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**Public version**

# Statement of Unresolved Issues

## Proposed merger of Foodstuffs North Island and Foodstuffs South Island

**Date:** 16 July 2024

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## Introduction

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, together with potentially also the existing Foodstuffs (N.Z.) Limited (FSNZ) entity (the Proposed Merger).[1]

2. To clear an application, we must be satisfied that the Proposed Merger will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

3. Since registering the Application from the Parties, we have published:

   3.1 a Statement of Preliminary Issues (SoPI) setting out the issues that we considered important at the start of our investigation in deciding whether or not to grant clearance;[2] and

   3.2 a Statement of Issues (SoI) setting out the potential competition issues that we had identified following our initial investigation.[3]

4. The SoPI and SoI also provided background information about the Parties as well as the industry in which they operate. These documents are available on our website, along with public versions of the submissions we received following publication of the SoPI and SoI.

5. This Statement of Unresolved Issues (SoUI) sets out the competition issues on which we are not satisfied and that we therefore continue to test. This is to give all parties an opportunity to provide us with additional information.

6. In reaching the views set out in this SoUI, we have considered all information provided to us before and after we published the SoI. We have not yet made any final decisions on the issues outlined below (or any other issues) and our views may change, and new competition concerns may arise, as our investigation continues.

7. We invite submissions on this SoUI and any other competitive effects of the Proposed Merger. We request that parties who wish to make a submission do so by **12 August 2024**.

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1 A public version of the Application is available on our website at: https://comcom.govt.nz/case-register. 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.

2 The SoPI dated 18 January 2024 is available at: https://comcom.govt.nz/__data/assets/pdf_file/0020/340823/FSNI-FSSI-Statement-of-Preliminary-Issues-18-January-2024.pdf.

3 The SoI dated 4 April 2024 is available at: https://comcom.govt.nz/__data/assets/pdf_file/0037/348859/FSNI-and-FSSI-Statement-of-Issues-4-April-2024.pdf.

## The concerns we continue to test

8. On the basis of the information collected to date, we are currently not satisfied that the Proposed Merger will not have, or would not be likely to have, the effect of substantially lessening competition in a New Zealand market.

9. The Proposed Merger would give rise to a significant structural change in the grocery sector. While we are still investigating and have made no final decisions, we:

   9.1 continue to have concerns that the Proposed Merger would substantially lessen competition due to unilateral effects in relevant upstream markets for the acquisition of groceries; and

   9.2 are currently not satisfied that the Proposed Merger would not be likely to substantially lessen competition due to coordinated effects in a national market for the retail supply of groceries.

10. In relation to potential unilateral effects in relevant upstream markets for the acquisition of groceries, our unresolved concerns with respect to the Proposed Merger are primarily that:

    10.1 the Parties and Woolworths New Zealand Limited (Woolworths) are the largest buyers of grocery products in New Zealand and a key route to market for many suppliers;

    10.2 the structural change with the Proposed Merger would reduce the number of major grocery retailers competing to acquire groceries from three to two;

    10.3 the loss of competition as a result of the Proposed Merger would remove an important option for many suppliers and create the largest acquirer of groceries in New Zealand. Many suppliers would sell most of their output to just two remaining customers (the merged entity and Woolworths) rather than the existing three major grocery retailers;[4]

    10.4 we are not satisfied that the loss of existing competition between the Parties would not result in a substantial lessening of competition in relevant upstream markets for the acquisition of grocery products, through an increase in the merged entity's buyer power. This could allow the merged entity to extract lower prices from some suppliers, "cherry pick" the most favourable terms, disadvantaging some suppliers and/or otherwise get more favourable trading terms from some suppliers. It may result in some suppliers that are currently only supplying either FSNI or FSSI exiting the market if the merged entity elects not to stock their product(s);

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[4] The Parties disagree with the conception of a reduction of three to two major customers in acquisition markets, and emphasise the other options available to suppliers, but the major grocery retailers account for such a large proportion of groceries supplied in New Zealand, that it is unlikely national suppliers could substitute supply from major grocery retailers to other channels, particularly in dry/ambient, chilled and frozen product markets, as discussed later.

10.5 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 could impact the pace and development of new product innovation, resulting in reduced consumer choice and quality of grocery products;

10.6 we are not satisfied that competition from the remaining competing buyers in relevant upstream acquisition markets is likely to be sufficient to constrain the merged entity from exercising buyer power;

10.7 we are not satisfied that grocery suppliers would have sufficient countervailing power to constrain the merged entity from exercising buyer power in relevant upstream acquisition markets; and

10.8 based on the evidence before us, we are not satisfied that entry or expansion by rival grocery retailers is likely to occur in a timely manner, and at sufficient scale, to significantly constrain the merged entity from exercising buyer power in relevant upstream acquisition markets.

11. In relation to potential coordinated effects, we continue to investigate whether the Proposed Merger would make coordination nationally between the merged entity and Woolworths more likely, complete or sustainable.

12. The Grocery Industry Competition Act (GICA) was passed in 2023 in response to a market study the Commission conducted into the retail grocery sector (for which it released its final report in March 2022),[5] introducing new regulations and giving the Commission new powers to monitor and report on competition and efficiency in the grocery sector for the long-term benefit of retail consumers. The Commission is hopeful that the GICA will in the long-term, make improvements in the grocery sector which improve outcomes for New Zealanders. However, the new regulations are designed to address some of the competition issues brought about by the existing high levels of concentration in the grocery sector. They are not intended to, and would not, mitigate the structural loss of competition in relevant upstream and retail grocery markets that would result from the Proposed Merger.

13. We discuss these outstanding concerns/issues in more detail below.

## Process and timeline

14. We have agreed with the Parties to extend the period in which to decide whether to clear or decline the Application until **1 October 2024**. However, this date may change as our investigation progresses.[6]

5 https://comcom.govt.nz/__data/assets/pdf_file/0024/278403/Market-Study-into-the-retail-grocery-sector-Final-report-8-March-2022.pdf.

6 The Commission maintains a clearance register on our website at https://comcom.govt.nz/case-register where we update any changes to our deadlines and provide relevant documents.

15. We would like to receive submissions and supporting evidence from the Parties and other interested parties on the issues raised in this SoUI. We request submissions be provided by close of business on **12 August 2024**, including a public version of any submission.

16. All submissions received will be published on our website with appropriate redactions.[7] All parties will have the opportunity to cross-submit on the public versions of submissions from other parties by close of business on **23 August 2024.**

17. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with us at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible. We note however that in order to ensure the timeliness of our process, where submissions are provided after each of these submission dates, we may need to consider what weight we put on those submissions.

## The Parties

18. FSNI is owned by 332[8] co-operative members all based in the North Island and FSSI is owned by 198[9] members all based in the South Island. The members of FSNI and FSSI operate individual retail and wholesale grocery stores.

19. FSNI members operate under the following retail grocery brands:[10]

    19.1 New World;

    19.2 PAK'nSAVE; and

    19.3 Four Square.

20. FSSI members operate under the following retail grocery brands:[11]

    20.1 New World;

    20.2 PAK'nSAVE;

    20.3 Four Square;

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7 Confidential information must be clearly marked (by highlighting the information and enclosing it in square brackets). Submitters must also provide a public version of their submission with confidential material redacted. At the same time, a schedule must be provided which sets out each of the pieces of information over which confidentiality is claimed and the reasons why the information is confidential (preferably with reference to the Official Information Act 1982).

8 45 PAK'nSAVE, 108 New World, 172 Four Square and 7 Gilmours wholesale members.

9 12 PAK'nSAVE, 43 New World, 60 Four Square, 72 On The Spot, 5 Raeward Fresh and 6 Trents wholesale members. As noted in the Application at footnote 12, FSSI also has a number of additional non-branded members, although we understand that
[
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10 The Application at [25].

11 The Application at [32].

20.4 Raeward Fresh; and

20.5 On the Spot.

21. 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:

21.1 FSNI operates Gilmours Wholesale Limited in the North Island;[12] and

21.2 FSSI operates Trents Wholesale Limited in the South Island.[13]

22. The Parties are also subject to legal obligations to provide wholesale grocery offerings to rival grocery retailers, as required by the GICA.[14]

23. 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).[15] Despite the interrelationship between the Parties, FSNI and FSSI are separate legal entities and are not currently interconnected bodies corporate.

## Our general framework

24. The Commerce Act 1986 (the Act) requires us to assess mergers and acquisitions using the substantial lessening of competition test. The Act, together with relevant case law, governs the way in which we consider all mergers, including the Proposed Merger. Our approach to this assessment is also based on the principles set out in our Mergers and Acquisitions Guidelines (Guidelines).[16]

25. We determine whether a merger or acquisition is likely to substantially lessen competition in a market by considering what would change with a merger. We do so 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).[17] This allows us to assess the degree by which a merger might lessen competition.

26. Whether or not a lessening of competition as a result of a merger is substantial depends on the particular circumstances.[18] It is the degree to which competition has

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12 The Application at [29]-[30].
13 The Application at [2] and [36]-[38].
14 The Application at [49]-[50].
15 The Application at [4] and [20].
16 Commerce Commission, Mergers and Acquisitions Guidelines (May 2022).
17 *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].
18 *ANZCO Foods Waitara Ltd v AFFCO NZ Ltd* (2005) 11 TCLR 278 at [240] (CA).

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 in a market, for that lessening to be substantial. A lessening of competition that adversely affects a significant section of a market may be enough to amount to a substantial lessening of competition.[19] Further, 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.[20]

27. In considering the Application and assessing whether the Proposed Merger is likely to substantially lessen competition, our role is not to address any issues we may see with existing market structures or behaviour. Rather, our focus is on what would change competitively with the Proposed Merger.

28. Unless we are satisfied that any lessening of competition as a result of the Proposed Merger is not likely to be substantial, we cannot give clearance. The burden of proof is on the Parties to satisfy us that the Proposed Merger will not have, or would not be likely to have, the effect of substantially lessening competition in a New Zealand market.

29. In assessing whether the Proposed Merger is likely to substantially lessen competition, we need to ask ourselves to what extent would competition in the relevant grocery markets be materially different with the Proposed Merger of FSNI and FSSI, compared to the likely state of competition that would exist in those markets if the Proposed Merger did not proceed.

## How we are assessing the Proposed Merger

30. Our remaining concerns arise both in markets where the Parties compete to buy goods (acquisition markets) and in markets where the Parties compete to supply goods (selling markets). In this section, we discuss our framework for assessing whether the Proposed Merger will have, or would be likely to have, the effect of substantially lessening competition in markets at these different levels of the supply chain. This includes our approach to considering claims of efficiencies.

31. The discussion focuses mainly on the framework used to analyse the effect or likely effect of a merger on competition in acquisition markets, since this is a particular feature of our analysis of the Proposed Merger.

32. However, it is important to note that there are commercial dependencies between selling markets and acquisition markets that are relevant to our assessment. For example, market power in acquisition markets likely derives from scale or market share in selling markets. Moreover, the accretion by the merged entity of market power in acquisition markets could have the effect of reducing competition in selling markets, by providing the merged entity with such an advantage in the terms on which it procures supplies (eg, as to price or exclusivity) that it becomes much more difficult for a new grocery retailer to enter the selling markets.

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

20 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).

**The SoI and the Parties' submissions**

33. In the SoI, we noted that within a bargaining framework, an increase in buyer-side market power with the Proposed Merger may be likely to result in a substantial lessening of competition, if the Proposed Merger resulted in:[21]

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

    33.2 reduction in choice or quality of groceries for retail consumer;

    33.3 exit by suppliers from acquisition markets;

    33.4 a reduction in the number of channels for suppliers to reach retail consumers, or a reduction in the number of opportunities suppliers have to pitch new ideas or products ; and/or

    33.5 a reduction in grocery suppliers' ability and incentives to invest or innovates.

34. We further noted that:

    34.1 it may be necessary to modify or depart from chapter 4 of our Guidelines;[22] and

    34.2 we were considering the extent to which a substantial lessening of competition may occur whether or not there is a reduction of output.[23]

35. In response to the SoI, the Parties accept the merged entity may obtain better buying terms (eg, lower prices from suppliers),[24] but further submit (including through Houston Kemp) that:

    35.1 within a bargaining framework, this is only likely to result in a wealth transfer, not a reduction in output;[25]

    35.2 this is the result of rivalry, not an increase in buyer power;[26]

    35.3 a mere transfer of surplus is not a lessening of competition because it is either neutral or pro-competitive if passed on to consumers;[27] pointing to previous Commission decisions and the approach of the Competition and Markets Authority in the United Kingdom;[28] and

    35.4 something more than lower prices paid to suppliers is required for a substantial lessening of competition to occur.[29]

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21 SoI at [39].
22 SoI at [34].
23 SoI at [40].
24 SoI submission from the Parties (26 April 2024) at [87].
25 Houston Kemp report on SoPI (7 March 2024) at [18].
26 SoI submission from the Parties (26 April 2024) at 21 and [89].
27 SoI submission from the Parties (26 April 2024) at [70] and [73].
28 SoI submission from the Parties (26 April 2024) at [71]-[72].
29 SoI submission from the Parties (26 April 2024) at [71].

## Substantial lessening of competition

36. We consider that a substantial lessening of competition can occur in any market. This is because the Act in s66(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 notes at s3(1A) that "Every reference…to the term **market** is a reference to a market in New Zealand for goods or services…" (emphasis added).

37. In any market, we are concerned about assessing the potential effects of a merger on the competitive process. Our focus when considering whether there is an effect on competition is on the process of independent rivalry. In our view, the Act does not further limit the scope of this inquiry to:

    37.1 certain markets (ie, markets for supply rather than acquisition markets); or

    37.2 competitive harm to certain groups (ie, consumers rather suppliers).

38. In other words, we proceed on that basis that the 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.

## Competition in acquisition markets

39. In the case of the Proposed Merger, we have identified a number of relevant acquisition markets (as set out in Table 2 starting on page 31). Currently, the Parties compete to acquire grocery products in these markets.

40. 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 consumers. 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.[30]

41. Competition among buyers can have a variety of beneficial effects analogous to competition among sellers. For example, buyers may compete by raising the prices offered to suppliers, by expanding supply networks, through transparent and predictable contracting, procurement and payment practices, or by investing in technology that reduces frictions for suppliers. In contrast, a reduction in competition among buyers can lead to artificially suppressed input prices or purchase volumes, which in turn reduces incentives for suppliers to invest in capacity or innovation.

42. The particular concerns that we continue to test and that relate to the effect of the Proposed Merger on acquisition markets are outlined at in a separate section of this SoUI starting at [65]. We consider that if the Proposed Merger resulted in a substantial lessening of competition, it would likely be accompanied by:

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[30] Mergers and Acquisitions Guidelines above n16 at 33.

42.1 a transfer of surplus from grocery suppliers to the merged entity as a result of prices being forced below the competitive level;

42.2 a reduction in choice or quality of groceries;

42.3 exit by suppliers from any acquisition market;

42.4 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; and/or

42.5 a reduction in grocery suppliers' ability and incentives to invest or innovate.

**The concept of the long-term benefit of consumers**

43. 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". We have regard to that purpose when performing our functions under the Act, including deciding on merger clearance applications.

44. Our view is that as it relates to the assessment of clearance applications, s1A reinforces that the intended beneficiaries of the Commission's directed focus on the protection and promotion of competition are consumers. In the long run, it is expected that consumers will benefit from a concerted focus on the protection and preservation of the competitive process, even where acquisitions mainly concern effects in acquisition markets. Consumers enjoy benefits from competitive tension at all levels of a supply chain, not just in the level with which they directly interact.

45. 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.

46. Notwithstanding the ultimate purpose being consumer welfare, the relevant provisions in the Act relating to mergers and s66 merger clearances focus on the impact on competition, not on the impact on consumers as such. We note that the s67 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).

47. In assessing whether a substantial lessening of competition arises in acquisition markets, we do not consider that we are required, for reasons of either law or policy, to quantify the extent of any harm to consumers. In our view, this would be an inappropriate 'gloss' on the statutory language to read in a restriction on the Commission's primary directive of preventing a lessening of competition in any market.

48. 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. This would in turn likely be detrimental to consumers' long-term interests as the competitive process plays out over time. However, where a substantial interference with the competitive process has taken

place in acquisition markets (or is likely post-merger), that may be a sufficient basis on which to decline clearance, without trying to measure or predict impacts on the welfare of downstream consumers. Moreover, 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[31] and Australia.[32]

49. We do not consider that we are required to establish links between effects in acquisition markets and impacts on consumers. However, we note that a number of the ways a substantial lessening of competition in relevant upstream markets for the acquisition of groceries might manifest (as outlined at [42] above), could negatively impact on consumers in downstream retail 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. In addition, the major grocery retailers may be able to leverage their increased market power in relevant upstream markets for the acquisition of groceries to gain such an advantage in the terms on which they procure supplies, (eg, as to price or exclusivity) that it becomes much more difficult for a new grocery retailer to enter the downstream retail markets. These potential flow through effects are considered in our analysis of retail grocery markets.

50. We invite submissions on the extent to which we need to take into account the downstream effects on retail consumers in assessing whether the Proposed Merger would be likely to substantially lessen competition in relevant upstream markets for the acquisition of groceries.

**The role of efficiencies**

51. 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",[33] and that they are relevant "when efficiency gains prevent customers from being adversely affected in a material way".[34] 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.[35]

52. Our view is that cost savings accruing to a merged entity simply from the exploitation of acquired market power in acquisition markets by negotiating prices below the competitive level should not be treated as relevant efficiencies. Such cost savings reflect a harm to competition.

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

[32] ACCC, Public Competition Assessment *Saputo Dairy Australia/Murray Goulburn* (17 May 2018).

[33] Mergers and Acquisitions Guidelines above n16 at [3.118].

[34] Mergers and Acquisitions Guidelines above n16 at [3.120]

[35] Mergers and Acquisitions Guidelines above n16 at [3.119]-[3.120]

53. Moreover, even where actual efficiencies can be demonstrated, we are presently of the view that the clearance framework does not allow efficiencies in a downstream retail market to 'offset' harm in an upstream acquisition market. Instead, applicants are required to establish that claimed efficiencies counteract the expected lessening of competition or harm to participants in the relevant market(s) (ie, in this case relevant upstream markets for the acquisition of groceries). For example, applicants could seek to establish that efficiencies would:

    53.1 make a merged entity more competitive, such that competition in an upstream market increases or stays level (rather than decreases); or

    53.2 result in benefits to market participants who would otherwise be harmed by the lessening in competition (in this case, suppliers to the Parties).

**An alternative approach**

54. We acknowledge that the Application and the Parties' submission on the SoI appear to proceed on the basis that the clearance assessment process requires us to balance the impact of the Proposed Merger on suppliers with its impact on retail consumers. The Parties' position appears to be that if we were to be satisfied that the net impact of the Proposed Merger on retail grocery prices paid by consumers were to be neutral or negative, however that impact arose, then we would be obliged to clear the Proposed Merger. In other words, if the merged entity were to secure better buying terms (eg, reductions in the prices paid by it) for grocery supplies and any portion of that cost reduction were passed on to consumers in the form of lower retail prices, then a clearance should be granted even if this occurred through reductions of competition and the exploitation of increased market power in acquisition markets.[36]

55. The Parties submit that the Proposed Merger would not result in a substantial lessening of competition in any acquisition markets,[37] even where the Proposed Merger results in a transfer of surplus from grocery suppliers to the merged entity.[38] Instead, the Parties (per the submissions summarised above) appear to argue that identifiable harms to one group (suppliers) is irrelevant provided another group (consumers) receives a benefit.

56. Our view is that the merger clearance framework is not an appropriate framework for us to be weighing up potential harm to competition in one market against claimed benefits to consumers in another market. The clearance process requires an assessment of each market separately and regardless of whether it is an acquisition or a selling market. The detailed assessment of "net benefits" is instead more appropriately conducted under the merger authorisation process provided under s67 of the Act.

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36 See for example, the Application at [121] and SoI submission from the Parties (26 April 2024) at [73] and [87]-[88].

37 SoI submission from the Parties (26 April 2024) at [87].

38 SoI submission from the Parties (26 April 2024) at [69]-[70].

57. However, to the extent that our view is incorrect, and that we are in fact obliged in a clearance process to engage in this balancing exercise, then we may continue to be of the view that there would be a real chance that the Proposed Merger would have the effect or likely effect of substantially lessening competition in acquisition markets. The reasons for this include:

    57.1 due to the existing high levels of concentration in the relevant retail grocery markets, the merged entity is unlikely to face strong competitive pressure to pass on cost savings to consumers; and

    57.2 that a complete analysis of the effect of the Proposed Merger on the long-term interests of retail consumers would need to take account of the effects on choice and quality of groceries resulting from the impact on suppliers in relevant acquisition markets.

## With and without scenarios

58. Assessing whether a substantial lessening of competition is likely requires us to:

    58.1 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 with a merger, often referred to as the counterfactual); and

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

59. 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.[39] 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.[40]

### With the Proposed Merger

60. The Proposed Merger would give rise to a 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.[41]

61. The stated commercial rationale for the Proposed Merger is to create a world-class, customer-driven national food and grocery retailer and wholesaler.[42] The Parties submit that the Proposed Merger would combine the best aspects of both.[43] They also submit that the Proposed Merger would lead to cost reductions, efficiency gains,

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39 Mergers and Acquisitions Guidelines above n16 at [2.29] and [2.35].
40 *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128.
41 The Application at [13.2].
42 The Application at [19].
43 The Application at [20].

increased agility and innovation and a more cohesive national offering, which would ultimately deliver better value for retail consumers at the checkout, and enhance competition.[44] The Parties further submit that increasing retail competition (and our role under the GICA) should ensure significant pressure on the merged entity to pass through the benefit of savings and efficiencies to retail consumers.[45]

62. With the Proposed Merger, the number of distinct major retail suppliers of grocery products and buyers of grocery products would be reduced. The management and operation functions of the support centres for each of FSNI and FSSI would merge, although there would be no effect on local store ownership.[46] The number of major grocery retailers in New Zealand would reduce from three to two. The merged entity would have a national footprint with stores operating in both the North Island and South Island and one central head office, similar to Woolworths.[47]

**Without the Proposed Merger**

63. We are assessing the Proposed Merger against a counterfactual scenario of the status quo. In this counterfactual scenario:

    63.1 FSNI and FSSI would continue to operate independently of each other, each in its island, with a continued relationship to manage the fact that they are trading under the same brands and present as a single national offering;[48]

    63.2 while [ ],[49] and any such changes would not result in a competitively distinct counterfactual to the status quo;

    63.3 in buying markets, FSNI and FSSI would continue to work together to acquire private label products, but otherwise continue to separately acquire groceries from suppliers (ie, continue to be alternative options for suppliers), and each of FSNI and FSSI would continue to progress their own centralised buying programme;[50]

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

    63.5 in retail grocery markets, FSNI and FSSI would continue to each operate in its own island and not in competition with each other,[51] but would continue to

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

45 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 in this SoUI.

46 The Application at [5].

47 For completeness, we note that while the merged entity would have a central head office, it would still operate as a co-operative.

48 The Application at [97].

49 The Application at [97] and [ ].

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

51 The Application at [99].

work together in a range of ways (eg, in relation to marketing, brand alignment and other initiatives).

64. We are satisfied based on the evidence before us 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. However, based on the evidence before us, we do not consider that there are any arrangements between the Parties to not compete, or that prevent them from competing, in any retail grocery markets.

## Competition assessment – unilateral effects in acquisition markets

65. We continue to have concerns that the Proposed Merger would substantially lessen competition due to unilateral effects in relevant upstream markets for the acquisition of groceries.

66. The market study concluded that the grocery sector in New Zealand was not working well for consumers or many suppliers, and one of the problems that it identified was the bargaining power imbalance between the major grocery retailers and suppliers. The reason for this imbalance includes that many suppliers have limited alternative options available to sell their products other than to just the major grocery retailers.[52]

67. The Proposed Merger would create the largest acquirer of groceries in New Zealand, and result in many suppliers selling most of their output to just two remaining major grocery retailer customers (the merged entity and Woolworths) rather than the existing three. We are concerned that this would result in increased buyer power, materially worsening the bargaining power imbalance between suppliers and the Parties, and substantially lessen competition in many markets in which the Parties acquire groceries, as set out further below. We note that in order to clear the Proposed Merger we need to be satisfied that there would be no substantial lessening of competition in any relevant market for the acquisition of groceries.

### Summary of what we said in the SoI

68. In the SoI, we considered that:[53]

    68.1 the Proposed Merger would reduce the number of major customers with which many suppliers can negotiate from three to two. In the factual, the merged entity may be able to unilaterally extract more favourable terms from suppliers than the Parties would in the counterfactual because of an increase in its bargaining power relative to suppliers;

    68.2 some suppliers that are currently only supplying either FSNI or FSSI could be forced out of the market if the merged entity elects not to stock their product(s). As well as removing a distribution channel for those suppliers, this could have an impact on the market more generally if it is not viable for that supplier to supply the market without supplying the merged entity; and

[52] Market study final report (8 March 2022) at 44 and 324.
[53] SoI at [61], [62.1] and [82.1].

68.3 in the case of suppliers who may not have the ability to divert supply through other channels (ie, through other grocery retailers, export, wholesale, foodservices and direct to retail consumers) the Proposed Merger would reduce their major customers by one, and the merged entity would account for more of a suppliers' total business. In contrast, the merged entity would continue to have many suppliers from whom it could acquire grocery products, with little to no change in its options.

**Summary of our current view**

69. Our unresolved concerns are:

69.1 the structural change with the Proposed Merger would reduce the number of major buyers of groceries from three to two;

69.2 this would harm the competitive process in acquisition markets, and substantially lessen competition in some of these markets, causing an increase in the merged entity's bargaining power and enabling it to extract lower prices from some suppliers, "cherry pick" the most favourable terms, disadvantaging some suppliers and/or otherwise get more favourable trading terms from some suppliers;

69.3 the Proposed Merger would affect suppliers differently depending on the strength of their options (alternative supply channels);

69.4 we have some evidence of direct competition between FSSI and FSNI to acquire groceries from some suppliers where there is a shortage of supply (ie, fresh produce) and/or where a supplier's capacity is restricted to supplying either FSSI or FSNI but not both;[54]

69.5 suppliers who currently supply FSSI or FSNI but not both, may be forced from the market if the merged entity elects not to stock their products;

69.6 even where suppliers have the capacity to supply both FSSI and FSNI and wish to do so, we consider a substantial lessening of competition is likely as a result of the aggregation of volume and the loss of an option for suppliers; and

69.7 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 could impact the pace and development of new product innovation for some suppliers, resulting in reduced consumer choice and quality of grocery products.

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[54] For example, [ ] only services FSSI and does not consider that it would be big enough to sell into FSNI, in addition to the logistics of freighting into the other island. Commerce Commission interview with [ ]. See also Houston Kemp Report on SoPI (7 March 2024) at [93], and Commerce Commission interviews with [ ] and [ ].

70. We invite submissions on our assessment of unilateral effects in relation to the acquisition of grocery products. The specific information we are interested in is set out in each of the sections below.

**Market definition**

71. 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.[55]

72. The relevant markets to assess the impact of the Proposed Merger on the acquisition of groceries are the wholesale markets in which the Parties and their suppliers interact. Suppliers may be 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.

*Framework for defining acquisition markets*

73. 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, not 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.

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

    73.2 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.

74. 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 decrease in price (SSNDP).

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

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55 Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81] and Mergers and Acquisitions Guidelines above n16 at [3.7]-[3.10].

75.1 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

75.2 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.

*What we said in the SoI*

76. In the SoI, we set out our views on the relevant framework for identifying affected acquisition markets, but we did not define specific markets. We stated that it may not be practical to fully assess substitution in the supply chain for all products due to the thousands of products available at the major grocery retailers.[56]

77. We noted that the Parties acquire goods from thousands of suppliers, ranging from large multinationals that manufacture or import larger ranges of products, to small local suppliers that supply a small number of products, potentially to a localised area of stores. We stated that some suppliers may find other channels (eg, supply to food service, convenience retailers or export) as substitutable with the major grocery retailers, depending on how easily a supplier can adapt its product for those alternative channels.[57]

78. In the SoI, we noted that we had not defined the dimensions of any market for the acquisition of grocery products more precisely, but considered that it may be appropriate to define markets on a local, regional, national or even global basis (ie, local or regional markets for perishable goods and national or global markets for frozen goods). We noted that we were continuing to investigate whether there are particular product categories or types of suppliers for which the effects of the Proposed Merger are likely to be heightened or lessened, such that they are meaningful to assess in our analysis.[58] We invited submissions on our approach to market definition and for any evidence on the scope of markets relating to the acquisition of groceries.[59]

*Submissions received*

79. Neither the Parties, nor any third parties, have provided detailed submissions with respect to market definition. 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".[60] The Parties further submit that "[a]lthough it may be possible to argue that sales of each product could be

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56 SoI at [72].
57 SoI at [68]-[69].
58 SoI at [72].
59 SoI at [73].
60 SoI submission from the Parties (26 April 2024) at [18].

considered as a separate market, to avoid complexity suppliers can be 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]".[61]

80. Houston Kemp (on behalf of the Parties) 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).[62]

*Our current view*

81. A number of relevant upstream markets for the acquisition of groceries 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, there will be many relevant markets with different characteristics. Our current view is that, due to the large number of relevant markets for the acquisition of groceries, in order to assess the competitive effects of the Proposed Merger, it is necessary to aggregate across similar markets, or classes of similar markets.

82. 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).

83. In this section, we set out the framework with which we are thinking about the product, geographic and customer dimensions of relevant upstream markets for the acquisition of groceries, before identifying common features of categories of markets.

<u>Product dimensions of the relevant markets</u>

84. We consider that there are likely to be separate relevant upstream markets for the acquisition of groceries based on individual products or types of products. On both the demand-side and the supply-side, products in one category are not readily substitutable with products in another category.

85. 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 producing 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 product or category, to producing other types of products or categories.

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

62 Houston Kemp report on SoPI (7 March 2024) as summarised in Houston Kemp report on SoI (26 April 2024) at [40].

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

87. The general proposition that the acquisition of groceries 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.[63] Examples include:

87.1 separate product markets for the supply of laundry detergents, laundry pre-wash aids and toilet cleaner products;[64]

87.2 a distinct product market for the supply of tofu that was separate from plant-based meat alternatives (excluding tofu);[65]

87.3 separate product markets for savoury pies and sausage rolls;[66]

87.4 separate product markets for each of colony cage, barn and free-range eggs;[67]

87.5 a distinct product market for the supply of Greek yoghurt that was separate from “mainstream yoghurt products”;[68] [69]

87.6 separate product markets for each of red sauces (primarily tomato sauce and ketchup), barbecue sauce, steak sauce and Worcestershire sauce;[70] and

87.7 a distinct product market for the supply of primary and secondary processed chicken that was distinct from other animal protein product markets.[71]

88. As noted above, for the assessment of the effects of the Proposed Merger, we are aggregating categories of products. These categories are likely to exhibit common dynamics such that, in general, product markets within these categories may be impacted by the Proposed Merger in similar ways.

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63 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 our analysis of the current relevant markets.

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

65 Life Health Foods NZ Limited and Chalmers Organics Limited [2022] NZCC 21 at [35].

66 Allied Foods (N.Z.) Limited and Dad’s Pies Limited [2021] NZCC 21 at [17].

67 Heyden Farms Limited, Henergy Cage-Free Limited and Rasmusens Poultry Farms Limited [2020] NZCC 19 at 17. We note that colony cage eggs are in the process of being phased out by the major grocery retailers.

68 Goodman Fielder New Zealand Limited and Lion – Dairy & Drinks (NZ) Limited [2018] NZCC 12 at [59].

69 We note that we left open the possibility of other yoghurt products constituting their own markets, but did not define it more specifically as it was not necessary to assess the competitive effects of that merger.

70 H.J. Heinz Company (New Zealand) Limited and Cerebos Pacific Limited [2018] NZCC 2 at 45.

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

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

90. We invite submissions on our framework for assessing relevant upstream product markets for the acquisition of groceries, and the categories that we are considering are relevant to the Proposed Merger. We also invite submissions on any particular product markets where the Proposed Merger may have a greater, or lesser effect on competition to acquire products.

<u>Geographic dimensions of the relevant markets</u>

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

92. At present, it appears that, for most of the relevant markets, the relevant geographic dimension is national. Due to the small size of domestic New Zealand grocery markets, it makes sense for some 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 fewer examples of suppliers (usually large suppliers) having multiple manufacturing sites. 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.[72]

93. 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.[73] In general, competition in markets supplied by these suppliers is more likely to be materially affected by the Proposed Merger, subject to the availability of other customers (discussed below).

94. This view is consistent with the Commission's consideration of the 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".[74]

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72 SoI at [71.2].

73 The Application at [122].

74 Progressive Enterprises Limited and Woolworths (NZ) Limited (Commerce Commission Decision 448, 14 December 2001) at [72]. We note that 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.

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

96. Some suppliers of fresh produce, perishable products with a short shelf, or fragile products, 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 markets supplied by these suppliers 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.

97. This is consistent with two past merger clearance decisions, in which the Commission identified that there were distinct geographic markets for the wholesale supply of relevant products:

    97.1 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 (and the lack of inter-island volumes) indicated that a North Island market for the production and wholesale supply of eggs was appropriate;[75] and

    97.2 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 any extended travel time.[76]

98. In relation to these types of products, the Parties submit that "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",[77] with or without the Proposed Merger.

99. We invite submissions on our current thinking in terms of the geographic dimension of relevant upstream markets for the acquisition of groceries.

<u>Customer dimensions of the relevant markets</u>

100. In the SoI, we said that suppliers may have a range of channels that they regard as being substitutable to the major grocery retailers, such as wholesalers, foodservice customers, direct to retail consumers, and exports. However, we also said that this will depend on how easily a supplier can adapt its product for those alternative channels.[78]

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

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

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

78 SoI at [69].

101. As we noted in the market study, suppliers are often dependent on major grocery retailers as their main route for selling their products to retail consumers.[79] For many grocery suppliers, the large proportion of demand that is aggregated through the major grocery retailers means that there are unlikely to be close substitutes for the major grocery retailers. This view:

101.1 is based on interviews we have done with more than 50 suppliers and responses to requests for information we have received from approximately 30 suppliers of either or both of the Parties as part of our investigation of the Proposed Merger;

101.2 is consistent with the view expressed by the Food and Grocery Council, and the results of a survey it conducted of 70 of its members about the Proposed Merger;[80] and

101.3 is consistent with the market study, which concluded that "suppliers are often dependent on major grocery retailers as their main route for selling their products to consumers",[81] based on a survey of 126 suppliers, and follow-up interviews with many of these, and 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".[82]

102. This view is also informed by responses to voluntary requests for information received by the Commission from a sample of suppliers as part of our investigation of the Proposed Merger, illustrated in Table 1.

**Table 1: Approximate proportion of suppliers' sales (%) by channel[83]**

| Supplier | Major grocery retailers | Other domestic supply (including other retail channels, food service etc) | Export |
|---|---|---|---|
| [ ] | 98% | 2% | 0% |
| [ ] | 96% | 0% | 4% |
| [ ][84] | 94% | 6% | 0% |
| [ ] | 88% | 12% | 0% |
| [ ] | 86% | 14% | 0% |
| [ ] | 81% | 19% | 0% |
| [ ] | 79% | 14% | 7% |
| [ ] | 74% | 26% | 0% |

79 Market study final report (8 March 2022) at [8.50].
80 SoPI submission from the Food and Grocery Council (19 February 2024).
81 Market study final report (8 March 2022) at [8.5].
82 Market study final report (8 March 2022) at [8.16].
83 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.

84 We note this supplier does not currently supply both Parties.

| Supplier | Major grocery retailers | Other domestic supply (including other retail channels, food service etc) | Export |
|---|---:|---:|---:|
| [ ] | 71% | 16% | 13% |
| [ ] | 62% | 38% | 0% |
| [ ] | 60% | 27% | 13% |
| [ ] | 56% | 24% | 20% |
| [ ] | 55% | 34% | 11% |
| [ ] | 54% | 46% | 0% |
| [ ] | 53% | 1% | 46% |
| [ ] | 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% |
| [ ][85] | 5% | 1% | 94% |

103. Table 1 represents the approximate proportion of suppliers' total sales (by percentage) that is supplied into the major grocery retailers (FSNI, FSSI and Woolworths), other domestic supply channels (other grocery retailers, foodservice, wholesale, direct to consumers) and exported (where relevant).

104. Table 1 illustrates the relative size of the major grocery retailer channel for these suppliers. 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. This 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.[86] Also, as an example, we have been told that the production process for eggs for retail is different for food service. Food service customers focus solely on price and quality, whereas grocery retail customers may have ethical or other concerns. This leads to two different production methods (colony and free range) which are uneconomical to be switched.[87]

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85 We note this supplier does not currently supply both Parties.

86 Commerce Commission interviews with [ ] and [ ].

87 Commerce Commission interview with [ ].

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

105.1 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;[88]

105.2 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;[89] and

105.3 in 2008, we identified different markets based on retail foodservice, 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, there are likely to be three distinct customer types.[90]

106. We also recognise that there are likely relevant markets in which alternative types of customers or sales channels are substitutable with supply to the major grocery retailers, such as, for example, for beverages, or for confectionery products – where convenience retailers account for significant proportions of supply (albeit still less than supply through the major grocery retailers).

107. The viability of these alternative channels for suppliers varies according to the individual supplier's products and whether suppliers either can, or would be able to, divert a large proportion of their output to these alternative channels in order to defeat an exercise of market power by the merged entity.

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

108.1 **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.[91] The Food and Grocery Council submits that The Warehouse is too small to have a significant impact

88 Reckitt Benckiser Group Plc and Johnson and Johnson [2015] NZCC 12 at X4.
89 H.J. Heinz Company (New Zealand) Limited and Cerebos Pacific Limited [2018] NZCC 2 at 52.
90 Tegel Foods Limited and Brinks Group of Companies (Commerce Commission Decision 658, 22 October 2008).
91 RNZ "Two major grocery 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.

or provide a viable alternative to the major grocery retailers.[92] Suppliers that we have spoken with (across different categories) noted The Warehouse stocks a limited range, and tends to focus on value products;[93]

108.2 **Costco** – Costco offers a narrower range of products than the major grocery retailers, many of which are in large wholesale quantities.[94] 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 the major grocery retailers;[95]

108.3 **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 grocery retailer), Commonsense (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 stores in Auckland) and Paddock to Pantry (a primarily online premium supermarket with one store near Auckland).[96] These account for a marginal proportion of grocery acquisitions;

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

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

109. Other channels include:

109.1 **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

109.2 **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.

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

93 Commerce Commission interviews with [ ] and [ ].

94 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.

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

96 Other grocery retailers in this sector include Farro Fresh (a specialist grocery retail operating in Auckland) and Moore Wilson's (also a specialist grocery retailer operating in the Wellington region).

110. We invite submissions on our framework for assessing relevant upstream customer markets for the acquisition of groceries, and the extent to which, for some products or categories of products, the supply to major grocery retailers constitutes its own market.

Relevant markets to assess the effect of the Proposed Merger

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

**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 encompasses 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 likely to be 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 it is likely 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.[97]<br><br>We are concerned that the Proposed Merger may be likely to substantially lessen competition in many markets in this category. |
| National markets for the acquisition of chilled and frozen | Chilled and frozen groceries encompass packaged products that are | The geographic dimension of these markets is likely to be national, with products generally | For most suppliers active in these markets, it does not appear that they would be able to substitute meaningful proportions of their supply to | Suppliers active in these markets have raised concerns |

[97] For example, [ ] considers itself a medium sized business and expressed concern with the Proposed Merger that it would make it riskier with less major grocery retailers given that it is not a multi-national sized business, but thought that smaller local and regional suppliers would be covered because planograms allow for local/regional suppliers. [ ] considers itself a medium sized business and expressed concern with the Proposed Merger that it would be difficult for manufacturers and that it would be especially difficult for smaller businesses. [ ] 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 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 [ ].

| Category of market | Products included | Geographic dimension | Substitutes | Concerns |
|---|---|---|---|---|
| groceries by major grocery retailers. | temperature controlled including sauces, dips, fruits, frozen vegetables, ice cream, frozen meats etc. | supplied from single manufacturing sites, or imported, and no shelf-life issues. | other channels in the event of a SSNDP, implying it is likely that other customer channels fall outside the scope of the relevant market. | in relation to the Proposed Merger.[98]<br><br>We are concerned that the Proposed Merger may be likely to substantially lessen competition in many markets in this category. |
| National markets for the acquisition of health and beauty products. | This includes personal care products such as toothpaste, deodorant and shampoo. | The geographic dimension of these markets is likely to be national, with products generally supplied from single manufacturing sites, or imported, and | 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 the Chemist Warehouse. However, the | Suppliers active in these markets have raised concerns in relation to the Proposed Merger.[99]<br><br>We are not satisfied that the Proposed Merger would not substantially lessen |

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98 For example, [ ] expressed concern with the Proposed Merger that smaller suppliers, particularly South Island based manufacturers would struggle. While [ ] considers itself in a unique position to other suppliers in terms of already supplying across the geographies and better placed to navigate the Proposed Merger, it does express concern in relation to the potential impact on smaller suppliers who may only be able to range to a smaller supply base without the scale or operation to supply at a national level. It also considers that for a lot of suppliers, if they lost volume to the merged entity, they could not redirect volume into the domestic market. [ ] 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 interviews with [ ], [ ] and [ ].

99 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 product to market in New Zealand if not ranged with the merged entity. [ ] considers itself a medium-large supplier in a fortunate position but expressed concern with the Proposed Merger that suppliers who cannot supply nationwide would be removed or have their margin squeezed leading to fewer small suppliers, loss of innovation and large suppliers increasing. See Commerce Commission interviews with [ ] and [ ].

| Category of market | Products included | Geographic dimension | Substitutes | Concerns |
|---|---|---|---|---|
| | | generally no shelf-life issues or issues with transportation. | extent to which suppliers would be able to switch volumes to alternative customer channels to defeat a SSNDP is unclear. | competition in many markets in this category. |
| National markets for the acquisition of beverages by retailers and other customers. | Beverages encompasses non-alcoholic beverages such as coffee, juices or soft drinks/energy drinks. These can both be refrigerated or non-refrigerated. | The geographic dimension of these markets is likely to be 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. 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.[100]<br><br>We are not satisfied that the Proposed Merger would not substantially lessen competition in many markets in this category. |
| National markets for the acquisition of snacks by retailers | This category includes chips, chocolate, confectionery, | The geographic dimension of these markets is likely to be national, with | For suppliers in these markets, we consider that it is generally possible to substitute between supplying the major grocery | Suppliers active in these markets have raised concerns |

[100] 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 |
|---|---|---|---|---|
| and other customers. | chewing gums, savoury snacks like nuts, etc. | products generally supplied from single manufacturing sites, or imported, and generally no shelf-life issues or issues with transportation. | 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. | in relation to the Proposed Merger.[101]<br><br>We are not satisfied that the proposed acquisition would not substantially lessen competition in many markets in this category. |
| National and regional markets for the acquisition of meat and seafood products by retailers and other customers. | This category includes the wholesale supply of animal proteins (ie, meat, poultry and seafood). | The geographic dimension of these markets is likely to vary 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, we note, as described above, the Commission has previously identified separate markets according to customer channel for the wholesale supply of | Suppliers active in these markets have raised concerns in relation to the Proposed Merger.[103]<br><br>We are not satisfied that the proposed acquisition would not substantially lessen competition in many markets in this category. |

[101] 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 [ ].

[103] For example, [ ] considers itself a large supplier with a unique product but expressed concern with the Proposed Merger that smaller suppliers would be impacted. [ ] 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 |
|---|---|---|---|---|
| | | | chicken. The Parties submit that for meat and seafood, export is a key option and drives bargaining outcomes.[102] The extent to which they would be able to switch volumes to alternative customer channels to defeat a SSNDP is therefore unclear. | |
| National markets for the acquisition of beer and wine. | 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 likely to be 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 food service. 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.[104]<br><br>We are not satisfied that the proposed acquisition would not substantially lessen competition in many markets in this category. |

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

104 For example, [ ] expressed concern with the Proposed Merger that the Parties are present in [ ] and so a loss in volume to the merged entity would affect its minimum threshold volume to actually produce a product. It also considers that harmonising national suppliers could potentially affect local suppliers. [ ] 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 |
|---|---|---|---|---|
| Regional and local markets for the wholesale supply of fresh produce. | This category includes fresh fruit and vegetables and eggs.<br><br>(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.<br><br>(See further points below). | We consider that the relevant markets are likely to include supply to various types of customers, but note that the major grocery retailers are likely to be 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.[105] The Parties submit that export is a key option for suppliers of some types of fresh produce and drives bargaining outcomes.[106] | At this stage, as a general proposition, we consider that the Proposed Merger is unlikely to raise concerns in markets for the acquisition of most fresh produce products.<br><br>A notable exception is any potential instances where the Parties compete for volume in times of short supply. We invite further submissions on instances where this may occur later in this SoUI. |

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

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

112. In terms of the scope of regional and local markets for the wholesale supply of fresh produce, we note that:

112.1 in terms of the product markets, cool storage is needed to varying degrees for different types of products (eg, salad greens require cold storage whereas root crops do not), and all types of produce are not fully substitutable for each other (eg, a potato is not a substitute for a kiwifruit), there are elements of demand-side substitutability in that grocery retailers vary the type of produce they buy on any given day depending on the quality, price and availability of produce, and what is being demanded by retail consumers;[107]

112.2 the Parties 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 more of one of their grocery stores) is acquiring from relevant suppliers, and that would not change as a result of the Proposed Merger;[108] and

112.3 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.[109]

113. We invite submissions on whether we have grouped together categories of products in an appropriate manner, the appropriateness of categories of products, and the relevant geographic and customer dimensions of these categories. We are also interested in whether suppliers of any particular products or product classes are more, or less likely to be impacted by the Proposed Merger.

114. 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.

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107 Turners & Growers Fresh Limited and Freshmax NZ Limited [2020] NZCC 6 at [33].
108 SoPI cross submission from the Parties (7 March 2024) at [7.3].
109 Turners & Growers Fresh Limited and Freshmax NZ Limited [2020] NZCC 6 at [31].

**Increased buyer power with the Proposed Merger**

115. We are concerned that the Proposed Merger could give rise to unilateral effects in relevant upstream markets for the acquisition of groceries. As set out above, our concerns are greatest in product markets where supply is national and major grocery retailers account for a large proportion of suppliers' output. 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 upstream product markets for the acquisition of groceries that fall within other categories.

116. In relevant upstream markets for the acquisition of groceries, the reduction in competition with the Proposed Merger would provide the merged entity with greater buying power, thus enabling it to extract lower prices from some suppliers, "cherry pick" the most favourable terms, disadvantaging some suppliers and/or otherwise get more favourable trading terms from some suppliers.

117. The Parties submit and have told us that they are not generally in competition to acquire groceries, with each of FSNI and FSSI negotiating individually with suppliers, [ ],[110] meaning that 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 such an argument would be that there is in practice no competition in markets for the acquisition of groceries, not just between the Parties, but between the Parties and Woolworths (or any other potential customer channels). However, as discussed below, even where suppliers do not explicitly refer to other grocery retailer customers when negotiating with the Parties, the presence of options generate competitive tension and lowers the stakes of disagreement for suppliers. The removal of a major grocery retailer with the Proposed Merger could represent a substantial lessening of competition, for suppliers of various sizes, and further entrench the bargaining imbalance that is present between many suppliers and the major grocery retailers.

*Bargaining framework*

118. As set out in the SoI,[111] we consider that it is appropriate to analyse the effects of the Proposed Merger for most products using a bargaining framework. The Commission has previously considered a bargaining framework to be appropriate for analysing the relationship between grocery retailers and suppliers, such as during the market study, where it noted that for many grocery product categories, grocery retailers have relatively fewer suppliers, with prices and other terms being negotiated bilaterally. As a result, trading terms are likely to differ across retailer-supplier relationships, rather than there being a single market price for the product (as might be expected under a market framework).[112]

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110 The Application at [116], [118] and [128.3] and Commerce Commission interview with FSNI (22 February 2024).

111 SoI at [39].

112 Market study final report (8 March 2022) at [8.22]-[8.23].

119. A bargaining framework is appropriate where buyers (powerful or not) negotiate bilaterally with individual suppliers. This approach 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. We note that, 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 (ie, fresh produce where prices are driven by market prices).

120. In terms of submissions received on the framework for assessing buyer power:

120.1 Houston Kemp (on behalf of the Parties), consistent with our approach, submits that a bilateral bargaining framework is the more appropriate model in this instance compared to the monopsony framework because it better reflects the relevant structural features of most upstream grocery supply and tends to be capable of predicting observed outcomes of negotiations between retailers and suppliers;[113] and

120.2 The Warehouse Group in its submission, questioned "whether it is consistent with the wider Commerce Act framework and objectives [for the Commission] to allow itself to be boxed into … [a] "bargaining framework'' or "monopsony power" dichotomy".[114] This is because, it submits "on any analysis, if there is an enhancement of bargaining power through a structural change to a market that shifts surplus from suppliers to buyers, that looks like an enhancement of market power, which is conventionally also framed as a lessening of competition".[115] We consider that, due to the way competition works in the grocery sector, using a bargaining framework is the most useful way to analyse the competitive effects of the Proposed Merger, and it does not impact our objectives under the Act.

121. We consider that if the Proposed Merger resulted in a substantial lessening of competition, it would likely be accompanied by:

121.1 a transfer of surplus from grocery suppliers to the merged entity as a result of prices being forced below the competitive level;

121.2 a reduction in choice or quality of groceries;

121.3 exit by suppliers from any acquisition market;

121.4 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; and/or

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

113 Houston Kemp report on SoPI (7 March 2024) at [40].
114 SoI cross submission from The Warehouse Group (10 May 2024) at [12].
115 SoI cross submission from The Warehouse Group (10 May 2024) at [12]. We note the Parties' response to this submission that any change in bargaining outcome, or price, is not in and of itself a competitive harm. SoI cross submission from the Parties (31 May 2024) at 5.

122. We consider that the reduction in competition in relevant acquisition markets with the Proposed Merger could have a number of effects:

122.1 the merged entity may be able to extract lower prices from some suppliers, "cherry pick" the most favourable terms, disadvantaging some suppliers and/or get more favourable terms from some suppliers. This increase in buyer power may also reduce the ability of some suppliers to invest, resulting in effects such as reduced capacity, quality or innovation in the product market or markets in which the supplier is active; and/or

122.2 some suppliers that are currently only supplying either FSNI or FSSI could be forced out of the market if the merged entity elects not to stock their product(s). As well as removing a distribution channel for those suppliers, this could have an impact on grocery markets in New Zealand more generally because, if it is not viable for that supplier to supply its grocery products without supplying the merged entity, that supplier might exit the domestic market.

*The way negotiations work*

123. 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.

124. 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.[116]

125. The major grocery retailers assess supplier performance regularly as part of category review processes. In a category review, a major grocery retailer will consider the mix of products it stocks in a product category. Changes may be made to shelf-space allocation based on the performance of existing products. Some products may be delisted to make way for new or more profitable products.

126. 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.

127. In terms of supply arrangements with the Parties, we understand that suppliers will often have [ ]. For instance, we understand that
[

[116] We note 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 [ ].

].[117] Suppliers have 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.[118]

*What we said in the SoI*

128. In the SoI, we considered that:[119]

   128.1 the Proposed Merger would reduce the number of major customers with which many suppliers can negotiate from three to two;

   128.2 in the factual, the merged entity may be able to unilaterally extract more favourable terms from suppliers than it would in the counterfactual because of an increase in its bargaining power relative to suppliers;

   128.3 there may be immediate harm to suppliers regardless of whether the merged entity purchases less product from them; and

   128.4 harm may also arise if suppliers have less ability and incentive to invest and innovate over time because the subsequent imbalance of bargaining power increases risk and reduces their profitability.

*Submissions from the Parties*

129. 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 in their view:[120]

   129.1 they are not in competition with each other in relation to retail supply, the same is true of the acquisition of groceries;

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117 Response to request for information from the Parties (23 May 2024) at [5] and [7], responses to request for information from FSNI (29 February 2024) at [5] and [8] and FSSI (27 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 [ ]. Albeit 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 [ ]. We discuss the move to centralisation with the Proposed Merger in detail later.

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

119 SoI at [61]-[62], [81] and [90].

120 The Application at [118] and [131], SoPI cross submission from the Parties (7 March 2024) at [5], [16], [23] and [106] and SoI submission from the Parties (26 April 2024) at [132.3].

129.2 there would be no change in the Parties' presence, scale or volumes acquired with the Proposed Merger;

129.3 there would be no material difference in their bargaining position with respect to smaller and larger suppliers with and without the Proposed Merger;[121]

129.4 the merged entity's overall bargaining power would not be greater because the Parties do not compete with each other to procure a greater share of supply;[122]

129.5 there should be no meaningful effect on suppliers' ability to negotiate with the Proposed Merger; and

129.6 the buyer's (ie, the merged entity's) ability to achieve lower prices is not in and of itself a lessening of competition.

130. 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.[123] While we acknowledge that the merged entity would like competitive supply, because more supply options reduce the bargaining power of suppliers, we note that in the event of disagreement with a supplier, the merged entity would have far more options to turn to than the supplier. As discussed below, suppliers noted 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.

131. However, we note that the savings from the Proposed Merger would arise from a combination of cost savings and buying benefits. The Parties' [ ].[124]

132. Houston Kemp (on behalf of the Parties) concedes in its submission on the SoPI, 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 (ie, major national suppliers with 'must have' products and small national suppliers

121 While we acknowledge that 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.

122 Conversely, we consider that the Parties' bargaining power is derived from their size and the size of outside options in any bilateral negotiations with suppliers (including each other). Therefore, they each contribute competitive tension and are in competition.

123 SoI submission from the Parties (26 April 2024) at [9]-[10].

124 [ ]

who negotiate individually with each of FSNI and FSSI).[125] In Houston Kemp's submission on the SoI, it provides some additional analysis of the options available to suppliers and submits:[126]

> 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.

133. 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.

134. Houston Kemp submits that suppliers falling outside of these two groups include smaller/medium national suppliers, and these are the focus of their additional analysis.[127] 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".[128] Houston Kemp acknowledged that [ ].[129] As Houston Kemp notes, [ ].[130]

135. Houston Kemp submits that most of the suppliers it examined had at least one material option outside of the major grocery retailers.[131] These options included the ability to sell their products into export markets, to foodservice providers, or to other key retailers (such as the 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".[132]

136. Houston Hemp further submits that "suppliers typically appear to have realistic options beyond simply supplying to major grocery retailers".[133]

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125 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 [40a].

126 Houston Kemp report on SoI (26 April 2024) at [43].

127 Houston Kemp report on SoI (26 April 2024) at [44].

128 Houston Kemp report on SoI (26 April 2024) at [44].

129 Response to request for information from Houston Kemp (6 June 2024) at 1a

130 Response to request for information from Houston Kemp (6 June 2024) at 1a.

131 Houston Kemp report on SoI (26 April 2024) at [45] and Figure 2.1.

132 Houston Kemp report on SoI (26 April 2024) at [44].

133 Houston Kemp report on SoI (26 April 2024) at [47].

*Third party submissions and evidence received*

137. We have had suppliers (of all sizes, including large multinationals and smaller local suppliers) decline to participate in our investigation of the Proposed Merger. Suppliers who have made submissions and/or been interviewed (and suppliers that have declined to speak with us) have expressed concerns around whether the information they provide us would be disclosed to the Parties, potentially due to a fear of retribution from the Parties for participating in this process. This is 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). We note 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".[134]

138. 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. In our experience, such concerns are not unusual where goods are supplied or acquired in highly concentrated markets. 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.

139. We are continuing to consider ways that we can gather information from suppliers that is, or may be valuable to our investigation. We also encourage suppliers to contact us if they have any views on how the Proposed Merger might impact them or markets for the acquisition of groceries.

140. The Food and Grocery Council broadly agrees with our view in the SoI and submits that in response to its survey, suppliers consider that:[135]

    140.1 the Parties would have increased market power in procurement and negotiations with 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

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

141. The Food and Grocery Council also submits that there was no analysis in the SoI on whether individual stores may have less countervailing power against a larger head office.[136]

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134 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.

135 SoI submission from the Food and Grocery Council (26 April 2024) at [4.19] and [11.3].

136 SoI submission from the Food and Grocery Council (26 April 2024) at [2.3(c)].

142. The Warehouse Group submits that the Parties' own economic report 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.[137]

143. 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.[138]

144. 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.[139]

145. Industry participants that we have spoken with (including suppliers across a range of categories and of all sizes, both large multinationals and smaller local suppliers) have 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:

145.1 there would be increased or greater buying power and/or leverage on the part of the merged entity in bargaining with grocery suppliers;[140]

145.2 the risk to grocery suppliers of losing product nationally and the outcome of ranging decisions would be greater with the Proposed Merger;[141]

145.3 the merged entity would seek for grocery suppliers to improve their offers thereby increasing margin expectations and further reducing supplier margin;[142] and

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137 SoI cross submission from The Warehouse Group (10 May 2024) at [6] and [9]. We note the Parties' response to this submission 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.

138 SoI cross submission from The Warehouse Group (10 May 2023) at [18(a)]. We note the Parties' response to this submission that there is no evidence presented by The Warehouse Group on this point. SoI cross submission from the Parties (31 May 2024) at 7.

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

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

141 Commerce Commission interviews with [ ] and [ ].

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

145.4 the merged entity would "cherry pick" the more favourable terms of each of FSNI and FSSI to implement across the supply base.[143]

146. 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.[144]

*Our current view*

147. Based on the evidence before us (discussed below) we are concerned that the Proposed Merger is likely to substantially lessen competition in relevant upstream acquisition markets, resulting in an increase in the merged entity's buyer power which could enable the merged entity to negotiate lower grocery prices paid to some suppliers. Harm may also arise if the Proposed Merger lessens suppliers' ability and incentive to invest in new product innovation (or to even remain operational). This could have a downstream effect on retail consumers (eg, through a reduction in range, quality and innovation). However, as noted earlier in discussing the framework for assessing the Proposed Merger, our current view is that if a merger strengthens the buyer power of the merged entity, it may significantly impede competition in acquisition markets and be harmful to the competitive process in those markets. We do not consider that we are required to establish links between effects in acquisition markets and impacts on retail consumers.

148. Generally, suppliers are currently able to negotiate different terms of supply with each of FSNI and FSSI.[145] Currently there are three separate opportunities for suppliers to negotiate with and obtain suitable terms of supply for their products through the major grocery retailers (with each of the Parties and Woolworths). However, the consolidation with the Proposed Merger would remove one of these opportunities. This 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).

149. We note that, contrary to the Parties maintained assertion that the Proposed Merger would not increase the merged entity's buyer power, some statements from internal documents provided by the Parties include comments around the [ ], being a [ ] and also that [ ].[146]

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

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

145 We note this is not the case for private label products which have national supply contracts.

146 [ ].

150. As noted previously, industry participants that we have spoken with (including suppliers across a range of categories and of varying sizes) have expressed concern around consolidation with the Proposed Merger, which would give the Parties (and the merged entity) greater bargaining/buyer power and leverage in negotiation with suppliers.[147] Two of these suppliers also specifically expressed a view that this would be detrimental to competition or grocery markets:

150.1 one supplier (of dry food products) told us that the Proposed Merger would limit the competitive nature of having three major grocery retailer customers;[148] and

150.2 a second supplier (of non-food products) expressed the view that any additional concentration in grocery markets in New Zealand, which it told us are already the most concentrated in the world, would be detrimental.[149]

151. We acknowledge that industry participants we have spoken with (including suppliers across a range of categories) have indicated that the Proposed Merger could create efficiencies or simplification for suppliers and/or be beneficial in that suppliers would only have to deal with a single merged entity rather than FSNI and FSSI separately.[150] In addition, [ ] considered the Proposed Merger would create ease for suppliers in having to only deal with a single merged entity.[151] One supplier (of fresh products) to FSNI noted a potential benefit of the Proposed Merger, namely that it may have the ability to instantly sell into the South Island post-merger. However, this same supplier also noted that the current separation of FSNI and FSSI means that if it lost business with FSNI it could go to FSSI, and that it considers it might be "in a completely different boat" if it did not also deal with store owners directly.[152]

152. However, the consolidation of purchasing volumes in the merged entity as opposed to FSNI and FSSI as separate entities, increases the risk to suppliers in negotiations.

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

148 Commerce Commission interview with [ ].

149 Commerce Commission interview with [ ].

150 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], and [ ]. We discuss the efficiencies/benefits of the Proposed Merger in more detail later. Further, for completeness we note that 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.

151 Commerce Commission interview with [ ].

152 Commerce Commission interview with [ ].

Concern has been raised with us by industry participants that we have spoken with (including suppliers across a range of categories and of all sizes, both large multinationals and smaller local suppliers) that the combined bargaining power of the merged entity 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:[153]

152.1 having increased or national margin expectations;

152.2 being able to extract more margin, or better terms, out of suppliers; and/or

152.3 putting suppliers under pressure to improve margins or offer it the best terms.

153. A supplier's inability to reach agreement with the merged entity and supply on a national basis or to negotiate favourable terms with the merged entity could lead a supplier to significantly reduce its offering or exit the market completely.[154] The potential "cherry picking" of terms by the merged entity is a real concern that has been raised with us by suppliers that we have spoken with (across a range of categories and of all sizes, both large multinationals and smaller local suppliers),[155] especially given the Parties have indicated that they are hoping to adopt the better of the Parties' practices in every aspect.[156] Industry participants that we have spoken with (including suppliers across a range of categories and of all sizes) see 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).[157] Some industry participants also expressed a view that the consequences could be severe for some suppliers, including:

153.1 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;[158]

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

154 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, noting if it is seeing that now, imagine what would happen with the merged entity's buying power. Commerce Commission interview with [ ].

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

156 SoPI cross submission from the Parties (7 March 2024) at [148].

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

158 Commerce Commission interview with [ ].

153.2 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 there would be a price to pay to access that scale;[159]

153.3 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";[160]

153.4 a second supplier (of dry food products) noted that smaller suppliers would struggle to stand up to the merged entity;[161] and

153.5 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".[162]

154. Freighting across the Cook Strait is recognised as a significant expense for suppliers.[163] We have been told that it is more costly moving product from the North Island to the South Island compared to the reverse,[164] and there are also some suppliers who do not move or move very little product between the North Island and South Island because of the costs involved.[165] 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.[166]

155. We invite submissions on the increased bargaining/buyer power that the merged entity would have and on:

155.1 the extent to which this would enable the merged entity to reduce prices paid to suppliers and/or worsening the trading terms on which suppliers deal with the merged entity; and

155.2 the implications for suppliers of any increased bargaining/buyer power and for competition in relevant upstream markets for the acquisition of groceries.

156. We discuss further in turn below:

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159 Commerce Commission interview with [ ].
160 Commerce Commission interview with [ ].
161 Commerce Commission interview with [ ].
162 Commerce Commission interview with [ ].
163 Commerce Commission interview with [ ].
164 Commerce Commission interview with [ ].
165 Commerce Commission interviews with [ ] and [ ]. In addition, [ ] currently only supplies FSNI. However, it does currently supply some [ ]) for the right price but notes the high freight costs. Commerce Commission interview with [ ].
166 Commerce Commission interview with [ ].

156.1 the extent of competition between FSNI and FSSI;

156.2 the level of constraint provided by other acquirers of grocery products;

156.3 the impact of the previous North Island Foodstuffs merger;

156.4 the countervailing power of suppliers;

156.5 the move to centralisation;

156.6 private label dynamics;

156.7 the impact of the GICA; and

156.8 the likelihood of the merged entity's buyer power impacting entry and/or expansion in retail grocery markets.

157. We discuss separately in a subsequent section the potential impacts of the Proposed Merger on the development and launch of new grocery products in New Zealand (ie, the Proposed Merger leading to reduced, delayed or no new product innovation).

**The extent of competition between FSNI and FSSI**

158. We have been considering:

158.1 how the Parties go about acquiring grocery products from suppliers and how these processes compare;

158.2 how closely the Parties have competed to date in acquiring grocery products, including how the Parties have competitively reacted to each other; and

158.3 the likely impact of the Proposed Merger on suppliers from removing one of only three major grocery retailer customers.

*What we said in the SoI*

159. In the SoI, we considered that there may be limited circumstances in which the Parties explicitly compete for volume to acquire grocery products from suppliers. Instead the Proposed Merger would reduce the number of major grocery retailer customers with which suppliers bilaterally negotiate from three to two. We noted that:[167]

159.1 FSNI and FSSI sometimes compete directly for volume (eg, for fresh produce in periods of short supply) where growers may not be able to supply all major grocery retailers and tend to go about seeking the best return for their product;

159.2 the Parties operate quite differently from one another with FSNI being more centralised in its operations and FSSI allowing suppliers the ability to

167 SoI at [82.2], [87], [87.1]-[87.2], [88] and [90].

negotiate at the store level (although we note that FSSI is moving to be more centralised);

159.3 the Parties have varied supply arrangements with suppliers; and

159.4 feedback from industry participants suggests that suppliers do not play the Parties off against each other or leverage their position with one in order to obtain better trading terms with the other.

*Submissions from the Parties*

160. The Parties submit that:[168]

160.1 a three to two merger is not a fact-based characterisation of the way buying occurs;

160.2 suppliers treat the Parties as a single national channel to market and it is incorrect to assume that FSNI and FSSI can be regarded as entirely separate heads in the market;

160.3 FSNI and FSSI operate in different territories with different physical distribution infrastructure, and do not meaningfully compete to acquire groceries from suppliers; and

160.4 a product shortage would not generally give rise to more direct competition between the Parties than would occur at any other time.

161. The Parties also submit that 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:[169]

161.1 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);

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

161.3 medium suppliers tend to have realistic options outside the major grocery retailers.

162. Houston Kemp (on behalf of the Parties) further submits that:[170]

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168 The Application at [8.2] and [80], SoPI cross submission from the Parties (7 March 2024) at [102] and SoI submission from the Parties (26 April 2024) at [28], [36] and [38].

169 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.

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

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

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

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

*Third party submissions and evidence received*

163. Anonymous G's submission agrees with our characterisation of the Proposed Merger as a three to two reduction in the number of major grocery retailers acquiring groceries from suppliers, and also that FSNI and FSSI currently present alternative channels to market and separate opportunities for suppliers to have products listed.[171]

164. Lisa Asher submits that there are currently three supermarket buyers in New Zealand and three options for suppliers to sell their product into.[172]

165. The Food and Grocery Council 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.[173]

166. Industry participants consider that:

166.1 the Parties do not generally compete for volume from grocery products (including due to the geographical separation and/or different territories in which each of FSNI and FSSI operate);[174] but

166.2 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.[175]

*Our current view*

167. The Parties compete directly for volume from suppliers in limited circumstances (for example, in periods of short supply, which may happen in relation to fresh produce, but there are also potentially other times when products are in short supply

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

172 SoI submission from Lisa Asher (25 April 2024) at 5. We note that 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 26.

173 SoI submission from the Food and Grocery Council (26 April 2024) at [13.3].

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

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

– eg, imported products facing shipping problems) and this competition would be lost as a result of the Proposed Merger.[176]

168. There appears to be a few 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.[177] However, suppliers that we have spoken with (across different categories and of varying sizes) consider that in practice:

168.1 there is no mechanism with which they can directly play the Parties off against each other;[178]

168.2 they do not leverage their position or terms with one in order to obtain better trading terms with the other;[179] or

168.3 they do not share terms between the Parties.[180]

169. Even when FSNI and FSSI are not explicitly competing for volume from a supplier, the Proposed Merger would lessen competition and increase buyer power. This is because a single negotiation with the merged entity would raise the stakes and the cost of disagreement for suppliers, compared to separate negotiations with each of FSNI and FSSI. Disagreement with either FSNI or FSSI, separately, could mean a supplier would lose the margins associated with sales to one of the Parties, whereas disagreement with the merged entity could mean a supplier would lose the margins associated with all sales to the Parties. We have been told that the Proposed Merger would reduce suppliers' ability to negotiate and that this would be challenging for small suppliers.[181]

170. While the Parties serve different islands and operate quite differently (including the potential for FSNI and FSSI to reach different terms),[182] we remain of the view that the Proposed Merger would reduce the number of major grocery retailer customers with which suppliers can negotiate from three to two and this would increase the merged entity's buyer power.

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176 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).

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

178 Commerce Commission interview with [ ]. However, one industry participant indicated there are instances where suppliers of fresh produce might play off the Parties against each other albeit this is more in respect of the wholesale space than retail. Commerce Commission interview with [ ].

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

180 Commerce Commission interview with [ ] and [ ]. FSNI also told us that suppliers [ ]. Commerce Commission interview with FSNI (22 February 2024).

181 Commerce Commission interview with [ ].

182 Our review of a sample of 50 supplier contracts common to both Parties indicated that [ ]. See responses to requests for information from FSNI (15 May 2024) and FSSI (10 May 2024).

171. We invite submissions on how closely FSNI and FSSI currently compete to acquire grocery products and the likely impact of the Proposed Merger on suppliers from removing one of the major grocery retailer customers.

**Level of constraint provided by other acquirers of grocery products**

172. We have been considering the extent of suppliers' ability to switch away from the merged entity to supplying rival grocery retailers or other distribution channels (eg, export, wholesale, foodservice, direct to retail consumers), and the constraint that the merged entity would face from other acquirers of grocery products.

*What we said in the SoI*

173. In the SoI, we considered that the merged entity's only meaningful competitor in the acquisition of groceries is Woolworths and that we were not satisfied that the constraint from other grocery retailers, in particular Woolworths, would be sufficient to constrain an exercise of buyer power by the merged entity in the acquisition of grocery products from suppliers. We noted that:[183]

173.1 while Woolworths would be most similar in size and scale to the merged entity, some industry participants consider that the Parties separately compete most closely with Woolworths, as opposed to with each other;

173.2 Woolworths would be the only other major grocery retailer customer (major acquirer of groceries) in New Zealand;

173.3 other grocery retailers[184] (outside of Woolworths) account for a very small proportion of grocery retailers in New Zealand and tend to provide different grocery offerings (ie, partial, wholesale/bulk, specialist and wholefoods);

173.4 feedback from industry participants suggests that they do not consider the smaller grocery retailers would provide any meaningful competitive constraint on the merged entity; and

173.5 evidence does not suggest that alternative channels (ie, export, wholesale, foodservice or direct selling to retail consumers/online) are a realistic alternative for most suppliers.

*Submissions from the Parties*

174. The Parties submit that:[185]

174.1 many suppliers have a strong negotiating position in relation to certain products, for example those that are in concentrated markets where there are limited alternatives, or where suppliers offer well-known brands which retail consumers consider to be a 'must have' product; and

[183] SoI at [96]-[98] and [100].
[184] These include but are not limited to The Warehouse, Costco, Moore Wilson's, Reduced to Clear, Farro Fresh and Bin Inn.
[185] The Application at [132.2] and SoPI cross submission from the Parties (7 March 2024) at [7].

174.2 there is significant market power on the supplier side, for instance in the fresh produce category.

175. The Parties and Houston Kemp (on behalf of the Parties) 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).[186]

176. Houston Kemp also submits that there is a spectrum of options available to suppliers (other than through export) to supply fresh produce into.[187]

*Third party submissions and evidence received*

177. 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.[188]

178. The Grocery Action Group submits that The Warehouse is the only other realistic competitor to the Parties and Woolworths.[189]

179. 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.[190]

180. Rival grocery retailers that we have spoken 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, or with the Proposed Merger would pay higher prices than the merged entity. 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:

180.1 one smaller grocery retailer having told us that the Proposed Merger would have a limited effect on it albeit it does consider the major grocery retailers to

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

187 Houston Kemp report on SoPI (7 March 2024) at [85].

188 SoI cross submission from The Warehouse Group (10 May 2024) at [18(b)]. We note the Parties' response to this submission 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.
[
]. Commerce Commission interview with The Warehouse Group (8 February 2024).

189 SoI submission from the Grocery Action Group (24 April 2024) at [3.10].

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

be its close competitors. It also considers that it already does not acquire groceries on the same supply terms as some of the major grocery retailers;[191]

180.2 [ ];[192]

180.3 [ ], it would consider itself a smaller player relative to the merged entity;[193] and

180.4 [ ].[194]

181. Industry participants that we have spoken with do not appear to see rival grocery retailers other than Woolworths as providing significant constraint on the Parties. For example, one industry participant told us that many other industry participants do not consider The Warehouse to be a "grocery player".[195] Another party that we spoke with noted that other grocery retailers (such as Costco) tend to sit on the "edges" compared to what the major grocery retailers are providing.[196]

182. Suppliers that we have spoken with (across a range of categories and of all sizes) have indicated that, for suppliers:

182.1 volume to the major grocery retailers is important and, for some suppliers, it would be difficult to function without them;[197]

182.2 diverting volume to other channels outside of the major grocery retailers would be challenging; [198] and

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191 Commerce Commission interview with [ ]. While [ ], we do not consider it a direct competitor to the Parties given the differentiated offering and customer base.

192 Commerce Commission interview with [ ].

193 Commerce Commission interview with [ ] and [ ].

194 Commerce Commission interview with [ ].

195 Commerce Commission interview with [ ].

196 Commerce Commission interview with [ ].

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

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

182.3 each of FSNI/FSSI is considered a separate viable option for suppliers and the Proposed Merger removes their ability to divert supply from one of the Parties to the other.[199]

*Our current view*

183. Based on the evidence before us (discussed below) we remain concerned that constraint from other grocery retailers, in particular Woolworths, would not be sufficient to constrain an exercise of buyer power by the merged entity in the acquisition of grocery products from suppliers such that competition would not be substantially lessened.

184. On the basis of the information gathered to date, it appears that for many suppliers, the merged entity's only meaningful competitor in the acquisition of groceries would be Woolworths. There are a number of other retailers who acquire groceries, as set out earlier where we discussed the scope of relevant acquisition markets. However, evidence indicates that these other retailers account for a very small proportion of grocery retailing in New Zealand, compared to the major grocery retailers (the Parties and Woolworths):

184.1 the major grocery retailers are the largest buyers of grocery products in New Zealand and a key route to market for many suppliers, which we have previously assessed (between 2015 and 2019) as accounting for a combined share of supply of between 70% and 90%,[200] and data gathered as part of our investigation of the Proposed Merger (set out in Table 1) shows that the major grocery retailers still account for a similar percentage of supply for some suppliers; and

184.2 anecdotal evidence from suppliers supports this data and other grocery retailers account for a very small proportion of grocery retailing, although we acknowledge that 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.[201] A third supplier (of a range of grocery products) told us that [ ]% of its products go through the major grocery retailers.[202] A fourth supplier (of beverages) told us that the Parties are the primary source of its business,[203] with a fifth supplier (of dry food products) highlighting the dominant role of the Parties in its category.[204] A sixth 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 negligible compared to volumes being acquired by the major grocery retailers.[205] A seventh supplier (of

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[199] Commerce Commission interview with [ ] and [ ].

[200] Market study final report (8 March 2022) at [8.50].

[201] Commerce Commission interviews with [ ] and [ ]. We note that the remaining sales of these suppliers may not solely be to other grocery retailers, as suppliers could also make sales to foodservice wholesalers.

[202] Commerce Commission interview with [ ].

[203] Commerce Commission interview with [ ].

[204] Commerce Commission interview with [ ].

[205] Commerce Commission interview with [ ].

imported food) advised that while, it sells into The Warehouse and Costco, this is relatively small business compared to the major grocery retailers.[206] 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.[207]

185. Suppliers that we have spoken with (across a range of categories) consider that channel diversity and having multi-channels to sell into, is important for suppliers,[208] 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.[209] However, other suppliers and industry participants indicated to us that they saw risks in supplying other grocery retailers or in offering them better prices than the Parties, currently or post-merger:

185.1 one supplier (of a range of grocery products) told us that it would struggle to supply The Warehouse because of that retailer's price demands;[210]

185.2 a second supplier (of a range of ambient products) said that it is not comfortable supplying The Warehouse and taking the risk of cheaper products on shelves being seen by the Parties;[211]

185.3 a rival grocery retailer expressed the view that [ ];[212] and

185.4 an industry participant described the practice of price indexing and noted in supply negotiations (on behalf of suppliers), they are asked what the opposition price is and how they index against it. For example, it 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.[213]

186. There are other alternative channels (including through food service, or direct selling online) for some suppliers. However, these do not appear to be a meaningful option for most suppliers (other than some suppliers of fresh produce).

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206 Commerce Commission interview with [ ].

207 Commerce Commission interview with [ ].

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

209 Commerce Commission interview with [ ].

210 Commerce Commission interview with [ ].

211 Commerce Commission interview with [ ].

212 Commerce Commission interview with [ ].

213 Commerce Commission interview with [ ].

186.1 Woolworths considers that producers and growers of fresh fruit and vegetables have significant options/alternative channels (eg, central markets, direct to customers, export, food service, food processors and meal kits), noting that export is the biggest market for many farmers/growers, while local consumer markets constitute a small proportion of their supply.[214]

186.2 One supplier (of fresh products) told us that its whole business is catered towards the major grocery retailers, and it would be very difficult to move to foodservice.[215]

186.3 A large supplier (of chilled products) 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.[216]

187. We consider that there are 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 the concern 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). In terms of evidence on this point from industry participants and suppliers (across a range of categories) that we have spoken with, we note that:

187.1 some 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;[217]

187.2 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;[218] and

187.3 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.[219]

188. Finally, even for suppliers that could divert some or all of their product to other channels such as export or food service, it may be difficult for those suppliers to do

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214 E-mail from Woolworths to the Commerce Commission (17 April 2024). We note this is consistent with the view shared by some growers of fresh produce that we have spoken with, that they tend to go about seeking the best return for their product in the market. Commerce Commission interviews with [ ] and [ ].

215 Commerce Commission interview with [ ].

216 Commerce Commission interview with [ ].

217 Commerce Commission interviews with [ ] and [ ].

218 Commerce Commission interview with [ ].

219 Commerce Commission interview with [ ].

so quickly and easily. For example, one supplier told us that if the merged entity's buyer power led to the merged entity wanting better terms, the supplier could look to alternative channels out of survival. However, it noted that food service would be unlikely to replace the volume lost 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).[220] Another industry participant also noted that when a product is delisted, a supplier has to create new customers to make up the volume, which is difficult to do in the short term.[221]

189. We invite submissions on:

189.1 the ability of suppliers to switch from the Parties to rival grocery retailers and/or other distribution channels;

189.2 the constraint that the merged entity would face from rival grocery retailers in relevant upstream markets for the acquisition of groceries; and

189.3 whether any constraint would be sufficient to constrain an exercise of buyer power by the merged entity.

**Impact of the previous North Island Foodstuffs merger**

190. We are considering what the impacts were of the previous North Island Foodstuffs merger in 2013 on upstream markets for the acquisition of groceries, including on buyer power and competition in those markets, and whether it offers any insights into the potential effects of the Proposed Merger in such markets.

*What we said in the SoI*

191. In the SoI, we considered that:[222]

191.1 a few suppliers we had spoken with consider that the previous North Island Foodstuffs merger did bring about efficiencies in terms of streamlining of processes, aligned strategy and simplification; but

191.2 conversely, however, we had also heard from industry participants who consider that the previous North Island Foodstuffs merger led to increased margin for the merging parties, a reduction of suppliers entering the market and did not result in the lower retail grocery prices for consumers that were promised at the outset.

*Submissions from the Parties*

192. The Parties submit that:[223]

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220 Commerce Commission interview with [ ].

221 Commerce Commission interview with [ ].

222 SoI at [113].

223 SoPI cross submission from the Parties (7 March 2024) at [63] and SoI submission from the Parties (26 April 2024) at [144]-[145].

192.1 they disagree with The Warehouse Group's submission on the previous North Island Foodstuffs merger (set out below);

192.2 the concerns suppliers have raised about the inefficiencies associated with the Parties separate buying structures were previously also raised with respect to the previous North Island Foodstuffs merger and subsequently alleviated by the completion of that merger; and

192.3 the previous North Island Foodstuffs merger was pro-competitive.

*Third party submissions and evidence received*

193. The Food and Grocery Council submits that in response to its survey, suppliers consider that:[224]

193.1 they experienced a shift towards centralised decision-making, with the new entity exerting dominance in negotiating better terms and that negotiations often favoured the terms where there was the lowest cost, resulting in reduced profitability for some suppliers;

193.2 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

193.3 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 the merged entity as well as alignment of terms and voidance of historical agreements.

194. 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 statements made by the Parties about the Proposed Merger should be treated with caution.[225]

195. Industry participants that we have spoken with (including suppliers across a range of categories and of all sizes, both large multinationals and smaller local suppliers) have expressed mixed views on the impacts of the previous North Island Foodstuffs merger and on the insights of this for our assessment of the Proposed Merger.

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224 SoI submission from the Food and Grocery Council (26 April 2024) at [15.2], [15.5] and [15.8]. We note the Parties' response to this submission 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.

225 SoPI submission from The Warehouse Group (9 February 2024) at [6]-[7], [31]-[36]

195.1 Four suppliers (in different categories) told us that the previous North Island Foodstuffs merger had very little impact or no significant change/difference, with one noting that with one point of contact, dealings with FSNI became easier, rationalised, centralised and/or smooth.[226] 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.[227] However, one supplier (of health and beauty products) expressed the view that Foodstuffs Wellington behaved very differently to Foodstuffs Auckland.[228] One supplier (of fresh products) explicitly told us that there were “no instances of increased pressure from Foodstuffs” with the previous North Island Foodstuffs merger.[229] 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.[230]

195.2 However, five suppliers indicated that there was a change in buyer power as a result of, 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.[231] 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.[232] A third supplier (of chilled products) noted that it lost a competitive customer with the previous North Island Foodstuffs merger.[233] A fourth supplier (of beverages) noted that while some suppliers benefitted from that merger, others lost out.[234] A fifth 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.[235]

195.3 In terms of the insights we might 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

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

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

228 Commerce Commission interview with [ ]. This supplier also considered 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.

229 Commerce Commission interview with [ ].
[ ].

230 Commerce Commission interview with [ ].

231 Commerce Commission interview with [ ].

232 Commerce Commission interview with [ ].

233 Commerce Commission interview with [ ].

234 Commerce Commission interview with [ ].

235 Commerce Commission interview with [ ].

Wellington than between FSNI and FSSI,[236] implying 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,[237] with another industry participant considering that head office had less control over individual members at the time of the previous North Island Foodstuffs merger,[238] both suggesting that the effects of the Proposed Merger could be different.

*Our current view*

196. While Foodstuffs Auckland and Foodstuffs Wellington both operated within the same island, with some industry participants considering that their operating models were quite similar, several concerns raised by suppliers with respect to the previous North Island Foodstuffs merger may be relevant to our assessment of the Proposed Merger. In particular, it may point to outcomes which could occur again, albeit we consider that any similar effects would likely be worse due to the greater consolidation represented by the Proposed Merger, and the fewer remaining alternative major grocery retailers though which suppliers can supply product. As outlined above, the concerns raised about the impact of the Foodstuffs Auckland and Foodstuffs Wellington merger generally consist of the ideas that:

  196.1 the reduction in customers from four (FSSI, Woolworths, Foodstuffs Auckland and Foodstuffs Wellington) to three (FSNI, FSSI and Woolworths) in and of itself resulted in fewer negotiation points for suppliers and one less customer with which suppliers could sell product into; and

  196.2 the centralised buying model led to a rationalisation in product range and supplier base as well as reduced opportunities to negotiate and form relationships at the store level, which has had an impact on smaller suppliers and the extent to which they are able to innovate and range in individual FSNI grocery stores.

197. Similar issues to those noted above have been raised by industry participants in respect of the Proposed Merger. We consider that the previous North Island Foodstuffs merger highlights the extent to which the Proposed Merger would further consolidate the number of customers with which suppliers can negotiate from three to two, removing a separate point of negotiation for suppliers, an avenue to supply product into and an opportunity to bring new products to market. Depending on the extent to which efficiencies are relevant to our assessment of whether the Proposed Merger substantially lessens competition, the previous North Island Foodstuffs merger may also assist us in assessing the extent to which any efficiencies from the Proposed Merger are likely to be realised and shared with retail consumers.

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236 Commerce Commission interviews with [ ] and [ ].

237 Commerce Commission interview with [ ].

238 Commerce Commission interview with [ ].

198. We invite submissions on the impact of the previous North Island Foodstuffs merger on upstream markets for the acquisition of groceries, including on whether following that merger:

198.1 the prices FSNI paid to suppliers reduced and/or the trading terms on which FSNI dealt with suppliers worsened;

198.2 any increased bargaining/buyer power held by FSNI negatively impacted on suppliers or competition in upstream acquisition markets for the of groceries; and

198.3 efficiencies were generated that were passed on by FSNI to retail consumers.

**Countervailing power of suppliers**

199. We have been considering the extent to which any suppliers possess countervailing power which they would be able to use to prevent the exercise of market power by the merged entity.

200. To assess countervailing power in a merger between competing buyers, we are generally concerned with 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 is not realistic that suppliers could sponsor new entry, and the major grocery retailers remain the gatekeepers of access to most New Zealand consumers regardless of the product.

201. It may be that there are some 'must have' products 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, but any such situation would not be common, and not material to our assessment of the Proposed Merger. Further, if an agreement is not reached between a supplier and the Parties, the immediate implications are far more severe for any supplier, regardless of the product, than a major grocery retailer (which would continue as normal).

*What we said in the SoI*

202. In the SoI, we considered that in general, suppliers may not have countervailing power, but if they do, they are not likely to be able to exercise it to the extent that they would meaningfully constrain an exercise of buyer power by the merged entity. We noted that:[239]

202.1 some suppliers may potentially be able to exercise some degree of influence over the major grocery retailers in relation to unique products and whether they have volume and resource to supply nationwide; but that

202.2 there is no evidence that points to a general ability of any suppliers to bypass, or credibly threaten to bypass the merged entity.

[239] SoI at [82.5] and [91]-[92].

*Submissions from the Parties*

203. The Parties submit that suppliers have material countervailing power and that in their view:[240]

    203.1 large, multinational suppliers (which make up a significant percentage of the Parties' total sales) generally have parent companies many times larger than the Parties and, in many cases sell "must-have" items;

    203.2 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; and

    203.3 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.

204. Houston Kemp (on behalf of the Parties) also submits that strength of brand and market power on the supply-side are due to larger national suppliers having a stronger bargaining position.[241]

205. Houston Kemp further considers that:[242]

    205.1 [ ];[243] and

    205.2 [ ].

*Third party submissions and evidence received*

206. 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.[244]

207. Industry participants that we have spoken with (including suppliers across a range of categories and of all sizes, both large multinationals and smaller local suppliers) have expressed mixed views on whether there is any countervailing power on the part of any suppliers.

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240 SoI submission from the Parties (26 April 2024) at [47]-[49].

241 Houston Kemp report on SoPI (7 March 2024) at [56].

242 Commerce Commission interview with Houston Kemp (12 June 2024).

243 We note 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.

244 SoI submission from the Food and Grocery Council (26 April 2024) at [10.2].

207.1 Evidence 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. For example, 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).[245] A second supplier (of a range of ambient products) expressed the view that a supplier the size of Coca Cola (for example) would never be delisted (even if it was underperforming) because it is a massive contributor to the margin of FSNI.[246] 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 "leg up", and the other noting that planograms allow for local/regional suppliers).[247] A fifth 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."[248]

207.2 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 argument/questions on price.[249] A second supplier into FSSI 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.[250]

207.3 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.[251] Woolworths considers that a large proportion of suppliers have alternative options to supplying it and therefore exert countervailing power and constraint on it in negotiations.[252]

207.4 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

245 Commerce Commission interview with [ ].

246 Commerce Commission interview with [ ]. Although we note that overseas Coca Cola has had products delisted or not ranged by major grocery retailers overseas at times. See https://www.smh.com.au/goodfood/eating-out/woolworths-refusing-to-stock-coca-cola-no-sugar-20170706-gx5kti.html and https://supermarketnews.co.nz/news/shifts-in-supermarket-strategy/.

247 Commerce Commission interviews with [ ] and [ ].

248 Commerce Commission interview with [ ].

249 In this instance, the supplier referred to its [ ]. See Commerce Commission interview with [ ].

250 Commerce Commission interview with [ ].

251 E-mail from Woolworths to the Commerce Commission (17 April 2024).

252 E-mail from Woolworths to the Commerce Commission (17 April 2024).

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:

207.4.1 An industry participant told us that [ ], a supplier of [ ] products was completely de-ranged in FSNI and [ ] (a supplier of [ ] products) was forced to exit the market due to an inability to meet the Parties' margin expectations;[253]

207.4.2 One supplier (of [ ] products) 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 [ ];[254]

207.4.3 A second 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;[255]

207.4.4 A third supplier (of [ ] products) told us that it has seen some big manufacturers exiting categories over time including [ ], major suppliers of [ ] which caused a shortage in the market and itself, having exited [ ] in the past few years because of the Parties' margin aspirations;[256]

207.4.5 A fourth supplier was listed over its competitor's product because it cut its margin in order to keep business;[257]

207.4.6 A fifth supplier told us that it had recently had to reduce its production because it could not afford to sell at FSNI's desired price;[258] and

207.4.7 A sixth supplier had its [ ] delisted in FSNI and noted these scenarios are usually in connection with FSNI seeking margin.[259]

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253 Commerce Commission interview with [ ].

254 The product referred is [ ]. Commerce Commission interview with [ ].

255 Commerce Commission interview with [ ].

256 Commerce Commission interview with [ ].

257 Commerce Commission interview with [ ].

258 Commerce Commission interview with [ ].

259 Commerce Commission interview with [ ].

*Our current view*

208. Some suppliers may have special characteristics that would enable them greater ability to resist a price reduction (or imposition of less favourable terms) by the merged entity including in terms of products that are unique, well-known, or have strong brand awareness. However, based on the evidence before us, we do not consider that the majority of suppliers are able to exert countervailing power to the extent that they could prevent an exercise of buyer power by the merged entity. Even if some suppliers do have a degree of countervailing power, the Parties generally have multiple sources of supply, have the ability to dictate terms to suppliers, and appear to prioritise margin expectations over strength of brand and ranging – all of which would be further exacerbated with the Proposed Merger.

209. We have received mixed evidence to support the proposition that, where a supplier might have a 'must have' product, or particular strength in one category, that the supplier would be able to leverage this power into the supply of other products in its portfolio. One supplier (of beverages) 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.[260] Conversely, Anonymous G submits that [ ].[261]

210. We remain concerned that suppliers (even large suppliers) may be impacted by a bargaining power imbalance with the Proposed Merger due to having one less major grocery retailer customer with which to negotiate and as a channel to reach the domestic grocery market.[262]

211. We invite submissions on the extent to which:

    211.1 different suppliers possess countervailing power;

    211.2 the Proposed Merger would materially increase or decrease any supplier countervailing power;

    211.3 suppliers would be able to exercise countervailing power to protect themselves from an exercise of buyer power by the merged entity; and

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260 Commerce Commission interview with [ ].

261 SoI submission from Anonymous G (18 April 2024) at [12b].

262 For example, [ ]. Commerce Commission interview with [ ].

211.4 whether there are any instances where suppliers have sought to (whether successful or not) bundle or tie the supply of a 'must have' product with other products they supply.

**Move to centralisation**

212. Currently individual FSNI and FSSI store owners can, to varying degrees, make some procurement decisions independently. For example, individual stores may make their own ranging decisions, or often make their own deals with suppliers in relation to promotions that overlay central arrangements (rather than all terms being controlled centrally by a head office). The prevalence of these types of arrangements appears to vary by region and by banner. Both parties are moving to more centralisation, but FSNI is more progressed in this endeavour.

213. We have been considering the extent to which the Proposed Merger would further accelerate the roll out of the centralised grocery procurement model in FSSI and alternatively, whether FSSI would take longer to 'centralise' in the counterfactual compared to the factual, and whether centralisation would harm competition by removing the potential for suppliers to negotiate directly with individual FSNI and FSSI grocery stores.

*What we said in the SoI*

214. In the SoI, we considered that:[263]

214.1 several industry participants considered that the Proposed Merger would enable the process of centralisation to accelerate, and that a move to a more centralised model would mean the loss of an opportunity and flexibility to negotiate at the store level, and overall, one less opportunity (in terms of the major grocery retailers) to negotiate entry to the market; but that

214.2 there are also some suppliers who consider that there would be benefits to dealing with one entity, as opposed to any negotiations taking place at a store level, due to enabling them to streamline processes and the efficiency of doing business[264] with one noting, however, that they are likely to lose range as a result.[265]

*Submissions from the Parties*

215. The Parties submit:[266]

215.1 that both FSNI and FSSI are in the process of transitioning to more centralised decision making (including more centralisation in relation to acquiring grocery products) and that FSNI is further advanced in this transition;

263 SoI at [115]-[116].
264 Commerce Commission interview with [ ].
265 Commerce Commission interview with [ ].
266 SoPI cross submission from the Parties (7 March 2024) at [22], [24], [27] and [29] and SoI cross submission from the Parties (6 May 2024) at [11]-[13] and 17.

215.2 suppliers (highlighting small suppliers) would continue to be able to deal with individual stores post-merger; and

215.3 centralised buying would continue with or without the Proposed Merger for both the Parties, although this does not eliminate the ability of suppliers to supply a single store or for stores to carry out local ranging (or that any local decision making would change).

*Third party submissions and evidence received*

216. The Food and Grocery Council submits that, in response to its survey, suppliers (including suppliers in various product categories, and large multinational suppliers):[267]

216.1 expressed the opinion that FSSI is currently a counterbalance to centralised power and worry that its integration into the merged entity would further exacerbate issues with centralised power; and

216.2 consider that a concentration of decision-making power at a national level and potential homogenisation of terms with the Proposed Merger could further restrict suppliers' autonomy and diversity within grocery markets, indicating that direct dealings with stores are becoming increasingly difficult which it expects to intensify post-merger.

217. Anonymous C submits that the Proposed Merger would allow the merged entity to centralise its decision-making power, and there is potential for the merged entity to wield its power to influence pricing and service quality.[268]

218. Industry participants and suppliers that we have spoken with (across a range of categories) are concerned that centralisation would result in fewer negotiation points and/or removal of the ability to deal at the grocery store level in the South Island,[269] with one supplier noting that central ranging decisions have big implications.[270] Suppliers (across a range of categories and of all sizes) have indicated that this networking and relationships at the store level in respect of FSSI is important to them and a unique feature of the current South Island model.[271] However, one supplier considers that it still has flexibility at the store level even though FSSI are moving to a centralisation model.[272] A second supplier (of fresh

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267 SoI submission from the Food and Grocery Council (26 April 2024) at [16.2]-[16.3] and [16.5]. We note the Parties' response to this submission that there would be no merger impact on direct dealing with grocery stores. SoI cross submission from the Parties (6 May 2024) at 19.

268 SoPI submission from Anonymous C (25 January 2024) at 2.

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

270 Commerce Commission interview with [ ].

271 Commerce Commission interviews with [ ], [ ], [ ] and [ ]. [ ] told us that it can make the most of leveraging currently with FSSI. Commerce Commission interview with [ ].

272 Commerce Commission interview with [ ].

products) also said in respect of FSNI that the relationship at the grocery store level is important and has been built over the last 30 years.[273]

219. However, other suppliers that we have spoken with (across a range of categories and of all sizes) have indicated that there are benefits to dealing with one central entity, as opposed to any negotiations taking place at a store level, due to enabling suppliers to streamline processes and the efficiency of doing business or because those suppliers broadly prefer a centralised buying model.[274]

220. We have been told that the Proposed Merger "would centralise what is already a power-driven market dynamic".[275]

*Our current view*

221. Based on the evidence before us (discussed below) we do not consider that there is a material difference between the factual and counterfactual in terms of centralisation of procurement by the Parties. The Proposed Merger may not make a substantial difference to the extent of centralisation of procurement by the Parties.

222. FSNI and FSSI are both, currently and absent the Proposed Merger, independently transitioning toward greater centralisation of procurement at the head office level. While FSNI is generally more advanced in this transition, in the counterfactual, FSSI is still likely to continue to transition toward more centralised procurement, and we have not received any evidence that this transition would be materially more complete or expedient if undertaken by a merged entity as opposed to FSSI.

223. Evidence gathered to date indicates that FSSI has incentives to centralise its procurement without the Proposed Merger, in order to recognise the benefits of simplified arrangements with suppliers. We have not identified any structural limitations due to FSSI's size that suggest it could not successfully implement a centralised procurement strategy without the Proposed Merger to the same degree as the merged entity could with the Proposed Merger.

224. As noted above, we have heard from many suppliers that FSNI has moved to a centralised buying model for acquisition of groceries, thereby removing store-by-store negotiation, and there is concern that this would also be rolled out within FSSI, potentially at a faster rate with the Proposed Merger. However, the Parties submit that the Proposed Merger would have no effect on suppliers' ability to deal with individual grocery stores.[276]

225. We invite submissions on:

    225.1 the implications of the merged entity having one centralised buying office for the whole of New Zealand; and

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273 Commerce Commission interview with [ ].

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

275 Commerce Commission interview with [ ].

276 SoI cross submission from the Parties (6 May 2024) at 17.

225.2 whether moves by the Parties towards a more centralised grocery procurement model would differ in the factual versus the counterfactual and, if so, what the implications of this would be for competition in acquisition markets.

**Private label**

226. We have been considering whether the Proposed Merger would increase the ability and/or the incentive of the merged entity to:

226.1 increase private label penetration (and whether this would lessen competition in any relevant acquisition markets by potentially resulting in some suppliers of branded grocery products getting squeezed out and less choice/range for consumers); and/or

226.2 use the threat of switching to private label as a tool in negotiations with suppliers, such that it would be able to extract better terms from suppliers.

227. Private label grocery products (also known as home brands, own brands, store brands or generics) are products manufactured or provided by a company for sale under a grocery retailer's brand. Private label products are generally produced by existing suppliers, who win private label contracts through a tender process.

228. The Parties each own 50% of FOBL. FOBL functions to negotiate trading terms and pricing with national suppliers in respect of products purchased and marketed under the Parties' private label brands. The Parties' private label brands include the Pams, Pams Superfoods, Pams Finest and the Value ranges.[277]

229. The Parties, in submissions on the market study, explained that private label brands were first developed in response to suppliers of commoditised products having a strong negotiating position. As private label brands have gained greater acceptance, the Parties have extended the model to items that are less commoditised (for example, Pams Finest).[278]

230. The market study noted that the impact of private label grocery products on New Zealand consumers is unclear. It noted that consumers can benefit from lower prices and greater choice offered by private label products, but that private label products can also distort competition between suppliers.[279] Suppliers of private label products typically also produce products under their own brand (supplier-branded products) in competition with private label. Therefore, the Parties when selling private label products are both customers and competitors of branded suppliers.

231. Further, in the market study, the Commission considered that private label grocery products have the potential to negatively affect the already weak bargaining position of suppliers. Given that the major grocery retailers selling private label products are both customers and competitors of suppliers, the major grocery retailers may have

[277] The Application at [43] and [128.1].
[278] FSSI post conference submission (3 December 2021) at [44] and FSNI post conference submission (3 December 2021) at [64].
[279] Market study final report (8 March 2022) at [3.182].

incentives to ensure their private label products receive preferential treatment to supplier-branded products.[280]

*What we said in the SoI*

232. In the SoI, we considered that:[281]

232.1 suppliers compete with the Parties' private label products and work hard to differentiate their products in terms of quality and price point;

232.2 some suppliers have noted a recent increase in volume for private label products, which they see as a result of the cost-of-living crisis/economic conditions or the Parties' promotional push for private label; and

232.3 an increase in private label penetration is a concern for suppliers who may supply both private label and their own branded products to the Parties, with some noting a concern around erosion in the acquisition of their branded products compared with private label, or the potential erosion of their own products in light of an increase in buyer power with the Proposed Merger.

*Submissions from the Parties*

233. The Parties submit that the Proposed Merger is not capable of giving rise to a lessening of competition with respect to private label:[282]

233.1 there is some joint procurement by the Parties already occurring (mainly in relation to private label), and this would effectively continue following the Proposed Merger;

233.2 private label products must compete with branded products on price; and

233.3 private label products are considered against the same criteria as branded products (including for de-ranging) and compete with branded products.

234. The Parties further submit that private label:[283]

234.1 is pro-competitive and enhances competition at the supplier level;

234.2 is often increased to promote competition in product categories where there is high supplier concentration;

234.3 provides valuable volume to local suppliers and increases efficiency; and

234.4 promotes innovation and offers more choice for retail consumers.

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280 Market study final report (8 March 2022) at [8.170].

281 SoI at [119].

282 The Application at [132.1], SoI submission from the Parties (26 April 2024) at [124] and SoPI cross submission from the Parties (7 March 2024) at [35], [37] and [89].

283 SoPI cross submission from the Parties (7 March 2024) at [37] and SoI submission from the Parties (26 April 2024) at [129]-[135].

235. Houston Kemp (on behalf of the Parties) submits that the Grocery Supply Code means that the Parties could not discriminate against suppliers in favour of private label products.[284]

*Third party submissions and evidence received*

236. The Warehouse Group submits that the increased market power of the merged entity may allow it to expand its own private label offering at the expense of a wider range of other products or brands, and that if this occurred, it would have a negative outcome for suppliers who would be squeezed out of supplying products under their own brands, and also for retail consumers who would have reduced product choice.[285]

237. Northelia submits that the Proposed Merger would further perpetuate the scale of private label and “value chain theft” from New Zealand suppliers.[286]

238. The Food and Grocery Council submits that the Proposed Merger would consolidate “brand buying power, particularly for [the Parties’] private label (because the proposed merged entity would represent close to 60% of the grocery sector). Deranging to accommodate this leaves consumers with less choice. Further effects would include a loss of benchmarking and options”.[287]

239. The Food and Grocery Council’s SoI submission centres around the private label aspect and further submits that:[288]

    239.1 the merged entity would have the ability and incentive to expand private label when the only competing major grocery retailer seems to be adopting that path;

    239.2 in response to its survey, suppliers consider that the merged entity would pivot towards private label offerings, shifting away from traditional suppliers and reducing consumer choice;

    239.3 the merged entity could potentially favour national contracts and sourcing more private label products; and

    239.4 in response to its survey, suppliers consider that the Proposed Merger may result in increased pressure to convert products to private label or to support the introduction new private label items.

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284 Houston Kemp report on SoI (26 April 2024) at [50].

285 SoI cross submission from The Warehouse Group (10 May 2024) at [25]. We note the Parties’ response to this submission that both Parties make ranging decisions based on customer demand, as well as other considerations including profit margin. The Parties further note that the Proposed Merger should not give rise to any material effect on private label. SoI cross submission from the Parties (31 May 2024) at 9.

286 SoPI submission from Northelia (27 February 2024).

287 SoPI submission from the Food and Grocery Council (19 February 2024) at [5(g)].

288 SoI submission from the Food and Grocery Council (26 April 2024) at [4.6(a)(ii)], [17.2], [17.4] and [17.6(vi)]. We note the Parties’ response to this submission that the Proposed Merger is not capable of giving rise to change to competition with respect to private label. SoI cross submission from the Parties (6 May 2024) at 19-20.

240. Two parties we have spoken with have noted a concern around the potential for an increase in buyer power to enhance the merged entity's private label offering,[289] with a supplier (of dry food products) also indicating that private label can alter a supplier's negotiating position.[290]

*Our current view*

241. Based on the evidence before us (discussed below) we do not consider that there is likely to be a material difference between the factual and counterfactual in terms of penetration of private label, or the ability for either FSNI or FSSI to use private label as a bargaining tool in their negotiations with suppliers. However, we consider that the prevalence of private label is relevant to the assessment of any current disparities in the bargaining power between the Parties and some grocery suppliers. For example, one large multinational supplier told us that if grocery retailers increase demands year on year, and use private label as a fall back, the power imbalance is significant.[291]

242. The negotiations with suppliers of private label (for private label) would be largely unaffected by the Proposed Merger, since most private label activities[292] are already conducted by the Parties jointly as a shared national operation FOBL, and this would continue in both the factual and counterfactual.

243. FSNI and FSSI each currently make their own ranging decisions in relation to private label (and the products with which private label products compete), including with respect to private label. However, FSNI and FSSI currently have the ability and incentive to maximise private label penetration across various products in their stores to the extent that it is profitable, and we have no evidence to suggest the Proposed Merger would materially affect these incentives or this ability.

244. While there are some statements in the Parties internal documents which indicate that [ ],[293] and we have identified one instance where the Parties [ ] and we do not consider this indicates that there is a material increase in the Parties' ability and incentive to anti-competitively increase private label in comparison to the factual.

245. While the ability and incentive of the Parties in terms of private label may be the same both with and without the Proposed Merger, the impact of private label on negotiations with suppliers may be greater with the Proposed Merger. This could be the case if the greater buyer power of the merged entity, combined with private

289 Commerce Commission interviews with [ ] and [ ].

290 Commerce Commission interview with [ ].

291 Commerce Commission interview with [ ].

292 A notable exception is fresh milk, for which each of the Parties has their own private label supplier within each of the North Island and South Island (given the nature of the product).

293 [ ]

label being used as a tool by the merged entity in negotiations, meant that suppliers felt more pressure to accept unfavourable terms with the Proposed Merger.

246. We invite submissions on whether the Proposed Merger would increase the ability and/or the incentive of the merged entity to:

246.1 increase private label penetration;

246.2 use private label as a tool to tie up the capacity of suppliers and limit their capacity to supply rival grocery retailers; and/or

246.3 use the threat of switching to private label as a tool in negotiations with suppliers, such that it would be able to extract better terms from suppliers.

**Impact of the GICA**

247. The GICA was passed in 2023 in response to the market study, introducing new regulations and giving the Commission new powers to monitor and report on competition and efficiency in the grocery sector for the long-term benefit of retail consumers. In particular, the GICA provided for the Grocery Industry Competition Regulations 2023, which contain the Grocery Supply Code. The Grocery Supply Code is a set of rules about the agreements and conduct between the regulated grocery retailers (which are FSNI, FSSI and Woolworths) and grocery suppliers.

248. We have considered whether the existence of the GICA (and associated grocery sector-specific regulation) would act to constrain the merged entity from exercising buyer power or otherwise protect the competitive process in relevant upstream markets for the acquisition of groceries.

*Submissions from the Parties*

249. The Parties submit that 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 consumers.[294]

250. The Parties further submit that:[295]

250.1 the Proposed Merger would not defeat the purpose of the GICA and the Grocery Supply Code and that they are committed to complying with the Grocery Supply Code; and

250.2 there would continue to be intense scrutiny of regulated grocery retailer's conduct towards suppliers, in both the factual and counterfactual, which would buttress suppliers' countervailing power.

294 The Application at [7].

295 SoI submission from the Parties (26 April 2024) at [54] and [93.3] and SoI cross submission from the Parties (6 May 2024) at 10 and 20.

*Third party submissions and evidence received*

251. Few industry participants have referred to the GICA and/or the Grocery Supply Code in engagement with us during our investigation of the Proposed Merger, and the few that have done so have differing views.

251.1 The Food and Grocery Council submits that despite the Grocery Supply Code, there remains a significant imbalance of power between the regulated grocery retailers and suppliers, which is evidenced by the Parties' general approach to compliance with the Grocery Supply Code, and by the fact that the Parties appear to contract out of key protections of the Grocery Supply Code. The Food and Grocery Council further submits that the Proposed Merger would be contrary to the achievement of expectations in GICA and there is nothing in the Grocery Supply Code to address the effects of an increase in market power from a three to two buy-side merger.[296]

251.2 The Grocery Action Group submits that the Proposed Merger would effectively defeat the purpose of GICA and the Grocery Supply Code which are both in place to protect retail consumers from this type of merger.[297]

251.3 Conversely, one supplier (of chilled products) told us that the good faith obligations and prohibitions in the Grocery Supply Code may help mitigate the risks of some of the potential negative consequences of the Proposed Merger.[298] A second supplier (of dry food products) similarly noted that while the Proposed Merger would substantially increase the merged entity's bargaining position, it would be more nervous about the Proposed Merger if New Zealand did not have the Grocery Supply Code.[299]

*Our current view*

252. The GICA was introduced to address instances of competition issues observed by the Commission in its market study. In relation to suppliers, the market study concluded that many suppliers are reliant on business with the major grocery retailers and that the limited state of competition in the grocery sector allows the major grocery retailers to transfer costs, risks and uncertainty onto suppliers – and this can reduce the ability and incentives for suppliers to invest and innovate, reducing choice for consumers.[300]

253. The Commission is hopeful that the GICA will in the long-term, make improvements in the grocery sector which improve outcomes for New Zealanders. However, new regulations are designed to address some of the competition issues brought about by

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296 SoPI submission from the Food and Grocery Council (19 February 2024) at [80] and SoI submission from the Food and Grocery Council (26 April 2024) at [3.5], [4.8] and [6.4]. We note the Parties' response to this submission that there is no merger effect identified. SoI cross submission from the Parties (6 May 2024) at 10.

297 SoI submission from the Grocery Action Group (24 April 2024) at [1]. We note the Parties' response to this submission that the Proposed Merger would not defeat the purpose of GICA and the Grocery Supply Code. SoI cross submission from the Parties (6 May 2024) at 20.

298 Commerce Commission interview with [ ].

299 Commerce Commission interview with [ ].

300 Market study final report (8 March 2022) at 324.

the existing high levels of concentration in the grocery sector. They are not intended, and would not, mitigate the structural loss of competition that would result from the Proposed Merger. If the Grocery Supply Code does improve conditions for suppliers, a future in which suppliers are able to use the Grocery Supply Code to obtain better terms from three major grocery retailer customers, would be materially more competitive than a future with the Proposed Merger, where suppliers can use the Grocery Supply Code to obtain better terms from only two major grocery retailer customers.

254. Furthermore, it is not clear that the current regulatory intervention will make a material impact in a timeframe that would be relevant to assessing the effects of the Proposed Merger. For example, the Grocery Supply Code is based on similar codes in Australia and the United Kingdom. In Australia, the relevant code has been in operation for almost a decade, and power imbalance issues have been consistently identified in successive reviews of its efficacy.[301] These reviews highlight that breaches of the Australian code are often unreported, with suppliers fearful of retaliation due to the buyer power of Australian major grocery retailers. In this respect it is possible that the Proposed Merger could lessen the efficacy of new regulations.

255. We invite submissions on whether the existence of the GICA (and associated grocery sector-specific regulation) would act to constrain the merged entity from exercising buyer power or otherwise protect suppliers/competition in relevant upstream markets for the acquisition of groceries. Conversely, we also invite submissions on whether any increase in buyer power resulting from the Proposed Merger, could impact the efficacy of sector-specific regulation (for example, the Grocery Supply Code).

**Likelihood of the merged entity's buyer power impacting entry and/or expansion in retail grocery markets**

256. Under the Act, we are required to decline to give clearance if we are not satisfied that the Proposed Merger would not be likely to have the effect of substantially lessening competition in a market. As discussed previously, the Act does not limit the scope of the markets in which we can or should identify a likely substantial lessening of competition to seller-side markets only.

257. As noted earlier in discussing the framework for assessing the Proposed Merger, our view is that a substantial lessening of competition between buyers is a concern in itself, and that it is not necessary to demonstrate that the Proposed Merger would also

301 See, for example, Australian Treasury, Independent review of the Food and Grocery Code of Conduct Review 2018 Final Report (September 2018) at 37, where the review noted that it was not aware of any disputes undergoing mediation or arbitration under the Australian code "due to a fear [by suppliers] of retribution associated with escalating complaints against retailers." Similarly, in ACCC, Perishable Agricultural Goods Inquiry 2020 (November 2020) at 69, the ACCC noted that "a frequent concern raised by suppliers throughout this inquiry and in previous studies, is that industry participants are reluctant to report concerning supermarket conduct, for fear of retribution." See also Australian Food and Grocery Code Independent Reviewer, Annual Report 2022-23 (30 November 2023).

substantially lessen competition in a downstream ‘consumer-facing’ market, or otherwise directly harm retail consumers.

258. We have invited submissions on this framework earlier in this SoUI.

259. However, we also consider that the Proposed Merger could lead to harm in retail grocery markets that:

259.1 increases the barriers to entry and/or expansion for rival grocery retailers (because rival grocery retailers cannot acquire groceries on as favourable terms as the merged entity);[302] and

259.2 means that retail consumers do not get to experience the benefit of increased retail grocery competition in the future.

*What we said in the SoI*

260. In the SoI, we stated that further and broader entry or expansion in retail grocery markets would be likely to substantially improve outcomes in retail grocery markets, but that we considered the Proposed Merger may make it less likely for any entry or expansion to occur by changing the incentives or ability of potential competitors.[303]

261. As regards the way in which the merged entity’s increased buyer power could make it less likely for entry and/or expansion in retail grocery markets to occur, we further noted in the SoI that:[304]

261.1 the merged entity’s increased buyer power could increase the merged entity’s ability to achieve better terms relative to rival acquirers of grocery products and may allow the merged entity to offer lower retail grocery prices – while lower prices could benefit retail consumers in the short run, it may also raise the minimum required scale for rival acquirers of groceries to enter and effectively compete in the market. In the long run this may lead to worse outcomes for retail consumers;

261.2 the merged entity’s increased buyer power could lead to a ‘waterbed effect’ – ie, suppliers may seek to recoup revenue lost to the merged entity by raising prices or providing worse terms to rival grocery retailers. This could potentially lead to other grocery retailers raising their prices which could weaken competition and may allow the merged entity to raise prices and/or reduce the quality of their service offerings to the detriment of retail consumers; and

261.3 the merged entity’s increased buyer power (alongside having access to a larger combined set of data on retail sales and customer insights) could, for example, increase the ability of the merged entity to be able to implement

302 The difference in terms that the merged entity may enjoy could include all elements of the terms of supply including (but not limited to) lower prices, better rebates and more promotional spend by the supplier.

303 SoI at [152].

304 SoI at [156]-[160].

strategically targeted price cuts in locations in which it faces entry from rival grocery retailers. This could potentially be used to drive entrants out of retail grocery markets allowing the merged entity to increase retail prices again once an entrant has exited the market. We also noted that just knowing that the merged entity may have the increased ability to offer steep targeted price cuts in response to competition may also discourage any potential entry by rival retail grocery retailers, as they would be aware that there is a risk of targeted response on entry which they may not be able to match with their relatively smaller scale.

*Submissions from the Parties*

262. As a general point in response to the SoI, the Parties submit that whether further and broader entry or expansion in retail grocery markets would be likely to substantially improve outcomes in retail grocery markets is not in and of itself relevant to the merger clearance process. Rather, in the Parties' view, that information is relevant to the current state of retail grocery markets, which is the backdrop to the factual and the counterfactual.[305]

263. The Parties also submit that:

263.1 the Proposed Merger would not alter concentration in any retail grocery market, and therefore cannot increase barriers to entry and expansion;[306]

263.2 if procurement gains arising from the Proposed Merger are based on a marginal increase in bargaining power with respect to some suppliers, and any other gains are not structural or systematic (eg, speedier application of better buying practices or different procurement personnel making decisions) then they cannot be expected to lead to the concerns that are being raised regarding waterbed effects in retail grocery markets;[307] and

263.3 if the merged entity achieves better terms and offers lower prices to retail consumers, that is pro-competitive.[308]

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305 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/or expansion.

306 SoI cross submission from the Parties (6 May 2024) at 17 and SoI cross submission from the Parties (31 May 2024) at 8.

307 SoI cross submission from the Parties (31 May 2024) at 3.

308 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).

264. Houston Kemp (on behalf of the Parties) further submits:[309]

264.1 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 entrants and existing rival grocery retailers, including (but not limited to) Woolworths;

264.2 an important shortcoming to the contention in the SoI that lower prices for retail consumers could increase the minimum scale for rival grocery retailers to enter and compete effectively is the implied suggestion that any competitive action that resulted in a firm offering lower prices would raise barriers to entry. For example, if Woolworths undertook some form of private investment that lowered its costs (but not the costs of rival grocery retailers) and subsequently lowered prices for retail consumers, the contention in the SoI would suggest that investment was anti-competitive; and

264.3 the means by which the waterbed effect ultimately affects retail consumers is unclear, because retail grocery prices may still fall if the effect of reducing one buyer's costs outweighs pricing pressure in retail grocery markets for other firms. In addition, the economic literature recognises the 'anti-waterbed effect', because suppliers have an incentive to reduce a buyer's bargaining power by offering lower prices to a buyer's competitors. Houston Kemp submits that the economic literature is unclear on whether a waterbed or anti-waterbed effect is stronger, and that a study undertaken in the United Kingdom found no evidence of a waterbed effect in relation to supermarket bargaining power.

*Our current view*

265. We continue to consider whether the merged entity's increased buyer power could ultimately increase barriers to entry and/or expansion, or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets, which over the long run would harm consumers.

266. Set out below is our view on:

266.1 the likelihood of entry and/or expansion without the Proposed Merger; and

266.2 whether the Proposed Merger could increase barriers to entry and/or expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand such that retail consumers would be harmed over the long run.

<u>Likelihood of entry and/or expansion without the Proposed Merger</u>

267. In the SoI, we stated that further and broader entry or expansion by rival grocery retailers would likely lead to a substantial change in competitive outcomes.[310] As

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309 Houston Kemp report on SoI (26 April 2024) at [16]-[17] and [65]-[66] .

310 SoI at [153].

regards the current competitive conditions of the market, the Parties submit that (among other things):[311]

267.1 retail grocery markets have become increasingly competitive in recent years, as 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; and

267.2 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, and 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.

268. In addition to the above:

268.1 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.[312] 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;[313] and

268.2 FSSI told us that it considers it operates in competitive retail grocery markets (which are only getting more competitive).[314]

269. We agree with the Parties that 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 retail grocery which may have provided additional competition for some product lines in the locations where it has stores. There have also potentially 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 GICA includes to lower barriers to entry, although it is yet to be seen whether it will achieve its desired outcomes. However, there has also been some exit since the market study, for example: Supie (as noted in the SoI), and Huckleberry, that announced on 31 May 2024 that it had gone into liquidation.[315] We continue to consider whether market developments in recent years have:

269.1 resulted in the major grocery retailers losing significant market share to other grocery retailers;

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311 SoI submission from the Parties (26 April 2024) at [93].

312 Commerce Commission interview with FSNI (20 February 2024).

313 Commerce Commission interview with FSNI (31 May 2024).

314 Commerce Commission interview with FSSI (5 June 2024).

315 https://www.nzherald.co.nz/business/organic-grocer-huckleberry-in-liquidation-three-auckland-stores-to-close-up-to-35-staff-affected/B7CPRXPLHVHBRJL7J6MMDHA4WA/.

269.2 driven material increases in cross-shopping behaviour by retail consumers, or lead to consumers moving away from doing a weekly "one-stop-shop"; and

269.3 forced the major grocery retailers to competitively respond to other grocery retailers.

270. We consider that retail grocery markets (and grocery markets generally) are characterised by weak competition. Entry/expansion has occurred however grocery retailers other than the Parties and Woolworths account for a very small portion of retail grocery sales. Although the constraint imposed by other grocery retailers is currently limited, given the state of grocery markets, even a relatively small absolute loss of potential competition could be substantial. We are assessing whether an increase in buyer power with the Proposed Merger would raise barriers to entry and expansion and substantially lessen potential competition to the extent that retail grocery prices rise above levels that would exist in the counterfactual.

271. While we also want to ensure the Proposed Merger would not impact the ability and/or incentive for new grocery retailers to enter in New Zealand, we consider that the most likely form of entry and/or expansion to occur in a timely fashion without the Proposed Merger would be expansion by existing rival grocery retailers.

271.1 As well as refurbishing and rebranding existing stores, Woolworths told us it plans to open [ ] new stores over the next 3-4 years.[316]

271.2 Notwithstanding the supply issues it has engaged with us about (discussed below), The Warehouse Group told us that while it is not looking to become a major grocery retailer like the Parties, it intends to continue to have an essentials grocery range [ ].[317]

271.3 [ ].[318]

271.4 [ ].[319]

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[316] Commerce Commission interview with Woolworths (14 June 2024) and e-mails from Troy Pilkington of Russell McVeagh to Commerce Commission (20 June 2024) and (12 July 2024). Some details of planned investment being done by Woolworths in new stores and to upgrade existing stores 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/.

[317] Commerce Commission interviews with The Warehouse Group (8 February 2024) and (22 May 2024).

[318] E-mail from [ ] to Commerce Commission [ ].

[319] Commerce Commission interview with [ ].

272. As noted previously, Woolworths would be the merged entity's closest competitor as it would be the only other major grocery retailer. Other grocery retailers, including but not limited to The Warehouse, Costco, Farro Fresh, Bin Inn and Reduced to Clear, only provide a partial grocery offering and only compete in some locations. These other grocery retailers account for a small proportion of grocery products acquired from suppliers in New Zealand (and retail grocery sales in New Zealand). We do not consider these grocery retailers are large enough acquirers of grocery products in New Zealand (or likely to become large enough acquirers of grocery products in the near future) to alleviate our buyer power concerns with the Proposed Merger. Despite this, given competition in retail grocery markets is weak, even a relatively small absolute loss of potential competition in the retail grocery markets could be substantial. An increase in barriers to entry or expansion for rival grocery retailers with the Proposed Merger could also limit any constraint provided by other grocery retailers in the locations where they operate.

<u>Likelihood that Proposed Merger would increase barriers and/or otherwise impact rivals' ability and/or incentives to enter or expand in retail grocery markets in New Zealand</u>

273. The Parties submit that the Proposed Merger would not alter concentration and therefore cannot increase barriers to entry.[320] However, as we have explained in the acquisition section, we consider that the Proposed Merger could increase buyer power. If so, this could raise barriers to entry and expansion in the retail grocery markets.

274. Suppliers we have spoken with have expressed to us mixed views on whether the Proposed Merger would increase barriers to entry and/or expansion and/or otherwise impact rivals' ability and/or incentives to enter or expand in retail grocery markets in New Zealand. We have heard from suppliers (across a range of categories and of all sizes) that the consolidation in market power with the Proposed Merger would make it harder for rival grocery retailers to enter or expand.[321] However, other suppliers (across a range of categories and of all sizes) told us that they do not see the Proposed Merger materially changing any existing barriers to entry.[322] Table 3 summarises other, more-specific mixed evidence from suppliers.

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320 SoI cross submission from the Parties (6 May 2024) at 17 and SoI cross submission from the Parties (31 May 2024) at 8.

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

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

**Table 3: Evidence from suppliers on barriers to entry/expansion**

| Evidence that the Proposed Merger would make entry/expansion harder | Evidence that the Proposed Merger may not make a material difference |
|---|---|
| • There would be a "large war chest" available to the merged entity to make new entry unprofitable.[323]<br>• Proposed Merger would increase barriers to entry because there would be "two behemoths" for entrants to compete against.[324]<br>• The merged entity may be able to exert its power if it feels threatened by an outside party, and would have more buying power, and more money to invest in infrastructure than any entrant.[325]<br>• While Costco and The Warehouse have opportunity to expand, they would "get beaten up" by the merged entity.[326] | • It would be a risky and bold move to try and set up a rival grocery retailer now.[327]<br>• The retail grocery market may not be big enough for new entry.[328]<br>• Costco and any other new entrant grocery retailers seem open to suppliers.[329]<br>• Any entrant already looks at the Parties as one entity.[330]<br>• The way the Parties operate is already a barrier to entry for rival grocery retailers, and the Proposed Merger just amalgamates the two Boards of the Parties.[331] |

275. In addition to the above supplier evidence, we have also received submissions and evidence from other industry participants on whether that the Proposed Merger would impact barriers to entry and/or expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets in New Zealand.

275.1 Anonymous A submits that the merged entity would become considerably more powerful to resist rival grocery retailers entering and establishing themselves. It also 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.[332]

275.2 Habilis submits the Proposed Merger would consolidate the grocery sector further with a high likelihood of adverse outcomes for retail consumers and

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323 Commerce Commission interview with [ ].
324 Commerce Commission interview with [ ].
325 Commerce Commission interview with [ ].
326 Commerce Commission interview with [ ].
327 Commerce Commission interview with [ ].
328 Commerce Commission interview with [ ].
329 Commerce Commission interview with [ ].
330 Commerce Commission interview with [ ].
331 Commerce Commission interview with [ ].
332 SoPI submission from Anonymous A (22 January 2024) at 1-2.

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.[333]

275.3 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, it would strengthen the barrier to potentially 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.[334]

275.4 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,[335] and consolidation/greater concentration structurally upstream would increase barriers to entry in retail grocery markets.[336]

275.5 Monopoly Watch and Northelia submit that the Proposed Merger would increase the cost of capital for a third major grocery retailer.[337]

275.6 The Warehouse Group submits that the Proposed Merger is likely to increase barriers to entry and/or 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 and further limits 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.[338]

275.7 Lisa Asher submits the Proposed Merger would increase barriers to entry for new entrant rival grocery retailers, based on the stronghold this "mega

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333 SoPI submission from Habilis (1 February 2024) at 2.

334 SoPI submission from Ernie Newman (5 February 2024) at 1 and 5.

335 We note the Parties' response to this submission 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].

336 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.

337 SoPI submissions from Monopoly Watch (27 February 2024) at [3] and Northelia (27 February 2024). We note the Parties response to the Monopoly Watch submission that the submitter does not identify 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].

338 SoI cross submission from The Warehouse Group (10 May 2024) at [22].

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.[339]

275.8 One rival grocery retailer [ ].[340]

275.9 Another rival grocery retailer reserved its judgement on whether the Proposed Merger would be likely to impact its expansion plans. [ ].[341]

276. We continue to consider whether the merged entity's buyer power could ultimately increase barriers to entry and/or expansion and/or otherwise impact the ability and/or incentives of rival grocery retailers to enter or expand in retail grocery markets, and whether this could result in harm to retail consumers over the long run.

276.1 We consider that the merged entity could negatively impact the ability and/or incentives of rival grocery retailers to enter or expand due to either, all, or a combination of:

276.1.1 the merged entity's increased buyer power enabling it to negotiate better terms relative to rival acquirers of some grocery products (and raise the minimum required scale of rival grocery retailers to compete effectively, and/or respond to entry/expansion by rival grocery retailers with strategic price cuts that rival grocery retailers cannot compete with to deter entry/expansion); and/or

276.1.2 an increased likelihood of rival grocery retailers being unable to obtain competitive supply (or facing an outright refusal to supply) for

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339 SoI submission from Lisa Asher (25 April 2024) at 1 and 2. We note the Parties response to this submission that they strongly disagree with any suggestion they would, or do, "retaliate" against suppliers for partnering with new entrants. The Parties further note that, 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 competition. SoI cross submission from the Parties (6 May 2024) at 24. We discuss this further below.

340 Commerce Commission interview with [ ].

341 Commerce Commission interview with [ ].

some grocery products due to the increased buyer power of the merged entity 'raising the stakes' for suppliers.

276.2 The Parties submit that if the merged entity achieves lower prices to retail consumers this would be pro-competitive.[342] [343] We are not persuaded that retail grocery prices would fall with the Proposed Merger but note that even if they did, this could be part of a longer-term entry deterrence strategy, which could adversely affect retail consumers over the longer run where:

276.2.1 rival grocery retailers are impacted in such a way that they do not renew their plans for entry or expansion even when prices increase in the future;

276.2.2 this enables the merged entity to increase retail grocery prices above the levels that would have occurred in the counterfactual; and

276.2.3 these increased prices offset any benefits that retail consumers enjoy from any initial decrease in price that the merged entity may offer.

277. First, we consider the merged entity's increased buyer power would allow it to negotiate better terms relative to rival grocery retailers for some grocery products (through which it can reduce retail prices and raise the minimum required scale of rival grocery retailers to compete effectively).

277.1 As discussed below, we currently consider it is unclear to what extent efficiencies from the Proposed Merger would be passed through to retail consumers (eg, in terms of reduced prices). Nonetheless, in the event that the merged entity did pass-through some or all of the cost savings arising from the Proposed Merger, (either immediately or in response to a real threat of entry) this could raise the minimum required scale of rival grocery retailers to compete effectively. With lower consumer prices, rival grocery retailers that do not have the benefit of economies of scale may struggle to compete.

277.2 We agree that a reduction in retail grocery prices would be beneficial in the short term to retail consumers. However, we continue to consider whether such a reduction would impact the ability and/or incentive of rival grocery retailers to enter and/or expand, and result in long-term detrimental impacts

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342 SoI submission from the Parties (26 April 2024) at [168.1]. Here, the Parties further explain that the offering of lower retail grocery 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 would be pro-competitive for the merged entity to offer retail consumers 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).

343 Houston Kemp (on behalf of the Parties) submits that having concerns about the increase in the minimum scale to enter implies that any competitive action that resulted in a firm offering lower prices would raise barriers to entry. Houston Kemp report on SoI (26 April 2024) at [65]-[66]. We do not agree with this implication. We consider unilateral actions by individual firms to lower prices would normally be pro-competitive. However, there may be circumstances where they are not, for example, where a firm is engaging in predatory pricing. We are assessing whether in the case of the Proposed Merger any anticompetitive effects might arise in retail grocery markets from increased buyer power.

to retail consumers. Put another way, while an initial price reduction (if it occurred) would be beneficial, it may not be in the long-term interests of retail consumers if the merged entity would face little or lesser constraint from increasing its retail grocery prices in the future above those in the counterfactual.

278. Second, we consider the merged entity's increased buyer power might enable it to negotiate better terms relative to rival grocery retailers and improve its ability to respond to/deter entry and/or expansion by rival grocery retailers with strategic price cuts that rival grocery retailers cannot compete with.

278.1 The Parties already monitor the activities and pricing of their competitors,[344] and as we understand it, have sometimes (at least temporarily) reduced their local pricing in the past in response to entry and/or actions of rival grocery retailers.[345] As discussed in the retail coordination section below, this is possible because [ ] the Recommended Retail Price (RRP) [ ]. For example:

278.1.1 [ ].[346]

[ ];[347] and

278.1.2 The Warehouse Group told us that it sees the Parties' stores in the same local catchments as its stores reacting to the prices of products in the relevant The Warehouse store, 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).[348]

278.2 In terms of how the merged entity's increased buyer power could improve its ability to respond to/deter entry and/or expansion by rival grocery retailers with strategic price cuts, we note the following:

278.2.1 if the merged entity can acquire grocery products from suppliers at more favourable pricing than the Parties can currently, the merged entity would have the ability to implement deeper price cuts than

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344 Commerce Commission interviews with FSNI (31 May 2024) and FSSI (5 June 2024).

345 https://www.newshub.co.nz/home/money/2022/10/the-costco-effect-auckland-supermarket-near-costco-lowers-grocery-prices.html.

346 Commerce Commission interview with [ ].

347 Commerce Commission interview with [ ].

348 Commerce Commission interview with The Warehouse Group (22 May 2024).

the Parties each could now, while presumably still maintaining pre-merger margins (or better); and

278.2.2 if the waterbed effect was to occur (discussed further below), this could further increase the impact of any strategic price cut. This is because, if the Proposed Merger results in rival grocery retailers receiving higher prices (or other less favourable terms) from suppliers, any deep strategic price cut from the merged entity may have an even larger impact on rival grocery retailers.

279. The effects above could be exacerbated if suppliers reacted by worsening the terms offered to rival grocery retailers. One mechanism that we identified in the SoI is the so-called waterbed effect. This could occur if suppliers seek to recoup revenue lost to the merged entity by increasing their prices to rival grocery retailers.

280. Houston Kemp (on behalf of the Parties) submits that it is unclear how the waterbed effect would ultimately affect retail consumers, because consumer prices could still fall even if wholesale prices increase for some grocery retailers.[349] We accept that as a theoretical possibility, but it does not mitigate our concerns about the effect of the Proposed Merger on future entry and/or expansion. On the contrary, it serves to underline the greater challenge faced by potential rival grocery retailers. Similarly, we accept the anti-waterbed effect as a theoretical construct but note that our investigation suggests in the relevant markets there is currently real fear on the part of many suppliers at the prospect of offering rival grocery retailers sharp pricing. We consider it appropriate to assess whether it is likely to cause harm in a particular matter. We invite submissions on this. In particular we invite submissions from:

280.1 suppliers on:

280.1.1 how the prices they charge to different grocery retailers relate to one another, for example, whether a reduction in the price to one retailer would likely affect the price they charge another retailer;

280.1.2 their current enthusiasm for offering sharp prices to grocery retailers other than the Parties and Woolworths, and how that might change post-merger;

280.1.3 how in past cases where the Parties have negotiated a reduction in price, this affected the prices to other grocery retailers; and

280.1.4 whether, and how, they envisage the Proposed Merger impacting the terms at which they would supply rival grocery retailers; and

349 Houston Kemp report on SoI (26 April 2024) at [16]-[17].

280.2 grocery retailers on:

280.2.1 any evidence to suggest that suppliers behave in the way that the waterbed effect suggests (that is, increase prices to other grocery retailers if they are forced to decrease price to one grocery retailer);

280.2.2 how they would be likely to respond to any reductions in price by the merged entity (for example, would they seek to match prices or accept a potential loss in market share); and

280.2.3 if they were to lose market share whether there would be any barriers preventing them expanding again if the merged entity was to raise prices in the future.

281. We also considered in the SoI whether having access to a larger combined set of data on retail sales and customer insights could allow the merged entity to better implement strategic price cuts where new entry occurs. We now consider that combining data sets is unlikely to make any material difference to barriers to entry. This is because the most relevant data for strategic price cuts would be data specific to a local area which is already available to the Parties individually.

282. Third, we consider 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.

282.1 We have received some evidence from industry participants that we have spoken with (including suppliers across a broad range of categories) which suggests that some rival grocery retailers already struggle to either obtain supply, or obtain supply on competitive terms for some products.

282.1.1 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). [

].[350]

[350] Commerce Commission interviews with The Warehouse Group (8 February 2024) and (22 May 2024). [

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282.1.2 [

].[351]

282.1.3 One large supplier told us that [ ] when Costco came in, the Parties did not want anyone to supply Costco. It did not indicate that the major grocery retailers threatened to take away business, but simply questioned (where they faced supply issues) why a supplier cannot supply a major grocery retailer but can supply a new entrant rival grocery retailer.[352]

282.1.4 A second supplier (of ambient products) said that it looked at supplying The Warehouse in 2005/2006 and was told by "both supermarket chains" (ie, Foodstuffs and Woolworths) that, if it supplied The Warehouse, it would not be able to supply them.[353]

282.1.5 An industry participant told us that the Parties have more power to encourage suppliers to deal with them exclusively and on better terms, and are constantly trying to leverage suppliers. It indicated that it was common for other grocery retailers (beyond the Parties and Woolworths) to face higher prices or for the major grocery retailers to get better buying prices. It noted that supplying other grocery retailers diversified risk, but a supplier has to weigh the ramifications of that retailer setting its retail price at a lower level than the major grocery retailers.[354]

282.1.6 A third supplier (of a range of products) indicated that it is not comfortable taking the risk of being seen by the Parties as cheaper on the shelves of The Warehouse. 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.[355]

282.1.7 An industry participant noted that a lot of grocery suppliers are looking for opportunities to grow, 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,

351 Commerce Commission interview with [ ].
352 Commerce Commission interview with [ ].
353 Commerce Commission interview with [ ].
354 Commerce Commission interview with [ ].
355 Commerce Commission interview with [ ].

particularly given they are currently minuscule grocery retailers. For example, suppliers may have signed or given a brand promise to PAK'nSAVE that it will be 15% less than any rival grocery retailer, so cannot afford to offer lower prices to other grocery retailers.[356]

282.1.8 However, [ ].[357] [ ] said it did not notice any reaction from the Parties when it [ ] The Warehouse.[358] [ ] said it is always open to new customers.[359] [ ] said it is always open to new grocery retailers but currently the opportunity to supply them was not as big as with the major grocery retailers.[360] Another industry participant thought there would be no more downward pressure on suppliers to not supply a new entrant rival grocery retailer so long as the new entrant "has enough skill and expertise to get going".[361]

282.2 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 supply on competitive terms.

282.2.1 As noted above, the merged entity would be the largest 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.

282.2.2 This 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. Two industry participants told us that they considered the merged entity might/would have more power to ask suppliers for exclusivity,[362] and Woolworths noted that while it is generally not in the interests of suppliers to have exclusive arrangements, that does not mean a supplier would not enter an arrangement with the merged entity. [

[356] Commerce Commission interview with [ ].
[357] Commerce Commission interview with [ ].
[358] Commerce Commission interview with [ ].
[359] Commerce Commission interview with [ ].
[360] Commerce Commission interview with [ ].
[361] Commerce Commission interview with [ ].
[362] Commerce Commission interviews with [ ] and [ ].

].[363]

283. We continue to assess the extent to which the potential effects above arising from the increase buyer power would impact on existing rival grocery retailers and potential rivals. We recognise that the effects described above will 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) or where the products are only supplied locally. 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 rival grocery retailers. It may not apply for those products for which rival grocery retailers stock (or could stock) alternative products from other suppliers. If overall these effects only apply to small proportion of a typical basket, then it is less likely that it would impact on the entry and expansion plans of rival grocery retailers.

284. We invite submissions whether the Proposed Merger is likely to increase barriers to entry and/or expansion by rival grocery retailers in retail grocery markets and harm retail consumers over the long run. In particular we invite submissions on:

284.1 whether the Proposed Merger would be likely to impact the terms on which suppliers supply competing grocery retailers; and/or

284.2 the extent to which suppliers consider the Proposed Merger might increase or decrease the likelihood of them supplying rival grocery retailers (and why).

## Impact on innovation for new grocery products

285. We are concerned that the Proposed Merger may lessen the ability and incentive for local suppliers to develop new grocery products, or for multinational suppliers to bring new products into New Zealand.

285.1 This concern in one respect follows from the transfer of surplus away from suppliers, as a result of the increased bargaining power outlined above. With less surplus, suppliers have less money to invest in product development.

285.2 However, the concern in relation to innovation is also a result of the structural loss of the Parties as two separate channels for new products to gain a foothold in the New Zealand market. Irrespective of the merged entity's buyer power, the loss of an independent channel for new suppliers and/or products to come to market may result in a substantial lessening of competition (both in relevant acquisition markets, and in potential future markets for new products).

286. In relation to the impact of innovation, our concerns are strongest with regard to local and smaller suppliers, for which each of FSNI and FSSI are the main avenues to

363 Commerce Commission interviews with Woolworths (14 June 2024) and (15 February 2024).

be listed. However, we also have concerns in relation to larger suppliers and 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 to local customer preference. We note that in order to clear the Proposed Merger we need to be satisfied that there would be no substantial lessening of competition in any relevant market for the acquisition of groceries.

287. 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 quality of grocery products.

**Summary of what we said in the SoI**

288. In the SoI we considered the impact of the Proposed Merger on product innovation. We expressed the concern that:[364]

288.1 any increase in buyer power may also reduce suppliers' ability and incentives to invest in new and innovative products, due to reduced profitability; and

288.2 the reduction in channels for suppliers may in and of itself adversely affect competition by removing one of the options for new and innovative products or new suppliers to be listed (even if there was not a material increase in the merged entity's buying power).

289. In doing so, we stated that we were considering:[365]

289.1 the extent to which suppliers currently invest in innovation; and

289.2 the extent to which the Proposed Merger might increase or decrease the level of, or investment in innovation for new suppliers and/or new products.

290. We noted the Parties' view that the Proposed Merger would result in increased innovation in general, due to the Parties' increased ability to innovate due to the increased efficiency and agility of the merged entity compared with the Parties separately.[366]

**Summary of our current view**

291. We consider there is insufficient evidence to be satisfied that the Proposed Merger would not be likely to cause a substantial lessening of competition due to unilateral effects by impacting on innovation in relevant upstream markets for the acquisition of groceries. Our concerns are that the Proposed Merger would:

291.1 reduce supplier profitability through margin decrease (discussed above), which in turn could lead to small and local suppliers reducing investment in innovation, and prevent or delay multinational suppliers from launching new

[364] SoI at [102].
[365] SoI at [103].
[366] SoI at [104].

products in New Zealand, ultimately reducing the range and quality of grocery products available to retail consumers in New Zealand; and

291.2 consolidate channels through which new and innovative products or new suppliers can be listed, potentially slowing the pace of product innovation, and ultimately reducing the range and quality of grocery products available to retail consumers in New Zealand.

**Profitability/investment in innovation**

292. We have been considering if 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.

*What we said in the SoI*

293. In the SoI we considered the impact of the Proposed Merger on product innovation. We expressed a concern that any increase in buyer power may reduce suppliers' ability and incentives to invest in new and innovative products, due to reduced profitability.[367]

*Submissions from the Parties*

294. The Parties submit that the Proposed Merger would not reduce suppliers' ability or incentives to innovate or the merged entity's incentives to promote innovation. Rather, the Parties consider that the Proposed Merger would have a positive impact on product innovation.[368]

295. The Parties make a distinction between three types of suppliers (noting that larger, multinational suppliers and smaller suppliers are the two key supplier groups that drive new product development (NPD)):[369]

295.1 **large national suppliers, including multi-nationals**: the Parties submit that 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 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. While we agree the Proposed Merger would not affect multinational suppliers' global innovation, we are concerned it may impact competition in New Zealand if these suppliers have less opportunities to bring new products into New Zealand;

367 SoI at [102.1].
368 SoI submission from the Parties (26 April 2024) at [112].
369 SoI submission from the Parties (26 April 2024) at [117] and Houston Kemp report on SoI (26 April 2024) at [28].

295.2 **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

295.3 **medium suppliers**: the Parties submit that the Proposed Merger would allow an easier growth trajectory for these suppliers than dealing with each of the Parties separately.

296. The Parties also submit that the Proposed Merger would not give rise to any change in competitive conditions downstream and so there would be no change in the merged entity's incentive to support innovation.[370] According to the Parties, this is due to the fact that the Parties' relationships with suppliers are driven by the 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.[371] The Parties submit that as a result they:[372]

296.1 benefit from suppliers' innovation, as this can expand sales for both the supplier and the Parties so that both share incentives to bring better value to the consumer; and

296.2 have no incentive to harm innovation (or their supplier base more generally).

297. The Parties further 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 have no incentive to cease a practice they perceive as a key competitive advantage, and where their downstream incentives would not change as a result of the Proposed Merger.[373]

298. Houston Kemp (on behalf of the Parties) submits that investment involves the incurring of resource costs and, at an economy-wide level, the sacrifice of present-day consumption. It further states that firms undertake investment with the objective of increasing their future profits, including by raising the quality of their products, reducing their costs and improving their bargaining position. However, in Houston Kemp's view, neither investment nor innovation are inherently beneficial; rather, it is the changes arising from successful investment or innovation that bring

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370 SoI submission from the Parties (26 April 2024) at [119].
371 SoI submission from the Parties (26 April 2024) at [120].
372 SoI submission from the Parties (26 April 2024) at [120].
373 SoI submission from the Parties (26 April 2024) at [123].

the prospect of economic benefits, such as lower prices and new or higher-quality products.[374] Houston Kemp further submits that:

298.1 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;[375]

298.2 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;[376]

298.3 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;[377] and

298.4 under the bargaining framework whereby buyers and sellers engage and are incentivised to maximise their joint surplus (and therefore to undertake efficient investment), a buyer with increased bargaining power may face increased incentive to co-finance supplier investment, because:[378]

298.4.1 the buyer can buy more of the product from the supplier and so benefit to a greater extent, enabling it to be a better downstream competitor; and

298.4.2 the presence of larger buyers may reduce transaction costs and coordination problems between suppliers and buyers (ie, avoiding the hold-up problem).

299. Specifically in terms of the Proposed Merger, Houston Kemp submits that:

299.1 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);[379]

[374] Houston Kemp report on SoI (26 April 2024) at [20].
[375] Houston Kemp report on SoI (26 April 2024) at [21].
[376] Houston Kemp report on SoI (26 April 2024) at [22].
[377] Houston Kemp report on SoI (26 April 2024) at [23].
[378] Houston Kemp report on SoI (26 April 2024) at [24].
[379] Houston Kemp report on SoI (26 April 2024) at [25].

299.2 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;[380] and

299.3 notwithstanding the overarching principle that a transfer of surplus is not consistent with a lessening of competition, 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.[381]

*Third party submissions and evidence received*

300. The Food and Grocery Council submits it conducted a member survey which raised concerns about potential adverse effects of the Proposed Merger on supply, ranging, quality, and innovation due to tighter margins and reduced pricing flexibility. Additionally, the Food and Grocery Council submits that increased costs of doing business could impact the attractiveness of the market for investment, potentially jeopardizing the long-term viability of the industry. 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 answered yes.[382]

301. The Food and Grocery Council also submits that statements from its members suggest that a reduction in 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.[383]

302. The Food and Grocery Council further submits that many of its members have indicated the Proposed Merger may impact innovation, with 68%[384] of its members who responded to its survey indicating it would (and the remainder split between those who were unsure and those believe that the Proposed Merger may lead to greater investment and efficiency in the innovation process). Its members explained that the Proposed Merger would impact innovation in the following ways:[385]

302.1 **reduced prices or margins:** suppliers express 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'

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380 Houston Kemp report on SoI (26 April 2024) at [26].
381 Houston Kemp report on SoI (26 April 2024) at [29].
382 SoI submission from the Food and Grocery Council (26 April 2024) at [14.2].
383 SoI submission from the Food and Grocery Council (26 April 2024) at [14.3].
384 SoI submission from the Food and Grocery Council (26 April 2024) at [14.3].
385 SoI submission from the Food and Grocery Council (26 April 2024) at [14.4a]-[14.4j].

ability to take risks in new product development, limit resources available for innovation efforts and/or restrict marketing support for new products;

302.2 **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;

302.3 **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

302.4 **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.

303. As set out below, evidence from industry participants we have spoken with is mixed. Suppliers we have spoken with (across a range of categories) indicated that investment in NPD may be impacted by the Proposed Merger.[386] However, some other industry participants consider the Proposed Merger is unlikely to impact its own innovation,[387] with some industry participants also thinking that innovation might increase or become easier with the Proposed Merger or that the Proposed Merger would provide suppliers with better insights on which to engage in NPD.[388] In terms of the details of evidence before us from suppliers on how suppliers' post-merger profitability might impact their investment in innovation, we note:

303.1 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

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386 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ] (although this supplier indicated it is already hard to innovate in a mature category), [ ], [ ], [ ], [ ], and [ ].

387 Commerce Commission interviews with [ ] (however, this supplier noted it that it sticks to its core products, and considered 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), [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], and [ ].

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

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;[389]

303.2 a second supplier (of non-food products) said that if the Proposed Merger resulted in it giving more margin to the merged entity, this would potentially cause the quality of its products to lessen as it would have less money in its "pot";[390]

303.3 a third supplier (of dry food products) noted that NPD is costly and is 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;[391]

303.4 an industry participant 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 "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 [ ];[392]

303.5 a fourth supplier (of frozen products) said it would have to consider the resources it puts towards innovation if profitability came down;[393] and

303.6 a second industry participant told us that ultimately the Proposed Merger would force suppliers to innovate less as they would feel they cannot make a mistake with only two paths to market (to major grocery retailers), as there would be more pressure on the negotiation.[394]

304. 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 [ ], but also noted that in the future it would not do this innovation unless it has the ability to invest.[395] 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.[396]

389 Commerce Commission interview with [ ].
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 [ ].
395 Commerce Commission interview with [ ].
396 Commerce Commission interview with [ ].

*Our current view*

305. Although there is mixed evidence from suppliers (as noted above), we remain concerned that the Proposed Merger may be likely to cause a substantial lessening of competition due to unilateral effects on innovation in relevant upstream markets for the acquisition of groceries through a reduction in investment in innovation due to a reduction in supplier profitability.

306. 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 when negotiating with buyers. The increased bargaining power of the merged entity may mean that the merged entity can capture a greater share of the value of the investments.

307. Suppliers' ability to invest may be reduced by the worsening of their terms of trade if it is harder for them to finance investments that they would otherwise make. This may be because they would have reduced profitability to finance those investments and it may be harder for them to obtain low cost external financing because less profitable firms may be considered to be higher risk.

308. Furthermore, innovation would be lessened if suppliers become unprofitable, resulting in their exit. We accept that it would theoretically not be in the merged entity's interests for suppliers to be squeezed so far that they exit. However, 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, or that squeezing may inadvertently go too far.

309. We recognise that there are arguments that suppliers faced with buyers with increased bargaining power may have stronger incentives to invest. One supplier noted that it would "probably have to invest more to keep up with the supermarket chain"[397] as a result of the Proposed Merger. However, we have not seen evidence to support that this theoretical effect is likely to eventuate in response to the Proposed Merger. Nor do we have evidence that suppliers would have the ability to fund these innovations even if they had a greater incentive to do so. We consider it likely that the Proposed Merger would result in reduced investment in innovation from grocery suppliers, as well as reduced introduction of innovative products into the New Zealand market.

310. We are therefore continuing to consider how the impact of the Proposed Merger may differ depending on the extent to which particular suppliers are impacted by changes in bargaining power, including (but not limited to) how the impact may differ between large, multinational suppliers; medium suppliers; and small suppliers. We invite further submissions on:

  310.1 current supplier investment in NPD;

  310.2 whether the Proposed Merger would reduce supplier profitability; and

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[397] Commerce Commission interview with [ ].

310.3 whether this potential reduction in supplier profitability could lead to a reduction in investment in NPD.

**Reduction in channels for innovation**

311. We have been considering if the reduction in channels for suppliers with the Proposed Merger may in and of itself adversely affect competition by removing one of the options for new and innovative products or new suppliers to be listed (even if there was not a material increase in the merged entity's buying power).

*What we said in the SoI*

312. In the SoI we considered the impact of the Proposed Merger on product innovation. We were concerned that the reduction in channels for suppliers may in and of itself adversely affect competition by removing one of the options for new and innovative products or new suppliers to be listed (even if there was not a material increase in the merged entity's buying power).[398]

313. We further noted that evidence from industry participants had highlighted the importance to new suppliers or suppliers of new products of having multiple grocery retailer channels to gain a foothold in the market. We stated that each of the Parties currently provide separate opportunities and each have scope to bring different new products and suppliers to the market. Furthermore, some information suggests that the smaller volume and geographic footprint of the Parties, as non-national retailers (particularly FSSI), makes them particularly important buyers in the market, enabling new or innovative suppliers to gain a foothold prior to being able to supply nationally.[399]

314. We stated that while several industry participants do not consider that the Proposed Merger would likely result in any change or a reduction in suppliers' investment in innovation (with a few industry participants who consider that the Proposed Merger would benefit innovation), there is a broad consensus that suppliers may be less inclined to innovate to bring new products to market with one less major grocery retailer with the Proposed Merger in which to test a new product, or secure initial volume and/or ranging. We noted that we were also considering whether a reduction in price might adversely affect suppliers' incentives to innovate.[400]

*Submissions from the Parties*

315. The Parties submit the merged entity would have the same retail presence as the Parties do currently (and would in the counterfactual). 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.[401]

398 SoI at [102.2].
399 SoI at [105].
400 SoI at [106].
401 SoI submission from the Parties (26 April 2024) at [115].

316. The Parties submit that the SoI cites a limited number of mixed views from suppliers in relation to the impact of the Proposed Merger and as such the Parties consider that the basis for the view in the SoI that there is a broad consensus is unclear.[402]

317. The Parties also submit the Proposed Merger would be likely to make it easier for suppliers to innovate. The Parties submit that, in particular:[403]

317.1 the merged entity would likely offer one NPD cycle, rather than two separate NPD cycles, which would make it considerably easier for suppliers to launch a new product nationally across the Parties' banners. In the Parties' view, the misalignment between the Parties' NPD cycles is a particular pain point for suppliers; and

317.2 the merged entity's national footprint would mean that, if desired, 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), suggesting suppliers would be incentivised to work with the merged entity to launch new products.

318. The Parties further submit they are already not entirely separate heads in the market currently and work together in certain scenarios, limiting the potential change that can arise with the Proposed Merger.[404]

319. Houston Kemp (on behalf of the Parties) submits the merged entity would:[405]

319.1 offer a single NPD cycle and process – rather than two, separate and misaligned NPD cycles, which Houston Kemp understands to be perceived by suppliers as a limitation; and

319.2 provide a simpler pathway to national supply, which would enable and encourage suppliers to invest in new products – in Houston Kemp's view 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.

*Third party submissions and evidence received*

320. 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. [ ].[406]
Anonymous G also submits that to support a successful introduction of a new product, it would be necessary

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402 SoI submission from the Parties (26 April 2024) at [113].
403 SoI submission from the Parties (26 April 2024) at [118].
404 SoI submission from the Parties (26 April 2024) at [121].
405 Houston Kemp report on SoI (26 April 2024) at [27].
406 SoI submission from Anonymous G (18 April 2024) at [6].

[ ]. 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), [ ].[407]

321. 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.[408]

322. Evidence from industry participants we have spoken with is mixed on whether the Proposed Merger would have a negative impact on innovation by reducing the channels through which new products can be introduced in major grocery retailers. Industry participants we have spoken with (including suppliers across a range of categories, both large multinationals and smaller local suppliers) highlighted the importance of new suppliers or suppliers of new products, having multiple channels to gain a foothold in the market and laid out concerns about the Proposed Merger reducing channels for innovation.[409] However, other suppliers/industry participants we have spoken with (across a range of categories and of all sizes) also considered that the Proposed Merger would make it easier (or no more difficult) for them to innovate.[410] Table 4 summarises other, more-specific mixed evidence from industry participants.

**Table 4: Evidence from industry participants on channels for innovation**

| Evidence that the Proposed Merger may reduce channels for innovation | Evidence that the Proposed Merger may not make a material difference |
|---|---|
| • Currently, suppliers have three opportunities to get new products ranged in grocery stores (FSNI, FSSI and Woolworths) and ranging in two out of the three would often warrant NPD. With the Proposed Merger, suppliers would only have two options (the | • Proposed Merger would not impact NPD, as each product is ranged on its merit.[411]<br>• One supplier said it is always looking to innovate, and that it cannot imagine this would change with Proposed Merger.[412] |

407 SoI submission from Anonymous G (18 April 2024) at [17].
408 SoI submission from Anonymous G (18 April 2024) at [19].
409 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ] and [ ].
410 Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ], [ ] and [ ].
411 Commerce Commission interview with [ ].
412 Commerce Commission interview with [ ].

| Evidence that the Proposed Merger may reduce channels for innovation | Evidence that the Proposed Merger may not make a material difference |
|---|---|
| merged entity and Woolworths), making it harder to do NPD (potentially unless get both the merged entity and Woolworths on board), and the risk on the supplier higher.[413]<br>• In order 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 grow. FSSI is more receptive to new products and new suppliers entering which suppliers would lose with the Proposed Merger. It would be more difficult for smaller suppliers to supply the Parties, particularly new brands trying to enter.[414]<br>• With the Proposed Merger, if the merged entity does not range a new product, one supplier said it would not be worth launching just with Woolworths.[415]<br>• To make a new product viable, the channel it is sold through must have scale. If the merged entity would not range a new product, then a supplier only has a couple of other choices of where it could launch the new product.[416] | • From an innovation perspective, large customers are not prioritised by this supplier, and Proposed Merger would not change this.[417]<br>• For innovation done across both Australia and New Zealand, the Proposed Merger would not impact innovation in New Zealand, but concentration would make the New Zealand market less attractive.[418]<br>• Proposed Merger would not have a large impact on investment in innovation, as supplier needs to innovate in order to grow and succeed, but it might impact timing of each individual launch.[419]<br>• Having less people making ranging decisions means less chance of a supplier getting a “champion”, but this supplier’s innovation would happen regardless because of the export market.[420]<br>• A supplier (of bakery items) said it innovates a lot now and hopes that the Proposed Merger would make it easier to bring NPD to market.[421]<br>• Proposed Merger would be from a marketing launch perspective much better.[422] |

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

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

415 Commerce Commission interview with [ ].
416 Commerce Commission interview with [ ].
417 Commerce Commission interview with [ ].
418 Commerce Commission interview with [ ].
419 Commerce Commission interview with [ ].
420 Commerce Commission interview with [ ].
421 Commerce Commission interview with [ ].
422 Commerce Commission interview with [ ].

| **Evidence that the Proposed Merger may reduce channels for innovation** | **Evidence that the Proposed Merger may not make a material difference** |
|---|---|
| • If a multinational supplier was not ranged in the merged entity, it might not bring some of its innovation to New Zealand (which might result in more homogenous, less curated product ranges).[423]<br>• The Proposed Merger could mean a supplier is able to have nationwide supply with the merged entity, but could also mean its products get delisted, with which the hurt would be more significant.[424]<br>One supplier told us that retail media is expensive and required for innovation. It considered 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.[425] | • One supplier (of beverages) told us the Proposed Merger would not impact its innovation because it needs to innovate for the long-term growth of its business.[426]<br>• One supplier (of beverages) said it innovates with Woolworths as there is no proper process for innovation with FSNI, but also noted that it thinks about innovation from an international market.[427]<br>• 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).[428]<br>• The Proposed Merger could help a supplier to know whether a piece of innovation is worth producing.[429]<br>• The Proposed Merger would probably be beneficial for its innovation due to how it uses the Parties' insights on sales data, and because the merged entity would have more insights to share.[430] |

*Our current view*

323. We remain concerned that the Proposed Merger may lead to a substantial lessening of competition due to unilateral effects by reducing the ability and incentive for suppliers to invest in innovation and the introduction of new products by removing one independent channel for innovation.

324. 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.

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423 Commerce Commission interview with [ ].
424 Commerce Commission interview with [ ].
425 Commerce Commission interview with [ ].
426 Commerce Commission interview with [ ].
427 Commerce Commission interview with [ ].
428 Commerce Commission interview with [ ].
429 Commerce Commission interview with [ ].
430 Commerce Commission interview with [ ].

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.

325. In our view, the reduction from three to two major grocery retailers and independent channels to bring new products to market would make it more difficult for some suppliers to innovate and introduce new products into New Zealand.

326. We invite submissions on:

326.1 whether innovation in grocery products is driven by different sized suppliers and to what degree; and

326.2 the extent to which overseas products supplied by multinationals are tailored to local consumer preference.

Loss of FSSI as an effective channel for fostering innovation

327. While FSNI holds Emerging Supplier and Foodies Connect Forums at various intervals throughout the year and is seen to provide additional support to smaller suppliers,[431] information currently before us (summarised below) indicates that FSSI may be more receptive to supporting suppliers' innovation, with industry participants that we have spoken with (including suppliers across a range of categories) telling us that it is easier to get new products ranged in FSSI than in FSNI.[432] However, one supplier we have spoken with had a different view.[433] While we are continuing to explore this point, we note that:

327.1 The Food and Grocery Council submits that its members' views vary on the ease of entering the market or launching new products with FSSI, with some finding it more open to innovation and supportive of local manufacturers. It further submits that other suppliers express challenges in entering the market or getting products accepted by FSNI.[434]

327.2 a large supplier told us that the Proposed Merger would take away an element of innovation because currently FSSI "does things a little bit their own way and are trying things" such that, in this supplier's view, if the

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431 Response to our request for information from FSNI (23 February 2024) and Commerce Commission interview with FSNI (22 February 2024). FSNI has a "Small Supplier Guide" which sets out a detailed seven step process for small suppliers to get "the best possible chance of landing on shelves and becoming a hit with customers". Small Supplier Guide Version 2 (August 2023) at 4. A version of the Small Supplier Guide is also available online here https://www.foodstuffs-exchange.co.nz/assets/documents/FSNI-docs/small-Supplier-guide/Foodies-Small-Supplier-Guide.pdf. Of note, FSSI also holds Foodies Forums on an 8-12-week cycle for all suppliers, Foodstuffs Emerge competitions to help new suppliers onboard and scale up, and is separately recruiting for a small supplier support manager. See response to our request for information from FSSI (27 February 2024) at [3] and [6] and Commerce Commission interview with FSSI (20 February 2024).

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

433 Commerce Commission interview with [ ].

434 SoI submission from the Food and Grocery Council (26 April 2024) at 38.

Proposed Merger goes ahead, there might be a reduction in innovation because that current tension between FSNI/FSSI would be gone;[435]

327.3 a second supplier (of dry food products) told us that FSSI will "take a punt on a product" more easily than FSNI will. It considers that the threshold for launching new products with FSNI is much higher than FSSI (who will load the product so long as there is one FSSI store that wishes to buy the product), and added that it took a few years of being in FSSI before it was ranged in FSNI;[436]

327.4 an industry participant told us that it is a common pathway for a supplier to form a relationship with one of the Parties first before slowly building up distribution. It considers that while suppliers can form relationships with FSNI, its view is that is generally easier to form this initial relationship with FSSI because it is a smaller entity that is more engaged with its community;[437]

327.5 a third industry participant told us that FSSI is more supportive of taking on new products and that their review cycles are more consistent. However, it also noted that while FSSI are more willing to take on new products, there is an added complexity of having to engage directly with stores. The industry participant also considers that FSSI has a scalability issue in that it will not meet minimum order requirements and suppliers need to supply either both of FSNI/FSSI, or one of FSNI/FSSI and Woolworths;[438]

327.6 a fourth supplier (of dry food products) told us that FSSI is approachable and has more disciplined windows of opportunity to present new products. On the other hand, it considers that it has to wait for a category review to present NPD to FSNI;[439]

327.7 a fifth supplier (of a range of products) told us there have been many occasions where FSSI has launched a product that FSNI did not want to launch, and that it is able to introduce more innovation through FSSI. On the other hand, it considers that FSNI is more about "less product, less range, less brands", with a focus on margin. However, it noted that often when a product has been successful with FSSI, it gives the supplier an opportunity to re-request and obtain ranging from FSNI by referring to its record with FSSI;[440]

327.8 a sixth supplier (of beverages, [ ]) told us that, with FSSI, a supplier can approach any store to discuss ranging, whereas in FSNI a supplier needs approval from the category manager first. The supplier went on to explain that right now there are three opportunities to gain national relevance in industry, but if the Proposed Merger goes ahead there would only be two opportunities. This suppliers' view was that if the FSNI approach was adopted by the merged entity, the opportunity to present to individual

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435 Commerce Commission interview with [ ].
436 Commerce Commission interview with [ ].
437 Commerce Commission interview with [ ].
438 Commerce Commission interview with [ ].
439 Commerce Commission interview with [ ].
440 Commerce Commission interview with [ ].

stores in the South Island would be lost;[441]

327.9 a seventh supplier (of chilled products) told us that if FSNI does not want to range a product, a supplier can have it ranged in FSSI and go back to FSNI once it has gained some traction. This opportunity would be lost with the Proposed Merger;[442] and

327.10 lastly, an eighth supplier (of dry food products) told us if it wants to do something more innovative, it is harder to do so in the South Island because FSSI, while more partnership orientated, is more conservative. On the other hand, it told us that FSNI are “pushing more” on how many brands of product are in-store, and are more likely to “push the envelope” (either positively or negatively).[443]

Impact on smaller vs larger suppliers

328. We consider the Proposed Merger may be more likely to impact innovation by smaller and/or local suppliers that do not have alternative distribution channels, compared to large and/or multinational suppliers. However, as noted previously, we are also concerned that the Proposed Merger could prevent or delay multinational suppliers from launching new products in New Zealand.

329. We received feedback from industry participants that we have spoken with (including suppliers across a range of categories) that the impact of the reduction in an independent option for ranging new products would be felt differently by different sized suppliers. In particular:

329.1 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/small businesses that have not yet formed relationships with the major grocery retailers, especially if the merged entity operates more similarly to Woolworths and suppliers cannot engage directly with local stores;[444]

329.2 a second supplier (of dry food products) told us that NPD has a huge upfront cost, and the risk factor of dealing with only the merged entity means that suppliers might have to make decisions about whether the NPD is worthwhile. It thought this might inhibit NPD for smaller and medium businesses;[445]

329.3 a third supplier (of non-food products) considers that small suppliers are often the most innovative, and are the ones that may be impacted the most

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441 Commerce Commission interview with [ ].
442 Commerce Commission interview with [ ].
443 Commerce Commission interview with [ ].
444 Commerce Commission interview with [ ].
445 Commerce Commission interview with [ ].

by the Proposed Merger (given they generally have a higher cost of doing business and may not have scale to supply nationally);[446]

329.4 a fourth supplier (of a range of products) 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;[447]

329.5 a fifth supplier (of fresh products) told us that its innovation is unlikely to be affected by the Proposed Merger because of its activity in the export market;[448]

329.6 an industry participant 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 disincentivized to do so following the Proposed Merger (and may end up deleting new lines entirely if they can only supply half of the market);[449] and

329.7 a second industry participant told us that the Proposed Merger does create concern for smaller suppliers because there is a lot more at stake.[450]

330. We invite submissions on:

330.1 how a reduction in profitability would impact the ability and incentive for investment in innovation for small, medium, and large suppliers;

330.2 how the loss of an independent channel for bringing products to market would impact the ability and incentive for innovation by small, medium and large suppliers; and

330.3 whether there are any types (size or category) of supplier whose ability and/or incentive to invest in innovation may be particularly lessened by the Proposed Merger.

<u>Ultimate impact on consumers</u>

331. In our view, any potential reduction in innovation by suppliers may lead to fewer products, lower quality products, and the slower introduction of new products on retail grocery shelves for consumers. It may also result in fewer efficient suppliers entering the market which could also increase retail grocery prices in the long-term.

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446 Commerce Commission interview with [ ].
447 Commerce Commission interview with [ ].
448 Commerce Commission interview with [ ].
449 Commerce Commission interview with [ ].
450 Commerce Commission interview with [ ].

332. We have received feedback from suppliers that we have spoken with (across different product categories) about the impact of lower innovation by suppliers on end consumers.

332.1 One supplier (of a range of products) told us that the Proposed Merger (and having one less customer to introduce new products through) might change branded players' ability to bring innovation to market, ultimately resulting in less choice for consumers and a lack of offering/variety in brands.[451]

332.2 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.[452]

332.3 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 to introduce innovative (ie, sustainable, environmentally friendly, more nutritional) products given there would be less channels to "try" those products through. In this supplier's view, this would result in consumers subsequently having less choice and options for products to buy.[453]

333. We invite submissions on:

333.1 how often new suppliers enter the New Zealand retail grocery sector, and any impact that these have been shown to have on the range of quality of products available in major grocery retailer stores;

333.2 whether there are viable alternative channels for new products to gain a foothold in New Zealand outside the major grocery retailers; and

333.3 whether there are instances in New Zealand where new suppliers or products have resulted in downward pressure on the price of incumbent suppliers and/or products.

## Competition assessment – coordinated effects in retail markets

334. The Proposed Merger could substantially lessen competition if it increases the potential for the merged entity and all or some of its rival grocery retailers to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase. When assessing whether a merger may give rise to coordinated effects in a given market, we assess whether:

334.1 the relevant market is vulnerable to coordination; and

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451 Commerce Commission interview with [ ].
452 Commerce Commission interview with [ ].
453 Commerce Commission interview with [ ].

334.2 a merger would change the conditions in the relevant market so that coordination is more likely, more complete or more sustainable.

335. We are currently not satisfied that the Proposed Merger would not be likely to substantially lessen competition due to coordinated effects in a national market for the retail supply of groceries.

336. As we discuss further below, we consider that the relevant market for our assessment is the national market for the retail supply of groceries.

336.1 The product market that the Parties compete within is likely to include all physical retail grocery stores which offer the ability for retail consumers to do a one-stop grocery shop. We recognise that other grocery retailers such as The Warehouse and Costco may impose a constraint for some products in locations where they have stores, and take this into account in our assessment.

336.2 There are local, regional and national geographic dimensions to competition in markets for the retail supply of groceries. Decisions on pricing, promotions and the discounting of products by the major grocery retailers mostly take place at a national level (in the case of Woolworths) or island level (in the case of the Parties).[454] However, customers will only be willing to travel limited distances to a grocery store meaning there are likely local grocery markets. The primary means through which we have considered retail coordination is in relation to the national elements of competition.

337. We consider coordinated effects could arise in a national market for the retail supply of groceries through the potential for the merged entity and Woolworths reaching a tacit agreement on the level of some national retail prices. Through this 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.

337.1 First, we consider that retail grocery markets may be vulnerable to coordination on the level of some national retail prices. Some features of a national market for the retail supply of groceries that may support coordination are transparency of prices, high concentration levels, high barriers to entry/expansion and stable demand.

337.2 Second, we consider that the Proposed Merger may increase the likelihood, completeness and sustainability of coordination on the level of national retail prices between the merged entity and Woolworths. The Proposed Merger may make it easier for the Parties to set prices on a national basis, which in turn would make it easier for Woolworths to align its prices with those of the merged entity, or make it easier for the merged entity to align its prices more closely with those of Woolworths (than each of the Parties could individually do without the Proposed Merger).

454 Market study final report (8 March 2022) at [4.137]-[4.142].

338. We invite submissions on our assessment of the coordinated effects in relation to the retail supply of groceries. The specific information we are interested in is set out in subsections below.

**What we said in the SoI**

339. In the SoI, we did not reach a definitive view on the relevant markets for assessing the likely impact of the Proposed Merger on the retail supply of groceries.[455] However, we considered it is appropriate to assess the impact of the Proposed Merger on local, regional and national retail grocery markets.

339.1 For the product dimension, we considered that the relevant market was likely to include all grocery stores which offer the ability for retail consumers to do a one-stop grocery shop. We considered whether it would be appropriate to consider narrower product markets including:

339.1.1 whether online offerings should be considered separately; and

339.1.2 whether there are narrower markets by size of store.

339.2 We did not consider it necessary to define exact geographic markets. We recognised that there are different elements of competition on the local, regional and national levels. There are likely local retail grocery markets because consumers are generally only willing to travel limited distances to purchase groceries. There are also regional and national elements of competition. For example, there are national or regional product sourcing and control of pricing and promotions.

340. We were not satisfied that the Proposed Merger would not be likely to substantially lessen competition due to coordinated effects in retail grocery markets.[456]

341. First, we considered retail grocery markets to be vulnerable to coordination.

341.1 In the market study, the Commission considered that a number of features make retail grocery markets vulnerable to coordination. These features included the major grocery retailers being each other's closest competitors, major grocery retailers closely monitoring each other, high levels of transparency, other grocery retailers facing difficulties entering/expanding and the market being stable.[457]

341.2 Evidence from our investigation of the Proposed Merger suggests there is a high level of price monitoring. Internal documents of the Parties show that FSNI monitors the pricing of Woolworths [ ].[458]

455 SoI at [134].
456 SoI at [165].
457 SoI at [170].
458 SoI at [172.1].

341.3 Since the market study there has been limited entry and some exit from retail grocery markets, which leaves it unclear whether there are any potential other grocery retailers that are sufficiently likely to enter and which would disrupt coordination.[459]

341.4 We stated that we were continuing to assess what metric could be the focal point for coordination. Potential metrics that could serve as a focal point for coordination, include:[460]

341.4.1 prices for a certain group of grocery products such as key products that drive retail consumer choice or private label products; and

341.4.2 the timing of promotions.

342. Second, we considered that the Proposed Merger could potentially increase the likelihood, completeness, and sustainability of coordination between the merged entity and Woolworths.[461]

342.1 The merged entity may move to setting prices at a national level which may make it easier for Woolworths to monitor the merged entity's prices and detect any changes, or make it easier for the merged entity to align its prices more closely with those of Woolworths (than each of the Parties could individually do without the Proposed Merger). The ability to observe prices and detect changes may help facilitate price coordination.

342.2 The merged entity would have a national footprint, size and structure that is more similar to Woolworths which could help facilitate coordination.

342.3 The Proposed Merger may increase barriers to entry and or expansion for a third national retail grocery retailer, reducing the likelihood of a third-party disrupting coordination.

342.4 The reduction in number of major grocery retailers with the Proposed Merger may make information seeking from suppliers easier and thereby allow for more likely, complete, or sustainable coordination between the merged entity and Woolworths.

**Submissions from the Parties**

343. The Parties 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.[462] However, the Parties agree that it is not necessary to conclusively define the relevant retail grocery

[459] SoI at [172.2].
[460] SoI at [169].
[461] SoI at [175].
[462] SoI submission from the Parties (26 April 2024) at [155].

markets as there is no overlap or potential overlap between the Parties and therefore (in their view) no possible lessening of competition.[463]

344. The Parties submit that the retail grocery markets are not vulnerable to coordination.[464] The Parties further submit that:

344.1 they disagree with the market study finding that the major grocery retailers have similar strategies that are well known and put forward that monitoring reflects the fact that they do not know their rivals' strategies well;[465]

344.2 the ability to detect and respond to a rival grocery retailers' change in strategies is not in and of itself indicative of or 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 procompetitive to respond to a rival grocery retailers' 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;[466]

344.3 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;[467]

344.4 the monitoring of Woolworths pricing is aimed at increasing FSNI's competitiveness against Woolworths and [ ] is wholly inconsistent with a coordinating agreement;[468]

344.5 the number and differentiation of products offered in retail grocery markets also acts as a material hindrance to coordination. Additionally, 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;[469] and

344.6 finally, 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.[470]

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463 SoI submission from the Parties (26 April 2024) at [155].
464 SoI submission from the Parties (26 April 2024) at 56.
465 SoI submission from the Parties (26 April 2024) at [175]-[176].
466 SoI submission from the Parties (26 April 2024) at [177].
467 SoI submission from the Parties (26 April 2024) at [178].
468 SoI submission from the Parties (26 April 2024) at [179].
469 SoI submission from the Parties (26 April 2024) at [180].
470 SoI submission from the Parties (26 April 2024) at [181].

345. The Parties also submit that the Proposed Merger would not increase the likelihood, completeness, and sustainability of coordination.[471] The Parties further submit that:

345.1 the Proposed Merger does not increase barriers to entry such that it would affect a potential disruptor from entering retail grocery markets;[472]

345.2 in relation to the increase in 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;[473]

345.3 the merged entity and Woolworths would not have similar size or cost structures. There would be significant differences such as the corporate versus co-operative model, number of banners and store network and trans-Tasman versus New Zealand presence;[474] and

345.4 finally, 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.[475]

346. Houston Kemp (on behalf of the Parties) submit that there is no evidence relating to coordination in retail grocery markets.[476] Houston Kemp further submits that:

346.1 price monitoring and [ ] is consistent with ensuring that the Parties compete effectively with Woolworths. [ ], is inconsistent with coordination;[477]

346.2 there would not be a meaningful increase in Woolworths' ability to monitor prices at the Parties' grocery stores, as Woolworths already has this ability;[478] and

346.3 the Parties' owner-operator co-operative model means that individual stores may set different prices, and this would continue with the Proposed Merger.[479]

347. The Parties further submit:

471 SoI submission from the Parties (26 April 2024) at 58.
472 SoI submission from the Parties (26 April 2024) at [183.2].
473 SoI submission from the Parties (26 April 2024) at [184].
474 SoI submission from the Parties (26 April 2024) at [186].
475 SoI submission from the Parties (26 April 2024) at [187].
476 Houston Kemp report on SoI (26 April 2024) at 14.
477 Houston Kemp report on SoI (26 April 2024) at [60].
478 Houston Kemp report on SoI (26 April 2024) at [62].
479 Houston Kemp report on SoI (26 April 2024) at [62].

347.1 [ ];[480]

347.2 [ ];[481] and

347.3 [ ].[482]

**Market definition**

348. We consider that the relevant market for assessing coordination risk is the national market for the retail supply of groceries. However, in line with submissions from the Parties, we do not consider it necessary for us to conclusively determine the scope of the relevant markets relating to the retail supply of groceries.[483]

349. The retail product market that the Parties compete within is likely to include all physical retail grocery stores which offer the ability for retail consumers to do a one-stop grocery shop. The Parties submit that the market should be wider than "one-stop-shop" as the Parties are constrained by other retailers (such as The Warehouse, Costco, Reduced to Clear and Chemist Warehouse) that have a narrower or more specialised offering.[484] While we have used a "one-stop-shop" product market for our assessment, we have taken into account the constraint from other grocery retailers such as The Warehouse and Costco on the major grocery retailers. We acknowledge other grocery retailers like these may impose a degree of constraint albeit only for some products in the locations where they have stores. We do not see a need to consider narrower markets for purposes of assessing coordination risks. However, we invite further submissions on our current view of the scope of the relevant product dimension relating to the retail supply of grocery products.

350. We continue to consider there are local, regional and national geographic dimensions to competition in markets for the retail supply of groceries. As stated in the SoI, we consider that while there are numerous local retail grocery markets across New Zealand, there are also elements to competition in the retail supply of groceries that occur on a regional or national basis (eg, a degree of national or regional product sourcing and control of pricing and promotions).[485] Decisions on

480 [ ]
481 [ ]
482 [ ]
483 The Application at [73].
484 SoI submission from the Parties (26 April 2024) at [155] and the Application at [77].
485 The SoI at [135].

pricing, promotions and the discounting of products by the major grocery retailers mostly take place at a national level (in the case of Woolworths) or island level (in the case of the Parties).[486] However, retail consumers will only be willing to travel limited distances to a grocery store meaning there are likely local retail grocery markets.

351. As we discuss below, the primary means through which we have considered retail coordination is in relation to the national elements of retail grocery competition. Accordingly, we consider the relevant market to assess competition in a national market for the retail supply of groceries.

**Are retail grocery markets vulnerable to coordination?**

352. We consider that the retail grocery markets may be vulnerable to coordination on national retail prices. We explain this in further detail below but in summary:

352.1 the merged entity and Woolworths may be able to reach a tacit agreement to raise the level of national retail prices for some products. There are some characteristics of a national market for the retail supply of groceries that may enable coordination on that basis, including high concentration levels and transparency of prices; and

352.2 the high degree of transparency may allow the merged entity and Woolworths to monitor, detect and punish deviations from a tacit agreement, without the threat of disruptions by rival grocery retailers.

*Could the merged entity and Woolworths reach a tacit agreement?*

353. We have considered whether the merged entity and Woolworths could reach a tacit understanding to accommodate each other's behaviour. We consider this would be more likely where:

353.1 there is a metric that the merged entity and Woolworths can coordinate on such as price, volumes, or quality;

353.2 few rival grocery retailers operate nationally;

353.3 the products that are being coordinated on are not too complex;

353.4 there is symmetry between rival grocery retailers; and

353.5 there are grocery retailers that can play a facilitating role.[487]

<u>Metric of coordination</u>

354. For the reasons discussed below we consider the most likely metric that the merged entity and Woolworths would coordinate on are national retail grocery prices. We consider retail grocery prices and the process through which those prices are set

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486 Market study final report (8 March 2022) at [4.137]-[4.142].

487 An example of this is where a third party collects data or information and pass these on to any coordinating firms. However, this does not seem relevant in this case as the major grocery retailers use different firms for their data analysis: [ ] and Woolworths uses Quantium.

have features that may support coordination. We describe the price setting process below and how price coordination on national retail grocery prices could potentially take place.

355. The Parties appear to have similar price setting processes, although [ ], they set prices separately from one another and would likely continue doing so in the counterfactual. The main principles of the Parties' price setting are as follows:

355.1 The Parties each set RRPs for their member stores. FSSI told us that [ ].[488] For example, both FSNI and FSSI [ ].[489]

355.2 FSSI told us [ ]:[490]

355.2.1 [ ];

355.2.2 [ ];

355.2.3 [ ];

355.2.4 [ ];

355.2.5 [ ];

355.2.6 [ ]; and

355.2.7 [ ].[491] [ ].[492]

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488 Commerce Commission interview with FSSI (5 June 2024).

489 Commerce Commission interviews with FSNI (31 May 2024) and FSSI (5 June 2024).

490 Commerce Commission interview with FSSI (5 June 2024).

491 [ ]

492 Commerce Commission interview with FSSI (5 June 2024).

355.3 FSNI told us that
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355.4 The Parties
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].[494] Both FSNI and FSSI
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**Table 5: [ ]**[496]

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355.5 The Parties
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493 Commerce Commission interview with FSNI (31 May 2024).
494 [ ] Commerce Commission interview with FSSI (5 June 2024).
495 Commerce Commission interviews with FSSI (5 June 2024) and FSNI (31 May 2024).
496 [ ]
497 Commerce Commission interview with FSSI on (5 June 2024).

355.6 [ ].[498] In rare cases, the Parties [ ].[499]

356. The main features of Woolworths price setting are as follows.

356.1 Woolworths operates a national business model for its Woolworths and Countdown stores. This means that pricing in these stores is almost entirely consistent nationwide (the exception being fresh products where there may be price differences between the North Island and South Island).[500] Woolworths told us that [ ].[501] Woolworths [ ].[502] [ ]. Woolworths told us that [ ].[503]

356.2 Woolworths told us [ ]. Woolworths told us that the competitors it monitors are PAK'nSAVE and New World banners, but also increasingly other retailers such as Costco and Chemist Warehouse.[504]

356.3 Woolworths is the franchisor of Fresh Choice and SuperValue. There are 58 Fresh Choice stores and 16 SuperValue stores throughout New Zealand.[505] Woolworths sets RRP for Fresh Choice and SuperValue stores which the owners of individual stores have discretion to follow. The exception is if the

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498 Commerce Commission interviews with FSSI (5 June 2024) and FSNI (31 May 2024).

499 [ ]

500 Market study final report (8 March 2022) at [4.140].

501 Commerce Commission interview with Woolworths (14 June 2024).

502 [ ] E-mail from Russell McVeagh (on behalf of Woolworths) to the Commerce Commission (20 June 2024).

503 Commerce Commission interview with Woolworths (14 June 2024).

504 Commerce Commission interview with Woolworths (14 June 2024).

505 Fresh Choice "Find your local store" <www.freshchoice.co.nz> (as at 25 June 2024) and SuperValue "Find your local store" <www.supervalue.co.nz> (as at 25 June 2024).

RRP is part of a wider national promotion, in that case, the store owners must not exceed the RRP, but can price below.[506]

357. There are some features of the retail grocery price setting process that may support coordination post-merger.

357.1 The merged entity and Woolworths would both have a mechanism to set retail grocery prices on a national basis: Woolworths already makes decisions on prices at a national level, and the merged entity would be able to set RRPs on a national basis. This is why we think that the most likely metric that the merged entity and Woolworths would coordinate on are national retail grocery prices.

357.2 Retail prices for groceries are transparent and the Parties and Woolworths can collect information on prices from each other's websites.[507] The ease with which the Parties and Woolworths can obtain this retail pricing information supports coordination because it makes it easier to monitor prices and detect deviations from a tacit agreement.[508] The Parties submit that the ability to detect and respond to a rival's change in strategy is not itself indicative of coordination.[509] We agree with this. However, it does nevertheless support coordination and therefore increase the risk of coordination and needs to be considered alongside other features of retail grocery markets.

357.3 There are frequent interactions between the Parties and Woolworths on price and the terms of coordination could emerge from these interactions. The Parties and Woolworths regularly monitor both price and non-price dimensions of competition of each other's retail banners on an ongoing and frequent basis.[510] The Parties and Woolworths also monitor price levels for specific products with the aim of maintaining specified price differentials between retail banners.[511] Monitoring is particularly focused on products that retail consumers tend to focus on to form their perceptions of value or the competitiveness of a retail grocery offer.[512] For example, [ ]. The frequency of these interactions supports coordination because it makes it easier for the Parties and Woolworths to test retail price rises and then quickly revert if the other does not follow. It also implies the Parties and Woolworths can adjust retail prices quickly to punish any deviation from an understanding.

506 Commerce Commission interview with Woolworths (14 June 2024).

507 Some firms that offer groceries do not list prices online. For example, not all SuperValue supermarkets have an online offering and we understand that Costco does not list all its prices online. However, prices from these stores can be collected through a visit and, as we discuss further below, these stores are unlikely to materially impact the likelihood of coordination.

508 As we explain further below, as the major grocery retailers have different brand positions (which could change over time) the Parties and Woolworths would need to monitor quality-adjusted prices.

509 SoI submission from the Parties (26 April 2024) at [177].

510 Market study final report (8 March 2022) at [4.82].

511 Market study final report (8 March 2022) at [4.83.1].

512 Market study final report (8 March 2022) at [5.114].

Few firms in the market

358. The number of competing firms in a market affects the ability to coordinate. It is easier to reach an understanding when there are only a few firms in the market. In both the North Island and South Island there are already only two major grocery retailers (the Parties and Woolworths). With the Proposed Merger, the merged entity and Woolworths would be the only major grocery retailers operating nationally. As noted in the market definition section we do not include grocery retailers such as The Warehouse and Costco within the relevant market as they are not 'one-stop-shops' and only compete in some locations but consider their impact on coordination in the external stability section below. With fewer rival grocery retailers operating nationally, it may be easier to reach a tacit understanding. However, one complication to reaching a sustainable coordinated outcome may be the ability of individual FSNI/FSSI stores [ ].

359. Price coordination implies that prices are set above the levels that would exist if competing firms were acting alone. It would only be profitable for a firm to raise prices to those levels if it could rely on other competing firms to accommodate those price increases by also raising their price to match. Individual FSNI/FSSI stores may have an incentive to deviate and to undercut any coordinated national retail price. Individual FSNI/FSSI stores may find it profitable to do so if Woolworths wishes to maintain its strategy of having the same prices across all its stores. This would make it difficult for Woolworths to react to deviations on any coordinated agreement by individual FSNI or FSSI stores.[513]

360. We have analysed the extent to which individual FSNI/FSSI stores currently follow RRPs. **Attachment A** (confidential) explains how we assessed this and includes some figures. This analysis shows that:

360.1 [ ];

360.2 [ ]; and

[513] 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.

360.3 [ ].

361. These figures illustrate that the Parties' stores [ ]. FSNI New World stores have a [ ], FSSI New World stores have a [ ], and the Parties PAK'nSAVE stores have a [ ]. We are continuing to assess whether the Parties are likely to continue to do so if the merged entity attempted to coordinate on national retail grocery prices with Woolworths. We are also assessing whether the merged entity may be able to exert greater control over the retail pricing in different banners. For example, the merged entity may be able to control retail grocery prices using promotions [ ] or through altering the terms of the co-operative ownership structure.

362. In particular, we invite submissions on whether the ability of FSNI/FSSI store owners [ ], would materially undermine coordination of retail grocery prices and whether there would be a way for the merged entity to exert greater control over those store owners.

<u>Complexity of products</u>

363. Price coordination is more likely where firms can reach agreement on the terms of a coordinated strategy. This may be the case where firms supply homogenous products and there are only few products, implying the coordinating firms only need to reach an understanding on a few prices.

364. The Parties submit that the number and differentiation of products offered in retail grocery markets also acts as a material hindrance to coordination.[514] We accept that there are some features of retail grocery markets that may add some complexity to firms reaching a coordinated agreement.

365. First, the major grocery retailers 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 is subject to different promotional activity. The Parties may wish to set a different level of retail price (and price differential) for different types of products depending on how sensitive customers are to retail grocery prices, product availability or whether the product is on promotion or not. As noted, FSSI [ ].[515]

366. One means that could be used to overcome these complexities would be to coordinate on average retail grocery prices across a smaller basket of goods, rather than individual shelf prices. The Parties [ ].

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514 SoI submission from the Parties (26 April 2024) at [180].

515 Commerce Commission interview with FSSI (5 June 2024).

Woolworths [ ]. Post-merger the merged entity and Woolworths could potentially reach a shared understanding on the level of the average retail price of a targeted basket of goods. This would make it harder to monitor adherence to an understanding since it may be unclear if price differences were due to 'cheating' on the understanding or [ ].[516] However, using [ ] retail prices may be sufficient to detect significant price changes.

367. A related issue is that FSNI and FSSI may not have consistent product ranges. It would be more difficult to coordinate if the product range between stores differed as it would be harder for Woolworths to compare its prices with that of the merged entity. However, internal documents show that [ ].[517]

368. Second, the respective banners of the Parties (PAK'nSAVE, New World and Four Square) and Woolworths (Woolworths, SuperValue and Fresh Choice) all compete on different aspects of price and non-price dimensions of competition. 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 of service and range). Alternatively, coordination could focus on (say) New World on the understanding that the merged entity would in any case continue to manage pricing between its banners.

369. Further complicating matters is that the Parties [ ]. The different brand positioning and categories may increase the difficulty to reach and sustain a tacit understanding since it requires reaching an understanding on multiple retail prices (or price differentials). It is nonetheless possible that the merged entity and Woolworths could reach an understanding over time that reflect any differences between the firms.

370. Third, not all products that the Parties and Woolworths supply may be suitable for national retail price coordination, even in a basket of goods (as discussed above). Due to the ability of individual FSNI/FSSI stores [ ], candidate products for coordination are likely to be [ ]. Our retail pricing analysis (see figures in **Attachment A**) suggests [ ]. FSSI told us that [ ].[518] Although FSSI

516 [ ]

517 [ ]

518 Commerce Commission interview with FSSI on (5 June 2024).

[ ].[519]

371. Although the analysis above identifies products that have the most suitable characteristics for coordination, coordinating on only a category of products (the coordinated group) may add complications. For example, the merged entity and Woolworths would need to understand which products are within the coordinated group and which are outside. The merged entity and Woolworths would each have an incentive to lower the retail price for products outside the coordinating group since they would take into account the higher profits available on the products in the coordinated group in the customer's basket. This could make it more difficult to maintain a tacit agreement to coordinate on a group of products.

372. We invite submissions on:

372.1 whether the merged entity and Woolworths could reach a tacit agreement despite the complexity of the products; and

372.2 the product categories or groups of products most likely vulnerable to coordination, including how such coordination could be achieved, monitored and sustained.

Symmetry of the firms

373. Symmetry between firms (in terms of market shares, costs, product design, and other attributes) 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.

374. We consider there is likely to be some element of symmetry between the Parties and Woolworths. At present they are the only major grocery retailers and are likely to have a similar geographic footprint with the Proposed Merger. We consider there are some similarities between the Parties and Woolworths and some differences.

375. However, there are also some differences between the Parties and Woolworths that reduces symmetry between them.

375.1 At this point we do not know how similar the cost base between the Parties and Woolworths are. The Parties submit that the cost base is likely to be different.[520]

519 Commerce Commission interview with FSSI on (5 June 2024).

520 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).

375.2 When considered on an island basis, the Parties and Woolworths are likely to have similar overall coverage (since grocery stores will normally follow population growth). However, the Parties and Woolworths appear to have strengths in different regions. For example, Woolworths is relatively large in Auckland, while FSNI is larger than Woolworths in Wellington.[521] The Parties and Woolworths stores are also geographically differentiated. Four Square or SuperValue might be the only store in some local areas.

375.3 The Parties also submit that a difference between them and Woolworths is the trans-Tasman versus New Zealand presence and corporate versus co-operative model.[522] It is unclear that the trans-Tasman model of Woolworths reduces symmetry significantly, since [ ].[523] However, as noted above, we recognise that the co-operative model of the Parties may complicate coordination.[524]

376. It is unclear whether the Proposed Merger would increase or decrease the symmetry between the merged entity and Woolworths in a national market for the retail supply of groceries.

376.1 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, national retail market shares may be more asymmetric. 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.[525]

376.2 If the Proposed Merger increases the buyer power of the merged entity, then this may lower its costs compared to Woolworths. If so, this would make coordination less likely because it would be harder for Woolworths to punish the merged entity for deviating from a tacit agreement. On this point, [ ].[526]

377. We invite submissions on whether the Proposed Merger would make the Parties and Woolworths more symmetrical, in particular, whether supplier costs are likely to become more or less symmetrical.

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521 Market study final report (8 March 2022) at footnote 383.

522 SoI submission from the Parties (26 April 2024) at [186.1]-[186.3].

523 Commerce Commission interview with [ ].

524 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, counsel for the Parties argued that the structural/operational differences between the Parties and Woolworths explain why coordination has 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 Limited* (2008) 12 TCLR 194 (CA) at [202].

525 Commerce Commission interview with Woolworths (14 June 2024).

526 Commerce Commission interview with [ ].

*Could the merged entity and Woolworths sustain a tacit understanding?*

378. We consider that market conditions may enable the merged entity and Woolworths to sustain a tacit understanding in a national market for the retail supply of groceries. Sustaining a tacit understanding requires that:

378.1 the firms in a market can detect and quickly and effectively punish deviations from the agreement; and

378.2 there is external stability to a market, that is, the agreement is not at risk of being undermined by entry and expansion by third parties or significant changes in demand.

379. We invite submissions on whether the merged entity and Woolworths could sustain a tacit understanding, in particular, the extent to which other grocery retailers such as The Warehouse would disrupt a tacit agreement.

<u>Detecting and punishing deviations</u>

380. 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.

381. The major grocery retailers monitor each other's prices frequently on a regular ongoing basis.[527] The Parties and Woolworths also already monitor price levels for specific products with the aim of maintaining specified price differentials between retail banners.[528] Although this could be an indication that some coordination may already be occurring on some products, as noted above, it may be difficult to know whether a retail price change for an individual product is consistent with a coordinated agreement. However, the high degree of transparency in retail grocery markets implies the merged entity and Woolworths would likely be able to quickly detect large scale deviations from a coordinated agreement, for example, a sustained change in the retail prices (or price differentials) of a category of products.

382. The merged entity and Woolworths are likely to have credible and effective strategies available to punish deviations that are identified. A grocery retailer could go through a period of low retail pricing to reduce a rival grocery retailer'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, although Woolworths would need to be willing to move from its national pricing strategy to engage in this type of punishment.

527 Market study final report (8 March 2022) at [4.82].

528 Market study final report (8 March 2022) at [4.83.1].

External stability

383. Coordination is more likely where the higher profits from a coordinated strategy are unlikely to be threatened from new entry and/or expansion of non-participating rivals.

384. We consider it unlikely that any potential new entrants are likely to enter the national market for the retail supply of groceries (ie, enter on a national basis) in the near term. In the market study, the Commission considered that there were a number of factors preventing or slowing entrant and expansion in grocery retail markets.[529] 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 retail grocery and 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 GICA includes to lower barriers to entry, although it is yet to be seen whether it will achieve its desired outcomes. We acknowledge that if the merged entity obtained lowers supplier prices due to the Proposed Acquisition this could potentially lower wholesale prices available from the merged entity under the GICA. However, neither of the Parties [ ] 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.

385. Coordination on certain products may be disrupted by rival grocery retailers such as The Warehouse and Costco. In locations where The Warehouse has a store, major grocery retailers may face the risk of being undercut on certain products.[530] The Warehouse appears to price aggressively for core essential products (such as butter, milk and eggs) and may have influenced pricing by the Parties in nearby stores. [ ].[531] The Warehouse is not present in all local grocery retail markets, but may complicate the ability of the Parties and Woolworths to sustain a coordinated agreement as it may require them agreeing on different retail grocery price levels in different areas for the same product. However, if the Proposed Merger raises barriers to entry and expansion (as we discussed earlier), then this could inhibit The Warehouse from playing a disruptive role.

[529] Market study final report (8 March 2022) at [6.5] and 189.

[530] The Commission opposed the proposed acquisition by Foodstuffs 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 (Decisions Nos. 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 Limited* (2008) 12 TCLR 194 (CA) at [203].

[531] Commerce Commission interview with The Warehouse Group (22 May 2024).

386. We invite submissions including any further information available on the impact that other grocery retailers such as The Warehouse, Costco, Reduced to Clear and Chemist Warehouse have had on retail prices of the major grocery retailers.

*Is there evidence of existing coordination?*

387. Where there is evidence of existing coordination it would suggest a market is vulnerable to coordination and that even small changes from a merger could make coordination 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. For example, monitoring and reacting to the prices of rivals occurs in markets without coordination.

388. At this point, we consider the evidence whether coordination in retail grocery markets is already occurring is unclear, even though the major grocery retailers monitor each other's prices frequently on a regular ongoing basis, including for specific products with the aim of maintaining specified price differentials between retail banners.[532]

389. First, market stability may indicate coordination as it may suggest the major grocery retailers are adhering to a coordinated strategy. If retail grocery market shares are stable it may indicate that retail grocery markets are vulnerable to coordination. On the other hand, market shares could be stable because overall grocery demand is stable and the major grocery retailers have established stores within certain local areas which limits how much shares are likely to change in aggregate. Bearing this in mind, a review of the internal documents of the Parties shows some evidence to suggest that retail grocery markets are stable.

389.1 Market shares in both the North Island and South Island appear to have had limited variation. [ ].[533] [ ].[534] 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, [ ].[535]

389.2 [ ].[536] However, we note these figures would not capture retail consumers

[532] Market study final report (8 March 2022) at [4.82] and [4.83.1].

[533] [ ]

[534] [ ]

[535] 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. [ ]

[536] [ ]

that permanently switched between the different banners.

390. Second, leader follower behaviour may be an indicator of existing coordination, although such behaviour can also occur in competitive markets.

390.1 The Parties and Woolworths monitor price levels for specific products with the aim of maintaining specified price differentials between retail banners.[537] [ ].[538] The use of [ ] suggests the Parties have the ability to follow Woolworths pricing (ie, if Woolworths raises or lower prices, then the Parties can readily identify this change and change their pricing [ ]).[539] [ ].[540] Woolworths also stated that [ ].[541]

390.2 There is mixed evidence of [ ].[542] This suggests there may not currently be an understanding between the Parties and Woolworths, [ ].

390.3 The Parties state that [ ].[543] The Parties have taken steps that appear inconsistent with a strategy to reach a tacit agreement with Woolworths. The Parties [ ]. The Parties have also [ ].[544] FSNI indicated that

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537 Market study final report (8 March 2022) at [4.83.1].

538 The Court of Appeal considered that the market conditions in 2008 were suitable f or 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 Limited* (2008) 12 TCLR 194 (CA) 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.

539 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].

540 Commerce Commission interview with FSSI (5 June 2024).

541 Commerce Commission interview with Woolworths (14 June 2024).

542 See for example [ ].

543 SoI submission from the Parties (26 April 2024) at [179].

544 [ ]

[ ].[545] The internal documents of the Parties also show [ ].[546]

391. Third, evidence of the Parties pre-empting the pricing strategies of rival grocery retailers may be consistent with coordination. However, at this point we have not seen evidence suggesting that the Parties are able to predict the future prices or promotions of Woolworths. Rather, as mentioned above we have seen evidence of the Parties [ ].[547]

**Would the Proposed Merger make coordination more likely or more sustainable?**

392. We have considered the possible ways in which the Proposed Merger could make coordination more likely or sustainable in a national market for the retail supply of groceries.

393. We consider that the Proposed Merger may increase the likelihood, completeness and sustainability of coordination on the level of national retail prices between the merged entity and Woolworths. The Proposed Merger may make it easier for the Parties to set prices on a national basis, which in turn would make it easier for Woolworths to align its prices for some products with those of the merged entity, or make it easier for the merged entity to align its prices for some products more closely with those of Woolworths (than each of the Parties could individually do without the Proposed Merger).

*Removal of a potential disruptor*

394. A merger can increase the likelihood of coordination if it removes a potential disrupter (either an existing or potential competitor). We do not consider the Proposed Merger would remove a potential disruptor. We do not consider that FSNI is a likely entrant into the South Island, nor is FSSI a likely entrant into the North Island. Therefore, the Proposed Merger there would not cause a reduction in the number of direct or potential competitors.

*Changes in symmetry*

395. A merger can increase the likelihood of coordination if it increases the symmetry between the market participants. We consider the Proposed Merger may impact on the symmetry of the merged entity and Woolworths. However, as discussed above, it is unclear whether these changes would make coordination more or less likely.

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545 Commerce Commission interview with FSNI (31 May 2024).

546 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.

547 [ ]

*Impact on multi-market contact*

396. A merger can increase the likelihood of coordination where it increases the level of multi-market contact (that is, the number of markets in which firms interact). This can increase the opportunities competing firms have to retaliate and punish rivals for a deviation from a coordinating agreement.

397. However, we consider the Proposed Merger would not materially impact the likelihood or sustainability of coordination through increased multi-market contact. It is likely the Parties could already punish deviation by cutting prices generally, and that having the ability to do so in different locations does not materially change the threat of punishment.

*Adoption of new technologies*

398. A merger can increase the likelihood of coordination where it increases the ability of firms to monitor and respond to price changes (which might be relevant where the products that are the target of coordination are complex). We have considered whether the Proposed Merger may make the merged entity better-positioned to implement technology such as AI and algorithms to facilitate coordination. However, at this point we cannot say whether the Proposed Merger would have such an effect.

399. The academic literature identifies that AI and algorithmic technologies can increase or decrease competition.[548] For example, new technology could make it easier for firms to monitor rivals, however it could also be used by consumers to seek out the lowest price. It is unclear the overall effect that these technologies will have on retail grocery markets.

*Increase in national pricing and range compliance*

400. A merger can increase the likelihood of coordination where it makes the products in a market less complex. We consider that this could be an effect from the Proposed Merger if there is an increase in national pricing and greater range compliance among FSNI/FSSI stores.

401. The Proposed Merger may lead to an increase in national pricing and range compliance. The Proposed Merger may result in a move towards more centralised pricing. The Parties submit [ ].[549] However, FSNI suggests that [ ].[550] If post-merger there was a move to more national pricing

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548 See for example OECD "Algorithmic Competition" (OECD Competition Policy Roundtable Background Note, 2023). The literature on algorithmic coordination is relatively new and there are papers that suggest it could help coordination and others that raise doubts about it. Algorithms could enhance efficiency and competition by introducing disruptive technologies, improving production processes, reducing barriers to make it easier for new players to gain market insights and reducing customer search costs. Algorithms could increase the risk of coordination by increasing visibility and responsiveness, and increase the potential size of the coordinating group.

549 SoI submission from the Parties (26 April 2024) at [184].

550 Commerce Commission interview with FSNI (31 May 2024).

this would resemble the pricing practice of Woolworths. We have seen evidence of [ ]. Following the Proposed Merger [ ].

402. The Parties submit 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.[551] However, we consider the impact of an increase in national pricing and range compliance arising from the Proposed Merger is that Woolworths would no longer need to reach an understanding on retail grocery prices (or price differentials) that satisfies the brand position of both FSNI and FSSI but instead only reach a single retail price (or price differential) with the merged entity. Woolworths would no longer need to monitor both FSNI and FSSI but instead only monitor the merged entity. If this change would make it much easier for Woolworths to follow the retail grocery prices set in the Parties' stores it could make coordination more likely or sustainable.

403. The Parties submit there would be no change in the incentive to price nationally as a result of the Proposed Acquisition and that FSNI and FSSI are already capable of setting national retail prices. The Parties provided an example of [ ].[552] However, FSNI told us that [ ].[553]

404. We invite further information on why this is the case. We are considering whether one possibility is that FSNI and FSSI currently set retail grocery prices to maximise their own profits which results in a different optimal price. This may make it more difficult to agree on a single national price. However, the merged entity may be able to set RRPs that increase collective profits, especially where it would enable coordination on national retail grocery prices.

*Increase in barriers to entry*

405. 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.[554] However, as identified earlier, we are still considering whether the Proposed Merger may raise barriers to entry in various ways for rival grocery retailers. If so, this may inhibit the ability of The Warehouse to act as a disruptor. This would increase the sustainability of coordination if The Warehouse was an important constraint on coordination.

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551 Houston Kemp report on SoI (26 April 2024) at [62].

552 [ ]

553 Commerce Commission interview with FSNI (31 May 2024).

554 SoI submission from the Parties (26 April 2024) at [183.2].

## Assessment of consumer harm and efficiencies

406. Notwithstanding our view outlined earlier in discussing the framework for assessing the Proposed Merger that we do not have to consider the likelihood of downstream effects in selling markets in assessing whether the Proposed Merger would substantially lessen competition in any buying markets, we have been considering and continue to consider:

406.1 the harm to consumers that might arise due to increased buyer power held by the merged entity and/or less innovation by grocery suppliers; and

406.2 the extent to which efficiencies that are likely to arise from the Proposed Merger would pass through to consumers and potentially offset the competitive impact from the Proposed Merger such that it would not substantially lessen competition.

### Consumer harm

407. In discussing earlier our unresolved competition concerns in acquisition markets, we noted that we continue to have concerns that the Proposed Merger would substantially lessen competition due to unilateral effects in relevant upstream markets for the acquisition of groceries. Our unresolved concerns with respect to the Proposed Merger's potential downstream impacts on consumers are primarily that:

407.1 it could result in a substantial lessening of competition in the markets in which groceries are acquired from suppliers, and increase the merged entity's buyer power. This could allow the merged entity to extract lower prices from some suppliers, "cherry pick" the most favourable terms, disadvantaging some suppliers and/or otherwise get more favourable trading terms from some suppliers. 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;

407.2 the merged entity's buyer power could lead to harm in retail grocery markets that increases the barriers to entry and/or expansion for rival grocery retailers (eg, because rival grocery retailers cannot acquire groceries on as favourable terms as the merged entity) and means that retail consumers do not get to experience the benefit of increased retail grocery competition in the future; and

407.3 each of FSNI and FSSI provide separate opportunities for new grocery products to be listed in New Zealand. With fewer opportunities, 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. This could impact the pace and development of new product innovation, resulting in reduced consumer choice and quality of grocery products.

408. We note that additional harm to consumers could arise from the Proposed Merger making coordination in a national market for the retail supply of groceries more likely,

complete or sustainable. Coordinated behaviour could be particularly harmful to retail consumers if it resulted in higher retail grocery prices.

409. We invite submissions on the harm to consumers that would arise due to increased buyer power held by the merged entity, less innovation by grocery suppliers and coordination in the national market for the retail supply of groceries being more likely, complete or sustainable. In particular, on the likelihood of:

409.1 an exercise of buyer power by the merged entity causing suppliers to rationalise their operations, stop production, fail or exit to such an extent that there would be a reduction in the product range, quality and innovation that retail consumers might otherwise enjoy;

409.2 the merged entity's buyer power increasing the barriers to entry and/or expansion for rival grocery retailers, such that retail consumers do not get to experience the benefit of substantially increased retail grocery competition in the future; and

409.3 the Proposed Merger impacting the pace and development of new product innovation, resulting in reduced consumer choice and quality of grocery products.

**Efficiencies**

410. Further to the short text earlier in discussing the framework for assessing the Proposed Merger, we set out below further information on the framework for assessing efficiencies in a merger clearance context and then our current view on efficiencies in the case of the Proposed Merger. In summary, we currently consider that:

410.1 efficiencies can be taken into account in merger clearances but are rarely of the required type, magnitude and credibility to prevent a substantial lessening of competition (and are instead more commonly assessed as part of the merger authorisation process);

410.2 in a merger clearance context, our consideration of any efficiencies should be limited to only in-market, rivalry-enhancing efficiencies (in the market they are found). We do not think we should be unconcerned about substantial harm to suppliers in buying markets because efficiencies may flow through to customers in selling markets; and

410.3 in the case of the Proposed Merger:

410.3.1 we acknowledge that there may be some in-market efficiencies in upstream acquisition markets arising from reduced transaction costs (eg, fewer negotiations);

410.3.2 the efficiency benefits of the Proposed Merger, to the extent they are realised, may arise in different markets (downstream retail and wholesale grocery markets) to where a potential substantial lessening of competition may occur (buyer markets relating to the acquisition of groceries); and

410.3.3 we are currently not satisfied that any efficiencies from the Proposed Merger would be passed through to retail consumers (eg, in terms of reduced prices), or kept as additional profits by the co-operative members of the merged entity.

*Framework for assessing efficiencies*

411. 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.

412. The merger clearance test in the Act encourages us to focus on the effect of a merger on competition in a market or markets in New Zealand. While efficiencies tend to be most relevant in the context of an authorisation application, our Guidelines note that efficiencies can be relevant to our assessment of clearance applications.[555]

413. 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"[556], 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).[557] 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.[558]

414. We note that our Guidelines currently focus to a great degree on pass-through of efficiencies to customers, and are unclear 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 outweigh a substantial lessening of competition (by providing benefits to customers that might be more valuable than the harmful impacts of a substantial lessening of competition). The latter is akin to what we consider as part of merger authorisation applications.

415. Case law states that the substantial lessening of competition test is a net test in each relevant market, that requires us to consider any procompetitive outcomes of a merger. 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 procompetitive outcomes against any lessening of competition arising from the competitive aggregation, and form an overall view on

555 Mergers and Acquisitions Guidelines above n16 at [3.118].
556 Mergers and Acquisitions Guidelines above n16 at [3.118].
557 Mergers and Acquisitions Guidelines above n16 at [3.120].
558 Mergers and Acquisitions Guidelines above n16 at [3.119]-[3.120].

whether competition would be substantially lessened in that market.[559] However, we do not consider that the substantial lessening of competition test allows us to ignore a substantial lessening of competition in a relevant market because there may be factors that enhance competition in some other markets.

416. As noted earlier, our view is that cost savings accruing to a merged entity simply from the exploitation of acquired market power in acquisition markets should not be treated as relevant efficiencies. Such cost savings reflect a harm to competition. 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:

416.1 the s66 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;

416.2 there is another provision of the Act that does permit us to consider out of market efficiencies more holistically – the s67 merger authorisation test;

416.3 the only case law that discusses efficiencies in New Zealand (cited above) 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

416.4 while our Guidelines note that efficiencies "may be relevant to our assessment of whether a merger would be likely to substantially lessen competition",[560] 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.

417. We note that, while technically separate markets, upstream and downstream markets (such as grocery buying and selling markets) are vertically linked and interdependent. We also note that in the market study, the Commission noted that:

417.1 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);[561]

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559 See for example, *ANZCO Foods Waitara Ltd v Affco New Zealand Limited* [2006] 3 NZLR 351 (CA) at [249] and *Fisher & Paykel* [1990] 2 NZLR at 740.

560 Mergers and Acquisitions Guidelines above n16 at [3.118].

561 Market study final report (8 March 2022) at [8.29]-[8.30].

417.2 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;[562] and

417.3 the extent to which customers may benefit depends on the strength of competition between grocery retailers.[563] A more competitive retail market increases the likelihood of any benefits grocery retailers obtain from buyer power being passed through to consumers,[564] but consumers may not benefit unless strong retail competition forces firms to pass on benefits.[565]

418. Moreover, even where actual efficiencies can be demonstrated, we are presently of the view that the clearance framework does not allow efficiencies in a downstream retail market to 'offset' harm in an upstream acquisition market. Instead, applicants are required to establish that claimed efficiencies counteract the expected lessening of competition or harm to participants in the relevant market (ie, the upstream market). For example, applicants could seek to establish that efficiencies would:

418.1 make a merged entity more competitive, such that competition in the upstream market increases or stays level (rather than decreases); or

418.2 result in benefits to market participants who would otherwise be harmed by the lessening in competition (in this case, suppliers to the Parties).

419. We invite submissions on the framework for assessing efficiencies, and their relevance in the context of a clearance application.

*Efficiencies in the case of the Proposed Merger*

420. Our view is that the merger clearance framework is not an appropriate framework for us to be weighing up potential harm to competition of the Proposed Merger in one market against claimed benefits to consumers in another market (the detailed assessment of "net benefits" is instead more appropriately conducted under the merger authorisation process provided under s67 of the Act). To the extent that our view is incorrect, and that we are in fact obliged in a clearance process to engage in this balancing exercise, then the Parties would need to satisfy us that:

420.1 they would be realised in a timely fashion;

420.2 that they would not likely be realised without the Proposed Merger; and

420.3 that they would be passed on to customers (in this case, in particular, retail consumers).

421. Unlike other jurisdictions, we do not have the ability to accept behavioural undertakings as part of our merger clearance process, which could in theory provide a greater level of assurance that efficiencies would be passed on to retail consumers.

562 Market study final report (8 March 2022) at [6.122].
563 Market study final report (8 March 2022) at [8.30].
564 Market study final report (8 March 2022) at [8.33].
565 Market study final report (8 March 2022) at [3.211].

Instead we have to make a judgement as to the likelihood of efficiencies being passed on to consumers.

422. Consequently, for us to be satisfied on the above points, we would first require evidence that efficiencies and cost savings from the Proposed Merger would be realised in a timely fashion and would not likely be realised without the Proposed Merger. Secondly, we would require strong evidence that efficiencies and cost savings from the Proposed Merger would likely be passed on to retail consumers by the merged entity to a material extent, including as a result of competitive pressures or incentives it would have to act competitively by offering retail consumers lower prices or improved non-price elements (eg, greater innovation, increased range/choice or better service quality).

423. 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.[566] 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 consumers.[567] 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 and/or otherwise be advantageous to consumers.[568] One supplier considers there is a possibility the merged entity might pass on some cost savings to consumers in the short term but that the Proposed Merger would nonetheless have a negative impact in the long-term,[569] with another supplier similarly noting that while consumers might not suffer in the short term, long term they would suffer on choice.[570]

424. Based on the evidence before us at this time, we are not currently satisfied that efficiencies from the Proposed Merger would be passed through to retail consumers (eg, in terms of reduced prices), or kept as additional profits by the merged entity.

425. We discuss further below the submissions and evidence before us from the Parties on the efficiencies of the Proposed Merger.

426. In publicly announcing the Proposed Merger in 2023, the Parties stated that:[571]

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566 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).

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

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

569 Commerce Commission interview with [ ].

570 Commerce Commission interview with [ ].

571 FSNI/FSSI Media Release re Proposed Merger (7 November 2023).

426.1 the Boards of each of the Parties "have been clear it must deliver meaningful benefits for customers and all our Stakeholders";

426.2 the Proposed Merger would "make us more efficient and able to deliver more innovation and better value for New Zealanders";

426.3 a single, merged co-operative would be able to work on initiatives that improve efficiency and competitiveness "better and faster"; and

426.4 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".

427. 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".[572]

428. We consider it plausible that some portion of the benefits that would arise from the Proposed Merger are likely to be passed through to retail consumers. However, based on the evidence before us we do not know exactly what proportion would be passed through or in what way pass through might occur (ie, reduced retail prices or more indirect investment by the merged entity). Although (as noted below) the Parties submit that "a significant part" of the benefits of the Proposed Merger would pass through to customers, there is no certainty that this would happen to a material extent. We note that the Parties do not have any particular mechanism through which they would ensure pass through, but rather they say that it would be competitive pressure and customer expectation that means they would pass savings on.

429. The benefits/savings from the Proposed Merger would arise from a combination of cost savings and buying benefits. The Parties' [ ].[573]

430. 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

572 Foodstuffs Update on Merger Application (20 May 2024).

573 [ ]

checkout prices and to wholesale customers through lower wholesale prices. The Parties also submit that:[574]

430.1 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;[575]

430.2 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;

430.3 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;

430.4 increased retail competition and the GICA (plus other public and political pressure) should ensure the benefits of savings and efficiencies are passed on;

430.5 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 [ ];

430.6 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;

430.7 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; and

430.8 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 is neutral, or pro-competitive if it results in lower downstream prices than would otherwise prevail.

431. The [ ] for the Proposed Merger states the following in terms of savings being passed on to customers:[576]

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574 The Application at [6]-[7], [20] and [119]-[121], SoPI cross submission from the Parties (7 March 2024) at [3], [33.5], [60]-[62], [66]-[68] and [137], SoI submission from the Parties (26 April 2024) at [5], [70]-[73], [85]-[106] and [141]-[146], SoI cross submission from the Parties (6 May 2024) at 18-19 and SoI cross submission from the Parties (31 May 2024) at 4-7.

575 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].

576 [ ]

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432. However, the Parties’
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]:[577]

432.1 [
];

432.2 [
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432.3 [
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and

432.4 [
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433. Regarding these comments, FSNI advised us that
[
]. FSNI further told us in terms of efficiencies:[578]

433.1 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;

433.2 there are absolutely benefits for customers with the Proposed Merger, in terms of the merged entity passing benefits on;

433.3 what is impossible to pinpoint is how much growth the merged entity would earn from customers who see more value:

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[577] [ ]

[578] Commerce Commission interview with FSNI (31 May 2024).

433.3.1 from efficiency in buying being passed on (ie, better pricing across a merged FSNI/FSSI); and

433.3.2 from buying efficiencies (and reducing costs for suppliers, enabling them to engage for a better outcome) being retained to maintain fair co-operative returns or to head off increases in prices and costs;

433.4 a pool of value is going to be generated by the Proposed Merger, and the Parties have been very clear that a significant portion of that pool would pass through to customers, as that is how the merged entity would grow and earn more customers;

433.5 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);

433.6 the grocery sector faces a lot of scrutiny and value pressures would continue to exist. For example, PAK'nSAVE is committed to having New Zealand's lowest food prices;

433.7 in terms of assurance that the efficiencies of the Proposed Merger would pass through to consumers, the Parties have been very public and committed multiple times on this point. It would be quite a brand risk if the Parties do not deliver on that and cannot show the benefits from the Proposed Merger flowing to New Zealanders over the next three to five years; and

433.8 a number of forces are at work that would hold the merged entity to account to ensure efficiencies would appropriately pass through to customers, and the merged entity would need to account to all stakeholder groups for benefits from the Proposed Merger in a transparent way.

434. FSSI advised that
[

].[579]

[579] Commerce Commission interview with FSSI (5 June 2024).

435. While we acknowledge that the Parties have publicly stated that the Proposed Merger would enable the merged entity to "deliver better value for our customers", nothing in the evidence above gives us any certainty or clear indication:

435.1 on the magnitude or/extent to which efficiencies from the Proposed Merger would be passed through to retail consumers (nor what portion may be passed through by way of reduced retail prices, or in other ways), versus being kept as additional profits by the merged entity. The Parties have told both consumers and co-operative members that they would benefit from the Proposed Merger, but we have no way of knowing what proportion of efficiencies may be allocated to each group. Economic rationality would suggest that the more competitive pressure the merged entity faces, the more confident we can be that a greater proportion of the benefits would go to consumers. Given the existing high levels of concentration in the relevant retail grocery markets, we are currently not persuaded that the level of competition in those markets is sufficiently high, such that the merged entity would face strong competitive pressure to pass through a substantial portion of efficiencies versus retain them for its co-operative members; or

435.2 that any efficiencies from the Proposed Merger would necessarily be realised in a timely fashion. On this point, we note that the Parties' [ ],[580] 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. We note that a complete analysis of the effect of the Proposed Merger on the long-term interests of retail consumers would need to take account of the effects on choice and quality of groceries resulting from the impact on suppliers in acquisition markets.

436. Given this, we are considering 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 tells us anything about the likelihood of efficiencies being passed through to consumers with the Proposed Merger. Some of the impacts of the previous North Island Foodstuffs merger were discussed earlier as part our assessment of the unilateral effects of the Proposed Merger in acquisition markets. Specifically in terms of efficiencies, FSNI told us that [ ]. It considers that with the Proposed Merger, there is an opportunity to obtain real value for retail consumers through the buying process.[581] At this time, this evidence does 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

580 [ ]

581 Commerce Commission interview with FSNI (22 February 2024).

that we are required to consider 'out of market' efficiencies).

437. We invite submissions on the efficiencies/benefits of the Proposed Merger and on the extent to which these are realisable in the counterfactual. We also invite submissions on:

437.1 the extent to which any efficiencies would be passed through to retail consumers (eg, in terms of reduced prices), or kept as additional profits by the merged entity:

437.2 how the Parties would show savings flowing to retail consumers from the Proposed Merger;

437.3 the extent of competitive pressure each of FSNI and FSSI currently face to pass on savings to retail consumers, including as a result of any [ ];

437.4 how we can have a high degree of confidence (or be assured) that the requisite level of efficiencies would be passed through to retail consumers;

437.5 evidence of savings flowing through to retail consumers from the previous North Island Foodstuffs merger; and

437.6 evidence of FSNI growing from the previous North Island Foodstuffs merger by passing on savings to retail consumers.

## Next steps in our investigation

438. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **1 October 2024**. However, this date may change as our investigation progresses.[582] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

439. As part of our investigation, we are continuing to identify and contact parties that we consider will be able to help us assess the issues identified above.

### Making a submission

440. We are continuing to undertake inquiries and seek information from the Parties and any interested parties about the impact of the Proposed Merger. We welcome any further evidence and other relevant information and documents that the Parties or any interested parties are able to provide regarding the issues identified in this SoUI.

441. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Foodstuffs merger" in the subject line of your e-mail, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **12 August 2024**.

[582] The Commission maintains a clearance register on our website at https://comcom.govt.nz/case-register where we update any changes to our deadlines and provide relevant documents.

442. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with us at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible. We note however that in order to ensure the timeliness of our process, where submissions are provided after the submission date, we may need to consider what weight we put on those submissions.

443. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website.

444. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would be likely to unreasonably prejudice the commercial position of the supplier or subject of the information.

# Attachment A: Assessment of whether stores follow RRPs

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