COMMERCE COMMISSION NEW ZEALAND
Te Komihana Tauhokohoko

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Statement of Issues

Foodstuffs North Island/Foodstuffs South Island

4 April 2024

Introduction

1. On 15 December 2023, the Commerce Commission (the Commission) registered a clearance application (the Application) from Foodstuffs North Island Limited (FSNI) and Foodstuffs South Island Limited (FSSI) (together, the Parties) seeking clearance to merge into a single national grocery entity, together with potentially also the existing Foodstuffs (N.Z.) Limited entity (the Proposed Merger).[1]

2. As required by the Commerce Act 1986[2] (the Act), we assess mergers and acquisitions using the substantial lessening of competition test, which we describe further below.

3. To grant clearance for the Proposed Merger, we must be satisfied that it will not have, or would not be likely to have, the effect of substantially lessening competition in any market in New Zealand.

4. This Statement of Issues (SoI) sets out the competition issues on which we are not currently satisfied following our initial investigation. This is so the Parties and other interested parties can provide us with submissions relating to those issues.

5. In reaching the preliminary views set out in this SoI, we have considered information provided by the Parties and other industry participants. We have not yet made any final decisions on the issues outlined below (or any other issues) and our views may change, and new competition concerns may arise, as the investigation continues.

The issues we are continuing to investigate

6. We are continuing to investigate the competitive effects of the Proposed Merger.

7. As detailed in this SoI, we are considering whether competition in upstream market(s) for the acquisition of groceries and/or downstream market(s) for the retail supply of groceries would be substantially lessened with the Proposed Merger.

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1 A public version of the Application is available on our website at: http://www.comcom.govt.nz/businesscompetition/mergers-and-acquisitions/clearances/clearances-register/. As noted in the Application at [12], FSNI and FSSI propose to carry out the Proposed Merger by way of amalgamation under Part 15 of the Companies Act 1993.

2 Commerce Act 1986, s66(3).

8. We are continuing to explore the possible competitive effects of the Proposed Merger in these markets, but are currently not satisfied that the Proposed Merger would not substantially lessen competition.

9. We explain our reasons for our current views below and invite submissions on them.

Process and timeline

10. We have agreed with FSNI and FSSI to extend the period in which to make a decision until **31 May 2024**. Further extensions may be agreed between the Commission and the Parties.

11. We invite submissions and supporting evidence from the Parties and other interested parties on the issues raised in this SoI. We request responses by close of business on **18 April 2024**, including a confidential and public version of any submission made where relevant. All submissions received will be published on our website with appropriate redactions.[3] All parties will have the opportunity to cross-submit on the public versions of submissions received from other parties. Cross-submissions must be received by close of business on **30 April 2024**.

12. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with us before 18 April 2024 at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

The Parties and the Proposed Merger

13. The Parties submit that they currently comprise two separate co-operatives jointly presenting a national bricks-and-mortar and online retail grocery offering through common retail grocery brands (New World, PAK'nSAVE and Four Square).[4] The Parties further submit that they have a close relationship, share ownership of some trading and non-trading entities (eg, Foodstuffs (N.Z.) Limited and Foodstuffs Own Brands Limited) and work together in a range of ways (including in relation to marketing, brand alignment, private label products and other initiatives).[5] Despite the interrelationship between the Parties, FSNI and FSSI are separate legal entities and are not currently interconnected bodies corporate.

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

[4] The Application at [2] and [24].

[5] The Application at [4] and [20].

14. FSNI is owned by 332[6] co-operative members all based in the North Island and FSSI is owned by 198[7] members all based in the South Island. The members operate individual retail and wholesale grocery stores.

15. FSNI members operate under the following retail grocery brands:[8]

    15.1 New World;

    15.2 PAK'nSAVE; and

    15.3 Four Square.

16. FSSI members operate under the following retail grocery brands:[9]

    16.1 New World;

    16.2 PAK'nSAVE;

    16.3 Four Square;

    16.4 Raeward Fresh; and

    16.5 On the Spot.

17. As well as operating retail grocery stores, the Parties operate wholesale grocery businesses through which they supply grocery products to foodservice customers, route trade customers and other retailers. In this regard:

    17.1 FSNI operates Gilmours Wholesale Limited (Gilmours) in the North Island;[10] and

    17.2 FSSI operates Trents Wholesale Limited (Trents) in the South Island.[11]

18. Both FSNI and FSSI are also subject to legal obligations to provide wholesale grocery offerings to retailers, as required by the Grocery Industry Competition Act 2023 (GICA).[12]

19. The Proposed Merger would see FSNI and FSSI merge by way of a Court-approved amalgamation under Part 15 of the Companies Act 1993. With the Proposed Merger,

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6 45 PAK'nSAVE, 108 New World, 172 Four Square and 7 Gilmours wholesale members.

7 12 PAK'nSAVE, 43 New World, 60 Four Square, 72 On The Spot, 5 Raeward Fresh and 6 Trents wholesale members. FSSI also has a number of additional non-branded members. The Application at footnote 12.

8 The Application at [25].

9 The Application at [32].

10 FSNI also has a 25% share of Fresh Connection Limited, a produce wholesaler specialising in foodservice. The Application at [29]-[30].

11 The Application at [2] and [36]-[38].

12 The Application at [49]-[50].

the Parties would consolidate within and under the management of a single national grocery entity. Foodstuffs (N.Z.) Limited may also be included in the amalgamation.[13]

20. We discuss in more detail what might change with the Proposed Merger later in this SoI.

Our framework

21. As noted in our earlier Statement of Preliminary Issues and earlier in this SoI, the Act requires us to assess mergers and acquisitions using the substantial lessening of competition test. The Act, together with relevant case law, governs the way in which we consider all mergers, including the Proposed Merger. Our approach to this assessment is also based on the principles set out in our Mergers and Acquisitions Guidelines (Guidelines).[14]

22. We determine whether a merger or acquisition is likely to substantially lessen competition in a market by considering what would change with a merger. We do so by comparing the likely state of competition if a merger proceeds (the scenario with a merger, often referred to as the factual), with the likely state of competition if a merger does not proceed (the scenario without a merger, often referred to as the counterfactual).[15] This allows us to assess the degree by which the Proposed Merger might lessen competition.

23. Whether or not a lessening of competition as a result of a merger is substantial depends on the particular circumstances.[16] It is the degree to which competition has been lessened which is critical. A lessening of competition does not need to be felt across an entire market, or relate to all dimensions of competition in a market, for that lessening to be substantial. A lessening of competition that adversely affects a significant section of the market may be enough to amount to a substantial lessening of competition.[17] Further, in markets that are already concentrated, a smaller change in competition with a merger may amount to a substantial lessening of competition than would be the case in markets that are less concentrated to begin with.[18]

24. In considering the Application and assessing whether the Proposed Merger is likely to substantially lessen competition, our focus is on what would change with the Proposed Merger. Unless we are satisfied that any lessening of competition as a result of the Proposed Merger is not likely to be substantial, we cannot give clearance. We have been considering the impact of the Proposed Merger in markets where the Parties compete to buy goods (acquisition markets) and in markets

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13 The Application at [13.2]. We do not consider our assessment of the Proposed Merger is impacted by whether or not Foodstuffs (N.Z.) Limited is directly included in the amalgamation: even if it is not directly included in the amalgamation, it will remain in the Foodstuffs group as a wholly owned subsidiary of the merged entity.

14 Commerce Commission, Mergers and Acquisitions Guidelines (May 2022).

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

16 *ANZCO Foods Waitara Ltd v AFFCO NZ Ltd* (2005) 11 TCLR 278 at [240] (CA).

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

18 M Sumpter, *New Zealand Competition Law and Policy* (CCH, Auckland, 2010) at 186-187, discussing the decision in *Air New Zealand v Commerce Commission* (2004) 11 TCLR 347 (HC).

whether the Parties compete to supply goods (selling markets). When making these market-specific assessments, we have been considering, and will consider, among other matters:

24.1 how much actual or potential competition between the Parties could be lost as a result of the Proposed Merger – in other words, the extent to which the Parties compete with each other today (as a potential indication of what competition may be lost in future with the Proposed Merger), or might be likely to compete with each other in the future in the absence of the Proposed Merger;

24.2 the constraint from existing competitors to the Parties:

24.2.1 in acquisition markets, the extent to which Woolworths New Zealand Limited (Woolworths) and other existing purchasers of groceries compete with the Parties, and the degree to which they may expand their purchases in the future; and

24.2.2 in selling markets, the extent to which Woolworths and other existing grocery retailers compete with the Parties and the degree to which they would expand their sales if prices increased;

24.3 the constraint from potential new entry:

24.3.1 in acquisition markets, the extent to which new purchasers of groceries would enter the market and compete if prices decreased or the merged entity worsened any aspect of the arrangement with suppliers; and

24.3.2 in selling markets, the extent to which new competitors would enter. In particular, the extent to which new grocery retailers would:

24.3.2.1 enter retail grocery markets and compete if prices increased, quality reduced, innovation declined or other elements of service or competition reduced (eg, worse or less frequent promotions); or

24.3.2.2 be deterred from entering retail grocery markets if the Proposed Merger created a stronger duopolist, more able to inflict losses on an entrant;

24.4 the countervailing power of other market participants:

24.4.1 in acquisition markets, the countervailing power of suppliers of grocery products to the Parties in markets in which the Parties acquire grocery products; and

24.4.2 in selling markets, the countervailing power of customers.

25. We note that there are important commercial dependencies between markets that are relevant to our assessment but are not covered in the above discussion of acquisition and selling markets. Supermarkets are two-sided markets (platforms) because there are indirect network externalities and the volume of trade depends on price structures. For example, market power in acquisition markets likely derives from scale or market share in selling markets.

26. Under a separate part of the Act, the Commission completed a market study into the retail grocery sector in March 2022, and the GICA was passed in 2023 empowering the Commission to monitor and report on competition and efficiency in the grocery sector for the long-term benefit of consumers. The market study and GICA form part of the background for our consideration of the Proposed Merger.

27. Several submissions on our Statement of Preliminary Issues suggested that we should require some form of divestment before, or instead of, granting clearance to the Proposed Merger.[19] We have no such power. It is a matter for the Parties to determine whether to offer a divestment undertaking and the scope of any such undertaking: we cannot require a divestment (only a court has that power). We can also only accept structural undertakings by the Parties to divest assets or shares, meaning that some of the alternative remedies/measures suggested by submitters (such as to prohibit loss leader strategies and eliminate private label brands)[20] are outside the scope of our powers in a merger context.[21]

28. Further submissions on our Statement of Preliminary Issues raised concerns that any benefits or efficiencies achieved by the Parties with the Proposed Merger would not ultimately be passed on to consumers.[22] Efficiencies passed to consumers are relevant to our assessment if the Parties can satisfy us that they would be realised in a timely fashion, that they would not likely be realised without the Proposed Merger, and that they would be passed on to consumers sufficiently to prevent a substantial lessening of competition.[23] We are still considering the extent to which any benefits or efficiency gains expected to arise from the Proposed Merger might be relevant to our assessment of the Proposed Merger.

29. Finally, several submissions query whether the Parties' current relationship amounts to cartel conduct (which would be in breach of Part 2 of the Act).[24] To this end, we

[19] Submissions to the Commerce Commission from Anonymous C (25 January 2024), Grocery Action Group (9 February 2024), Lisa Asher (9 February 2024), Monopoly Watch (27 February 2024) and Northelia (27 February 2024).

[20] Submission to the Commerce Commission from Anonymous C (25 January 2024).

[21] Further information regarding divestments (including the relevant legal framework, how we analyse divestments, our process for considering divestments and the type of content a divestment undertaking may include) can be found at Attachment F of our Mergers and Acquisitions Guidelines above n14.

[22] Submissions to the Commerce Commission from The Warehouse (9 February 2024), Lisa Asher (9 February 2024) and the Food and Grocery Council (19 February 2024).

[23] Further information regarding how the Commission considers efficiencies can be found at page 32 of our Mergers and Acquisitions Guidelines above n14.

[24] Submissions to the Commerce Commission from Ernie Newman (5 February 2024), Grocery Action Group (9 February 2024), Lisa Asher (9 February 2024), the Food and Grocery Council (19 February 2024), and Monopoly Watch (27 February 2024).

note that only a Court can decide whether a breach of cartel laws has occurred. Our role in this context is to determine whether or not we are satisfied that the Proposed Merger is not likely to substantially lessen competition. Evidence relating to the existing relationship between the Parties may be relevant to that decision including because it informs what may occur in the factual (with the Proposed Merger) and counterfactual (without the Proposed Merger).

Framework for assessing the counterfactual

30. To assess whether the Proposed Merger is likely to substantially lessen competition requires us to compare the likely state of competition if the Proposed Merger proceeds, with the likely state of competition if it does not. This requires us to make a pragmatic and commercial assessment of what is likely to occur with and without the Proposed Merger, based on information we obtain through an investigation.[25]

31. As the High Court in *Woolworths* noted there can be more than one likely scenario without a merger (ie, more than one likely counterfactual). This is because a scenario can be likely even if it has less than an even (less than 50%) chance of occurring, provided there is a real chance of that scenario occurring. The High Court considers that likely means something less than "more likely than not", but something more than only a remote prospect of occurring. To be likely, there must be a real and substantial possibility of a scenario occurring. The High Court has also directed that where more than one counterfactual is 'likely', it is not a case of choosing the one counterfactual that has the greatest prospects of occurring.[26]

32. Ultimately, if we consider that a substantial lessening of competition is likely when the Proposed Merger is compared against any real chance counterfactual, we must decline to give clearance. Practically, we may choose to focus on a single counterfactual that is the most competitive. However, in complex cases involving multiple markets it may be appropriate for us to consider different likely counterfactual scenarios, or different aspects of the same counterfactual, for the assessment of the different markets or competitive effects of the Proposed Merger.

Commission may amend or depart from previous Guidelines

33. The Commission publishes and acts in accordance with its Guidelines. The Guidelines are general and necessarily cannot cover every situation that may arise.

34. We are considering the extent to which it is necessary to apply or modify Chapter 4 of the Guidelines, 'How we assess mergers between competing buyers' for the purposes of the Proposed Merger. We may decide it is not necessary to modify or depart from the Commission's Guidelines as the matters set out in Chapter 4 are broad, but we consider it is appropriate to signal that we may do so.

35. As noted by the Court of Appeal in *NZME v Commerce Commission*, the Commission is equipped to develop its Guidelines within the statutory framework and it is the

[25] Mergers and Acquisitions Guidelines above n14 at [2.29] and [2.35].
[26] *Woolworths & Ors v Commerce Commission* (2008) 8 NZBLC 102,128.

Court's responsibility to assess its decisions against that statutory framework.[27] Ultimately it is the statutory test that matters.

36. The Guidelines were substantially revised in 2013, and have been updated incrementally since then. In July 2019, the Commission updated Chapters 6 and 7, and noted that it intended to update other substantive chapters.[28] Separate to this matter, the Commission intends to update Chapter 4 in the future. That update will be subject to its own process, similar to the process the Commission has followed previously.

37. The need to update Chapter 4 arises from the same general matters discussed in Houston Kemp's helpful submission on behalf of the Parties.[29] Namely, the growing economic consensus around the distinction in buyer-side markets between applying a 'monopsony power framework' and a 'bargaining framework'. As Houston Kemp submits, it is "critical to apply the relevant economic lens, including as to whether a bargaining or monopsony power framework is appropriate (including that both may be appropriate for different buyer/supplier interactions), because the economic consequences can differ considerably between the frameworks."[30]

38. Chapter 4 of the Guidelines do not currently address the distinction between the frameworks. The Commission itself has previously adopted a bargaining framework in a non-merger context during its 2022 market study into the retail grocery sector.

39. We generally agree with Houston Kemp's preference for using a bargaining framework to analyse competition in the acquisition markets relevant to this matter. However, we do not necessarily agree with their conclusions or their approach to the way in which an increase in buyer-side market power may lead to a substantial lessening of competition. Within a bargaining framework we are currently interested in whether a substantial lessening of competition may be likely if the Proposed Merger results in:

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

39.2 a reduction in choice or quality of groceries for retail consumers;

39.3 exit by suppliers from the acquisition market;

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

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

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27 *NZME v Commerce Commission* [2018] NZCA 389, at [75]. As the Court noted in *NZME*, the Court did not suggest that the Commission was bound to apply its Guidelines in that case (at fn 93).

28 See our Mergers and Acquisitions Guidelines above n14 at cover page.

29 Houston Kemp Report for the Parties (7 March 2024).

30 Houston Kemp Report for the Parties (7 March 2024) at [29].

40. We are also considering the extent to which a substantial lessening of competition may occur whether or not there is a reduction in volume or output. We note many of these effects are dynamic and interrelated to each other. We discuss these issues further in the relevant sections below.

How the Proposed Merger could substantially lessen competition

41. In this section, we outline how the Proposed Merger could potentially substantially lessen competition and discuss the broad markets (or levels of the supply chain) in which we currently consider any substantial lessening of competition could arise. In later sections, we discuss in more detail the potential competitive effects of the Proposed Merger in specific markets.

42. The stated commercial rationale for the Proposed Merger is to create a world-class, customer-driven national food and grocery retailer and wholesaler.[31] The Parties submit that with the Proposed Merger they would combine the best aspects of both co-operatives.[32] [33] They also submit that the Proposed Merger would lead to cost reductions (including overhead and product costs), efficiency gains, increased agility and innovation and a more cohesive national offering, which would ultimately deliver better value for retail consumers at the checkout, and enhance competition.[34] The Parties further submit that increasing retail competition (and our role under the GICA) should ensure significant pressure on the merged entity to pass through the benefit of savings and efficiencies to consumers.[35]

43. With the Proposed Merger, the number of distinct major retail and wholesale suppliers of grocery products and buyers of grocery products would be reduced. The management and operation functions of the support centres for each of FSNI and FSSI would merge, although there would be no effect on local store ownership.[36] The merged entity would have a national footprint with stores operating in both the North and South Islands and one central head office similar to Woolworths.

44. Table 1 explains how the Parties' operations in each functional level of the grocery sector might change with the Proposed Merger.

Table 1: Functional levels of grocery sector

Functional level	How Parties currently operate	How Parties might operate following the Proposed Merger
Acquisition of groceries	Generally, the Parties separately acquire from, and negotiate supply terms with, suppliers of grocery products. However, they undertake	The purchasing functions of FSNI and FSSI would consolidate under the management of a single national entity, meaning the merged entity

31 The Application at [19].
32 The Application at [20].
33 [ ]
34 The Application at [6] and [20].
35 The Application at [7].
36 The Application at [5].

Functional level	How Parties currently operate	How Parties might operate following the Proposed Merger
	some joint buying, including in terms of private label products purchased via Foodstuffs Own Brands Limited.[37]	would acquire from, and negotiate supply terms nationally with, suppliers of grocery products for all New World, PAK'nSAVE, Four Square, Raeward Fresh and On the Spot stores, and also Gilmours and Trents wholesale outlets. The merged entity would also make decisions on the products that would be ranged and stocked, although the Parties submit that there is a high degree of alignment in ranging at the retail level already.[38] The Parties further submit that the Proposed Merger would not have any impact on the quantity of grocery products acquired by the Parties, overall or in any geography, and is not expected to change the Parties' strategy associated with the acquisition of groceries.[39] Relatedly, the Parties currently operate separate and distinct distribution networks in the North Island and South Island. The merged entity would instead operate a single distribution network, with seven distribution centres and a further seven transport depots across New Zealand.
Wholesale supply	The Parties' wholesale operations are currently separate (including FSNI and FSSI's regulated wholesale offerings pursuant to the GICA, and FSNI and FSSI's commercial wholesale offerings through Gilmours and Trents). That said, the Parties already work closely together (including through Gilmours and Trents) to supply national wholesale customers.	The wholesale offerings of the Parties (including regulated wholesale offerings pursuant to the GICA, and through Gilmours and Trents) would consolidate within and under the management of a single national wholesale grocery entity.

37 The Application at [128].
38 The Application at [122].
39 The Application at [132].

Functional level	How Parties currently operate	How Parties might operate following the Proposed Merger
Retail supply	The Parties currently comprise two separate co-operatives. This means a number of decisions at the retail level are made separately by each co-operative (eg, pricing). That said, despite currently operating as separate co-operatives, the Parties have a close relationship at the retail level and work together in a range of ways (including in relation to marketing, brand alignment, private label products and other initiatives).[40] They submit that they present as a single national bricks-and-mortar and online retail grocery offering through common brands (New World, PAK'nSAVE and Four Square).[41]	With the Proposed Merger, the retail offerings (including all brands and stores) of FSNI and FSSI would consolidate within and under the management of a single national retail grocery entity. At the retail level, the merged entity would operate, and input into the pricing, promotional activity, product ranging and competitive strategies for, all New World, PAK'nSAVE, Four Square, Raeward Fresh and On the Spot stores across New Zealand. The merged entity would have access to a larger combined set of data on retail sales and customer insights that may influence its retail strategies.

Acquisition of groceries

45. Our main concerns at present with the Proposed Merger relate to the potential for the merged entity's buyer power to result in unilateral and coordinated effects in upstream market(s) for the acquisition of groceries. We are also considering this as one of the ways in which competition in downstream retail grocery markets could be impacted by the Proposed Merger. We discuss this issue in the next section.

46. Currently and absent the Proposed Merger there would be three major grocery retailers that acquire grocery products from suppliers in New Zealand (FSNI, FSSI and Woolworths), with some joint buying by the Parties. With the Proposed Merger, there would only be two major grocery retailers that acquire grocery products from suppliers in New Zealand (being the merged entity and Woolworths).

47. Some parties have raised issues about the impact of the Proposed Merger on markets for the acquisition of groceries and suppliers' increased vulnerability in negotiating trade terms and being squeezed on margins,[42] suggesting that the merged entity would have an ability to exercise greater buyer power. As noted above, the Parties submit that the Proposed Merger would lead to cost reductions, a significant portion of which would be passed on to retail consumers.[43] We note that the cost savings from the Proposed Merger would arise from a combination of cost

40 The Application at [4] and [20].
41 The Application at [2] and [24].
42 See submissions to the Commerce Commission from Anonymous B (23 January 2024), Anonymous C (25 January 2024), Lisa Asher (9 February 2024) and the Food and Grocery Council (19 February 2024).
43 The Application at [6]-[7] and [20].

savings and buying benefits. The Parties'
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48. We are continuing to investigate the extent to which:

48.1 the Proposed Merger would increase the merged entity's buyer power (in comparison to FSNI and FSSI separately), which may enable it to:

48.1.1 negotiate lower prices it pays for goods from suppliers and/or otherwise obtain terms of supply more favourable to the merged entity; or

48.1.2 give the merged entity greater ability and incentive to increase the penetration of private label products (potentially resulting in some suppliers of branded grocery products getting squeezed out and less choice/range for consumers);

48.2 the reduction from three to two major acquirers of groceries in New Zealand (ie, reduced customers or supply options for grocery suppliers) with the Proposed Merger may result in fewer opportunities for new or innovative suppliers or products to be sold by the major grocery retailers, slowing the pace of product innovation (and ultimately reducing the range and quality of grocery products available); and

48.3 the Proposed Merger may increase the potential for the merged entity and Woolworths to coordinate their behaviour to obtain lower prices and/or more favourable trade terms with suppliers.

Retail supply of groceries

49. We also see potential issues with the Proposed Merger in downstream markets for the retail supply of groceries, in terms of both unilateral and coordinated effects.

50. Some third parties have raised issues about the impact of the Proposed Merger on markets for the retail supply of groceries.[45]

Unilateral effects

51. Unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining

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44 [
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45 Submissions to the Commerce Commission from Ernie Newman (5 February 2024), Grocery Action Group (9 February 2024), The Warehouse (9 February 2024), Lisa Asher (9 February 2024), the Food and Grocery Council (19 February 2024), Monopoly Watch (27 February 2024) and Northelia (27 February 2024).

competitors) such that a merged firm can exercise market power in supplying goods.[46]

52. The Proposed Merger could potentially give rise to unilateral effects in retail grocery markets if it would:

52.1 result in a loss of actual or potential competition at the retail level between FSNI and FSSI; and/or

52.2 increase the barriers to entry and/or expansion by third parties in retail grocery markets.

53. On the first point, the Parties submit that there is no existing competition between FSNI and FSSI at the retail level, as they operate in separate geographies (islands) and each co-operative focuses on competing within the island in which it is based.[47] The Parties further submit that the Proposed Merger would not remove any potential competition, as the only realistic counterfactual is that FSNI and FSSI would continue to operate in their own islands, not in competition with each other. The Parties would continue to have a relationship to manage the fact that FSNI and FSSI are both trading under common retail brands and present as a single national retail offering.[48]

54. We are continuing to consider what the Parties would likely do absent the Proposed Merger, in order to assess whether the Proposed Merger would result in a loss of (or remove the potential for) competition at the retail level between FSNI and FSSI. We are exploring whether there is a real chance that the Parties would compete at the retail level in the counterfactual. This counterfactual is discussed in more detail separately in confidential attachments to this SoI.

55. On the second point, we are considering a number of ways in which the Proposed Merger could increase the barriers to entry and/or expansion by third parties in retail grocery markets, including through:

55.1 change in the Parties' buyer power in the acquisition of groceries impacting on the ability of rival grocery retailers to acquire groceries on terms which allows them to compete effectively;

55.2 advantages the merged entity gains (over smaller scale retailers) from having access to a larger combined set of data on retail sales and customer insights to influence its retail strategies; and/or

55.3 the ability of the merged entity to deter entry and/or expansion though strategically targeted price cuts or other behaviour.

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46 Mergers and Acquisitions Guidelines above n14 at [4.2].

47 The Application at [112].

48 The Application at [97], [99] and [115].

Coordinated effects

56. We are continuing to investigate the extent to which retail grocery markets are already vulnerable to coordination and whether the Proposed Merger could increase the likelihood, completeness and sustainability of coordination between the merged entity and Woolworths.

57. We are considering whether retail grocery markets may be vulnerable to coordination. This includes assessing:

    57.1 whether there is a potential mechanism through which the Parties could coordinate such as reaching an understanding on the relative prices set in each supermarket chain or when to carry out promotions; and

    57.2 whether other conditions in retail grocery markets are suitable to monitor and sustain the coordinated agreement, such as the number of competitors and level of barriers to entry.

58. We are considering whether the Proposed Merger would make coordination more likely or more complete. Currently and absent the Proposed Merger, there would be three major supermarket retailers in New Zealand (FSNI, FSSI and Woolworths), with the Parties having a close relationship at the retail level and working together in a range of ways (including in terms of their common brands). With the Proposed Merger there would only be two major national supermarket retailers (being the merged entity and Woolworths). As a consequence, the Proposed Merger could make the merged entity and Woolworths more similar in structure, and make it easier for them to coordinate.

Wholesale supply of groceries

59. We have considered the potential for the Proposed Merger to raise competition issues in any markets for the wholesale supply of groceries, in terms of both wholesale foodservice customers (eg, cafes, restaurants, fast food outlets, caterers) and wholesale retailer customers (eg, dairies, fuel stations, independent grocery stores and other retailers), and in terms of both commercial and regulated wholesale supply.

60. The competitive effects of the Proposed Merger on markets for the wholesale supply of groceries is not currently a focus of our investigation, and we do not consider such markets any further in this SoI. This is because we consider that the merged entity would face competitive constraint in wholesale markets from other wholesalers, and wholesale customers buying in other ways (in particular, direct from grocery suppliers). However, interested parties are welcome to submit on the competitive effects of the Proposed Merger at the wholesale level.

Potential impact of Proposed Merger on the acquisition of grocery products

61. The Proposed Merger would reduce the number of major buyers of grocery products from grocery suppliers, from three to two.

62. We are concerned about the competitive harm this could have in upstream markets for the acquisition of groceries. In summary:

62.1 the Proposed Merger could create unilateral effects through providing the merged entity with greater buyer power. The reduction in competition could emerge in different ways, for example:

62.1.1 the merged entity may be able to extract lower prices and more favourable terms from suppliers. This increase in buyer power may also reduce the ability of suppliers to invest, resulting in effects such as reduced capacity, quality or innovation in the supplier's market;

62.1.2 the merged entity may have greater ability and incentive to increase the penetration of private label products (potentially resulting in some suppliers of branded grocery products getting squeezed out and less choice/range for consumers); and/or

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

62.2 the Proposed Merger could create coordinated effects by increasing the ability and incentive for the merged entity and Woolworths to coordinate their behaviour to collectively exercise market power in upstream markets.

Market definition

63. Market definition is a tool that helps identify and assess the close competitive constraints a merged entity is likely to face. We define markets in the way that we consider best isolates the key competition issues that arise from a specific merger or acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Act, as a matter of fact and commercial common sense.[49]

The Parties' submissions

64. The Parties do not consider it necessary to conclusively define any relevant markets for the acquisition of groceries, given they operate in separate geographies.[50] In considering the effects of the Proposed Merger on the acquisition of groceries, the Parties submit that they offer a consistent brand position across the country, and that suppliers treat them as a single national channel to market.[51]

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49 Section 3(1A). See also *Brambles v Commerce Commission (2003) 10 TCLR 868* at [81] and Mergers and Acquisitions Guidelines above n14 at [3.7]-[3.10].

50 The Application at [73].

51 The Application at [80].

65. The Application notes that (despite their different retail footprints geographically) there is a high degree of alignment in ranging as between FSNI and FSSI, with over [ ]% overlap in stockkeeping units. In addition, [ ].[52]

66. The Parties further submit that, to the extent that suppliers are geographically constrained, whether their products are targeted to (or demanded by) specific geographic areas or because the products have a short shelf life, such as fresh produce or milk, relevant markets may be smaller (eg, island-wide, regional or even local). In these cases, the Parties submit that given the Parties do not have any geographic overlap, only one of the Parties will be a customer and it is not necessary to define the markets with more precision.[53]

Our current view

67. The standard approach that we use to assess the boundaries of selling markets is to identify those products and geographic locations which are close substitutes to those supplied by the Parties. For acquisition markets, the relevant approach is to assess the alternative channels and geographic locations that suppliers would view as close substitutes to the Parties. That is, if the major grocery retailers were to reduce the price they paid to suppliers, would those suppliers switch to other channels and other geographic locations?

68. The Parties acquire goods from thousands of suppliers. These range from large multinationals that manufacture or import larger ranges of products, to small local suppliers that supply a small number of products, potentially to a localised area of stores.[54] These suppliers cover the full range of products available in supermarkets. The relevant market may differ between each type of supplier and might even differ for each supplier.

69. Some suppliers may find other channels as being substitutable to the major grocery retailers. This will depend on how easily the supplier can adapt their product for those alternative channels. Other channels that goods might be supplied into include:

    69.1 wholesalers such as Bidfood and Service Foods;

    69.2 foodservice customers such as restaurants and hotels;

    69.3 direct to retail consumers; and

    69.4 exports (where suppliers are in a position to direct volumes into export markets).

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52 The Application at [122].
53 The Application at [81].
54 For example, [ ].

70. The options available to suppliers could differ between product categories, raising the potential for narrower markets by category. It is also possible that different types of suppliers within the same category have different options. For example, some suppliers may face specific barriers that means that they are not capable of supplying to any channels other than the major grocery retailers. It may therefore be justified to define a narrow market for these suppliers comprising only the major grocery retailers.

71. The geographic areas that suppliers could switch their products into appear to be dependent on the type of product or category into which the product falls.

    71.1 Some suppliers of fresh produce and products with a short shelf may only be able to supply the products locally or regionally.

    71.2 Due to the small size of the New Zealand domestic market, it makes sense for some suppliers to supply both islands from the same site (or a small number of sites). For example, we understand that a supplier will typically have a single manufacturing site from which they supply both the North Island and South Island, with fewer examples of suppliers (usually large suppliers) having multiple manufacturing sites.[55] In the case of frozen goods and dry groceries, we understand that suppliers will often supply both FSNI and FSSI from the same physical manufacturing site.[56]

    71.3 Some suppliers have the ability to export products. For example, we understand that many domestic suppliers of meat, fish, dairy wine are also exporters.

72. For the reasons above it may be appropriate to define markets on a local, regional, national or even global basis. For example, it may be appropriate to define local or regional markets for (say) some perishable goods but national or global markets for (say) some frozen goods. At this stage, we have not defined the dimensions of any market for the acquisition of grocery products more precisely. Due to the thousands of products available at supermarkets, it may not be practical to fully assess substitution in the supply chain for all products that are affected by the Proposed Merger. However, we are continuing to investigate whether there are particular product categories or types of suppliers for which the effects of the Proposed Merger are likely to be heightened or lessened, such that they are meaningful to assess in our analysis.

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55 Commerce Commission interview with [ ].

56 For example, [ ]. See Commerce Commission interviews with [ ], [ ], [ ], and [ ].

73. We invite submissions on our approach to market definition and for parties to provide us with further evidence on the scope of markets relating to the acquisition of groceries. In particular, we are interested in:

73.1 any barriers suppliers face in switching between different channels or from supplying domestically to export;

73.2 how suppliers have reacted in the past when the major grocery retailers have changed their price or other terms relating to the acquisition of groceries; and

73.3 whether there are any particular product categories or types of suppliers for whom there would be few other options other than the major grocery retailers.

Unilateral effects

74. Similar to a merger between competing suppliers, a merger between competing buyers may lessen competition, which is equivalent to increasing the merged firm's market power when buying products.[57]

75. We consider that a substantial lessening of competition that arises from a merger between competing buyers could emerge in different ways.

75.1 First, a merged entity may have the ability to profitably depress prices paid to suppliers to a level below the competitive price for a significant period of time such that the amount of product acquired is reduced.

75.2 Second, where prices are determined by bilateral negotiation between a buyer and seller, a merger may increase a merged entity's bargaining power such that it may have the ability to negotiate a lower price for the acquisition of the same amount of input. This could adversely affect the ability of the supplier to make the same level of investments resulting in such effects as reduced capacity, quality or innovation in the supplier's market.

76. With the Proposed Merger, the separate purchasing functions of FSNI and FSSI (for both their retail and wholesale businesses) would consolidate under the management of a single national entity. The merged entity would acquire from, and negotiate supply terms with, suppliers of grocery products for all New World, PAK'nSAVE, Four Square, Raeward Fresh and On the Spot stores, and also all Gilmours and Trents wholesale outlets.[58] The merged entity would operate seven distribution centres and a further seven transport depots across New Zealand.

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57 Mergers and Acquisitions Guidelines above n14 at [4.1].

58 Although we note that individual store owners also procure some of their product through direct negotiations with suppliers. The prevalence of direct procurement by stores varies according to a variety of factors, including whether it is a member of FSNI or FSSI, the banner, the product category, and geography. This is discussed in more detail further below.

The Parties' submissions

77. The Parties submit that the Proposed Merger is not capable of lessening competition in any market for the acquisition of grocery products from suppliers, because in their view:[59]

77.1 the co-operatives operate in different territories with different physical distribution infrastructure, and that they do not meaningfully compete to acquire groceries from suppliers;

77.2 the Proposed Merger would have no effect on the volume of groceries the Parties acquire (either overall or in any geography) and that there is joint procurement already occurring which would effectively continue following the Proposed Merger;

77.3 the Parties offer a brand positioning that is consistent across the country (which inevitably results in a high level of consistency in range) and that suppliers treat the Parties as single national channel to market, so there would be no material difference in their bargaining position with respect to smaller and larger suppliers with and without the Proposed Merger; and

77.4 product cost savings and efficiencies are expected to arise from the Proposed Merger.

78. The Parties further submit that:

78.1 a buyer's ability to achieve lower prices is not in and of itself a lessening of competition;[60]

78.2 a three-to-two merger is not a fact-based characterisation of the way buying occurs;[61]

78.3 the supplier relationship with each of the co-operatives is likely to differ significantly between suppliers;[62]

78.4 there may be some limited, temporary competition between the co-operatives during periods where there might be insufficient or limited supply in fresh produce;[63]

78.5 there is a different market dynamic for fresh produce (ie, seasonal influences and supply and demand);[64] and

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59 The Application at [6], [80], [110.3], [118]-[119], [131]-[132], and cross submission from the Parties (7 March 2024) at [23].

60 Cross submission from the Parties (7 March 2024) at [5].

61 Cross submission from the Parties (7 March 2024) at [102].

62 Houston Kemp Report for the Parties (7 March 2024) at [43].

63 Houston Kemp Report for the Parties (7 March 2024) at [93].

64 Houston Kemp Report for the Parties (7 March 2024) at [78]

78.6 there should be no meaningful effect on suppliers' ability to negotiate with the Proposed Merger.[65]

79. The Parties also submit that:

79.1 many suppliers have a strong negotiating position in relation to certain products, for example those that are in concentrated markets where there are limited alternatives, or where suppliers offer well-known brands which consumers consider to be a "must have" item;[66] and

79.2 there is significant market power on the supplier side, for instance in the fresh produce category[67] and there is a spectrum of options available to suppliers (other than through export) to supply fresh produce into.[68]

Summary of our current view

80. As noted above, with the Proposed Merger, there would be a three-to-two reduction in the number of major grocery retailers acquiring groceries from suppliers, with FSNI and FSSI consolidating their operations and acquisition capabilities.

81. We are continuing to explore the issues set out in this SoI, but we are currently not satisfied that the Proposed Merger would not substantially lessen competition due to unilateral effects in markets for the acquisition of groceries. This is based on our current view that in the factual, the merged entity may be able to unilaterally extract more favourable terms from suppliers than it would in the counterfactual because of an increase in its bargaining power relative to suppliers. This may cause immediate harm to suppliers regardless of whether the merged entity purchases less product from them. In addition, we are concerned that harm may also arise if suppliers have less ability and incentive to invest and innovate over time because the subsequent imbalance of bargaining power increases risk and reduces their profitability.

82. This is because, based on our current evidence:

82.1 FSNI and FSSI each present separate opportunities for suppliers to negotiate listings, prices, other terms of trade and contract renewals. FSNI and FSSI thus form part of the 'outside option' available to suppliers in their dealings with each buyer individually. Following the Proposed Merger, for suppliers who may not have the ability to divert supply through other channels (ie, through other grocery retailers, export, wholesale, foodservices and direct to retail consumers) this would reduce their major customers by one, and the merged entity would account for more of a suppliers' total business. The value of those suppliers' outside option would consequently be reduced. In contrast, the merged entity would continue to have many suppliers from whom it could acquire grocery products, with little to no change in its outside options;

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65 Cross submission from the Parties (7 March 2024) at [106].
66 The Application at [132.3].
67 Cross submission from the Parties (7 March 2024) at [7].
68 Houston Kemp Report for the Parties (7 March 2024) at [85].

82.2 FSNI and FSSI sometimes compete directly for volume (eg, for fresh produce in periods of short supply) where growers may not be able to supply all major grocery retailers and tend to go about seeking the best return for their product;[69]

82.3 FSNI and FSSI both invest in new product development (NPD), but present separate opportunities for new suppliers, or existing suppliers with new products, to get these new products listed;

82.4 other existing grocery retail competitors, including Woolworths, may not be sufficient to materially constrain the merged entity and prevent a substantial lessening of competition in the acquisition of grocery products from suppliers. Beyond Woolworths, other existing grocery retail competitors are of smaller scale and/or focus on different offerings within different geographic areas. Barriers to entry and expansion have the potential to inhibit rival grocery retailers from purchasing more products from suppliers;

82.5 the bargaining power of some suppliers may not be significantly affected by the Proposed Merger where they have "must have" products and/or strong brand positioning; and

82.6 as noted earlier, cost savings from the Proposed Merger would arise from a combination of cost savings and buying benefits. [ ].[70]

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

84. We discuss further, in turn below:

84.1 the extent of competition between FSNI and FSSI;

84.2 the level of constraint provided by other rival acquirers of grocery products;

84.3 the countervailing power of suppliers;

84.4 the reduction in options for new and innovative suppliers or new products; and

69 Houston Kemp Report for the Parties (7 March 2024) at [93], and Commerce Commission interviews with [ ] and [ ].

70 [ ]

84.5 other areas of investigation which relate to the extent of increased buyer power (including the potential increase in private label, the move towards centralisation and the ‘waterbed effect’).

The extent of competition between FSNI and FSSI

85. We have considered the degree of constraint that the Parties impose on one another in the acquisition of grocery products from suppliers, to assess how closely they compete and the extent of competition that would be lost with the Proposed Merger.

86. In doing so, we have considered:

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

86.2 how closely the Parties have competed to date in acquiring grocery products; and

86.3 the likely impact of the Proposed Merger on suppliers from removing one of the major customers.

87. Some suppliers consider that in practice, in terms of the way in which the Parties acquire groceries, there is limited competitive tension between the two co-operatives, including no mechanism with which they can play the Parties off against each other, or leverage their position with one in order to obtain better trading terms with the other.[71]

87.1 The Parties operate quite differently to one another; many suppliers have noted the differences in their negotiations with each. For instance, we have heard that FSSI can be easier to deal with, including where suppliers can negotiate with owner/operators at the store level, and it is easier to get a foot in the door for a new product. In contrast, FSNI is more centralised in its operations and all decisions tend to come under the relevant category manager.[72]

87.2 In light of the fact that the Parties largely (except for private label contracts) negotiate the acquisition of groceries separately, there are likely to be variations in the actual supply arrangements between the two co-operatives. We have heard that this is the case from a few suppliers. Suppliers have indicated that, while there are fixed terms which tend to be similar or

[71] Commerce Commission interviews with [ ], [ ], [ ], [ ] and [ ]. However, one industry participant indicated there are instances where suppliers might play off the co-operatives against each other albeit this is more in respect of the wholesale space than retail. See Commerce Commission interview with [ ].

[72] Commerce Commission interviews with [ ], [ ], and [ ]. See also submission from Anonymous C (25 January 2024).

consistent across both co-operatives, there are other variable terms which may differ.[73]

88. Differences in the way in which FSNI and FSSI operate may impact how closely they compete with one another in the acquisition of grocery products from suppliers, or how market participants see them as competing. Several participants do not consider that the Parties compete in the acquisition of groceries because of their geographical separation.[74] However, comments from market participants indicate this tends to be the way that contracts are negotiated in the industry, taking into account logistics and other factors rather than being driven by their separate retailing geographies.[75] Currently, suppliers are able to deal with each of the Parties separately when negotiating terms of trade.

89. Some suppliers we have spoken with view FSNI and FSSI as separate entities and/or channels to market.[76] In this respect, each of the Parties and Woolworths offers a separate opportunity to have a product listed, obtain terms, and negotiate contract renewals. The existence of three major customers absent the Proposed Merger enables suppliers three opportunities for listing, negotiations and renewals, compared with two major customers with the Proposed Merger. A considerable degree of concern has been raised around the viability of suppliers who might not be able to range nationally, and the removal of a separate point of negotiation and potential pathway for entry into the grocery market with the Proposed Merger.[77] We also note that suppliers that supply both co-operatives have real concerns that the merged entity might "cherry pick" the more favourable supply terms of the two co-operatives, or negotiate more "punitive" terms for suppliers, post-merger.[78] This view
[ ].[79]

90. Our preliminary view is that, because the Proposed Merger would reduce the number of major customers with which suppliers can negotiate from three to two, it would potentially increase the merged entity's ability to extract better terms from suppliers. As noted earlier, cost savings from the Proposed Merger would arise from a combination of cost savings and buying benefits. The Parties

[73] Commerce Commission interviews with [ ] and [ ].

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

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

[76] Commerce Commission interviews with [ ], [ ] and [ ]. A small number of suppliers we have spoken with treat the co-operatives as one entity, but still negotiate with each separately. See Commerce Commission interviews with [ ] and [ ].

[77] Commerce Commission interviews with [ ], [ ] and [ ].See also submission from Anonymous B (23 January 2024).

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

[79] [ ]

estimate],[80] at least some of which may reflect an increase in buying power.

91. We recognise that some suppliers of groceries to the Parties may have countervailing power and could use this in such a way as to constrain an exercise of buyer power by the merged entity. That is, some suppliers may have special characteristics that would enable them to resist a price reduction (or imposition of less favourable supply terms) by the merged entity. We are considering whether any such power might increase or decrease as a result of the Proposed Merger. At this point we note the following.

   91.1 Our investigation to date has identified that some suppliers may potentially be able to exercise some degree of influence over grocery retailers.[81] There may be instances where some larger suppliers may be able to exercise a degree of countervailing power, potentially in relation to unique products, and where they have the volume and resource to supply both islands.[82] FSNI considers that [ ].[83] The Parties also submit that strength of brand and market power on the supply-side are due to larger national suppliers having a stronger bargaining position.[84] Conversely however, the evidence before us suggests that even large suppliers may be impacted by a power imbalance with the Proposed Merger due to having so few channels with which to reach the domestic market.[85]

   91.2 We have not identified evidence that points to a general ability of any suppliers to bypass, or credibly threaten to bypass the merged entity. We also note that the Grocery Supply Code came into force on 28 September 2023. The Government's rationale for the Code was to address potential power imbalance between suppliers and the major supermarkets.[86]

92. Our preliminary view is that, in general, suppliers may not have countervailing power, but if they do, they are not likely to be able to exercise it to the extent that they would meaningfully constrain an exercise of buyer power by the merged entity.

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80 [ ]

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

82 Commerce Commission interviews with [ ] and [ ]. Examples provided by suppliers included products with a short shelf-life.

83 Commerce Commission interview with FSNI (22 February 2024).

84 Houston Kemp Report for the Parties (7 March 2024) at [56].

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

86 Cabinet paper on Policy Approvals for Grocery Supply Code of Conduct (16 June 2023) at [15]-[17].

93. We invite industry participants to provide us with further evidence on how closely the Parties compete in the acquisition of grocery products (including frozen goods, dry groceries and fresh produce) and on the extent of competition that would be lost with the Proposed Merger. We are particularly interested in evidence parties can supply on:

    93.1 the extent to which the Parties represent alternative channels that suppliers could supply products to;

    93.2 how the Parties have competitively reacted to each other in instances where they share suppliers; and

    93.3 the extent to which larger suppliers or suppliers with strong brand positioning are currently able to derive better terms than small or medium sized suppliers and the extent to which they would be able to protect themselves, and other suppliers, from any increase in the merged entity's bargaining power.[87]

Level of constraint provided by other acquirers of grocery products

94. We are considering the degree of constraint that other grocery retailers and acquirers of grocery products would impose on the merged entity and whether that would be sufficient to prevent a substantial increase in buyer power by the merged entity in the acquisition of grocery products from suppliers.

95. In doing so, we have considered the extent of suppliers' ability to switch to supplying other grocery retailers (or other distribution channels eg, export, wholesale, foodservice, direct to retail consumers), other than the merged entity.

96. Woolworths would be the only other major customer in New Zealand. We are still considering the extent to which it would have the ability and incentive to constrain the merged entity's buyer power.

97. Beyond Woolworths, there are other grocery retailers currently operating in New Zealand, including, but not limited to:[88]

    97.1 The Warehouse, which provides a partial grocery offering as a general merchandiser, nationwide;

    97.2 Costco, which provides a wholesale/bulk grocery offering in West Auckland;

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[87] See Houston Kemp Report for the Parties at [53]. The report defines major national suppliers as those that supply FSNI and FSSI and have products sold at all or nearly all retail stores, smaller national and regional suppliers as those that supply one or both FSNI and FSSI and may have products sold at many retail stores and small local suppliers as supplying only a few stores and typically deal direct with stores. Our preliminary view is that large, medium sized and small suppliers align with each of these definitions, respectively.

[88] As well as the retailers listed below, we note that there are specialist retailers that supply some of the same products/product ranges as the major grocery retailers, such as Chemist Warehouse.

97.3 Moore Wilson's, which provides a specialist grocery offering and operates within the Wellington region;

97.4 Huckleberry, which provides a specialist grocery offering and operates within the Auckland region;

97.5 Farro Fresh, which provides a specialist grocery offering within the Auckland region; and

97.6 Bin Inn, which provides a specialist grocery offering in bulk and wholefoods, nationwide.

98. However, these other grocery retailers account for a very small proportion of grocery retailing in New Zealand. Suppliers we have spoken with have indicated that volume to the major customers is important, which is also highlighted by many having different sales teams to deal with each.[89] In light of that, suppliers we have engaged with do not tend to consider that the smaller grocery retailers would provide any meaningful competitive constraint on the merged entity. We understand that some suppliers have previously been unwilling to supply groceries to retailers other than the current three major grocery retailers (ie, FSNI, FSSI and Woolworths).[90] One industry participant noted that other grocery retailers (such as Costco) tend to sit on the "edges" compared to what the major supermarkets are providing.[91] While there are also other supply channels outside of grocery retailers (ie, export, wholesale, food service, or direct selling to retail consumers/online), we have not to date seen any evidence that suggests that those alternatives are a realistic alternative for most suppliers.

99. Further, as discussed further below in relation to retail grocery markets, there are high barriers to entry for grocery retailers (which the Proposed Merger could make higher) which could make it difficult for rival grocery retailers to enter and/or expand their presence to mitigate any loss of competition in acquisition markets.

100. Our preliminary view is that the merged entity's only meaningful competitor in the acquisition of groceries is Woolworths, given it is most similar in size and scale to the merged entity. Some market participants consider that the Parties separately compete most closely with Woolworths, as opposed to with each other.[92] We are not currently satisfied that the constraint from other retail grocery competitors, in

89 Suppliers provided us with approximate proportions of their business that is attributed to the major grocery retailers. Commerce Commission interviews with [ ], [ ], [ ], [ ], [ ], [ ] and [ ]. One smaller grocery retailer considered that the Proposed Merger would have limited effect on them albeit they do consider the larger supermarkets to be their close competitors. They also consider that they are not on the same supply terms as some of the larger supermarkets. Commerce Commission interview with [ ].

90 Commerce Commission interview with [ ].

91 Commerce Commission interview with [ ].

92 Commerce Commission interview with [ ] and [ ].

particular Woolworths, would be sufficient to constrain an exercise of buyer power by the merged entity in the acquisition of grocery products from suppliers.

101. We invite industry participants to provide further evidence on the ability of suppliers to switch supply between different grocery retailers, including Woolworths and other grocery retailers, and/or other non-retail distribution channels and whether there are variations in supply arrangements depending on product category or geography which might constrain the merged entity. The types of evidence we are interested in includes:

101.1 the proportion of a supplier's volumes accounted by each of the Parties compared to Woolworths and other channels;

101.2 differences in the terms (including price and non-price aspects) between what the Parties offer compared to Woolworths and other channels; and

101.3 how suppliers have reacted when the price that either of the Parties pay has changed (for example, has the supplier changed the volumes they supply into other channels).

Impact on innovation

102. We are also considering the impact of the Proposed Merger on product innovation. We are concerned that:

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

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

103. In doing so, we are considering:

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

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

104. The Parties submit that the Proposed Merger would result in an increased ability to innovate due to the increased efficiency and agility of the merged entity compared with the two co-operatives.[93]

105. Market feedback has highlighted the importance to new suppliers or suppliers of new products of having multiple grocery retailer channels to gain a foothold in the

[93] The Application at [6] and [20.1], and cross submission from the Parties at [33.5].

market.[94] Each of FSNI and FSSI currently provide separate opportunities and each have scope to bring different new products and suppliers to the market. Furthermore, some information suggests that the smaller volume and geographic footprint of the Parties, as non-national retailers (particularly FSSI), makes them particularly important buyers in the market, enabling new or innovative suppliers to gain a foothold prior to being able to supply nationally.

106. While several parties do not consider that the Proposed Merger would likely result in any change or a reduction in suppliers' investment in innovation (with a few parties who consider that the Proposed Merger will benefit innovation),[95] there is a broad consensus that suppliers may be less inclined to innovate to bring new products to market in light of having one less grocery retailer channel in which to test a new product, or secure initial volume and/or ranging.[96] As noted earlier, we are also considering whether a reduction in price might adversely affect suppliers' incentives to innovate.

107. We invite suppliers to provide us with further evidence on:

107.1 instances where channel diversity (including channels outside of major grocery retailers ie, export, wholesale, foodservice, direct to retail consumers, including online) has been an important consideration in their ability to bring new products to market and/or new suppliers being able to enter the market; and

107.2 whether a reduction in price is likely to affect investment in innovation.

Other areas of investigation

108. We are still considering other issues in relation to the acquisition of grocery products.

109. The Parties submit that the Proposed Merger will bring about cost savings (for both the merged entity and suppliers) as well as simplification of engagement and more consistent marketing of products across the two islands.[97]

110. We can consider efficiencies when assessing mergers.[98] In principle efficiencies could offset the competitive impact from the Proposed Merger such that it would not substantially lessen competition. However, efficiency gains are rarely of the required type, magnitude and credibility.[99] The Parties must satisfy us that that the efficiencies would be realised in a timely fashion, would not likely be realised

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94 Commerce Commission interviews with [ ], [ ] and [ ]. See also submission from Anonymous A (22 January 2024).

95 Commerce Commission interviews with [ ] and [ ].

96 Commerce Commission interviews with [ ], [ ] and[ ]. See also submission from Anonymous A (22 January 2024).

97 The Application at [132].

98 See our Mergers and Acquisitions Guidelines above n14 at 32.

99 See our Mergers and Acquisitions Guidelines above n14 at [3.119].

without the Proposed Merger and would be passed on to buyers sufficiently to prevent a finding of a substantial lessening of competition.

111. As part of this assessment, we are considering the extent to which the previous merger between Foodstuffs Auckland and Foodstuffs Wellington in 2013 resulted in efficiencies and/or cost savings on the supply-side, that were passed through to consumers, notwithstanding that the Parties operate in different islands.

112. FSNI told us that [ ].[100]

113. If the Proposed Merger brings about cost savings to suppliers, then those suppliers may willingly offer lower prices to the merged entity. A few suppliers we have spoken with consider that the North Island Foodstuffs merger did bring about efficiencies in terms of streamlining of processes, aligned strategy and simplification.[101] Conversely, however, we have also heard from industry participants who consider that the North Island Foodstuffs merger led to increased margin for the merging parties, a reduction of suppliers entering the market and did not result in the lower prices that were promised at the outset.[102] We also note that in the case that costs were passed through previously there is no guarantee they will be passed through again with the Proposed Merger.

114. We invite interested parties to provide us with instances where efficiencies and/or costs savings came about as a result of the North Island Foodstuffs merger from the supply-side and the extent to which they consider any efficiencies and/or cost savings might arise as a result of the Proposed Merger. We are also interested in evidence of the pass-through of any such cost savings into retail consumer prices.

<u>Move toward centralisation</u>

115. At present, individual store owners in both the FSNI and FSSI co-operatives are able to procure a proportion of product independently (rather than acquiring it centrally through the co-operatives). The prevalence of this type of procurement appears to vary by region and by banner. However, both Parties are in the process of centralising more of this procurement model.

116. Several participants consider that the Proposed Merger would enable this process of centralisation to accelerate and a move to a more centralised model would mean the loss of an opportunity and flexibility to negotiate at the store level, and overall, one

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100 Commerce Commission interview with FSNI (22 February 2024).

101 Commerce Commission interviews with [ ] and [ ].

102 Commerce Commission interviews with [ ] and [ ]. See also submissions from The Warehouse (9 February 2024) and Grocery Action Group (9 February 2024).

less opportunity to negotiate entry to the market.[103] However, there are also some participants who consider that there are benefits to dealing with one entity, as opposed to any negotiations taking place at a store level, due to enabling them to streamline processes and the efficiency of doing business.[104]

<u>Private label</u>

117. We have been considering whether the Proposed Merger could lead to an increase in buyer power and afford the merged entity a greater ability and incentive to increase the penetration of private label products, and whether this would have a negative effect on competition.

118. The Parties submit that private label products are considered against the same criteria as branded products (including for de-ranging)[105] and compete with branded products.[106] As evidence of this, the Parties refer to [ ].[107]

119. Suppliers compete with the Parties' private label products and work hard to differentiate their products in terms of quality and price point. Some suppliers have noted a recent increase in volume for private label products, which they see as a result of the cost of living crisis/economic conditions or the Parties' promotional push for private label.[108] An increase in private label penetration is a concern for suppliers who may supply both private label and their own branded products to the Parties, with some noting a concern around erosion in the acquisition of their branded products compared with private label, or the potential erosion of their own products in light of an increase in buyer power with the Proposed Merger.[109]

120. The Food and Grocery Council submits that the Proposed Merger would consolidate "brand buying power, particularly for [Foodstuffs] private label (because the proposed merged entity will represent close to 60% of the grocery sector). Deranging to accommodate this leaves consumers with less choice. Further effects would include a loss of benchmarking and options".[110]

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103 Commerce Commission interviews with [ ], [ ], [ ], [ ] and [ ].
104 Commerce Commission interviews with [ ] and [ ].
105 Cross submission from the Parties (7 March 2024) at [35].
106 Cross submission from the Parties (7 March 2024) at [37].
107 Cross submission from the Parties (7 March 2024) at [36].
108 Commerce Commission interviews with [ ], [ ] and [ ].
109 Commerce Commission interviews with [ ] and [ ]. See also submission from Northelia (27 February 2024). [ ] also noted this as a concern, albeit not from the direct perspective of a supplier. Commerce Commission interview with [ ].
110 Submission from the Food and Grocery Council (21 February 2024).

Coordinated effects

121. When assessing whether a merger may give rise to coordinated effects in a market, we assess whether:

121.1 a market is vulnerable to coordination; and

121.2 a merger changes the conditions in the relevant market so that coordination is more likely, more complete or more sustainable.

122. We are currently not satisfied that the Proposed Merger would not be likely to substantially lessen competition due to coordinated effects in the acquisition of grocery products.

123. In the acquisition of grocery products from suppliers, a merger could substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power. This could be through, for example, by decreasing wholesale prices and/or worsening supply terms, or dividing up the market such that output reduces and/or prices fall. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way. Successful coordination requires firms to reach at least an implicit agreement,[111] and then to maintain that agreement by detecting and punishing any firm that deviates from the agreement.[112]

124. We are considering whether the consolidation of FSNI and FSSI would increase the potential for the merged entity and Woolworths in particular (given their similarity in size and scale in the factual) to coordinate their behaviour and obtain trade terms with suppliers that are less favourable to suppliers.

125. The Parties submit that the Proposed Merger would not be likely to substantially lessen competition in any relevant market due to coordinated effects. Specifically in relation to the acquisition of grocery products from suppliers, the Parties submit that:[113]

125.1 the co-operatives have no visibility of their competitors' terms of supply, or interaction with competitors with respect to terms of supply, and the Proposed Merger would not change that; and

125.2 suppliers would not gain increased visibility as a result of the Proposed Merger, and there would be no merger-specific change to competitive strategies or the merged entity's competitors' visibility of such strategies.

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111 Mergers and Acquisitions Guidelines above n14 at footnote 91, this includes behaviour that may not be regarded as a contract, arrangement or understanding for the purpose of assessing whether a cartel prohibited by the Act exists.

112 Mergers and Acquisitions Guidelines above n14 at [3.88].

113 The Application at [171-172].

126. In our view, there are several factors which could increase the ability and incentive for the merged entity and Woolworths in particular, to coordinate in the acquisition of grocery products, including:

    126.1 the merged entity would be a similar national operation to Woolworths; and

    126.2 as discussed above, the Proposed Merger may accelerate the centralisation of buying decisions (compared to the way FSNI operates at present), which would be more similar to the way that Woolworths undertakes buying decisions.

127. To date, we have not received any direct evidence relating to coordinated effects either between FSNI, FSSI or with Woolworths. Both suppliers and retailers we have spoken with have made it clear that they do not enter into discussions about their terms with other retailers or suppliers. While suppliers might reference market changes in negotiating with retailers, this does not indicate visibility of the kind that would lead to coordinating behaviour.

128. We have however received some evidence of indirect ways in which retailers' terms of supply with other suppliers might be construed as being better or more favourable, including by virtue of product positioning on shelves.[114] FSNI noted that there [ ].[115] Suppliers might otherwise simply monitor retail prices of their competitors at the shelf/store level, or data from third party providers (ie, Nielsen).[116]

129. We invite submissions and further information on the extent to which the Proposed Merger could materially facilitate coordination in markets for the acquisition of groceries, making it more likely, more complete or more sustainable.

Potential impact of Proposed Merger on the retail supply of groceries

130. We see potential issues with the Proposed Merger in downstream markets for the retail supply of groceries, in terms of both unilateral and coordinated effects.

131. We are currently not satisfied that the Proposed Merger would not substantially lessen competition in retail grocery markets due to:

    131.1 a loss of actual or potential competition at the retail level between FSNI and FSSI with the Proposed Merger;

    131.2 the Proposed Merger increasing the barriers to entry and/or expansion by third parties in retail grocery markets; and/or

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114 Commerce Commission interview with [ ].

115 Commerce Commission interview with FSNI (22 February 2024).

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

131.3 the Proposed Merger increasing the likelihood, completeness and sustainability of coordination between the merged entity and Woolworths.

132. We discuss below in more detail the reasons as to why we are currently not satisfied, starting with market definition, followed by unilateral and coordinated effects.

Market definition

The Parties' submissions

133. The Parties submit that, given FSNI and FSSI operate in separate geographies and accordingly do not compete in relation to the retail supply of groceries, it is not necessary to conclusively determine the relevant market relating to the retail supply of groceries.[117] The Parties further submit that:

133.1 it is not necessary to precisely define the geographic dimension of retail grocery markets. Rather, the Parties submit that the Commission's perspective in the previous market study that "grocery retailers typically compete for consumers within small local areas but there are some regional and national dimensions to competition" can be adopted for purposes of analysing the Proposed Merger;[118] and

133.2 in the product dimension of retail grocery markets, they compete with a wide range of market participants across many product categories, and that it is not necessary to precisely define product markets given there is no competition between the Parties (so, no competition can be lost as a result of the Proposed Merger).[119]

Our current view

134. We have not yet reached any definitive views on the relevant market(s) for assessing the likely impact of the Proposed Merger on the retail supply of groceries. However, we currently consider it is appropriate to assess the impact of the Proposed Merger on local, regional and national retail grocery markets.

135. We understand that there are different elements of competition at each of these levels. There are likely local markets because consumers are generally only willing to travel limited distances to purchase groceries.[120] This means that the actions of a particular grocery store in one area of the country such as better service or lower prices are unlikely to have a significant impact on consumers located in a different region. There are, however, other factors which indicate it would also be appropriate to assess regional and national markets: there are elements to competition which appear to be conducted on that basis, for example there is some degree of national or regional product sourcing and control of pricing and promotions.[121]

117 The Application at [73].
118 The Application at [75]-[76].
119 The Application at [77]-[79].
120 Market study final report (8 March 2022) at [4.22].
121 Market study final report (8 March 2022) at [4.138].

136. Currently, for the purpose of our analysis, we do not consider it is necessary to define exact geographic boundaries of competition and we note that the size of local markets is unlikely to be uniform across New Zealand and will vary based on local factors. In our competition assessment we are considering both whether there are any competition effects locally and on broader geographic dimensions. For example, if we were to conclude that the Proposed Merger would through a 'waterbed effect' lead to exit or lack of entry in a particular local market, this could lead to a substantial lessening of competition in that market even if it did not have a substantial effect on the national market.

137. As regards the product dimension of the relevant retail grocery market(s) we currently consider that the relevant market is likely to include all stores which offer the ability for consumers to do a one-stop grocery shop.[122] We are still considering whether it would be appropriate to consider narrower product markets including:

137.1 whether online offerings should be considered separately; and

137.2 whether there are narrower markets by size of store.

138. We invite submissions on our approach to market definition and for interested parties to provide us with further evidence on the scope of retail grocery markets, including on:

138.1 how competition may occur in retail grocery markets at a national level (as distinct from local or regional competition);

138.2 whether online grocery retailing (where groceries are ordered online and delivered to consumers) takes place in the same local retail grocery markets as physical supermarket stores, or broader geographic markets;

138.3 the extent to which consumers substitute between buying groceries from major grocery retailers (ie, the Parties and Woolworths) and other smaller grocery retailers, general merchandisers and/or specialist retailers; and

138.4 how easily smaller grocery retailers, general merchandisers and/or specialist retailers could expand to provide a greater range of grocery products.

Unilateral effects

139. In the supply of goods, unilateral effects arise when a firm merges with a competitor that would otherwise provide a significant competitive constraint (particularly relative to remaining competitors) such that the merged firm can profitably increase prices above the level that would prevail without a merger without the profitability of that increase being thwarted by rival firms' competitive responses.[123] In addition

[122] Market study final report (8 March 2022) at [2.6] stated that: *"Consumers value the convenience of a wide range of groceries at a single location. A sufficiently wide range that accommodates one-stop shopping is therefore an important element of convenience, as well as the location and accessibility of a grocery store"*.

[123] Mergers and Acquisitions Guidelines above n14 at [3.62]-[3.63].

to price rises, unilateral effects could also arise where a merged firm can profitably reduce quality or innovation or worsen an element of service or any other element of competition (eg, worse or less frequent promotions) below the level that would prevail without a merger – such changes leading to an increase in quality-adjusted prices.

140. If a merger enables a merged entity to reduce existing rivals' or potential entrants' access to scale or customers, it could also lead to unilateral effects by raising barriers to entry or expansion for rivals and limiting the ability of rivals to compete effectively.

141. We continue to investigate whether or not the Proposed Merger is likely to give rise to unilateral effects in the retail supply of groceries. In particular, we are continuing to consider:

141.1 the extent to which the Proposed Merger could result in a loss of actual or potential competition at the retail level between FSNI and FSSI, such that the loss of that actual or potential competition may result in a substantial lessening of competition; and

141.2 whether the Proposed Merger could substantially lessen competition by increasing the barriers to entry and/or expansion by third parties in retail grocery markets.

142. We discuss each of these issues in turn below. As noted previously, we are also considering whether the increase in buyer power in acquisition markets (as discussed above) could subsequently affect competition in retail grocery markets.

142.1 This could occur if the increased buyer power of the merged entity leads to suppliers raising prices or providing worse terms to rival grocery retailers (the 'waterbed effect'). This could in turn lead to rival grocery retailers needing to raise their prices, or exiting the market completely, thereby weaking competition and allowing the merged entity to raise prices and/or reduce the quality of their service offerings which may harm consumers. We discuss this further below, as part of our discussion on barriers to entry/expansion.

142.2 Similarly, as noted previously, the increased buyer power of the merged entity could reduce the ability of suppliers to invest, resulting in reduced capacity, quality or innovation in the supplier's market. This could impact consumers in retail grocery markets if it means there are less, or lower quality, products on supermarket shelves.

143. We invite submissions and further information on whether the Proposed Merger is likely to give rise to unilateral effects in the retail supply of groceries. We set out more detail on the types of further information we would like to receive in the sections below.

Loss of actual or potential competition between the Parties

144. The Parties submit that there is no actual or potential competition between the two co-operatives at the retail level in any realistic counterfactual, such that the Proposed Merger is not capable of lessening competition in any market for the retail supply of groceries.[124] In particular, the Parties submit that:

144.1 there is no existing competition between the two co-operatives at the retail level, with each co-operative focused on competing within the island in which it is based;[125]

144.2 the owner/operator co-operative model means that individual members have discretion as to pricing and some promotions, which would not change as a result of the Proposed Merger;[126] and

144.3 the only realistic counterfactual is that each Party's retail businesses would continue to operate in its island, and not in competition with the other,[127] and that while the realistic counterfactual is the status quo, (ie, that the Parties would continue to have a relationship to manage the fact that FSNI and FSSI are both trading under common retail brands and present as a single national retail offering), this would include the current trajectory for each co-operative (eg, FSSI would continue to progress its centralised buying programme, noting FSNI is adopting a similar programme but is more progressed with rolling it out).[128]

145. The Parties further submit that:

145.1 while there are no agreements that prevent the Parties from establishing a retail grocery business in the other island, there is not a real chance the one co-operative would establish a retail grocery business in the other island. They submit that each co-operative "has continued to take the view that the current business model is the best use of capital and efforts, and that there is no reason to expect that to change in any realistic counterfactual";[129] and

145.2 each co-operative would be in the same position as any other new entrant in terms of one co-operative entering the other island in which they do not currently operate. Neither co-operative owns land, nor any existing supply chain distribution infrastructure, in the other island.[130]

146. We have been considering the extent to which there is current competition between FSNI and FSSI at the retail level. Evidence gathered through our investigation to date supports the Parties' submissions that there is no existing competition between FSNI

124 The Application at [111].
125 The Application at [112].
126 The Application at [114].
127 The Application at [115].
128 Cross submission from the Parties (7 March 2024) at [48].
129 Cross submission from the Parties (7 March 2024) at [44].
130 The Application at [99.1].

and FSSI at the retail level. The Parties do not currently compete for retail consumers in any local or regional markets, or for retail consumers in any national market. Nationally, the Parties present a single retail grocery offering through common brands and work collaboratively together in a range of ways.[131]

147. We are continuing to consider what the Parties would likely do absent the Proposed Merger in order to assess whether the Proposed Merger would result in a loss of (or remove the potential for) competition at the retail level between FSNI and FSSI. In other words, we are assessing whether there is a real chance that the Parties would compete in the counterfactual: for example, if absent the Proposed Merger, FSNI might be incentivised to start competing in local retail grocery markets in the South Island, or FSSI might be incentivised to start competing in local retail grocery markets in the North Island (including, in either case, by means of online grocery retailing). This is discussed separately in confidential attachments to this SoI.

148. We invite submissions and further information on the extent to which there would be a loss of actual or potential competition between the Parties with the Proposed Merger in any specific local, regional or national retail grocery markets.

148.1 As regards actual competition, we invite submissions and further information on the extent of existing competition between FSNI and FSSI at the retail level that would be lost with the Proposed Merger.

148.2 As regards potential competition and whether the Proposed Merger would remove the potential for competition at the retail level between FSNI and FSSI, we invite any evidence that interested parties can provide on whether, absent the Proposed Merger, FSNI and FSSI might begin competing at the retail level.

Increased barriers to entry/expansion

149. Several submissions have raised concerns that the Proposed Merger would increase the barriers to entry and/or expansion by third players in retail grocery markets.[132] We currently consider that if the Proposed Merger was to increase the barriers to entry and/or expansion for rival grocery retailers, it could lead to a substantial lessening of competition. This would particularly be the case if actual or potential third-party competition would be likely to increase without the Proposed Merger, and the Proposed Merger would prevent this improvement in competition from occurring. As discussed previously and further below, the Proposed Merger would change the bargaining position of the merged entity relative to its suppliers, which could in turn impact the ability of rival grocery retailers to enter or expand.

150. To date, we have considered the likelihood of the Proposed Merger increasing barriers to entry/expansion in light of a counterfactual scenario where the Parties

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131 The Application at [4] and [20].

132 Submissions to the Commerce Commission from Northelia (27 February 2024), Monopoly Watch NZ (27 February 2024), The Warehouse (9 February 2024), the Food and Grocery Council (19 February 2024), Grocery Action Group (9 February 2024), Ernie Newman (5 February 2024), Habilis (1 February 2024), and Anonymous A (22 January 2024).

continue to operate as separate co-operatives in different geographies. That said, in light of the discussion above regarding whether there is a real chance counterfactual of future competition between the Parties at the retail level, we are considering whether this is the only appropriate counterfactual to assess this issue against.

151. The Parties submit that:

151.1 the competitive landscape in New Zealand's retail grocery industry continues to be strong, with key players and recent entrants continuing to invest in growing their physical and online presence;[133]

151.2 the pro-competitive changes introduced under the GICA increasing retail competition more generally, and our ongoing role in monitoring and promoting competition in the sector, should be expected to ensure significant competitive (and regulatory) pressure;[134]

151.3 the view expressed in the market study that the market is relatively stable and there are barriers to entry and expansion is a factor that would not change as a result of the Proposed Merger,[135] noting that the Proposed Merger would not give rise to a change in the Parties' footprint in any local market, nor would it give rise to any change in the concentration of distribution infrastructure;[136] and

151.4 that the Proposed Merger would not be likely to result in a substantial lessening of competition precludes there being an impact on barriers to entry and expansion.[137]

152. As set out below, we currently consider that:

152.1 further and broader entry or expansion in retail grocery markets would be likely to substantially improve outcomes in those markets; and

152.2 the Proposed Merger may make it less likely for any entry or expansion to occur by changing the incentives or ability of potential competitors.

<u>Would further entry or expansion be likely to substantially improve outcomes?</u>

153. In considering the potential impact of expansion and entry in retail grocery markets, we are considering both the extent of current competition (to inform our assessment of likely competition in the factual), and how entry and expansion may change this. We currently consider that further and broader entry or expansion by rival grocery retailers would likely lead to a substantial change in competitive outcomes because:

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133 The Application at [59].
134 The Application at [120].
135 The Application at [165]-[166].
136 Cross submission from the Parties (7 March 2024) at [109].
137 Cross submission from the Parties (7 March 2024) at [135].

153.1 as noted previously, the market study found that the intensity of competition between the major grocery retailers is muted and does not reflect workable competition;[138]

153.2 there has been limited entry and expansion in retail grocery markets since the market study;[139]

153.3 we understand that there have been some targeted responses, including price cuts from incumbent grocery retailers in locations and product lines where competitors have entered,[140] which we consider could demonstrate the potential gains from further third party entry or expansion;

153.4 FSSI noted that
[
];[141] and

153.5 while there have been some reductions in barriers to entry since the market study,[142] we consider that there are still likely to be high barriers to entry and/or expansion in retail grocery markets. For example:

153.5.1 The Warehouse Group submits that we cannot exclude a real chance that conduct described in the market study will remain a barrier to entry and expansion;[143] and

153.5.2 the recent liquidation of supermarket entrant Supie could indicate that there are barriers to entry and expansion, with the liquidation report noting that the reasons for the company's insolvency was primarily due to a lack of sales volume and scale to operate the business profitably.[144]

154. We invite submissions and further information on how further and broader entry or expansion in retail grocery markets would improve outcomes in those markets, including information on:

154.1 the impact that recent entry or expansion has had on retail grocery markets;

154.2 how and to what extent competition has changed in retail grocery markets since the market study; and

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138 Market study final report (8 March 2022) at 146.

139 In terms of key entry and expansion that has occurred since the market study, The Warehouse has increased its grocery offering (https://www.thewarehousegroup.co.nz/news-updates/warehouse/warehouse-adds-further-10-stores-offer-fresh-produce) and Costco has opened a store in Auckland (https://www.nzte.govt.nz/blog/costcos-usd100-million-investment-into-new-zealand).

140 https://www.consumer.org.nz/articles/what-effect-is-the-warehouse-having-on-pak-nsave-s-prices/investigation.

141 Commerce Commission interview with FSSI (26 February 2024).

142 For example, the removal of covenants on land and introduction of the GICA regime.

143 Submission by The Warehouse (9 February 2024).

144 See https://www.pwc.co.nz/pdfs/2023/liquidators-first-report-supie-limited.pdf.

154.3 the plans that existing or potential retailers may have to enter or expand.

Would the Proposed Merger make it less likely for entry or expansion to occur?

155. Several interested parties have submitted that the Proposed Merger may lead to higher barriers to entry or expansion in retail grocery markets.[145] We are still considering this point, but set out below some of the ways that we currently consider the Proposed Merger may make it more difficult for rival grocery retailers to enter and expand their presence in the retail supply of groceries.

156. As discussed previously, the Proposed Merger would change the bargaining position of the merged entity relative to its suppliers. This could increase the merged entity's ability to achieve better terms relative to rival acquirers of grocery products and may allow the merged entity to offer lower prices. While lower prices could benefit consumers, it may also raise the minimum required scale for rival acquirers of groceries to enter and effectively compete in the market.[146] In the long run, this may lead to worse retail consumer outcomes.

157. The Proposed Merger may also lead to the merged entity having access to a larger combined set of data on retail sales and customer insights (compared to the counterfactual) that may provide the merged entity with advantages that rival grocery retailers are unable to replicate. This increased data access, combined with the increased buyer power that the merged entity may have, could, for example, increase the ability of the merged entity to be able to implement strategically targeted price cuts in locations in which it faces entry. This could potentially be used to drive entrants out of retail grocery markets, and then increase retail prices again once an entrant has exited the market.

158. Knowing that the merged entity may have the increased ability to offer steep targeted price cuts in response to competition may also discourage any potential retail grocery entrants, as they would be aware that there is a risk of targeted response on entry which they may not be able to match with their relatively smaller scale.

159. In addition, the increased buyer power of the merged entity could lead to suppliers raising prices or providing worse terms to rival grocery retailers through the potential for a 'waterbed effect'.[147] These effects could in some circumstances lead to other retailers needing to raise their prices which could weaken competition and

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145 Submissions to the Commerce Commission from Northelia (27 February 2024), Monopoly Watch NZ (27 February 2024), The Warehouse (9 February 2024), the Food and Grocery Council (19 February 2024), Grocery Action Group (9 February 2024), Ernie Newman (5 February 2024), Habilis (1 February 2024), and Anonymous A (22 January 2024).

146 Salop, Potential Competition and Antitrust Analysis, OECD, 2021 at [12] https://one.oecd.org/document/DAF/COMP/WD(2021)37/en/pdf.

147 Dobson and Inderst, The waterbed effect: Where buying and selling power come together (2008) at 14 https://www.researchgate.net/publication/265406963_The_waterbed_effect_Where_buying_and_selling_power_come_together.

may allow the merged entity to raise prices and/or reduce the quality of their service offerings which may harm consumers.

160. This ‘waterbed effect’ can occur through two mechanisms which we are exploring further:

160.1 the potential for the Proposed Merger to lead to consolidation of suppliers in response to the weakening of suppliers’ bargaining position; and

160.2 the potential for the Proposed Merger to lead to a circular effect where rival grocery retailers lose share due to their relatively worse terms and, as a consequence of reduced scale, obtain increasingly worse terms from suppliers.

161. Finally, we note that given barriers to entry and expansion in retail grocery markets are already high, even small increases in barriers could make entry or expansion less likely to occur. Where retail grocery markets are already concentrated, even a small reduction in entry or expansion (or the likelihood of entry or expansion) by rival grocery retailers could substantially change (and reduce) the extent of competition that would exist in retail grocery markets with the Proposed Merger, compared to what may be the case without the Proposed Merger.

162. We invite submissions and further information on whether the Proposed Merger would make any entry or expansion less likely, including on:

162.1 the extent the Proposed Merger may increase the minimum efficient scale in the groceries market;

162.2 the likelihood the Proposed Merger would result in suppliers offering worse terms to other grocery retailers; and

162.3 the impact of data consolidation and extent to which the Proposed Merger may change the ability of the merged entity to employ a targeted pricing strategy to prevent or deter entry/expansion.

Coordinated effects

163. In the retail supply of groceries, the Proposed Merger could substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power such that output reduces and/or prices increase.

164. As noted previously, when assessing whether a merger may give rise to coordinated effects, we assess whether:

164.1 a market is vulnerable to coordination; and

164.2 a merger changes the conditions in the relevant market so that coordination is more likely, more complete or more sustainable.

165. We are currently not satisfied that the Proposed Merger would not be likely to substantially lessen competition due to coordinated effects in retail grocery markets.

165.1 First, for the reasons we set out below, we consider that retail grocery markets may be vulnerable to coordination.

165.2 Second, we consider that the Proposed Merger could potentially increase the likelihood, completeness and sustainability of coordination between the merged entity and Woolworths. We consider that the metric of coordination between the merged entity and Woolworths could be either or both of price or non-price (such as coordination between the merged entity and Woolworths on metrics such as range, promotions and/or advertising).

166. We invite submissions and further information on whether the Proposed Merger is likely to give rise to coordinated effects in the retail supply of groceries.

The Parties' submissions

167. The Parties submit that:[148]

167.1 they do not agree with the Commission's conclusions in the market study that retail grocery markets have some features that make them vulnerable to coordination (but in any event, submit that none of the market factors that the Commission considered reduce the incentive to compete would change as a result of the Proposed Merger);

167.2 the high degree of product and brand differentiation, the large number of products and the presence of discounts and non-price promotions would continue to be a very material hindrance to any attempt at coordination; and

167.3 regardless of the Proposed Merger, store owners will maintain the same level of freedom to price independently.

168. With reference to our Guidelines that identify a number of features that may facilitate coordinated conduct, the Parties also submit that:[149]

168.1 the high degree of product and brand differentiation and large number of products sold by the major grocery retailers are features of the market that hinder accommodating behaviour, and given the number and range of products and brands acquired and sold by the merged entity would not change as a result of the Proposed Merger, this market feature will be unchanged;

168.2 the Proposed Merger would not reduce the number of competitors given the Parties do not compete in downstream markets (with each co-operative focusing on competing in the island in which it is based);

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[148] The Application at [164], [166] and [169].

[149] Cross submission from the Parties (7 March 2024) at [33].

168.3 the major grocery retailers do not (and would not, post-merger) interact directly (eg, through transactions, or beyond small interactions in industry forums) or indirectly (eg, through suppliers, given suppliers do not offer information regarding Woolworths to FSNI and FSSI and, the Parties assume, vice versa); and

168.4 the merged entity would not have the same cost structures or necessarily be a similar size to Woolworths, and the Parties operate different banners while Woolworths' operations are mostly under the Countdown/Woolworths banner (making the businesses not easily comparable).

Are retail grocery markets vulnerable to coordination?

169. The Parties submit that differentiation and the number of products would hinder accommodating behaviour. We continue to assess this and also whether there may be other metrics that could serve as a focal point for coordination. For example, we are considering whether coordination could take place on:

169.1 prices for a certain group of products such as key products that drive retail consumer supermarket choice or private label products; and/or

169.2 on the timing of promotions.

170. In the market study, the Commission considered that a combination of features in retail grocery supply reduce the incentives for the major grocery retailers (FSNI, FSSI and Woolworths) to compete more intensely with each other (particularly on price). In particular, the Commission found that:[150]

170.1 the major grocery retailers are each other's closest competitors and have similar competitive strategies which are well known;

170.2 they closely monitor each other, and the high degree of transparency means they can quickly detect and respond to any changes in their closest rival's competitive strategy; and

170.3 the market is relatively stable (ie, the retail grocery sector is highly concentrated, the market shares of the major grocery retailers have been relatively high and stable over time, other grocery retailers face difficulties entering and expanding, and the demand for groceries is relatively stable and predictable, largely reflecting population growth).

171. The market study also found that there are some features of the retail grocery sector which suggest it is vulnerable to tacit coordination such as a high degree of common relationships with the same suppliers. We also saw some evidence of grocery retailers seeking information from suppliers about the prices, discounts and promotions of their rivals.[151]

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150 Market study final report (8 March 2022) at [5.148].
151 Market study final report (8 March 2022) at 146 and [5.156].

172. The evidence we have gathered in the current investigation suggest conditions are similar to those identified in the market study. For example:

172.1 [ ];[152] and

172.2 since the market study there has been limited new entry and some exit.[153] One key difference since the market study is the introduction of the GICA, which may have reduced barriers to some extent for example by providing some retailers with additional options for wholesale supply. However, it is unclear that there are any potential rival grocery retailers that are sufficiently likely to enter that would disrupt coordination.

173. We invite submissions and further information on the extent to which conditions in retail grocery markets make such markets vulnerable to coordination, including whether coordination is more likely to occur on a national basis and/or in specific local or regional markets.

Would the Proposed Merger facilitate coordination in retail grocery markets?

174. Currently (and as the Parties submit, absent the Proposed Merger) there are three major supermarket retailers in New Zealand (FSNI, FSSI and Woolworths), with the Parties having a close relationship at the retail level and working together in a range of ways (including in terms of their common brands). With the Proposed Merger there would only be two major supermarket retailers (being the merged entity and Woolworths).

175. We are still considering whether the Proposed Merger could facilitate coordination in retail grocery markets. We are currently not satisfied that the Proposed Merger would not facilitate coordination in retail grocery markets. Although the Parties do not currently compete at the retail level, we consider that there are ways in which the Proposed Merger could make coordination more likely, more complete or more sustainable.

175.1 In the case that either FSNI or FSSI was a potential entrant into any retail market in the counterfactual, the Proposed Merger would eliminate a potential disrupter to any coordinated behaviour.

175.2 Currently, FSNI and FSSI make retail pricing decisions independently of each other. Post-merger, pricing across the New World, PAK'nSAVE, Four Square, On The Spot and Raeward Fresh stores could be set at a more national level,

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152 [ ]

153 As noted previously, in terms of key entry and expansion that has occurred since the market study, The Warehouse has increased its grocery offering (https://www.thewarehousegroup.co.nz/news-updates/warehouse/warehouse-adds-further-10-stores-offer-fresh-produce) and Costco has opened a store in Auckland (https://www.nzte.govt.nz/blog/costcos-usd100-million-investment-into-new-zealand). In terms of exit since the market study, one example is online-only grocery retailer Supie, which went into liquidation in October 2023.

(notwithstanding the Parties' submission that owner operators have, and would continue to have, pricing discretion to sell products for less than recommended retail prices). We consider that pricing set at a more national level may make it easier for Woolworths to monitor the merged entity's prices and detect any changes (and vice versa). This ability to observe and detect changes in each other's pricing may help facilitate coordination on price.

175.3 The Proposed Merger would create a national Foodstuffs entity that, compared to the current two co-operative model, would have a similar national footprint to Woolworths operating across the North and South Island with a central head office. Firms being similar in size and structure can facilitate coordination. The Proposed Merger could also make the two firms more different in some aspects, and we continue to test this.

175.4 If we consider that the Proposed Merger would increase barriers to entry and/or expansion for a third retail grocery retailer, as discussed above, this could reduce the likelihood of coordination being disrupted by a new entrant.

175.5 As noted above, the market study found some evidence of grocery retailers seeking information from suppliers about the prices, discounts and promotions of their rivals. We are considering whether this is still prevalent, and whether the reduction in number of major grocery retailers could make this information seeking easier and thereby allow for more likely, complete or sustainable coordination between the merged entity and Woolworths.

176. We invite submissions and further information on the extent to which the Proposed Merger could facilitate coordination in retail grocery markets, making it more likely, more complete and more sustainable.

Next steps in our investigation

177. We are currently scheduled to decide whether or not to give clearance to the Proposed Acquisition by **31 May 2024**. However, this date may change as our investigation progresses.[154] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

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

Making a submission

179. We are continuing to undertake inquiries and seek information from industry participants about the impact of the Proposed Merger. We welcome any further

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

evidence and other relevant information and documents that the Parties or any other interested parties are able to provide regarding the issues identified in this SoI.

180. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference 'FSNI/FSSI' in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **18 April 2024**.

181. If you would like to make a submission but face difficulties in doing so within the timeframe, please ensure that you register your interest with us before 18 April 2024 at registrar@comcom.govt.nz so that we can work with you to accommodate your needs where possible.

182. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on our website.

183. All information we receive is subject to the Official Information Act 1982 (OIA), under which there is a principle of availability. We recognise, however, that there may be good reason to withhold certain information contained in a submission under the OIA, for example in circumstances where disclosure would unreasonably prejudice the supplier or subject of the information.

Attachment A [CONFIDENTIAL]: Counterfactual for FSSI

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Attachment B [CONFIDENTIAL]: Counterfactual for FSNI

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