly used concept to describe a particular type of shopping trip is a shopping mission. It is generally defined by the motivational factors that drive consumers to shop, the context in which they shop, and the shopping behaviours that drive their purchasing decisions. Market Study Final Report (8 March 2022) at [4.8].

694 Consumer research conducted during the market study suggests that competition between the major grocery retailers and other grocery retailers tends to mostly occur in some local markets for secondary or top-up shopping missions. Market Study Final Report (8 March 2022) at [4.81].

474. The Parties have submitted that the relevant product market is wider than a "one-stop shop".[695] However, we consider there is likely to be limited scope for demand-side substitution by consumers between the major grocery retailers and other grocery retailers who cannot fulfil the needs of a one-stop shop. There is limited evidence to suggest that other grocery retailers are sufficiently close competitors and substitutes for consumers as to constrain a hypothetical one-stop shop monopolist from profitably imposing a SSNIP.

475. Evidence gathered during the market study showed that other grocery retailers tend to strategically differentiate their retail grocery offers from the major grocery retailers by focusing on the non-price dimensions of the retail grocery offer such as product range and quality.[696] The breadth and depth of product range stocked at most supermarkets as compared to other grocery retailers means that consumers are more likely to find the range of products that they want to purchase at a supermarket rather than having to visit numerous grocery retailers to purchase the same basket of products.[697] This means that the supermarkets operated by the major grocery retailers are uniquely placed to offer the convenience of one-stop shopping to consumers.[698]

476. Other grocery retailers may impose a degree of constraint on the major grocery retailers in some locations. The extent of constraint imposed on the major grocery retailers will differ depending on the retail grocery offer of different types of retailers. However, the market study found that on average, these other grocery retailers stock between 38-85% fewer SKUs than the major grocery retailers, implying that they are more likely to be suitable for top-up shops in those locations where they are available.[699] Further, most retail consumers prefer to buy groceries at one of the major grocery retailer banners. This because consumers value location, price, range and store familiarity when deciding where to shop.[700]

477. We also considered whether it would be appropriate to define separate markets for each of the major grocery retailer banners. However, although they choose to differentiate their banners by emphasising different elements of price and non-price competition, we do not consider it is necessary for purposes of our assessment. The major grocery retailers tend to compete across the full PQRS spectrum and have broadly similar retail grocery offers. We therefore consider they are each other's closest competitors, irrespective of differentiation between their various retail banners.

478. Grocery retailers such as Costco, Farro Fresh and Moore Wilson's are likely to be the next closest competitors to the Parties and Woolworths. These retailers offer a one-stop shop option for retail consumers in some local markets. However, the extent to which retail consumers regard these stores as viable substitutes to the major grocery

695 SoI submission from the Parties (26 April 2024) at [155].
696 Market Study Final Report (8 March 2022) at [4.86].
697 Market Study Final Report (8 March 2022) at [4.93].
698 Market Study Final Report (8 March 2022) at [4.7.2].
699 Market Study Final Report (8 March 2022) at [4.97].
700 Market Study Final Report (8 March 2022) at [4.13], [4.40] and [4.44].

retail banners is unclear (see Figure 2). We also note that they do not have a wider regional or national presence, which limits their ability to constrain the major grocery retailers.

479. We considered whether online grocery shopping is likely to constrain instore shopping to such an extent as to include online shopping in the same market as grocery shopping at physical grocery stores. However, we are of the view that it is unnecessary for us to reach a conclusion on this for purposes of assessing the Proposed Merger.

480. We therefore consider it appropriate to define the relevant product dimension as the retailing of grocery products by retail grocery stores which offer the ability for retail consumers to do a one-stop shop grocery shop.

<u>Supply-side substitution</u>

481. Supply side substitution in the context of market definition is typically reserved for situations in which suppliers of other consumers, products or geographic areas already have the key assets needed to supply the focal consumers, product or geographic area. If entry into supply of the focal product by a firm currently producing another product would require significant cost associated with investment in new capacity, particularly sunk cost, or would take some time to occur, the other product will not normally be considered a sufficiently close substitute to justify defining a broader market.

482. There is currently limited evidence to suggest that supply-side substitution is likely in retail grocery markets. Entry into providing a similar grocery retail offer to those of the major grocery retailers would require significant sunk costs and time. For example, there is some evidence of The Warehouse investing significantly into expanding its grocery product offering in the recent past in an attempt to compete with the major grocery retailers. However, the available evidence suggests it does not currently have the scale and capability to be regarded as a close substitute to the major grocery retailers for a one-stop shop.

483. The Warehouse has 86 stores.[701] This is significantly fewer stores than the major grocery retailers (FSNI had 108 New World stores and 45 PAK'nSAVE, FSSI had 43 New World stores and 12 PAK'nSAVE stores, and Woolworths has 191 Countdown or Woolworths stores) which means The Warehouse does not compete with the major grocery retailers in all local grocery markets.[702] The Warehouse offers a limited range of dry goods in all its stores. It has recently started offering fruit and vegetables and offers these in 43 stores.[703] The Warehouse does not have a chilled and frozen offering.

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701 The Warehouse "FY24 Annual report" (26 September 2024) at 15.

702 For FSNI and FSSI store numbers see the Application at Figure 3. For Woolworths see Woolworths Group "Full year results announcement" (press release, 23 August 2023) at 17.

703 The Warehouse Group "Almost half of The Warehouse stores now sell fresh produce" (press release, 1 May 2024).

484. We are therefore of the view that it is unlikely that there are any existing suppliers of grocery products or grocery retailers that would be able to easily, profitably and quickly (generally within one year) switch to offering a one-stop shop service to defeat a SSNIP by a hypothetical one-stop shop monopolist.

Geographic dimension

485. There are local, regional and national geographic dimensions to competition in grocery retail markets. Grocery retailers compete for specific shopping missions in local markets where consumers live and work. This is consistent with the findings from the market study that found convenience of location is one of the key drivers of store choice for consumers.[704]

486. There is not a one-sized estimation of the approximate geographic size of local markets that applies to all local areas across New Zealand. Consumers are generally willing to travel limited distances to purchase grocery products.[705] This means grocery retailers typically compete for consumers in small local markets. However, the approximate geographic size of local markets may vary between different types of grocery retailers and shopping missions.[706]

487. Although grocery retailers typically compete for consumers in small local areas there are also some regional and national dimensions to competition between the major grocery retailers. Several important aspects of the retail grocery offer, such as centralised pricing and product acquisition, are set uniformly across the retail banners of the Parties and Woolworths at a national or regional (island) level. This means that there are also some regional and national dynamics to competition in retail grocery markets that have an impact on the nature and intensity of competition between grocery retailers.[707]

488. We do not consider it necessary for us to conclusively determine the scope of the relevant geographic markets as the impact of the Proposed Merger could take place on different dimensions. For example:

488.1 an increase in the barriers to entry and expansion in retail grocery markets could affect existing rival grocery retailers that are looking to expand to offer a national one-stop shop option to retail consumers (eg, The Warehouse), or potential new entrants aiming to provide an alternative one-stop shop option to retail consumers in local, regional or national markets; and

488.2 retail price coordination could potentially take place on products that are centrally priced either on a national or more localised (regional) basis.

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704 Market Study Final Report (8 March 2022) at [4.21].
705 Market Study Final Report (8 March 2022) at [4.22].
706 Market Study Final Report (8 March 2022) at [4.22].
707 Market Study Final Report (8 March 2022) at [4.114].

Likelihood of the merged entity's buyer power impacting entry and expansion in retail grocery markets

489. A merger may substantially lessen competition if it raises the barriers for potential competitors to enter the market, or if it raises the barriers for existing competitors to the merged entity to expand their businesses within the market. This is because a firm's market power depends substantially on the level of barriers to entry and expansion in the relevant market in which the firm operates.[708] In this way, raising barriers to entry and expansion can be seen as equivalent to increasing an incumbent firm's market power, because it decreases the likelihood that the firm will be disciplined by timely and comprehensive entry and expansion if it raises price above competitive levels. Raising barriers to entry and expansion can also increase the stability and effectiveness of coordinated behaviour among firms in a market.

490. Broadly speaking, a barrier to entry and expansion is an obstacle – be it structural, regulatory, or strategic – that obstructs or impedes a competitor from entering or expanding into or within a market. For example:[709]

    490.1 structural barriers relate to the technologies, resources, or inputs that a firm would need to enter or expand. These may include, for example, economies of scale and scope, and difficulties in accessing required inputs (such as suitable land, or grocery supply) or distribution channels;

    490.2 regulatory barriers include planning consents, licensing requirements, intellectual property rights, etc; and

    490.3 strategic barriers arise where incumbent firms take action to discourage prospective entry and expansion, such as by raising customers' switching costs, or signalling through present or past conduct that entry would provoke an aggressive response.

491. We are not satisfied that the Proposed Merger would not increase barriers to entry and expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets. We consider that this would substantially lessen competition, potentially depriving consumers of a more competitive grocery industry in the future.

492. In this section, we summarise the submissions from the Parties and third parties. We then set out the reasons why we are not satisfied that the Proposed Merger would not raise barriers to entry and expansion in the retail grocery market(s) in which groceries are supplied to consumers.

Submissions from the Parties

493. The Parties submit that, whether further and broader entry and expansion in retail grocery markets would be likely to substantially improve outcomes in retail grocery markets, is not itself relevant to the merger clearance process. Rather, in the Parties'

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[708] *Commerce Commission v Southern Cross Medical Care Society* (CA) above n27 at [68].
[709] Mergers and Acquisitions Guidelines above n3 at [3.109]-[3.111].

view, that information is relevant to the current state of retail grocery markets, which is the backdrop to the factual and the counterfactual.[710] The Parties further submit that:

493.1 retail grocery markets have become increasingly competitive in recent years. Along with the continued competitive pressure from the Parties' closest competitor, Woolworths, there have been a number of market developments such as the entry of Costco and the development of The Warehouse's grocery offering (with a number of updates since the Application was filed);[711]

493.2 even assuming the intensity of competition in retail grocery markets is muted (which the Parties do not agree is the case), the fact is that the Parties do face competition. If they did not compete on price and non-price terms, they would lose sales to Woolworths, The Warehouse, Costco, Chemist Warehouse and other grocery retailers;[712] and

493.3 the Parties observe that rival grocery retailers (including Woolworths, Costco, The Warehouse and Chemist Warehouse) are competitive in retail grocery markets suggesting the terms they acquire groceries at are competitive. The Parties further note that it appears The Warehouse is saying it has obtained competitive terms by importing.[713]

494. The Parties submit that their incentive in relation to the acquisition markets is primarily to present a competitive retail offering.[714] The Parties have stated their intention to share buying benefits with retail consumers ([ ]), is consistent with their incentives.[715] The Parties also consider that they would face competitive and regulatory pressure to share savings with customers.[716]

495. Houston Kemp submits that currently, in retail grocery markets, the intensity of competition with Woolworths and other relevant retailers can be taken to be at some sort of equilibrium position.[717] It submits that economic principles show that at

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710 SoI submission from the Parties (26 April 2024) at [165]. In relation to the current state of the market, the Parties disagree with our view in the SoI that there has been limited entry and expansion since the market study, and consider that there has been some reduction in barriers to entry since the market study and that the evidence offered by us in the SoI does not support the view that there are still likely to be high barriers to entry and expansion. SoI submission from the Parties (26 April 2024) at [167.1]-[167.2].

711 SoI submission from the Parties (26 April 2024) at [93.1]. FSNI separately told us that the competitive landscape in retail grocery markets is strong, cross-shopping is heightened, and that retail consumers are shopping more frequently with smaller shopping missions rather than one big shop. It also told us that, in its view, competitive pressure in retail grocery markets continues to build, with different grocery retailers with different propositions emerging. Commerce Commission interviews with FSNI (20 February 2024) and (31 May 2024).

712 SoI submission from the Parties (26 April 2024) at [93.2].

713 SoUI submission from the Parties (13 August 2024) at 108.

714 SoUI cross submission from the Parties (26 August 2024) at 34.

715 SoUI cross submission from the Parties (26 August 2024) at 32.

716 SoI cross submission from the Parties (6 May 2024) at 17.

717 Houston Kemp report on the SoUI (13 August 2024) at [6].

least some part of the anticipated reduction in marginal costs would always be passed on by a profit maximising firm. The reduction in marginal costs would give effect to a new equilibrium in retail grocery markets.[718] This would give rise to an increase in the intensity of competition between grocery retailers, leading to lower prices and higher output.[719]

496. Unlike Houston Kemp, which anticipates an increase in retail competition from the Proposed Merger, the Parties themselves submit that the Proposed Merger would not alter concentration in any retail grocery market or change retail grocery market competitive dynamics,[720] and therefore cannot increase barriers to entry and expansion. They say there would be no material change to retail competition, in particular, as there would be no consolidation at the retail level as the Parties operate in separate islands.[721] In our view there is a tension between the claim that competitive dynamics would not change post-merger, and the claim that cost savings would be passed through to retail consumers post-merger, because all else being equal we would expect the pass through of cost savings to increase competition.

497. The Parties further submit that:

497.1 the better terms the merged entity would achieve would be very small overall so cannot be expected to make a material difference to the likelihood of entry. If the change expected to arise from the Proposed Merger would be significant, it would suggest the Parties would currently be at a very significant competitive disadvantage to Woolworths as far as product costs are concerned (to which the Parties submit they do not know the terms Woolworths achieves, but perceive their own pricing to be competitive with Woolworths', suggesting they are not at a material disadvantage);[722]

497.2 if the merged entity achieves better terms and offers lower prices to retail consumers, that would be pro-competitive;[723]

497.3 it would seem an odd conclusion for the Commission to prefer retail grocery prices to remain at higher levels than risk them being reduced, just in case that deterred entry (and for the same reasons, strategic price cuts appear

718 Houston Kemp report on the SoUI (13 August 2024) at [11].

719 Houston Kemp report on the SoUI (13 August 2024) at [13].

720 SoPI cross submission from the Parties (7 March 2024) at [135], SoI cross submission from the Parties (6 May 2024) at 17, SoI cross submission from the Parties (31 May 2024) at 8 and SoUI cross submission from the Parties (26 August 2024) at 20-21, 30 and 32-33.

721 SoI cross submission from the Parties (6 May 2024) at 8, 15 and 17 and SoUI cross submission from the Parties (26 August 2024) at 20-21 and 33.

722 SoUI submission from the Parties (13 August 2024) at [109] and SoUI cross submission from the Parties (26 August 2024) at 33.

723 SoI submission from the Parties (26 April 2024) at [168.1]. Here, the Parties further explain that the offering of lower prices might make entry practically less likely because the commercial opportunity for entry does not present, but that is not the same as an anti-competitive increase to barriers to entry and expansion. In the Parties view, it is pro-competitive for the merged entity to offer customers better outcomes, noting that the Act and, in particular the substantial lessening of competition test, exists to protect the competitive process, not specific competitors (including potential competitors).

unlikely to have the potential to have any adverse impact on retail competition);[724]

497.4 that they would and do not “retaliate” against suppliers for partnering with new entrants (and in any event, the Proposed Merger would not alter the ability or incentive to engage in such conduct, given it would not have any material impact on retail grocery competition);[725]

497.5 they do not seek exclusivity arrangements except in limited circumstances, and there is no plan, and no basis to expect, that this would change as a result of the Proposed Merger. In any event, the Parties submit that they would not expect suppliers to agree to exclusivity without a sound basis;[726] and

497.6 while the Parties also seek the best terms they can, their advocacy to receive better terms is limited to checking in a general way (as in any normal commercial negotiation) that they are being treated “fairly” relative to other customers.[727]

498. Houston Kemp further submits that:[728]

498.1 if the merged entity offered lower prices to retail consumers, this would appear to be a benefit of the Proposed Merger, because the merged entity could compete harder against new entrant grocery retailers and existing rival grocery retailers, including (but not limited to) Woolworths; and

498.2 [

]. In other words, it is unlikely that a change in the scale of the merged entity’s buying would affect the prospect of, entry. It further submits that it is difficult to understand how, if scale were a material barrier, the Parties can presently compete at all with Woolworths and other national grocery retailers. In other words, if an island-based entity (each of the co-operatives, separately) can presently compete effectively with a national retailer (and others), it is not clear why this ability would not persist in the future, with the Proposed Merger.[729] and

724 SoUI submission from the Parties (13 August 2024) at [110].

725 SoI cross submission from the Parties (6 May 2024) at 24.

726 SoUI submission from the Parties (13 August 2024) at 112-113. The Parties further note that they only have exclusive arrangements where it would be pro-competitive (eg, they are seeking to support the emergence of competition in a category). SoUI submission from the Parties (13 August 2024) at 111 and the Application at [128.2].

727 SoUI submission from the Parties (13 August 2024) at 111.

728 Houston Kemp report on SoI (26 April 2024) at [16]-[17] and [65] and Houston Kemp report of the SoUI (13 August 2024) at [57]-[59].

729 For completeness, Houston Kemp also submits that a contention that the Proposed Merger would
[

Third party submissions and evidence received

499. Suppliers we have spoken with have expressed mixed views on whether the Proposed Merger would increase barriers to entry and expansion and/or otherwise impact rivals' ability and/or incentives to enter or expand in retail grocery markets in New Zealand.

499.1 We have heard from suppliers (across a range of categories and of all sizes) that the Proposed Merger would or may make it harder for rival grocery retailers to enter or expand.[730]

499.2 Other suppliers (again across a range of categories and of all sizes) have told us that they do not see the Proposed Merger materially changing existing barriers to entry.[731]

500. For example, some suppliers consider the consolidation with the Proposed Merger, including the merged entity's enhanced size, resources and buying power may make entry and expansion by rival grocery retailers harder.[732] Others thought it would depend on the merged entity's behaviour,[733] and that it was more a question around likelihood of investment in New Zealand rather than whether there would be a barrier.[734]

501. On the other hand, some suppliers consider that barriers to entry are already high or entry risky, such that the Proposed Merger is unlikely to make a difference.[735] Others queried whether New Zealand retail grocery markets are big enough to sustain an additional competitor.[736]

502. In addition to the above supplier views, we have also received submissions and evidence from other submitters, suppliers and industry participants (including rival

]. Houston Kemp report on SoUI (13 August 2024) at [59].

[730] Commerce Commission interviews with [ ],[ ], [ ], [ ], [ ], [ ], [ ], and [ ].

[731] Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ] and [ ].

[732] Commerce Commission interviews with [ ], [ ], [ ], [ ] and [ ].

[733] Commerce Commission interview with [ ]

[734] Commerce Commission interview with [ ].

[735] Commerce Commission interviews with [ ] and [ ].

[736] Commerce Commission interviews with [ ] and [ ].

grocery retailers) on the impact of the Proposed Merger on entry and expansion conditions in retail grocery markets in New Zealand, as noted below.

502.1 Anonymous A submits that the merged entity would become considerably more powerful to resist rival grocery retailers entering and establishing themselves. It noted that the Proposed Merger would reduce the attractiveness and ability of rival grocery retailers to enter the marketplace and improve competition, pricing and choice for retail consumers.[737]

502.2 Habilis submits the Proposed Merger would consolidate the grocery sector further with a high likelihood of adverse outcomes for retail consumers and increase the barriers to entry for new rival grocery retailers. In its view, the sole beneficiary of the Proposed Merger would be the merged entity.[738]

502.3 Ernie Newman submits that it would be highly unwise to allow further consolidation in the grocery sector, and that the signal to the market and especially potential entrants would be that the Commission is incapable of protecting them. In his view, the Proposed Merger would strengthen the barrier to potential new entrant rival grocery retailers, and would result in potential local and global competitors in this and other industries walking away to invest in markets where there is protection of an effective regulator focused on the best interests of the consumer. He considers that the prospect of entry and expansion by rival grocery retailers is dismal now, and if the Proposed Merger was allowed, it would be even smaller and "less than winning lotto".[739]

502.4 The Food and Grocery Council submits that (among other things), 74% of its members who responded to its survey consider that the Proposed Merger would make new entry by rival grocery retailers (or expansion by small/niche rival grocery retailers) harder,[740] and greater structural concentration in acquisition markets would increase barriers to entry in retail grocery markets.[741]

502.5 Monopoly Watch and Northelia submit that the Proposed Merger would increase the cost of capital for a third major grocery retailer.[742]

737 SoPI submission from Anonymous A (22 January 2024) at 1-2.

738 SoPI submission from Habilis (1 February 2024) at 2.

739 SoPI submission from Ernie Newman (5 February 2024) at 1 and 5 and SoUI submission from Ernie Newman (12 August 2024) at 2.

740 The Parties' response to this submission is that the source of this concern is unclear, but that the Parties consider the Proposed Merger would not be likely to result in a substantial lessening of competition, which would therefore preclude impact on barriers to entry and expansion. SoPI cross submission from the Parties (7 March 2024) at [135].

741 SoPI submission from the Food and Grocery Council (19 February 2024) at 8, 30, 32 and 37 and SoI submission from the Food and Grocery Council (26 April 2024) at 26 and 48.

742 SoPI submissions from Monopoly Watch (27 February 2024) at 3, 6 and 7 and Northelia (27 February 2024). The Parties response to the Monopoly Watch submission is that the submitter does not identify

502.6 The Warehouse submits that the Proposed Merger is likely to increase barriers to entry and expansion in retail grocery markets at scale, noting that the concentration of the major grocery retailers makes it much harder for potential rival grocery retailers to achieve the scale and scope required to compete. Such concentration would further limit the incentive for suppliers to supply new rival grocery retailers when doing so may risk their current arrangements with the major grocery retailers, exacerbating the existing barriers to entry and expansion. It further notes that preventing rival grocery retailers from entering and expanding in retail grocery markets due to the merged entity's high bargaining power would not provide long term pro-competitive outcomes for retail consumers.[743]

502.7 Lisa Asher submits the Proposed Merger would increase barriers to entry for new entrant rival grocery retailers, based on the stronghold this "mega retailer" would have, also noting that evidence of abuse of market power is already present within the grocery sector, which would increase barriers to entry for rival grocery retailers as suppliers would fear retaliation if they partner with new entrant rival grocery retailers.[744]

502.8 One rival grocery retailer [ ].[745] The rival grocery retailer
[
].[746]

502.9 In contrast to the Parties' submission (set out at [493.3]), the Warehouse Group told us that it has been difficult for it to obtain access to competitive supply in New Zealand, such that it has had to start importing grocery products (eg, flour, spreads and sauces).
[

the source of the increase in barriers to entry for a "third party challenger". But, in the Parties view, if the Proposed Merger would have no adverse effect on competition, it follows it would not adversely impact barriers to entry and it is not necessary to offer divestments. SoPI cross submission from the Parties (7 March 2024) at [141].

743 SoI cross submission from The Warehouse Group (10 May 2024) at [19] to [22].

744 SoI submission from Lisa Asher (25 April 2024) at 1, 2 and 9.

745 Commerce Commission interview with [ ].

746 Commerce Commission interview with [ ].

].[747] The Warehouse told us that
[ ].[748]

502.10 Another rival grocery retailer reserved its judgement on whether the Proposed Merger would be likely to impact its expansion plans.
[ ].[749]

503. In the paragraphs above, we set out the high-level views from industry participants we spoke with on whether the Proposed Merger would be likely to impact barriers to entry and expansion. In addition, we have also received other relevant, more specific matters from industry participants.

503.1 An industry participant told us that in its experience the Parties do not seek exclusive supply, but do use it as a "carrot" to suppliers, in that for experienced suppliers/negotiators, it is understood that offers of exclusivity are met with more favourable ranging results or stocking decisions. It considers that a merged entity would have more leverage in respect of this, given the lessening of supply options for customers, and increased ranging opportunity the larger group presents. It also noted that a larger number of suppliers have been offering exclusivity in this context, providing an example where [ ]. It also indicated that to a certain extent – the bigger major grocery retailers get a better buying price from suppliers. It noted that supplying other grocery retailers (outside of the major grocery retailers) diversifies risk, but when a supplier frames its offer to a retailer outside of the major grocery retailers, it

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747 Commerce Commission interviews with The Warehouse Group (8 February 2024) and (22 May 2024), and e-mail from The Warehouse Group to the Commerce Commission (12 July 2024).
[ ].

748 E-mail from The Warehouse Group to the Commerce Commission (12 July 2024).

749 Commerce Commission interviews with [ ].

has to think about the ramifications if that retailer was to set its retail price at a lower level than what the major grocery retailers have.[750]

503.2 One supplier (of a range of products) indicated that its sales team is not comfortable taking the risk of being seen by the Parties (or Woolworths) as cheaper on the other shelves. It commented that if a banner of a major grocery retailer wants to do a promotion, it gets calls from other banners/major grocery retailers asking why product is cheaper in that banner and why promotion is not with them instead.[751]

503.3 A second supplier (of fresh produce) noted that if smaller grocery retailers get a better price, the major grocery retailers seek to question it on why that is. The supplier added that if power "continues to consolidate", it would eliminate smaller-medium sized growers. It further noted that smaller grocery retailers cannot compete with the major grocery retailers if suppliers are not there to supply them at a price they can compete with.[752]

503.4 An industry participant noted that a lot of large grocery suppliers are looking for alternatives to grow (eg, alternative channels or retailers), but do not want to risk annoying the major grocery retailers (who drive [ ]% of revenue) by supplying other grocery retailers like Costco and The Warehouse, particularly given they are currently minuscule grocery retailers.[753] One supplier told us that it had not engaged with The Warehouse in recent years, noting that when it had done so during The Warehouse's previous attempt to enter the retail grocery market in the mid-2000s, the existing major grocery retailers had threatened the supplier.[754]

503.5 However, [ ].[755] [ ] said it did not notice any reaction from the Parties when it [ ] The Warehouse.[756] [ ] said it is completely open to new customers.[757] [ ] said it is always open to new grocery retailers but currently the opportunity to supply them is not as big as with the major grocery retailers.[758] Another industry participant thought there would be no more downward pressure on suppliers to not supply a new entrant grocery

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750 Commerce Commission interview with [ ] and e-mails from [ ] to the Commerce Commission (12 September 2024) and (13 September 2024).

751 Commerce Commission interview with [ ].

752 Commerce Commission interview with [ ].

753 Commerce Commission interview with [ ].

754 Commerce Commission interview with [ ].

755 Commerce Commission interview with [ ].

756 Commerce Commission interview with [ ].

757 Commerce Commission interview with [ ].

758 Commerce Commission interview with [ ].

retailer so long as the entrant "has enough skill and expertise to get going".[759]

504. We asked suppliers about the extent to which the prices charged to one grocery retailer impact on the prices to another retailer, and how the Proposed Merger might impact supply to rival grocery retailers.

504.1 A number of suppliers (as discussed below) consider that supply terms are similar in some cases, as the same list prices are offered to different grocery retailers. However, the actual prices paid by grocery retailers will often vary according to a range of terms, relating to, for example, volumes and promotional spend.

504.2 In terms of the likely impact of the Proposed Merger on supply to other rival retailers, most suppliers indicated there would unlikely be a direct impact on their appetite to supply other grocery retailers. However, some concerns were raised that the merged entity would increase the threat around delisting of products which could in turn impact the ability and willingness of suppliers to supply rival grocery retailers.

504.3 A number of suppliers said there are differences in the terms on which they supply FSNI and FSSI (and in the case of some suppliers, other grocery retailers).[760] Some suppliers indicated that FSNI often secures better terms than FSSI (ie, terms that are less favourable for the supplier),[761] [ ] noted that FSSI typically ends up with a lower margin than FSNI because it is half the size of FSNI and because of its cost to serve,[762] and [ ] noted that if a customer is after a smaller volume, the pricing may be more expensive (and vice versa).[763]

Impact of the Proposed Merger on suppliers' willingness to supply rival grocery retailers

505. Many suppliers consider it unlikely that the Proposed Merger would have any impact on their willingness to supply rival grocery retailers.[764] For example, one supplier told us that it did not envisage that its appetite to supply rival grocery retailers would be affected by the Proposed Merger, as it assesses supply to, and negotiates the terms

[759] Commerce Commission interview with [ ].

[760] Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ] and [ ].

[761] Commerce Commission interview with [ ], [ ], [ ],

[762] Commerce Commission interview with [ ].

[763] Commerce Commission interview with [ ].

[764] E-mail from [ ] to the Commerce Commission (9 September 2024), e-mail from [ ] to the Commerce Commission (10 September 2024), e-mail from [ ] to the Commerce Commission (11 September 2024), e-mail from [ ] to the Commerce Commission (11 September 2024), e-mail from [ ] to the Commerce Commission (12 September 2024) and e-mail from [ ] to the Commerce Commission (12 September 2024).

on which it supplies, each retailer on a customer-specific basis.[765] Another supplier stated that it was open to encouraging more competition in the grocery markets and diversifying where its products are sold, and that the Proposed Merger would make it more critical for it to supply rival grocery retailers in order to de-risk its business.[766]

506. However, one supplier suggested that behaviour of the merged entity could have an impact on its appetite to supply rival grocery retailers, commenting that, were the merged entity to delete a product or brand from all its stores nationally, it would have to consider whether the volumes left across other customers would be sufficient for it to continue to supply products in New Zealand.[767] Similarly, another supplier suggested that its ability to maintain supply of a product could be impacted by it being delisted by one grocery retailer.[768]

507. One industry participant is of the view that suppliers are already reserved in looking at opportunities in alternate retailers as they "don't want to upset" the major grocery retailers. It considers the merged entity would increase the threat around deletion (due to a greater percentage of a supplier's business being at risk) and might mean suppliers are less likely to want to supply new retail opportunities. However, it acknowledged that it could depend on the size of any opportunity, noting that if a very large new opportunity was presented, suppliers would be much more likely to "take the risk".[769]

508. The responses from market participants may underestimate the reluctance of suppliers to supply rival grocery retailers. In this regard:

508.1 a number of suppliers told us that they do not wish to provide evidence as part of our investigation of the Proposed Merger for fear of jeopardising their commercial relationship with the Parties;

508.2 other suppliers have provided evidence and their views, but emphasised their fears of retaliation if it were to become known that they had spoken to us;

508.3 eight industry participants have only provided evidence to us through our Anonymous Reporting Tool (ART);

508.4 one supplier only agreed to provide us with evidence anonymously via their external legal counsel, who informed us that their client's desire for anonymity was motivated specially by fear of retaliation from the Parties. The party also provided less information than we had requested, for fear that more specific information would reveal their identity if disclosed to any market participant in the grocery sector;[770]

765 E-mail from [ ] to the Commerce Commission (11 September 2024).
766 E-mail from [ ] to the Commerce Commission (12 September 2024).
767 E-mail from [ ] to the Commerce Commission (11 September 2024).
768 E-mail from [ ] to the Commerce Commission (11 September 2024).
769 E-mail from [ ] to the Commerce Commission (12 September 2024).
770 See correspondence with and file note for meeting with [ ].

508.5 the Food and Grocery Council advised us that [ ];[771]

508.6 the New Zealand Specialist Cheesemakers Association submits that its individual members fear retribution, and so agreed amongst themselves to use the New Zealand Specialist Cheesemakers Association to present the submission, rather than do it through multiple submissions from individual businesses;[772] and

508.7 some industry agencies told us that their clients are cautious to not do anything that would put at risk their commercial relationship with the Parties. As noted elsewhere, one such agency noted that – to a certain extent – the bigger major grocery retailers get a better buying price from suppliers. It also noted that supplying other grocery retailers (outside of the major grocery retailers) diversifies risk, but when a supplier frames its offer to a retailer outside of the major grocery retailers, it has to think about the ramifications if that retailer was to set its retail price at a lower level than what the major grocery retailers have. Further, as noted elsewhere, another agency noted that large suppliers are looking for alternatives to grow (eg alternative channels/retailers), but do not want to risk annoying the major grocery retailers (who drive [ ]% of revenue) by supplying other grocery retailers like Costco and The Warehouse, particularly given they are currently minuscule grocery retailers.[773]

Impact of the Proposed Merger on supply terms for rival grocery retailers

509. We received mixed responses on the extent to which the Proposed Merger is likely to impact supply terms for rival grocery retailers. Some suppliers consider that the Proposed Merger is unlikely to have an impact on supply terms as they use the same list prices across the board for all retail customers, with price increases applied equally to all customers.[774] For example, one supplier indicated that the terms on which suppliers may supply the merged entity would not necessarily impact on supply terms to rival grocery retailers. However, it commented that when prices to

771 Call between Food and Grocery Council and Commerce Commission (22 July 2024).

772 SoUI submission from the New Zealand Specialist Cheesemakers Association (12 August 2024) at 11.

773 Commerce Commission interviews with [ ] and [ ].

774 E-mail from [ ] to the Commerce Commission (10 September 2024), e-mail from [ ] to the Commerce Commission (10 September 2024), e-mail from [ ] to the Commerce Commission (11 September 2024), e-mail from [ ] to the Commerce Commission (11 September 2024), e-mail from [ ] to the Commerce Commission (12 September 2024), e-mail from [ ] to the Commerce Commission (12 September 2024).

one grocery retailer are reduced, prices are usually reduced to other grocery retailers too.[775]

510. In contrast, two suppliers indicated that the terms on which they supply each customer are set in isolation and not influenced by terms for other customers.[776] However, one noted that if prices are coming down, very often this happens for many customers at the same time (if not all).[777]

511. Another supplier noted that as negotiations are undertaken independently for each grocery retailer, a change in pricing for one retailer does not necessarily impact the prices it offers other retailers. That aside, it noted that issues generally arise when grocery retailers make pricing decisions different to what is occurring in the market and pressure is applied from other retailers to fund them deeper and allow them to compete while maintaining their margins. It considers that the Proposed Merger could have direct pressure on the terms on which it supplies the wider market, and from Woolworths and the merged entity who would know that suppliers do not have as many alternatives and would not be able to "say no" as easily.[778]

512. A few suppliers noted that the actual prices paid by grocery retailers often vary according to a range of terms, relating to, for example, volumes and promotional spend.[779]

513. A supplier commented that any reduction in competition amongst its customers (grocery retailers) as a result of the Proposed Merger would be likely to enhance the leverage of those competing customers in negotiations and adversely affect its terms with other retailers over time.[780] Similarly, an industry participant commented that where one major grocery retailer achieves a better margin or deal that results in it adjusting its retail pricing, rival grocery retailers tend to seek commensurate changes from a supplier to keep their commercials in line. In its view, the greater buyer power of the merged entity may mean that suppliers need greater cost recovery from rival retailers (meaning that new grocery retailers get a worse deal).[781]

Our view

514. We have noted (at [41] and elsewhere) that competition in retail grocery markets is muted. We consider that barriers to entry and expansion are already high. Against this background, and recalling that in markets that are already concentrated, a smaller change in competition with the Proposed Merger may amount to a substantial lessening of competition than would be the case with a merger in other

775 E-mail from [ ] to the Commerce Commission (9 September 2024).
776 E-mail from [ ] to the Commerce Commission (11 September 2024) and e-mail from [ ] to the Commerce Commission (11 September 2024).
777 E-mail from [ ] to the Commerce Commission (11 September 2024).
778 E-mail from [ ] to the Commerce Commission (12 September 2024).
779 E-mail from [ ] to the Commerce Commission (12 September 2024) and e-mail from [ ] to the Commerce Commission (12 September 2024).
780 E-mail from [ ] to the Commerce Commission (11 September 2024).
781 E-mail from [ ] to the Commerce Commission (12 September 2024).

markets that are less concentrated to begin with,[782] we are not satisfied that the Proposed Merger would not increase barriers to entry and expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets in such a way as to substantially lessen competition in retail grocery markets, potentially depriving consumers of a more competitive grocery industry in the future.

515. We consider that the raising of barriers to entry and expansion could occur in at least two ways:

515.1 first, the increased buyer power that the merged entity would achieve through the Proposed Merger would enable it to negotiate more favourable price and non-price terms with suppliers, increasing its margins, further extending its scale advantage against new entrants and smaller grocery retailers, and enhancing its ability to engage in strategic retaliation in response to attempted entry and expansion by rival grocery retailers; and

515.2 second, the Proposed Merger could increase the likelihood of rival grocery retailers being unable to obtain competitive supply due to the increased buyer power of the merged entity 'raising the stakes' for suppliers, and suppliers not wanting to risk damaging their relationship with the merged entity.

516. We consider there is a real chance that a potential entrant, or a rival grocery retailer considering expansion, would be well aware of these dynamics – ie, that the merged entity is likely to be able to negotiate better price and non-price terms than the Parties could independently, and that post-merger some suppliers may be more reluctant to engage with smaller grocery retailers in a way that would jeopardise their relationships with the merged entity – and that this knowledge would factor into their strategic decision making when considering entry and expansion. However, potential entrants and rival grocery retailers may not have complete information about the extent of the merged entity's advantages and its capacity to engage in strategic retaliation in response to their entry and expansion. This uncertainty could deter entry and expansion if actual and potential rivals expect a significant strategic response from the merged entity. Even if a rival grocery retailer did attempt to enter or expand, the price and non-price advantages achieved by the merged entity through the Proposed Merger could impact the timeliness or extent of that entry, by raising the overall costs to the rival grocery retailer of entering or expanding in a manner which imposed actual competitive constraint on the merged entity.

Barriers to entry and expansion are currently high

517. We regard barriers to entry and expansion into and within retail grocery markets as high. The cessation by FSNI of the use of restrictive land covenants and exclusivity provisions in leases is likely to have ameliorated at least one barrier that rival grocery retailers would otherwise have faced when entering or expanding. However, while

782 M Sumpter, *New Zealand Competition Law and Policy* (CCH, Auckland, 2010) at 186-187, discussing the decision in *Air New Zealand v Commerce Commission* above n17 (HC).

there has been some entry and expansion in recent years (discussed further below), this has been relatively small-scale, and generally involving product offerings that are differentiated from the 'one-stop shop' model operated by the Parties, limiting the competitive constraint that that entry and expansion is likely to impose on the Parties.

518. Specifically, in recent years Costco has entered into Auckland, and The Warehouse has expanded its presence in retail grocery markets. To date, these developments do not appear to have materially strengthened competitive conditions in most relevant retail grocery markets. The Commission's first annual grocery report noted that entry and expansion had been geographically limited (some to just Auckland) and usually range constrained (ie, does not meet consumers' preference for a one-stop shop).[783] Grocery retailers other than the Parties and Woolworths continue to account for a small portion of retail grocery sales.[784]

519. There has also been some exit since the market study, including Supie (an online grocery retailer)[785] and Huckleberry (an organic grocery chain).[786]

520. In terms of proposed future entry and expansion by existing rival grocery retailers:

520.1 As well as refurbishing and rebranding existing supermarkets, Woolworths told us that (as at 12 July 2024) it plans to open [ ] new supermarkets over the next 3-4 years.[787]

520.2 Notwithstanding the supply issues it has engaged with us about (discussed above), The Warehouse told us that while it is not looking to become a major grocery retailer like the Parties, it intends to continue to have what it describes as an "essentials" grocery range [ ].[788]

[783] First annual grocery report (4 September 2024) at 19.

[784] We estimate that retailers other than the major grocery retailers account for just under 20% of total grocery sales in New Zealand. See Figure 2.

[785] https://www.pwc.co.nz/services/business-restructuring/liquidations/supie-group.html.

[786] https://supermarketnews.co.nz/news/huckleberry-shuts-down/.

[787] Commerce Commission interview with Woolworths (14 June 2024) and Woolworths RFI responses (20 June 2024) and (12 July 2024). Some details of planned investment being done by Woolworths in new supermarkets and to upgrade existing supermarkets has also been publicly announced. See https://www.nzherald.co.nz/business/countdown-70-of-185-supermarkets-rebranded-woolworths-where-new-outlets-are-planned/AFENKFG5HNE4PAXEX7TQYJQR2Y/.

[788] Commerce Commission interviews with The Warehouse Group (8 February 2024) and (22 May 2024). For completeness, we note that since we spoke to The Warehouse Group as part of our investigation, it publicly announced (see here: https://www.nzx.com/announcements/434931) that it was in discussions about a potential sale to Adamantem Capital Management Pty Ltd. While The Warehouse Group has since confirmed it is "not progressing" these discussions, its NZX announcement (see here: https://www.nzx.com/announcements/435562) states that: "We're committed to acting in the best interest of all our shareholders. While the board has not yet formed a view on value, we're open to

520.3 [ ].[789]

520.4 [ ].[790]

521. The Parties' advisors submit that [ ].[791]

522. We consider this view to be overstated. As noted above, recent entry and expansion that has occurred has been relatively small-scale, and generally involving product offerings that are differentiated from the 'one-stop shop' model operated by the Parties, limiting the competitive constraint that entry and expansion is likely to impose on the Parties. Each of, for example, The Warehouse, Costco, Farro Fresh, Bin Inn and Reduced to Clear provide partial or differentiated product offerings relative to the Parties, as well as, in many cases, competing only in a small number of locations. These other rival grocery retailers account for a small proportion of grocery products acquired from suppliers in New Zealand (and retail grocery sales in New Zealand).

523. Despite the fact that entry and expansion has not, to date, materially strengthened competitive conditions in most relevant retail grocery markets, we nevertheless regard those instances of entry and expansion as positive developments in the context of an industry with muted competition (as noted at [41]). Indeed, some of the entry and expansion identified above has prompted some competitive reaction from the Parties, if only to a relatively minor degree:

523.1 [ ].[792] [ ];[793] and

continue discussions if a further proposal generates shareholder support sufficient to make its execution viable."

789 E-mail from [ ] to Commerce Commission [ ].

790 Commerce Commission interview with [ ].

791 Confidential SoUI submission from the Parties' advisors (30 August 2024) at [25].

792 Commerce Commission interview with [ ].

793 Commerce Commission interview with [ ].

523.2 The Warehouse told us that it has seen a localised pricing reaction from the Parties where they have stores in the same local catchment areas, particularly for "key items" that customers tend to know the price of such as butter, eggs and milk. While The Warehouse Group considers that, overall, its activity has "brought prices down on key lines over time", it told us that it often also sees temporary price reactions (eg, during a promotion by The Warehouse, the Parties' stores nearby may reduce/match prices for the same period of time that The Warehouse stores do).[794]

524. We consider a reduction of even a small prospect of future entry and expansion is a substantial lessening of competition.[795]

The Proposed Merger would substantially lessen competition by further raising barriers to entry and expansion into and within the relevant retail grocery markets

525. We are not satisfied that the Proposed Merger would not increase barriers to entry and expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets. We consider that this would substantially lessen competition, potentially depriving consumers of a more competitive grocery industry in the future.

526. We consider that the raising of barriers to entry and expansion could occur in at least two ways:

526.1 first, the increased buyer power that the merged entity would achieve through the Proposed Merger would enable it to negotiate more favourable price and non-price terms with suppliers, increasing its margins, further extending its scale advantage against new entrants and smaller grocery retailers, and enhancing its ability to engage in strategic retaliation in response to attempted entry and expansion by rival grocery retailers; and

526.2 second, the Proposed Merger could increase the likelihood of rival grocery retailers being unable to obtain competitive supply due to the increased buyer power of the merged entity 'raising the stakes' for suppliers, and suppliers not wanting to risk damaging their relationship with the merged entity.

527. The raising of barriers to entry and expansion as result of the increased buyer power of the merged entity could affect rival grocery retailers in different ways.[796]

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794 Commerce Commission interview with The Warehouse Group (22 May 2024).

795 We note that the Court of Appeal in *Woolworths,* grappling with the similar issue of whether small decreases in price potentially lost from a merger extinguishing a new entrant could substantially lessen competition, rejected the High Court's view that the small impact of The Warehouse's entry was not substantial, noting "we are not satisfied that at this early stage in the development of the concept it can safely be concluded that Extra will have no material impact on the competitive process in the markets at issue". *Woolworths* (CA) above n5 at [201].

796 As noted earlier, Houston Kemp submits that if scale were a material barrier, it is difficult to understand how the Parties can presently compete with Woolworths and other national grocery retailers. We consider that Woolworths and the Parties each have the scale to obtain sufficiently good terms from

527.1 Potential new entrant grocery retailers that are looking to open stores that offer a full one-stop shop offering will need to incur significant upfront sunk costs (such as leasing costs, advertising, etc). These costs make entry more challenging and risky.[797] Such entrants would likely be impacted more by the Proposed Merger increasing the likelihood of rival grocery retailers being unable to obtain competitive supply due to suppliers not wanting to risk damaging their relationship with the merged entity.

527.2 Existing rival grocery retailers that are looking to use their current store and network chains to incrementally add a wider range of products to compete against the merged entity with a full one-stop shop offering are likely to be impacted to a greater degree by scale advantages of the merged entity that would enable it to negotiate more favourable price and non-price terms with suppliers across a wide range of products.

528. However, regardless of current or future business models of new entrants and existing rival grocery retailers we consider that the increased buyer power of the merged entity would increase existing barriers to entry and expansion significantly, irrespective of the way the merged entity chooses to use its increased ability to use strategic retaliation in response to such new entry and expansion.

529. We discuss each of these points in turn below.

530. For completeness, we have also considered the extent to which the regulatory regime established by the GICA would be effective at preventing the Proposed Merger from raising barriers to entry and expansion.

531. We do not consider that the GICA would prevent the Proposed Merger from raising barriers to entry and expansion in such a way as to protect against a substantial lessening of competition in retail grocery markets. The Commission has stated in its first annual grocery report that there are “fundamental issues with the wholesale offerings that have been established under the regime, on pricing, product ranges, and systems and processes”.[798] It has also observed that “wholesale customers do not appear to have reasonable access to the benefits of the scale and efficiency of the [major grocery retailers], including via trade/promotional spend”.[799] Therefore, even to the extent that some scale benefits the merged entity would achieve with the Proposed Merger are reflected in wholesale offers made by it to smaller rival grocery retailers, we are not satisfied that those offers would reflect – and be proportionate to – the benefits that the merged entity would receive by virtue of its position in retail grocery markets.

suppliers to operate in the retail grocery markets. It is smaller existing rival grocery retailers and potential new entrants that likely face challenges to obtaining sufficiently good terms to compete in retail grocery markets. The Proposed Merger would further exacerbate those barriers.

797 Mergers and Acquisitions Guidelines above n3 at n62. Sunk costs can make entry more challenging because a firm, when entering, will take into account what costs it would be likely to recoup if it exited. The greater the sunk costs, the greater the risk faced by a person contemplating entry into the market.

798 First annual grocery report (4 September 2024) at 91.

799 Commerce Commission, Wholesale supply inquiry preliminary issues paper (24 September 2024) at [31.2].

Enhanced ability to negotiate more favourable price and non-price terms

532. We have concluded above that the Proposed Merger would substantially lessen competition for the acquisition of grocery products, including by increasing the merged entity's buyer power.

533. We consider that this greater buyer power would enable the merged entity to extract better price terms from suppliers. This is, indeed, a publicly-stated rationale for the Proposed Merger from the perspective of the Parties.[800] While the Parties submit that the quantum of surplus they expect to achieve as a result of enhanced buyer power resulting from the Proposed Merger is [ ] relative to the Parties' expenditure on groceries,[801] we understand that more than half of the benefits to the Parties of the Proposed Merger would be expected to come from securing better terms from suppliers:
[
].[802]

534. We also consider it likely that the merged entity's buyer power would allow it to negotiate more favourable non-price contractual terms. Such terms can take a wide range of forms, but could include preferential or guaranteed supply in the event of supply shortages, more favourable billing terms than rival grocery retailers can achieve, more favourable rebate structures, full or partial exclusivity, or other preferential terms.

535. Overall, we are concerned that the merged entity's ability to negotiate more favourable price and non-price terms would increase the merged entity's competitive advantage over other actual or potential rival grocery retailers that those rivals – by virtue of lacking the merged entity's same level of buyer power – would find more difficult to replicate or match compared to the status quo. This would in effect raise the costs of entry and expansion by rival grocery retailers if the Proposed Merger were to proceed. The merged entity would have an enhanced ability to engage strategically through actual or threatened price cuts in a way that increases barriers to entry and thus reduces, rather than enhances, competition in retail grocery markets in the long run.

536. As discussed at [428], it is not clear to us the extent to which cost savings from the Proposed Merger would be variable costs that are more likely to be passed through to retail consumers or the magnitude and extent of any pass through. We think it is likely that any pass through would be low, as a consequence of the muted competition at the retail level (as noted at [41]) and the firm-specific nature of the cost savings. We therefore consider it likely that the merged entity would have additional margin or 'headroom' to implement (or threaten to implement) deeper price cuts as part of a strategic response to actual or potential entry and expansion

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800 The Application at [6] and [20.1].

801 SoUI submission from the Parties (13 August 2024) at [60]-[62].

802 [ ]

than the Parties each could now, while presumably still maintaining pre-merger margins or better.

537. The merged entity would also be better placed to implement a single national plan to respond strategically to entry and expansion that occurs on a national basis.

538. This would be known to all parties, including investors in potential entrants and existing rival grocery retailers who are considering expansion. There is a real chance that an actual or potential competitor's knowledge of the ability of the merged entity to react to competitive threats with even deeper discounting, and on a more coordinated national basis, than the Parties can achieve currently (but likely lack of knowledge as to the magnitude and extent of that ability), would have a greater deterrent effect on entry and expansion by rival grocery retailers than would exist under the counterfactual.

539. If this strategic response is effective in preventing or delaying new entry, then the merged entity would not need to lower its prices (as no competitive threats meriting a response would have eventuated), and would be able to retain the additional margin achieved by the Proposed Merger, such that consumers would not benefit from the lower prices in the short term that may accompany any strategic reaction by the merged entity to new entry and expansion.

540. Even if the actual terms negotiated by the merged entity as a result of the Proposed Merger do not have the effect of raising costs for rival grocery retailers, the enhanced ability of the merged firm to negotiate more favourable price and non-price terms with suppliers would be known by actual or potential rival grocery retailers although the magnitude and extent of these advantages would not be. We consider this uncertainty could deter entry and expansion by rival grocery retailers to a greater degree than under the counterfactual.

<u>Supplier reluctance to supply competing retailers</u>

541. We consider the Proposed Merger would increase the likelihood of rival grocery retailers being unable to obtain competitive supply due to the increased buyer power of the merged entity 'raising the stakes' for suppliers, and suppliers not wanting to risk damaging their relationship with the merged entity. Irrespective of whether rival grocery retailers can currently obtain competitive supply, we consider that the Proposed Merger – and the merged entity's increased buyer power – may increase the likelihood and/or prevalence of rival grocery retailers not being able to be price competitive.

542. As noted above, the merged entity would be the largest single acquirer of grocery products in New Zealand for many products, and as discussed above, would be an important (and in some cases, crucial) customer to many suppliers such that the risk of losing the merged entity's custom would be even higher than it is currently. An indicator of this is the number of market participants who were reluctant to provide evidence that might identify them (see paragraph 508).

543. As noted earlier, The Warehouse Group considers that the Proposed Merger and the resulting concentration would make it much harder for potential competitors to achieve the scale and scope required to compete and further limit the incentive for suppliers to supply new rival grocery retailers when doing so may risk their current arrangements with the major grocery retailers, exacerbating the existing barriers to entry and expansion.[803] However, [ ].[804]

544. The Parties have also submitted that they do not – and would not post-merger – retaliate against suppliers for partnering with new entrant grocery retailers.[805]

545. Ultimately, however, we do not regard the question of whether the Parties have in fact already expressly threatened to cease buying from suppliers if they continue supplying rival grocery retailers as determinative of whether increased supplier reluctance to supply rival grocery retailers in the factual is likely to raise barriers to entry and expansion. We consider the most relevant issue to be how suppliers would be likely to act, rather than whether those actions would be motivated by explicit inducements by the merged entity. For the reasons set out above, we consider there is sufficient evidence that many suppliers currently fear retribution from the Parties, and that this retribution informs their strategic behaviour in market. Even if this fear is subjectively held, we regard it as objectively reasonable given the dynamics of the market and the very large share of supply that the merged entity would represent for many suppliers.

546. In our view, it is likely that the Proposed Merger would exacerbate these dynamics by increasing the merged entity's buyer power and further raising the consequences for suppliers of losing the merged entity as a customer.

547. The Proposed Merger may increase the likelihood that suppliers might be either disincentivised from supplying rival grocery retailers at risk of damaging their relationship with the merged entity, or might be more likely to agree to exclusivity arrangements with the merged entity. While a number of suppliers have indicated that the Proposed Merger would not necessarily change their willingness to supply rival grocery retailers, others have expressed their concerns around the potential consequences for their commercial relationships with the Parties.

548. [ ] told us that they consider the merged entity might have more power to ask suppliers for exclusivity.[806] Woolworths noted that while it is generally not in the

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803 SoI cross submission from The Warehouse Group (10 May 2024) at [22].

804 Commerce Commission interview with [ ].

805 SoI cross submission from the Parties (6 May 2024) at 24.

806 Commerce Commission interviews with [ ]. As noted previously, another industry participant similarly considers that for experienced suppliers/negotiators, it is understood that offers of exclusivity are met with more favourable ranging results or stocking decisions. It considers that a merged entity would have more leverage in respect of this, given the lessening of supply options for customers, and increased ranging opportunity the larger group presents. Commerce Commission interview with [ ] and e-mails from [ ] to the Commerce Commission (12 September 2024) and (13 September 2024).

interests of suppliers to have exclusive arrangements with retailers, that does not mean a supplier would not enter an arrangement with the merged entity.[807]

549. The Parties submit that the idea that the Proposed Merger would reduce the attractiveness to enter would conventionally be interpreted as the Proposed Merger improving competition, and therefore reducing the commercial opportunity to enter (ie, pro-competitive, and beneficial for consumers).[808] However, we do not think this is necessarily the case, especially if the reason a rival grocery retailer does not enter or expand is because the Proposed Merger increases the likelihood of rivals being unable to obtain competitive supply. Indeed, it is well-known that firms with a substantial degree of market power can employ strategic pricing behaviour in a way that deters entry.[809]

550. The effects of the Proposed Merger described above may not apply to all products. For example, it may not apply in relation to those products where the Proposed Merger does not materially change buyer power (since the merged entity is unlikely to obtain better terms), for example products of which a large proportion of a supplier's products are supplied to alternative channels (such as high export products). The risk of suppliers refusing to supply rival grocery retailers would only apply for those products where a supplier supplies both the merged entity and such rival grocery retailers. It may not apply for those products for which rival grocery retailers stock (or could stock) substitute products from other suppliers. If overall these effects were to only apply to small proportion of a typical basket, then it would be less likely that there would be an impact on the entry and expansion plans of rival grocery retailers. However, we are not satisfied that this would be the case.

Conclusion

551. Overall, we are not satisfied that the Proposed Merger would not increase barriers to entry and expansion for rival grocery retailers. We consider the Proposed Merger would allow the merged entity to negotiate better price and non-price terms with suppliers, extending its margins and enabling it to react strategically to competitive threats with deeper discounts than the Parties could individually. The Proposed Merger would otherwise provide the merged entity with a greater competitive advantage than the Parties currently have, raising costs for new entrants and existing rival grocery retailers looking to expand (who would know of the enhanced ability of the merged firm to negotiate more favourable price and non-price terms with suppliers, though likely remain uncertain as to the magnitude and extent of that ability). Even if the new entrant or existing rival grocery retailer looking to expand could surmount those barriers, it is likely that some suppliers would remain unwilling to supply them for fear of jeopardising their relationships with the merged entity.

807 Commerce Commission interviews with Woolworths (15 February 2024) and (14 June 2024).
808 SoUI submission from the Parties (13 August 2024) at 105.
809 Commerce Commission, Misuse of Market Power Guidelines (March 2023) at [114].

The Proposed Merger could increase the potential for retail coordination

552. A merger can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power to reduce output or increase prices in a market.[810] For example, firms may accommodate each other's prices if they consider it more profitable than competing.[811] We refer to these effects as 'coordinated effects'. Unlike unilateral effects, which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.

553. Tacit coordination can develop where firms are able to reduce uncertainty by observing each other's actions and reactions so that they each learn how the others will respond. For example, that one firm's price rises will be matched by others rather than competed away through inter-firm rivalry. In this section we use the terms 'accommodating behaviour' and 'tacit coordination' to refer to this type of conduct.

554. Coordinated behaviour involves firms recognising that they can reach a more profitable outcome if they accommodate each other's price increases. Firms may coordinate their behaviour on price or any other dimension of competition, or allocate customers or territories. Such a tacit agreement for the purposes of assessing coordinated effects may fall short of being a contract, arrangement or understanding for the purpose of assessing whether a cartel exists.[812]

555. When firms engage in accommodating behaviour this can result in higher than competitive prices being charged, or a decline in other non-price aspects of competition. Prices above competitive levels can generate higher than normal industry profits, to the detriment of consumers and efficiency.

556. When assessing whether a merger may give rise to coordinated effects in a given market, we assess whether:[813]

    556.1 the relevant market is vulnerable to coordination; and

    556.2 a merger would change the conditions in the relevant market so that coordination is more likely, more complete or more sustainable.

557. Even if these conditions are met, coordination may not be sustainable if it can be disrupted by the entry of other firms or the countervailing actions of consumers.

558. Other relevant considerations are the extent to which the firms can:

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810 Mergers and Acquisitions Guidelines above n3 at [3.84].

811 Accommodating behaviour or tacit coordination does not require an explicit agreement or express coordination between competing firms.

812 Mergers and Acquisitions Guidelines above n3 at [3.88].

813 Mergers and Acquisitions Guidelines above n3 at [3.86].

558.1 reach similar views[814] on how they can maintain or increase industry profits; and

558.2 detect and punish deviation from the tacit agreement ('cheating'), so that the potential individual profit gains from cheating are outweighed by the costs of punishment.[815]

559. Accordingly, we are not assessing whether coordination *will* occur with the Proposed Merger. We are only assessing whether the Proposed Merger would substantially increase the prospects of coordination through a tacit agreement emerging, or substantially increase the risk that such coordination was more complete or durable, such that we are not satisfied that the Proposed Merger would not be likely to result in a substantial lessening of competition.

560. Coordinated effects would arise in retail grocery markets through the potential for the rival grocery retailers reaching a tacit agreement on the retail price of some common individual goods (or a basket of goods). The coordinated effects could affect prices set on a national basis (where there is a single national price) or where prices are set on an island or more local level (where prices differ between islands or between individual stores).

561. Retail grocery markets are vulnerable to sustainable coordination on retail prices. Some of the features of retail grocery markets that makes them vulnerable to coordination include transparent prices, few competitors, frequent interactions between competitors, high barriers to entry and expansion and stable demand.

562. The Commission has previously observed major grocery retailers to regularly monitor both price and non-price dimensions of each other's retail banners on an ongoing and frequent basis.[816] The Commission has also previously observed major grocery retailers monitoring price levels for specific products with the aim of maintaining specified price differentials between retail banners,[817] both of which suggests that the conditions for coordination are present.

563. In our view, the Proposed Merger would increase the likelihood, completeness and/or sustainability of coordination between the merged entity and Woolworths. The Proposed Merger would result in the Parties no longer setting prices independently, with the merged entity instead setting prices centrally rather than in each island. Woolworths also recently introduced a new pricing model in which some products are no longer priced on a national basis, which more closely matches the pricing structure of the Parties.[818]
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814 As outlined above, this may occur with or without an agreement between the firms.

815 Punishment may take the form of a period of aggressive market behaviour by a rival (or rivals) to retaliate against a firm deviating from the accommodating behaviour. For example, the rival could set prices low (or increase quantity) which would reduce the profits of the deviating firm. For example: M Motta "Competition Policy: Theory and Practice" *Cambridge University Press, Cambridge* (2004) at 139.

816 Market study final report (8 March 2022) at [4.82].

817 Market study final report (8 March 2022) at [4.83.1].

818 Jonathan Milne "Big supermarket revamp lays groundwork for postcode price wars" *Newsroom* (7 August 2024).

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564. These changes in pricing strategies would increase symmetry between the merged entity and Woolworths, thereby increasing the likelihood of coordination. It would also lead to increased transparency and visibility between the merged entity and Woolworths of each other's retail grocery offerings by making it easier to obtain information about rivals' behaviour. We consider this would make the retail grocery market more vulnerable to sustainable accommodating behaviour, as it would make it easier for the merged entity and Woolworths to align their prices to one another and reach a tacit agreement on retail grocery prices for some goods (or a basket of goods). Flat nationwide (or island-based) pricing irrespective of delivery and transportation costs could also be viewed as supporting price transparency by eliminating a source of local cost variation.

565. Increased price transparency would also make it easier for the merged entity and Woolworths to monitor, detect and punish any deviations from a coordinated outcome, without the threat of disruption by new entrants. Such alignment could take different forms, including (but not limited to) the merged entity and Woolworths setting a uniform retail price above competitive levels for some common individual goods (or a basket of goods), or through an increased ability to determine, [ ] between their respective retail banners. We discuss this further below.

566. We consider the Proposed Merger substantially increases the potential for the merged entity and Woolworths (as each other's closet rivals and the only major grocery retailers) to coordinate their behaviour. We are therefore not satisfied that the Proposed Merger will not have, or would not be likely to have, the effect of substantially lessening competition due to coordinated effects in retail grocery markets.

The retail grocery markets are vulnerable to coordination

567. A strategy by competitors to accommodate each other's behaviour may not always be sustainable, as individual firms have an incentive to undercut competitors so as to increase sales and earn additional profits. Coordination is more likely to emerge where the characteristics of the market allow market participants to reach a tacit agreement, and then maintain that agreement by detecting and punishing any firm that deviates from the agreement.

568. Some of the key features of retail grocery markets that make them vulnerable to coordination are:

568.1 the high degree of price transparency;

568.2 the small number of competitors at both a national and regional level;

568.3 repeated interaction between rival grocery retailers over a long period of time;

819 Woolworths RFI response (12 September 2024).

568.4 frequent interaction with common suppliers on promotional schedules and other supply conditions;

568.5 stable demand for grocery products;

568.6 the ability to detect and punish deviations; and

568.7 the limited scope for new entry and expansion.

569. As part of our assessment of whether retail grocery markets are vulnerable to coordination, we have also considered the extent to which the Parties and Woolworths are currently coordinating. While the evidence on existing coordination is mixed, none of the evidence undermines our view that retail grocery markets are vulnerable to coordination and in part supports that view.

Submissions from the Parties

570. The Parties submit that retail grocery markets are not vulnerable to coordination.[820] In summary, the Parties are of the view that:

570.1 the ability to detect and respond to a rival grocery retailer's change in strategies is not in and of itself indicative of the retail grocery markets being conducive to coordination. The Parties believe that this points away from the stability necessary to reach a coordinating agreement. The Parties also submit that it is pro-competitive to respond to a rival grocery retailer's change in strategy, where the response requires rival grocery retailers to improve their own offerings. Further, there is no evidence of punishing rival grocery retailers for deviating from an existing arrangement, and the Parties consider they do not engage in it;[821]

570.2 the number and differentiation of products offered in retail grocery markets acts as a material hindrance to coordination. There are many considerations to price setting, such as promotions, interaction and interdependence between products and wider strategy priorities that inhibit accommodating rival grocery retailers' prices.[822] Such strategies include, for example, the pricing differentials within and across categories and between substitutes and complementary products, pack size and label;[823] and

570.3 the long-term nature of promotion planning, the importance of supplier negotiations and the fact that the Parties do not know the planned retail promotional campaigns of rival grocery retailers in advance means that accommodation through promotions is not feasible.[824] The Parties have many

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820 SoI submission from the Parties (26 April 2024) at 56 and SoUI submission from the Parties (13 August 2024) at 53 and [149]-[149.6].

821 SoI submission from the Parties (26 April 2024) at [177].

822 SoI submission from the Parties (26 April 2024) at [180] and SoUI submission from the Parties (13 August 2024) at [177].

823 SoUI submission from the Parties (13 August 2024) at [177.6].

824 SoI submission from the Parties (26 April 2024) at [181].

products on promotion on any given week. The Parties submit that in any given week FSNI [ ] and FSSI [ ].[825]

571. The Parties further submit that:

571.1 grocery retailing competition encompasses competition on the entire “retail offer” with many variations in terms of both quality level and price points, implying that price coordination alone would be unsustainable.[826] Therefore, retail price coordination between Woolworths and the merged entity could be disrupted by either of the major grocery retailers adjusting the non-price elements of their retail offer (eg, quality, range and service);[827]

571.2 the fact that the Parties and Woolworths have multiple retail banners would require any coordinated agreement to adjust for differences in non-price dimensions, which would not be practicable, particularly given there is no mechanism for arriving at a basket of products on which to coordinate;[828]

571.3 maintaining price coordination would not be feasible across a wide range of complex products.[829] For example, FSSI offers [ ] individual product SKU’s, [ ], with Woolworths likely offering a similarly large number of products. Coordination across such a large range would be costly and time consuming to implement;[830]

571.4 coordination on the average retail grocery prices across a subset or basket of products would not be practicable.[831] Firstly, there is no accepted definition of an “average basket of goods”. In any case, selecting an average basket of goods requires the coordinating members to monitor the range of one another and judge whether their products are sufficiently close substitutes. Secondly, if substitutes are not accurately identified it is possible for one of the coordinating members to undermine the collusive agreement by lowering the prices of goods outside of the collusive agreement. It may be difficult to detect and address these deviations;[832] and

571.5 there are a range of additional factors that further complicate coordination. These being:[833]

825 SoUI submission from the Parties (13 August 2024) at [177.3].
826 SoUI submission from the Parties (13 August 2024) at [169]-[170].
827 SoUI submission from the Parties (13 August 2024) at [171.2].
828 SoUI submission from the Parties (13 August 2024) at [3.1(c)].
829 SoUI submission from the Parties (13 August 2024) at [149.4].
830 SoUI submission from the Parties (13 August 2024) at [174]-[175].
831 SoUI submission from the Parties (13 August 2024) at [149.5].
832 SoUI submission from the Parties (13 August 2024) at [179.1]-[179.3].
833 SoUI submission from the Parties (13 August 2024) at [149.6].

571.5.1 the ability of FSNI/FSSI stores to [ ];

571.5.2 the interdependence of pricing between products and the application of promotions;

571.5.3 grocery retailers' wider strategic priorities, for example New World offers products at everyday low prices. The prices of products that have everyday low prices are intended to remain consistently low; and

571.5.4 the Parties' [ ].

572. Houston Kemp submits that the retail grocery market is not currently vulnerable to coordination and is unlikely to be with the Proposed Merger.[834]

572.1 First, the price setting process employed by the Parties and Woolworths makes coordination highly impracticable in the absence of explicit communication.[835] The Parties' owner-operator co-operative model means that individual stores may set different prices, and this would continue with the Proposed Merger.[836]

572.2 The divergence in the level at which profits are maximised (and therefore prices are set) limits the feasibility of the Parties and Woolworths agreeing on a collusive equilibrium or sustaining coordination if an agreement could be reached.[837] Furthermore, the Proposed Merger would not change the co-operative structure of the Parties. Therefore, store owners' [ ].[838]

572.3 Second, the complexity of products sold by grocery retailers, including the number of products and differentiation between banners makes the coordination problem intractable.[839] Furthermore, this limits the ability for the Parties and Woolworths to punish deviation. This is because the differentiated product offerings limit the severity of imposing a price war because retail consumers may be less likely to switch to a rival grocery retailer by consequence of a reduction in price. For example, consumers may value a higher level of customer service.[840]

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834 Houston Kemp report on SoUI (13 August 2024) at [92].

835 Houston Kemp report on SoUI (13 August 2024) at [113] and [116].

836 Houston Kemp report on SoI (26 April 2024) at [62].

837 Houston Kemp report on SoUI (13 August 2024) at [149].

838 SoUI submission from the Parties (13 August 2024) at [187.2].

839 The coordination problem is the phenomenon by which firms achieve a common understanding, whether derived tacitly or explicitly of how they each should conduct themselves and potentially allocate the benefits of collusion. Houston Kemp report on SoUI (13 August 2024) at [81].

840 Houston Kemp report on SoUI (13 August 2024) at [165].

572.4 Additionally, the Parties and Woolworths are uncertain of each other's costs, which means that they are uncertain of each other's ability to punish deviations, which would make the Parties and Woolworths wary of reaching a collusive agreement.[841] Furthermore, if the Parties and Woolworths had an understanding of each other's costs, the recognised lower cost firm would have an incentive to deviate because it would have less fear of retaliation since the higher cost firm would not be able to induce a substantial profit loss without imposing an even larger burden on itself.[842]

573. The Parties and Houston Kemp submits that if Woolworths has moved to more localised pricing it would make coordination on a national basis more challenging.[843] Houston Kemp further submits:

573.1 the asymmetry between the Parties' and Woolworths' corporate structures and its effect on the level at which the profit maximising incentive applies (at the local level for the Parties and at the national level for Woolworths) is also unchanged, both by consequence of the Proposed Merger and any shift towards more localised pricing by Woolworths;[844]

573.2 the Parties are unlikely to have an incentive to maintain national prices whereas Woolworths may have an incentive to set a nationally consistent price to maximise profits across all its stores;[845] and

573.3 a move by Woolworths from national pricing to more local pricing means that the Proposed Merger could not give rise to any increase in coordination at a local level.[846]

Third party submissions

574. The Food and Grocery Council submits that the Proposed Merger could make it easier for a major competitor to coordinate pricing, if the merged entity engaged in more national pricing.[847]

575. The New Zealand Specialist Cheesemakers Association submits that the Parties and Woolworths do not need to form tacit or indirection communication to coordinate their pricing, as they can simply use each other's highly visible pricing for price matching and indexing.[848]

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841 Houston Kemp report on SoUI (13 August 2024) at [151].
842 Houston Kemp report on SoUI (13 August 2024) at [152].
843 SoUI submission from the Parties (13 August 2024) at [177.7] and Houston Kemp report on SoUI (13 August 2024) at 33.
844 Houston Kemp report on SoUI (13 August 2024) at [179].
845 Houston Kemp report on SoUI (13 August 2024) at [180].
846 Houston Kemp report on SoUI (13 August 2024) at [182].
847 SoI submission from the Food and Grocery Council (26 April 2024) at [5.3].
848 SoUI submission from New Zealand Specialist Cheesemakers Association (12 August 2024).

Price transparency and pricing strategies

576. We consider the considerable degree of price transparency in retail grocery markets would allow the merged entity and Woolworths to coordinate on retail grocery prices.

577. First, the Parties and Woolworths [ ]. The ease with which the Parties and Woolworths can obtain retail pricing information supports coordination because it makes it easier to monitor prices and detect deviations from a tacit agreement.

578. The Parties submit that the ability to detect and respond to a rival's change in strategy is not itself indicative of coordination.[849] The Parties also submit that firms continually monitoring prices of rivals and responding to changes in those prices is a feature of a highly competitive market.[850] Competitors would be monitoring and responding to each other's competitive offers unless competition is entirely absent in a market. However, we consider that the [ ] and ability to respond to each other's price competition in highly concentrated markets (such as the retail grocery market) weakens the incentives of firms to deviate from their competitive strategies which are well known and understood by each other. These strategies are interdependent and formed on the basis of considering how each other is likely to respond to a particular strategy.

579. Given the [ ] and transparency in retail grocery markets we consider it would be rational for the Parties and Woolworths to expect its closest competitor to observe and respond to any significant deviations from the established competitive strategy and for the rival competitor to respond as expected to avoid a loss of sales and market share. We consider this creates the necessary conditions for the Parties and Woolworths to be able to monitor, detect and quickly punish any deviations from a tacit agreement on retail prices.

580. Second, while it may not be practical to coordinate on all products, price coordination could take place on a basket of common goods sold across the respective retail banners of the Parties and Woolworths (or a subset of a basket of goods).[851] We consider the price transparency and [ ] would enable the merged entity and Woolworths to identify a suitable basket of goods to coordinate over.

581. The Parties and Woolworths have different brand positioning and appear to be strategically differentiating their retail grocery offers from each other, which could make it more difficult to identify a suitable basket of goods and reach a tacit agreement on retail prices. Such brand positioning could also, in and of itself, facilitate coordination. The evidence suggests that the Parties and Woolworths [ ]. We consider

849 SoI submission from the Parties (26 April 2024) at [177].

850 SoUI submission from the Parties (13 August 2024) at [163].

851 It may be difficult to coordinate on all product because the major grocery retailers supply many thousands of products, there are differences in the brands and product ranges that each major grocery retailer chain supplies and there are some products (especially fresh products) that are not priced on a national basis but to local availability and demand.

the [ ] respectively supports coordination. It creates an incentive for the Parties and Woolworths to avoid direct price competition and reach a tacit agreement on their respective price levels and subsequent brand positioning in the retail grocery market. We discuss this further below.

582. The evidence shows that the Parties have a similar price setting process. Both FSNI and FSSI independently set a RRP for their member stores.[852] FSSI told us that [ ].[853] Owner-operators [ ].

583. As discussed above, the Parties [ ]. These differentials, [ ]. [ ].[854] [ ]. For the Parties [ ].[855]

584. At Woolworths, pricing decisions are controlled by category managers who for a given category have the responsibility of determining the retail prices of products in that category. Woolworths [ ].[856] Woolworths has [ ].

584.1 [ ].

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852 Commerce Commission interviews with FSNI (31 May 2024) and FSSI (5 June 2024).

853 Commerce Commission interview with FSSI (5 June 2024).

854 [ ] Commerce Commission interview with FSSI (26 February 2024).

855 For example, [ ]. Commerce Commission interview with FSSI (5 June 2024).

856 Woolworths RFI response (29 August 2024).

584.2 [ ].[857]

585. Since we began our assessment of the Proposed Merger, Woolworths has transitioned from national pricing (where prices were the same throughout the country) to allow for some products to have different prices in the North and South Island.[858] Woolworths [ ].[859] [ ].[860] Woolworths stated that [ ].[861] [ ].[862] [ ].[863]

586. While pricing strategies have become sophisticated over time, we note that they are enduring. The Court of Appeal in *Woolworths* describes similar pricing practices by Woolworths in relation to conduct in 2007.[864]

587. [ ].[865]

Table 4: [ ]

857 Woolworths RFI response (29 August 2024).
858 See for example, Jonathan Milne "Big supermarket revamp lays groundwork for postcode price wars" *Newsroom* (7 August 2024).
859 Woolworths RFI response (12 September 2024).
860 Woolworths RFI response (29 August 2024).
861 [ ] Woolworths RFI response (29 August 2024).
862 Woolworths RFI response (29 August 2024).
863 Woolworths RFI response (12 September 2024).
864 *Woolworths* (CA) above n 4 at [202].
865 [ ]

588. We consider this evidence shows the ability of the Parties and Woolworths to coordinate on retail grocery prices as they can [ ]. This suggests that the market is not so complex as to prevent the merged entity and Woolworths from monitoring each other's prices and detecting deviations from an understanding on [ ]. The use of [ ] suggests that the Parties and Woolworths [ ]. This may suggest price coordination is already occurring or, at least, that the Parties and Woolworths are capable of coordinating their behaviour.

589. We further observe that:

589.1 New World has [ ]. [ ]. This implies that [ ]. If the Parties and Woolworths [ ], it could create conditions for [ ], as they may have an incentive to [ ].

589.2 [ ]. This creates the risk that [ ]. This evidence shows the Parties and Woolworths [ ]. We consider these price setting strategies makes the retail grocery markets vulnerable to price coordination on a basket of common goods (or a subset of a basket of goods).

590. The Parties and Woolworths [ ] may be an indicator of an intent to engage in price coordination.[866] While the Parties and Woolworths, [ ], coordination does not require that parties coordinate on every product, every time, or be entirely successful in their attempts to coordinate. Furthermore, the significant degree of price transparency and [ ] implies it is possible that in future the Parties and Woolworths could [ ] to more closely align with one

866 [ ] can also be present in highly competitive markets. However, based on the evidence in this case and applying our expert judgment in light of our repeated findings in other grocery matters that competition is not working well in retail grocery markets we consider that, in this case, they reflect the ability to coordinate on retail grocery prices rather than particularly close competition.

another.[867]

591. We consider that Woolworths’ move to island-based pricing on some products is consistent with this. Woolworths’ change means its price setting strategies will be able to more closely mirror those currently used by the Parties. Post-merger Woolworths would continue to have the ability to align its prices to any national price setting strategies by the merged entity and also, following its change to island pricing for some goods, the ability to align its prices to the Parties that are island based.

592. The Parties submit that wider strategic priorities would complicate price coordination and make it more difficult to follow Woolworths price changes. For example, Four Square offers “Everyday Great Value” products which have prices generally set for a minimum of 12 weeks. New World offers “Everyday Low Prices” products which remain at consistently low prices.[868] While this may limit how frequently the merged entity could adjust price, we do not consider it would eliminate the ability of the merged entity and Woolworths to reach an understanding over time. Furthermore, the merged entity could change those pricing practices if it would assist with reaching a tacit agreement on prices of a basket (or subset of a basket) of common goods sold across their respective retail banners.

593. The merged entity would remain a co-operative, where the stores are owner operated.[869] Individual FSNI/FSSI [ ].[870] They may therefore have an incentive to deviate from any tacit agreement and to undercut any coordinated retail price. However, we are not satisfied that the ability of individual FSNI/FSSI stores to [ ] is sufficient to prevent price coordination. The ability of the Parties and Woolworths to [ ] shows that individual FSNI/FSSI stores [ ] as to prevent the Parties and Woolworths aligning prices.[871]

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867 For example [ ]. SoUI submission from the Parties (13 August 2024) at [157].

868 SoUI submission from the Parties (13 August 2024) at [177.5].

869 SoUI submission from the Parties (13 August 2024) at [187.2].

870 Commerce Commission interviews with FSSI (5 June 2024) and FSNI 31 May 2024). Woolworths operates the SuperValue and Fresh Choice brands as franchises and sets RRPs for these banners. The owners of these stores are not required to follow the RRP, although may not exceed the RRP for promotions. Commerce Commission interview with Woolworths (14 June 2024) and market study final report (8 March 2022) at [E111]. However, these stores are less likely to disrupt coordination than FSNI/FSSI New World or PAK’nSAVE stores as they tend to smaller format and located in rural or medium and small urban areas.

871 FSNI/FSSI’s ownership structure as barrier to coordination was specifically dismissed by the Court of Appeal in *Woolworths. Commerce Commission v Woolworths Ltd* (CA) above n5 at [202].

Frequent interactions

594. There are repeated frequent interactions between the Parties and Woolworths that have taken place over a long period of time. Retail grocery markets are therefore characterised by short information lags and frequent transactions.

595. We consider this makes retail grocery markets vulnerable to coordination, as the terms of a tacit agreement could emerge from these interactions. The Parties and Woolworths [ ]. As discussed above, the Parties and Woolworths [ ]. For example, [ ].

596. Frequent interactions support coordination as it makes it easier for the Parties and Woolworths to test retail price rises and quickly revert if the other does not follow. It also implies that rivals can quickly change price to punish any deviation from a tacit agreement to coordinate.

Complexity of products

597. Price coordination requires that firms can reach agreement on the terms of a coordinating strategy. This is more likely where firms supply homogeneous products and there are only few products, implying the coordinating firms only need to reach an understanding on a few prices.

598. Some features of retail grocery markets introduce some complexity that could make price coordination between the Parties and Woolworths more difficult.

    598.1 First, the Parties and Woolworths sell many thousands of products which would make reaching and monitoring an agreement covering all products more difficult. Each individual product is likely to have different demand characteristics and be subject to different promotional activity (some of which is supplier funded). The prices of some products change frequently.

    598.2 Second, the respective banners of the Parties (PAK'nSAVE, New World and Four Square) and Woolworths (Woolworths, Countdown, SuperValue and Fresh Choice) all compete on different aspects of price and non-price dimensions of competition. Price coordination between Woolworths and the merged entity could be disrupted by either major grocery retailer adjusting the non-price elements of their retail offer (eg, quality, range and service).

    598.3 Third, there appears to be a move towards personalised promotions. Personalised promotions are unique to each customer based on what that shopper typically buys. These promotions are communicated directly to individual customers and are not visible to rivals.[872] Woolworths offers personalised promotions through its "Everyday Rewards Programme Boost

[872] SoUI submission from the Parties (13 August 2024) at [161].

Offers”.[873]
[
].[874]

599. However, we consider that the merged entity and Woolworths over time and through frequent interactions can overcome these complexities and reach an understanding on the price for a basket of goods (or a subset of goods).

599.1 First, coordination could be over a basket of goods (rather than every product) and [ ]. While some products may have features less suitable to sustainable price coordination (such as, for example, fresh produce goods that are procured in local retail grocery markets and not subject to centralised pricing decisions), price coordination would not need to apply to all goods and could instead focus on common goods sold by the Parties and Woolworths that are priced centrally.

599.2 The Parties and Woolworths [ ]. This would require the coordinating members to monitor the range of one another and judge whether their products are sufficiently close substitutes. However, we consider that over time and with frequent interactions the merged entity and Woolworths could reach this understanding. The Parties submit that the interdependencies between products means one of the coordinating members could undermine the tacit agreement by lowering the prices of goods outside of the tacit agreement.[875] However, so long as the value of the basket of goods is large enough, we consider it would still be profitable to coordinate on those products even if direct price competition continues on products outside the agreement.

599.3 Second, the merged entity and Woolworths would need to reach an understanding on the relative retail grocery prices between them and adjust for differences in non-price dimensions of competition between the various banners (eg, quality, range and service). The Parties and Woolworths [ ]. Use by the Parties and Woolworths of [ ] suggests that they consider that this a sound basis on which to make their current pricing decisions. This suggests that the merged entity and Woolworths would be able to achieve sustainable price coordination, despite the existence of quality-adjusted price differences between their respective retail banners.

599.4 Therefore, while the merged entity and Woolworths could alter the non-price attributes of their respective retail grocery offerings, we consider that any material changes would be observable to each other. This means that the Parties and Woolworths would be able to quickly react to changes in non-

873 SoUI submission from the Parties (13 August 2024) at [162.1.
874 SoUI submission from the Parties (13 August 2024) at [162.3].
875 SoUI submission from the Parties (13 August 2024) at [179.3].

price dimensions of competition and adjust the [ ] accordingly. Given the [ ] in retail grocery markets it is unlikely that there would be changes in non-price dimensions of competition between the merged entity and/or Woolworths that are observable to consumers but not to each other.

599.5 Third, we are also not satisfied that personalised pricing would undermine price coordination. The depth and breadth of the planned personalised promotions is currently unclear. Regardless, we consider the personalised pricing is designed to target price conscious consumers and does not limit the potential for price coordination on shelf prices which reach most consumers. In this respect, personalised pricing can be used by coordinating parties to isolate price-sensitive consumers from destabilising successful coordination in respect of less price-sensitive consumers.

Few firms in the market

600. A small number of competitors can increase the likelihood of coordination, particularly in the absence of a particularly vigorous competitor or strong competition from any outside coordinating firms that could disrupt a tacit agreement.[876] It is therefore easier to reach, monitor and sustain a tacit agreement when there are only a few firms in the market.[877]

601. For coordination to be successful, other competitive constraints must be relatively weak so that the actions of potential new entrants and consumers are unlikely to be successful in disrupting any attempts by the parties to an agreement to accommodate each other's behaviour.

602. The retail grocery sector is highly concentrated. Following the Proposed Merger, there would be only two major grocery retailers in New Zealand.[878] There is also limited scope for new entry/and or expansion in retail grocery markets. These features limit the scope for significant disruption to the existing competitive strategies of the Parties and Woolworths and supports coordination.

Stable demand

603. Stable demand enhances the ability to coordinate because when sales volumes are predictable it is easier to detect deviations from a tacit agreement. In general, we expect incumbent firms to have less incentive to compete vigorously in markets where the competitive environment is relatively stable and unlikely to be disrupted by external factors, such as fluctuations in demand.

604. Retail grocery markets have relatively stable and predictable demand when compared to other industries, with trend growth largely reflecting population

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876 Mergers and Acquisitions Guidelines above n3 at [3.89].

877 A firm with a larger market share will have less incentive to deviate and lower prices, as it would risk losing profits on a larger number of inframarginal units.

878 We consider the impact of The Warehouse and Costco on price coordination on the 'External stability' section.

growth. For example, over the past five years, total sales by grocery and supermarket retailers in New Zealand only increased by approximately 2% in real terms.[879]

605. Grocery purchases are necessary and frequent. In the absence of the threat of disruption by new entry and expansion, stable demand will tend to lead to greater incentive for the Parties and Woolworths to coordinate, as they have weak incentives to compete vigorously and risk triggering a price war that may ultimately only serve to reduce industry profitability.

Symmetry of the firms

606. Firms may find it easier to reach a common understanding if they are relatively symmetric, for example in terms of cost structures, market shares, capacity levels and extent of vertical integration. Symmetry between firms increases the likelihood of coordination because incentives to coordinate are more likely to be aligned. For example, a firm with a smaller market share has more to gain from deviating from coordination, and less to lose in the event that such deviation is punished. If firms are similar in other dimensions, then they are more likely to have incentives that are aligned. This reduces the complexity of the communication required for firms to initiate coordination.

607. We consider there is some symmetry between the Parties and Woolworths. At present they are the only major grocery retailers and their combined market shares are high and relatively stable over time. The merged entity is also likely to have a similar geographic footprint to Woolworths.

608. There are some differences between the Parties and Woolworths which reduces symmetry between them.

    608.1 When considered on an island basis, the Parties and Woolworths are likely to have similar overall coverage. However, the market shares and relative strengths of the Parties and Woolworths appear to differ in some regional and local areas.

    608.2 The different business operating models of the Parties and Woolworths may make it more difficult to reach and sustain price coordination, specifically with regards the trans-Tasman (Woolworths) versus New Zealand presence (the Parties) and corporate (Woolworths) versus the co-operative model of the Parties.[880] It is unclear that the trans-Tasman model of Woolworths reduces symmetry significantly, since

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879 Stats NZ retail trade (ANSIC06). Based on the change between year ending March 2019 to March 2024. Total sales for the year ending 2019 was $18.2 billion and for the year ending 2024 $18.9 billion, which equates to an approximate 2% increase.

880 SoI submission from the Parties (26 April 2024) at [186.1]-[186.3].

[ ].[881] However, the co-operative model of the Parties may complicate coordination.[882]

608.3 There may be some differences in the cost base between the Parties and Woolworths.[883] Although, some suppliers have indicated that they match prices between different grocery retailers (see [509]).

609. However, we consider there is sufficient symmetry between the Parties and Woolworths to make the retail grocery market vulnerable to price coordination.

Detecting and punishing deviations

610. Sustaining a tacit agreement requires that firms can detect and effectively punish deviations from the agreement. This creates the incentive for competing firms to adhere to a tacit agreement by reducing the likely profitability of deviating from a coordinated outcome.

611. As discussed earlier, the Parties and Woolworths [ ]. The high degree of transparency in the retail grocery market implies the merged entity and Woolworths would likely be able to quickly detect and respond to deviations from a tacit agreement to coordinate on retail prices.

612. We consider the merged entity and Woolworths are likely to have credible and effective strategies available to punish deviations that are identified. For example, a grocery retailer could go through a period of low retail pricing to reduce their rival's profits before returning to the coordinated price. This would likely be most effective for [ ] products as these are products that [ ] and may be the means by which a rival grocery retailer is likely to feel the need to follow any downward retail price movements. Another strategy could be to cut retail grocery prices in a certain local or regional area in response to any localised deviations from a tacit agreement by store owners.

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881 Commerce Commission interview with [ ].

882 Structural/operational differences between the Parties and Woolworths were identified in the Court of Appeal's 2008 consideration of the Commission's decision to decline to grant clearance for Woolworths and/or three Foodstuffs co-operatives (now FSNI and FSSI) to acquire The Warehouse Group. In this case, advisors to the Parties submit that the structural/operational differences between the Parties and Woolworths explain why coordination have not arisen in the New Zealand context and why it would not arise in the future. However, the Court ultimately considered that "While we accept that those features may make coordination more difficult, we do not see them as removing it as a plausible possibility". *Commerce Commission v Woolworths Ltd* (CA) above n5 at [202].

883 SoI submission from the Parties (26 April 2024) at [186.1]-[186.3]. The Parties submit that this is due to the differences between a co-operative (the merged entity) and corporate (Woolworths) structure, the number of banners and store network that are supported, as well as an exclusively New Zealand based entity (the merged entity) and an entity that may have support from Australia (Woolworths).

External stability

613. Coordination is more likely where the higher profits from a coordinated strategy are unlikely to be disrupted by new entry and expansion of non-participating rivals.

614. We consider there is limited scope for new entry and expansion by other grocery retailers to compete more effectively with the Parties and Woolworths in the foreseeable future. It is therefore unlikely that any potential new entrants would disrupt an attempt by the merged entity and Woolworths to accommodate each other's behaviour. In the market study, the Commission considered that there were several factors preventing or slowing entrant and expansion in retail grocery markets.[884]

615. Although there have been some market developments in recent years (since the market study), such as the entry of Costco in Auckland and continued growth by The Warehouse in some local retail grocery markets, small-scale entry is likely to have a limited effect on the behaviour of the Parties and Woolworths.

616. Coordination by the merged entity and Woolworths on certain products may be disrupted by rival grocery retailers such as The Warehouse and Costco in some local markets. For example, in local retail grocery markets where The Warehouse has a store, the major grocery retailers may face the risk of being undercut on certain products.[885] The Warehouse appears to price aggressively for core essential products (such as butter, milk and eggs). [ ].[886] However, the Warehouse has a more limited footprint as compared to the major grocery retailers and is not present in all local retail grocery markets. As discussed earlier, we consider the Proposed Merger would likely raise barriers to entry and expansion further which would likely inhibit The Warehouse from playing a disruptive role in retail grocery markets in future.

617. There have been some pro-competitive reductions in barriers to entry since the market study, such as the removal of covenants on land. Further, the legislative purpose of the GICA includes to lower barriers to entry. However, it is yet to be seen whether it will achieve its desired outcomes.

618. Further, if the merged entity obtained lower supplier prices due to the Proposed Merger this could potentially lower wholesale prices available from the merged entity to potential new entrants under the GICA. However, neither of the Parties

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884 Market study final report (8 March 2022) at [6.5] and 189.

885 The Commission opposed the proposed acquisition by three Foodstuffs co-operatives and Woolworths of The Warehouse Group in part because of concerns that it would potentially disrupt coordination. Commerce Commission, Foodstuffs (Auckland) Limited, Foodstuffs (Wellington) Co-operative Society Limited, and Foodstuffs South Island Limited; and (separately) Woolworths Limited (Commerce Commission Decision 606 and 607, 8 June 2007). The Court of Appeal considered that "a successful Extra is likely to reduce the potential for collusion between Woolworths and Foodstuffs that would otherwise exist". *Commerce Commission v Woolworths Ltd* (CA) above n5 at [203].

886 Commerce Commission interview with The Warehouse Group (22 May 2024).

[ ] and it is unclear if lower wholesale prices would lower barriers to such an extent as to make entry of a sufficient scale to constrain the major grocery retailers more likely.

Evidence of existing coordination

619. Evidence of existing coordination would suggest a market is vulnerable to coordination and that even small changes from a merger could make coordination more likely, more complete or more sustainable. In practice it can be difficult to clearly identify existing coordination because many of the behaviours we observe can be consistent with unilateral behaviour. We consider the evidence on this point is mixed.[887] Given the volume of submissions on this point, we have separated out our analysis into the sub-headings below, before concluding on whether the market is vulnerable as a whole.

<u>Submissions from the Parties</u>

620. The Parties submit that there is no evidence of existing coordination.[888]

620.1 The Parties consider that consistent with the conclusions of the market study there is no evidence of existing coordination between the Parties and Woolworths.[889]

620.2 The Parties disagree with the market study finding that the major grocery retailers have similar strategies that are well known and submit that monitoring reflects the fact that they do not know their rivals' strategies well.[890]

620.3 The monitoring of Woolworths is aimed at increasing FSNI's competitiveness against Woolworths and [ ] is wholly inconsistent with a coordinating agreement.[891]

620.4 There has been material entry and expansion by rival grocery retailers, with the expansion of The Warehouse's retail grocery offering, and the entry of Costco.[892]

620.5 The Parties refute any suggestion that there is information sharing between major grocery retailers through suppliers, and that this would change following the Proposed Merger. The Proposed Merger would not change the conditions associated with such conduct.[893]

887 The market study also did not find evidence of price coordination. Market study final report (8 March 2022) at 146.
888 SoUI submission from the Parties (13 August 2024) at 54.
889 SoUI submission from the Parties (13 August 2024) at [149.1]
890 SoI submission from the Parties (26 April 2024) at [176].
891 SoI submission from the Parties (26 April 2024) at [179].
892 SoI submission from the Parties (26 April 2024) at [178].
893 SoI submission from the Parties (26 April 2024) at [187].

621. Additionally, the Parties submit that:

621.1 the Parties and Woolworths engage in activities designed to make their conduct less (rather than more) predictable to each other.[894] In recent months there has been an increased focus by grocery retailers on developing "personalised promotions" which cannot be detected by other grocery retailers;[895] and

621.2 there is no evidence that the Parties are able to predict the future prices or promotions of Woolworths.[896]

622. Houston Kemp submits there is no evidence relating to coordination in retail grocery markets.[897] Houston Kemp additionally submits that price monitoring and the use of [ ] is consistent with ensuring that the Parties compete effectively with Woolworths. [ ], is inconsistent with coordination.[898]

<u>Third party submissions</u>

623. Ernie Newman submits that the Parties and Woolworths tacitly collude by avoiding aggressive competition for market share, and that tacit collusion or accommodating behaviour are cornerstones of New Zealand's retail grocery markets.[899]

624. The New Zealand Specialist Cheesemakers Association submits that the Parties and Woolworths are already de factor 'coordinating' their market pricing, much in the same way as petrol companies.[900]

<u>Our view on existing coordination</u>

625. We have not seen evidence to suggest there is explicit, unlawful coordination between the Parties and Woolworths. There is mixed evidence on the existence of any tacit price coordination.

626. First, market stability could be an indication of existing coordination as it may suggest the major grocery retailers are adhering to a coordinated strategy. Market stability also facilitates monitoring of rivals' behaviour, which makes it easier to detect and punish any deviations from a price coordination agreement. A review of the internal documents of the Parties shows some evidence to suggest that retail grocery markets are relatively stable.

626.1 Market shares in both the North Island and South Island appear to have had limited variation. [ ].[901]

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894 SoUI submission from the Parties (13 August 2024) at [151.1]
895 SoUI submission from the Parties (13 August 2024) at [151.2]
896 SoUI submission from the Parties (13 August 2024) at [151.4]
897 Houston Kemp report on SoI (26 April 2024) at 14.
898 Houston Kemp report on SoI (26 April 2024) at [60].
899 SoPI submission from Ernie Newman (5 February 2024) at 6.
900 SoUI submission from New Zealand Specialist Cheesemakers Association (12 August 2024).
901 [ ]

[ ].[902] These market shares have been taken from internal documents and the different time periods reflect the different information available. Therefore, while there may be a greater level of variation over a shorter time period and in local markets, [ ].[903]

626.2 [ ].[904] However, these figures would not capture retail consumers that permanently switched between different retail banners.

626.3 [ ].[905]

627. Second, leader follower behaviour may be an indicator of existing coordination, although such behaviour can also occur in competitive markets.

627.1 As discussed above, the Parties and Woolworths [ ].[906] The Parties submit that monitoring of rival grocery retailers would occur in competitive markets and is aimed at increasing its competitiveness.[907] However, the use of [ ] also suggests the major grocery retailers have the ability to follow each other's pricing (for example, if Woolworths raises or lowers prices, then the Parties can readily identify this change and change their pricing accordingly to maintain any price differentia).[908]

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902 [ ]

903 In the grocery market study, the Commission considered that there had been limited market share variation. Market study final report (8 March 2022) at [5.79]. Woolworths however disagreed with the market study's observation that market shares are 'stable over time' and argued that a closer assessment showed significant volatility. For example, Woolworths' pre-packaged market share varied over [ ]% in the past 2-3 years. [ ]

904 [ ]

905 Woolworths RFI response (29 August 2024).

906 The Court of Appeal considered that the market conditions in 2008 were suitable for leader/follower. It stated that "Given the evidence that [ ], we do not see why co-ordination of the leader/follower type identified by the Commission is not possible even with Foodstuffs' structure". *Commerce Commission v Woolworths Ltd* (CA) above n5 at [202]. While it is difficult to direct compare the markets in 2008 to now, some features of the market are similar. For example, there are few major grocery retailers in the market and the major grocery retailers closely monitor one another.

907 SoUI submission from the Parties (13 August 2024) at [163] and [164].

908 In the market study, the Commission did not consider there was evidence of leader-follower behaviour. Market study final report (8 March 2022) at [5.155].

627.2 There is mixed evidence of the Parties and Woolworths [ ]. The Parties [ ].[909] Woolworths' [ ]. However, the Parties and Woolworths [ ], which suggests that they consider the available pricing information is sufficient to inform their current pricing decisions.

627.3 The Parties submit that evidence of [ ] is wholly inconsistent with a coordinating agreement.[910] Further, the Parties have also [ ].[911] FSNI indicated that [ ].[912] The internal documents of the Parties also show [ ] and, as noted above, there have been moves towards [ ].[913]

628. Not all of these actions are consistent with price coordination. However, as noted earlier, it is not necessary for coordination to currently be occurring, and nor do we consider that price coordination needs to take place on all products, all the time, for a coordination strategy to be successful and sustainable. Nor does it imply that coordination is not possible in the retail grocery market or that coordination could not occur in future following the change from the Proposed Merger.

629. Third, evidence of the Parties predicting future pricing strategies of rival grocery retailers may be consistent with coordination. However, we have not identified examples where the Parties and Woolworths are able to predict each other's specific future prices or promotions.

630. While the evidence on existing coordination is mixed, none of the evidence undermines our view that retail grocery markets are vulnerable to coordination and at in part supports that view.

Our view on whether the retail grocery markets are vulnerable to coordination

631. Given these characteristics of retail grocery markets, we consider that retail grocery markets are vulnerable to coordination, including that the merged entity and

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909 See for example, [ ].

910 SoI submission from the Parties (26 April 2024) at [179].

911 [ ]

912 Commerce Commission interview with FSNI (31 May 2024).

913 Another interpretation of this evidence is that these are periods where major grocery retailers are punishing one another for deviations or are simply in a discovery period prior to reaching a tacit understanding.

Woolworths are likely able to reach a tacit agreement and sustainably coordinate their behaviour. In summary:

631.1 the high degree of retail price transparency would allow the merged entity and Woolworths to monitor and detect deviations from a tacit agreement to align its prices on some common goods (or a basket of goods). We consider they are likely to have credible and effective strategies available to punish deviations that are identified, thus reducing the incentive to do so;[914]

631.2 retail grocery markets are highly concentrated and there is little variation in market shares over time. The relatively stable environment of the retail grocery sector also facilitates monitoring of rivals' behaviour;[915]

631.3 there are frequent interactions between the Parties and Woolworths on price. [ ]. The frequency of these interactions supports coordination because it makes it easier to effectively monitor and adjust retail prices quickly to punish any deviations from a coordinated outcome;

631.4 [ ];

631.5 the symmetry between Woolworths and the Parties;

631.6 retail grocery markets are characterised by high barriers to entry and expansion, which means any attempt by the merged entity and Woolworths to accommodate each other's behaviour would be unlikely to be disrupted by non-participating rivals; and

631.7 retail grocery markets have relatively stable and predictable demand when compared with other industries, as grocery purchases are necessary and frequent. In the absence of threat of disruption by new entry and expansion, stable demand will tend to lead to stable market shares because grocery retailers have weaker incentives to compete vigorously and risk triggering a price war that may ultimately only serve to reduce industry profitability.

632. Some features of retail grocery markets may hinder accommodating behaviour, such as:

632.1 the high degree of product and brand differentiation;

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914 Punishment may take the form of a period of aggressive market behaviour by a rival (or rivals) to retaliate against a firm deviating from a tacit agreement. For example, a rival could set prices low (or increase quantity) which would reduce the profits of a deviating firm. The threat of punishment deters firms from deviating from accommodating behaviour.

915 An unstable market makes it more difficult for firms to determine whether a price adjustment reflects current market dynamics or is instead partly due to a deviation from the coordination strategy.

632.2 the large number of products sold by grocery retailers;

632.3 frequent discounts and non-price promotions; and

632.4 the ability of owner operated stores to set their own retail prices.

633. However, given the structure of the New Zealand retail grocery sector and that there is already muted competition in retail grocery markets (as noted at [41]), we do not consider these features would prevent the merged entity and Woolworths from reaching a coordinated outcome on retail grocery prices.

634. We reiterate that given the Parties and Woolworths [ ], these potential challenges to effective coordination are plainly surmountable.

635. Many of the Parties' submissions contend that they are not currently coordinating with Woolworths, and/or that perfect coordination between major grocery retailers is not possible. Such submissions do not satisfy us that retail grocery markets are not vulnerable to coordination (or that the Proposed Merger would not make coordination more likely, more complete or more sustainable).

The Proposed Merger would make coordination more likely or more sustainable

636. We consider the Proposed Merger would increase the likelihood, completeness and sustainability of price coordination between the merged entity and Woolworths in the retail grocery market. Woolworths currently competes with both FSNI and FSSI. However, fewer firms in in the retail grocery market, together with increased centralisation of pricing, would lower the complexity of reaching a common understanding. The Proposed Merger would change the competitive environment to a significant extent and make it easier for the merged entity and Woolworths to reach, monitor and sustain price coordination.

637. Further, the increase in range compliance between the North and South Island together with an increase in barriers to entry post-merger would also make coordination more likely and sustainable. We discuss this in more detail below.

Submissions from the Parties

638. The Parties submit that the Proposed Merger would not enhance the ability of the merged entity to coordinate its activity with competitors.[916] The Parties also submit that the Proposed Merger would not increase the likelihood, completeness, and sustainability of coordination.[917] The Parties further submit that:

916 The Application at [162].

917 SoI submission from the Parties (26 April 2024) at 58 and SoUI submission from the Parties (13 August 2024) at 66.

638.1 the only relevant change that would arise from the Proposed Merger would be to combine the Parties' support centres. There would be no change in:[918]

638.1.1 the number of products offered or the differentiation of the respective banners of the merged entity or Woolworths;

638.1.2 the Parties owner operator model; or

638.1.3 the level of transparency of pricing;

638.2 the Proposed Merger would not increase barriers to entry such that it would affect a potential disruptor from entering retail grocery markets;[919] and

638.3 in relation to the prevalence of national pricing, [ ]. Regardless, the transparency and dynamics in retail grocery markets that drive national and regional pricing would be the same in the factual and counterfactual.[920]

639. The Parties further submit:

639.1 [ ];[921]

639.2 [ ];[922]

639.3 [ ];[923] and

639.4 additionally, the merged entity and Woolworths would not have similar size or cost structures. There would continue to be significant differences between them, such as the corporate versus co-operative model; the number

918 SoUI submission from the Parties (13 August 2024) at [187.1]-[187.3].
919 SoI submission from the Parties (26 April 2024) at [183.2].
920 SoI submission from the Parties (26 April 2024) at [184].
921 RFI response from the Parties (13 June 2024) at [9]. We note that agreements between parties as to price can breach Part 2 of the Act even if parties do not directly compete in retail markets, if they substantially lessen competition in any market.
922 RFI response from the Parties (13 June 2024) at [10.1].
923 RFI response from the Parties (13 June 2024) at [10.2].

of banners and store network; and trans-Tasman versus New Zealand presence.[924]

640. Houston Kemp submits that:

640.1 there would not be a meaningful increase in Woolworths' ability to monitor prices at the Parties' grocery stores, as Woolworths already has this ability;[925] and

640.2 there would be no change in the risk that a third party would reduce the stability of a collusive equilibrium.[926]

Third party submissions

641. The Food and Grocery Council submits that the Proposed Merger could strengthen coordinated effects, reduce competition and lift retail prices.[927]

642. Ernie Newman submits the Proposed Merger would make tacit coordination between the Parties and Woolworths more efficient.[928]

Our view on whether the Proposed Merger would make coordination more likely, complete or sustainable

643. The Parties submit that there are many features of retail grocery markets that would not change as a result of the Proposed Merger, such as retail demand and competitive conditions.[929] While some aspects of the retail grocery market would likely remain unchanged, we consider the Proposed Merger changes conditions in the retail grocery market in a way that would make coordination more likely, more complete or more sustainable. We discuss this further below.

644. Ultimately, we consider the Proposed Merger would make it more likely that the Parties and Woolworths would reach at least a tacit agreement to coordinate on price (or other aspects of competition). This is because the Proposed Merger would remove a major grocery retailer (which currently Woolworths has to take into account when making its pricing decisions), increase barriers to entry for new or expanding grocery retailers, and increase range compliance. The Proposed Merger would potentially increase the symmetry between the remaining market participants. We also consider that the Proposed Merger would make any such tacit agreement more sustainable. Our view on whether the Proposed Merger would make coordination more likely, complete or sustainable is also informed by the evidence set out above in relation to the extent to which the retail grocery markets are vulnerable to coordination.

924 SoUI submission from the Parties (13 August 2024) at [187.6].
925 Houston Kemp report on SoI (26 April 2024) at [62].
926 Houston Kemp report on SoUI (13 August 2024) at [92].
927 SoI submission from the Food and Grocery Council (26 April 2024) at [5.3].
928 SoUI submission from Ernie Newman (12 August 2024).
929 SoUI submission from the Parties (13 August 2024) at [187.4].

645. Given we have reached the view that the evidence is mixed as to whether the Parties and Woolworths are currently coordinating, we do not need to reach a view as to whether the Proposed Merger would make any existing more coordination more complete.

Removal of a major grocery retailer

646. A horizontal merger can increase the likelihood of coordination as it removes a competitor, thereby reducing the complexity of reaching a sustainable tacit agreement. A key element of this is the reduction of the number of participants a competitor wishing to coordinate need to monitor and anticipate the likely response of. Given the highly concentrated nature of retail grocery markets we consider the Proposed Merger would change the competitive environment to a significant extent. The presence of fewer firms in retail grocery markets, together with increased centralisation of pricing, would make it easier for the merged entity and Woolworths to reach, monitor and sustain price coordination.

647. The Parties submit [ ].[930] However, FSNI suggests that [ ].[931] The merged entity would have ability to set its prices in such a way as to increase the likelihood of coordination. For example, the risk of price coordination would be particularly heightened if post-merger there was a move to more national pricing that would resemble the previous pricing practice of Woolworths. However, even without national pricing, with a single centralised price setter and removal of independent and potentially divergent pricing between the Parties in the North Island and the South Island, there is likely to be more price alignment between the North Island and South Island as a result of the Proposed Merger.

648. Houston Kemp submits there would not be a meaningful increase in Woolworths' ability to monitor retail prices at the Parties' grocery stores with the Proposed Merger, as Woolworths already has this ability.[932] However, we consider the impact of the Proposed Merger is that Woolworths would no longer need to reach an understanding on retail grocery prices (or [ ]) with both FSNI and FSSI but instead would only need to reach tacit agreement with a single merged entity. Woolworths would also no longer need to monitor both FSNI and FSSI (with each likely having divergent pricing) but instead only monitor the merged entity, reducing the costs and complexities associated with reaching a sustainable tacit agreement. We consider this would make it easier for the merged entity and Woolworths to align their retail pricing strategies, reach an understanding to coordinate on prices and punish any deviations from a tacit price coordination agreement. That FSSI and FSNI do not operate in the same retail markets does not change that Woolworths

930 SoI submission from the Parties (26 April 2024) at [184].
931 Commerce Commission interview with FSNI (31 May 2024).
932 Houston Kemp report on SoI (26 April 2024) at [62].

currently operates in both, and would need to coordinate with one party instead of two.[933]

649. The Parties submit there would be no change in the incentive to price nationally as a result of the Proposed Merger and that FSNI and FSSI are already capable of setting national retail prices. The Parties provided an example of [ ].[934] However, FSSI told us that [ ].[935] We consider that the Proposed Merger would make it easier for the merged entity to implement a national pricing strategy and align its retail pricing more closely with those of Woolworths.

<u>Changes in symmetry</u>

650. The Proposed Merger could increase symmetry between the Parties and Woolworths, making it easier to reach a sustainable coordination agreement. However, there is mixed evidence on the extent to which the Proposed Merger would increase symmetry between the Parties and Woolworths.

651. As a result of the Proposed Merger, the merged entity would have a national footprint, which is more similar to Woolworths. On the other hand, retail market shares may be more asymmetric post-merger. Woolworths told us that the Proposed Merger would make the retail grocery market more asymmetrical because the merged entity would be much larger than Woolworths.[936]

652. It is unclear whether the Proposed Merger would change cost symmetries between the Parties and Woolworths, and if so, to what extent. The Parties submit that the merged entity and Woolworths would not have similar size or cost structures.[937] We consider there is potential for the Proposed Merger to result in changes to the cost structures of the merged entity and Woolworths. For example, if the Proposed Merger increases the buyer power of the merged entity, then this may lower its costs compared to Woolworths and result in increased cost asymmetry between the merged entity and Woolworths. Woolworths [ ].[938] However, it is unclear to what extent any changes to buyer power of the merged entity would make costs more or less symmetric post-merger. Some suppliers indicated that they may need to match any price reductions given to the merged entity for other grocery retailers (see [509]). If so, the costs of the merged entity and Woolworths may be aligned.

933 We note that FSSI explained that, while they do not compete with FSNI in retail markets, [ ]. Commerce Commission interview with FSSI (5 June 2024)
934 RFI response from the Parties (13 June 2024) at [9].
935 Commerce Commission interview with FSSI (5 June 2024).
936 Commerce Commission interview with Woolworths (14 June 2024).
937 SoUI submission from the Parties (13 August 2024) at [187.6].
938 Commerce Commission interview with Woolworths (14 June 2024).

<u>Increase in range compliance</u>

653. The Proposed Merger may also increase greater range compliance among FSNI/FSSI stores. We have seen evidence of [ ].[939] Following the Proposed Merger [ ]. An increase in the similarity of products stocked by the merged entity across the country would make it easier for Woolworths to monitor prices and make coordination more likely or sustainable.

<u>Increase in barriers to entry</u>

654. A merger can increase the likelihood of coordination where it raises barriers to entry, thus stabilising coordination. The Parties submit that the Proposed Merger would not increase barriers to entry such that it would affect a potential disruptor from entering retail grocery markets.[940] However, as identified earlier, we consider that the Proposed Merger would likely raise barriers to entry in various ways for rival grocery retailers. If so, this may inhibit the ability of rival grocery retailers such as The Warehouse and Costco to disrupt and destabilise a tacit price coordination agreement. This would make coordination more likely and sustainable.

Wholesale supply of groceries

655. We considered the potential for the Proposed Merger to raise competition concerns in markets for the wholesale supply of groceries, in terms of both wholesale foodservice customers (eg, cafes, restaurants, fast food outlets, caterers) and wholesale retailer customers (eg, dairies, fuel stations, independent grocery stores and other retailers), and in terms of both commercial and regulated wholesale supply.

656. As noted earlier, as well as operating retail grocery stores, the Parties operate wholesale grocery businesses through which they supply grocery products to foodservice customers, route trade customers and other retailers. In this regard:

    656.1 FSNI operates Gilmours Wholesale Limited in the North Island;

    656.2 FSSI operates Trents Wholesale Limited in the South Island; and

    656.3 the Parties are also subject to legal obligations to provide wholesale grocery offerings to rival grocery retailers, as required by the GICA.

657. Post-merger, the wholesale offerings of FSNI and FSSI would consolidate within and under the management of a single national wholesale grocery entity. The merged entity would operate, and input into the pricing and competitive strategies for, all Gilmours and Trents outlets, including in terms of any national wholesale customers that may utilise Gilmours or Trents. The merged entity would also operate a single

939 For example, [ ].
940 SoI submission from the Parties (26 April 2024) at [183.2].

regulated wholesale business under the GICA, rather than separate FSNI and FSSI regulated wholesale businesses.

658. For the reasons discussed below, we are satisfied that the Proposed Merger is unlikely to substantially lessen competition in markets for the wholesale supply of groceries.

Market definition – wholesale grocery markets

659. The Parties submit that the effects of the Proposed Merger at the wholesale level can be analysed by reference to local, regional and national markets for the:[941]

659.1 commercial wholesale supply of grocery products; and

659.2 regulated wholesale supply of grocery products.

660. We have assessed the competitive effects of the Proposed Merger in terms of local, regional and national markets for the:

660.1 wholesale supply of groceries to foodservice customers; and

660.2 wholesale supply of groceries to retailer customers.

661. On the demand-side, foodservice customers and retailer customers tend to have different needs – for example, a foodservice customer that wants a bulk delivery of multiple 5kg cans of tomatoes is unlikely to substitute and buy the same quantity of canned tomatoes in smaller (400g quantities) that retailer customers demand. In addition, on the supply-side not all wholesalers supply both types of customers and some are more focused on supplying foodservice, and do not stock all the smaller pack size of items that retailer customers demand.

662. We have not reached a definitive view on the precise boundaries of wholesale markets.

Unilateral effects

663. The Parties submit that the Proposed Merger would not substantially lessen competition due to unilateral effects in the wholesale supply of groceries.[942] The Parties further submit that:

663.1 there is no existing competition between the Parties in any wholesale market;[943] and

663.2 a number of strong competitors would continue to provide a material constrain on the merged entity in wholesale markets.[944]

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941 The Application at [73].
942 The Application at 41 and 48.
943 The Application at [141]-[143] and [157].
944 The Application at [149.2] and [152].

664. We consider that the Proposed Merger is unlikely to substantially lessen competition unilateral effects in markets for the wholesale supply of groceries). This is because:

664.1 the Parties do not currently compete in any wholesale markets, and we are satisfied that there is not a real chance that they would do so absent the Proposed Merger;

664.2 [ ], which impacts on the extent of competition that might be lost with the Proposed Merger; and

664.3 in all local, regional and national wholesale foodservice markets, the merged entity would face competitive constraint from:

664.3.1 other wholesalers (including the market leader Bidfood), who have the ability to expand; and

664.3.2 foodservice customers (large and small) buying direct from grocery suppliers.

Coordinated effects

665. The Parties submit that the Proposed Merger would not substantially lessen competition due to coordinated effects in the wholesale supply of groceries.[945] The Parties further submit that wholesale markets are not conducive to coordination because:[946]

665.1 supply is of a large number and variety of differentiated products;

665.2 grocery wholesalers have little interaction with one another;

665.3 grocery wholesalers have little visibility over each other's terms of supply, with wholesale prices and volumes not being readily observable;

665.4 there is a variety of size and cost structure among grocery wholesalers; and

665.5 wholesale demand is likely to change over time as retail entrants emerge and develop.

666. We do not consider that wholesale grocery markets are vulnerable to coordination. The reasons why include that:

666.1 unlike in retail grocery markets, wholesale prices (and terms of supply) are not readily observable or transparent. Instead, they are bilaterally negotiated between wholesalers and foodservice customers;

945 The Application at [162].
946 The Application at [173] and [175].

666.2 the market includes a range of different types of grocery wholesalers, including specialist wholesalers, and wholesalers of varying size/scale and ownership structure (who likely have different cost structures);

666.3 foodservice customers operate under tight margins, so shop around between wholesalers constantly seeking the cheapest prices and therefore are likely to be aware of small increases in price (or attempts to coordinate on price); and

666.4 many foodservice customers purchase from multiple wholesalers and also direct from suppliers, which may disrupt any attempts by wholesalers to coordinate.

Overall conclusion

667. The preceding sections have considered the likely effects of the Proposed Merger. While it is necessary to examine each of the potential effects in turn, the ultimate question we are required to consider is whether we are satisfied that the acquisition would not have, or would not be likely to have, the effect of substantially lessening competition in any market.

668. For the reasons outlined above, we are not satisfied that the Proposed Merger would not have, or would not be likely to have, the effect of substantially lessening competition in multiple acquisition and retail grocery markets in New Zealand.

Determination on notice of clearance

669. We are not satisfied that the Proposed Merger will not have, or would not be likely to have, the effect of substantially lessening competition in multiple acquisition and retail grocery markets in New Zealand.

670. Under section 66(3)(b) of the Commerce Act 1986, the Commerce Commission determines to decline to give clearance to Foodstuffs North Island Limited and Foodstuffs South Island Limited to merge into a single national grocery entity, together with potentially also the existing Foodstuffs (N.Z.) Limited.

Dated this 30th day of September 2024

Dr John Small

Chair