

## SUMMARY OF CROSS-SUBMISSION IN RESPONSE TO FSNI AND FSSI STATEMENT OF ISSUES

Ref	Topic	Key points	Comments
<b>The Warehouse Group</b>			
6.a	Real world considerations	<p>Structural change that exacerbates market dynamics that limit profitable expansion, inevitably has a real chance of substantially lessening competition.</p> <ul style="list-style-type: none"> <li>• Since the Market Study, there has been more exit. If the market were competitive then those profits would have attracted entry and expansion, particularly with the legislative reform that followed the Market Study.</li> <li>• The major grocery retailers, including the Parties, were found in the Market Study to be making excessive profits, yet the Market Study noted no material entry and expansion had occurred.</li> <li>• TWG's results reveal how hard expansion is in reality. Any other potential scale entrant would likely also be discouraged by the challenges that an established scale retailer such as TWG is having.</li> </ul>	<p>The parties' key point is that the Proposed Transaction will not entail structural change that could give rise to a substantial lessening of competition.</p> <ul style="list-style-type: none"> <li>• Since the market study there has been entry, expansion and exit. FSNI and FSSI have also gained wholesale customers. Evidence is provided in the Parties' submission in response to the statement of issues, at paragraphs [167] and [178].</li> <li>• The Parties acknowledge they do not have knowledge of TWG's challenges. However, they note that public information indicates that TWG's grocery business is growing strongly, and now accounts for approximately 20% of all Warehouse sales.<sup>1</sup></li> <li>• Further, TWG recently announced it was expanding its fresh range to 10 more stores.<sup>2</sup></li> <li>• These developments are additional to the constraint already experienced e.g. from Woolworths, Costco and other retailers (hardware stores, Chemist Warehouse, etc.)</li> <li>• In any event, as set out below the Parties consider TWG would not face a detrimental change in competitive conditions arising from the Proposed Transaction.</li> </ul>

<sup>1</sup> <https://www.nzx.com/announcements/430882>; <https://businessdesk.co.nz/article/retail/the-warehouses-grocery-gambit>

<sup>2</sup> <https://www.thewarehousegroup.co.nz/news-updates/warehouse/Fresh-expansion>

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6.b		<ul style="list-style-type: none"> <li>The Parties' own economic report concludes that the merger will improve the bargaining position of the merged entity relative to large and small national suppliers to the Parties.</li> <li>No evidence was provided of the volume and value that national suppliers represent, but TWG expects that a large proportion of suppliers to the Parties actually supply on a national basis or have the capacity to do so.</li> <li>The HoustonKemp Response appears to acknowledge that all of these suppliers are likely to be detrimentally affected by the Proposed Merger.</li> </ul>	<ul style="list-style-type: none"> <li>Any change in bargaining outcome, or price, is not in and of itself a competitive harm, as explained in the Parties' cross submission on the statement of issues at paragraphs 2-15. Further, the Commission in its merger clearance analysis focuses on the possibility of harm to competition, or the competitive process, not individual competitors.</li> <li>Houston Kemp considers the relative bargaining position of the merged entity would be likely to improve "slightly", or "marginally", for the reason that "Foodstuffs would be in a position to assess its business nationally, which is especially relevant for major, 'must have' suppliers". That is, currently each co-operative might take account of national positioning in thinking about procurement, but be uncertain as to whether the other will secure supply. The removal of that uncertainty would drive the marginal uptick in bargaining position. The extent of the merged entity's ability to improve its terms would depend on the countervailing power of each individual supplier, as to which see Houston Kemp's 26 April report. See also the Parties' submission on the statement of issues at paragraph [21], and paragraphs [13] and [14] of the Parties' cross submission regarding the statement of issues.</li> </ul>
6.c		<ul style="list-style-type: none"> <li>The suggestion that the Commission ought not to be concerned about a structural change to market that the Parties' economic report describes as a shift of surplus from those national suppliers to the Parties, is indicative of TWG's concern about the Parties' motivations and the likely outcome of the Proposed Merger. Describing the transfer of surplus from suppliers to the Parties as a "mere" transfer ignores the real world implication of that effect.</li> </ul>	<ul style="list-style-type: none"> <li>As above, and as explained in the Parties' cross submission, changes in bargaining outcomes, or price, occur in many scenarios for reasons other than a change in competitive conditions.</li> <li>No evidence is provided about the real world implication of the effect.</li> <li>The Parties consider an adverse effect would not arise, as set out in the Parties' cross submission regarding the statement of issues at paragraphs [13] to [14]. (The</li> </ul>

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			Parties also reiterate their commitment to sharing benefits with customers.)
6.d		<ul style="list-style-type: none"> <li>Significantly, the transfer of surplus away from suppliers logically impacts the “waterbed effect” identified by the Commission. HoustonKemp’s suggestion of an “anti-waterbed effect” in this context is in TWG’s respectful view, academic, and removed from the facts. In reality, as TWG has experienced first hand in the situation it faced with Sanitarium, when national suppliers are bound by onerous terms (likely including best price clauses) in arrangements with the major retailers, and have promotional terms that extract the maximum available surplus for the benefit of the major retailers, the national suppliers do not have the available margin that might otherwise be used to offer competing retailers better pricing and terms. In this situation the suppliers default to offering worse terms to competing retailers - or refusing to supply them at all when supply becomes constrained.</li> </ul>	<ul style="list-style-type: none"> <li>The Parties acknowledge they do not have visibility of the Sanitarium scenario described here, as they had no involvement with it (although the Parties understand the Commission does have knowledge of it).</li> <li>[REDACTED].</li> <li>If procurement gains arising from the Proposed Transaction are based on a marginal increase in bargaining power with respect to some suppliers, and any other gains are not structural or systematic (e.g. 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 (see further below in relation to buyer power).</li> <li>Houston Kemp has provided information on the waterbed effect in its 26 April report at paragraph [16] to [17].</li> </ul>
6.e		<ul style="list-style-type: none"> <li>Finally, when considering the market definition discussion in the SoI, it is important to recall that the Parties do not sell grocery items at retail, the Parties’ Franchisees do. The importance of this, is that, as the Commission identifies, bypassing the central buying team at head office is unique to the Parties’ grocery operations, and a key way that suppliers bring new products to market. To the extent that one of the expected outcomes of the Proposed Merger is to centralise, or “bring into line” the purchasing by Franchisees (as FSNI has done more successfully than FSSI to date), that avenue for product innovation and market testing will be lost, as will the ability to compare between</li> </ul>	<ul style="list-style-type: none"> <li>There is no basis to expect any change in store level buying attributable to the Proposed Transaction. There would be no change in the ability to range products locally.</li> <li>The Parties have presented evidence of the current initiatives they have implemented to support innovation. See the Parties’ submission on the statement of issues, at paragraphs [65], [122] to [123], and [132] to [133]. The incentive to support innovation would not change as a result of the Proposed Transaction.</li> <li>Further, the Emerge competition (where new and small suppliers compete to be ranged in Foodstuffs supermarkets) and Emerging Supplier Forum (through</li> </ul>

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		<p>the two franchise groups the benefits of more, or less, alignment by Franchisees with head office buying approaches. In any event, HoustonKemp's assertion that procurement by individual stores would be unaffected by the Proposed Merger does not appear to be based on a real world assessment of the likely outcomes of the merger, calling into question also its conclusions based on that assumption. As the Commission identified, the ability to introduce new products through store level buying has real implications for welfare enhancing innovation.</p>	<p>which FSNI seeks to engage with emerging suppliers across the country in order to bring new products to market) is another key example of a current initiative, which is expected to continue following the Proposed Transaction.</p>
9.	Pass-through of benefits	<ul style="list-style-type: none"> <li>As TWG expressed in its original submission, despite claims from the Merging Parties that the rationale for the Proposed Merger is to generate cost efficiencies which will be passed on, there is no evidence that there will be any such pass through of savings to consumers.</li> </ul>	<ul style="list-style-type: none"> <li>The Proposed Transaction would not result in a substantial lessening of competition, so it is not necessary for the Commission to reach a conclusion on this point.</li> <li>Nevertheless, the Parties have presented evidence as to why they would face competitive and regulatory pressure to share merger benefits with customers at the Parties' submission in response to the statement of issues from paragraph [95] (including Figure 9 showing the food price index and the Parties' efforts not to pass on the full amount of increased supplier costs) and at paragraph [145].</li> </ul>
10.	Pass-through of benefits	<ul style="list-style-type: none"> <li>The Commission has heard from industry participants who consider the 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 prices promised at the outset. This is of course also the predicted outcome of the Proposed Merger.</li> </ul>	<ul style="list-style-type: none"> <li>The available information suggests FSNI's margins did not increase as a result of the North Island merger – see the Parties' submission in response to the statement of issues from paragraph [144]. It is not clear what information or evidence industry participants are relying on in suggesting the merger led to increased margins (and not clear how they would be in a position to observe such margins).</li> </ul>

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			<ul style="list-style-type: none"> <li>• FSNI has presented evidence that lower prices did follow the merger, and has not seen any evidence the merger resulted in a reduction of suppliers entering the market.</li> <li>• The expected impact of the Proposed Transaction on NPD is provided in the Parties' submission in response to the statement of issues from paragraph [113].</li> </ul>
12.	Buyer power	<ul style="list-style-type: none"> <li>• 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. Where that shift arises in respect of a large proportion of suppliers (e.g. all national suppliers) then it is difficult to see how the Commission can exclude a real chance of that lessening of competition being substantial.</li> </ul>	<ul style="list-style-type: none"> <li>• Any change in bargaining outcome, or price, is not in and of itself a competitive harm, as explained in the Parties' cross submission on the statement of issues at paragraphs 2-15. Further, the Commission in its merger clearance analysis focuses on the potential for harm to competition, or the competitive process, not individual competitors.</li> <li>• Houston Kemp considers the relative bargaining position of the merged entity would be likely to improve "slightly", or "marginally", for the reason that "Foodstuffs would be in a position to assess its business nationally, which is especially relevant for major, 'must have' suppliers". That is, currently each co-operative might take account of national positioning in thinking about procurement, but be uncertain as to whether the other will secure supply. The removal of that uncertainty would drive the marginal uptick in bargaining position. The extent of the merged entity's ability to improve its terms will depend on the countervailing power of each individual supplier, as to which see Houston Kemp's 26 April report. This point is also addressed in the Parties' submission on the statement of issues from paragraph [66] to [84].</li> <li>• Further information about suppliers' countervailing power (including smaller suppliers) is set out in the Parties' submission on the statement of issues from paragraph [45] to [54].</li> </ul>

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13.a	Pass-through of benefits	<ul style="list-style-type: none"> <li>The Commission identified in the Market Study that competition is not working well for consumers in the retail grocery sector, and that if competition was more effective, the major grocery retailers would face stronger pressure to deliver the right prices, quality and range to consumers. The Parties have not explained how, in that weak (and since then, reduced) competitive environment, competition will ensure pass through of these efficiencies to consumers.</li> </ul>	<ul style="list-style-type: none"> <li>The Parties consider the Proposed Transaction would not be likely to substantially lessen competition in any market, and accordingly it is not necessary for the Commission to reach a definitive view on this question.</li> <li>Nevertheless: <ul style="list-style-type: none"> <li>It is not clear the basis on which TWG considers competition has weakened – no evidence is provided. In the Parties’ view, competition has strengthened – see the Parties’ clearance application, at paragraph [58] to [60], and the Parties’ submission on the statement of issues, at paragraph [93] to [94].</li> <li>The Parties have provided evidence of their incentives to compete on price (which would not change as a result of the Proposed Transaction) in their submission on the statement of issues, paragraph [85] to [106].</li> </ul> </li> </ul>
13.b	Pass-through of benefits	<ul style="list-style-type: none"> <li>As TWG has explained in its original submission, reliance on the Commission to deliver outcomes for consumers via regulation is not an answer.</li> </ul>	<ul style="list-style-type: none"> <li>As above, the Parties do not rely on regulatory pressure to make the case that they can be expected to share efficiencies with customers. The Parties also point to competitive pressure, which operates now and would be likely to continue (and increase) in the factual.</li> <li>But the Parties also disagree that the threat of regulation is not effective. The Parties are working to comply with all the new regulation they face (including the Code which is new and in respect of which not all impacts will yet have been felt), and are engaging constructively with the Commission in doing so.</li> <li>More broadly, the Parties are acutely aware of the public, supplier and Government scrutiny they face. They have every incentive to respond to this scrutiny – they are a retail business and support from customers, as well as supply of products, are critical to their ability to survive. They cannot but be aware they stop listening</li> </ul>

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			to these stakeholders at their business peril. See the Parties' submission on the statement of issues, paragraphs [2] to [8] as well as [93] to [94]. To make a public commitment and then fail to stick to it would be self-defeating.
14		<ul style="list-style-type: none"> <li>The Parties assert that they have a strong track record of passing on cost savings to consumers. This was not the conclusion in the Market Study Report. Moreover, as explained in TWG's original submission, the fact the promised benefits to consumers of the previous Foodstuffs Auckland/Wellington merger have not been mentioned in the merger application, and the reality that many of the claims of the benefits that consumers would gain from the merger were not fully realised, raises significant concern as to the accuracy of the Parties' statement that it can be expected to pass on such benefits this time.</li> </ul>	<ul style="list-style-type: none"> <li>The Parties have presented evidence as to their incentives to compete on price (rather than asserted it). See the Parties' submission on the statement of issues from paragraph [85] to [106].</li> <li>Relevant evidence on the Auckland/Wellington merger has also been provided in the Parties' response to the statement of issues, paragraph [141] to [147], and paragraph [63] of the Parties' cross submission on the statement of preliminary issues.</li> </ul>
18.a	Buyer power	<ul style="list-style-type: none"> <li>As TWG has previously submitted, it is inevitable that the bargaining power of suppliers, when faced with a request for a single national supply contract post-merger, would be materially reduced when compared to suppliers facing a similar request today from two separate entities with separate supply arrangements.</li> </ul>	<ul style="list-style-type: none"> <li>No evidence is presented as to this in the TWG submission or its previous submission.</li> <li>The impact on bargaining outcomes is discussed above and in the Houston Kemp reports. See also the comments at paragraph [21] of the Parties' submission on the statement of issues, and paragraphs [13] and [14] of the Parties' cross submission regarding the statement of issues.</li> </ul>
18.b	Buyer power	<ul style="list-style-type: none"> <li>It is unrealistic to suggest that many suppliers will have options beyond simply supplying to major grocery retailers; the retailers outside of the duopoly are of an entirely different scope and scale to the major retailers, and do not provide a true alternative for suppliers.</li> </ul>	<ul style="list-style-type: none"> <li>The 26 April Houston Kemp report at section 2.2 illustrates the options available to suppliers and demonstrates why it is incorrect to characterise the Proposed Transaction as a reduction from three to two buyers. As an example, for suppliers in many markets, options of at least the scope and scale of the Parties are available (e.g. exports), for suppliers in many markets other local retailers are easily of sufficient scope and</li> </ul>

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			scale to provide an alternative (e.g. Chemist Warehouse). For suppliers in lower-volume markets, retailers do not need to be of a comparable scope and scale to provide an alternative. It is both simplistic and inaccurate to describe the Proposed Transaction as a three to two.
18.c	Buyer power	<ul style="list-style-type: none"> <li>It is inconsistent for the Parties to argue that on the one hand, there will be limited impact on suppliers, but on the other hand customers will benefit from lower prices achieved through cheaper supply. In TWG's view, neither is true.</li> </ul>	<ul style="list-style-type: none"> <li>The Parties consider there will not be an adverse effect on <i>competition</i> in acquisition markets in which suppliers operate. The Parties aspire to achieve some procurement gains, as described above, in submissions and in the Houston Kemp report. To the extent such gains are achieved, the Parties are committed, and will face competitive and regulatory pressure, to share gains with consumers.</li> </ul>
18.d	Buyer power	<ul style="list-style-type: none"> <li>TWG also agrees with the Commission's concern expressed in the SoI that increase buyer power of the Merged Parties could lead to a 'waterbed effect' where suppliers increase their prices, or provide worse terms, for competing retailers. Its own experience in respect of the withdrawal of supply by Sanitarium suggests this is a real concern.</li> </ul>	<ul style="list-style-type: none"> <li>If procurement gains arising from the Proposed Transaction are based on a marginal increase in bargaining power with respect to some suppliers, and any other gains are not structural or systematic (e.g. 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.</li> <li>Houston Kemp has provided information on the waterbed effect in its 26 April report at paragraph [16] to [17].</li> </ul>
22	Barriers to entry	<ul style="list-style-type: none"> <li>The concentration of the major retailers makes it much harder for potential competitors to achieve the scale and scope required to compete and further limits the incentive for suppliers to supply new retail channels when doing so may risk their current arrangements with the major retailers, exacerbating the existing barriers to entry and expansion. The Parties do not address the long-term worsened outcomes for consumers that could</li> </ul>	<ul style="list-style-type: none"> <li>No merger effect is identified. That is, the Proposed Transaction would not alter concentration in any retail market, and therefore cannot increase barriers to entry and expansion. That is because there would be no difference to retail competition, as the Parties operate in two separate islands.</li> <li>See above in relation to the impact associated with bargaining power.</li> </ul>



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		<p>arise due to the barriers to entry and expansion created for rival grocery retailers who cannot compete effectively. Preventing rivals from entry and expansion due to the merged entity having high bargaining power will not provide long term pro-competitive outcomes for consumers.</p>	
25	Private label	<ul style="list-style-type: none"> <li>Ranging decisions are governed by the best price margin, which can often disadvantage new or small brands, and lead to consolidation of the market to big, well-known brands, or private label products. There is a possibility that the increased market power of the Merged Entity may allow Foodstuffs to expand their own private label group offering at the expense of a wider range of other products or brands. This would have negative outcomes for suppliers who would be squeezed out of supplying products under their own brands, and also for customers who would have reduced product choice.</li> </ul>	<ul style="list-style-type: none"> <li>Both Parties make ranging decisions based on customer demand, as well as other considerations including profit margin.</li> <li>The Proposed Transaction should not give rise to any material effect on private label. Evidence is provided in the Parties' submission in response to the statement of issues from paragraph [124].</li> </ul>
29	Coordinated effects	<ul style="list-style-type: none"> <li>As expressed in our original submission TWG has concerns that the greater symmetry of scale and cost structures between the merged entity and Woolworths New Zealand could increase the risk of coordinated effects. This effect would be exacerbated by the Parties increasing centralisation of Franchisees' purchasing as a result of the Merger, given the potential disrupting effect that Franchisee divergence from central purchasing decisions would otherwise continue to have on coordination between the major retailers in the counterfactual.</li> </ul>	<ul style="list-style-type: none"> <li>The Parties have addressed these, including the impact of centralisation and points about symmetry of scale and cost structures compared with Woolworths, in their response to the statement of issues from paragraph [149].</li> </ul>
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	Buyer power	<ul style="list-style-type: none"> <li data-bbox="562 252 1265 371">• A merger-related concern appears to be that the Proposed Transaction would increase centralisation of procurement and reduce suppliers' access to individual stores.</li> </ul>	<ul style="list-style-type: none"> <li data-bbox="1296 252 2069 339">• This concern, including regarding local ranging, is addressed in the Parties' submission on the statement of issues from paragraph [55].</li> </ul>
		<ul style="list-style-type: none"> <li data-bbox="562 395 1265 478">• The other merger-related concern appears to be that the Proposed Transaction would reduce the number of channels to market for suppliers.</li> </ul>	<ul style="list-style-type: none"> <li data-bbox="1296 395 2069 478">• This concern is addressed in the 26 April Houston Kemp report and in the Parties' submission on the statement of issues from paragraph [41].</li> </ul>