

EXECUTIVE SUMMARY

This is an application by Woolworths Limited (**Woolworths**) an Australian company listed on the Australian Stock Exchange, or any interconnected body corporate of Woolworths, seeking clearance to acquire up to 100% of the shares in or assets of The Warehouse Group Limited (**WHS**) and/or of any interconnected body corporate of WHS (the **Acquisition**).

The Acquisition will not substantially lessen competition in any New Zealand market.

Rationale for the Acquisition – Entry into the general merchandise market

In New Zealand, Woolworths owns Progressive Enterprises Limited (**Progressive**) which, through its subsidiaries, operates supermarkets under the Woolworths, Foodtown and Countdown brands. It also owns Dick Smith Electronics (**DSE**), a consumer electronics retailer and currently owns approximately 10% of WHS through Woolworths' wholly owned subsidiary Bancroft Limited. In Australia, Woolworths principally operates food, liquor and grocery (operating under Woolworths and Safeway brands), dedicated liquor stores (operating under the Dan Murphy and BWS brands), consumer electronics (operating under the Dick Smith Electronics, PowerHouse and Tandy brands) and general merchandise (operating under the Big W brand¹).

Woolworths sees WHS as an entry point into general merchandise in New Zealand. An Acquisition would see the WHS business operated by Woolworths in parallel with its Australian, Big W, brand and as a complement to its existing New Zealand food, liquor and grocery and consumer electronics businesses. Woolworths has for some time identified the acquisition of WHS as the most efficient, timely and sustainable means of entering general merchandise in New Zealand.

Rationale for the application for clearance – minor food, liquor and grocery market impacts

Woolworths is not a participant in general merchandise in New Zealand (absent an acquisition). Accordingly, the Acquisition has no impact on general merchandise

¹ For further detail on the Big W concept see www.bigw.com.au

competition, where the overwhelming majority of WHS's sales occur and in which WHS has a market share of approximately 45% of the "department store sales" and 10% of total "retail sales".²

WHS has announced a limited roll out of a small grocery and fresh food supermarket business – 15 combined general merchandise and supermarket facilities to be developed over five years and trading under the name "The Warehouse Extra". Currently, there are two The Warehouse Extra stores situated at Sylvia Park in Auckland and at Whangarei. The Acquisition will, therefore, result in some aggregation of market share in the retail and wholesale food, liquor and grocery markets. Accordingly, Woolworths has considered it appropriate to seek Clearance for the Acquisition in respect of the relevant food, liquor and grocery markets.

However, the extent of the aggregation is minor and the new business will provide limited competition with Woolworths' supermarket business. Currently, with two The Warehouse Extra stores, WHS's share of supermarket stores is less than 1% (2 of 321 "supermarkets"). To put the size of the *proposed* WHS food, liquor and grocery business into perspective, the 15 Warehouse Extra stores to be developed over the next five years must be compared with an existing 150 Woolworths supermarkets and 169 Foodstuffs supermarkets operating today – not to mention additional stores Woolworths and Foodstuffs are likely to open over the same five year period.

In any event, share of stores does not reflect share of sales. Foodstuffs, in its recent application to the Commission has estimated WHS's likely share of sales revenue at the end of five years *conservatively* at 2.78%. Woolworths agrees with Foodstuffs that WHS's likely share of sales would be far below its share of stores.

The fundamental reason for this is that food, liquor and grocery retailing is driven by scale – very low margins mean that a supermarket operator's ability to effectively compete at the retail level is driven by its ability to source product at the wholesale level on prices and on terms equal to or better than its competitors. The majority of suppliers respond to volume, which creates a perpetual cycle: the lower the wholesale price, the lower the retail price; the lower the retail price, the higher the

² See Foodstuffs application for clearance at footnote 1.

volume sold; the higher the volume sold, the lower the wholesale price. WHS will have much lower volume than either of Woolworths or Foodstuffs – it is presumably for this reason, WHS executives have stated publicly that they do not intend to compete aggressively on price – resulting in likely higher prices and lower sales per store.

It is against this alternative scenario (the Counterfactual) that the Acquisition falls to be assessed under competition law principles.

Affected food, liquor and grocery markets

While the Commission has previously analysed retail food, liquor and grocery mergers between supermarket groupings based on local markets, in this case, true competition in both retail and wholesale food, liquor and grocery markets is driven by the national decisions of Woolworths and Foodstuffs. As a result, the competitive impacts are invariably the same throughout New Zealand. Woolworths considers the Acquisition is best analysed at both the retail and wholesale levels on a national basis, particularly given the critical role wholesale share plays in determining a retailer's competitive impact.

Furthermore, as the WHS food, liquor and grocery roll-out has not for the most part yet come into existence, there is no available data to reliably or usefully model likely competitive impacts in local markets. The effects of the Acquisition are best analysed by examining national trends.

Why no substantial lessening of competition will result from the Acquisition

The Acquisition will result in only minor aggregation. Furthermore, both of the relevant food, liquor and grocery markets, retail and wholesale, are characterised by intense competition between Woolworths and Foodstuffs, a trend that has been continuous since 2002 when Progressive Enterprises acquired Woolworths New Zealand (**Woolworths NZ**) (the **2002 Acquisition**). This intensity of competition between the two supermarket groups has taken a marked step up since the acquisition of Progressive by Woolworths (Australia) in 2005. There is no doubt that the intensity in competition will continue into the foreseeable future.

No lessening of competition has resulted from Progressive acquiring Woolworths NZ

When considering the competitive implications of the 2002 Acquisition, the Commerce Commission concluded Progressive would continue to be constrained from unilaterally increasing prices post-acquisition by the presence of Foodstuffs. It modelled likely price increases of less than 1-2%, well within acceptable levels in competition law terms. However, the Commission was concerned the reduction in the number of supermarket operators from three (Progressive, Woolworths NZ and Foodstuffs) to two (Progressive and Foodstuffs) might increase the likelihood of tacit collusion occurring. Ultimately, Progressive was allowed to complete the acquisition of Woolworths NZ making it possible to now analyse the Commission's concerns in the light of the actual impacts of that merger over a lengthy period – in economic terms a “natural experiment” can be carried out.

Analysis of competition in the market since 2002 indicates:

- (i) There is no evidence that retail food, liquor and grocery prices have increased as a result of the 2002 Acquisition, and certainly not at the level of 1-2% modelled by the Commission at that time. In fact, analysis of data for the period from before 2002 up to the present indicates that average real food, liquor and grocery prices have generally decreased.
- (ii) There is no evidence Woolworths (or Progressive) and Foodstuffs have engaged in any form of collusive behaviour, indeed the opposite is the case. Competition between the two supermarket groups has intensified over the whole of the period as evidenced by, for example:
 - (A) Woolworths reducing its cost of doing business and passing on those savings to its customers and Foodstuffs immediately lowering its prices further.
 - (B) Woolworths' introduction of New Zealand's first national systematic fuel discount scheme. Woolworths has operated a similar scheme in Australia for many years, although neither Progressive nor Foodstuffs had followed this model, although some individual Foodstuffs store owners had implemented ad hoc schemes in response to Woolworths'

acquisition of Progressive. However, when Woolworths launched its national scheme on 26 October 2006, Foodstuffs immediately responded announcing a similar national scheme later that day.

- (C) The introduction by Woolworths of its “Onecard” in 2003 in response to Foodstuffs’ membership of Flybuys.
- (D) The continued broadening of product offerings via Foodstuffs’ Duffy & Finn Liquor store roll-out in response to rumoured roll-out of Woolworths’ Dan Murphy liquor chain.
- (E) Progressive’s introduction of Home Brand milk at an “everyday low price” across all stores at a new low price point of \$2.47 for 2 litres for blue/light blue and green top. Previously 2 litre milk had retailed at between \$2.79 to \$3.20, depending on brand and location.

Accordingly, the “natural experiment” provided by analysis of the effects of the 2002 Acquisition evidences that the nature of competition in New Zealand between Woolworths and Foodstuffs is of itself sufficient to ensure strongly competitive outcomes. The presence of a third participant has no incremental impact, particularly one with such a limited offering as that announced by WHS.

Acquisition will enhance competitive tension between Woolworths and Foodstuffs

The Acquisition will enhance retail competition by allowing Woolworths to reduce the wholesale advantage Foodstuffs currently enjoys. Foodstuffs already controls upwards of an estimated **[CONFIDENTIAL]**% of the organised wholesale market in New Zealand, which translates into a significant cost advantage over Woolworths which has only **[CONFIDENTIAL]**% of that market.

Prior to its acquisition by Woolworths, Progressive had struggled to match Foodstuffs’ competitive offerings given its wholesale disadvantages. Since it acquired Progressive, Woolworths has to some extent been able to mitigate its wholesale disadvantage by gaining some trans-Tasman buying benefits in respect of a sub-set of products supplied on both sides of the Tasman. As originally envisaged when Woolworths acquired Progressive, all the buying benefits achieved by Progressive to date are being passed on to New Zealand consumers as reduced

prices. In addition, Woolworths has introduced a number of other significant competitive initiatives, for example, fuel discounts.

Foodstuffs have responded quickly to these price changes and service innovations reflecting the continuing intense competition between the two supermarket groups. This level of competition will continue post-acquisition of WHS.

Acquisition of WHS by Woolworths will create a strong point of entry into the New Zealand general merchandising market in which Woolworths has a real and demonstrable interest. In respect of the limited food, liquor and grocery side of the WHS business the acquisition of WHS by Woolworths will take Woolworths' organised wholesale market share from **[CONFIDENTIAL]**% to around **[CONFIDENTIAL]**% and by increasing Woolworths' ability to compete with Foodstuffs can be seen as pro-competitive.

An alternative counterfactual

By comparison, if Foodstuffs is cleared to acquire WHS, then Foodstuffs will be approved to increase an already dominant wholesale presence, and in Woolworths' estimate (assuming roll-out of 15 The Warehouse Extra stores), the acquisition of WHS will give Foodstuffs control over at least **[CONFIDENTIAL]**% of New Zealand's wholesale food, liquor and grocery categories.

However, Foodstuffs would be likely to use the acquisition of WHS to substantially increase its retail and therefore wholesale presence far beyond that estimate. In its recent application for clearance to acquire WHS, Foodstuffs noted at paragraph 4.13 that it would look to "develop the supermarket business of the Warehouse and develop new approaches to retailing together grocery and general merchandise". In Woolworths' view the true motivation for an acquisition of WHS by Foodstuffs is to generate an unassailable position of wholesale food, liquor and grocery market control. Woolworths' internal analysis suggests that if Foodstuffs did expand The Warehouse Extra concept beyond 15 stores as discussed above, it could take its control of the New Zealand wholesale market to an even greater level.

Woolworths believes Foodstuffs have no true commitment to general merchandising. Foodstuffs' application is a clear demonstration of an intention to cannibalise the WHS sites in order to grow its food, liquor and grocery business and

therefore its already dominant wholesale market share at the expense of the WHS general merchandise segment – a poor outcome for the New Zealand public given the resulting reduction in competition for general merchandise and the increased market power Foodstuffs would enjoy.

COMMERCE ACT 1986: BUSINESS ACQUISITION

SECTION 66: NOTICE SEEKING CLEARANCE

Date: 17 January 2007

The Registrar

Market Structure Team

Commerce Commission

PO Box 2351

WELLINGTON

Pursuant to s66(1) of the Commerce Act 1986 notice is hereby given seeking **clearance** of a proposed business acquisition.

PART I: TRANSACTION DETAILS

1. What is the business acquisition for which clearance is sought?

2. Woolworths Limited (**Woolworths**), an Australian company listed on the Australian Stock Exchange (**ASX**), or any interconnected body corporate of Woolworths, seeks clearance to acquire up to 100% of the shares in or assets of The Warehouse Group Limited (**WHS**) and/or of any interconnected body corporate of WHS (the **Acquisition**).

The Person Giving Notice

2. Who is the person giving this notice?

3. This notice is given by Woolworths.
4. Woolworths requests that all correspondence is directed in the first instance to:

Bell Gully
48 Shortland Street, Auckland
Telephone: 09 916 8800
Facsimile: 09 916 8801
Attention: Phil Taylor/Torrin Crowther
Email: phil.taylor@bellgully.com / torrin.crowther@bellgully.com

Confidentiality

3. Do you wish to request a confidentiality order for:

3.1 The fact of the proposed acquisition

5. No.

3.2 Specific information contained in or attached to the notice?

6. Yes. Confidentiality is sought for information contained in bold square brackets in this application (i.e., []).

7. The information that has been deleted is commercially sensitive and valuable information that is confidential to Woolworths. Disclosure of that information could result in material financial loss and prejudice to the competitive position of Woolworths. In this respect, Woolworths relies on section 9(2)(b) of the Official Information Act 1982. The foregoing applies equally in respect of all additional information (expressed to be confidential) that Woolworths might provide to the Commission.

Details of the Participants

4. Who are the participants (i.e. the parties involved)?

8. The participants are Woolworths and WHS:

Woolworths	1 Woolworths Way Bella Vista NSW 2153 Australia Attention: Peter Horton General Counsel and Company Secretary
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WHS	The Warehouse Limited Level 8 Westpac Tower 120 Albert Street Auckland Attention: Company Secretary
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5. Who is interconnected to or associated with each participant?

5.1 Acquirer group/associates

9. Woolworths is an Australian company which is listed on the ASX. Its head office is in Sydney. In Australia, Woolworths operates Woolworths and Safeway Supermarkets, Big W, Dan Murphy's, BWS (Beer Wine Spirits), Dick Smith Electronics, PowerHouse, Tandy, Woolworths and Safeway Petrol,

Woolworths/Caltex co-branded fuel outlets, Woolworths HomeShop, Woolworths Financial Services, ALH hotels.

10. In 2005 Woolworths acquired Progressive Enterprises Limited (**Progressive**) (a New Zealand registered company) from Foodland Associates Limited. Progressive operates the Foodtown, Woolworths and Countdown supermarket banner groups in New Zealand. It sells a wide range of branded products, as well as the “Home Brand”, “Signature Range” and “Basics” controlled label brands. Progressive is also the franchise coordinator for the FreshChoice and SuperValue banner groups. Progressive operates 150 “supermarkets”, excluding SuperValue and FreshChoice, consisting of:

- 63 Woolworths stores;
- 30 Foodtown stores; and
- 57 Countdown stores.

11. Progressive through its wholly owned subsidiary Wholesale Distributors Ltd is the food, liquor and grocery wholesale supplier and co-ordinator of the Fresh Choice and SuperValue franchise banner group supermarkets, and supplies 14 Fresh Choice and 34 SuperValue supermarkets. These franchise operations are predominantly in the South Island.

5.2 Target company group/associates

5.2.1 Identify all subsidiaries of the target company and all companies in which the target company or any subsidiary owns 10% or more of the shares

12. WHS is a New Zealand incorporated company owned 51% by its founder, Stephen Tindall, interests associated with Stephen Tindall and the Tindall Foundation. It is listed on the New Zealand Stock Exchange (**NZSX**).

13. WHS owns and operates 85 “The Warehouse” stores (including 2 The Warehouse Extra stores) and 43 Warehouse Stationery stores located across New Zealand. It is New Zealand’s largest general merchandise retailer. A

diagram showing the structure of WHS is annexed to this Application as **Confidential Annexure B.**³

5.2.2 If any company owns over 10% of the shares in the “target company”, and will continue to do so after the proposed acquisition, then identify all of the interconnected bodies corporate of that company and all companies in which it or its interconnected bodies corporate own over 10% of the shares.

14. If the Acquisition proceeds by way of share purchase, it is unclear whether any company other than Woolworths would own more than 10% of the shares in WHS post-Acquisition.
15. If the Acquisition proceeds by way of asset purchase, Woolworths would be the legal and beneficial owner of any assets purchased.

6. Does any participant, or any interconnected body corporate thereof, already have a beneficial interest in, or is it beneficially entitled to, any shares or other pecuniary interest in another participant?

16. Woolworths currently owns approximately 10% of the issued share capital of WHS via Woolworths' wholly owned subsidiary Bancroft Limited.

7. Identify any links, formal or informal, between any participant/s including interconnected bodies corporate and other persons identified at paragraph 5 and its/their existing competitors in each market.

17. There are no such links.

³ This structure diagram has been compiled based on the records held by the Registrar of Companies at Auckland and not from information provided by WHS. To the extent such records are incomplete or inaccurate, the structure diagram will be incomplete and inaccurate.

8. Do any directors of the ‘acquirer’ also hold directorships in any other companies which are involved in the markets in which the target company/business operates?

18. For completeness, Woolworths notes Roderick Deane, a director of Woolworths, is also on the Board of Fletcher Building Limited, although there is very little overlap between the products and customer bases of Woolworths and Fletcher Building.

9. What are the business activities of each participant?

19. See response to Question 5 above.

10. What are the reasons for the proposal and the intentions in respect of the acquired or merged business?

20. While Woolworths is an active participant in general merchandise in Australia, it is not (DSE notwithstanding) a participant in general merchandise in New Zealand. Progressive sells a limited range of general merchandise products in convenience categories in its supermarkets. Those categories are generally of such a nature that most consumers would consider them to be part of their normal grocery shopping (e.g., batteries, light bulbs and buckets). Acquiring WHS will provide an effective, timely and sustainable point of entry for Woolworths into New Zealand general merchandise. Woolworths considers that the Acquisition will allow it to:

- (a) reduce WHS’s general merchandise unit costs by allowing Woolworths to jointly procure general merchandise products for both the Australian and New Zealand markets (including via reduced shipping costs) – consumers will benefit via reduced prices resulting from lower unit costs;
- (b) expand WHS’s general merchandise product range bringing certain Big W products into WHS stores;
- (c) selectively consider opportunities to change usage of certain stores into other formats, including supermarket combinations to assist in competing even more effectively with Foodstuffs; and

- (d) seek out New Zealand suppliers and encourage greater participation from them both in WHS and in Woolworths' Australian formats.
21. Woolworths intends to continue with "The Warehouse" brand and continue with WHS's current customer commitment – "Where Everyone Gets a Bargain" – which fits comfortably with its own Big W customer commitment – "We Sell for Less".
22. However, WHS's recent adaptation of two of its stores to The Warehouse Extra offering fresh food and grocery, means that the Acquisition will result in some minor aggregation in the retail food, liquor and grocery market. Like Foodstuffs, Woolworths considers WHS will not be able to establish a sustainably competitive food, liquor and grocery offering due to its limited wholesale presence and buying ability as outlined below. Food, liquor and grocery retail is a scale business. A supermarket operator's ability to compete effectively at the retail level is driven by its ability to source food, liquor and grocery and fresh products at prices that are equivalent to or below those of its competitors. Accordingly, the interaction between an operator's retail and wholesale operations is of vital importance. In this regard:
- (a) Foodstuffs is the largest participant at both the retail and the wholesale levels of the New Zealand food, liquor and grocery market. Foodstuffs' retail pre-eminence is driven by its scale at the wholesale level where it controls upwards of an estimated **[CONFIDENTIAL]**% of the organised New Zealand wholesale market. (Its wholesale share exceeds its retail share because Foodstuffs also acquires goods from suppliers for resale via its wholesaling operations (e.g. to corner dairies, oil companies and via Cash 'n Carry operations)).
- (b) Foodstuffs' wholesale scale advantage is evidenced by the pricing advantage it enjoys over Progressive supermarkets. Pak 'N Save is typically the lowest price supermarket banner, due to its cost advantages, principally arising from scale.
- (c) The importance of scale can be seen in the declining market shares of Progressive and Woolworths NZ *vis a vis* Foodstuffs prior to the 2002 Acquisition.

- (i) Progressive's retail food, liquor and grocery market share **[CONFIDENTIAL]** over the period from August 1998 to August 2002; and
- (ii) Woolworths NZ's retail food, liquor and grocery share **[CONFIDENTIAL]** over the same period.

Progressive has managed to consolidate its market share at or around 2002 levels since the 2002 Acquisition, although it has not been able to increase that share.

- (d) Were Foodstuffs to acquire WHS and expand the The Warehouse Extra food, liquor and grocery concept as it has stated in its application it intends to do,⁴ Woolworths estimates that Foodstuffs would dominate at least **[CONFIDENTIAL]**% of the total New Zealand wholesale market, and potentially a lot more.
23. Woolworths has created a more aggressive competitive environment in the market since its acquisition of Progressive. Key examples of this include significant price reductions, and the introduction of a national fuel discounting scheme.
24. Foodstuffs currently maintains a pricing advantage over Progressive **[CONFIDENTIAL]** (on a national basis across all brands). This indicates that Foodstuffs is able to utilise its scale advantage and local market dominance to achieve a lower cost structure.
25. Progressive has gained buying benefits by harmonising trans-Tasman buying arrangements with Woolworths, and is passing all of those benefits back to customers in the form of lower prices. **[CONFIDENTIAL**

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The savings will be fully invested in an attempt to reduce the price gap with Foodstuffs, however whether or not this is successful will depend on the

⁴ See paragraphs 4.13 and 6.5 of Foodstuffs application for clearance to acquire WHS.

competitive response of Foodstuffs which will continue to utilise its scale advantage and local market dominance.

26. Woolworths in Australia has for many years operated a national fuel discounting scheme. As speculated, in October 2006 Woolworths introduced a similar scheme offering discounted petrol to all New Zealanders. Foodstuffs had never previously offered customers a national scheme, but was forced to respond to the Woolworths offer.

PART II: IDENTIFICATION OF MARKETS AFFECTED

Horizontal Aggregation

11. Are there any markets in which there would be an aggregation of business activities as a result of the proposed acquisition?

27. The Acquisition will result in some minor aggregation in the wholesale and retail food, liquor and grocery markets. The Commission's most recent decisions relating to the affected markets were in 2001 and related to the 2002 Acquisition (**Decision 438** and **Decision 448**). In both Decisions, the Commission defined the affected markets as:

(a) The market for the retailing of food, liquor and grocery items in supermarkets, incorporating regional markets of not less than 5 km in radius. Nevertheless, the Commission recognised that in many regions the geographic market will be wider than 5km. Accordingly, in each area where the 2002 Acquisition resulted in high levels of concentration, the Commission considered whether there were features that justified defining a wider market. In certain instances (e.g., Nelson), it concluded the market was wider.

(b) The national market for the wholesale supply of groceries.

Supermarket food, liquor and grocery retailing

Product markets

28. Woolworths considers that adopting a narrow supermarket market definition is too conservative. Competition for the retail sale of food, liquor and grocery products occurs across a spectrum of formats, including supermarkets, convenience and specialty stores. While these formats have different characteristics, they are ultimately seeking to meet the same consumer demand, eliminating any perceived distinctions in retail formats.

29. While different retailers may adopt a different retail format, each competes to gain the greatest share of sales available to it at the prices it determines

appropriate for its business. Each retailer is seeking to increase its share of sales by competing for the “next” or marginal customer in the absence of an ability to easily price discriminate. Competition for customers takes place across a spectrum of relevant competitive factors including price, quality, service, range and convenience. No retailer (including Woolworths) can ignore any relevant competitive factor.

30. Major participants in this segment in addition to supermarkets include (for example): The Mad Butcher (36 stores throughout New Zealand, with a number opening recently⁵), Bakers Delight and Brumbies Bakeries, (35 and 23 stores respectively), Fruit World (19 stores), and various seafood shops (e.g., Sea Mart) as well as independent retailers such as Moore Wilsons Fresh⁶ in the Wellington region, and Nosh in Auckland. Nosh, which opened in 2006, describes itself as “a one-stop gourmet food market designed to become a daily destination” and is indicative of the new trend towards upmarket “market” place type stores. On its website it sets out the rationale for its existence:

The New Zealand appetite has changed.

It's broader, it's bigger, and it's certainly better.

It's because we have changed. Our standards, our ideals, our demands for new and authentic experiences. Our generation has seen a resurgence of traditional values. We insist on exploring, we're happy to experiment, our natural curiosity and growing confidence fed by an overwhelming infusion of new tastes. In other words, we're a lot fussier than we used to be.

Now we have 'worldwide appetites'. And that's why Nosh is bringing the very best of local and international foods right to your doorstep. It's unlike any other retail environment in the country.

Nosh is a unique collection of many of New Zealand's best food merchants and artisans, all under one roof. And they don't just have the goods on their shelves - they also have knowledge between their ears and a passion in their hearts. And they want to share it. They want you to experience the same discoveries that have made their lives such a joy. In their world, food is fun. And there's plenty of it, at Nosh.⁷

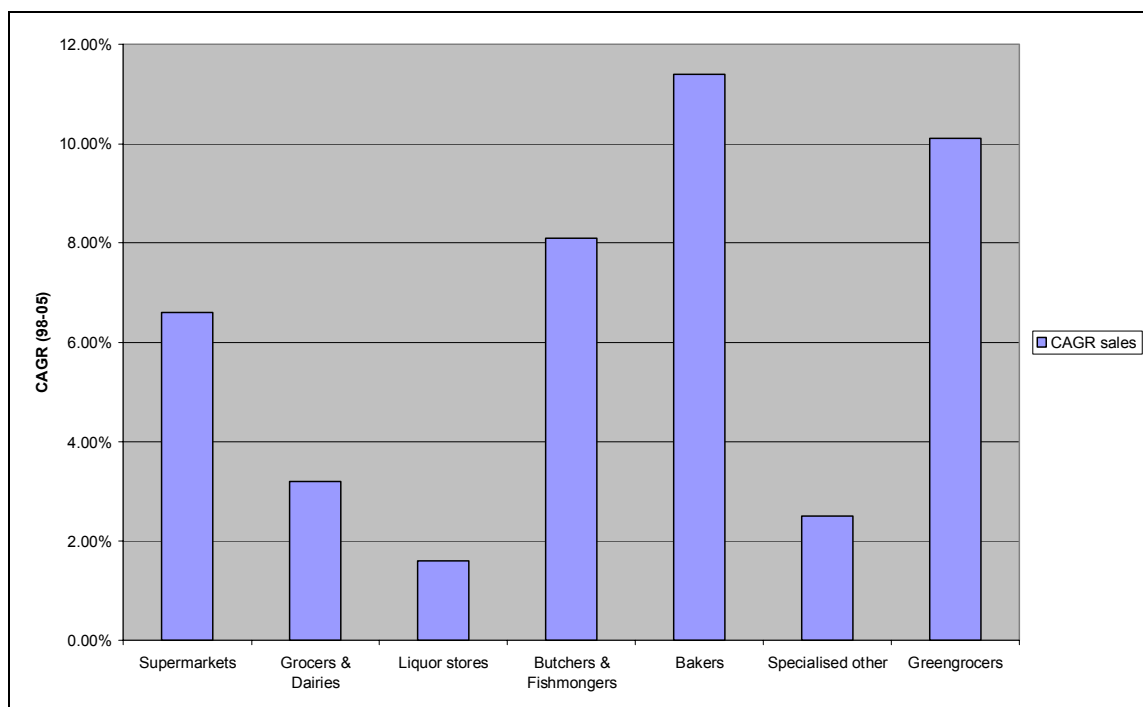
⁵ See www.themadbutcher.co.nz for locations.

⁶ Moore Wilsons offers a wide variety of fresh food and produce including meats, breads and seafood in addition to bulk grocery items. See www.moorewilsons.co.nz for more details.

⁷ See www.noshgourmet.com

31. To illustrate the importance of these retailers, Woolworths estimates *fresh food* (i.e. meat, seafood, produce and bakery) sales in New Zealand amount to NZ\$3.5b per year, with non-supermarkets accounting for approximately 37% of those sales.
32. Furthermore, this segment continues to grow rapidly. Figure 1 illustrates the strong turnover growth enjoyed by specialist retailers over the period from 1998 until 2005, with butchers and fishmongers' turnover growing by 8.1%, greengrocers' turnover growing by 10.1% and bakeries' turnover growing by 11.4%.

Figure 1: Turnover CAGR (1998-2005) by store type⁸



33. In its previous decisions, the Commission concluded that while nominally, the basket of goods purchased from a supermarket could be substituted with a basket of goods acquired from a number of other outlets, the transaction cost associated with acquiring goods from a number of sources meant buyers were

⁸ Based on data presented by Coriolis "New Zealand Retail Market Overview", July 2006.

unlikely to regard “the other outlets collectively as a substitute to a supermarket”.⁹

34. In Australia, the two key customer demand driven trends in fresh food and grocery retailing that have emerged over the past 15 years are an increase in customers making more frequent, lower value purchases on each visit to a retailer to meet their short term needs for food, liquor and groceries and an increase in the number of retail formats customers shop across (cross-shopping trend).
35. In New Zealand, over one third of all meat, produce, seafood and bakery retail purchases are made from non-supermarket retailers. This suggests a material volume of consumers *do* consider specialist stores as a real and viable substitute for supermarkets such as to render any attempt to impose an anti-competitive price increase unprofitable.
36. Accordingly, while some consumers might choose to acquire products from supermarkets, specialist retailers do impose, collectively, a material constraint on supermarkets and that constraint will continue post-Acquisition.
37. In any event, even if the Commission determines that the bundle of goods sold in supermarkets is a discrete product grouping, it is bound to have regard to the constraints provided by specialist retailers notwithstanding they might fall outside the Commission’s defined market. In New Zealand the position is as stated by the High Court in *Brambles v Commerce Commission* ((2003) 10 TCLR 868) at paragraph 137:

“It is important to recognise that market definition is a tool for competition analysis rather than an end in itself. A decision to define the market by reference to crates only can provide an appropriate basis for analysis of the competition issues which need to be decided, but defining the market in that way should not lead to any under-estimation of the potential substitutability and level of constraint on market participants in that narrowly defined market, from cardboard packaging both pre-merger and post-merger”.

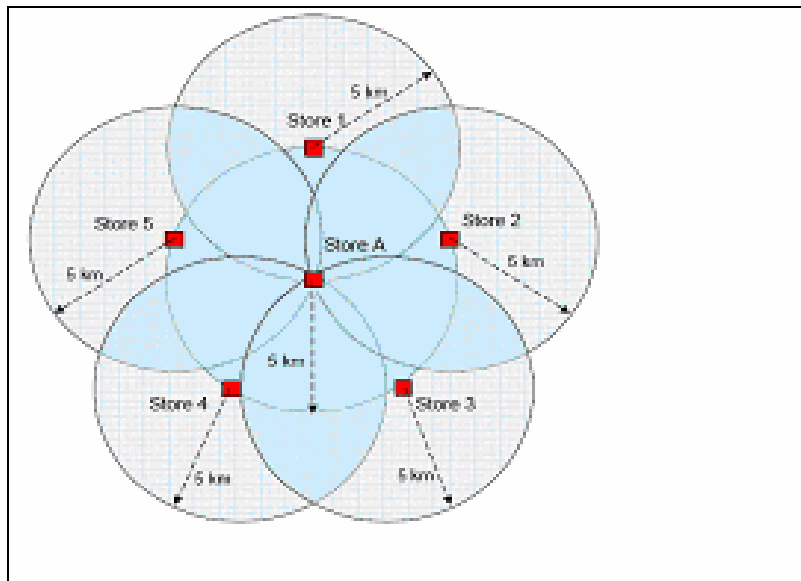
⁹ Decision 448, paragraph 66.

38. Notwithstanding Woolworths' views (and reserving to Woolworths the right to continue to argue for a broader market definition), Woolworths considers the scope of the product market is not a determinative factor in the analysis and has, accordingly, used the Commission's previous product market definition in this application. However, consistent with the Commission's own practice and the High Court's decision in *Brambles*, the material constraints imposed by specialist retailers must be factored into the competition analysis.

Geography

39. While the Commission has previously examined local geographic markets, in this case true competition in both retail and wholesale food, liquor and grocery markets is driven by the national decisions of Woolworths and Foodstuffs. Furthermore, as the WHS grocery roll-out has not for the most part yet come into existence, there is no available data to reliably or usefully model likely competitive impacts in local markets.
40. As a result, the competitive impacts are invariably the same throughout New Zealand and therefore, in Woolworths' view, the Acquisition falls to be properly analysed at both the retail and wholesale levels on a national basis. It is only by this means that the impacts of the Acquisition can be properly tested.
41. However, *even if* the Commission determined to examine local markets, Woolworths considers each local market would be broader than the 5km starting point previously used by the Commission. Supermarkets themselves are spatially differentiated – that is, not every supermarket creates the same circle of constraint. The result being that in many locations there is a chain of overlapping supermarkets creating a wider market than one purely focussed on discrete local areas as illustrated in Figure 2 below.

Figure 2: Geographic market overlap



42. This chain of substitution was accepted by the Commission in Decisions 438 and 448 and has also been accepted by the Commission in other contexts (both in respect of product markets¹⁰ and geographic markets¹¹). Woolworths considers a more appropriate local market definition would be to define markets based on large regions where there is no material break in the chain of substitution. On that basis, by way of example, there might be a market in the greater Auckland region and a market in the greater Wellington region.
43. Again, geographically, highway accessibility and rural distances will affect the distance that consumers will travel to a supermarket. Time to destination in rural and smaller urban and outlying centres will impact consumer travel decisions and need to be taken into account when considering the extent of local markets.
44. Nevertheless, again Woolworths does not consider the size of the relevant market is a determinative factor in this case and, accordingly, while reserving its position to argue for a broader market, has used the Commission's 5km starting point as a commencing threshold for local analysis in this application for clearance.

¹⁰ See Decision 482 (Cendant/Budget) for example.

¹¹ See Decision 273 (Weddel New Zealand Limited) for example.

Wholesale market

45. For the purposes of this application for clearance, Woolworths has adopted the Commission's previous definition of the national market for the wholesale supply of groceries.

Differentiated Product Markets

- 12. Please indicate whether the products in each market identified in question 11 are standardised (buyers make their purchases largely on the basis of price) or differentiated (buyers make their purchases largely on the basis of product characteristics as well as price).**
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46. Supermarket offerings are differentiated but not to such a degree as to warrant separate market definitions.
47. The supermarket banner groups are positioned along a price-service spectrum. While there is demarcation between offerings (i.e., Pak 'N Save and Countdown at the lower price/lower service end of the spectrum) there are no barriers to individual supermarkets adjusting pricing to create or negate a competitors' competitive advantage. For example, in Masterton Progressive reacted to Pak 'N Save's entry by reducing prices at its competing Woolworths outlet in order to retain sales lost to the lower priced Pak 'N Save (there is no Countdown in Masterton). This reaction indicates the ability of supermarkets to quickly move along the price-service spectrum in reaction to competitive pressures.

13. For differentiated product markets

13.1 Please indicate the principal characteristics of products that cause them to be differentiated one from another.

48. Competition for customers takes place across a spectrum of relevant competitive factors including price, quality, service, range and convenience.

13.2 To what extent does product differentiation lead firms to tailor and market their products to particular buyer groups or market niches?

49. See response to Question 12.

13.3 Of the various products in the market, which are close substitutes for the products of the proposed combined entity and which are more distant substitutes?

50. Countdown and Pak 'N Save compete most closely at the lower price/lower service end of the spectrum. New World and Foodtown and Woolworths compete more closely at the fuller service end of the spectrum. However, all supermarkets compete with each other across the spectrum as a full service supermarket will lose customers to a discount supermarket if it seeks to charge a margin which does not reflect the value of the additional service it provides.

13.4 Given the level of product differentiation, to what extent do you consider that the merged entity would be constrained in its actions by the presence of other suppliers in the affected market(s)?

51. Woolworths will continue to be constrained by all Foodstuffs supermarkets, including both Pak 'N Save and New World.

Vertical Integration

14. Will the proposal result in vertical integration between firms involved at different functional levels?

52. No.

15. In respect of each market identified in questions 11 and/or 14 identify briefly:

15.1 All proposed acquisitions of assets of a business or shares involving either participant (or any interconnected body corporate thereof) notified to the Commission in the last three years.

53. In 2005 Woolworths acquired Progressive from Foodland Associates Limited.

15.2 Any other acquisition of assets of a business or shares which either participant (or any interconnected body corporate) has undertaken in the last three years.

54. Woolworths is unaware of any acquisitions by WHS in the last 3 years.

55. There have been no such acquisitions by Woolworths or Progressive in the last 3 years apart from:

- Woolworths' acquisition of 100% of Progressive; and
- Woolworths' acquisition of (now) approximately 10% of WHS.

PART III: CONSTRAINTS ON MARKET POWER BY EXISTING COMPETITION

Existing Competitors

16. In the market or markets, who are the suppliers of competing products, including imports?

Market share summary

56. At the retail level, the most accurate measure of supermarket market share is AC Neilson and Aztec data which illustrates that in today's market, Woolworths' *share of sales* in major supermarket chains is approximately 44%, with Foodstuffs' *share of supermarket sales* in major supermarket chains being approximately 56%.

57. However, the AC Neilson/Aztec data excludes wholesale sales made to the non-supermarket sector – these non-supermarket sales account for approximately 31% of all wholesale sales. Accordingly, Foodstuffs' 56% *share of sales* in major supermarket chains materially understates its true market power. Woolworths estimates around [CONFIDENTIAL]% of Foodstuffs' business is its wholesale business (i.e., Gilmours, Toops and Trents). The result being that Foodstuffs' share of the organised wholesale market is approximately [CONFIDENTIAL]%, meaning Foodstuffs acquires over twice the volume of product in New Zealand than Woolworths does – Woolworths' share is estimated at [CONFIDENTIAL]%..

58. More information is annexed as **Confidential Annexure A**.

Retail market

WHS is a general merchandise retailer

59. Fundamentally, WHS is a general merchandise retailer and has been since its establishment in 1982. It operates 85 The Warehouse stores throughout New Zealand. The Acquisition will not result in any aggregation in respect of

general merchandise markets where Woolworths is not a participant or likely participant in general merchandise in New Zealand, other than by an acquisition.

60. Accordingly, the Acquisition provides Woolworths with an entry point into the New Zealand general merchandise market. An acquisition by Woolworths would result in substantial complementary benefits between Woolworths' Big W stores in Australia and WHS's business in New Zealand. These complementary benefits would flow on to benefit Progressive and WHS in respect of their food, liquor and grocery offerings and allow Woolworths to slightly expand its wholesale presence enabling it to compete more effectively with Foodstuffs at that functional level.
61. No such synergies would be achieved following a Foodstuffs' acquisition. Indeed, it is difficult to see what complementary benefits Foodstuffs would obtain from acquiring WHS other than preventing Woolworths from improving its wholesale position, thereby maintaining Foodstuffs' position in the relevant New Zealand markets or even increasing Foodstuffs' dominant position as a food, liquor and grocery retailer by growing its wholesale business to a point where other competitors are likely to be marginalised.

Retail market is already very competitive

62. Competition between Foodstuffs and Woolworths in the retail food, liquor and grocery market is intense as evidenced by the competitive activity described in paragraph 90 below, the fact that average real food, liquor and grocery prices have generally fallen since the 2002 Acquisition and by the fact there have been no material changes in gross margins since 2002. The Acquisition will not reduce the intensity of competition between Woolworths and Foodstuffs. If anything, competition will intensify as a result of the Acquisition as Woolworths will achieve additional wholesale scale bringing its scale closer to that currently possessed by Foodstuffs and will, therefore, allow Woolworths to compete more effectively with Foodstuffs (particularly, if the counterfactual is Foodstuffs acquiring WHS).

Minor aggregation – no local monopolies

63. The Acquisition will result in very minor aggregation.
64. Currently, there are two The Warehouse Extra stores – at Sylvia Park in Auckland and at Whangarei. WHS has announced a limited roll out of a small grocery and fresh food supermarket business – 15 combined general merchandise and supermarket facilities to be developed over five years trading under the name “The Warehouse Extra”.
65. Taking a conservative approach, Woolworths has assumed for the purposes of this clearance application that WHS will succeed in rolling out 15 The Warehouse Extra stores over the next five years in the counterfactual as it has publicly indicated. For the avoidance of doubt that is 13 stores in addition to the two stores already opened at Sylvia Park and Whangarei.

Local aggregation

66. While Woolworths does not know which sites WHS will ultimately utilise to roll-out these stores, it does not expect the Acquisition will result in a local monopoly. In every case where expansion might be feasible, there is already strong existing competition between the incumbents. Accordingly, for convenience, the remainder of this application focuses on describing the local retail markets affecting Sylvia Park and Whangarei (where the two current The Warehouse Extra stores are located) as well as broader market trends, which Woolworths considers are replicated throughout other New Zealand local markets.
67. The Acquisition will result in little local aggregation based on WHS having The Warehouse Extra stores in Whangarei and Sylvia Park.
- (a) In Whangarei, there is a competing Pak ‘N Save and a competing New World.
- (b) In Sylvia Park, there are two competing Pak ‘N Save supermarkets at Sylvia Park and Botany Downs, and two competing New World supermarkets at Panmure and Botany.

National retail trends and aggregation

68. As discussed earlier, the impact of the 13 additional The Warehouse Extra stores falls to be properly analysed based on national market trends.
69. It is difficult to predict what market share WHS might obtain during the next five year period. Currently, with two The Warehouse Extra stores, WHS *share of supermarket stores* is less than 1% (2 of 321 “supermarkets”). To put the size of the *proposed* WHS grocery business into perspective, the 15 Warehouse Extra stores to be developed over the next five years must be compared with an existing 150 Woolworths supermarkets and 169 Foodstuffs supermarkets operating today – not to mention additional stores Woolworths and Foodstuffs are likely to roll-out. Even if successful in rolling out 15 The Warehouse Extra stores, WHS would operate less than 5% of the supermarkets in New Zealand (15 of 334 supermarkets) and less if Woolworths or Foodstuffs open further supermarkets.
70. In any event, *share of stores* does not reflect *share of retail sales*. Foodstuffs, in its recent application to the Commission, have “conservatively” estimated WHS’s likely *share of supermarket sales* at the end of five years at 2.78%. Woolworths agrees with Foodstuffs that WHS’s likely *share of supermarket sales* would be far below its *share of supermarkets*.
71. The fundamental reason for this is that food, liquor and grocery retailing is driven by scale – very low margins mean that a supermarket operator’s ability to compete effectively at the retail level is driven by its ability to source product at the wholesale level on prices and on terms that are equal to or better than its competitors. The majority of suppliers respond to volume, which creates a perpetual cycle: the lower the wholesale price, the lower the retail price; the lower the retail price, the higher the volume sold; the higher the volume sold, the lower the wholesale price. WHS will have much lower volume than Woolworths and Foodstuffs – it is presumably for this reason, WHS executives have stated publicly that they do not intend to compete aggressively on price – resulting in likely higher prices and lower sales per store.

72. Evidence of this can be seen in the fact that while Woolworths *share of supermarket stores* is 47%, its *share of sales* in major supermarket chains based on AC Nielsen surveys is 43.7% (national twelve months ending 24 December 2006 (moving annual total)) down from 44.9% last year. Conversely, Foodstuffs' *share of stores* is 53% while its *share of sales* in major supermarket chains is 56.3% up from 55.1% last year.¹²
73. While market shares (whether measured by store numbers or share of sales) are a useful proxy, in themselves market shares and market share aggregation do not determine whether a substantial lessening of competition is likely to occur. Given the strong existing competition between Woolworths and Foodstuffs, arguments over WHS's likely market share in the counterfactual are likely to detract from the key competitive dynamics of the market. Accordingly, for the purposes of this Application for clearance, Woolworths has for convenience proceeded on the basis that WHS's likely market share would be no greater than its *share of stores* and, for reasons outlined in this application, its actual *share of sales* in major supermarket chains is likely to be much lower.

No material retail price impacts

74. The Acquisition would not result in material price increases compared to the counterfactual.

Commission's previous price modelling

75. In Decision 448, the Commission modelled the price increases likely to arise following the 2002 Acquisition. At that time, Woolworths NZ held a market share of approximately **[CONFIDENTIAL]**, far in excess of any share WHS is likely to secure even if all 15 The Warehouse Extra stores are successfully rolled-out. The Commission's modelling predicted maximum price increases of 1-2% even in markets where the highest levels of aggregation were said to arise.
76. The two key inputs into the Commission's price model were:

¹² www.foodstuffs.co.nz.

- (a) the size of the gross margin (assumed to be 4%), measured as the difference between price and incremental cost; and
- (b) the diversion ratios between the merging brands (i.e., the degree of substitutability between the brands).

77. **[CONFIDENTIAL]**]
For the year to 31 July 2003, the first full year after the 2002 Acquisition, Progressive's EBITA margin was **[CONFIDENTIAL]**%, and it has remained around that level since: **[CONFIDENTIAL]**

.]

- 78. Furthermore, there is no reason to treat the diversion ratio between The Warehouse Extra and Progressive as materially different to the diversion ratio used previously as between Progressive and Woolworths NZ.
- 79. Accordingly, one would expect predicted maximum price increases following the Acquisition to be *even less* than the 1-2% predicted in 2001, which the Commission considered did not give rise to a substantial lessening of competition in the relevant markets.

Evidence of actual price changes since 2001

80. There is no evidence of prices increasing since 2001. Woolworths analysis suggests that average real prices have decreased since 2001. As noted previously, Progressive has passed on to consumers all the buying benefits it has achieved since Woolworths acquired Progressive in 2005 to consumers in reduced prices **[CONFIDENTIAL]**

]

WHS's entry would not materially decrease prices

81. There is no evidence to suggest that WHS's expansion into the retail food, liquor and grocery market will result in a dichotomy change in pricing. The

analysis above suggests prices have remained at competitive levels since 2001.

82. Pak 'N Save is typically the lowest price supermarket banner, due to its cost advantages principally arising from its scale and due to Foodstuffs' wholesale power. The following table illustrates the pricing relativity.

[Confidential Table]

83. Woolworths has been working to address the price relativity as between Progressive and Foodstuffs. **[CONFIDENTIAL**

]

84. In fact as discussed above, Woolworths now expects those cost savings to be as high as approximately NZ\$**[CONFIDENTIAL**], all of which it has determined to continue to apply to reducing prices. Woolworths' incentives to compete in this way will in no way be lowered as a result of the Acquisition, particularly given Foodstuffs' major advantage with respect to wholesale prices.

85. Furthermore, WHS has stated publicly that it does not intend to beat the current operators on price. The Herald on Sunday reported in June 2006 prior to The Warehouse Extra opening at Sylvia Park:

“The Warehouse format manager Michael Pook, who is project managing the new stores was coy on the prices of The Warehouse Extra's supermarket goods, but said the retailer would not be trying to beat supermarket chains on price, although it would be very competitive”.¹³

86. Woolworths is not surprised by this comment. WHS's pricing strategy in the longer term will depend on its ability to obtain cost-competitive supply at the

¹³ Herald on Sunday *The Warehouse - where everyone is getting more than they bargained for*, 4 June 2006.

wholesale level. National *supermarket sales share* (and hence volume) is a key determining factor in securing competitive supply terms. This point is acknowledged by Foodstuffs in its application for clearance¹⁴ and is the key reason why Woolworths is currently unable to close the retail price advantage held by Foodstuffs. The importance of sales scale in achieving buying discounts/rebates was recognised by the Commission in Decision 448. The Commission commented:

Size is also necessary to achieve “buying clout” with suppliers. This meant that effective entry is only likely to be viable on a large scale.¹⁵

87. Indeed, as discussed above in response to Question 10 a key driver of Progressive’s and Woolworths NZ’s declining retail sales shares prior to the 2002 Acquisition was their lack of volume compared to the much larger Foodstuffs group.

88. Nevertheless, Woolworths is aware of the perception that supermarket prices in Sylvia Park stores are low relative to prices in the remainder of Auckland. That perception is driven by a comparison of Foodtown prices at Sylvia Park compared to other Foodtown outlets around Auckland. This comparison is incorrect because the Sylvia Park Foodtown supermarket is effectively operating as if it were a Countdown, meaning that the more appropriate price comparison is between the Sylvia Park Foodtown and other Countdown supermarkets. This is driven to a certain degree as a result of:

- (a) the simultaneous opening of *three* supermarkets at Sylvia Park; and
- (b) the much lower than projected foot traffic into Sylvia Park,

which means the three supermarkets (including Foodtown) are competing for the same number of customers that would typically be serviced by a single supermarket.

¹⁴ Insert reference.

¹⁵ Decision 448, paragraph 235.

89. Moreover, available anecdotal evidence suggests WHS's entry has had little discernible effect on the pricing behaviour of the incumbent banner groups. For example:

(a) In relation to The Warehouse Extra pricing at Sylvia Park, Coriolis note in its Quarter 2 2006 Chart Watch:

The pricing, while not the cheapest you would find in the New Zealand market, was broadly in line with that of the average mid-market supermarket.¹⁶

(b) A pricing survey relating to Sylvia Park conducted by The Aucklander newspaper concluded:

Overall Pak 'N Save was the cheapest place to shop in this suburb – 15 per cent less expensive than the most expensive supermarket in this survey, Foodtown. The Warehouse Extra was close though, and Countdown held its ground as a competing discounter.¹⁷

Evidence of current service competition

90. Notwithstanding its modelling in Decision 448 indicating very low price impacts, the Commission also considered the potential for a loss of service competition. No such loss of service competition can be said to result from the Acquisition. Woolworths and Foodstuffs already aggressively compete on service and the Acquisition will not change this dynamic or the incentives for both banner groups to innovate. Evidence of this competition can be seen in the following:

(a) Fuel Discounts: On 26 October 2006, Woolworths announced that any customer spending \$40 or more shopping at any Woolworths, Foodtown or Countdown supermarket will receive a voucher for four cents per litre off fuel purchases, redeemable at any of 250 participating Shell and Gull service stations throughout the country. Woolworths has successfully applied this competitive model in Australia for some time. Neither Foodstuffs nor Progressive (prior to its acquisition by Woolworths) had

¹⁶ Coriolis Research *Chart Watch Q2 2006 Part 2*, page 3.

¹⁷ The Aucklander *Apples with Apples*, 22 November 2006.

commenced a similar national programme, although various local *ad hoc* schemes had been periodically trialled. Woolworths was the first to offer a national fuel discount scheme in New Zealand. As soon as Woolworths announced its scheme, Foodstuffs immediately responded, announcing that it was finalising a similar national scheme.

- (b) Loyalty programmes: Woolworths operates its “Onecard” (launched in 2003)¹⁸ and Foodstuffs is a member of the Fly Buy rewards programme. Both of these programmes reflect added cost to encourage consumer loyalty, which would be unlikely to occur in the presence of tacit collusion.
- (c) Broadened product offering: For example, Foodstuff’s Duffy & Finn Liquor store roll-out in response to the rumoured entry of Woolworths’ Dan Murphy liquor chain, and in-store pharmacies such as Progressive’s *Your Pharmacy*.¹⁹
- (d) Self check out pilot by Foodstuffs South Island at the Moorhouse Ave Pak ‘N Save store in Christchurch, which Woolworths understands has now been extended to Wellington.
- (e) Woolworths/Foodtown online shopping site: For the 12 months to 31 December 2005, Woolworths.co.nz was New Zealand’s most popular grocery and alcohol web-site according to the annual Hitwise Online Performance Awards. Foodstuffs re-launched its website in February 2005.
- (f) Ongoing drive to improve speed to market (supply chain focus): Woolworths is making ongoing investigations to improve its supply chain efficiencies to reduce cost and improve its speed to market.

¹⁸ More information is available at http://www.progressive.co.nz/food_for_thought/ftww_faq/index.asp

¹⁹ http://www.PEL.co.nz/news_and_publications

- (g) Food, liquor and grocery magazine innovations: For example, The Foodtown Magazine which offers recipes and focuses on food, wine, travel, home and garden, health and other lifestyle issues.

Competition from other speciality retailers

- 91. In addition to the constraint provided by Foodstuffs, Woolworths will continue to face constraints from speciality retailers as discussed in response to Question 11.
- 92. Grocery and fresh food sales to customers occur across a spectrum of formats. This is because the nature of overall customer demand has led to differentiation between firms competing to meet this demand. The result has been a dynamic and broad spectrum of retail formats including supermarket, convenience and specialty stores. While these formats have different characteristics they are ultimately seeking to meet the same consumer demand.
- 93. Woolworths considers the trends in Australia of:
 - (a) an increase in customers making more frequent, lower value purchases in each visit to a retailer to meet their short term needs for fresh food and grocery; and
 - (b) an increase in the number of retail formats customers shop across,are equally prevalent in New Zealand.

Wholesale Market

- 94. In Decision 448 the Commission said the acquisition by Progressive of Woolworths NZ would not give rise to a substantial lessening of competition in the wholesale market, for the reasons set out in the table below. Market conditions have not changed since 2002 and therefore the factors underpinning the Commission's conclusion in Decision 448 apply with equal force to the Acquisition.

Factor noted by the Commission in Decision 448 – Basis for conclusion	Current market conditions	Impact of the Acquisition
Combined wholesale market share of [CONFIDENTIAL]%	Woolworths estimates its wholesale supermarkets and food, liquor and grocery organised wholesale market share at [CONFIDENTIAL]%	Small aggregation at the wholesale level even if WHS successfully rolls-out 15 The Warehouse Extra Stores
Progressive will continue to face competition from the three Foodstuffs co-operatives.	Three Foodstuffs cooperatives still compete strongly in this market. Together, Woolworths estimates the three Foodstuffs cooperatives upwards of an estimated [CONFIDENTIAL]% share.	No change.
Although supermarkets are a very important distribution channel, they are not the only one	No change	No change
<p>The market would not appear to be one that would facilitate coordinated power; because:</p> <ul style="list-style-type: none"> ▪ prices are not transparent; ▪ sales are not as small and frequent as for the retail market; ▪ there is some vertical integration; ▪ for many goods there exist “fringe” 	<p>No change</p> <p>No change</p> <p>No change</p> <p>No change</p>	<p>No change</p> <p>No change</p> <p>No change</p> <p>No change</p>

Factor noted by the Commission in Decision 448 – Basis for conclusion	Current market conditions	Impact of the Acquisition
competitors prepared to purchase goods <ul style="list-style-type: none"> ▪ the four firms in the market will be of different size. 	No change in today's market	No change

95. There is a further reason why the Commission should be comfortable with a Woolworth's acquisition of WHS and that is the dominant presence of Foodstuffs in the Wholesale Market.
96. Foodstuffs' share at the wholesale level is even greater than its retail market share (and Woolworths' share correspondingly lower). This is because Foodstuffs also acquires goods from suppliers for resale via its wholesaling operations (e.g. to corner dairies, oil companies and via Cash 'n Carry operations).
97. Woolworths believes Foodstuffs' share of the organised wholesale market is approximately **[CONFIDENTIAL]**%. (While the three Foodstuffs co-ops may technically acquire independently, the retail prices offered by Foodstuffs (and hence the wholesale prices it must be securing) suggest that its collective size is a key determinant in the price negotiated with suppliers). That the three Foodstuffs organisations operate in concert seems well evidenced by the format of their application for clearance to acquire WHS, and that the application is certified correct by the Managing Director of one co-operative on behalf of all three.
98. If Foodstuffs acquired WHS, its wholesale share would increase further still particularly considering its statement in its Application for Clearance that it intends to grow WHS's food, liquor and grocery operations. Assuming that Foodstuffs' incremental organised wholesale share increase was around 2%, that would lead to a estimated share of **[CONFIDENTIAL]**%, with Woolworths reducing to around **[CONFIDENTIAL]**%. To the contrary, if Woolworths

acquired WHS, then Foodstuffs' share could be expected to reduce to around [CONFIDENTIAL]% - which is still extremely high, but somewhat less than [CONFIDENTIAL]% (or greater).

99. While Woolworths has extracted some savings from negotiations with trans-Tasman suppliers following its acquisition of Progressive, those savings have been passed back to consumers in the form of lower prices, and Woolworths will pass on [CONFIDENTIAL] in price reductions. Notwithstanding this, Foodstuffs have invariably matched, and in many cases bettered, Woolworths' price reductions. This suggests that Foodstuffs – despite the unsubstantiated allegations in the Foodstuffs' Application for Clearance to the contrary – is able to leverage its size/market share to extract better terms from suppliers.
100. If Woolworths acquired WHS, it would be able to compete better with Foodstuffs at the retail level, because it could reduce the pricing disadvantage it currently faces at the wholesale level. The *supermarket sales share* loss of the smaller Woolworths NZ and Progressive in the years prior to the 2002 Acquisition emphasise the importance of wholesale market share in terms of remaining competitive at the retail level.

17. Conditions of expansion and entry

101. The conditions of expansion via construction of new stores in local markets are obtaining access to suitable sites and obtaining resource consents. The Commission previously regarded such entry as not satisfying its *LET* test.
102. However, while obtaining sites and consents might impose a condition on entry, Woolworths considers that expansion in the form of constructing a new supermarket could occur within the three year timeframe used by the High Court in *Commerce Commission v NZ Bus Limited* (Unreported, High Court Wellington CIV 2006-485-585 29 June 2006).
103. Indeed expansion by both Woolworths and Foodstuffs continues – in the last 12 months Foodstuffs have opened:

- New World stores in Mount Maunganui (and at the same time announcing Tauranga's second Pak 'N Save will be built at Papamoa), Rotorua, Tauranga, Wanganui and Kaikohe;
- a New World Metro store at the Wellington Railway Station; and
- Pak 'N Save stores at Sylvia Park, Lower Hutt, Wainoni (Christchurch), and Hawera .

104. Similarly, Woolworths in the last 12 months has opened:

- a Foodtown supermarket at Sylvia Park; and
- a Woolworths supermarket in Hamilton.

18 Please name any business which already supplies the market - including overseas firms - which you consider could increase supply of the product concerned in the geographic market by any of the following means:

- **diverting production into the market (e.g., from exports)**
 - **increasing utilisation of existing capacity**
 - **expansion of existing capacity.**
-

105. All three Foodstuffs co-operatives could relatively quickly expand supply. There is no constraint on supermarkets increasing the number of customers serviced. A new supermarket can be built or expanded in approximately 12 months depending on the extent of any resource consent issues.

19. Of the conditions of expansion listed above, which do you consider would influence the business decision in each case to increase supply?

106. Both access to available sites and the ability to obtain appropriate environment and land use consents would equally influence any decision to expand in the market.

20. How long would you expect it to take for supply to increase in each case?

107. See response to Question 18.

21. In your opinion, to what extent would the possible competitive response of existing suppliers constrain the merged entity?

108. It is important that a snap-shot view of competition is not taken as this could potentially create a misleading impression of market dynamics. The continuing dynamic whereby supermarkets seek to achieve competitive advantages provides a continued and continual constraint. This dynamic and resulting constraint will continue post-Acquisition.

22. Looked at overall, and bearing in mind the increase in market concentration that would be brought about by the acquisition, to what extent do you consider that the merged entity would be constrained in its actions by the conduct of existing competitors in the markets affected?

109. The level and intensity of competition in the factual and the counterfactual will not change. WHS's entry via The Warehouse Extra roll-out will not create a new type of constraint or result in prices being systematically and sustainably lower than they would be if the Acquisition proceeded.

Coordinated Market Power

23. Identify the various characteristics of the market that, post-acquisition, you consider would either facilitate or impede coordination effects.

110. To determine whether any acquisition is likely to facilitate tacit collusion it is necessary to identify whether tacit collusion is currently occurring in the market and, if it is not, to what extent the relevant acquisition will undermine or remove those factors that are currently preventing tacit collusion. The retail

food, liquor and grocery markets do not currently exhibit any signs of tacit collusion.

111. This has been the case since the 2002 Acquisition and prior to the recent entry of the two The Warehouse Extra stores. Accordingly, the Acquisition cannot be plausibly said to make tacit collusion any more likely to occur and cannot, therefore, be said to substantially lessen competition.

112. In Decision 448, the Commission declined clearance for Progressive to acquire Woolworths NZ on the basis the acquisition was likely to materially enhance the potential for coordinated market power by reducing the number of market participants from three to two.

113. The Commission's analysis in that case was necessarily theoretical – the Commission had to *predict* the impact of a reduction in supermarket chains from three to two. However, because the merger proceeded anyway, pursuant to an earlier clearance, it provides a *natural experiment* from which to observe the *actual* impact. Events since the Commission's decision indicate that the Commission's concerns were unfounded.

114. As noted above:

- (a) Food, liquor and grocery prices have not increased as a result of the 2002 Acquisition – indeed they have generally decreased in real terms;
- (b) There have been no material increases in margins since the 2002 Acquisition;
- (c) Under Woolworths' ownership, Progressive is competing even more aggressively with Foodstuffs on price. For example:
 - Progressive has introduced Home Brand milk at an “everyday low price” across all stores at a new low price point of \$2.47 for 2 litres for blue/light blue and green top. Previously 2 litre milk had retailed at between \$2.79 to \$3.20, depending on brand and location;
 - There have been general catalogue price reductions;

- Progressive is increasingly using loss leaders, such as Weetbix to encourage foot traffic;
 - Progressive has undertaken a significant shift in branding of its supermarkets toward the discount end of the spectrum;
 - Progressive and Foodstuffs are constantly checking each others' prices. Woolworths considers leading advertised prices have fallen to levels not seen in the last 10 years;
- (d) Foodstuffs have responded to these initiatives and further dropped its prices;
- (e) There continues to be strong service competition and innovation; and
- (f) There is no evidence of tacit collusion, the reverse is the case.

24. Identify the various characteristics of the market that, post-acquisition, you consider would facilitate or impede the monitoring and enforcement of coordinated behaviour by market participants.

115. The Acquisition will have no impact on Woolworths' and Foodstuffs' ability to monitor and enforce coordinated behaviour (which in any event does not exist).
116. In Decision 448, the Commission said supermarkets appear to reduce the complexities of surveying prices on thousands of SKUs to a single index, which – the Commission said – enabled them to compare the relative prices among stores and tended to indicate comparisons between different stores were possible. It concluded prices are “sufficiently transparent to enable monitoring to take place”.
117. Woolworths and Foodstuffs engage in active price monitoring of each other. This will continue in the factual and the addition of The Warehouse Extra on a limited scale (i.e. only 15 The Warehouse Extra stores) is unlikely to make price monitoring significantly more complex. However, as noted above, there is no evidence that this level of monitoring has led to tacit collusion in any form.

25. Indicate whether the markets identified in paragraph 9 above show any evidence of price coordination, price matching or price following by market participants.

118. The markets show no evidence of price matching other than the sort of price matching that one would expect to see in an intensely competitive market. Prices are driven by market forces not by any tacit collusion between Woolworths and Foodstuffs. There is no evidence of *anti-competitive* price leader/follower activity.

26. Please state the reasons why, in your opinion, the transaction will not increase the risk of coordinated behaviour in the relevant market(s).

119. Notwithstanding the Commission's previously expressed concerns, actual evidence shows that the reduction in competing supermarket banners from 3 to 2 resulting from the 2002 Acquisition has not led to tacit collusion – indeed competition has intensified.

PART IV: CONSTRAINTS ON MARKET POWER BY POTENTIAL COMPETITION

120. Aldi is rumoured to be considering entering the New Zealand market. Aldi is an international food, liquor and grocery retailer with a network of more than 5,000 stores throughout Europe, the USA and Australia. Aldi entered the Australian market in January 2001 and now operates around 140 stores in Victoria, Queensland, ACT and New South Wales.
121. In Woolworths' view, Aldi would not seek to enter the New Zealand market via acquisition of WHS. Such an acquisition would not fit Aldi's strategy which is to focus on smaller stores. This has been Aldi's approach in Australia.
122. As a global organisation, Woolworths expects Aldi to be able to compete extremely effectively with both Foodstuffs and Woolworths notwithstanding its initial smaller New Zealand scale.
123. Due to the similar requirements of new *de novo* entry and expansion by an existing operator, the responses to Questions 19 – 22 above are equally applicable to entry by Aldi.

PART V: OTHER POTENTIAL CONSTRAINTS

124. Woolworths is not claiming constraint on it in retail food, liquor and grocery markets by suppliers or acquirers other than the ability for retail consumers to "vote with their feet" given the non-existence of switching costs faced by a consumer purchasing groceries.

THIS NOTICE is given by:

Woolworths Limited

The company hereby confirms that:

- * all information specified by the Commission has been supplied;
- * all information known to the applicant/s which is relevant to the consideration of this application/notice has been supplied;
- * all information supplied is correct as at the date of this application/notice.

The company undertakes to advise the Commission immediately of any material change in circumstances relating to the application/notice.

Dated this 17th day of January 2007.

Chief Executive Officer

I am an officer of the company and am duly authorised to make this application/notice.

Confidential Annexure A:

Confidential Annexure B

(1 share)