ISBN 978-1-99-101288-3

Statement of Preliminary Issues

Reward / Southern Hospitality

2 May 2023

Introduction

1. On 4 April 2023, the Commerce Commission registered an application (the Application) from Reward Supply Co Pty Limited (Reward) seeking clearance to acquire 100% of the shares in Southern Hospitality Limited (Southern Hospitality) (the proposed acquisition).[1]

2. The Commission will give clearance if it is satisfied that the proposed acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

3. This statement of preliminary issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.[2]

4. We invite interested parties to provide comments on the likely competitive effects of the proposed acquisition. We request that parties who wish to make a submission do so by **16 May 2023.**

The parties

The applicant – Reward

5. Reward is an Australian company that supplies food service solutions in Australia and is a member of the ECF Group, an international distribution company group specialising in the supply of food service solutions.[3] The ECF Group operates in New Zealand through:[4]

   5.1 Burns & Ferrall Limited, trading as Reward NZ (Reward NZ); and

   5.2 Safco Limited (Safco).

[1] A public version of the Application is available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/.

[2] The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.

[3] The Application at [4].

[4] The Application at [5].

6. Reward NZ's operations in New Zealand include:[5]

   6.1 importing or acquiring locally equipment (such as fridges, ovens and dishwashers), tabletop and kitchenware products, takeaway and packaging products, and other consumables for supply to food service customers;

   6.2 providing parts and servicing for food service equipment; and

   6.3 importing and wholesaling domestic sinks and tapware to merchants and other distributors in the domestic building products market.

7. Reward NZ has four showrooms in New Zealand (Auckland, Hamilton, Wellington and Christchurch)[6] and describes itself as "the largest supplier of non-food, food service products in our region".[7] Reward NZ supplies products to customers as required but also competes to supply products for projects such as when customers build or redevelop commercial kitchens.

8. Safco imports or sources locally equipment and supplies that it then supplies to QSR (quick service restaurant) customers such as Subway and Restaurant Brands.[8]

The target – Southern Hospitality

9. Southern Hospitality is a New Zealand supplier to the New Zealand hospitality and food service industry.[9] Its operations in New Zealand include:[10]

   9.1 importing and suppling products to food service customers in the following categories: tabletop and kitchenware, equipment, and consumables; and

   9.2 ownership interests in four stainless steel fabrication businesses which produce benches, shelving units, bain-maries, wall-lings and commercial ventilation systems.

10. Southern Hospitality has 12 showrooms nationwide and describes itself as a "a major player in the catering and hospitality industry providing a multitude of services and products".[11] Like Reward NZ, Southern Hospitality also supplies products to customers as required and as part of projects.

Our framework

11. Our approach to analysing the competition effects of the proposed acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.[12] As

---

5 The Application at [6] – [7].
6 The Application at [6].
7 Reward NZ "About us" <www.rewardhospitality.co.nz>
8 The Application at [10].
9 The Application at [16].
10 The Application at [17] – [18].
11 Southern Hospitality "About us" <www.southernhospitality.co.nz>
12 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019. Available on our website at www.comcom.govt.nz

required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.

12. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[13] This allows us to assess the degree by which the proposed acquisition might lessen competition.

13. If the lessening of competition as a result of the proposed acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:

    13.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;

    13.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and

    13.3 the countervailing market power of buyers – the potential constraint on a business from the purchaser's ability to exert substantial influence on negotiations.

Market definition

14. We define markets in the way that we consider best isolates the key competition issues that arise from the proposed 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 Commerce Act, as a matter of fact and commercial common sense.[14]

15. In the Application, Reward submitted that the relevant markets are:[15]

    15.1 the national market for the supply of commercial kitchen equipment including ovens, fryers, combi steamers, griddles, cooktops, pizza ovens, refrigeration, display cabinets, and dishwashers – the 'commercial kitchen equipment market';

    15.2 the national market for the supply of tabletop, kitchenware, and smallware used in commercial food service – the 'food service smallware market'; and

    15.3 the national market for the supply of consumables and hygiene products used in commercial food service – the 'food service consumables market'.

---

13 *Commerce Commission v Woolworths Limited* (2008) 12 TCLR 194 (CA) at [63].

14 Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

15 The Application at [32].

16. The Application also includes an assessment of the proposed acquisition in a market for the supply of project-based services for supplying and fitting out commercial kitchens (which it refers to as 'commercial kitchen project services'). Reward however submits that projects are primarily a subset of the commercial kitchen equipment market.[16]

17. We will consider whether the markets submitted by Reward are the most appropriate markets for assessing the competitive effects of the proposed acquisition, or whether the competitive effects are better assessed with reference to an alternative market definition(s). [17]

18. In assessing which products and services should be included in the relevant markets, some of the points we will consider include:

    18.1 whether competition for projects should be treated separately to competition for equipment sales more generally;

    18.2 whether it is appropriate to define the scope of markets:

        18.2.1 more narrowly for specific products (such as ovens) (for example, if suppliers cannot easily substitute between supplying different types of products); or

        18.2.2 more broadly to include equipment, smallware and/or consumables (for example, if suppliers could easily substitute between supplying different categories); and

    18.3 whether it is appropriate to define markets for particular types of customers (for example, if such customers had specific requirements that were not easy for all suppliers to meet).

19. We will also consider the appropriate geographic scope of the market(s). Reward has submitted that the geographic scope of each market is national. We will consider whether it is necessary to assess competition on a regional basis. This might be the case where (for example):

    19.1 customers prefer to purchase from suppliers located close to them; and/or

    19.2 it is not easy for suppliers in one region to supply other regions.

20. Regardless of the market definition, we will take into account all relevant competitive constraints as matters of fact.

---

16 The Application at [33].

17 The markets that the Application has identified relate to the supply of products and services from the parties to customers (for example, businesses that operate commercial kitchens). The parties may also compete as buyers of products from manufacturers and distributers. We will therefore consider whether it is appropriate to assess the effects of the proposed acquisition in any buyer-side markets.

Without the acquisition

21. We will consider what the parties would do if the proposed acquisition did not go ahead.

22. Reward has submitted that if this acquisition does not proceed, Southern Hospitality would continue to operate independently from Reward NZ as it does today whether under existing ownership (ie, the status quo), or under new ownership.[18]

23. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo, or whether the parties would seek alternative options, for example, finding a different buyer for Southern Hospitality.

24. We will also consider the likely state of the wider competitive landscape in the without-the-acquisition scenario.

Preliminary issues

25. We will investigate whether the proposed acquisition would be likely to substantially lessen competition in any of the relevant markets by assessing whether any horizontal unilateral, coordinated, vertical and/or conglomerate effects might result from the proposed acquisition. The questions that we will be focusing on are:

    25.1 unilateral effects: would the loss of competition between the parties enable the merged entity to profitably raise prices or reduce quality or innovation by itself?[19]

    25.2 coordinated effects: would the proposed acquisition change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable?

    25.3 vertical or conglomerate effects: would the proposed acquisition increase the merged entity's ability and/or incentive to foreclose rivals?

Unilateral effects: would the merged entity be able to profitably raise prices by itself?

26. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses.[20]

27. In the Application, Reward submitted that the proposed acquisition would not be likely to substantially lessen competition in any national market for commercial

---

[18] The Application at [26].

[19] For ease of reference, we only refer to the ability of the merged entity to "raise prices" from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition, ie, it could increase quality-adjusted prices.

[20] Commerce Commission, *Mergers and Acquisitions Guidelines,* above n12 at [3.62].

kitchen equipment, food service smallware, food service consumables and commercial kitchen project services due to unilateral effects for reasons including:[21]

27.1 the merged entity will have a low market share;

27.2 the existence of many strong established competitors;

27.3 the absence of material obstacles to expansion, the absence of material switching costs for customers, and the strong incentives for suppliers to expand and customers to support that expansion; and

27.4 the ability of customers to exercise countervailing power including to support expansion of a competitor into particular sectors.

28. We will consider the closeness of competition between the merging parties (that is, what competition would be lost due to the proposed acquisition if clearance is granted) in each of the markets. For example, we will look at the extent to which the parties compete closely for particular types of products and customers and in particular locations.

29. To the extent that any constraint between the parties is material, we will assess the impact of the loss of competition having regard to the remaining constraints in the market. We will consider the following factors.

29.1 First, the degree of constraint that existing competitors would impose on the merged entity. We will consider factors such as whether those rivals:

29.1.1 have a similar product range to the merged entity (or could source the relevant products on competitive terms and conditions);

29.1.2 can source those products at a comparable price to Reward NZ and Southern Hospitality;

29.1.3 have the necessary expertise to compete for any customer groups for which Reward NZ and Southern Hospitality compete; and

29.1.4 have the facilities in the necessary locations to supply and provide services to customers who are affected by the proposed acquisition.

29.2 Second, how easily rivals could enter and/or expand in the relevant markets.[22] We will assess the extent to which rivals could overcome any barriers to entry and expansion (such as the factors listed in the paragraph above) to impose a constraint on the merged entity.

[21] The Application, summarised at 1-2 and in more detail at 12-29.

[22] We assess whether entry by new competitors or expansion by existing competitors is likely to be sufficient in extent in a timely fashion to constrain the merged firm and prevent a substantial lessening of competition. This is referred to as the 'LET test'. See Commerce Commission, Mergers and Acquisitions Guidelines, above n12 at [3.95].

29.3 Third, the countervailing power of customers. We will consider whether customers are generally able to resist a price increase by the merged entity, as submitted by Reward.[23] We will also consider whether any countervailing power is unique to particular customers or is sufficient to protect all customers. The potential types of countervailing power we will consider include the ability of customers to:

29.3.1 sponsor new entry by committing to purchase their requirements from a new supplier;

29.3.2 bypass the merged entity's services and sourcing equipment, smallware and consumables directly from the manufacturer; and/or

29.3.3 by switching (or threatening to switch) their purchases away from the merged entity in markets where there are more choices.

Coordinated effects: would the proposed acquisition make coordination more likely?

30. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and limit competition by raising prices, reducing quality, and/or dividing up the market between them. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.[24]

31. In the Application, Reward submitted that the proposed acquisition would not be likely to substantially lessen competition in any of the relevant markets due to coordinated effects because of the numerous competitors that will remain.[25]

32. We will assess whether any of the relevant markets are vulnerable to coordination, and whether the proposed acquisition would change the conditions in the relevant markets so that coordination is more likely, more complete or more sustainable.

Vertical or conglomerate effects: would the merged entity be able to foreclose rivals?

33. A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to vertical or conglomerate effects. This can occur where a merger gives the merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively.[26]

34. In the Application, Reward submitted that the proposed acquisition would not be likely to substantially lessen competition in any of the relevant markets due to vertical or conglomerate effects because the proposed acquisition does not change the nature of vertical integration in the market and neither party to the proposed

---

23 The Application at [80], [99] – [102], and [127].
24 *Mergers and Acquisitions Guidelines* above n12 at [3.84].
25 The Application at [178.1].
26 *Mergers and Acquisitions Guidelines* above n12 at [5.1] – [5.5].

acquisition stocks any 'must have' products for customers that are not available to other market participants.[27]

35. We will investigate whether:

    35.1 the merged entity would have control over a 'must have' product and would be in a position to limit access to that product to rivals;

    35.2 the conduct would raise the costs of those rivals to such an extent they became less effective competitors; and

    35.3 that conduct would be likely to substantially lessen competition.

Next steps in our investigation

36. The Commission is currently scheduled to make a decision on whether or not to give clearance to the proposed acquisition by **2 June 2023**. However, this date may change as our investigation progresses.[28] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

37. As part of our investigation, we will be identifying and contacting parties that we consider will be able to help us assess the preliminary issues identified above.

Making a submission

38. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Reward/Southern" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **16 May 2023**.

39. 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. If you make a submission and we do not acknowledge receipt of that submission within two working days, you should resubmit your submission.

40. 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 unreasonably prejudice the supplier or subject of the information.

---

[27] The Application at [178.2].

[28] The Commission maintains a clearance register on our website at http://www.comcom.govt.nz/clearances-register/ where we update any changes to our deadlines and provide relevant documents.