25 November 2021

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Dear Sir/Madam

Attached are the comments that New Zealand Food & Grocery Council wishes to present on the *Market study into the retail grocery sector: Post Conference Submission.*

Yours sincerely

Katherine Rich
Chief Executive

Market study into the retail grocery sector: Post-Conference submission

Comments by New Zealand Food & Grocery Council

25 November 2021

1. INTRODUCTION

Overview

1.1. New Zealand Food & Grocery Council Inc (**NZFGC**) thanks the Commerce Commission (**Commission**) for this further opportunity to comment on all matters raised in submissions and at the Commission's online consultation conference (**Conference**).

1.2. NZFGC has seen no evidence that materially impacts the Commission's preliminary conclusions that competition is not working well for consumers or suppliers and that major regulatory reform is required.

1.3. In fact, the Conference has highlighted that the structural and behavioural factors are much greater than previously thought. Further, incumbents Foodstuffs 'group' [1] (**Foodstuffs**) and Woolworths New Zealand Limited (**Woolworths**)[2] (together, the **Majors**) have no interest in facilitating competition. A full range of regulatory solutions is needed.

NZFGC's submission on measures required to facilitate competition

1.4. NZFGC recommends the following:

a. Urgent introduction of a mandatory **Code of Conduct** (**Code**) based on the UK's.

b. Alternatively, urgent introduction a mandatory Code based on the Australian code, but with a UK-style independent adjudicator.

c. There is no reason to delay given the principles-based approach and available models and the immediate benefit these could deliver.

d. **Regulation to address the conflicts of interest with private labels.**

e. Commerce Act **section 36 reform**, including confirmation that the Majors have "Substantial Market Power".

f. Other section 36 reforms should be considered including deemed markets and potential rebuttable presumptions (eg that pocket pricing is anti-competitive).

g. The Commission should have the **power to issue 'block authorisation' and related collective bargaining authorisation.**

h. A **broader review of all ownership interests** of the Majors and associated parties to assess overall market power issues (including horizontal, vertical and conglomerate issues).

i. Relatedly there should be **greater accounting / operational transparency** and **mandatory notification of acquisitions** (coupled with rebuttable presumptions, ie requiring acquirers to demonstrate no anti-competitive effects).

1.5. NZFGC **strongly supports strong measures to facilitate retail competition.** Many measures may be needed to facilitate different potential competitive models, including structural and/or operational separation. Even then, NZFGC has concerns as to the

[1] Foodstuffs North Island (**FSNI**) and Foodstuffs South Island (**FSSI**)
[2] Woolworths New Zealand (**WWNZ**)

likelihood of meaningful competition emerging over a competitively relevant timeframe given onerous, entrenched, barriers to entry & expansion, and likely incumbent response.

1.6. NZFGC continues to recommend its recommendations at paragraphs 1.9 to 1.20 and part 7 of its submission on the Draft Report (except to the extent developed in this submission).

Structure of this submission

1.7. This submission has the following sections:

a. **Part 2:** *Observations from the Conference & remedies required*

b. **Part 3:** *Market structure - duopoly with fringe providers*

c. **Part 4:** *Market outcomes*

d. **Part 5:** *Market processes – competition not working for suppliers or consumers*

e. **Attachment A:** *NZFGC recommendations for New Zealand Code based on retailer obligations under the AU and UK grocery codes*

1.8. NZFGC thanks all the suppliers who submitted written submissions on the Draft Report and shared their experiences, including those who submitted anonymously or through a supplier association, and all submitters and Conference attendees who made comments on behalf of suppliers. We also thank Christine Tacon, the first UK Groceries Code Adjudicator, and Graeme Samuel, former Chairman of the ACCC, for sharing their valuable insights and perspectives, and generously devoting time to attend and prepare for the Conference.

2. OBSERVATIONS FROM THE CONFERENCE & REMEDIES REQUIRED

Overview

2.1. NZFGC again commends the Commission for its comprehensive and thorough *Market study into the retail grocery sector: Draft report* (**Draft Report**), as well as the supporting materials from truly independent experts. It thanks the Commission for the well-run Conference where all parties had ample opportunity to comment.

2.2. In short, it is now even clearer that the past two decades have seen major structural and behavioural changes to the competitive landscape indicating significant regulatory intervention is necessary to get the benefits of a workable competition.

2.3. Following its review of the submissions on the Draft Report, and having heard the oral submissions at the Conference, NZFGC submits that:

a. The evidence confirms the Commission's preliminary conclusions (which are consistent with common sense) that competition is not working well for consumers or suppliers.

b. Structural changes over the past two decades, coupled with behavioural factors, confirm that significant legislative and regulatory change is required.

c. The vertical and conglomerate aspects of the two Majors' market power (including Private Label, vertical and horizontal acquisitions) should be scrutinised.

d. Measures to facilitate market entry and/or expansion must be robust if they are to achieve their objectives. We agree with concerns raised by other submitters that the wholesale market in New Zealand is currently broken. All options must be considered.

2.4. We urge the Commission, MBIE and Government to note damage already occurring (much of which we worry may be irreversible in terms of manufacturing capacity and capability) even in the face of potential regulation or other intervention. Conversely, swift regulatory action could deliver immediate benefits to consumers and producers.

2.5. We note that during the conference and subsequently, one of the Majors continued so-called 'customer-driven' product rationalisations. These resulted in brands popular with consumers being deleted, apparently largely on margin grounds. This means less consumer choice, reduced innovation and sometimes, lower quality. Worse still that this same major grocery retailer has maintained an extended price increase moratorium (negatively impacting suppliers, particularly in the context of escalating costs including transportation and numerous commodities) whilst continuing to rationalise brands (also detrimental to suppliers). Some suppliers have had a price freeze, then products 'rationalised' off the shelves as well as being hit by Covid-19's effects on foodservice supply. Conversely, the supermarket conducting the rationalisation has had the privilege and protection of trading as essential businesses.

2.6. Not only is there real urgency, it is also critical that any regulation is independent and robust. We note the Right Honourable David Cunliffe's comment that "*The moral of the story is that it [a voluntary code in the fishing industry] only worked as long as regulators were able to enforce it, and when they took their eyes off it, it didn't work.*"[3]

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[3] p22 Cunliffe D, Polis Consulting, Conference Day-7-Transcript

2.7. This can be done. For example, we believe that, building on the knowledge and experiences in Australia and the United Kingdom, a strong mandatory Code could and should be in place in 2022.

Observations from the Conference – approach of the Majors

2.8. The need for urgency is in our view reinforced by the Majors' regulatory strategy and comments. Anything that is offered seems to be too little too late and subject to lawyerly caveats and ambiguities.

2.9. The written submissions and conference commentary can arguably best be described as a strategy of "deny, delay and assert". For example,

a. **Deny:** "*In our view, the market is already intensely competitive*"[4], "*This market study process has been incredibly corrosive*"[5], "*number of areas where we contest the key findings*"[6]

b. **Delay:** "*There will need to be a process for the development of the code*"[7], "*wholesale supply to other retailers by Foodstuffs SI is theoretically feasible. But of course we'd need to address all the considerations that were raised in the Commission's draft report and many more which have just been highlighted*"[8], "*meaningful change is already happening due to this market study"*[9]

c. **Assert:** "*Every product on our shelves is substitutable for products sold by other retailers*"[10], "*We see competition for every store*"[11], "*there are no barriers to anyone else choosing to compete for the main shop"*[12]*.*

2.10. Despite numerous indicators of the lack of competition, there have been continued assertion of constraints from other 'missions'[13], yet there has been no evidence given on substitutability of these as substitutes. It is stretching credibility to say the Chemist Warehouse is a material constraint[14]. We consider it telling that even with the numerous highly regarded economists retained by the Majors, none of them seemed able to provide evidence to support this key plank in their arguments.

2.11. While it was correctly argued that a forward-looking approach should be taken to competitive constraints, again there was no evidence that there would be any material

[4] p8, Gluckman J, WWNZ, Conference Day-1-Transcript
[5] p10 Anderson S, FSSI, Conference Day-1-Transcript
[6] p11 Quin C, FSNI, "number of areas where we contest the key findings", Conference Day-1-Transcript; p8 Stewart D, FSNI "[collective bargaining] is unnecessary and not in the interests of consumers", Conference Day-3-Transcript; p8 Sullivan M, FSSI, "if it is cost or there are some sort of prohibitive terms in there that it just 32 won't be used", Conference Day-3-Transcript
[7] p8, Brooker M, FSNI, Conference Day-3-Transcript
[8] p30, Donaldson T, FSSI, Conference Day-5-Transcript
[9] p11, Quin C, FSNI, Conference Day-1-Transcript
[10] p12 Quin C, FSNI, Conference Day-1-Transcript
[11] p12-13, Quin C, FSNI, Conference Day-1-Transcript
[12] p15, Quin C, FSNI, Conference Day-1-Transcript
[13] p15 Quin C, FSNI, "main shops are diminishing in favour of other missions and that competitive advantage is being eroded" Conference Day-1-Transcript
[14] p32 Gluckman J, WWNZ, Conference Day-3-Transcript. Clearly, Chemist Warehouse only overlaps with a small fraction of the Majors' SKUs. Shoppers go to the Chemist Warehouse for a different shopping purpose and cannot get daily essential groceries at the Chemist Warehouse. As Matthew Lane from Night 'n Day stated during the Conference: *"Prescriptions are the fringe part I suspect of Woolworths' business, the core part that needs to be protected is that dry grocery and sort of everything flows off from there."* (p37 Conference Day-1-Transcript)

competitive constraints over a meaningful timeframe. Barriers to entry (including likely incumbent response) suggests this is unlikely. Submissions to the Market Study from The Warehouse Group reminded the Commission of the "*challenges of entering the grocery market in 2008. It could not make the entry work nothwithstanding its size, retail footprint and brand awareness*" [15].

2.12. Instead of clear evidence, the Majors put forward a series of assertions and contradicting statements, which were hard to reconcile with evidence previously provided to the Commission and first-hand reports from suppliers to the NZFGC.

2.13. Some comments were opinion dismissing decades of economic thinking, such as the idea that collective bargaining would not be in the "*best interests of consumers*"[16] or that increasing competition in the grocery market was a "*recipe for higher prices*"[17]. We can think of no example where increased competition has resulted in higher prices for consumers. This would be at odds with over two hundred years of economic thought.

2.14. While we accept the sincerity of the Majors, and that their opinions were genuinely held, to suppliers some senior executives are clearly out of touch with recent history or activities that happen further down the retail hierarchy. There, coercion and pressure of suppliers is constant. For example, Jo Allen - in our view quite incorrectly - told the Commission during the Conference: "*the comment was made yesterday by Hexis Quadrant that we bring suppliers into our DC and we transfer the cost to the suppliers. That's factually incorrect and I do want to refute that statement. Basically,* ***suppliers come into our DC by choice and they make that choice based off what's the best cost to serve for them. So what's the best commercial arrangement for them? Is it cheaper for them to deliver directly to a central warehouse or is it cheaper for them to deliver directly to a store? So that becomes a supplier challenge.***" (emphasis added). Having to move from 'direct to store' delivery into the Foodstuffs warehouse has not been a choice or a more efficient option for many suppliers. Likewise, is the 'choice' to use Foodstuffs' transport companies, which have less accountability and higher costs.

2.15. Getting the Majors to accept the Commission's conclusion in its Draft Report of the existence of the duopoly was a challenge. As Foodstuffs noted, "*We consider that the market is not a duopoly, it has two large players and a fast-growing fringe*"[18] and while Woolworths initially said "*there are many different flavours of competition and many different flavours of competitors*"[19] it finally made a small concession that "*Worst case we have a fiercely competitive duopoly*"[20].

2.16. Scale is clearly a current and future barrier to many entrants,[21] yet Commissioners were told by the Majors that scale was not a barrier to entry[22]. This position apparently contradicts statements made in the Conference session on separation, where the

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[15] The Warehouse Group submission on the Preliminary Issues Paper 4, February, 2021
[16] p9 Donaldson T, FSSI, and p44 Stewart D FSNI, Conference Day-3-Transcript
[17] p8, Gluckman J, WWNZ, Conference Day-5-Transcript
[18] p25, Quin C, FSNI, Conference Day-5-Transcript
[19] p21 Gluckman J, WWNZ, Conference Day-1-Transcript
[20] P45, Gluckman J, WWNZ, Conference Day-5-Transcript
[21] P4-5 Balle S, Supie, Conference Day-5-Transcript and p33 Conference Day-7-Transcript; p5-6 Lane M, Night 'n Day, Conference Day-5-Transcript; p7 Edwards T, Monopoly Watch NZ, Conference Day-5-Transcript; The Warehouse Group submission on the Preliminary Issues Paper (4 February 2021)
[22] For example p8, Gluckman J, WWNZ, Conference Day-5-Transcript ("*we don't think that there's a minimum scale or a prerequisite model that exists in order to be an effective competitor*")

Majors said the grocery retail "*business model is high sensitive to scale*"[23] and that "*you'd certainly want to preserve the benefits of our scale*"[24]. Once again, the submissions made by The Warehouse Group, unique in terms of being from the only retailer with significant national scale to have attempted to enter the market and experienced extreme retaliation from the Majors, rebuts the belief that scale is not a barrier to entry.[25]

2.17. We note that Tex Edwards' response to the preservation of scale was "*if there's a substantial ownership change up at the distribution centre then in the pathway of going from two distribution centre ecosystems in New Zealand, to three, possibly four, then you can preserve scale, you're just changing ownership. It actually is a risk mitigant in a concern that prices might rise.*"[26]

2.18. Other points made by the Majors during the Conference were hard to reconcile with reality as we see it:

a. That the Majors compete locally on price but set prices nationally.

b. That private label is used to constrain the power of suppliers in categories[27] where there are few and yet the reduced number of suppliers in category is a direct result of range consolidation and playing suppliers off against one another.

c. We also heard inconsistent approaches on private label, with suggestions that they are generic low costs options[28], but also that they are highly innovative[29]. Private label products are often cheaper because the cost of research, development and innovation has been met by others.

d. That "*barriers aren't getting access to land, they aren't getting access to supply chain*"[30].

e. That "*land banking*" is an "*incredibly pejorative*" term, they don't land bank but *"strategically buy land well ahead*"[31] of further supermarket needs a.k.a. land banking.

f. That the Majors are not wholesalers[32] yet perform wholesaling functions[33].

2.19. An important point made by Monopoly Watch NZ and other Conference participants is that what is relevant is not how the Majors see themselves, but how others judge them and the impression that grocery retail concentration and returns contributes to higher valuations by the market is compelling. The Demerger Booklet for the Demerger of Endeavour Group from Woolworths Group stated:

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[23] p8, Gluckman J, WWNZ, Conference Day-5-Transcript
[24] p8, Gluckman J, WWNZ, Conference Day-5-Transcript
[25] The Warehouse Group submission on the Preliminary Issues Paper 4, February 2021
[26] p7 Edwards T, Monopoly Watch NZ, Conference Day-7-Transcript
[27] p9 Donaldson T, FSSI, Conference Day-3-Transcript
[28] p31 Stewart FSNI, Conference Day-3-Transcript
[29] p10 Gluckman J, WWNZ, Conference Day-3-Transcript
[30] p40 Quin C, FSNI, Conference Day-5-Transcript
[31] p23 Brooker M, FSNI, Conference Day-5-Transcript
[32] p29 Quin C, FSNI, Day-5; p30 Donaldson T, FSNI, Conference Day-5-Transcript
[33] As "a vertically integrated retailer" p36 and p37 Gluckman J, WWNZ, Conference Day-5-Transcript; p34 Donaldson T, FSNI, Conference Day-6-Transcript

"*In Grant Samuel's view, the critical issue is the impact of the Demerger on the financial stability of Woolworths Group. If the Demerger is implemented, Woolworths Group Demerger: will remain a leading Australian supermarket business, with a strong market share in a mature industry with relatively high barriers to entry. Woolworths Group post Demerger will retain its defensive characteristics (e.g. an earnings profile that is resilient through economic cycles)*".[34]

2.20. Tex Edwards referred Commissioners to the description by stockbroking firm Wilsons[35] advisory on Woolworths' stock as remaining "*one of the most expensive (PER) supermarket businesses in the world. World-leading margins, duopoly-like structure and high returns on capital are all reasons cited for the high valuations of Australian supermarkets.*"[36]

2.21. The final statement from FSNI that "*It's not a duopoly with a fringe and we don't behave like it is every day*"[37] does not reconcile with the behaviour of some stores, processes or the list of behaviours we laid out in section 174 of our initial submission that we believe should be covered by a Code.

2.22. While it may be helpful that the Majors are reviewing restrictive covenants, it remains unclear if/when these will be removed and/or whether there will be any action around land banking. If the argument that returns should factor in land-ownership, this suggests a further entry barrier.

2.23. It was suggested that wholesaling was not possible or at least very complicated to implement – yet apparently this was previously offered[38] and is currently being offered by Woolworths in Australia to independent retailers. It is legitimate to ask whether the withdrawal of such an offering, or at least a failure to offer this, is a deliberate strategy to make new entry or expansion less likely. That can be inferred from the apparent treatment of Night 'n Day who told the Commission that after launching into the North Island, FSSI withdrew wholesaling support.[39] In a workably competitive market incumbents would be "enthusiastic wholesalers".

2.24. FSNI stated it "*will remove any barriers to market entry that are within our control and deliver better competition for the benefit of NZ consumers*".[40] In NZFGC's view, offering wholesaling to independents like Night 'n Day or Supie is in Foodstuffs' North Island's control.

2.25. Even on more simple matters such as the need for a Code, which appears now to be accepted, the Majors have indicated that this needs considerable engagement and a New Zealand solution[41]. This could be seen as both a delaying ploy and/or a desire to control the outcome. Both Australia and the UK have principle-based codes that could be adopted with little change. Principles such as 'fair dealing' are arguably universal and are unlikely to require being 'New Zealandised'. The only New Zealand-specific

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[34] Woolworths Group Limited "Demerger Booklet for the Demerger of Endeavour Group" (10 May 2021): https://www.woolworthsgroup.com.au/content/Document/Demerger/Demerger%20of%20Endeavour%20Group%20-%20Demerger%20Booklet.pdf at p183
[35] p7 Wilsons *Woolworths: calling drinks on Endeavour – Our monthly view on Australian Equities*, 10 June 2021
[36] p30 Edwards T, Monopoly Watch NZ, Conference Day-4-Transcript
[37] p6 Quin C, FSNI, Conference Day-6-Transcript
[38] p10 Lane M, Night 'n Day, Conference Day-5-Transcript
[39] See Conference Day-5-Transcript at p9
[40] p11 Quin C, FSNI, Conference Day-1-Transcript
[41] p16 Dixon A, WWNZ, Conference Day-7-Transcript

consideration suggested by NZFGC is the consideration of Treaty principles within a New Zealand Code and the requirement to take into account indigenous businesses.

2.26. Incumbents also engaged in scaremongering suggesting structural separation was an "*extreme precedent that such intervention into a sector such as ours would represent*"[42], and that "*a separated or a wholesale model would have a number of significant issues*"[43] yet there are numerous examples of this domestically and abroad in both the competition/antitrust sphere and more broadly. More specifically both the EU and US have draft legislation specifically providing for structural separation, either immediately or as a sanction, for powerful platforms.[44]

2.27. The Majors have also implied that consumers could somehow miss out from the introduction of competition.[45] We consider it self-evident that consumers benefit from competition and that the New Zealand grocery sector can sustain more than two players.[46]

2.28. There has been much assertion and hyperbole, or marketing buzzwords, which the evidence seems to contradict, rather than support, such as the continued mantra of 'consumer-focused' and 'customer-driven'. Apart from not being rational for profit-maximising entities, this is inconsistent with preferred market-leading brands being delisted because minor, less popular brands have agreed to a superior margin. The most recent high-profile examples were the deletion of market-leading New Zealand-sourced fish products from Sealord and frozen berries from Sujon. Being 'customer driven' logically should place value on customer preferences and not delist their favourite products due to extreme margin demands.

2.29. Finally, we note that there is anecdotal commentary that media companies can feel pressure to minimise content that is negative to the Majors or face losing advertising placements. We are surprised there has been only limited coverage of issues (mainly in the print media) when groceries and cost of living topics are in the public interest.

Comments from other parties

2.30. Consumer NZ made a number of powerful submissions which we support on how consumers see the state of competition and whether the status quo is best meeting the needs of consumers.

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[42] p11 Gluckman J, WWNZ, Conference Day-6-Transcript
[43] p8 Gluckman J, WWNZ, Conference Day-5-Transcript
[44] We submitted further information to the Commission regarding this following the Conference: https://comcom.govt.nz/__data/assets/pdf_file/0030/269841/Andrew-Matthews-Consultation-conference-Day-7-Follow-up-2-November-2021.pdf, this submission also identifies examples at [3.13]
[45] For example, Gluckman J, WWNZ, Conference Day-5-Transcript at p36 ("*I think you'd just want to be wary that any wholesale solution didn't disincentivise development and innovation of private label products because that wouldn't be a good thing for Kiwi consumers*")
[46] See Castalia "Private Labels, Buyer Power and Remedies in the NZ Grocery Sector" (August 2021) https://comcom.govt.nz/__data/assets/pdf_file/0034/265786/Food-and-Grocery-Council-Submission-on-Market-study-into-grocery-sector-draft-report-Attachment-26-August-2021.pdf at p15 ("*Internationally, we observe that other comparable countries have more than two large supermarket groups. Ireland, which has a similar population to New Zealand, though is more compact, has seven competing supermarket chains. Norway, Finland and Sweden which, like New Zealand, have a long thin land mass, all have four major supermarket chains. Iceland, which has a much smaller population, also has four retailers. These international outcomes indicate that scale may not be a barrier to entry by least one to two additional retailers.*")

2.31. Night 'n Day gave significant and revealing evidence. Most notably it appears that it did receive wholesale services until it risked becoming a competitive constraint.[47] Related to this it appears that previously the incumbents were wholesalers. A clear inference is that they have chosen to deny wholesale supply because this could facilitate entry and/or expansion by actual/potential competitors. This reinforces the concern about platforms self-preferencing and any appropriate structural separation.

2.32. Northelia's submissions[48] highlighted a number of key points:

a. That financial markets have a very different view of the profitability of Woolworths (and market structure assisting that profitability) than has been submitted.

b. The need to consider the challenges if the objective is like-for-like competition across a full range of grocery products (for the one-stop shop). These include necessary footprint, and the range of potential incumbent responses.

c. Reinforcing a point in Ernie Newman's written submission[49], the different geographic positions of strength of the parties.

2.33. Supie is a new entrant, perhaps best characterised as a nascent competitor. Supie's evidence also showed the challenges in getting wholesale supply and funding for that business model. We note that The Honest Grocer does not appear to have taken part in this process and now seems to be taking a price-follower model. Their respective business models remain unproven.

2.34. Allan Botica on Day 6 of the Conference stated: "…*Josh and Tim, earlier, both mentioned the sectors exemplary performance during the Covid response. That's instructive because they didn't engage at that point in protracted discussion and equivocation about costs, risks, difficulty, they simply got on with it and they benefited. And the point about that is that the question that this comes down to is one of Government intervention."*[50]

2.35. Mike Chapman from New Zealand Horticulture made comments on Day 3 of the Conference in support of a flexible Code that will respond quickly: *"Strong support for the code from our members but that support is around having a flexible code that will respond quickly. And the process that we've been hearing about in the UK is certainly one which would really fit well. And you know, often there isn't the evidence there for a full investigation, but there is a systemic practice that can be curbed with a proactive approach. And that's certainly what we would support."*[51]

NZFGC's submission on what is required

2.36. **Immediate and urgent introduction of a Code based on the UK or Australian model (but if the latter, with a UK-style independent adjudicator):** We submit that given acceptance by the Majors this should be implemented expeditiously. There does not need to be further and protracted dialogue which risks delay and potential capture.

[47] p9 Lane M, Night 'n Day, Conference Day-5-Transcript
[48] p3-4 Northelia, Northelia-Ver-1.4-Submission-on-Market-study-into-grocery-sector-draft-report-26-August-2021
[49] p5 Newman E, Ernie-Newman-Submission on Market Study into Grocery Sector Draft Report 26 August 2021
[50] p33 Botica A, Northelia, Conference Day-6-Transcript
[51] p29 Chapman M, Horticulture NZ, Conference Day-3-Transcript

Both Majors should be "designated" as subject to the Code. If the Majors were sincere, they could have (as we submitted during the conference) specified any changes they considered necessary by now, particularly FSNI which told Commissioners during the Conference that they have conducted research on both the UK and Australian Codes during 2015 and since. Commissioners were told that following this research, FSNI's conclusion was they were "*not sure that either of [the codes] have got it completely right at this stage, with the greatest respect"* but chose not to comment as to why this was the case.

2.37. **Regulation to address the conflicts of interest with private labels:** We have provided further evidence, supported by Castalia,[52] of the potential harms from private label unique to, and amplified by, New Zealand market structure. Growing use of private labels will only exacerbate these concerns. While the Majors claim these offer growth opportunities to New Zealand manufacturers, in reality, the many contracts are for a single year and if a supplier has had its own brands delisted in that year and then loses the private label contract, they can lose everything. We also submitted a follow up to the Commission in response to its question on how structural separation of private labels could work.

2.38. At a minimum, and consistent with the concerns around (and proposed legislation for) platforms in the US and EU, in particular dealing with self-preferencing and private label issues, there must be robust rules in place to address the inherent conflict of interest when the market operators then compete in those markets. These rules must provide safeguards and:

a. prevent the misuse of confidential information;

b. protect suppliers from being coerced into becoming private label manufacturers (diverting production);

c. prevent supermarkets from requiring and misusing manufacturer intellectual property (**IP**); and

d. ensure equivalence in treatment – 'buy' side (wholesale) and 'sell' side (retail supermarket) of the platform. In particular preferencing on shelf in planograms or online through algorithms and setting price gaps between private label and branded products.

2.39. These could be handled independently of the Code, assuming the Code is a quick adoption based on the Australia or UK model. We could see these private label rules as being independent, particularly given the need to consider the appropriate model of separation noted in the table in paragraph 3.31 below.

2.40. Similar rules should apply to 'sponsored' or 'controlled' brands and other supermarket-owned or part owned businesses – nappies, supplements, personal care, fish and meat for example.[53]

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[52] Castalia "Private Labels, Buyer Power and Remedies in the NZ Grocery Sector" (August 2021) https://comcom.govt.nz/__data/assets/pdf_file/0034/265786/Food-and-Grocery-Council-Submission-on-Market-study-into-grocery-sector-draft-report-Attachment-26-August-2021.pdf

[53] See also NZFGC "Submission on Market study into grocery sector draft report" (26 August 2021) https://comcom.govt.nz/__data/assets/pdf_file/0022/265801/NZ-Food-and-Grocery-Council-Submission-on-Market-study-into-grocery-sector-draft-report-26-August-2021.pdf at [6.52]

2.41. **Substantial Market Power (SMP) designation for s36 Commerce Act:** There should be amendments to section 36 of the Commerce Act to confirm that the Majors have 'Substantial Market Power' on the 'buy' and 'sell' sides, as wholesalers and retailers, and both nationally and locally. Even on this basis the other elements of section 36 would need to be made out but it would avoid 'cute' arguments to the effect that the Majors did not have substantial market power because they each faced a major competitor (there may need to be related consideration of deemed markets to aid efficient identification and enforcement of abuses of SMP). We also recommend that consideration be given to potential rebuttable presumptions/per se rules that may alleviate strategic barriers to entry. For example, there could be a prohibition on 'pocket pricing', or presumptions around predatory behaviour.

2.42. **Commission power to issue 'block authorisation' and related collective bargaining authorisation:** Collective bargaining could complement other interventions by providing a useful 'tool' to help reduce the imbalance of bargaining power between the Majors and suppliers, resulting in more efficient outcomes, as well as reducing barriers to entry to the retail market.

2.43. **A broader review of conglomerate and vertical ownership and acquisitions of the Majors – transparency in this enquiry and rules going forward (and greater transparency on Foodstuffs):** One area which the Draft Report did not consider was the enhancement of market power by the supermarket chains since 2002. There has been a further enhancement of market power, or consolidation of that power, through subsequent events and acquisitions (discussed also at paragraphs 3.14(e) and 3.35). NZFGC submits there may need to be a line of business limitations, notification of any acquisitions perhaps with a rebuttable presumption looking at national and local market effects. We therefore recommend that there should be mandatory notification obligations in respect of future acquisitions by supermarkets.

2.44. **Information disclosure regime**: To the extent structural separation is not implemented, there will need to be accounting separation and disclosure for greater review going forward. They may also be necessary even with full structural separation

2.45. **Measures to facilitate retail competition:** NZFGC supports measures to facilitate retail competition. This would provide greater benefits to consumers through innovation and choice. For producers/manufacturers, it would also provide opportunities for innovation and could at least partially mitigate the dominance of the demand-side market power of the two monopsonies. NZFGC suspects that many measures to facilitate various potential types of competition may be necessary. Even then, there may be real concerns about the likelihood of meaningful competition emerging over a competitively relevant timeframe given the considerable, and entrenched, barriers to entry and expansion, including the likely incumbent response.

3. MARKET STRUCTURE – DUOPOLY WITH FRINGE PROVIDERS

Overview

3.1. The Majors' submissions and conference comments fail to evidence that they are constrained by fringe providers nor mission shopping. The Draft Report correctly characterised the retail grocery market as a duopoly with fringe providers and high barriers to entry.

3.2. Contrary to assertions by, and on behalf of the Majors, structural remedies are not unprecedented or unorthodox. In fact, they have been used often globally, and are increasingly being considered in the EU and US as necessary to enable competition. As such, structural remedies may be appropriate – or even necessary – remedies to introduce much needed competition in the retail grocery sector. Measures to facilitate market entry and/or expansion must be robust if they are to achieve their objectives. All options must be considered.

No evidence fringe providers or mission shopping are material constraints

3.3. The Majors' submissions and conference comments fail to evidence that they are constrained by fringe providers or mission shopping. Even on the premise that the Majors compete for customer 'missions', there is no evidence that fringe providers, which may be able to service some missions, form a material competitive constraint on the Majors' pricing or other strategic decisions.

3.4. As noted in the Draft Report and during the Conference:

a. The Majors' market shares have remained relatively stable, likely at around 80-90% of the market for both main shops and top up shops.

b. The number of independent supermarkets in a local area and entry and exit in local markets have very little effect on local prices, which suggests other providers and local entry are not significant constraints on retail grocery prices. While this is likely a consequence of the Majors having national or North/South Island wide pricing policies, it is also a consequence of small, local providers being unable to materially constrain a large, nationwide network.

3.5. Grocery shopping should not be conflated with all other types of food consumption. The other retailers the Majors mentioned in their submissions and during the Conference should be considered proportionately to their ability to constrain the Majors, which we have not seen evidence of. The following describes the supposed 'wave of competition' facing the Majors:

a. Costco is a membership warehouse club and its website only advertises one Auckland warehouse opening in 2022.[54] It sells memberships and offers a limited selection of products, many of which are private label, typically in bulk volumes. Costco would be geographically limited to one location and uses a different business model, so will not compete closely with the Majors. It will likely be attractive to particular segments e.g. large families, and does not fit with the trend of consumers making more frequent, smaller shopping missions.

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[54] https://www.costco.co.nz/#about-costco

b. The Warehouse does not have a full grocery offering and its attempts to expand to grocery with 'The Warehouse Extra' stores were unsuccessful. Some commentators attribute this lack of success directly to actions taken by the Majors at the time[55]. Its strategy seems to be offering deals on one or two products, making it unlikely to be an effective competitor for most grocery missions nor a substitute for the 'one stop shop' by marshalling 'portfolio power'.

c. The Chemist Warehouse does not have a grocery offering. Clearly, Chemist Warehouse only overlaps with a small fraction of the Majors' SKUs. Shoppers go to the Chemist Warehouse for a different shopping purpose and cannot get daily essential groceries at the Chemist Warehouse. As Matthew Lane from Night 'n Day stated during the Conference: "*Prescriptions are the fringe part I suspect of Woolworths' business, the core part that needs to be protected is that dry grocery and sort of everything flows off from there.*"[56]

d. Animates does not have a grocery offering.

e. Circle K appears to have 4 convenience stores / gas stations in New Zealand akin to dairies.[57]

f. Aldi has confirmed this year that it has no plans to enter New Zealand.[58]

3.6. NZFGC has not seen evidence that online only options have the scale needed to truly pose a competitive constraint on the Majors. Supie commented during the Conference that it does not have the scale needed to be considered an effective competitor.[59] The Honest Grocer's online entry also faced obstacles to competing with the Majors. As it stands, the Majors look to dominate the future retail grocery market across both online and physical options.

3.7. It seems internet shopping may ultimately, and at best only, be a substitute for some customers some of the time. Online offerings tend to be most successful in dense big cities, like London[60], and are often in addition to traditional physical stores. Perishability and delivery windows may be limiting factors.[61] For example Amazon's acquisition of

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[55] https://www.nzherald.co.nz/business/ibrian-gaynori-no-extra-room-between-the-behemoths/3ORZDRTZQ274CE52HLEG2OO5Y4/

[56] P37 Lane M, Night 'n Day, Conference Day-1-Transcript

[57] https://circlek.co.nz/

[58] https://www.newshub.co.nz/home/money/2021/07/discount-chain-aldi-confirms-it-still-has-no-plans-to-set-up-in-new-zealand.html

[59] p5 Balle S, Conference Day-5-Transcript "*Supie has been mentioned several times throughout the conference already, yet we do not currently have sufficient scale to be considered an effective competitor.*"

[60] https://www.forbes.com/sites/richardkestenbaum/2017/01/16/why-online-grocers-are-so-unsuccessful-and-what-amazon-is-doing-about-it/?sh=cc4f77e7f56b ("*London has a combination of factors that make it the leader in online grocery. The population density is high, incomes are high, it has a lot of young consumers who work long hours, stores are not open late and deliveries are usually made in under two hours. Those factors make London an ideal market for online groceries and it is in fact the world leader in penetration.*" and "*The other factor that makes online grocery sales work so far is teaming up with an existing store. In London, Amazon delivers groceries from Morrison's, a large chain with existing stores In Seattle, Amazon delivers health and beauty products from Bartell Drugs, a long-established, local family-owned business. That may be an important model because it doesn't require a separate inventory cost for online sales.*")

[61] https://www.forbes.com/sites/forbesfinancecouncil/2018/02/15/the-future-of-the-supermarket-fresh-is-king/?sh=7677f7f26ace ("*Online shopping cannot solve immediate needs. Even e-commerce giants are seeking physical stores to organically integrate the online shopping and offline experience. …*

Whole Foods suggests the internet giant still saw the need for a bricks and mortar presence. We understand the physical presence enables Amazon to provide fast delivery times – 2 hour delivery for households with a Whole Foods store nearby. Further, given that the incumbents will presumably offer a mix of physical and online options, this creates an additional incumbency advantage and barrier to entry.

3.8. NZFGC therefore considers the Draft Report correctly characterised the retail grocery market as a duopoly with fringe providers. No evidence has been provided to suggest otherwise on a forward-looking basis.

3.9. For suppliers, the situation is arguably starker. For most suppliers, the Majors are not substitutes because supply to both of the Majors is necessary to get the necessary volume. Loss of one retailer can sometimes be a mortal blow to a supplier, something which would not occur if there was more competition and suppliers served a range of competing retailers. Each of the Majors therefore enjoys its own monopsony. The lack of options for suppliers, and strong buyer power of the two Majors, reflects the relatively small size of other grocery retailers and the small share of consumer expenditure they represent.

3.10. As Katherine Rich noted in her opening remarks on day 3 of the Conference[62]:

> *"From the supplier perspective the position is arguably starker. There is generally no substitute for supplying both major supermarkets. Due to NZ's unique market structure the two are complements not substitutes from a supplier's perspective… [For] suppliers each major effectively has a monopoly over its network and its marketplace."*

High barriers to entry

3.11. It is evident that the New Zealand market is large enough to sustain more than two large players and the Majors have not provided evidence to suggest that two players represent minimum efficient scale. It is worth noting that countries similar in scale to New Zealand appear to sustain more players. Ireland has 10[63] and Denmark has 7[64]. This was a specific agenda item at the Conference and the Majors did not provide any evidence despite this being something they could have addressed at the time.

3.12. New Zealand previously had a third player before Progressive and Woolworths New Zealand merged in 2002, and countries that are comparable to New Zealand in terms of population and geography commonly have four major supermarket chains[65]. Even within New Zealand, other smaller sectors have more than two major players – for example, the telecommunications industry, which is a capital-intensive industry worth only $5bn, still has more competitors than the $22bn retail grocery industry. We earlier provided evidence from Castalia indicating that there was no basis to assume the

Walmart does better in online grocery because its ubiquitous physical stores have built a vast online grocery pick-up network, which eliminated the delivery process to preserve the freshness of the perishables")

[62] p5 Rich K, NZFGC, Conference Day-3-Transcript

[63] List of supermarket chains in Ireland - Wikipedia

[64] List of supermarket chains in Denmark - Wikipedia

[65] As previously submitted in the August 2021 Castalia report (p. 16) that accompanied NZFGC's submission on the Commission's Draft Report.

minimum efficient scale for New Zealand meant it could only support two supermarket chains:[66]

> *"Internationally, we observe that other comparable countries have more than two large supermarket groups. Ireland, which has a similar population to New Zealand, though is more compact, has seven competing supermarket chains. Norway, Finland and Sweden which, like New Zealand, have a long thin land mass, all have four major supermarket chains. Iceland, which has a much smaller population, also has four retailers. These international outcomes indicate that scale may not be a barrier to entry by least one to two additional retailers."*

3.13. However, there are a number of significant barriers to entry and expansion, many of which are related to the entrenched incumbency of the duopolists. In particular, strategic barriers to entry that have been created by the duopolists have blocked entry and expansion by potential rivals and will continue to do so, in the absence of intervention.

3.14. NZFGC considers the following factors contribute to high barriers to entry to grocery retailing:

a. **Product portfolio:** The Majors derive portfolio power from the large range of products they offer in their 'one-stop shop'. General retailers like Chemist Warehouse and The Warehouse Group, and specialist retailers such as butchers and greengrocers, do not, and likely cannot, replicate the same portfolio and range.

b. **Location / sites**: The Majors have large footprints and own the most desirable locations, for example those with good access and parking spaces. The Majors seem to have a large number of stores relative to the population, which crowds out other potential entrants. The Majors have a first mover advantage in having taken the most suitable sites. Their nationwide network of stores gives them greater purchasing power. We will never know the full impact of the use of restrictive land covenants identified by the Commission on preventing improved competition.

While pure online models may not 'need' store sites, there are few large-scale examples of pure online models. It can be expected the strongest retail grocery competitors would have both physical and online offerings, as the Majors do, and so be able to offer the benefits of both (for example physical stores have the benefit of product being immediately available, shoppers being able to see the product, customer service, easier return process and increased likelihood of customer loyalty). Having both offerings available also has the benefits of flexible payment and pick up options, for example fast local delivery options, and physical stores increasing traffic to websites.

c. **Access to wholesale supply on competitive terms:** The Warehouse Group's submission offers an insightful perspective as a previous entrant: "*In our original submission we outlined the significant barriers to entry or expansion for any new or fledgling grocery operator, in particular, access to skill (physical and digital infrastructure and end-to-end supply chain capability) and scale (immediate access*

[66] Castalia "Private Labels, Buyer Power and Remedies in the NZ Grocery Sector" (August 2021) https://comcom.govt.nz/__data/assets/pdf_file/0034/265786/Food-and-Grocery-Council-Submission-on-Market-study-into-grocery-sector-draft-report-Attachment-26-August-2021.pdf at p15

to competitive supply and operational efficiency)."[67] The Warehouse Group identified two elements of wholesale grocery supply that should be considered separately: (a) access to product range and scale benefits from aggregated procurement; and (b) access to the end-to-end supply chain infrastructure required to move goods from supplier to consumer.[68] It recommended that the Government considers either providing investment support in the end-to-end supply chain infrastructure to support scalable retail and wholesale alternatives or intervening in the incumbent vertically integrated structures to provide access to other parties.

d. **Differentiated brands**: Similarly, the Majors each have a large variety of banners targeted towards different customer segments, making it harder for potential entrants to establish a niche:[69]

> *An incumbent can also react to the threat of entry by committing to reduce the demand that is available for the entrant. Several variables of the marketing mix can be used to achieve this objective…. In terms of product positioning, an incumbent may decide to increase the number of varieties it puts on the market so as to leave fewer niches that an entrant could occupy.*

For example a strategy of setting up multiple New World / Countdown Metro stores for city-shoppers would make it difficult for a similar competitor to enter the market. Natural switching barriers and consumer inertia may also play a role.

e. **Ownership of vertically related & complementary services**: We understand FSNI has acquired business assets or shares in Leigh Fisheries in 2019, Fresh Connection in 2019, Eat My Lunch in 2017, Raewood Fresh in 2012, Henry's Beer, Wine & Spirits in 2007 and Liquorland in 2008 (70 stores) and 2015 (21 stores). It may also have interests or arrangements regarding retail fuel.[70] Woolworths NZ has noted its "*partnership with Hilton Foods Group, where we've co-invested in a hundred million dollar meat plant based in Auckland to supply 2 Kiwis.*"[71] These holdings and interests, and probably others NZFGC is not aware of, strengthen the Majors' position in retail grocery. They also allow the Majors to increase barriers to competing in the retail grocery market and leverage their retail grocery market power to adjacent industries. Relatedly, the Majors' media advertising spend, if sufficiently large, may also enable them to influence media.

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[67] The Warehouse Group "Submission on Market Study into grocery sector draft report" (26 August 2021) at p1

[68] The Warehouse Group "Submission on Market Study into grocery sector draft report" (26 August 2021) at p1-2

[69] Belleflamme, Paul; Peitz, Martin. *Industrial Organization: Markets and Strategies (2nd Edition)* (Kindle Locations 12199-12202). 2015, Cambridge University Press. Kindle Edition.

[70] https://comcom.govt.nz/__data/assets/pdf_file/0033/269493/Ampol-Limited-Z-Energy-Limited-Clearance-Application-1-November-2021.pdf at [3.7(c)] ("*Z currently [redacted] Foodstuffs' network of retail fuel sites.*"), [15.7] ("*Z also supplies fuel [redacted] Foodstuffs' fuel sites [redacted]. For the purpose of measuring the effects of aggregation, this supply should be treated the same way as supply to a distributor [redacted] Furthermore, Foodstuffs has a history of switching suppliers (having previously been supplied by Mobil, and prior to that BP53). [redacted]*") and [15.10] ("*As set out above, the Parties consider that distributors' retail participation should not be aggregated with that of their suppliers. However, for the sake of completeness, Ampol has also considered based on the above methodology Local Retail Markets where a Gull station overlaps with the station of a distributor which is supplied wholesale fuel, directly or indirectly, by Z, i.e. stations branded Challenge (supplied by Farmlands Fuel), Southfuels, McKeown, Foodstuffs (New World and Pak'n'Save) and K&L Distributors. Using this methodology, Ampol has identified a further 1 Local Retail Market (in addition to the 67 Local Retail Markets already identified).*")

[71] p16 Dixon A, WWNZ, Conference Day-7-Transcript

f. **Information & data**: The Majors will have greater information from data collected from retail buying, supplier contracts, and consumer loyalty programs.

g. **Incumbent response – wholesale:** Feedback from members is that suppliers are under direct or indirect pressure to either not supply a new entrant, or supply them on less favourable terms. For example Foodstuffs inducing supplier refusals to supply "exclusive pack" variations to other retailers in 2010). This remains Foodstuffs' policy as per its website to this day[72]. Other case studies include the Honest Grocer's entry in online retailing in 2020 and the Warehouse Extra in 2007. Unfortunately, the nature of such pressure means there is unlikely to be evidence that it occurs. We understand such concerns can be factored into ranging discussions.

h. **Incumbent response – retail:** One could expect a strong incumbent response to real competitive retail competition. This could encompass pricing, specials, increased expenditure on advertising, increased loyalty benefits and pressure on suppliers not to supply new entrants. Such responses can be pro-competitive. However, we may see:

   i. *Predatory pricing* – rules around predation may need to be reconsidered. Incumbents should be designated as having 'Substantial Market Power' for section 36 (at least for a finite period). There may also need to be a prohibition on 'pocket pricing'. This could deliver the benefits of any incumbent response nationally, while potentially mitigating the risks of being seen to simply be targeting a new entrant.

   ii. *Increased attention on loyalty programs* to create switching barriers.

   iii. *The further rollout of private label, 'fighting' or sponsored brands*. This forecloses access to the essential facility of the distribution network or marketplace (restricting supplier entry or expansion through private label). Continued switching from brands to private label products, absent a Code, could see requirements for suppliers of branded goods having to supply increased levels of private label.

   iv. *Continued 'creeping acquisitions'* which go under the radar leading to potential issues around vertical and conglomerate affects strengthening the portfolio power of supermarkets. Mandatory regulatory notification of acquisitions by the Majors could address this concern.

   v. *Continued investment in the 'footprint' and Internet offering*, making this a 'ticket to play' even for 'bricks and mortar' stores.

3.15. As touched on above, there should be amendments to section 36 of the Commerce Act to confirm that the Majors have 'Substantial Market Power' on the 'buy' and 'sell' sides, as wholesalers and retailers, and both nationally and locally. Even on this basis, the other elements of section 36 would need to be made out but it would avoid 'cute' arguments to the effect that they did not have substantial market power because they each faced a major competitor.

3.16. NZFGC also recommends that consideration be given to potential rebuttable presumptions/per se rules that may alleviate strategic barriers to entry. For example,

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[72] https://suppliers.foodstuffs.co.nz/assets/documents/Exclusive-Packs-Policy-Nov-2017.pdf

there could be a prohibition on 'pocket pricing', or presumptions around predatory behaviour.

3.17. NZFGC also recommends a broader review of conglomerate and vertical ownership and acquisitions by the Majors, transparency in this enquiry and rules going forward (and greater transparency on Foodstuffs' complex structure and ownership).

3.18. More generally, while a number of existing strategic barriers to entry have been identified and could be addressed individually, the nature of these types of barriers is that they are created by incumbents that are protecting their privileged market position. While the Commission can identify conduct that has already occurred to create strategic barriers, if those are addressed by regulatory intervention new strategic barriers can be created in response. As a result, the market structure lends itself to structure remedies that address the underlying market power that enables strategic barriers to be created in the first place.

Structural remedies

3.19. NZFGC supports measures to facilitate retail competition. This would provide greater benefits to consumers through innovation, better pricing and choice. For producers it would also provide opportunities for innovation and could mitigate the considerable demand-side market power. It could provide greater scrutiny of supply with more players. However, there will be different impacts on different suppliers and NZFGC does not have the expertise to comment on exactly how this should be done. Nor would it wish to be seen as seeking to 'pick winners'. It has fears on likelihood of meaningful competition given the considerable, and entrenched, barriers to entry and expansion, including the likely incumbent response.

3.20. While structural remedies are generally seen as a last resort, NZFGC considers it could be appropriate for the Commission to recommend structural remedies in these circumstances. It does not appear other remedies will be able to address the deeply rooted and entrenched structural problems in retail grocery identified in the Draft Report.

3.21. Many other submitters supported the need for structural intervention e.g. The Warehouse Group[73], Night 'n Day[74], Consumer NZ[75], and Northelia: "*So all dialogue leads back to this infrastructure which is a strapline of ours which is market structure matters*".[76]

3.22. Conversely (and unsurprisingly) the Majors denied any need for structural change: "*We don't believe that supply chain infrastructure is a limiting factor. There are numerous options for both warehousing and distribution in the South Island*"[77], "*The more you separate the more inefficient you become, the more inflexible you become, I'm not sure that, you know, open heart surgery on the food supply chain is the best idea and so it would come with some risks.*"[78] This seems contradictory to the Majors' suggestion (discussed above) that these services can be independently and easily provided by third party contractors.

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[73] p1-2 Grayston N, The Warehouse Group Ltd, The Warehouse Group Submission on Market Study into Grocery Sector Draft Report, 26 August 2021
[74] p39 Lane M, Night 'n Day, Conference Day-5-Transcript
[75] p29 Duffy J, Consumers NZ, Conference Day-7-Transcript
[76] p22 Edwards T, Monopoly Watch NZ, Conference Day-1-Transcript
[77] p13 Donaldson T, FSSI, Conference Day-5-Transcript
[78] p45 Gluckman J, WWNZ, Conference Day-5-Transcript

Structural remedies are not unprecedented, 'radical' or 'extreme' in the circumstances

3.23. Structural change is not an unprecedented remedy to market structure problems. Examples include:

a. **NZ electricity industry:** In New Zealand, electricity industry reform involved full ownership separation of distribution line businesses from retail and generation businesses and splitting the largest electricity generator into three competing, state-owned generators.[79] The *Electricity Industry Act 2010* allowed lines businesses back into retailing and incorporated revised 'continue of supply' provisions.[80]

b. **NZ telecommunications industry:** The telecommunications industry saw Telecom demerge into Spark and Chorus in 2011. While the demerger was 'voluntary', the Government's fibre investment programme, the Ultra-Fast Broadband (UFB) Initiative, prohibited successful partners in the programme from providing retail telecommunications services. "*This was intended to facilitate open access and competition in the new network by removing incentives for wholesale operators to discriminate against competitors who operate at the retail level. Telecom chose to structurally separate in order to partner with the Government in the roll-out of the UFB network.*"[81] Previously the *Telecommunications Act 2001* (**Telecommunications Act**) had also required operational separation. The *Telecommunications Amendment Act (No 2) 2006* (**2006 Amendment Act**) introduced into the Telecommunications Act new equivalence and non-discrimination obligations to support Telecom's operational separation. The Commission has spoken positively about how this structural separation has resolved long-standing competition concerns.[82] Structural separation has enabled smaller retailers continue to grow their share of market connections, reducing retail market concentration.[83]

c. **NZ Three Waters Reforms**: It aims to ensure that New Zealand's three waters — our drinking water, wastewater and stormwater — infrastructure and services are planned, maintained and delivered so that these networks are affordable and fit for purpose. Currently 67 different councils own and operate the majority of the

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[79] MBIE Energy & Resources Branch "Chronology of New Zealand Electricity Reform" (August 2015): https://www.mbie.govt.nz/assets/2ba6419674/chronology-of-nz-electricity-reform.pdf at [42] and [44]
[80] MBIE Energy & Resources Branch "Chronology of New Zealand Electricity Reform" (August 2015): https://www.mbie.govt.nz/assets/2ba6419674/chronology-of-nz-electricity-reform.pdf at [112]
[81] WTO Trade Policy Review New Zealand Minutes of the Meeting (29 June & 1 July 2015) at p90: https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=135064,134592,134423,133574,133080,133052,133056,132972,132973,132974&CurrentCatalogueIdIndex=1&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True
[82] 'Regulation of Telecommunications - the lessons learned over the last 25 years and their application in a broadband world' (CLPINZ Workshop, 5 August 2011): http://www.comcom.govt.nz/the-commission/archive-10/speeches1/ ("*It is impossible to underestimate the impact of structural separation – it really is a game changer. The entire history of telecommunications has been predicated on finding ways to minimise the adverse effects on competition of vertical integration, where the network owner must supply input services to parties who are competitors of its downstream business; inputs which those parties cannot obtain from any other source. The practices which raise concerns are almost endless – the classic deny, delay, degrade strategy, the margin squeeze, price and non-price discrimination, loyalty discounts, and so on. Structural separation removes the incentive to engage in the type of discriminatory behaviour described above. There is no integrated downstream business to benefit.*")
[83] Commerce Commission, 2020 Annual Telecommunications Monitoring Report, p. 25

drinking water, wastewater and stormwater services across Aotearoa. Working with councils, the Government will establish four new publicly-owned, multi-regional entities that benefit from scale and operational efficiencies.

d. **International telecommunications industries:** Several countries have undergone separation in the telecommunications industry, as illustrated in a study by Cullen International below.[84] Separation is often accompanied with equivalence of access obligations.

Yes / No / Past/projects

Country	CZ	DK	IS	IRL	IT	PL	SE	UK	AUS	NZ
Separation applied at wholesale level?	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes
Functional				Yes	Yes	Yes			Yes	
Legal	Yes	Yes	Yes		Past/projects: 2018 Project of voluntary legal separation notified to NRA		Past/projects: 2008-2017 Skanova Access AB established as a legally separate entity, 100% owned by Telia	Yes		
Structural									Past/projects: 2020 Structural separation	Yes
Supervisory committee?	No	No	Yes	Yes	Yes	No	No	Yes	No	Past/projects: 2008-2011 The IOG ceased to exist after the 2011 structural separation
Equivalence of access obligations	General non-discrimination	EoO	EoI	Both EoI and EoO	Both EoI and EoO	EoO	Both EoI and EoO	EoI	EoO	EoI

Cullen International Ltd, 2019

e. **US examples:** Now FTC Chair Lina Khan's article *The Separation of Platforms and Commerce* identifies five examples of structural separation in the US regarding railroads, bank holding companies, television networks and telecommunication carriers.[85] This is not an exhaustive list and footnote 356 notes that other separation regimes include "*provisions of the Glass–Steagall Act, 12 U.S.C. §§ 24, 378 (2012), the Public Utility Holding Company Act, 15 U.S.C. § 79 (2000) (repealed by the Energy Policy Act of 2005, 42 U.S.C. §§ 16451–16463 (2012)), the consent decree in United States v. Paramount Pictures, Inc., 334 U.S. 131(1948), and section 619 of the Dodd–Frank Act, 12 U.S.C. § 1851, known as the "Volcker Rule*".

f. **UK examples:** An Oxera Agenda article notes "*different forms of separation have been introduced in a number of sectors and jurisdictions since the early 1990s. Examples include, in the UK, the gas and electricity sectors and the fundamental restructuring of the rail industry*".[86]

g. **US technology platforms:** The US *Ending Platform Monopolies Act* could have the effect of splitting companies into two entities or do away with their private label

[84] Cullen International "Models of separation, equivalence of treatment and the role of the supervisory committee" (December 2019) at p6

[85] Lina M Khan "The Separation of Platforms and Commerce" (2019) 119 Columbia Law Review 973: https://columbialawreview.org/content/the-separation-of-platforms-and-commerce/ at p1037

[86] Oxera Agenda "Separating incumbents: panacea or a sledgehammer to crack a nut?" (September 2009): https://www.oxera.com/wp-content/uploads/2018/03/Vertical-separation_1.pdf at p1

products.[87] A news release by congresswoman Pramila Jayapal, who introduced the bill, explains:[88]

> *"The Ending Platform Monopolies Act is bipartisan legislation that eliminates the conflicts of interest that arise from a dominant platform's ownership and reach across multiple business lines. This monopolistic behavior allows a company to leverage its control to disadvantage competitors while hurting small businesses, consumers, and innovation. Representative Jayapal's H.R. 3825 addresses this anti-competitive conduct by making it unlawful for a dominant online platform — such as Google, Apple, Amazon, and Facebook — to simultaneously own another line of business when that dual ownership creates a conflict of interest. Companies in violation could have to divest lines of business where their gatekeeper power allows them to favor their own services or disadvantage rivals."*

An article from ISLR considers "*Amazon is both a gatekeeper that they must rely on to reach online shoppers and an aggressive competitor selling its own goods and services to those same shoppers. Unless lawmakers eliminate this conflict of interest through structural separation, Amazon will continue to have an overwhelming incentive and ample opportunity to use its gatekeeper power to preference its own interests while exploiting and undermining smaller competitors.*"[89] It also shares concerns around leveraging of monopoly power to other industries. The article considers structural separation is a proven solution and a common occurrence.

The Ending Platform Monopolies Act was introduced alongside a 'nondiscrimination bill', the American Choice and Innovation Online Act, which seeks to prohibit 'Covered Platforms' from engaging in self-preferencing, discrimination, and exclusionary arrangements.

h. **EU technology platforms:** In the EU, proposed regulation under the new Digital Markets Act prohibits companies deemed to be 'gatekeepers' from ranking their offerings above rivals on their own platforms, or using competitors' data to compete with them.[90] Possible sanctions include fines of up to 10% of the company's worldwide annual turnover and periodic penalty payments of up to 5% of the company's worldwide annual turnover, and orders to divest businesses. "*Gatekeepers will also need to inform regulators about smaller acquisitions that would otherwise fall below traditional merger-review thresholds*".[91]

3.24. We also understand Endeavour Group has recently demerged from Woolworths Group, showing demergers of the Majors is possible. Demerging the acquisitions the Majors

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[87] A copy of the bill for the Ending Platform Monopolies Act and its current status can be found here: https://www.congress.gov/bill/117th-congress/house-bill/3825/text

[88] News release "Jayapal's Landmark Big Tech Legislation Passes House Judiciary Committee" (24 June 2021) Congresswoman Pramila Jayapal: https://jayapal.house.gov/2021/06/24/big-tech-legislation-passes-judiciary-committee/

[89] Stacy Mitchell, Katy Milani & Ron Knox "Why the "Ending Platform Monopolies Act" is Essential Reform" (21 June 2021) ILSR: https://ilsr.org/fact-sheet-why-the-ending-platform-monopolies-act-is-essential/

[90] Natalia Drozdiak "Tech Giants Risk Breakup Under Strict EU Digital Rules" (16 December 2020) Bloomberg: https://www.bloomberg.com/news/articles/2020-12-15/tech-giants-risk-breakup-under-strict-eu-digital-rules

[91] Natalia Drozdiak "Tech Giants Risk Breakup Under Strict EU Digital Rules" (16 December 2020) Bloomberg: https://www.bloomberg.com/news/articles/2020-12-15/tech-giants-risk-breakup-under-strict-eu-digital-rules

have undertaken could be a possible starting point for separation. NZFGC is not aware that the Majors have evidenced their claimed vertical efficiencies.

Motivations for structural separation

3.25. There are strong analogies between the concerns behind the proposed digital platform reforms and supermarkets in New Zealand. The supermarket similarly acts as a gatekeeper, here between grocery suppliers and consumers, has vertical and conglomerate interests, has extreme buyer power due to the high volume of the sales that pass through the platform, and are in a strategically important industry. Supermarkets are a platform.

3.26. Lina Khan identifies various policy motivations and functional goals for structural separations, including eliminating conflicts of interest, preventing companies using protected profits to finance entry into new lines of business, promoting the resiliency of systems, preventing excessive concentration of power and control.[92] She also notes structural separations are highly administrable compared to having to detect, monitor and take enforcement action against discrete acts of wrongdoing.[93]

3.27. Director and head of NERA's European Competition Economics Group, Professor Maier-Rigaud discussed how structural remedies can be seen as less extreme from an economics perspective:[94]

> *"While it is possible to look at remedies from a property rights perspective, ie expropriation versus restriction of use, and therefore consider a divestiture as a harsher remedy than a behavioural one, one may well come to a different conclusion when considering the underlying economics. … Structural remedies make use of the dynamics of markets in removing the incentives for committing similar infringements in the future, thereby eliminating competition problems. Behavioural remedies, on the other hand, do not make use of market dynamics but constrain market forces based on some strategy dimension of the firm, thereby distorting market allocation. As a result, behavioural remedies have a more significant social cost than a property rights approach would suggest. Whenever the underlying competition problem is structural, behavioural remedies will hardly be 'selfexecuting'. … as structural remedies generate revenue from the sale of the relevant asset at current market value, a structural remedy is different from expropriation as the firm is remunerated … behavioural remedies often come with additional trustee costs and ongoing supervision that bears the risk of detracting attention from the firm' s core business. A structural remedy therefore has the added advantage of allowing the firm to move on."*

3.28. Structural remedies are a 'one-off' solution whereas behavioural remedies restrict natural market behaviour and so often require ongoing monitoring, are less effective and lead to greater social cost. For example, the Commission's Mobile Market Study findings considered mobile virtual network operators (**MVNO**) wholesale access in the telecommunications industry did not need to be regulated because the three national

[92] Lina M Khan "The Separation of Platforms and Commerce" (2019) 119 Columbia Law Review 973: https://columbialawreview.org/content/the-separation-of-platforms-and-commerce/ at p1052-1064
[93] Lina M Khan "The Separation of Platforms and Commerce" (2019) 119 Columbia Law Review 973: https://columbialawreview.org/content/the-separation-of-platforms-and-commerce/ at p1063
[94] Frank P Maier-Rigaud (2016) Behavioural versus Structural Remedies in EU Competition Law, chapter 7, 207-224 in: Philip Lowe, Mel Marquis and Giorgio Monti (eds.), European Competition Law Annual 2013, Effective and Legitimate Enforcement of Competition Law, Hart Publishing: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2457594 at p211-212

mobile networks created sufficient competitive conditions at the wholesale level.[95] The existence of a third player therefore avoided the costs of MVNO access regulation.

3.29. The Oxera article explained the rationale for vertical separation as follows:[96]

> *"A number of economic studies have found that, in the absence of regulation, vertically integrated firms tend towards vertical leverage of market power and the foreclosure of third parties that seek to enter the retail (downstream) market by using the wholesale inputs provided by vertically integrated incumbents. The implication is that downstream competition may be limited and, as a result, the incumbent may have little incentive to reduce prices and innovate."*

3.30. The article also provides comments on the potential downsides of separation, a framework for assessing separation and practicable implementation that the Commission may find helpful.[97] NZFGC acknowledges separation comes with costs and other potential downsides, however these must be weighed against the cost and harms of a duopoly retail sector for one of the most fundamental consumer products, groceries. To that end, we agree a thorough cost benefit analysis should be done, and the Commission's work in evaluating the state of competition in the grocery market sector will help contribute to that analysis.

3.31. Other resources the Commission may find helpful are:

a. The Body of European Regulators for Electronic Communications' guidance on functional separation: https://berec.europa.eu/doc/berec/bor_10_44rev1.pdf.

b. Ofcom, UK's communications regulator, outlined several possible models of separation in the below table partially based on Martin Cave's *Six Degrees of Separation*.[98]

[95] https://comcom.govt.nz/__data/assets/pdf_file/0022/177331/Mobile-Market-Study-Findings-report-26-September-2019.PDF finding number F11.
[96] Oxera Agenda "Separating incumbents: panacea or a sledgehammer to crack a nut?" (September 2009): https://www.oxera.com/wp-content/uploads/2018/03/Vertical-separation_1.pdf at p1
[97] Oxera Agenda "Separating incumbents: panacea or a sledgehammer to crack a nut?" (September 2009): https://www.oxera.com/wp-content/uploads/2018/03/Vertical-separation_1.pdf
[98] Ofcom "Strengthening Openreach's strategic and operational independence: Proposal for comment" (July 2016): https://www.ofcom.org.uk/__data/assets/pdf_file/0022/76243/strengthening-openreachs-strategic-and-operational-independence.pdf at p5

Table 1: Models of separation

1. Accounting separation	Separate financial reporting, with costs and revenues of the upstream and downstream products allocated into different baskets
2. Creation of a wholesale division	A separate wholesale division established to supply inputs to competitors, but without equivalence of access
3. Virtual separation	Services offered to internal and external customers on equal terms, without any physical separation of the businesses
4. Functional separation	Physical separation of the business and its processes, e.g. location, staff, branding, management information systems
5. Functional separation with local incentives	Functional separation with separate governance and different management incentives to those of the wider firm
6. Functional separation with independent governance	Creation of a divisional Board with non-executive members who act independently from the group Board
7. Legal separation	Upstream business is established as a separate legal entity within the wider group, but remains under the same overall ownership
8. Structural separation	Split of the vertically-integrated operations into separate legal entities, with no significant common ownership and 'line-of-business' restrictions to prevent them re-entering each other's markets

3.32. The rich and growing body of literature on the topic shows structural separation and divestment does have a place as a competition enforcement tool.

3.33. The Majors' somewhat emotive (and in our view incorrect) claims that structural measures would be 'confiscating property' clearly are not 'consumer focused'. Rex Ahdar's text *The Evolution of Competition Law in New Zealand* when discussing refusals to supply, quotes now Justice Fogarty QC:[99]

> *"It should be obvious that competition law proceeds upon the assumption that not all exercises of property rights are of social worth or in the public interest. It follows that it begs the question to contended that the conduct under scrutiny is an exercise of property or contract rights. Yet, that is a basic stance taken by defendants in many cases."*

3.34. Ahdar goes on to say:[100]

> *"It rather depends on how you see competition law. Is it as an incursion upon some laissez-fair state of nature where companies were originally free to pursue their inherent interest? Or is it an inherent limitation or derogation that was built into the very scope of the rights of their ownership (and their exercise) in the beginning? I prefer the latter view. As Prof John Flynn observed: "anti-trust policy should be viewed as… Part of the fundamental laws defining the scope of property and contract rights, rather than as a bothersome limitation upon the unfettered right to invoke the communities law to exercise such rights."*

3.35. The context is relevant here. The Commission correctly was not satisfied the original Progressive / Woolworths merger would not have the effect of substantially lessening

[99] John G Folk D, "Property and Contract Influence on Competition Law Thresholds" (2001) 9 TPL J149, 151 at footnote 259
[100] Rex Ahdar *The Evolution of Competition Law in New Zealand* (2020) ISBN: 9780198855606 at p188

competition.[101] Woolworths Australia then acquired Progressive when Woolworths Australia possibly could have been a likely entrant. The Majors then each acquired 10% shares in The Warehouse Group, which had a blocking effect of a nascent competitor and undermined its position. The Warehouse Group subsequently withdrew from the grocery market. There was then a merger of the two FSNI companies and there is an ongoing non-compete between the two Foodstuffs co-operatives. The market exhibits an overbuild of brands, restrictive covenants, land holdings and wealth transfers from suppliers and consumers.

3.36. Structural separation would not involve a confiscation of property. If assets were sold there would presumably be a contestable process and a market value established. If there was a demerger, this might simply be a separation and/or there could be a sale value depending on the structure. If instead there were a change in rules enabling franchisees to switch more easily (or to prevent potentially anti-competitive collaborations such as those within or between the Foodstuffs franchises) this would just be facilitating switching.

3.37. We note that Foodstuffs referred to its members as being owner-operator businesses – if so, they should be free to switch which group they choose to be part of. Foodstuffs also suggested that this would be challenging because the cooperative itself held the land.[102] It seems no accident that there is this separation but this could be readily addressed through a sale or lease arrangement. Again, market values (which do not incorporate monopoly rents) should rectify this. In short, there are market solutions to address the structure and conduct of the incumbents, which are consistent with international best practice and economic efficiency. But there are no property rights in monopoly rents. Nor should parties be compensated for their own actions creating anti-competitive conditions. (As an aside Foodstuffs' structure could lead to multiple inefficiencies, eg supplier negotiation at both head office and local level, slow roll-out of internet shopping due to informal turf wars, duplication of management functions. These issues do not appear to have been scrutinised.)

3.38. In the Conference, NERA commented "*Now, coming to the cost of capital, that may not come through in the CAPM WACC. Rather, this is more likely to be regarded as a sort of idiosyncratic or asymmetric risk that would come through in hurdle rates for investment. And for example, the value of waiting for new information or more certainty would mean the real option would be more valuable and therefore it would be more rational for investors to wait. So investment would be delayed as a consequence*".[103] A similar consideration would be investment delayed because of uncertainty arising from the duopoly nature of the market and the risk of incumbent response. NZFGC expects market intervention in these circumstances could lead to greater investment.

3.39. Structural separation is most unlikely to negatively affect investment in New Zealand. The opposite is more likely, that it could positively affect investment because it signals the Government is willing to take action to facilitate competition, making New Zealand a more attractive place to invest in. It would show that New Zealand places strong importance on competition. As the international examples above indicate, structural separation is not out of step with international norms. We are light-handed outliers.

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[101] *Progressive Enterprises Limited and Woolworths (NZ) Limited* NZCC Decision No. 448 at [277]
[102] p30, Quin C, FSNI, Conference Day-6-Transcript ("*we would keep referring back to that generally they have been voluntary in nature, because the ownership of our businesses, our stores, essentially, is basically a structure of an owner/operator who owns the business, employs all of the staff, owns the fixtures and fittings of the business. The land and building is owned by a cooperative in which they are a shareholder, but with protections around what can be removed by shareholders from that cooperative. And a very complex situation to look at to say, how do you sell a store and such.*")
[103] p32 Mellsop J, WWNZ, Conference Day-6-Transcript

4. MARKET OUTCOMES

Overview

4.1. The Majors' challenges to and denials of the Draft Report's market outcomes analyses are flawed.

a. **Profitability analysis:** The self-assessed figures Foodstuffs have substituted for the Draft Report's calculations lack transparency, independence and reliability. Assumptions and allocations are unknown. NZFGC also disagrees that comparisons to international grocery retailers are the most appropriate given other jurisdictions have also had retail grocery competition concerns.

b. **Price analysis:** Market exchange rates are more appropriate for international comparisons than PPP adjusted rates. International price comparisons provide valuable information as part of a broad set of outcome measures and should not be ignored. In addition, any analysis of likely pricing outcomes of intervention needs to account for dynamic effects of competition.

c. **QRS and innovation analysis:** High quality can be consistent with a lack of competition. Late adoption of online offerings by Foodstuffs indicates a lack of competitive pressure to innovate.

4.2. The Commission's competition assessment has been comprehensive and has drawn on many indicators across market structure, market outcomes and market processes (as illustrated by Parts 3, 4 and 5 of this submission and the Draft Report sections and Conference sessions to which they relate). Its recommendations do not rest on merely profitability or price, as the Majors have tried to argue.

Profitability analysis

4.3. As we do not have access to the relevant financial information, NZFGC was unable to scrutinize the Majors' profitability analyses, which reworked the Commission's calculations. We have concerns about information asymmetry and what is not said. For example are rebates and other fees paid by suppliers treated as revenue? Where do transport costs fit in? Does COGS include private label? In the case of Foodstuffs, it is not clear what figures have been used, what the 'whole of business' calculations entail, or who conducted the calculations given Incenta Consulting's report seems to suggest at one point that it was provided figures by Foodstuffs: "*the corresponding performance of the Foodstuffs cooperative* ***that we have been provided***" (emphasis added)[104].

4.4. The Majors' recalculations seem to involve a comingling of economic theory, specific accounting regulations for a particular purpose, opaque and unclear financial information, and commercial and deal negotiation, including for tax reasons. The Majors' continued assertions that their profit is half of that calculated in the Draft Report appears to disregard the danger of mixing those concepts. The different terminology used by the Majors is also confusing.[105]

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[104] https://comcom.govt.nz/__data/assets/pdf_file/0034/265768/Foodstuffs-North-Island-Submission-on-Market-study-into-grocery-sector-draft-report-10-September-2021.pdf at p154, [137] of Appendix A.

[105] For example the Commission noted in the price session at the Conference that Houston Kemp's consultant report for Foodstuffs analysed 'grocery services' rather than 'grocery products' to argue grocery services are not tradeable and so PPP rates should be used.

4.5. The use of averages in the profitability analysis may also hide areas of particular concern, for example categories where supermarket power is strongest e.g. Pak'nSave, New World individual returns. There are risks in relying on averages without understanding the underlying data distribution.

Property ownership assumptions

4.6. The Majors' property ownership adjustments may overstate the effect an assumption of property ownership has on profitability.

a. Experts for FSNI, FSSI and Woolworths acknowledge that if property ownership is included, asset revaluations must be treated as income. Incenta's report used inflation to calculate revaluation income, which likely significantly understates the revaluation because property values have been growing more quickly than inflation. As a result, the total implied revenue with property ownership included is higher than claimed

b. If leases are included, the value of the lease needs to be adjusted and the revaluation treated as income. This doesn't seem to have been done in the adjustments calculated by FSNI, FSSI and NERA.

4.7. Neither NZFGC nor our economic experts, Castalia, were able to rerun the analysis to adjust for revaluations as we do not have access to the underlying data, but doing so would result in higher returns than what the Foodstuffs 'group' and NERA (for Woolworths) have calculated.

Treatment of goodwill

4.8. There seemed to be broad consensus among experts during the conference session on profitability that it is inappropriate to include all of goodwill in the Majors' asset base for the profitability analysis. This is because goodwill captures any monopoly rents due to the pre-existing lack of competition.

4.9. However, it is also undesirable to include part of goodwill because there is no reliable way of valuing what proportion of goodwill is monopoly rents and what proportion is intangible assets. The value of goodwill in an acquisition is often negotiated between parties and can reflect other considerations such as tax. Adjustments would also need to be made to ensure goodwill is not double counted by expenditure to create or maintain goodwill, for example advertising expenses, or goodwill already captured in assets, such as real estate.

4.10. Discussion of goodwill should also bear in mind the conduct of the Majors, and how this could be seen as destroying genuine goodwill of suppliers. For example, a decision by a Major which may be purely financially driven, could be perceived as for some other reason – consumers may trust that the "marketplace" is genuinely unbiased, when in fact it is a competitor through private label and driven by brands. Once delisted or reduced, the brand value and perception by consumers could be permanently damaged.

4.11. Experts for the supermarkets suggested bypassing the goodwill problem by benchmarking supermarket returns against returns of international grocery retailers. However, the returns of international grocery retailers likely also contain some element of monopoly rent given the prevalence of competition concerns in this area. There are numerous examples of competition concerns that have arisen in countries included in the Commission's international ROACE comparison, such as the following:

a. Australia

- ACCC Chair Rod Sims identified supermarkets as a market dominated by a small number of providers recently when speaking about market power in Australia.[106]

- Court finds Coles engaged in unconscionable conduct and orders Coles pay $10 million penalties (2014): https://www.accc.gov.au/media-release/court-finds-coles-engaged-in-unconscionable-conduct-and-orders-coles-pay-10-million-penalties

b. **United Kingdom**

- CMA demands action after Tesco blocks rival supermarkets (2020): https://www.gov.uk/government/news/cma-demands-action-after-tesco-blocks-rival-supermarkets

c. Netherlands

- Concerns over Albert Heijn's market power over competitors (2015+): https://scripties.uba.uva.nl/download?fid=626652

d. United States

- Concerns over Walmart's grocery market dominance (2019): https://edition.cnn.com/2019/06/27/business/walmart-groceries-monopoly-amazon-antitrust/index.html

- "The consolidated buying power and market penetration of big food retailers hurts competition" (2021): https://www.forbes.com/sites/errolschweizer/2021/03/18/anti-trust-is-back/?sh=514624cb3d6b

- Independent Grocers Accuse Big-Boxes Of Edging Them Out (2021): https://www.law360.com/articles/1365709/independent-grocers-accuse-big-boxes-of-edging-them-out

- NGA calls for crackdown on grocery retail 'power buyers' (2021): https://www.supermarketnews.com/retail-financial/nga-calls-crackdown-grocery-retail-power-buyers?NL=SN-09&Issue=SN-09_20210317_SN-09_255&sfvc4enews=42&cl=article_1&utm_rid=CPG06000042923438&utm_campaign=44894&utm_medium=email&elq2=dbf4a4b5ec5c4ac9abd935a321b180aa

- Independent Grocers Demand Congress Investigate Big Grocery (2021): https://progressivegrocer.com/independent-grocers-demand-congress-investigate-big-grocery?utm_source=omeda&utm_medium=email&utm_campaign=NL_PG+Breaking+News&utm_keyword=&oly_enc_id=4002E0408178C0X

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[106] Sims R "Protecting and promoting competition in Australia" (Competition and Consumer Workshop 2021 – Law Council of Australia, 27 August 2021): https://www.accc.gov.au/speech/protecting-and-promoting-competition-in-australia

- NGA To Address Antitrust Laws, Economic Discrimination With Congress (2021): https://www.theshelbyreport.com/2021/03/16/nga-to-address-antitrust-laws-economic-discrimination-with-congress/?static=true

e. Canada

- Canada's competition laws come under scrutiny after grocery business controversies (2021): https://financialpost.com/news/retail-marketing/canadas-competition-laws-come-under-scrutiny-after-grocery-business-controversies

- Competition Bureau should come down hard on grocery store takeovers and price fixing (2021): https://www.thestar.com/business/opinion/2021/03/20/competition-bureau-should-come-down-hard-on-grocery-store-takeovers-and-price-fixing.html

- Federal report urges changes in Canada's grocery store competition laws (2021): https://www.vicnews.com/business/federal-report-urges-changes-in-canadas-grocery-store-competition-laws/

f. Portugal

- Portugal's competition authority fines 6 retail chains 304 mln euros (2020): https://www.reuters.com/article/portugal-retail-fines-idUSL8N2J14ZI

g. Belgium

- Belgian competition authority raids retail chains over suspicious of anti-competitive conduct (2019): https://www.lexgo.be/en/papers/distribution-competition-consumer/competition-law/belgian-competition-authority-raids-retail-chains,128541.html

h. Israel

- Israel's retail food market normally faces slow growth, limited competition, and high prices (2020): https://www.fas.usda.gov/data/israel-retail-foods

- Israel must increase competition in food industry (2021): https://www.jpost.com/israel-news/comptroller-report-reduce-competition-in-food-industry-668416

i. Mexico

- The Mexican grocery retail market has some issues present that mainly affect commercial negotiations between retailers and providers (2019): https://www.oecd.org/competition/competition-policy-in-the-mexican-grocery-retail-industry.htm

4.12. As a result, profitability in international grocery markets cannot be assumed to provide competition benchmarks. International competition concerns should be taken into account when interpreting international profitability comparisons.

4.13. NZFGC recommends that, if goodwill were to be considered, the Commission exclude goodwill for its profitability calculations and then interpret the results with this is mind. That way, what is included in the calculation is clear and objective.

NZX50 comparisons

4.14. NZX50 comparisons are useful to get a sense of the size of profitability compared to other New Zealand businesses and to consider the range and differences. Similar to international comparisons, while they are not perfect comparisons they do provide some insight particularly when interpreted alongside other indicators.

4.15. The 'comparable sectors' listed in paragraph 62 of FSNI's submission are clearly inappropriate. FSNI, which seem to be one of the lowest risk businesses in New Zealand, suggests it should be compared to businesses like Restaurant Brands New Zealand Limited, when restaurant and hospitality businesses are notoriously risky. Sanford is also an incredible risk – it has been badly impacted by the foodservice reduction due to Covid and China trade suspensions. It is also inappropriate to classify real estate, consumer stable products and industrial services as a comparable sector to retail grocery. (Relatedly, to the extent 'land' is included in returns, this is a distinct risk profile to 'retail', so appropriate returns for the two businesses would need to be considered.)

Margins seem above international norms

4.16. Grocery retailing is a high volume, low margin business. The Majors' comments about how their margins are just 'X cents for every dollar spent in store' therefore does not reveal much. FSNI's retail store revenues were $7.5b in 2019 – so even a small margin per dollar of revenue equates to a significant absolute profit. Comparing the size of retail margins to supplier costs reveals even less and no serious argument was made as to why supplier costs should or would be proportionate to retail margins.

4.17. FSNI submitted its NPAT margin is 4%[107] and Woolworths submitted its FY2020 margin is 2.4%[108]. Chron reports "*Grocery store profit margins typically range from 1 percent to 3 percent*"[109] and CSImarket reports net margin on a trailing 12-month basis fell to 1.49% in the third quarter of 2021 for grocery stores[110]. The net profit margin for FY 2019 of the top 250 international grocery retailers is listed in pages 19 to 24 of this Deloitte report.

4.18. In comparison FSNI and Woolworths' margins seem above international norms. As submitted by others, competition seems to be for the 'prized' ability to run a supermarket, with store owners regularly appearing in rich lists and media articles.

Price analysis

Market exchange rates should be used in international price comparisons

4.19. NZFGC would expect that a high proportion of grocery is tradeable. Although grocery retailers have some fixed costs that are localised, supermarkets have effectively said

[107] https://comcom.govt.nz/__data/assets/pdf_file/0034/265768/Foodstuffs-North-Island-Submission-on-Market-study-into-grocery-sector-draft-report-10-September-2021.pdf at p30
[108] https://comcom.govt.nz/__data/assets/pdf_file/0024/265812/Woolworths-NZ-Ltd-Submission-on-Market-study-into-grocery-sector-draft-report-10-September-2021.pdf at [2.1.4.3]
[109] https://smallbusiness.chron.com/profit-margin-supermarket-22467.html
[110] https://csimarket.com/Industry/industry_Profitability_Ratios.php?ind=1305

that these are small as a proportion of total revenue/prices. A high proportion of the Majors' revenue is Cost of Goods Sold: 77.8% for FSNI and 77.6% for FSSI (measured on a WOB basis for the period 2015 to 2019) and 76% for WWNZ[111]. Market exchange rates are therefore more appropriate for international comparisons than PPP adjusted rates.

4.20. NZFGC disagrees with the Majors' attempts to dismiss the relevance of the price analysis because of its insensitivity to profits. What is relevant in interpreting the international price comparisons is not whether prices are the same, but how large the deviations are.

4.21. While international price comparisons are not a perfect indicator, that does not mean they should be ignored. They will still contain valuable information that can be interpreted in the context of other indicators. We note the competition concerns internationally referred to above.

Comparisons to inflation are inappropriate

4.22. Woolworths has observed that retail grocery food price increases have been lower than inflation, with the implication that grocery price levels are not problematic.[112] Equally, this observation can be symptomatic of significant price increases for other goods and services in the CPI basket, such as housing costs. Similarly, FSNI observed "*New Zealand's grocery price inflation is consistent with Australia*".[113]

4.23. These comparisons seem to be simply a deflection away from the problematic structure of the retail grocery sector.

4.24. What would be more relevant would be to consider how retail food prices have varied with changes in underlying costs. However, this is a complex analysis as costs of supply are driven by a wide range of factors. The portfolio of products one buys from the supermarket is also broader than just food.

The Majors have severely understated price benefits of competition

4.25. The Majors contend that interventions in the grocery market would have little beneficial impact on retail grocery prices. However, these assertions are based on:

a. **Underestimated profits**: as discussed above, the Majors appear to have substantially understated profitability, and so will underestimate potential price reductions.

b. **Assumptions of efficiency:** the Majors appear to be assuming that competition will not place greater pressure on them to reduce costs.

c. **A static view of competition:** with extra competitors in the market, consumers may well benefit from new business models that compete much more heavily on price, and less on quality than the existing major retailers. For example, internationally, suppliers such as Aldi provide a budget shopping experience. As

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[111] Para 2.2.3 of the Commission's Draft Report states that WWNZ's gross profit margin was 24.4%.
[112] WWNZ Submission on Commerce Commission Draft Report at [2.1.2.3] ("*The fact that retail grocery food prices have fallen in real terms over the past decade is something that we think Kiwis should know*")
[113] FSNI's Submission on Commerce Commission Draft Report at [128] ("*New Zealand's grocery price inflation is consistent with Australia*")

explained by Alex Sundakov at the Conference, airline deregulation in the US resulted in changes to the level of service provided, accompanied by deep price cuts. As explained by Alfred E Kahn: [114]

> *"… travelers have endured an undeniable increase in congestion, delays, and discomfort. But these are not, in themselves, a sign of failure. After deregulation, low-cost, aggressively competing airlines, such as People Express, offered the public low fares, with correspondingly lower-cost service—narrower seating, longer lines, and fewer amenities. The incumbents responded with very deep discounts, accompanied by similarly poorer service. The enormous response of travelers to the availability of these new options is a vindication of deregulation, not a condemnation, even though the quality of the air travel experience has deteriorated as a result."*

As a result, the impact of competition on prices cannot be estimated through a simple calculation that is based on existing suppliers' profits.

d. **Suppliers' costs remaining constant:** changes in the market structure as a result of more competition could result in suppliers achieving cost efficiencies. For example, as we highlighted in previous submissions suppliers have faced requirements to purchase transportation from the Majors, even when other transport suppliers provide lower cost options. Remedies to this situation, whether as a result of a Code, changes to the market structure, or other forms of intervention, could therefore reduce suppliers' costs, potentially also resulting in lower retail prices.

e. **Averages:** The Majors' focus on average ignores that even small changes in the average price can mask significant changes to prices of individual products.

QRS and innovation analysis

Quality does not equate to competition

4.26. As is evident from the airline deregulation example above, higher quality does not necessarily equate to greater competition and can be consistent with a lack of competition. The focus on quality by many New Zealand supermarkets reflects a lack of pressure on prices, arising from the grocery retailing duopoly and limited pressure from other food options. The higher quality is reflected in the in-store experience in New Zealand, as compared with other countries where competition forces supermarkets to focus on offering lower prices.

4.27. There are analogies which show, prior to 2degrees, that Vodafone and Telecom often competed on (population) coverage not price.

Innovation has been restricted

4.28. One would expect duopolists would want to hold back innovations that could expose them to greater competition, for example innovations that could decrease switching costs like online options. Consequently, Foodstuffs has been slow to develop online options with FSNI New World only launching online deliveries for the first time in 2017. Stores instead favour pick & collect options to keep consumers going to their physical

[114] Alfred E Kahn, "Airline Deregulation" in the Concise Encyclopedia of Economics. https://www.econlib.org/library/Enc1/AirlineDeregulation.html at [4.25]

store. Potentially related is loyalty promotions where New World provides loyalty rewards.

4.29. There is a risk the duopoly market structure has been restricting the growth of online below the level it would be in a competitive market, not only because the Majors are not under competitive pressure to innovate, but also because online challengers do not have a competitive environment to grow in.

4.30. Suppliers see the Majors as blocking innovation. While Foodstuffs stated suppliers choose to supply to Foodstuffs' distribution centre, some suppliers did not feel they had a real choice and were instead forced to adopt these supply arrangements (and thereby offset the cost of development or investment in other infrastructure e.g. transport networks, for Foodstuffs). Suppliers have experienced inefficiencies in Foodstuffs' co-operative structure, such as the need for suppliers to negotiate twice, at a head office level and then again with individual stores who do not accept the terms agreed to by the head office.

Category rationalisation

4.31. Shoppers do not have real choice. Ranging is dictated by margin. Category rationalisations, which have dramatically reduced the number of choices for consumers in categories, have led to manufacturer exit and New Zealand is no longer seen as a place for FMCG manufacturing.

4.32. This adversely affects New Zealand's productivity levels and food security. It also increases concentration in supplier categories and may adversely affect competition at the supplier level.

5. MARKET PROCESSES – COMPETITION NOT WORKING FOR SUPPLIERS OR CONSUMERS

Overview

5.1. While the Majors agreed to a mandatory Code and remedies to improve consumer information, they seem to consider the need for considerable engagement which can delay a solution being implemented. The Commission and the Ministry of Business, Innovation and Employment (**MBIE**) should be aware that steps to delay development and implementation will no doubt be part of the Majors' strategy. It has already been 11 years since the implementation of the UK Code and 6 years since Australia's. Both Foodstuffs and Woolworths have delayed matters through the implementation of their weak voluntary measures.

5.2. Two things are clear:

a. **Competition is not working for suppliers.** A mandatory Code should be introduced immediately. Private label rules and collective bargaining exceptions for suppliers should also be introduced.

b. **Competition is not working for consumers.** We would similarly expect consumer side remedies to be implemented within an appropriate timeframe.

Supplier side competitive processes

5.3. NZFGC has submitted extensively on the harmful procurement practices the Majors have engaged in that have persisted for over a decade. On the final day of the Conference, we heard a single private label manufacturer say that he had never encountered any problems with the retailers. Other suppliers, who are not effectively in-house manufacturers, are not so fortunate.

5.4. Supplier side harms, including harms to the productive economy should not be ignored. A recent United States Department of Justice media release, announcing the filing of a civil antitrust lawsuit against one of the largest book publishers in the world which can exert influence over which books are published in the United States and how much authors are paid for their work, highlights demand-side market power concerns, stating:[115]

> *Courts have long recognized that the antitrust laws are designed to protect both buyers and sellers of products and services, including, as relevant here, authors who rely on competition between the major publishers to ensure they are fairly compensated for their work.*

Immediate introduction of Code

5.5. NZFGC submits that, given acceptance by the Majors, a mandatory Code should be implemented expeditiously. The Code should:

a. **Be based on the UK or Australian model:** Both are principles based, the UK more so, allowing for flexibility for an independent adjudicator to determine whether

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[115] Department of Justice "Justice Department Sues to Block Penguin Random House's Acquisition of Rival Publisher Simon & Schuster" (2 November 2021): https://www.justice.gov/opa/pr/justice-department-sues-block-penguin-random-house-s-acquisition-rival-publisher-simon

conduct should be permissible. NZFGC would accept a Code based on either the UK or Australian model.

b. **Have a UK-style independent adjudicator:** NZFGC expects this would work particularly well in the small New Zealand community where a small manufacturer may already be out of business if they go through the formal process of raising and settling a dispute. The adjudicator could communicate with suppliers and bring up recurring issues to the Majors to allow those retailers the chance to voluntarily fix issues.

c. **Designate the Majors as being subject to the Code:** We are concerned that Foodstuffs does not consider Four Square should be subject to a Code because of the smaller size of its individual stores. Principle-based practice and behaviour can be expected in all of the Majors' business. The Code must reach all parts of the Majors' hierarchy. The threshold for needing to comply with the Code should be based on the retail grocery turnover of a company and all of its interconnected bodies corporate, not individual stores. This is consistent with the fact that even individual Four Square stores benefit from being part of the Foodstuffs co-operative and share in, or can leverage off, the market power those co-operatives hold.

d. **Not take longer than a year to implement:** There is no reason to delay given the principles-based approach of available models and the immediate benefit these could deliver. Greater time spent on attempting to create a 'perfect code' will only have marginal benefits and unnecessarily delay the recognised benefits of a Code. We expect there would be monitoring of how well the Code is working, and for future amendments to further improve on the Code. A Code which is based on core principles with a clear spirit e.g. 'Fair Dealing' can be applied by an ombudsman, adjudicator and the supermarkets themselves and can be implemented quickly.

e. **Include a requirement to demonstrate support for indigenous food and grocery businesses** as part of New Zealand's Treaty of Waitangi commitments.

5.6. There does not need to be further dialogue which risks delay and potential capture. If the Majors were sincere, they could have (as we submitted during the Conference) specified any changes to the UK or Australian Code they considered necessary by now, not 10 years after first discussed as an option.

5.7. At this stage NZFGC considers adopting the UK or Australia Code (**AU Code**) provisions to be an appropriate way to address concerns about use of best price guarantees and exclusive price arrangements. Suppliers should be free to offer specials and differentiated products, especially to support new entrants, without undue pressure from a retailer about the supplier's business with other retailers. The Code provisions on supply contracts and principles of good faith and fair dealing provide a framework for this.

5.8. To assist with the efficient development of a Code, the table at Attachment A contains a provision-by-provision analysis of NZFGC's recommendations for the New Zealand Code based on retailer obligations under the AU and UK Codes. The AU and UK Codes each have their own advantages which the New Zealand Code would benefit from. The AU Code also provides for wholesaler obligations, which are not covered in the table, but NZFGC would expect New Zealand's Code would also provide for wholesaler obligations if there are major grocery wholesalers in the future.

5.9. NZFGC recommends adopting a UK style dispute resolution process (set out in Article 11 of the Groceries (Supply Chain Practices) Market Investigation Order 2009) under which:

i. **Retailers must negotiate in good faith** with the supplier to resolve any dispute arising under the Code.

ii. **Suppliers raise a dispute by informing the retailer's Code Compliance Officer** that the supplier believes the retailer has not fulfilled its obligations and wishes to initiate the dispute resolution procedure. The Code Compliance Officer will confirm whether the supplier wishes to initiate a dispute.

iii. If the dispute is not resolved to the satisfaction of the supplier within 14 days (NZFGC considers the 21 days provided for in the UK Code is too long), then **the supplier can submit an arbitration request**, which the retailer must comply with if it is made before 4 months after the dispute arises.

iv. **Arbitration is administered by an independent grocery adjudicator.** The costs of the arbitrator will be borne by the retailer unless the arbitrator decides the supplier's claim was vexatious or wholly without merit. The other costs of arbitration are assigned at the arbitrator's discretion. The decision of the arbitrator is binding and final.

Collective bargaining

5.10. Collective bargaining could be a useful 'tool' to help reduce the imbalance of bargaining power and result in more efficient outcomes, as well as reducing barriers to entry to the retail market. The Commission should have the power to issue 'block authorisations' or there could be a legislative exception for supplier collective bargaining with the Majors.

5.11. In Australia, the ACCC has the power to grant class exemptions, which it used to allow "*businesses with an aggregated turnover of less than $10 million in the financial year prior to them forming or joining a bargaining group to collectively bargain with customers or suppliers*".[116] NZFGC would recommend a higher turnover threshold for collective bargaining in the context of the New Zealand grocery sector because there are many suppliers who fall above that threshold and still have significantly weaker bargaining positions than the Majors. The power imbalance is much greater here.

5.12. Our previous submissions have identified a lengthy list of issues that suppliers have faced as a result of a significant imbalance of power in negotiating with major grocery retailers.[117] Collective bargaining would allow groups of suppliers that experience common issues in dealing with the Majors to collectively prepare and negotiate terms of supply with supermarkets. In doing so:

a. Efficiencies can be achieved by suppliers and Majors by avoiding time and cost associated with individual engagement.

b. Issues can be raised by the collective as a whole, rather than by an individual supplier, reducing fears of retribution through product deletion.

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[116] https://www.accc.gov.au/public-registers/class-exemptions-register/collective-bargaining-class-exemption-0

[117] For example, see pages 33 to 36 of NZFGC's submission on the Commerce Commission's Draft Report.

c. Small suppliers who could not otherwise afford to invest in specialised expertise can pool together resources and negotiate more effectively with the Majors. Or where a contract has been breached, suppliers could jointly fund legal action in cases where this course of action would have been too costly for a small individual supplier.

5.13. Collective bargaining would be a complementary tool to the Code, particularly for fresh produce growers. It may also be a helpful interim tool if it is implemented before the Code.

5.14. Woolworths submitted it would support collective bargaining by smaller retailers[118] and we understand Foodstuffs stores have formed buying groups in the past. Foodstuffs is still a buying group. Both of the Majors therefore seem to understand there are benefits and advantages of collective bargaining, so it is difficult to understand their opposition against collective bargaining for suppliers (which to us is clearly an inconsistent stance). The Majors' comments that supplier collective bargaining would "reduce competition"[119] is hard to reconcile with current economic thinking and Woolworths' submission (made in relation to collective bargaining by small retailers only) that "*joint buying groups can enhance competition*"[120]. In any case, to avoid concerns about the potential for collective bargaining to lessen competition, collective activity could exclude prices charged by suppliers and instead focus on other terms of supply.

5.15. An additional benefit of collective bargaining is that it could also facilitate retail entry. An entrant grocery retailer faces the cost of negotiating with a large number of suppliers. Collective bargaining would reduce those transaction costs (the time and cost of negotiating individually) and could also help it to achieve supply chain efficiencies by enabling coordination across suppliers on ordering and delivery processes.

Regulation to address the conflicts of interest with private labels

5.16. Taking a forward-looking approach requires consideration of the currently increasing role of private label.

a. In 2019, the Reserve Bank of Australia wrote about the trend of food and non-food retailers adjusting product mixes to incorporate more Own Brand or Private Label.[121]

b. Supermarket News has reported about the growth in private label at the expense of branded products.[122]

c. It's been reported that pre-Covid, 13.8% of every dollar went private label, but this value growth amplified during Covid with now 14.2% of every dollar spent on private label.[123]

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[118] WWNZ Submission on Commerce Commission Draft Report at [18]
[119] For example FSNI's Submission on Commerce Commission Draft Report at [424], FSSI's Submission on Commerce Commission Draft Report at [372.4] and WWNZ Submission on Commerce Commission Draft Report at [7.9]
[120] WWNZ Submission on Commerce Commission Draft Report at [18.2]
[121] https://www.rba.gov.au/publications/bulletin/2019/jun/competition-and-profit-margins-in-the-retail-trade-sector.html
[122] https://supermarketnews.co.nz/news/iri-state-of-the-industry-2020/ and https://supermarketnews.co.nz/wp-content/uploads/2020/11/State-of-the-Industry-2020-FINAL-VERSION-FOR-EVENT.pdf
[123] https://insideretail.co.nz/2020/06/30/the-covid-crisis-reveals-private-labels-winning-formula/

d. It's also been reported that the growth of private label is a disincentive to invest in innovation.[124]

5.17. The duopoly environment means private labels distort incentives of market participants. For example, retailers may take into account how suppliers affect their private label interests and suppliers may feel the need to take into consideration a retailer's private label interest during supply negotiations. NZFGC has provided further evidence, supported by Castalia, of the potential harms from private label is in the New Zealand environment.

5.18. The proposition that local manufacturers benefit from increased volume by supplying private labels assumes that manufacturers would not be able to supply that same product under their own brand. If the manufacturer would have been able to supply the product under their own brand, private label instead makes the manufacturer lose out on brand recognition and makes the brand manufacturer dependent on the retailer, thereby hindering, rather than supporting, growth.

5.19. At a minimum, and consistent with the concerns around platforms in the US and EU, there must be robust rules in place to address the inherent conflict of interest when the market operators then compete in those markets.

5.20. These rules should safeguard and prevent the misuse of confidential information, protect suppliers from being coerced into becoming private label manufacturers (diverting production), prevent supermarkets from requiring and misusing manufacturer IP, and ensure equivalence in treatment – 'buy' side (wholesale) and 'sell' side (retail supermarket) of the platform. Similar rules should apply to 'sponsored' brands and other supermarket-owned businesses. Elements of this are addressed in the AU Code, clauses 24 and 26 (Use of intellectual property and confidential information and Product ranging, shelf space allocation and range reviews in the table above) but all elements need to be addressed.

5.21. NZFGC contemplates a remedy that enables the benefits that private labels can bring but reduces the harms that Castalia and others have recognised. 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.

5.22. 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.

5.23. **Operational separation** may be a 'next best' in terms of achieving this goal. Operational separation measures could include the following requirements:

a. A separate standalone private label business unit operates at arms' length from the business unit that conducts retailing activities (with separate staff etc).

[124] Porter N Shelf life to shelf rife: Why private supermarket brands could kill suppliers | Stuff.co.nz, 10 October 2021

b. Confidential information provided to the retailer by supplier is not provided to staff in the private label business unit.

c. All private label procurement is only conducted by the private label business unit.

d. The retail business unit being prohibited from setting management targets based on private label sales or profitability.

e. Non-discrimination rule – the retailer must not provide preferential treatment to private labels – 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 the private label business unit. The private label business unit must provide separated accounts to demonstrate that even if the private label is required to pay the same charges to the retail business as branded labels, it still covers costs and makes a reasonable return.

5.24. **Structural separation** 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 during the Conference 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 private label. So the regime would still need: (1) to prohibit retailer from setting management (or store owner) targets based on private label sales or profitability; (2) a non-discrimination rule for the retailer.

5.25. 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 (including controlled brands), by product category. (Some form of accounting separation.)

5.26. We heard supermarkets say these options would be unworkable, but it was not clear what they have objected to or why, and their comments seemed to focus on the benefits of private label (which have not been disputed).

5.27. To assist further consideration by the Commission, we provide some brief commentary on non-discrimination rules, line of business restrictions, and self-preferencing conduct below.

Non-discrimination rules

5.28. Non-discrimination rules can support structural divestments and help reduce conflicts of interests. This does not stop the Majors from having private label businesses, rather, it just levels the playing field and requires self-supply to be done on the same basis as supply to third parties. As previously submitted, NZFGC considers non-discrimination rules would be beneficial to address conflicts of interests arising from private labels.

From what we have heard in the Conference, it would also seem non-discrimination rules would be beneficial to address conflicts of interests arising from wholesaling.

5.29. Lina Khan's article which examined five examples of structural separation notes:[125]

> *"…a majority of the separations were coupled with common carriage rules requiring equal access on equal terms. This was the case with railroads, data processing, and telecommunications, further capturing how structural separations and nondiscrimination rules can function as critical complements in the service of nondiscrimination.*"

5.30. Non-discrimination rules have also been:

a. Used in the telecommunications sector in New Zealand and numerous other jurisdictions

b. Been proposed in regards to digital platforms

c. Used as a remedy for vertical mergers, for example in Comcast/NBCU (2009) the merged entity was required to license its content to online video distributors on terms comparable to those in similar licensing arrangements with other video distributors, and to treat all internet traffic the same.[126]

d. Used as a remedy for abuse of market dominance. For example, in 2017 the European Commission adopted a decision fining Google €2.42bn for abusing its market dominance as a general search engine by positioning and displaying Google Shopping more favourably in its general search results pages compared to rival comparison shopping services. In addition to the fine, Google was also ordered to comply with the principle of giving equal treatment to rival comparison shopping services and its own service.[127]

5.31. Similarly, discrimination by dominant incumbents could be seen as breaching section 36 of the Commerce Act even as it now stands. For example, if Majors refused to supply wholesale services (whether constructively or outright) to third party access seekers, or favoured private labels over third-party branded labels.) Even in *Telecom v CLEAR* (1994) 6T TCLR 138 acknowledged that there was an obligation to supply the bottleneck service to the access seeker. While pricing was permitted on an ECPR (opportunity cost) basis, the court accepted the evidence of Dr Khan that this should be on *"the principle of competitive parity".* This meant that there was an obligation to provide the bottleneck service, that this could be priced on an ECPR basis, but that any monopoly rents should be captured in the appropriate (bottleneck) part of the business. (ECPR was of course subsequently expressly disapplied as an access-pricing methodology in the Telecommunications Act.) Their Lordships commented:

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[125] Lina M Khan "The Separation of Platforms and Commerce" (2019) 119 Columbia Law Review 973: https://columbialawreview.org/content/the-separation-of-platforms-and-commerce/ at p1051

[126] Chris Pike "Line of Business Restrictions – Background note" (8 June 2020) OECD: https://one.oecd.org/document/DAF/COMP/WP2(2020)1/en/pdf at [59]; United States v Comcast Corp 808 F Supp 2d 145 (DDC 2011) the court filings are all available at http://www.justice.gov/atr/cases/comcast.html

[127] Chris Pike "Line of Business Restrictions – Background note" (8 June 2020) OECD: https://one.oecd.org/document/DAF/COMP/WP2(2020)1/en/pdf at [81]; European Commission case register AT.39740 Google Search (Shopping): https://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=1_39740

> *"The Baumol-Willig rule itself and Dr Kahn's principle of comparative parity are designed to ensure that Clear and Telecom compete on a level playing field in the area in which they are to be competitors since both will be charged (and therefore hand on to their respective customers) the same amount for use of the PSTN from point alpha onwards."*

5.32. Submissions from actual/potential competitors indicate that they are not being offered access at all, let alone on a non-discriminatory ECPR basis.

5.33. Relevantly other jurisdictions, including the EU, *prohibit excessive pricing*. Such rules can cover prices both to other businesses and consumers, ie for B2B and B2C. For example, on 24 November 2021, it was reported by Global Competition Review that *"Israel seeks first excessive pricing penalty"*.[128] This is yet another international example highlighting just how out-of-touch the comments of the Majors and their experts seem to be. Their comments seem to ignore (or simply not know) about international norms, nor how protected their positions in New Zealand have been and remain, with (historically at least) such a light-handed legal and regulatory framework. Particularly when they are suppliers of necessities.

5.34. In the same way that the expert economists for Telecom suggested regulation was the correct way to address monopoly rents, it must be accepted that regulation is necessary to address these ongoing distortions. Alternatively, regulation may, to some extent, simply be seen as a more efficient way of ensuring compliance with existing law, although regulatory intervention may need to go further. (Clearly given the systematic, deeply entrenched structural and behavioural issues, litigation would be an ineffective and inefficient tool to seek to address the issues.)

5.35. Considering these points (and international regulatory developments discussed in this submission) we believe it is clearly inappropriate and wrong to characterise necessary reforms as anything other than consistent with international best practice. As noted elsewhere such reforms should increase rather than decrease international confidence in New Zealand's standing as an investment destination (as opposed to other outlier jurisdictions where, for example, powerful businesses may be seen as somehow protected.)

Line of business restrictions

5.36. Non-discrimination rules are a form of line of business restriction (**LOBR**). A stronger form of LOBR could be preventing certain parties from engaging in a line of business entirely. LOBRs could restrict grocery retailers from engaging in wholesaling or private label supply and can be used to achieve separation. For example, in the US, the Bank Holding Company Act 1956 prohibited companies holding two or more banks from owning non-banking companies; in 1970 the FCC made an order disallowing television networks from entering the production and syndication markets; and restrictions were placed on telecommunication carriers from entering the data-processing market in 1971.[129]

5.37. The OECD held a round table on line of business restrictions as a solution to competition concerns recently in 2020 (as Commissioner John Small will know

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[128] https://globalcompetitionreview.com/excessive-pricing/israel-seeks-first-excessive-pricing-penalty?utm_source=Israel%2Bseeks%2Bfirst%2Bexcessive%2Bpricing%2Bpenalty&utm_medium=email&utm_campaign=GCR%2BAlerts

[129] Lina M Khan "The Separation of Platforms and Commerce" (2019) 119 Columbia Law Review 973: https://columbialawreview.org/content/the-separation-of-platforms-and-commerce/

first-hand).[130] While the background note considered LOBRs "*are unlikely to be necessary even if a vertically integrated firm favours or 'self-preferences' its own products, as when supermarkets promote or favour the sale of their own-brand products*",[131] this is under the assumption that supermarket chains do not hold market power. This is not the case in New Zealand. The paper goes on to state:

> "*LOBRs are, however, a set of possible solutions to a number of concerns that can arise when a firm has market power*"[132] and that one possible vertical concern is "*the ability and incentive of an upstream dominant firm to exclude in downstream markets by 'self-preferencing' that raises rivals' costs and squeezes their margins, by imitating a successful product distributed on a platform and selling it at much lower prices, or by cross-subsidising its downstream price in order to predate and exclude rivals*".[133]

5.38. As Commissioner Small identified, LOBRs have been used in New Zealand in the telecommunications sector. They have also been proposed in relation to digital platforms.

Self-preferencing conduct may already be prohibited by laws in other jurisdictions

5.39. These remedies are not radical. Self-preferencing conduct may already be captured by antitrust and competition laws in other jurisdictions.

5.40. In the US, section 2 of the Sherman Act provides that "*[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony*". This monopolisation test can capture exclusive dealing, predatory pricing, loyalty discounts, tying, bundled pricing, MFN clauses, refusals to deal and monopoly leveraging.[134]

5.41. In the EU, the European Commission's decision to impose a pecuniary penalty on Google of €2 ,424,495,000 for abusing its dominant position by favouring its own comparison shopping service over competing comparison shopping services was recently upheld by the General Court.[135]

Consumer side competitive processes

5.42. There was a strong consumer response against the confusing price and promotion practices the Majors engage in. There is limited evidence of strong price competition. Frequent promotions, opaque pricing and alternating promotions make it harder to compare retail offerings.

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[130] https://www.oecd.org/daf/competition/line-of-business-restrictions-as-a-solution-to-competition-concerns.htm
[131] Chris Pike "Line of Business Restrictions – Background note" (8 June 2020) OECD: https://one.oecd.org/document/DAF/COMP/WP2(2020)1/en/pdf at [6]
[132] Chris Pike "Line of Business Restrictions – Background note" (8 June 2020) OECD: https://one.oecd.org/document/DAF/COMP/WP2(2020)1/en/pdf at [8]
[133] Chris Pike "Line of Business Restrictions – Background note" (8 June 2020) OECD: https://one.oecd.org/document/DAF/COMP/WP2(2020)1/en/pdf at [9]
[134] Barbara Sicalides & Lindsay Breedlove, Pepper Hamilton LLP "US Monopolisation Cases" (20 November 2019) GCR https://www.lexology.com/library/detail.aspx?g=016d4f45-9c02-49e5-9ffa-90ef53c80b69
[135] General Court of the European Union Press Release NO 197/21 (10 November 2021): https://curia.europa.eu/jcms/upload/docs/application/pdf/2021-11/cp210197en.pdf

5.43. NZFGC would similarly expect consumer side remedies to be implemented within an appropriate timeframe. Consumer NZ made a strong submission which NZFGC agrees with, including that structural separation options must remain live if there are not improvements.

ATTACHMENT A

NZFGC RECOMMENDATIONS FOR NEW ZEALAND CODE BASED ON RETAILER OBLIGATIONS UNDER THE AU AND UK GROCERY CODES

<table>
<tr><th>AU CODE</th><th>UK GSCOP</th></tr>
<tr><td colspan="2">Disclaimer: This table describes provisions of the AU and UK Codes in short form and so is not a substitute for the actual content of the codes.</td></tr>
<tr><td colspan="2">Fair dealing provisions</td></tr>
<tr><td>6B: Obligation to deal with suppliers lawfully and in good faith
• Must at all times deal with suppliers lawfully and in good faith.
• Supply agreement cannot exclude obligation to act in good faith.
• Includes non-exhaustive list of factors that may be taken into account in assessing good faith.</td><td>2: Principle of fair dealing
• Must at all times deal with suppliers fairly and lawfully.
• Fair and lawful dealing understood as requiring the retailer to conduct its trading relationships with suppliers in good faith, without distinction between formal or informal arrangements, without duress and in recognition of the suppliers' need for certainty as regards the risks and costs of trading, particularly in relation to production, delivery and payment issues.</td></tr>
<tr><td colspan="2">NZFGC position: Prefer a UK style fair dealing provision which provides more guidance with a detailed description of what fair and lawful dealing requires. However, either would be acceptable.</td></tr>
<tr><td colspan="2">GROCERY SUPPLY AGREEMENT PROVISIONS</td></tr>
<tr><td colspan="2">Form of grocery supply agreement</td></tr>
<tr><td>• 7: Must not enter into a supply agreement unless it is in writing.
• 8: Supply agreement must specify: delivery requirements, circumstances groceries may be rejected, payment period, circumstances payment may be withheld or delayed, term of agreement (if any), quantity and quality requirements, circumstances agreement may be terminated (if any).</td><td>Article 5 of the Order: Duty to incorporate Code in Supply Agreements
• Must not enter into or perform any supply agreement unless it incorporates the code and does not contain any provisions that are inconsistent with the code.
• Schedule 3 contains force majeure provisions which are not inconsistent with the code.
Article 6(1) of the Order: Must ensure all terms of any agreement with a supplier for the supply of groceries are recorded in writing.
Article 6(8) of the Order: Must confirm with supplier in writing within 3 working days orally agreed terms of subsequent agreements made under or pursuant to a supply agreement.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should require supply agreements are in writing and specify the details in clause 8 of the AU Code. Prefer AU version and would expect subsequent terms to be interpreted as a supply agreement like in the AU Code (making article 6(8) unnecessary).</td></tr>
<tr><td colspan="2">Provision of information to suppliers</td></tr>
<tr><td>(Clause 42 provides for keeping of records, but not provision of such records to suppliers)

(Clause 30 provides for provision of contact details)</td><td>Article 6 of the Order: Duty to provide information to suppliers
• Must not enter supply agreement unless the supplier has a written copy that incorporates all otherwise non-documented terms.
• Must hold written terms of supply agreements and agreements made under or</td></tr>
</table>

<table>
<tr><th>AU CODE</th><th>UK GSCOP</th></tr>
<tr><td></td><td>pursuant to a supply agreement for 12 months after expiry, and must make this available to the supplier on request.
• Must not enter into a supply agreement without first providing the supplier notice of certain information about the code and certain contacts details (this is distinct from the supply agreement), subject to a transitional exception.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should ensure supplier has a written copy of the supply agreement. In that case, it would not be essential to have a supplier right to request written copies from the retailer. Propose that all contract templates should be published on the retailers’ websites. This will improve scrutiny of contracts that are potentially unfair or one-sided. Prefer AU Code’s clause 42 for keeping records for at least 6 years. Consider it would be beneficial to have a supplier notice provision that requires the provision of a standard statement alerting suppliers of their rights under the Code and key contact details, and perhaps linking any official guidance materials.</td></tr>
<tr><td colspan="2">Unilateral variations</td></tr>
<tr><td>9: Unilateral variation of agreement
• Must not vary supply agreement without consent.
• Exception: Agreement expressly provides for variation AND clearly sets out the changed circumstances in which the variation can be made AND sets out the basis for calculating the adjustment (if variation involves quantitative adjustment) AND variation made in accordance with agreement AND variation is reasonable in the circumstances AND supplier given reasonable notice.
• In any dispute, the retailer has the onus of establishing the exception applies.</td><td>3: Variation of Supply Agreements and terms of supply
• Must not vary any supply agreement retrospectively or request or require that a Supplier consent to retrospective variations.
• Exception: Supply agreement clearly and unambiguously sets out specific change of circumstances allowing for such adjustments and detailed rules for calculating the adjustment.
• Must give reasonable notice of any allowed unilateral variation.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should prohibit unilateral variations except in acceptable circumstances. NZFGC prefers AU exception but either is acceptable.</td></tr>
<tr><td colspan="2">Retrospective variations</td></tr>
<tr><td>• 10: Must not vary a supply agreement with retrospective effect.</td><td></td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should prohibit retrospective variations.</td></tr>
<tr><td colspan="2">PAYMENT PROVISIONS</td></tr>
<tr><td colspan="2">Payment delays</td></tr>
<tr><td>12: Payments to suppliers
• Must pay for all products delivered and acceptance in accordance with a supply agreement within the time frame set out in the agreement and, in any case, within a reasonable time after receiving the supplier’s invoice.</td><td>5: No delay in payments
• Must pay for groceries delivered to the retailer’s specification in accordance with the relevant supply agreement, and, in any case, within a reasonable time after the date of the supplier’s invoice.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should provide for payment within a reasonable time. Prefer a clearer provision that requires prompt payment within a specified short timeframe. Grocery retailers sell their goods before they have to pay for them so there is scope to considerably reduce the payment periods to suppliers. 60 – 90 days should be ruled out as being completely unnecessary.</td></tr>
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<table>
<tr><th>AU CODE</th><th>UK GSCOP</th></tr>
<tr><td colspan="2">Payment set-offs</td></tr>
<tr><td>12(2)(a): Must not set off amounts against the supplier's invoice. Exception 1: Supplier consent in writing. Exception 2: Supply agreement provides for amount to be set off and set-off is reasonable (onus on retailer to establish in any dispute).
12(2)(b): Must not require a Supplier to consent to set off. Exception: Supply agreement provides for amount to be set off and set-off is reasonable (onus on retailer to establish in any dispute).</td><td></td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should have similar set off provisions.</td></tr>
<tr><td colspan="2">Payments for marketing costs</td></tr>
<tr><td></td><td>6: No obligation to contribute to marketing costs
Must not directly or indirectly require a supplier to make any payment towards retailer's costs of: buyer visits to new or prospective suppliers, artwork or packaging design, consumer or market research, the opening or refurbishing of a store or hospitality for that retailer's staff.
Exception: Provided for in the supply agreement.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should have similar provision.</td></tr>
<tr><td colspan="2">Payments for shrinkage</td></tr>
<tr><td>13: Payments for shrinkage
Must not enter into a supply agreement under which a supplier is required to make payments as compensation for shrinkage or otherwise require such payments.
This does not prevent discussing or agreeing with a supplier proposals and procedures to mitigate the risk and occurrence of shrinkage.</td><td>7: No payments for shrinkage
Supply agreement must not include provisions under which a supplier makes payments to a retailer as compensation for shrinkage.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should prohibit payments for shrinkage of any kind. Like AU Code, should extend to “otherwise require such payments”, though such conduct would likely breach the fair dealing obligation regardless. Payment of any kind for theft should be prohibited as this is entirely a retailer cost which the supplier cannot control.</td></tr>
<tr><td colspan="2">Payments for wastage</td></tr>
<tr><td>14: Payments for wastage
Must not directly or indirectly require a supplier to make any payment to cover any wastage of groceries incurred at the premises of the retailer, their contractor or agent or any other entity that is a retailer or wholesaler.
Exception: Supply agreement sets out expressly and unambiguously the circumstances, which could include</td><td>8: Payments for wastage
Must not directly or indirectly require a supplier to make any payment to cover any wastage of that supplier's groceries incurred at that retailer's stores.
Exception 1: Such wastage is due to the negligence or default of the supplier AND the supply agreement sets out expressly and unambiguously what will constitute negligence or default of the supplier.</td></tr>
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<tr><th>AU CODE</th><th>UK GSCOP</th></tr>
<tr><td>negligence, in which the supplier will be required to make such payments AND the wastage occurs in such circumstances AND the basis of the payment is set out in the supply agreement AND the payment is reasonable having regard to the retailer’s costs incurred by the wastage AND the retailer takes reasonable steps to mitigate those costs.
• In any dispute, the retailer has the onus of establishing the exception applies.
• If the supply agreement provides for the supplier to make wastage payments and the supplier seeks to negotiate a variation relating to wastage payments, the retailer must not in the course of negotiations or as a precondition to entering the negotiations, seek to negotiate other variations of the agreement.</td><td>• Exception 2: The basis of such payment is set out in the supply agreement.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should prohibit wastage payments except in acceptable circumstances. Should also have protections against intentional store damage. Prefer AU exception but either is acceptable.</td></tr>
<tr><td colspan="2">Payments as a condition of being a supplier</td></tr>
<tr><td>15: Payments as a condition of being a supplier
• Must not require a supplier to make any payment as a condition of stocking or listing grocery products.
• Exception 1: Payment is made in relation to a promotion (subject to clause 18).
• Exception 2: Payment is required under the supply agreement AND made in respect of groceries that have not been stocked, displayed or listed by the retailer during the preceding 365 days in 25% or more of its stores AND is reasonable having regard to the costs and risks to the retailer in stocking, displaying or listing the grocery products.
• In any dispute, the retailer has the onus of establishing an exception applies.</td><td>9: Limited circumstances for payments as a condition of being a supplier
• Must not directly or indirectly require a supplier to make any payment as a condition of stocking or listing that supplier’s grocery products.
• Exception 1: Payment is made in relation to a promotion.
• Exception 2: Payment is made in respect of grocery products which have not been stocked, displayed or listed by that retailer during the preceding 365 days in 25% or more of its stores, and reflects a reasonable estimate by that retailer of its risk in stocking, displaying or listing such new grocery products.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should prohibit payments as a condition of being a supplier except in acceptable circumstances. Prefer AU exception but either is acceptable.</td></tr>
<tr><td colspan="2">Payments for better positioning of groceries</td></tr>
<tr><td>16: Payments for better position of groceries
• Must not require a supplier to make any payment to secure better positioning or an increase in allocation of shelf space for a grocery product.
• Exception 1: Payment is required under the supply agreement AND the agreements sets out the particular circumstances in which the</td><td>12: No payments for better positioning of goods unless in relation to promotions
• Must not directly or indirectly require a supplier to make any payment in order to secure better positioning or an increase in shelf space allocation for any of the supplier’s grocery products within a store.</td></tr>
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<tr><th>AU CODE</th><th>UK GSCOP</th></tr>
<tr><td>payment may be required AND the payment is reasonable having regard to the additional benefits (if any) to the supplier and the costs and risks to the retailer of allocating additional or different shelf space.
• Example: A supply agreement may provide for a supplier to make a payment in relation to the promotion of the supplier’s product.
• In any dispute, the retailer has the onus of establishing the exception applies.</td><td>• Exception: Such payment is made in relation to a promotion.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should prohibit payments for better positioning of groceries except in acceptable circumstances. Prefer AU exception but either is acceptable.</td></tr>
<tr><td colspan="2">Payments for retailer’s business activities</td></tr>
<tr><td>17: Payments for retailer’s business activities
• Must not directly or indirectly require a supplier to make any payment towards the costs of any activity that is undertaken by the retailer in the ordinary course of carrying on a business as a retailer or wholesaler.
• Includes a non-exhaustive list of what a retailer’s business activity includes.
• Exception: The supply agreement provides for the payment AND the payment is reasonable in the circumstances.
• Includes a list of factors to have regard to in assessing whether payment is reasonable.
• In any dispute, the retailer has the onus of establishing the exception applies.</td><td></td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should have a similar provision.</td></tr>
<tr><td colspan="2">PROMOTION PROVISIONS</td></tr>
<tr><td colspan="2">Funding promotions</td></tr>
<tr><td>18: Funding promotions
• Must not directly or indirectly require a supplier to fund part or all of the costs of a promotion.
• Exception: Supply agreement provides for the funding AND the funding is reasonable in the circumstances.
• Includes list of factors to have regard to in assessing whether funding is reasonable.
• In any dispute, the retailer has the onus of establishing the exception applies.</td><td>13: Promotions
• Must not directly or indirectly require a supplier predominantly to fund the costs of a promotion.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should prohibit suppliers funding promotions except in acceptable circumstances. Prefer AU exception but either is acceptable.</td></tr>
<tr><td colspan="2">Funded promotions</td></tr>
<tr><td>(Funded promotions = Promotions of a product which suppliers agree to make a payment in support of.)</td><td>13: Promotions
• Must only hold funded promotions after reasonable notice has been given to the supplier in writing.</td></tr>
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<tr><td>20(1): May only hold a funded promotion only after giving the supplier reasonable written notice.
20(3): If products are ordered in connection with a funded promotion:
• Must not cancel the order or reduce the volume of the order by more than 10%.
• Exception 1: Supplier’s written consent.
• Exception 2: Reasonable written notice of the cancellation or reduction.
• Exception 3: Compensation for any net resulting costs, losses or expenses suffered by the supplier as a direct result of failure to give reasonable notice.</td><td>• Must not require or request a supplier to participate in a promotion where this would entail a retrospective variation to the supply agreement.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should include a similar provision, including a similar provision to the AU Code’s clause 20(3).</td></tr>
<tr><td colspan="2">Investment buying</td></tr>
<tr><td>20(2): If products are ordered from a supplier in connection with the funded promotion at a promotional price:
• Must ensure the basis on which the quantity of the order is calculated is transparent.
• Must not over-order.
• Must pay the supplier the different between the supplier’s promotional price and the supplier’s full price for any over-ordered product sold at or below the promotional resale price.</td><td>14: Due care to be taken when ordering for promotions
• Must take all due care to ensure that when ordering groceries from a supplier at a promotional wholesale price, not to over-order.
• If fail to take such steps, must compensate the supplier for any groceries overordered and subsequently sold at a higher non-promotional retail price.
• Compensation will be the difference between the promotional wholesale price paid and the supplier’s non-promotional wholesale price.
• Must ensure that the basis on which the quantity of any order for a promotion is calculated is transparent.</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should include a similar provision and also to ensure pass through of promotional discounts.</td></tr>
<tr><td colspan="2">OTHER CONDUCT</td></tr>
<tr><td colspan="2">Delisting</td></tr>
<tr><td>19: Delisting products
• May only delist a supplier’s grocery product in accordance with the supply agreement and for genuine commercial reasons (retailer onus to establish in any dispute).
• Includes a definition for delisting which includes the reduction of the distribution of the product likely to have a material effect on the supplier.
• Includes a non-exhaustive list of genuine commercial reasons for delisting.</td><td>16: Duties in relation to de-listing
• May only de-list a supplier for genuine commercial reasons.
• The exercise by the supplier of its rights under any supply agreement or the failure by a retailer to fulfil its obligations under the code or Order will not be a genuine commercial reason to de-list.
• Prior to delisting must provide reasonable notice to the supplier of the retailer’s decision to de-list, including written reasons for the retailer’s decision, inform the supplier of its right to have the decision reviewed by</td></tr>
</table>

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• Delisting as a punishment for a complaint, concern or dispute raised by a supplier is not a genuine commercial reason. • Prior to delisting, must provide reasonable written notice of decision to delist which includes the genuine commercial reasons for delisting, informs the supplier of their right to have the decision reviewed by the retailer's senior buyer for the supplier, informs the supplier of their right to complain to the Code Arbiter for the retailer, and includes the contact details of the Code Arbiter. • Exception 1 to providing reasonable written notice: Time is of the essence. • Exception 2 to providing reasonable written notice: There are persistent issues with supply that resulted in the retailer being out of stock or stocked at significantly reduced levels. • Senior buyer must promptly comply in writing to any written request from the supplier for a statement of the retailer's genuine commercial reasons for delisting or information relating to the delisting. • Senior buyer must, after receiving a written request from the supplier, promptly review any retailer delisting decisions and provide the supplier with written notice of the outcome of that review, including the basis for the retailer's decision. • A decision not to extend a supply agreement or enter a new supply agreement following the expiry of a fixed term supply agreement is not a decision to delist a product.	a Senior Buyer, and allow the supplier to attend an interview with the retailer's code compliance officer to discuss the decision to de-list. • Reasonable notice will include providing the supplier with sufficient time to have the decision to de-list reviewed by the Senior Buyer and in the interview with the Code Compliance Officer.
NZFGC position: Agree with the expanded definition of delisting in the AU code. Reasonable notice in the current environment of long lead time logistics (imports and packaging suppliers) needs to be between 3-6 months.	
Changes to supply chain procedures	
22: Changes to supply chain procedures • Must not directly or indirectly require a supplier to make any material change to supply chain procedures during the period of the supply agreement. • Exception: Reasonable written notice. • Exception: Compensation for any net resulting costs, losses or expenses incurred or suffered by the supplier as a direct result of the failure to give reasonable notice. Supplier can waive right to compensation.	**4: Changes to supply chain procedures** • Must not directly or indirectly require a supplier to change significantly any aspects of its supply chain procedures during the period of a supply agreement. • Exception: Reasonable notice in writing. • Exception: Full compensation of any net resulting costs incurred as a direct result of failure to give reasonable notice.

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NZFGC position: Agree the Code should have a similar provision. We do not, at this time, see the need for the supplier having the right to waive compensation.	
Threats of business disruption and termination	
23: Business disruption • Must not threaten a supplier with business disruption or termination a supply agreement without reasonable grounds.	
NZFGC position: Agree the Code should have a similar provision.	
Use of intellectual property and confidential information	
24: Intellectual property rights • Must respect the supplier's IP rights in relation to grocery products, including IP rights in branding, packaging and advertising. • This provision does not create, confer or extend any IP rights in or of the supplier. • Must not infringe the supplier's IP rights in developing or producing own brand products. • In any dispute relating to a breach of this clause, any relevant actions of the supplier in relation to the retailer's IP rights must be taken into account. **25: Confidential information** • Must not use confidential information (disclosed by a supplier in connection with the supply of grocery products) other than for a purpose for which it was disclosed. • May only disclose or make such confidential information available or accessible to employees or agents who need to have the information in connection with that purpose. • Must establish and monitor systems to ensure compliance. • Information is not confidential information if it is publicly available or comes into the retailer's possession or knowledge independently of the supplier and without breach. **27: Transfer for intellectual property rights** • Must not directly or indirectly require a supplier to transfer or exclusively license any IP right held by the supplier in relation to a grocery product as a condition or term of supply of an equivalent own brand product of the retailer. • This does not prevent the retailer from holding IP rights in own brand products, having exclusive rights of retail sale in own brand products, making the holding of such retailer rights as a condition or term of	

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supply by the supplier of an own brand product of the retailer to the extent the product, recipe or formulation of the product was developed, formulated or customised by or for the retailer.	
NZFGC position: Agree the Code should have similar provisions.	
Product ranging, shelf space allocation and range reviews	
26: Product ranging, shelf space allocation and range reviews • Must publish or provide to all suppliers the retailer has supply agreements with the retailer's product ranging principles and the retailer's shelf space allocation principles. • Must act in accordance with these principles and keep them up to date. • Within a reasonable time before conducting a range review, must provide suppliers who might be affected by any outcome of the review with clearly expressed written notice of the purpose of the range review and the key criteria governing ranging decisions. • Following the range review, must provide affected suppliers with a reasonable period of time to discuss the outcomes of the review, including the basis for the retailer's final decisions. • Must apply principles without discrimination (including without discrimination in favour of own brand products).	
NZFGC position: It is essential that the Code has these provisions.	
Price increases	
27A: Price increases • Within 30 days of being informed by a supplier in writing of a price increase, must notify the supplier in writing whether the retailer accepts the price increase, accepts an increase but does not accept the amount of the increase, or does not accept the price increase. • If retailer does not accept the amount or the price increase, the supplier may request the retailer to enter into negotiations about a price increase. • Must engage in such negotiations in good faith and take all reasonable steps to conclude position on the negotiations without delay. • Must not require the supplier to disclose commercially sensitive information in relation to the price increase nor the negotiations.	

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<tr><td>Does not affect rights of a supplier to determine the price of groceries that the supplier supplies.
27B: Information about price increases
Must give to Code Arbiter, in sufficient time for the information to be included in the Code Arbiter's report, certain information about price increase notifications.</td><td></td></tr>
<tr><td colspan="2">NZFGC position: Agree the Code should have similar provisions.</td></tr>
<tr><td colspan="2" align="center">Freedom of association</td></tr>
<tr><td>29: Freedom of association
Must not provide an inducement to prevent a supplier from forming an association of suppliers or associating with other suppliers for a lawful purpose.
Must not discriminate, or take any other action, against a supplier for forming an association of suppliers or associating with other suppliers for a lawful purpose.</td><td></td></tr>
<tr><td colspan="2">NZFGC position: Agree the Code should have a similar provision.</td></tr>
<tr><td colspan="2" align="center">Forecasting errors</td></tr>
<tr><td></td><td>10: Compensation for forecasting errors
Must fully compensate any cost incurred by a supplier as a result of any forecasting error in relation to grocery products attributable to the retailer.
Exception 1: Good faith AND due care AND consultation.
Exception 2: Supply agreement includes an express and unambiguous provision that full compensation is not appropriate.
Must communicate to supplier the basis on which any forecast is prepared.</td></tr>
<tr><td colspan="2">NZFGC position: Agree the Code should have a similar provision.</td></tr>
<tr><td colspan="2" align="center">Tying</td></tr>
<tr><td></td><td>11: No tying of third party goods and services for payments
Must not indirectly or indirectly require a supplier to obtain any goods, services or other property from any third party where that retailer obtains any payment for this arrangement from any third party.
Exception 1: The supplier's alternative source for those goods, services or property fails to meet the reasonable objective quality standards laid down for that supplier by the retailer for the supply of such goods, services or property.
Exception 2: The supplier's alternative source charges more than any other third party recommended by the retailer.</td></tr>
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<tr><td colspan="2">NZFGC position: Agree the Code should have a similar provision.</td></tr>
<tr><td colspan="2">Payments for consumer complaints</td></tr>
<tr><td></td><td>15: No unjustified payment for consumer complaints
• Must not directly or indirectly require a supplier to make any payment for resolving a consumer complaint.
• Exception if complaint can be resolved in store by retailer refund or replacement: The payment does not exceed the retail price of the grocery product charged by the retailer AND the retailer is satisfied on reasonable grounds that the consumer complaint is justifiable and attributable to the supplier’s negligence or default or breach of a supply agreement.
• Exception if complaint cannot be resolved in store by retailer refund or replacement: The payment is reasonably related to the retailer’s costs arising from the complaint AND the retailer has verified that the complaint is justifiable and attributable to supplier negligence or default AND the retailer has made a full report to the supplier about the complaint including the basis of the attribution AND the retailer has provided the supplier with adequate evidence.
• May agree with the supplier an average figure for payments for resolving customer complaints as an alternative to following the above. This average figure must not exceed the retailer’s expected costs of resolving such complaints.</td></tr>
<tr><td colspan="2">NZFGC position: Agree the Code should have a similar provision.</td></tr>
<tr><td colspan="2">Specific product category provisions</td></tr>
<tr><td>21: Fresh produce standards and quality specifications.
27A(1)(c): Price increases in respect of fresh fruit and vegetables.</td><td></td></tr>
<tr><td colspan="2">NZFGC position: Other participants will be better placed to comment on this. If further consultation is required, further provisions can also be added at a later stage so as not to delay the implementation of the base code.</td></tr>
<tr><td colspan="2">ADMINISTRATIVE PROVISIONS</td></tr>
<tr><td colspan="2">Dispute resolution provisions</td></tr>
<tr><td>30: Provision of contact details
• Must make available to suppliers and keep updated contact detailers of its buyers and senior buyers for the supplier and its Code Arbiter.
• Contact details must include position titles and contact telephone numbers.</td><td>17: Senior Buyer
• A retailer’s Senior Buyer will, on receipt of a written request form a Supplier, review any decisions made by the Retailer made in relation to the Code or Order.
• Must ensure that supplier is made aware, as soon as reasonably practicable, of any</td></tr>
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<tr><th>AU CODE</th><th>UK GSCOP</th></tr>
<tr><td>31-36D: Code Arbiter
37-37F: Independent Reviewer
38-39: Mediation and arbitration</td><td>change to the identity and / or contact details of the Senior Buyer for that supplier.
Article 11 of the Order: Dispute Resolution</td></tr>
<tr><td colspan="2">NZFGC position: Agree Code should require the provision of contact details and to provide for a Senior Buyer role. Prefer the UK's framework of having a Senior Buyer, Code Compliance Officer, and an independent adjudicator. Having different Code Arbiters for each retailer and an Independent Reviewer is not preferred as the Independent Reviewer usually will only be able to consider the Code Arbiter's process in dealing with complaints. Expect the independent adjudicator would have a more collaborative and active role than the Independent Reviewer, allowing them to develop a greater understanding of supplier and retailer relationships.</td></tr>
<tr><td colspan="2">Compliance provisions</td></tr>
<tr><td>40: Duty to train staff with respect to code
• Must provide buying team with a copy of code and training on requirements of code within 6 months of being bound by code.
• Must provide the same to new persons to the buying team within 20 business days.
• Must provide annual retraining to buying team on the requirements of the code.
42: Keeping records
• Copies of certain documents must be kept for at least 6 years.</td><td>Article 8 of the Order: Duty to train staff
• Must provide buying team with a copy of the code and training on the requirements of the Order and code.
• Must provide new persons to the buying team with a copy of the code within 1 week and training within 1 calendar month.
• Must provide annual retraining to buying team at least once each calendar years.
Article 9 of the Order: Duty to appoint in-house compliance officer and role of the compliance officer.
Article 10 of the Order: Code Compliance Officer annual compliance report to be submitted to the OFT, copied to the GCA.
Article 7 of the Order: Supply of information
• Must provide to OFT information and documents which the OFT reasonably requires for the purposes of monitoring and reviewing the operation of the Order.
• May be required by OFT to keep, maintain and produce those records.
• May be required by OFT to attend and provide in person information which may be relevant to the monitoring or review of any provision of the Order if the OFT reasonably believes the designated retailer to have such information.</td></tr>
<tr><td colspan="2">NZFGC position: Agree the Code should have similar provisions. Either versions of the staff training duties would be acceptable. We consider it would be beneficial for designated retailers to have an in-house code compliance officer.</td></tr>
</table>