

**Commerce Commission**  
New Zealand

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Dear Keston and Marette

**GROCERY MARKET STUDY – CLARIFICATIONS FOR SESSION 4 – PRIVATE LABEL SEPARATION**

1. Following on from our earlier letter, this is to give clarification on private label “separation”.

*How would the NZFGC proposal for structural separation of private labels work?*

2. NZFGC submitted it was worth considering structural separation. It had not developed this as a proposal. Recognising the potential benefits of private label, it has **not at this stage suggested “line of business” (full / partial) prohibitions, nor divestment**, despite the inherent conflicts of interest exacerbated by the unique market structure.
3. NZFGC’s concern is **outcomes focused**. The objective should be to enable the potential benefits of private labels (**PL**) while seeking to limit their potential harms given New Zealand’s unique market structure and the likely further growth of private labels.
4. Rather NZFGC contemplated a remedy that:
  - a. Enabled the benefits that private labels can bring.
  - b. But **reduced the harms** that Castalia and others have recognised, such as:
    - i. Expropriating product development of rival brands (suppliers), and misusing confidential information provided by those suppliers, for the purposes of their competing private label.
    - ii. Discriminating against competitors to private labels including through: (1) superior product placement and greater in-store promotional advertising; (2) levying charges on rival brands while not applying the same charges to private labels; (3) maintaining a price gap between the private label and named brands (not wishing to sell branded goods against private label).
5. If the outcomes are to be consumer-focused, private labels should be treated with **equivalence** to other suppliers. The objective should be to ensure that supermarket private labels should not benefit from confidential information of other suppliers; nor should supermarket private labels get favourable shelf space or otherwise be treated differently to other suppliers. Similarly, supermarket private label suppliers should not be provided with information that are not provided to other suppliers.
6. While accounting separation and operational separation may go partly towards addressing these issues, it seems that **structural separation (in the sense of separate companies)** may best

- enable such protections, particularly for protecting confidentiality of information provided by branded products.
7. Operational separation may be a “next best” in terms of achieving this goal.
  8. ***Operational separation measures could include the following requirements:***
    - a. A separate standalone PL business unit operates at arms’ length from the business unit that conducts retailing activities (with separate staff etc).
    - b. Confidential information provided to the retailer by supplier is not provided to staff in the PL business unit.
    - c. All PL procurement is only conducted by the PL business unit.
    - d. The retail business unit being prohibited from setting management targets based on PL sales or profitability.
    - e. Non-discrimination rule – the retailer must not provide preferential treatment to PLs – for example, in allocating premium shelf. [NZFGC appreciates that this could be difficult to monitor.]
    - f. Transfer pricing – all charges that would be applicable to branded suppliers are applied to PL business unit. PL business unit must provide separated accounts to demonstrate that even if the PL is required to pay the same charges to the retail business as branded labels, it still covers costs and makes a reasonable return.
  9. **Structural separation:** This is what NZFGC had suggested worth considering to best reinforce the obligations / boundaries and provide greater clarity. The objective being **equivalence**.
    - a. This would involve running the private label business through a stand-alone company, potentially with some / all independent directors, confidentiality obligations and ringfencing measures. Foodstuffs already have their own private label company, Foodstuffs Own Brands Limited, so this change will not necessarily be costly. We heard yesterday that Woolworths operates in this way, so it may not be onerous.
    - b. However, the retailer still owns the private label and so continues to have an incentive to maximise the profitability of the PL. So the regime would still need: (1) to prohibit retailer from setting management (or store owner) targets based on PL sales or profitability; (2) a non-discrimination rule for the retailer.
  10. Another measure (regardless of separation measures) is to require annual disclosure to the Commission of the proportion of sales that are accounted for by private labels, by product category. (Some form of accounting separation.)
  11. We heard supermarkets say these options would be unworkable, but it was not clear what they objected to or why, and their comments seemed to focus on the benefits of PL (which have not been disputed).
  12. We trust this assists.

Yours faithfully

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