IN THE COURT OF APPEAL OF NEW ZEALAND

CA55/2008
[2008] NZCA 276

BETWEEN	THE COMMERCE COMMISSION Appellant
AND	WOOLWORTHS LIMITED First Respondent
AND	FOODSTUFFS (AUCKLAND) LIMITED, FOODSTUFFS SOUTH ISLAND LIMITED, FOODSTUFFS (WELLINGTON) CO-OPERATIVE SOCIETY LIMITED Second Respondents
AND	THE WAREHOUSE GROUP LIMITED Third Respondent

Hearing: 28 April to 1 May 2008

Court: William Young P, O'Regan and Arnold JJ

Counsel: J A Farmer QC, D Laurenson, M Borrowdale and B Hamlin for Appellant
D J Goddard QC, J S Cooper and D A K Blacktop for First Respondent
B D Gray QC, I J Thain and M A Williamson for Second Respondents
M N Dunning for Third Respondent

Judgment: 1 August 2008 at 5 pm

JUDGMENT OF THE COURT

A We allow the appeal.

B We set aside the clearances granted in the High Court.

C **We direct Woolworths and Foodstuffs each to pay the Commission $24,000 in costs together with usual disbursements.**

D **We reserve to the Warehouse the right to seek costs.**

E **Costs of the proceedings in the High Court are to be fixed in that Court.**

REASONS OF THE COURT

(Given by William Young P)

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Introduction

[1] Woolworths Ltd and the three Foodstuffs co-operatives, Foodstuffs (Auckland) Ltd, Foodstuffs South Island Ltd, and Foodstuffs (Wellington) Co-operative Society Ltd (to which we will refer generally as "Foodstuffs"), wish to acquire the Warehouse Group Ltd. Woolworths (through its subsidiary, Progressive Enterprises Ltd) and Foodstuffs are the two primary supermarket operators in New Zealand. The Warehouse sells general merchandise (sometimes referred to as "GM & A" or general merchandise and apparel). But its three "Extra" stores (at Sylvia Park in Mt Wellington, Whangarei and Te Rapa) also operate as supermarkets. Given this, a takeover of the Warehouse by either Woolworths or Foodstuffs might contravene s 47 of the Commerce Act 1986. Woolworths and Foodstuffs therefore sought clearances (as provided for by s 66) to acquire up to 100% of the ordinary shares in the Warehouse from the Commerce Commission.

[2] The Commission declined the clearance applications and Woolworths, Foodstuffs and the Warehouse appealed to the High Court. In a judgment delivered on 29 November 2007, the High Court (Mallon J and Dr S King) allowed the appeal and granted clearances, see (2008) 8 NZBLC 102,128. The Commission then obtained leave from Mallon J to appeal against that decision to this Court.

[3] Primarily in issue are ss 47(1) and 66 of the Commerce Act. Section 47(1) prohibits an acquisition of the assets of a business or shares if the acquisition "would have, or would be likely to have, the effect of substantially lessening competition in a market". Section 66 permits the Commission to grant a clearance immunising an acquirer from subsequent action under s 47(1) if satisfied that the acquisition "will not have, or would not be likely to have, the effect of substantially lessening competition in a market".

[4] It is elementary that the required competition analysis involves a comparison of the "factual" (ie the likely state of competition if either acquisition proceeds) with the "counterfactual" (ie the likely state of competition if neither acquisition proceeds). An assessment of the counterfactual in this case requires two separate exercises: first, an analysis of the viability of the Extra concept; and secondly, a consideration of the likely competitive impact of the Warehouse Extra stores, assuming viability.

[5] The relevant markets were defined by the Commission as the markets for the retailing of grocery items in supermarkets not less than five kilometres in radius from actual or proposed Warehouse Extra stores or where there is a credible potential for a roll out of a Warehouse Extra store. The High Court saw no need to examine local markets other than those referable to the existing three Extra Stores and confined its inquiry accordingly. The High Court also recognised that the five kilometre radius was arbitrary in relation to Sylvia Park (for instance, it excluded a store 5.8 kilometres away) but took the view that this did not matter. As the Court recognised (at [159]), all constraints affecting competition are relevant, irrespective of whether they originate from within or outside the defined market. The High Court approach was not challenged before us.

[6] The case requires consideration of the proper approaches to be taken in clearance cases by the High Court, in relation to appeals from the Commerce Commission, and this Court, on appeal from the High Court. Another difficult issue is how the statutory test under ss 47 and 66 is to be applied in conditions of uncertainty.

[7] Against that background, we propose to address the appeal under the following headings:

(a) Factual background – general overview;

(b) The nature of the relevant rights of appeal;

(c) The application of the statutory test in conditions of uncertainty;

(d) The factual;

(e) The counterfactual – the viability of Extra;

(f) The counterfactual – likely competitive impact of the Extra stores; and

(g) Conclusion.

Factual background – general overview

The existing supermarkets

[8] Prior to June 2002, there were three supermarket operators: Progressive, Woolworths NZ and Foodstuffs. In that month, Progressive acquired Woolworths NZ, thereby reducing the major competitors from three to two (Progressive and Foodstuffs). In 2005, Woolworths Ltd (the Australian company which we refer to in this judgment as "Woolworths") acquired Progressive.

[9] The upshot of the takeovers in 2002 and 2005 is that there are now two major supermarket competitors: Woolworths and Foodstuffs.

[10] The Warehouse, with its three Extra stores, is the new entrant.

Woolworths and its supermarkets

[11] Woolworths has three supermarket banners: Countdown, Woolworths and Foodtown. There are 57 Countdown stores, 63 Woolworths stores and 30 Foodtown stores. As well, Woolworths, through its wholesale division, also coordinates the SuperValue and Fresh Choice franchise stores which, because they operate predominantly in the South Island, need not be mentioned again in this judgment.

[12] The Countdown, Woolworths and Foodtown banners have different price, quality, range and service (PQRS) mixes. Countdown stores offer the lowest prices but have comparatively limited ranges of products (around [ ] stock keeping units, or SKUs). The average store size is [ ]. Woolworths and Foodtown stores are typically more expensive but have greater ranges of products (around [ ] SKUs), and provide better quality and service. The average store size of Woolworths and Foodtown supermarkets is between [ ].

[13] Around [ ]% of sales through Woolworths supermarkets are at "shelf prices", with the balance being "specials". Shelf prices in each store are set by reference to the pricing zone within which the store is placed. Each pricing zone is allocated a pricing policy [ ].

[14] Woolworths surveys [ ] of its competitors and some specialist independent stores and adjusts its stores' prices accordingly.

[15] The takeover of Progressive by Woolworths affected supermarket margins. For the financial year ended 30 June 2007 Woolworths achieved cost savings of approximately [ ] through obtaining better buying terms from suppliers associated with harmonising its trans-Tasman arrangements. Woolworths says that these cost savings were passed on to consumers in the form of lower prices from May 2006

onwards.

Foodstuffs and their supermarkets

[16] As we have noted, there are three regionally based co-operatives to which we refer collectively as Foodstuffs. They coordinate their activities through Foodstuffs NZ Ltd, which the three co-operatives jointly own. All stores are owner operated. Foodstuffs operates the Pak'n Save, New World and Four Square banners. Because the Four Square stores operate typically in small catchments and very much as convenience stores, we will not mention them again.

[17] Pak'n Save stores offer the lowest prices (with prices which are generally lower than at the competing Countdown stores) but characteristically have relatively limited ranges of stock (approximately [ ] SKUs) and levels of service. The average Pak'n Save is 4,500 m^2. New World supermarkets are more expensive but offer a greater range of products (between [ ] SKUs), a higher level of service and are smaller (1,800 to 3,600 m^2). Both the Pak'n Save and New World banners offer a mix of shelf prices and specials.

[18] Store format, product range, pricing and store fit are provided for in agreements between individual store owners and the relevant regional co-operative. These regional co-operatives set maximum prices and provide for mandatory product specials. Individual store owners otherwise operate independently.

[19] Price checkers engaged by the regional co-operatives survey prices charged at both Foodstuffs' and Woolworths' stores. Analysis of point of sale data provides another method of monitoring prices charged by members. Service levels are also monitored.

The market shares and pricing of Woolworths and Foodstuffs

[20] The Commission's decision noted that supermarket sales are split between Foodstuffs (with a 56% share of New Zealand sales) and Woolworths (with 44%).

[21] As noted, Pak'n Save is the acknowledged price leader. In its decision (8 June 2007) Commerce Commission 606 & 607 at [62], the Commission provided the following table of pricing indices:

[ ]

The Warehouse

[22] The Warehouse was founded by Mr Stephen Tindall. It is listed on the New Zealand stock exchange, but 51% of the shares are held by Mr Tindall and associated interests (including the Tindall Foundation). The Warehouse is the largest retailer of general merchandise in New Zealand. It has 86 general merchandise stores located around the country as well as 43 stationery stores. It has retail sales of approximately NZ$1.7 billion per annum.

[23] For some time the Warehouse had been considering the possibility of entering the supermarket business. After the possibility of doing this via an acquisition of Progressive was pre-empted by the 2005 Woolworths takeover, it entered the business directly. The concept was to provide supercentres offering the convenience of a "one-stop" shop for groceries and general merchandise.

[24] The viability of the supercentre concept depends on the "halo" effect: increasing general merchandise sales over previous sales levels through attracting customers to buy groceries. So the underlying strategy is not that the Warehouse should become a major supermarket operator (in the sense that Woolworths and Foodstuffs are) but rather that the grocery sections of the Extra stores would increase non-food sales. The aim was to be [ ].

[25] The business case presented to the board of the Warehouse for proceeding with the Warehouse Extra at Whangarei was on the basis of an expected halo of [ ] in the first year of operation, rising to [ ] in the second year and [ ] in the third year. The strategy involved beginning with three Extra stores with a view, depending on results, to open others later. The possibility of having as many as 15 stores was discussed.

[26] The first Warehouse Extra store opened in June 2006 at the new Sylvia Park shopping centre in Mt Wellington; a Foodtown supermarket opened next door in July that year; and a Pak'n Save opened at the other end of the shopping centre in August. Within 5 km of this Warehouse Extra there is also a Countdown at Mt Wellington, a New World at Panmure and a Foodtown at Pakuranga. As well there is another Pak'n Save at Glen Innes, 5.8 km away. Because Sylvia Park is a new shopping centre, there are no pre-Extra figures against which a halo effect can be assessed.

[27] The Warehouse store in Whangarei was converted to the Extra format in November 2006. Because there are before and after figures for this store, it provides a better basis for assessing the viability of the Extra concept. Its closest competitors are a Countdown (300 metres away) and a Pak'n Save (1 km away). A Woolworths at Kensington and a New World at Regent also fall within the 5 km radius. There is also a Countdown at Tikipunga which is 5.8 km from the Warehouse Extra store.

[28] The third Warehouse Extra store opened in Te Rapa on 23 August 2007. Its closest competitor is a New World. Within just over a 5 km radius there are eight other stores, two of which are labelled New World, two as Countdown, two as Foodtown and two as Woolworths.

[29] There is some commonality between the products sold by Warehouse stores and supermarkets. Supermarkets sell some general merchandise and all Warehouse general merchandise stores offer some dry groceries, health and beauty products, beverages, packaged bread, small goods, snacks and confectionery. Warehouse Extra stores operate as normal supermarkets while also selling the usual general merchandise found at other Warehouse stores. Their grocery departments are placed broadly at the Pak'n Save and Countdown end of the PQRS continuum. They offer a more extensive range of products than Pak'n Save stores (around [ ] SKUs compared to [ ] SKUs) but their prices are somewhat higher. They offer lower prices but less range than is generally available in New World, Woolworths and Foodtown stores.

[30] As is apparent from what we have said, the Warehouse Extra's economic

model differs from those of Woolworths and Foodstuffs. Although the Warehouse has economies of scope, it lacks the economies of scale which are usually critical to the success of supermarkets. The halo is thus essential to the model's success.

[31] We will discuss later in the judgment (when we assess the viability and competitive impact of the Extra concept) details of the performance of the three Extra stores. At this point, it is sufficient to record:

(a) Initial performance was far below business case expectations. Establishment costs were higher and retail margins less than expected. Lower retail margins were attributed to the pricing policy introduced by Woolworths. Real difficulties were also encountered with the stores' fresh foods sections.

(b) [ ]. This came through very clearly in the record of a meeting between representatives of the Warehouse and the Commission on 17 May 2007. The board decided on 10 August 2007 not to open any further Extra stores after Te Rapa and to review the strategy in March 2008. The Warehouse also took a number of steps to improve the performance of the Extra stores and by the time the case was heard in the High Court there were some signs of improvement along with some indications of a competitive response from Woolworths, including [ ] in Whangarei.

(c) More recently (ie after the High Court judgment), the performance of the Extra stores has continued to improve and at the March 2008 board meeting, the decision was made to persist with the strategy pending further review in March 2009.

Foodstuffs' interest in the Warehouse

[32] On 7 July 2006 Foodstuffs purchased a 10% shareholding in the Warehouse. The evidence indicates that this purchase was unrelated to the launch of the Warehouse Extra concept. [ ]. [ ].

[33] Against this background, and in order to preserve maximum flexibility, Foodstuffs applied on 21 December 2006 for clearance to acquire up to 100% of the shares in the Warehouse.

Woolworths' interest in the Warehouse

[34] Progressive began investigating the possibility of acquiring the Warehouse in March 2004 (ie before the takeover of Progressive by Woolworths). Woolworths' current strategy is to acquire the Warehouse as a means of entering the general merchandise market. It acquired a 10% shareholding in September 2006. This was after the first Warehouse Extra opened its doors, but on the evidence, the decision to acquire this stake was triggered by Mr Tindall announcing that he intended to privatise the Warehouse. Woolworths purchased its stake to block Mr Tindall's privatisation plans which it saw as inconsistent with its own ambitions to take over the Warehouse.

[35] Woolworths applied to the Commission for a clearance on 17 January 2007.

The nature of the relevant rights of appeal

The nature of the appeal to the High Court

[36] Section 91 of the Commerce Act provides for the right of appeal from Commission decisions to the High Court that Woolworths and Foodstuffs exercised. The High Court's jurisdiction on appeal is described in s 93:

> **93 Determination of appeals**
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> In its determination of any appeal… the Court may do any one or more of the following things:
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> (a) Confirm, modify, or reverse the determination or any part of it:
>
> (b) Exercise any of the powers that could have been exercised by the Commission in relation to the matter to which the appeal relates.

The Court also has the option of referring the subject matter of the appeal back to the Commission, see s 94. The Act is otherwise silent as to the nature of an appeal. Accordingly, the appeal is subject to r 718 of the High Court Rules and is by way of rehearing (as distinct from a de novo hearing). Under r 716(3), further evidence may be adduced only with leave of the Court, which may be granted if there are "special reasons".

[37] Before the hearing of the High Court appeal there was a dispute as to what new evidence should be permitted. There was no dispute that updating evidence should be led. What was in issue was:

(a) Evidence addressed to what were said to have been errors on the part of the Commission associated with the impact of Progressive's 2002 acquisition of Woolworths NZ. First, it was alleged that the Commission's reservations about Dr Philip Williams' economic analysis that was submitted to the Commission were in error. Secondly, there were alleged to have been errors in both the data set used (about which the Commission had expressed reservations) and the approach taken by the Commission in carrying out its own modelling.

(b) Evidence which responded "to the Commission's reasoning in declining clearance". This in part addressed the updating evidence and as well commented on what was called "unseen material", being the information collected by the Commission as part of its investigation. It was, however, broadly a critique of the Commission's reasoning process.

In a judgment delivered on 12 September 2007, Mallon J and Dr King held that additional evidence along these lines could be led.

[38] In relation to the impact of the 2002 merger, this was because:

> [40] …We consider that it may assist the Court to have an explanation from economists (rather than the lawyers) as to its views of what was wrong with

> the Commission's analysis and why, if carried out correctly (according to Woolworths), it does not tend to support the Commission's conclusion but supports a contrary conclusion.

[39] The Court considered that the other evidence (ie responding to the Commission's reasoning) should also be admitted. The reasons for this conclusion were as follows:

(a) In part this evidence responded to the updated material of events which post-dated the Commission's decision. As to this, it was relevant that the Extra stores had been operating for only a short period.

(b) The nature of the clearance process (and its inquisitorial and non-adversarial nature) warranted a more than usually lenient approach to the admission of new evidence.

(c) Economic evidence may be of assistance where an appellant wishes to challenge the economic reasoning that underpins the Commission's approach.

(d) And the proposed evidence, which responded to the Commission's economic analysis, was "broadly comparable to other kinds of appeals (that are not a mix of legal and economic reasoning) where the legal submissions respond to the legal decision against which the appeal is lodged".

The additional evidence which was called

[40] The High Court heard updating evidence from Mr Peter Smith, who is in charge of Woolworths' New Zealand supermarkets, and Mr Ian Morrice, the chief executive officer of the Warehouse. There was also an uncontentious affidavit about data errors in scanning information provided to the Commission. More significantly, for present purposes, evidence from a number of experts was tendered.

[41] Dr Philip Williams (of Frontier Economics) gave evidence for Woolworths. He challenged the Commission's empirical analysis of competition among New Zealand supermarkets and responded to its criticisms of material that he had provided as part of the clearance process. In one sense this might be thought to have been unnecessary, as the Commission, in its decision, did not rely on its empirical analysis. But this part of his evidence was inextricably tied up with his broad argument that the 2002 takeover of Woolworths NZ by Progressive had not resulted in real price increases (after allowance for changes in the Consumer Price Index). He challenged the view of the Commission that the competitive relationship between Woolworths and Foodstuffs was one of tacit collusion. Instead he saw them as competing vigorously. Accordingly he concluded that the scope for a "third force" such as the Warehouse "to further limit the market power of Foodstuffs and Woolworths" was limited. He also analysed the material gathered by the Commission, which he had not seen until after the decision, and critiqued its reasoning process at some length. He concluded that the Extra stores were unlikely to provide a material competitive constraint on the incumbents.

[42] Professor Janusz Ordover also gave evidence for Woolworths. His evidence covered much the same ground as that of Dr Williams and he reached broadly similar conclusions. He identified the issues in this way (his quotations come from the Commission's decision):

> The key question I examine is whether the economic analyses and evidence on the Record and in the updating material support the Commerce Commission's conclusion that an acquisition by Woolworths or the Foodstuffs cooperatives… of The Warehouse Group Limited… would "lead to a substantial increase in market power of the remaining incumbent supermarkets" and whether "there is a real risk that prices will be materially higher, and quality, service and innovation materially lower, than in the counterfactual through either or both non-coordinated or coordinated effects after any merger."

As this indicates, his evidence was squarely addressed to what became the ultimate issues for the High Court. It also proceeded very much by way of critique of the Commission's decision.

[43] Mr James Mellsop gave evidence for Foodstuffs. This evidence too was in the nature of a critique of the Commission's decision albeit not as trenchantly

expressed as those by Dr Williams and Professor Ordover. The overall drift of his analysis of the factual and counterfactual (including his view that there was "a real prospect that The Warehouse Extra concept will not continue and may exit in the near future") was consistent with the conclusions of Dr Williams and Professor Ordover.

[44] In response, the Commission called evidence from Dr Gustavo Bamberger, Professor Jerry Haussman and Professor Ronald Cotterill.

[45] Dr Bamberger responded generally to the evidence of the experts for Woolworths and Foodstuffs although he did not address the econometric analysis of Dr Williams. He was less pessimistic as to the viability of the Extra concept, making the point that the Warehouse had continued with the concept despite shareholder and analyst calls for the strategy to be abandoned to facilitate a takeover by Woolworths or Foodstuffs. He was of the view that the Extra stores would provide a material competitive constraint in the relevant local markets associated with impact on prices and the convenience of one-stop shopping.

[46] Professor Hausman covered much the same ground as Dr Bamberger but with a slightly differently expressed premise that the case depended on whether consumer welfare would be higher if acquisition is permitted than if it is blocked. He favoured a precautionary approach, because he saw such an acquisition as having the consequence that "New Zealand consumers and competition in the market will never be able to determine whether the [Extra] concept will be a successful approach". A significant part of his evidence was addressed to the effects of the 2002 merger. He initially concluded that this merger had led, on a conservative estimate, to supermarket prices increasing by [ ] in the Tauranga, North Shore, West Auckland and Nelson regions. He subsequently revised these figures. The revised figure for Nelson was [ ] and figures for the other four regions were between [ ].

[47] Professor Cotterill disagreed with the conclusions of Dr Williams and Professor Ordover as to the impact on prices of the 2002 merger. He supported the Commission's approach to market definition and concurred with the Commission's definition and analysis of the factual and counterfactual.

[48] At the hearing in the High Court, Messrs Morrice and Smith gave oral evidence in the ordinary way. The economists participated in a "hot tub" exercise.

The approach of the High Court to the new evidence

[49] When the High Court came to deliver its final judgment, it observed:

> [18] An appeal to this Court is by way of rehearing. The Court considers the materials that were before the Commission and any further evidence received at this hearing. The Court must make up its own mind on that evidence. In doing so the Court is to give weight to any advantages that the Commission had in assessing that evidence. The Commission's decision is to be reversed only if the appellants have shown that it is wrong.
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> [19] An advantage which the Commission may sometimes have is in seeing and hearing the evidence first hand. In this case, Woolworths says that this Court is in as good as or better position to assess the evidence because of the further evidence that is before it. This followed discovery, and leave granted to file updating and additional evidence. Given the considerable updating and additional evidence we have received we agree with Woolworths' submission that this Court is not at any disadvantage to the Commission in assessing the evidence.
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> [20] The Commission places some emphasis on the expertise that it has as a specialist body tasked with (amongst other things) assessing the likely effects of proposed business acquisitions. Mr Kos QC, counsel for the Commission, accepts that this does not mean that this Court is to defer to the Commission's assessment. He says that it means no more than that the Court should "hesitate" before reaching a different conclusion to the Commission. We bear in mind that the Commission is a specialist body with experience and expertise in assessing mergers. But in this case we heard further evidence and arguments that were not before the Commission. Our task is to assess whether, on all the evidence that is now before us, we are satisfied that the acquisition is not likely to substantially lessen competition in a market.

So the High Court dealt with the case afresh, taking into account not only the evidence before the Commission and the reasons of the Commission but also additional evidence not before the Commission and, necessarily, updating evidence. Mallon J and Dr King made up their own minds on what they saw as the critical issue in the case and in this way inevitably substituted their view for that of the Commission.

Does the inquisitorial nature of the process before the Commission justify a de novo appeal?

[50] Before us, the Commission complained that the High Court, in dealing with the case de novo, had not approached its appellate function in an orthodox way. We have some sympathy with this complaint.

[51] Obviously the admission of so much new evidence facilitated a closer examination of the Commission's reasoning than would have been possible if the parties had been confined to the record and genuinely updating evidence. But similar considerations apply to many appeals which turn on issues of fact. Where a Judge has determined a case involving expert evidence, it is not customary for an appellate court to permit the losing party to produce expert evidence on appeal critiquing the approach of the Judge. This is so even though the appellate court would be better placed to assess the correctness of the first instance judgment if such evidence was given. While a de novo hearing will usually be "better" in terms of resolving the case at hand, a general policy of conducting appeals on this basis would have major resource and institutional implications – implications which have dissuaded appellate courts in New Zealand and similar jurisdictions from adopting this approach when hearing appeals.

[52] The rights of appeal created by s 91 of the Act are most likely to be exercised in relation to clearance and authorisation decisions. The Commission seldom if ever resorts to the conference process provided for by s 69B in relation to clearance applications and, in any event, a conference is not really equivalent to a full inter partes hearing before a court. So in most (and perhaps practically all) doubtful clearance and authorisation cases, a de novo appeal hearing in the High Court would permit a closer (and in that sense a "better") examination of the Commission's decision. But if the nature of the Commission's processes warranted a de novo appeal, we would have expected this to be provided for in the legislation and rules, which instead require "special reasons" for admitting new evidence. Considerations that are common to most (and possibly practically all) appeals can hardly be seen as amounting to special reasons.

[53] We note that the Commerce Amendment Bill currently before the House of Representatives proposes further rights of appeal to the High Court from decisions of the Commission. In relation to input methodology decisions, the proposed s 52Z provides that the appeal:

> … be by way of rehearing and must be conducted solely on the basis of the documentary information and views that were before the Commission when it made its determination, and no party may introduce any new material during the appeal.

But cl 18 of the Bill also proposes a right of appeal pursuant to s 92 in relation to determinations made under the proposed s 52O in relation to regulated goods and services. On the approach taken by the High Court it may be difficult to resist conducting s 52O appeals on a de novo basis.

[54] Such an approach to appeals from the Commission was seen as inappropriate in *Telecom Corporation Ltd v Commerce Commission* [1991] 2 NZLR 557 at 558 (CA):

> ... [T]here is power on such an appeal to rehear the whole or any part of the evidence or to hear and receive further evidence under R 696 of the High Court Rules [which corresponded to the current r 716(3)]. It is common ground that R 696 is applicable, but in exercising these powers the Court must be alert against the danger of allowing what the legislature intends to be a genuine appeal against a decision of an expert body - and a decision reached, it may be added, after a somewhat distinctive procedure of investigation, draft determination and conference – to be converted into a new trial, the prior proceedings being but a prelude or, as some counsel put it in argument, a dummy run. This consideration must weigh strongly against the allowance of any evidence which is little more than an improvement on, or a revised version of, material that was before the Commission.

We recognise that where there has been neither a conference nor a draft determination (as in the present case), there may be slightly greater scope for the admission of new evidence on appeal (for instance to address unexpected points or to correct palpable misunderstandings). That said, we regard the passage we have just cited as broadly applicable in the present context. The High Court should be astute not to allow the appellate process contemplated by the Act and the High Court Rules "to be converted into a new trial".

A fait accompli

[55] The reality is that rightly or wrongly, the case was effectively re-run in the High Court. Before us the Commission accepted that the way the case was conducted in the High Court is a *fait accompli*. So the Commission did not in the end pursue a challenge to the September 2007 judgment.

[56] The corollary of hearing the case de novo in the High Court was that the Court was practically required to adopt the approach that is reflected in [20] of its judgment. In the end, the Commission did not seek to resist that view.

The nature of the appeal to this Court

[57] The right of appeal to this Court is conferred by s 97(1):

> **97 Appeal to Court of Appeal in certain cases**
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> (1) Notwithstanding anything in any enactment, any party to any appeal before the High Court against any determination of the Commission who is dissatisfied with any decision or order of the Court may, with the leave of the Court or of the Court of Appeal, appeal to the Court of Appeal; and section 66 of the Judicature Act 1908 shall apply to any such appeal.

[58] Under r 47 of the Court of Appeal (Civil) Rules 2005, this appeal is also by way of rehearing.

[59] It is common ground that the principles discussed in *Austin, Nichols & Co Inc v Stichting Lodestar* [2008] 2 NZLR 141 (SC) apply to the appeal to this Court. An appellate court is required to come to its own view of the matter and, if satisfied that the lower court was wrong, is required to act accordingly. We thus propose to approach our appellate function with a view to coming to our own assessment of the merits of the case. Obviously we must do so in a way that reflects the advantages enjoyed by the High Court in relation to its factual assessments.

[60] In one important respect, we are better placed than the High Court in terms of making the necessary factual assessments: we have had the benefit of knowing what has happened since the High Court judgment. On the other hand, the hearing before

us was comparatively short (four days and not two weeks). We are also not as well placed as either the Commission or the High Court to assess the evidence of the economists.

[61] There is one associated aspect of the case we must mention. In this case, the High Court decision was made by a tribunal consisting of a Judge and an economist. In *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352 at 357 this Court stated:

> This appeal is on fact and law and in the factual area there are two special features which affect the weight we must give to the judgment under appeal. The first concerns the constitution of the High Court for the hearing of the case. In providing for the appointment of lay members in appropriate cases the legislation recognises that in this complex area the knowledge and experience in a particular field or fields of a member of the Court is likely to contribute to the just resolution of proceedings. It is not surprising that in the present case where, as it transpired, the parties placed great emphasis on the evidence of economists and on the impact of competition and the inhibition of competition in this industry it was considered desirable to appoint to the Court a lay member with special expertise in commerce and economics. Weight must be given to that in assessing the findings made by the High Court.
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> ...
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> In these circumstances we consider that the High Court, constituted as it was, was in a particularly good position to compare and assess the competing views and that its conclusions as to the acceptability and weight-worthiness of the expert opinion are entitled to great weight.

It is right to recognise that the *Tru Tone* case involved an appeal to this Court from a first instance decision of the High Court as opposed to the current situation in which two expert tribunals (ie the Commission and the High Court on appeal) have disagreed. In this context, the remarks of Cooke P in *Telecom Corporation of New Zealand Ltd v Commerce Commission* [1992] 3 NZLR 429 at 434 (CA) are material:

> Due weight must be given to the views of expert tribunals, but in this instance two expert tribunals have differed, in that the Commerce Commission considered that Telecom should be allowed to acquire one additional band (TACS-B) whereas the Administrative Division [of the High Court] considered that no addition to Telecom's spectrum right was acceptable. It has to be borne in mind as well that s 97 provides, if leave is granted, a full right of appeal to this Court. The wide prescription in s 97(2) of the matters to which regard is to be had in determining whether to grant leave, including "the importance of the issues to the parties", underlines that

> an effective appeal on the merits is intended by Parliament. While this Court will of course not allow an appeal unless satisfied that the decision under appeal is wrong, there can be no suggestion of rubber-stamping a decision simply because it represents the views of experts.

The application of the statutory test in conditions of uncertainty

Section 47

[62] Section 47(1) of the Act provides:

> **47 Certain acquisitions prohibited**
>
> (1) A person must not acquire assets of a business or shares if the acquisition would have, or would be likely to have, the effect of substantially lessening competition in a market.

[63] The proscribed effect (ie actual or likely substantial lessening of competition in a market) is assessed in relative rather than absolute terms. This exercise requires a comparison of the likely state of competition if the acquisition proceeds ("the factual") against the likely state of competition if it does not ("the counterfactual"). The expression "factual" is, in the context of a clearance application, a misnomer as it is just as hypothetical as the counterfactual. A substantial lessening of competition is "likely" if there is a "real and substantial risk" that it will occur, see *Port Nelson Ltd v Commerce Commission* [1996] 3 NZLR 554 at 562-563 (CA). Another way of putting it is that there must be a "real chance" that there will be a substantial lessening of competition, see *Tillmanns Butcheries Pty Ltd v Australasian Meat Industry Employees' Union* (1979) 27 ALR 367 at 382 (FCA).

Section 66

[64] A potential acquirer concerned at the possible retrospective application (ie after an acquisition has occurred) of s 47 may seek a clearance under s 66 of the Act, which materially provides:

66 Commission may give clearances for business acquisitions

(1) A person who proposes to acquire assets of a business or shares may give the Commission a notice seeking clearance for the acquisition.

…

(3) Within 10 working days after the date of registration of the notice, or such longer period as the Commission and the person who gave the notice agree, the Commission shall either—

> (a) If it is satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market, by notice in writing to the person by or on whose behalf the notice was given, give a clearance for the acquisition; or
>
> (b) If it is not satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market, by notice in writing to the person by or on whose behalf the notice was given, decline to give a clearance for the acquisition.

(4) If the period specified in subsection (3) of this section expires without the Commission having given a clearance for the acquisition and without having given a notice under subsection (3)(b) of this section, the Commission shall be deemed to have declined to give a clearance for the acquisition.

(5) A clearance given under subsection (3) of this section expires—

> (a) Twelve months after the date on which it was given; or
>
> (b) In the event of an appeal being made against the determination of the Commission giving the clearance, and the determination being confirmed by the Court, 12 months after the date on which the determination is confirmed

Section 47(1) does not apply to an acquisition that has been the subject of a s 66 clearance, see s 69. So a clearance immunises the acquirer from later action under s 47 whether at the suit of the Commission or another affected party.

Legislative history

[65] Section 66 has changed considerably since it was first enacted in 1986. In order to understand some of the cases to which we will later be referring and to put the current wording in context, it is necessary to discuss the legislative history.

[66] Under the Act as first enacted, there was no provision equivalent to the present s 47. And s 66 formed part of a tighter regulatory regime under which s 50 provided that particular classes of mergers and takeovers (being those referred to in the First Schedule to the Act) required either a clearance or an authorisation from the Commission. Thus the Commission was very much the primary regulator, in contradistinction to the present situation in which the lawfulness or otherwise of an acquisition may fall ultimately to be determined under s 47 and thus by the High Court.

[67] Under this scheme, the proscribed effect, which precluded the granting of a clearance, was the actual or likely acquisition or strengthening of a dominant position in a market.

[68] Section 66(3) – (9) relevantly provided:

> (3) Within 20 working days after the date of registration of the notice given under subsection (1) of this section, the Commission shall either—
>
> > (a) If it is satisfied that the merger or takeover proposal, if implemented, would not result or would not be likely to result in any person (whether or not that person is a participant in or otherwise a party to the merger or takeover proposal) acquiring a dominant position in a market or strengthening a dominant position in a market, give a clearance of the merger or takeover proposal by notice in writing to the person by or on whose behalf the notice was given; or
> >
> > (b) If it is not satisfied that the merger or takeover proposal, if implemented, would not result or would not be likely to result in any person (whether or not that person is a participant in or otherwise a party to the merger or takeover proposal) acquiring a dominant position in a market or strengthening a dominant position in a market, by notice in writing so inform the person by or on whose behalf the notice was given.
>
> (4) Where the period specified in subsection (3) of this section expires without the Commission having given a clearance of the merger or takeover proposal and without the Commission having given a notice under subsection (3)(b) of this section, clearance shall be deemed to have been given of the merger or takeover proposal under subsection (3)(a) of this section on the last day of that period.
>
> …
>
> (6) Where the Commission gives a notice pursuant to subsection (3)(b) of this section the Commission shall make a determination in writing—

(a) Giving a clearance or granting an authorisation of the merger or takeover proposal; or

(b) Declining to give a clearance or grant an authorisation.

(7) The Commission shall give a clearance under subsection (6) of this section unless it is satisfied that the merger or takeover proposal, if implemented, would result or would be likely to result in any person (whether or not that person is a participant in or otherwise a party to the merger or takeover proposal) acquiring a dominant position in a market or strengthening a dominant position in a market.

(8) The Commission shall grant an authorisation under subsection (6) of this section if it is satisfied that the merger or takeover proposal, if implemented, would result or would be likely to result, in a benefit to the public which would outweigh any detriment to the public which would result or would be likely to result from any person (whether or not that person is a participant in or otherwise a party to the merger or takeover proposal) acquiring a dominant position in a market or strengthening a dominant position in a market.

(9) If in any case where the Commission has given a notice under subsection (3)(b) of this section, the Commission has not within a period of 100 working days from the date of registration of the notice given under subsection (1) of this section—

(a) Given a clearance or granted an authorisation to implement the merger or takeover proposal; or

(b) Declined to give a clearance or grant an authorisation—

the Commission shall be deemed to have granted an authorisation to implement the merger or takeover proposal.

[69] Two features of this scheme should be noted:

(a) The two stage nature of the process, with s 66(3) and (4) applying to the first stage and s 66(6) to (9) governing stage two; and

(b) The requirement in s 66(7) for the Commission to give a clearance unless satisfied that the acquisition would have the proscribed effect.

[70] In 1991, the scheme of the legislation changed. Section 47 was amended so that it took the form of a general prohibition akin to the present prohibition save that the proscribed effect was actual or likely dominance or strengthening of dominance in a market. There were corresponding amendments to s 66, which became a voluntary process confined to the consideration of clearances.

[71] So, with effect from 1 January 1991, ss 47 and 66 relevantly provided:

> **47 Certain acquisitions prohibited**
>
> (1) No person shall acquire assets of a business or shares if, as a result of the acquisition,—
>
> > (a) That person or another person would be, or would be likely to be, in a dominant position in a market; or
> >
> > (b) That person's or another person's dominant position in a market would be, or would be likely to be, strengthened.
>
> **66 Commission may give clearances for business acquisitions**
>
> (1) A person who proposes to acquire assets of a business or shares may give the Commission a notice seeking clearance for the acquisition.
>
> …
>
> (3) Within 10 working days after the date of registration of the notice, or such longer period as the Commission and the person who gave the notice agree, the Commission shall either—
>
> > (a) If it is satisfied that the acquisition will not result in an effect described in paragraph (a) or paragraph (b) of section 47(1) of this Act, by notice in writing to the person by or on whose behalf the notice was given, give a clearance for the acquisition; or
> >
> > (b) If it is not satisfied that the acquisition will not result in an effect described in paragraph (a) or paragraph (b) of section 47(1) of this Act, by notice in writing to the person by or on whose behalf the notice was given, decline to give a clearance for the acquisition.
>
> (4) If the period specified in subsection (3) of this section expires without the Commission having given a clearance for the acquisition and without having given a notice under subsection (3)(b) of this section, the Commission shall be deemed to have declined to give a clearance for the acquisition.

For present purposes, it is important to notice that the burden of proof (not, as we will see, an entirely happy term) changed. Under the old s 66, the Commission had to give a clearance unless it was satisfied that there would be a proscribed effect, whereas under the "new" s 66, a clearance could only be given if the Commission was satisfied that there would not be a proscribed effect. The reason for this change was presumably the changed role of the Commission. Under the original scheme, the ultimate decision on an acquisition (subject of course to rights of appeal) was for the Commission. But under the scheme introduced in 1991, a withholding of a clearance does not preclude an acquisition. In such a case, the acquisition may

proceed and any challenge to it is determined by the High Court under s 47. The effect of a clearance is to preclude any later challenge.

[72] Section 66 largely took on its present form in 2001. Minor, and relatively inconsequential, amendments were made in 2005.

The clearance process in practice

[73] Parties seeking a clearance put forward the evidence and reasons they rely on to satisfy the Commission that no substantial lessening of competition in any market is likely. The Commission assesses that evidence, carries out whatever further investigations it considers appropriate and makes its decision. The Act sets a default timeframe of 10 working days for a decision to be reached. In practice this timeframe is generally inadequate and is extended by agreement. The Commission's report for the 2006-2007 year shows that the average time to determine clearance applications was 45 working days with an average of 56 working days for the giving of reasons. In the present case, after a number of agreed extensions, the Commission's decision was given more than five months after Foodstuffs' application and more than four months after Woolworths' application.

[74] The Commission's processes are comparatively informal and are investigative rather than adversarial in nature. It has the practical ability to require substantial co-operation from the applicant (because if there is insufficient co-operation there is likely to be a s 66(4) refusal). It also has extensive information gathering powers as well as the ability (under s 69B) to hold a conference. Where a conference is convened, those who participate have appeal rights (see s 92). In practice, conferences are seldom held for clearance applications (and there was no conference in this case). In the absence of a conference, any information put before the Commission is not directly tested in an adversarial manner unless an appeal is taken to the High Court, *Brambles New Zealand Ltd v Commerce Commission* (2003) 10 TCLR 868 at [62] (HC).

The problem of uncertainty

[75] Both factual and counterfactual are forward looking. They are necessarily incapable of accurate assessment.

[76] The High Court judgment noted that there are competing policy considerations in terms of where the burden of this uncertainty should lie:

(a) On the one hand, acquisitions can harm competition. Because a decision to permit an acquisition is irreversible, it might be thought sensible to be cautious.

(b) On the other hand, acquisitions can increase efficiency and benefit the public and thus should be permitted unless there is a good reason to prevent them. A starting at shadows approach to what constitutes an anti-competitive effect might thus be inimical to the public interest.

We agree that this is so, at least broadly. But it is right to recognise that efficiency considerations are more material to an authorisation than a clearance.

The Commission's approach to uncertainty

[77] The approach of the Commission was in these terms:

> 7. Under s 66 of the Act, the Commission is required to consider whether the proposal is, or is likely to have the effect of substantially lessening competition in the market. If the Commission is satisfied that the proposal is not likely to substantially lessen competition then it is required to grant clearance to the application. Conversely if the Commission is not so satisfied it must decline. In *Brambles v Commerce Commission*, the Court observed:
>
> The position is that the Commission is obliged to decline to give clearance for a proposed acquisition if:
>
> a) The Commission is satisfied that the acquisition will have, or would be likely to have, the effect of substantially lessening competition in a market;

b) The Commission is in doubt as to whether the acquisition will have, or would be likely to have, the effect of substantially lessening competition in a market.

8. The standard of proof that the Commission must apply in making its determination is the civil standard of the balance of probabilities.

[78] In the end, the Commission's decision was not influenced by its approach to the burden of proof because it was brought to the point of being satisfied that the proposed acquisition would substantially lessen competition:

> 334. The Commission has therefore concluded that the loss of existing and potential competition from an innovative firm in circumstances where it is the only likely entrant for the foreseeable future, and the other resulting foreclosure effects for other possible acquirers in the future, would lead to a substantial increase in market power of the remaining incumbent supermarkets. As a result of the loss of this significant competitive constraint in the factual, there is a real risk that prices would be materially higher, and quality, service and innovation materially lower, than in the counterfactual through either or both non-coordinated or coordinated effects. A lessening of competition through non-coordinated effects would materialise through a reduction in the incentive for both Woolworths and Foodstuffs to compete vigorously because of the loss of an innovative competitor. A lessening of competition through coordinated effects will materialise through the increased ability and incentive of Woolworths and Foodstuffs to coordinate their behaviour on prices and possibly on other dimensions of competition.
>
> 335. Having reached these conclusions, the Commission cannot be satisfied that the proposed acquisitions will not have, or would not be likely to have, the effect of substantially lessening competition in the relevant supermarket markets.

The High Court's approach to uncertainty

[79] The High Court addressed how uncertainties were to be resolved in this way:

> [105] *We consider it is unhelpful to focus on the burden of proof. This is because the question is whether the Commission is satisfied or is not satisfied on the evidence from whatever source it has come. The requirement is for the Commission to make up its mind whether a substantial lessening of competition is likely. The same requirement applies to this Court on appeal.*
>
> [106] There may be situations where the Commission is entitled to say there is insufficient evidence available in order to be able to decide whether a substantial lessening of competition is likely. That is, the proposed acquisition may not be likely to substantially lessen competition, but the

> Commission cannot tell that on the information before it. It therefore cannot be satisfied. A clear example of this would be an inadequate application for clearance and a refusal by the applicant to put forward information available to it from which the Commission could decide whether a substantial lessening of competition is likely.
>
> [107] Similarly we agree with the Commission, that if it is apparent that relevant and important evidence has been left out of the material before us which could affect our view of the likely effect of the proposed acquisition, then we could not be satisfied in order to grant a clearance. In that sense there is a burden on an applicant for a clearance. At the clearance stage the Commission may identify that omission and request the information from the applicant. But if this has not occurred, by the time of the appeal a material omission in the evidence is fatal to the Court being able to grant a clearance because the appeal proceeds on the record.
>
> [108] *Apart from situations where available relevant and important evidence is missing it is not clear to us whether there is any other situation where the Commission or the Court are entitled to say "we are not sure" and therefore we are "not satisfied".* Professor Hausman noted that an acquisition of the Warehouse was irreversible. As such there might be an economic benefit from refusing clearance in that this allows the Extra concept to take its course and for the market to determine its success. We consider, however, that the Commission (and the Court) are not entitled to say that a decision to grant a clearance should wait until further developments in the market have taken place so as to be able to better assess the likely effects. Otherwise potential acquisitions would either proceed without the certainty of a clearance or be put on hold until the Commission (or the Court) considers sufficient time had passed to assess the developments that have occurred. We consider that this is not what was intended under the clearance regime.
>
> [109] *We therefore consider that the Commission (and the Court) cannot say it is too early for us to be able to make up our mind what effect is likely – and this is not the position advanced by the Commission in any event. The Commission (and the Court) must decide on the evidence what is likely. We need to consider on the evidence before this Court whether we are satisfied that the proposed acquisition will not be likely to have the effect of substantially lessening competition in a market.*

And a little later:

> [126] *Overall we consider the appropriate approach is to ask whether there is a real prospect that the Warehouse Extra will continue absent an acquisition and, if so, whether there is also a real prospect that it will provide effective competition to Foodstuffs and Woolworths. If there is a positive answer to both of these questions then clearance must be denied*.

Towards the end of the judgment, when expressing its conclusions, the Court said:

> [270] We answer the following questions set out at the beginning ([13] above) as follows:

a) A clearance may be granted if the Court is satisfied that the proposed acquisition is not likely to have the effect of substantially lessening competition in a market. *The Court cannot decline a clearance on the basis of being "not satisfied" because it is not certain what developments might take place in the market and because of that uncertainty it wishes to allow time for further developments to take place. The Court must make up its mind on the evidence whether the proposed acquisition is or is not likely to have the effect of substantially lessening competition in any market*.

b) To be a "likely" effect means that there is a real and substantial risk or prospect of that effect occurring. Where there is more than one real prospect as to what may occur, each of those real prospects must be considered. If any of these real prospects are likely to substantially lessen competition then a clearance is to be declined even if there is also a real prospect that competition will not be substantially lessened. *In this case the likely effect of the proposed acquisition depends in part on whether the Warehouse Extra is likely to continue and in part on what effect it will have if it does continue. Both the prospect of it continuing and the prospect that it will have a "substantial" effect on competition must be real prospects in order for a clearance to be declined.*

…

g) We consider that there is a real prospect that the Warehouse Extra will be abandoned when it is reviewed in March 2008. There is also a real prospect that the Warehouse Extra will instead continue to be trialled for a further period and then abandoned without any further stores rolled out. We consider there is not a real and substantial prospect that the Warehouse Extra will continue for long enough to establish the necessary halo on which the concept depends. Because of that that, we consider that the roll out of more Extra stores on a scale that would make the concept sustainable is not "likely" to occur.

h) … For completeness, and although we consider that this is not a real prospect, we have also considered the likely state of competition in the event of a roll out of more Extra stores on a scale that would be sustainable for the Warehouse. We consider that the constraint from the Warehouse Extra, once rolled out to 15 stores, would not provide a material constraint on Woolworths or Foodstuffs. ….

i) Competition in the factual (Woolworths or Foodstuffs acquire the Warehouse) is not likely to be substantially lessened as compared with competition in the counterfactual (Woolworths or Foodstuffs do not acquire the Warehouse) in the three relevant markets. In the absence of an independent Warehouse Extra in these markets prices may increase, but if they do, that will be at a de minimus [sic] level. The one-stop convenience of a Warehouse Extra may also be removed but we consider this also to be a de minimus [sic] lessening if it occurs. *There is no basis to infer that competition effects in any other market where an Extra store might be rolled out will be any different from the competition effects in the three identified local markets.*

> [271] In summary we consider that the information now before us enables us to find that there is no real and substantial prospect that the Warehouse Extra will be a material constraint on Foodstuffs and Woolworths. …We are therefore satisfied that an acquisition by Foodstuffs or Woolworths of the Warehouse would not or would not be likely to substantially lessen competition in any market.
>
> (Emphasis added.)

[80] We will return later to discuss the remarks that we have italicised but at this point, we should note that the second to last sentence of [108] does not state the options completely. A potential acquirer does, of course, have the option of proceeding with an acquisition despite a failure to obtain clearance (subject of course to the possibility of an interim injunction being sought) and defending its actions if litigation later takes place. Moreover, a potential acquirer is also entitled to resubmit its application for clearance on the basis that further information justifying the acquisition has become available or it may choose to frame a further application in a different way (eg by giving undertakings as to divestments).

The authorities

[81] There are four judgments, two from this Court and two from the High Court, which have addressed the correct approach to s 66. The first three were decided when the proscribed effect was framed in terms of dominance in a market, but this distinction does not affect their relevance for present purposes.

[82] In *Foodstuffs (Wellington) Co-operative Society Ltd v Commerce Commission* (1992) 4 TCLR 713 at 722-723 (HC), Greig J observed:

> The procedure under s 66 cannot properly be described as a summary procedure or one which is available only for the clear case or the case which can be made clear in a short time. … That said, it is obvious that s 66 provides a relatively inexpensive and speedy means of seeking and obtaining a clearance to a business acquisition which is preferable to the other alternatives. Thus it is likely that clear cases or strong cases, cases in which the applicant feels there can be little controversy or doubt will be brought under s 66. But that does not alter the function or the duty of the commission or the standard of proof.

[83] In *Power NZ Ltd v Mercury Energy Ltd* [1997] 2 NZLR 669 at 674 (CA), McKay J, speaking for the Court, observed:

> It will be noted that s 47 prohibits certain acquisitions which would have, or be likely to have, certain effects. The prohibition is immediate, but depends on what would be the effects of the acquisition if it took place. Section 66 is similar. A clearance can be given to a "proposed acquisition", ie an acquisition in the future. The commission must be satisfied that it "will not result" in the effects described, assuming it takes place. We regard these words as the converse to those in s 47. *The words "likely to" appear in s 47 but not in s 66.* If certain effects are "likely to" result, however, the commission could not be satisfied that they "will not result". If they are not likely to result, then the commission can be satisfied on the balance of probabilities that they will not result. We reject the suggestion that there is a gap between the two sections.
>
> (Emphasis added)

We note in passing that at the time under s 66(3)(a) the Commission was required to give a clearance if satisfied that the acquisition "will not result in an effect described in paragraph (a) or paragraph (b) of section 47(1)". This is the explanation for the sentence in the passage that we have emphasised. Another, perhaps easier, way of approaching the section would have been to treat likely effect as part of the proscribed effect. This is now provided for specifically in the current section.

[84] In *Commerce Commission v Southern Cross Medical Care Society* (2001) 10 TCLR 269 (CA), Tipping J (speaking for himself and Richardson P) observed of s 66(3):

> [65] There was some difference between the parties as to the correct approach to s 66(3). … Paragraph (a) of subs (3) speaks of the Commission being satisfied, and para (b) of the Commission not being satisfied, that the acquisition will not result in a proscribed effect. The double negative inherent in para (b) is conceptually awkward. Mr Farmer argued that either the Commission would be satisfied or it would not. Mr Fogarty suggested that there were really three possibilities – (1) satisfaction that a proscribed effect would not result, (2) satisfaction that such an effect would result, and (3) doubt as to whether the acquisition would result in a proscribed effect. For the purposes of s 66, Mr Fogarty's second and third possibilities amount to the same thing because a clearance can be given only if the Commission is satisfied, on the balance of probabilities, that a proscribed effect would not result from the acquisition. Satisfaction that a proscribed effect will result, and not being satisfied that such an effect will not result, both mean that clearance cannot be given.
>
> [66] This interpretation of s 66(3) is consistent with the approach of the full Court of the High Court in *Foodstuffs (Wellington) Co-Op Soc Ltd v CC* (1992) 4 TCLR 713, 721 and of this Court in *Power NZ Ltd v Mercury Energy Ltd and CC* [1997] 2 NZLR 669, 674.

[85] In the same case, Keith J (who dissented on the merits) observed (at [101]):

> [W]hile the grant of a clearance gives legal protection to the applicant (ss 69 and 66(5)) the refusal of a clearance does not in law prevent the applicant proceeding with the acquisition. Were the application [sic, but presumably the acquisition] to be challenged the onus would be on the Commission or other person making the challenge to establish its case. It is consistent with that aspect of the scheme of the Act that if the applicant does not satisfy the Commission that its acquisition will not have the forbidden effects, it simply states that it is not satisfied. In such a situation, in terms of s 66(3) (from which para (b) could, it seems to me, be deleted without any change in function or effect), the clearance sought is simply not granted.

[86] The final case we should refer to is *Brambles* where the High Court (O'Regan J and Ms KM Vautier) observed (at [55]):

> [55] The use of the double negative in s 66(3)(b) was described as "conceptually awkward" in the majority judgment of the Court of Appeal in *CC v Southern Cross Medical Care Soc* (2001) 10 TCLR 269 (CA), at p 290, but the Court was clear as to the effect of the provision. That case was decided before the 2001 amendments to the Act, so that the "dominance" threshold for merger clearances still applied. Adapting the Court of Appeal's analysis to the present "substantial lessening of competition" threshold…, the position is that the Commission is obliged to decline to give clearance for a proposed acquisition if:
>
> a) The Commission is satisfied that the acquisition will have, or would be likely to have, the effect of substantially lessening competition in a market;
>
> b) The Commission is in doubt as to whether the acquisition will have, or would be likely to have, the effect of substantially lessening competition in a market.

[87] The approach in *Brambles* follows on from the formulation adopted by Richardson P and Tipping J in *Southern Cross* and was itself adopted by the Commission in the present case.

The competing arguments

[88] The Commission made an affirmative finding that a proscribed effect was likely if the acquisition proceeded. On this approach, the decision to decline a clearance did not turn on how issues of uncertainty should be resolved. Once the case went on appeal, however, the problem of uncertainty became more significant.

[89] On the approach taken by the High Court, and supported by Woolworths and Foodstuffs, the test for the Commission (and thus for the High Court) was practically

the same as it would have been in enforcement proceedings except that in enforcement proceedings the burden of proof would have been on the Commission. This exception might be more apparent than real given the approach taken by the High Court to the insignificance of the burden of proof and the reality that comparatively few civil cases turn on which party has the onus of proof.

[90] Woolworths and Foodstuffs defend this approach. They maintain:

(a) The approach contended for by the Commission, which means that doubts are resolved against those applying for clearances, is tantamount to treating the requirement in s 66(3) for the Commission to be "satisfied" as requiring proof beyond reasonable doubt. Such an approach is not consistent with the usual way in which the word "satisfied" is used in the Act or indeed in other legal contexts other than those involving criminal liability.

(b) The uncertainties in this case are of no greater magnitude than those which customarily arise when a court must assess hypothetical possibilities and future events. Indeed there are often major uncertainties associated with the reconstruction of past events.

(c) There are already significant disincentives to utilisation of the clearance procedure. These are the costs and delays associated with clearance applications and the reality that an acquirer who proceeds with an acquisition in the teeth of a refusal of a clearance is more likely to face enforcement action than one who proceeds outside of the clearance process. In this context, placing the risk of uncertainty on the applicant carries the risk of discouraging use of the process.

[91] In his written submissions, Mr Goddard QC addressed the issue of doubt in this way:

> The realm of "doubt" is not a large one, in which the Commission can seek refuge from making findings of fact on the balance of probabilities. If the Commission is satisfied, on the balance of probabilities, that a substantial lessening of competition is likely then it must decline a clearance. If it is satisfied, on the balance on probabilities, that a substantial lessening of competition is not likely then it must grant a clearance. Any "gap" in between these findings is a very narrow one, that could only be relevant in exceptional circumstances where the Commission is unable to reach a view on the balance of probabilities despite all the inquiries it has made and the information it has received. In particular, the Commission cannot choose not to form a view because some matters require prediction or involved uncertain outcomes, and conclude that this means it is not satisfied that a substantial lessening of competition is not likely.

[92] Mr Farmer QC for the Commission disputed Mr Goddard's contention that the Commission's approach (which followed that of *Southern Cross* and *Brambles*) was tantamount to requiring proof beyond reasonable doubt.

[93] He also argued that the approach adopted by the High Court was not logically consistent. The Court accepted that the Commission was not required to reach a conclusion one way or the other if it considered that insufficient evidence had been made available. So the approach favoured by the High Court only applies if there has been a full enquiry. But it would be unusual if the nature of the statutory test under s 66(3) varied depending on the nature of the process followed by the Commission. Further, there is a "how long is a piece of string" quality to what constitutes a full enquiry. It is not practicable for the Commission to defer making a decision until all conceivably relevant information is to hand, see *Wellington International Airport v Commerce Commission* (2002) 10 TCLR 460 at [51] and [70] (HC). There is thus no logical reason why uncertainty associated with deficiencies in the evidence should be more significant than uncertainty associated with the impracticality of predicting future events.

[94] Mr Farmer therefore argued that the High Court approach increases inappropriately the investigative obligations of the Commission and likewise the risk that the Commission might be bounced into giving a clearance which will later be shown to have been inappropriately granted.

Our evaluation

[95] Section 66(3)(b) incorporates a double negative. We consider that the subsection would read more easily as follows:

> (3) Within 10 working days after the date of registration of the notice, or such longer period as the Commission and the person who gave the notice agree, the Commission shall either—
>
> > (a) If it is satisfied that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market, by notice in writing to the person by or on whose behalf the notice was given, give a clearance for the acquisition; or
> >
> > (b) In any other case, by notice in writing to the person by or on whose behalf the notice was given, decline to give a clearance for the acquisition.

That is what Keith J thought the subsection meant (see his remarks cited above at [85]) and we broadly agree with him.

[96] The authorities indicate that the default 10 working day period is not a legislative indication that the clearance procedure is only for obvious cases (ie the sort of case which can be adequately investigated in 10 working days). This was the view of the High Court in the *Foodstuffs* case and the jurisprudence has subsequently developed on this basis. It is now too late for this Court to change course on this point. On this basis, the exercise before the Commission is similar to what is involved in enforcement proceedings under s 47 save that the burden of proof is reversed, see *Power New Zealand* at 674 and *Southern Cross* at [7]. But very much in issue in this case is the significance of the different burdens of proof.

[97] It is common ground that the standard of proof in this context is on the balance of probabilities. A hypothesis is established on the balance of probabilities if it is more likely than not to be true. So this means that s 66(3)(a) should be construed as applying if the Commission is of the view that it is more likely than not that the acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market. So we have "more likely than not" on top of "will not have, or would not be likely to have" along with the test of

substantial lessening of competition, which also necessarily involves questions of degree.

[98] We agree with Mr Farmer that when this Court in *Southern Cross* and the High Court in *Brambles* said that if the Commission is "in doubt" it should decline a clearance, this was not intended to adopt the concept of a "reasonable doubt" as that expression is used in the criminal law. For the present purposes, the existence of a "doubt" corresponds to a failure to exclude a real chance of a substantial lessening of competition.

[99] An equivalent situation under the Australian Trade Practices Act 1974 was addressed by French J in *Australian Gas Light v Australian Competition and Consumer Corporation* (2003) ATPR 41-966 at [356] (FCA). In his view, a party in the position of Woolworths or Foodstuffs:

> … must satisfy the Court that its hypothesis against any likely substantial lessening of competition in any relevant market is more probable than the competing hypotheses which are advanced to suggest a real chance of competition being substantially lessened in any such market.

This test is logically correct but it is phrased in such abstract language as to make it difficult to apply.

[100] At this point it is appropriate to identify and explain the respects in which we differ from the approach taken in the High Court. To do so, it is necessary to revert to the extracts from the High Court judgment set out in [79] above and in particular to the passages which are emphasised. For ease of reference we set them out again:

> [105] *We consider it is unhelpful to focus on the burden of proof. This is because the question is whether the Commission is satisfied or is not satisfied on the evidence from whatever source it has come. The requirement is for the Commission to make up its mind whether a substantial lessening of competition is likely. The same requirement applies to this Court on appeal.*
>
> …
>
> [108] *Apart from situations where available relevant and important evidence is missing it is not clear to us whether there is any other situation where the Commission or the Court are entitled to say "we are not sure" and therefore we are "not satisfied". ...*

> [109] *We therefore consider that the Commission (and the Court) cannot say it is too early for us to be able to make up our mind what effect is likely – and this is not the position advanced by the Commission in any event. The Commission (and the Court) must decide on the evidence what is likely. We need to consider on the evidence before this Court whether we are satisfied that the proposed acquisition will not be likely to have the effect of substantially lessening competition in a market.*
>
> …
>
> [270] We answer the following questions set out at the beginning ([13] above) as follows:
>
> a) … *The Court cannot decline a clearance on the basis of being "not satisfied" because it is not certain what developments might take place in the market and because of that uncertainty it wishes to allow time for further developments to take place. The Court must make up its mind on the evidence whether the proposed acquisition is or is not likely to have the effect of substantially lessening competition in any market.*
>
> b) … *In this case the likely effect of the proposed acquisition depends in part on whether the Warehouse Extra is likely to continue and in part on what effect it will have if it does continue. Both the prospect of it continuing and the prospect that it will have a "substantial" effect on competition must be real prospects in order for a clearance to be declined.*
>
> …
>
> i) … *There is no basis to infer that competition effects in any other market where an Extra store might be rolled out will be any different from the competition effects in the three identified local markets.*

[101] We agree that the Commission can be expected to engage in an inquisitorial process in which it would make a reasonable inquiry into the merits or otherwise of the clearance that is sought. The decision to grant or refuse a clearance is necessarily to be made on the basis of all the evidence. So the situation is not really analogous to that of a plaintiff in a civil case who either proves his or her case or loses.

[102] Conceivably, the Court in [105] was simply recognising that the Commission can be expected to obtain information from many sources and the requirement that it be "satisfied" can be discharged by reference to its consideration of all the evidence, whether adduced by the potential acquirer or otherwise; cf the comments of Greig J in *Foodstuffs (Wellington) Co-operative Society* at 721-722 and, from a completely different context, the remarks in *R v Leitch* [1998] 1 NZLR 420 at 428 (CA). For this reason we acknowledge that "burden of proof" is not an entirely happy phrase, although it is not easy to come up with a better one.

[103] We consider, however, that the Court went rather further than this. In particular, we read the italicised passages, as a whole, as implying a broad acceptance of the proposition that if the Commission is not satisfied that a proscribed effect is "likely", the Commission will necessarily be satisfied that a proscribed effect is not likely. On this approach, the choice for the Commission was effectively binary in nature: a substantial lessening of competition was either likely or it was not. This indeed is very much the way the issue was posed in [270](c).

[104] Interestingly, Mr Goddard did not try to defend this approach. Instead he advanced the submission which we have set out at [91] in which he acknowledged that there was a "gap", albeit one which he submitted was "very narrow".

[105] We are of the view that the binary approach of the High Court was erroneous.

[106] If the legislature intended clearances to be refused unless the Commission is satisfied that a proscribed effect was likely, it would have said so. This, after all, is pretty much what s 66(7), ie the precursor to s 66(3), provided (see [68] above). We do not accept that the change in statutory language between the old s 66(7) and the current s 66(3), associated, as it was, with a major change in the role of the Commission, was so inconsequential. As well, the remarks made in [108] are not consistent with *Southern Cross* and *Brambles*.

[107] We are reluctant to engage with any argument as to the width of Mr Goddard's "gap". What is more important is that the Commission and thus the Court should approach the giving of a clearance by direct reference to the statutory test, that is by granting a clearance only if satisfied that a substantial lessening of competition is not likely. As is apparent from what we have said already, we think that the Court instead in effect took the approach that it should grant a clearance unless satisfied that such an effect was likely. And, as will become apparent when we discuss the counterfactual, the significance of this came to be magnified by the Court's very close focus on what was very limited empirical evidence.

The factual

Overview

[108] There are two areas of possible contention as to the factual:

(a) Is it likely that if Woolworths or Foodstuffs acquire the Warehouse, the Extra concept will be continued?

(b) If Woolworths or Foodstuffs acquire the Warehouse, what level of competition in the relevant market is likely?

[109] The High Court's discussion of, and conclusions on, these two areas were not seriously challenged in this Court.

The approach of the High Court

[110] The High Court placed little significance on the possibility that an acquirer of the Warehouse would continue with the Extra concept. In part this was because neither Woolworths nor Foodstuffs had confirmed that they would continue with the concept post-acquisition. More importantly, an acquirer (ie either Woolworths or Foodstuffs) of the Warehouse would need to take into account the cannibalising effect of vigorous competition from Warehouse Extra stores on existing sales from its nearby supermarkets. As Foodstuffs and Woolworths have reasonably similar market shares, approximately half of the customers who, on this hypothesis, would switch to a Warehouse Extra store would have come from the acquirer's existing stores. For this reason, the incentives associated with the operation of the Extra concept differ considerably depending on whether the Warehouse continues in independent ownership or is acquired by Woolworths or Foodstuffs.

[111] The High Court judgment concluded on this point in this way:

> [171] We conclude that the Extra concept in the hands of the acquirer may change competition between Foodstuffs and Woolworths … but that is not the relevant comparison. The relevant comparison is the difference between

> the concept in the hands of an independent Warehouse and in the hands of the acquirer. The general submission, that the only way Woolworths or Foodstuffs would not have an incentive to continue with the Extra stores is if the halo does not or is unlikely to emerge (in which case there is no loss as compared with the counterfactual), does not answer the question of whether the different incentives would result in a less vigorous pursuit of the Extra concept in the factual as compared with the counterfactual. In the absence of economic modelling or similar we consider that there is an insufficient evidential basis to say that "the factual" may be more competitive than "the counterfactual".

[112] The more important aspect of this part of the case involves the likely level of competition between Woolworths and Foodstuffs if one or other acquires the Warehouse. Woolworths and Foodstuffs emphasised in their submissions to the High Court the intensity of the present competition between them. The Commission, whilst recognising that they did compete with each other, submitted that the key question must be the relative difference in competition between the existing level and that likely to be present in the counterfactual.

[113] The High Court took the view that a guide as to the existing state of competition was to be found in a comparison of prices before and after the 2002 acquisition by Progressive of Woolworths NZ. Having reviewed the evidence on that point, the High Court concluded that any lessening of competition (as measured by impact on pricing) had not been substantial; there had been, at worst, only a small effect on supermarket prices. As well, the Court concluded that there was some evidence of [ ]. On the other hand, although [ ].

[114] The High Court next referred to evidence suggesting some degree of tacit collusion was occurring but concluded (at [189]) that it fell short of establishing such collusion. The Court then went on:

> [190] Further, while competition may not be as 'tough' as it potentially could be, the practices of the supermarkets are in line with what would be expected for firms that provide differentiated products. In the same way that a luxury car maker may seek to maintain a certain gap in price between its cars and the price of more basic cars, so too a supermarket that offers a greater range, higher quality products or greater customer service may seek to maintain a certain price gap between itself and lower quality supermarkets. Indeed, to the extent that these non-price qualities involve greater cost, we would expect such a price gap to exist in a workably competitive market.

[115] The Court then discussed both Woolworths' and Foodstuffs' use of multiple supermarket banners and the extent to which this provided an indication of the level of competition currently present:

> [192] Professor Hausman gave evidence in his experience it was unusual for supermarkets to have more than one banner. He said that Woolworths and Foodstuffs each having more than one banner enables price discrimination. Woolworths has indicated that [ ]. Professor Hausman says that if the market was more competitive each competitor would have one banner.
>
> [193] Against that, multiple branding by individual producers is seen with other products. It seems unlikely that all markets that have producers selling under more than one "label" could be characterised, simply because of this, as less than workably competitive.

[116] All of this evidence was seen by the High Court as consistent with a workably competitive supermarket industry. So too was evidence of innovations introduced by Woolworths and Foodstuffs, the introduction of New World metro stores, fuel discount vouchers, the development of loyalty programmes and the availability of on-line shopping.

[117] The High Court's conclusions on the current level of competition between Foodstuffs and Woolworths were as follows:

> [195] There is no single characteristic that can tell us whether the relevant supermarket markets are workably competitive or not. The absence of evidence of significant price impacts since the 2002 merger; the reduction in costs and the passing on of these cost savings to customers as indicated by the direct evidence of Smith and the indirect evidence of the [ ]; and the innovations Woolworths and Foodstuffs have referred to are consistent with a competitive market. The evidence relied on by the Commission as evidence of tacit collusion is inconclusive. The existence of multiple banners is consistent with either workably competitive markets or markets with less competition.
>
> [196] In the 'hot tub', Dr Bamberger said that "I'm not sure that anyone can say exactly how competitive this industry is, I just haven't seen that in the Record." In contrast, Dr Williams said that "[t]he empirical evidence suggests that, with or without the presence of a 'third force' in New Zealand supermarkets, Foodstuffs and Woolworths are competing vigorously." We agree, at least in part, with both of these conclusions.
>
> [197] The evidence before us is not inconsistent with Woolworths and Foodstuffs being involved in reasonably vigorous and workable competition. In this sense we agree with Dr Williams. However, we consider that the nature of existing competition should not be overstated. As Dr Bamberger notes, the Court cannot determine the exact level of competition.

> Importantly, the evidence does not show that the current level of competition between Woolworths and Foodstuffs could not be made more vigorous through the presence of a successful Extra as an effective third competitor. As such, the acquisition of the Warehouse by either Foodstuffs or Woolworths may still represent a substantial lessening of competition. The key question is not how competitive are Woolworths and Foodstuffs today but rather, in light of this evidence of existing competition, how competitive will the relevant markets be in the future in the absence of the acquisition.

[118] Finally, in this part of the judgment, the High Court assessed the level of constraint posed by independent retailers. Having referred to the relevant evidence, the Court concluded:

> [199] This evidence supports Woolworths' and Foodstuffs' submission that the independent retailers provide some constraint. We do not, however, have evidence of how many stores are checked, nor direct evidence of any adjustments that have been made, nor evidence of how often adjustments are made nor how many items are benchmarked against items supplied by independent retailers. In the absence of more specific evidence we agree that the constraint from independent retailers is not of much relevance to whether the proposed acquisition of the Warehouse is likely to have the effect of substantially lessening competition in a market. The evidence is that they do provide some constraint, but whatever constraint that is, it will be present in the factual and the counterfactual and there is no evidence that the constraint is so material that any constraint that an independent Warehouse Extra might apply would be irrelevant.

Our approach to the factual

[119] As indicated, the approach of the High Court to the factual was not seriously challenged and we are accordingly content to adopt its conclusions. There is no finding that there is not, or could not be, tacit collusion. There is no finding that the current level of competition as between the two incumbents could not be made more vigorous. And there is thus nothing in the current level of competition which shows that any additional constraint by a new entrant would necessarily be irrelevant.

The counterfactual: the viability of Extra

The conclusions of the Commission

[120] The approach of the Commission was as follows:

184. …[T]he Commission is of the view that it is not necessary for The Warehouse Extra to offer the lowest grocery prices in order to compete effectively with other supermarket groups. In a CM Research Customer Survey provided to the Commission in the past, prices rank between third (equal) and fifth in terms of customer performance. Location, parking and range were more highly ranked. It also may be the case that the results of The Warehouse Extra to date have been negatively affected by the proposals to acquire The Warehouse.

185. The Warehouse informed the Commission that it planned to test the supercentre concept in its Extra stores in Whangerei, Mt Wellington and Te Rapa for a period of [ ]. This is the key point in establishing the counterfactual, and [ ]. The period of [ ] is also of significant relevance to the counterfactual because in this period the Warehouse Extra stores will provide competition, even if ultimately the supercentre concept were to prove not to be viable.

186. The Commission has found that the evidence indicates that the concept has found wide-spread acceptance and success overseas. While it does not appear to have been as successful in Australia in the past, the Commission notes Coles' recent announcement of its intention to develop 80 supercentre stores in Australia.

187. In any event, the Commission considers that the key factors relevant to establishing the appropriate counterfactual are as follows:

- The Warehouse is a $2 billion business that has made a commercial decision after considerable market research and evaluation to enter the supermarket markets using a supercentre format.

- The Warehouse has a nationwide network of large stores, a land-bank with resource consents, an efficient distribution infrastructure and experience of retailing some grocery lines (dry goods rather than fresh products). It is the principal retailer of general merchandise in New Zealand. This is a base on which a significant presence in grocery retailing could be developed. There are no other firms with a similar base in New Zealand.

- The Warehouse plans to trial the Extra concept for a period of [ ].

- The Warehouse has already rolled out two Extra stores in Whangerei and Mt Wellington, and is rolling out a third in Te Rapa this year.

- The Warehouse has plans to [ ].

188. It is these factors that are sufficient for the Commission to conclude that the appropriate counterfactual for each of the proposed acquisitions is that The Warehouse would remain independent of Foodstuffs or Woolworths, and would operate its existing and develop additional supercentres. This might mean The Warehouse

> continues to be owned by its existing shareholders, or it might mean that it is acquired by another party. While there has been some media speculation about other parties being interested in acquiring The Warehouse, the analysis below is not based on any particular owner or owners controlling it, but merely that it is somebody independent of Foodstuffs and Woolworths.
>
> *Conclusion on Counterfactual*
>
> 189. The Commission concludes that in the counterfactual the Warehouse Extra supercentres would compete against Woolworths and Foodstuffs, in Mt Wellington, Whangarei, Te Rapa supermarket markets and potentially, over time, a range of other local markets, under ownership independent of Foodstuffs and Woolworths.

[121] We have reservations whether this analysis of the facts was entirely correct at the time the decision was delivered. As we have noted, in May 2007, representatives of the Warehouse met with representatives of the Commission [ ]. By this stage there was no longer a commitment to a [ ] and no plans to roll out further Extra stores after Te Rapa.

The conclusions of the High Court

[122] The High Court had the benefit of updating evidence about the performance of the Extra stores, including:

(a) An internal Warehouse review of 28 June 2007 about the performance of the Whangarei store [ ]. This concluded with the recommendation for a further review of the Extra strategy in March 2008 to [ ] and [ ].

(b) A July 2007 survey of customers of the Sylvia Park store which [ ]. [ ].

(c) A similarly timed survey of customers of the Whangarei store. The overall conclusions were that [ ].

(d) A decision by the Board of 2 August 2007 to reassess the Extra strategy in March 2008.

(e) Information made publicly available by the Warehouse in September 2007. In its annual report the Warehouse noted that it was "too early to assess" the halo effect which was a "critical success factor". There was a related briefing to analysts and a radio interview in the course of which Mr Morrice said that the Extra format did not lose money, the Warehouse had given itself 12 months to work on issues, it would be January before the Warehouse could measure the halo and while acknowledging challenges in getting to 15 sites in five years, the sites were available.

[123] Mr Morrice gave further evidence before the High Court. He indicated that since Woolworths Australia had acquired Progressive, [ ]. He also expressed concern about the possibility of brand damage to the Warehouse if it was not price competitive with Pak'n Save. Performance at the three stores was improving. He was of the view that [ ], more improvement was required. Three stores were not, in his view, viable in the long term. He said that:

[ ].

[ ]. The brand implications of continuing with the concept was identified as one of the key issues governing future decisions. He noted that a final decision might not be made in March 2008.

[124] The High Court summarised the effect of the evidence in this way:

> [101] As to the future of the Warehouse Extra:
>
> a) The Warehouse is itself uncertain whether the concept will continue, although Mr Morrice believes that it is a concept that can succeed if given sufficient time;
>
> b) The Warehouse Extra must not cause brand damage to the Warehouse's general merchandise and apparel business and therefore, for so long as the food strategy is continued, the Warehouse must ensure that it is competitive in its supermarket offering;
>
> c) Achieving the halo remains the critical issue, but the timeframe to assess whether the halo will be achieved [ ];

d) Improvements have been made where they can. These improvements, although assisting with Extra, also benefit other stores. [ ].

e) Alongside the improvements [ ]. [ ]. [ ]. [ ]. [ ].

f) It is not viable to continue with the three existing stores alone. A roll out of further stores is necessary if the Warehouse is to continue with its supercentres.

g) No decision may be made [ ]. Instead the Board may decide to continue with the Extra format for the purpose of ongoing assessment as to whether the strategy should be continued.

[125] The Court then reached the following conclusions on this point:

> [223] Our assessment of all of the evidence is that [ ]. [ ]. [ ]. [ ]. [ ]. [ ].
>
> [224] While we cannot rule out (just as the management and the Board have not) the possibility that the three stores will continue in operation for long enough to achieve the halo at a level to make a roll out of more stores viable, we conclude that this is unlikely. It is possible, but there is nothing that indicates it is more than that. There is a prospect, but it is not a real and substantial prospect. On all the evidence before us we consider that the continuation of the Warehouse Extra and a roll out of further stores to make the concept viable is remote.

The updating evidence in this Court

[126] Mr Morrice swore an updating affidavit (of 17 April 2008) on which he was cross-examined before us.

[127] The key aspects of his evidence were as follows:

(a) The board of the Warehouse reviewed the Extra concept on 13 March this year. The ultimate decision was to continue the current strategy with no further long-term review being proposed until the 2009 calendar year. This means that the Extra concept will continue at the current three stores but will not be introduced at any other sites in the meantime.

(b) The Warehouse has moved away from treating the original business case as the measure of success and is instead looking to management's assessment of the stores' potential.

(c) The review focused on the Whangarei store because it had been open long enough to produce annualised accounts, which thus enabled a comparison with its pre-Extra performance.

(d) A halo effect for the Whangarei store of [ ] (as compared to the performance of a group of control stores) had emerged.

(e) Although the Whangarei store [ ]. [ ].

(f) If [ ].

(g) The profitability turn-around at Te Rapa had been achieved more quickly than at Whangarei largely because the Warehouse applied lessons learnt at Whangarei to the Te Rapa conversion.

(h) Three stores would not provide the scale which, in the medium to long term, will be necessary to engage the supplier support necessary to be competitive on price with Woolworths and Foodstuffs. [ ].

(i) The Warehouse's initial policy of being [ ] was broadly being met in relation to shelf prices but not promotions.

[128] We were shown a good deal of material generated within or for the Warehouse Extra Business Unit ("the WEBU"). This was set up in September 2007 to focus on improving the performance of the three Extra stores. It assembled a good deal of information for the purposes of the March 2008 board meeting. This included a market research presentation of which only an abbreviated version was provided to the Board. The presentation addressed changes that had been made to the way in which the Extra concept was being implemented in Whangarei and evolution in consumer attitudes. It also made recommendations for further change.

[129] In particular, the market research material (which focused on Whangarei) suggests:

(a) [ ].

(b) [ ].

(c) [ ].

(d) [ ].

[130] The material, which the WEBU submitted to the board, is reasonably optimistic. The executive summary is a fair reflection of the drift of what was said:

- [ ]
- [ ]
- [ ]
- [ ]
- [ ].

This presentation referred to [ ] and noted that [ ] and the WEBU is [ ]. All of this (and particularly the reference to [ ] in the fourth bullet point above) is written from the perspective of the WEBU.

[131] Obviously there are factors that point the other way. At the March 2008 board meeting there were reservations as [ ]. [ ]. On the other hand, grocery was also seen as [ ].

The Commission's argument

[132] Mr Farmer contended that the conclusion that the Extra concept was not viable was surprising. The supercentre concept has been proven internationally with new entrants being generally (although not invariably) successful. The Warehouse is a large and successful company and is the best judge of the concept's viability. It

went into the venture well aware of the nature of the risks involved. It has sunk substantial capital into the project and foregone revenue otherwise obtainable from the space devoted to the Extra concept. There are considerable incentives for it to succeed and the company's strong financial position makes it well able to persist with the concept. As a publicly listed company, it can be expected to seek to maintain growth. And, with its flat general merchandise sales over recent years, groceries offer a new opportunity for innovation-based growth.

[133] Mr Farmer maintained that the Extra strategy was necessarily always long-term and that the High Court's conclusion that the emergence of a halo effect was not anticipated (and thus the associated conclusion as to likely abandonment of the Extra concept) was based on misunderstandings of the evidence and had, in any event, been overtaken by subsequent performance figures.

The opposing argument

[134] Mr Goddard's argument for the respondents on this aspect of the case was that:

(a) The future of the Extra concept was on the table in March 2008 and will again be on the table in March 2009.

(b) There are currently no plans to roll out any future Extra stores.

(c) There is no commitment on the part of the Warehouse to persist with the Extra concept indefinitely until a halo effect occurs.

(d) The [ ] halo effect achieved to date is well short of what would be would be necessary to justify a roll out of new stores.

(e) Persisting with the Extra concept [ ]. As well, there is a risk of brand damage (if customers come to perceive that the Warehouse grocery prices are appreciably higher than those of Woolworths and Foodstuffs).

(f) Limitations associated with existing sites owned by the Warehouse and likely resource consent difficulties mean that the Warehouse does not have the sites to enable significant additional rollouts of the Extra concept.

Our evaluation

[135] We regard the key question on this aspect of the case as being whether there is a real and substantial prospect that the Extra concept will succeed to the extent that the Warehouse is prepared to roll out more stores. This question can, in the end, only be answered as a matter of impression. Further, given the nature of the clearance process, it has always been for Woolworths and Foodstuffs to establish that there is no such real and substantial prospect.

[136] Mr Goddard's propositions as to site availability and resource consent issues which limit the establishment of further Extra stores was not put to Mr Morrice in cross-examination and Mr Morrice has, on a number of occasions (for instance in September 2007), expressed confidence that there are other sites on which Extra stores could be established. We are, nonetheless, prepared to accept that there are comparatively few sites on which new Extra stores could be established in the short term. This, however, is of little relevance to our inquiry. Our primary focus is on the Extra stores now operating at Sylvia Park, Whangarei and Te Rapa. The likelihood of expansion in the short to medium terms is relevant only to the extent that such expansion (which would reduce economy of scale disadvantages) is a prerequisite to survival. The critical point is that, assuming that the Extra concept proves to be successful, the availability of new sites is not so constrained as to prevent the sort of expansion which Mr Morrice regards as necessary for survival in the long term.

[137] A point made by the Commission and not substantially addressed by the High Court is that the Extra concept has been implemented in unusual trading conditions where the two incumbent supermarket chains are both seeking to take over the Warehouse. This situation must, at the very least, have been a distraction for the Warehouse. As well, it may conceivably have affected (perhaps subconsciously) the

thinking of some of those associated with the company. We accept that at the meeting on 17 May 2007 with the Commission, the representatives of the Warehouse conveyed a high level of pessimism about the future of the Extra concept. But the management and board of the Warehouse then responded in a logical (and predictable) way to the disappointing early performance of the Extra stores. Areas of poor performance were identified, remedial action was taken and the WEBU was set up to focus on monitoring and improving performance. And from June 2007 on, performance has improved. Some improvement was manifest by the time of the High Court hearing – albeit not nearly to the level which warranted the rolling out of further stores – and there has been further improvement since then. All of this has occurred in an environment in which abandoning the Extra concept (in order to clear the way for a takeover) must have been attractive to at least some people associated with the Warehouse.

[138] It is clear that the Warehouse underestimated some of the difficulties it would face in the start up phase of the Extra concept. The costs of the set up were greater than anticipated. Execution of the development was not perfect. [ ].

[139] On the other hand, the Warehouse is well able financially to persist with Extra. [ ]. The setting up of the WEBU in September 2007, the refining of the way the concept is implemented, the further market research in January and February 2008, and the probable further refinement of the operating model are all consistent with an intention to make the concept viable if at all possible. The emergence of a halo effect and improvements in profitability are pointers to likely viability. It is also important to note that no brand damage has yet occurred, a factor viewed by Mr Morrice as crucial to the ongoing viability of the Extra concept.

[140] Mr Goddard and Mr Gray QC emphasised the role of economies of scale in the supermarket business. Mr Goddard identified two elements to this – operational economies and the costs of obtaining inputs from suppliers. Counsel argued the Warehouse would not have access to the economies of scale available to Woolworths and Foodstuffs, so that the Extra concept was unlikely to succeed.

[141] It is clear that economies of scale are important in the supermarket industry and that the Warehouse will not have access to scale economies to the same extent as Woolworths and Foodstuffs. But it is also clear, as the Commission said, that in order to succeed the Warehouse does not have to offer the lowest supermarket prices. As we noted at [12] and [17] above, Woolworths and Foodstuffs operate through several different banners, each having its own PQRS mix. The incumbents, then, do not regard price as everything. To succeed, the Warehouse needs to offer a PQRS mix that is attractive to consumers. Provided that its supermarket prices are broadly competitive, it will be able to succeed if sufficient consumers are drawn to its one-stop shop concept to create the necessary "halo" effect. In that context The Warehouse will, of course, have the benefit of economies of scope.

[142] Mr Goddard sought to downplay the significance of the one-stop shop concept in a New Zealand setting. While it is true that the concept has not been universally successful, it has had considerable success elsewhere. It is difficult to see why it cannot be developed to operate successfully in New Zealand, at least in some form. In this respect we are not prepared to second-guess the business judgment of the senior management and directors of the Warehouse. They would not have developed the Extra concept unless they saw it as viable. Its initial under-performance may well have been a function of poor execution of the concept which, with the benefit of experience, is being refined and improved. Trading performance has increased and a halo effect is emerging. Whether performance will improve to the point where other Extra stores are rolled out is uncertain, but we think that there is a real and substantial chance that this will occur.

The counterfactual – likely competitive impact of Extra

Preliminary comments

[143] The Commission's assessment of the competitive effects of the factual compared with the counterfactual focussed on the high barriers to entry, the very concentrated nature of the markets and what it saw as the associated prospects of coordinated and uncoordinated effects, which it regarded as appreciably less

significant under the counterfactual than the factual. The High Court, on the other hand, while recognising that a 3:2 merger might have the effect of substantially reducing competition in relevant markets, primarily focussed on the empirical evidence as to what had happened in the particular markets in which Extra stores had opened.

[144] Against that background, we propose first to examine the evidence as to the performance of the three Extra stores and their competitive impact, if any. We then turn to the approaches taken by the Commission and High Court and the differences between them before providing our own assessment.

Sylvia Park

[145] It will be recalled that the Sylvia Park Extra store opened in June 2006, with a Foodtown opening next door in July and a Pak'n Save opening at the other end of the shopping centre in August.

[146] Internal Woolworths documents in the period between January and April 2006 record a good deal of interest in the then proposed opening of the Warehouse Extra store. For instance, the relevant action points from a meeting on 13 February 2006 were:

> [ ]
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> [ ]
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> [ ]. [ ].
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> [ ].
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> [ ].
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> [ ]. [ ].
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> [ ].
>
> [ ].
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> [ ].

[147] As the document suggests, [ ]. [ ]. [ ]. In January 2007, the Sylvia Park Foodtown was [ ]. [ ].

[148] In May 2007, Woolworths [ ]. The Sylvia Park Foodtown and Mt Wellington Countdown stores were [ ]. [ ]. In other words there was no immediate change in pricing at those stores. Between July and September 2007 Woolworths' [ ].

[149] The evidence of reaction from Foodstuffs to the opening of the Extra store at Sylvia Park was more limited. [ ]. [ ]. [ ].

[150] As to market shares at Sylvia Park:

(a) For the period from opening (in June 2006) to March 2007, Woolworths had [ ]%, Foodstuffs [ ]% and Extra [ ]%.

(b) For the period between April and July 2007, Woolworths had [ ]%, Foodstuffs [ ]% and Extra [ ]%.

[151] Turnover figures for the Extra stores for the period from 5 August to 21 October 2007 which were available in the High Court showed weekly turnover at Sylvia Park [ ]. [ ] (at least until the end of March 2008) albeit that the figures are affected by Christmas and Easter trading which is always high for Warehouse stores. Excluding the last week in March (in which Easter fell) the average weekly turnover in February and March was approximately [ ].

[152] The April 2008 edition of *Consumer* magazine contained the results of its annual supermarket survey. This referred to improvements associated with the Woolworths banner and then went on:

> Another surprise was the second-place ranking of The Warehouse Extra in Auckland. Since it was opened in 2006 the store has struggled to compete but this year it ranked with Countdown and Woolworths.

[153] The Auckland price comparisons for a list of 40 grocery items were:

Store	$
Pak'n Save (Sylvia Park)	122
Warehouse Extra (Sylvia Park)	135
Countdown (Glenfield)	136
Foodtown (Glenfield)	136
Woolworths (Milford)	136
New World (Albany)	146

Whangarei

[154] It will be recalled that the Warehouse Extra store in Whangarei was converted to the Extra format in November 2006 and its closest competitors are a Countdown (300 metres away) and a Pak'n Save (1 km away).

[155] This store is also referred to in a number of internal Woolworths documents:

(a) Between April 2006 and October 2006, discussion about the possibility of other Extra stores opening focused very much on the Whangarei store. There was a cryptic note arising out of a meeting on 31 July 2006 (and similar notes from subsequent meetings up to 2 October 2006) that "[ ]" and which went on:

[ ].

(b) A meeting on 24 October 2006 produced the following action points:

[ ]

- [ ]. [ ].

- [ ]. [ ].

(c) This was further developed at a meeting on 6 November 2006, which included the additional action point:

- [ ].

(d) From the meeting on 13 November 2006, there was this action point:

[ ].

- [ ].

- [ ].

- [ ].

(e) On 11 December 2006, it was noted:

[ ]. [ ]. [ ]. [ ].

(f) On 15 January 2007, there was an additional note:

[ ]. [ ]. [ ]. [ ].

(g) On 5 February 2007, it was noted that the Whangarei Extra store had [ ].

[156] The evidence in the High Court from Mr Peter Smith, of Woolworths, was that [ ]. [ ]. [ ]. [ ]. [ ]. [ ]. [ ]. [ ].

[157] The evidence from Foodstuffs was that [ ]. [ ]. [ ]. [ ].

[158] As to market shares at Whangarei:

(a) For the period from opening (in November 2006) to March 2007, Woolworths had [ ]%, Foodstuffs [ ]% and Extra [ ]%.

(b) For the period between April and July 2007, the market was shared in a broadly similar way save that the Extra share [ ].

[159] Turnover figures for the Extra store at Whangarei for the period from August to 21 October 2007 that were available in the High Court showed weekly turnover at Whangarei [ ]. [ ]. Excluding the last week in March (in which Easter fell), the average weekly turnover in February and March 2008 was approximately [ ].

Te Rapa store

[160] The Te Rapa Extra store was opened on 23 August 2007 and thus after the Commission's decision had been released. The closest competing supermarket is a New World which is about 800 m away. The High Court judgment asserted that neither Woolworths nor Foodstuffs had responded with price decreases to the opening of this store. That in fact is not the case in relation to Foodstuffs as there was no direct evidence in the High Court of the pricing of Foodstuffs supermarkets within a five kilometre radius of the Te Rapa store. As to Woolworths, the High Court judgment (at [60]) noted that [ ]. Mr Smith testified in the High Court that [ ].

[161] The evidence available in the High Court showed that that turnover at Te Rapa had [ ] for the week of 21 October 2007. Taking the opening and closing figures in this way tends to obscure what was really happening as is shown by an analysis of all the weekly turnover figures from opening to the week of 21 October:

(a) 26 August [ ]

(b) 2 September [ ]

(c) 9 September [ ]

(d) 16 September [ ]

(e) 23 September [ ]

(f) 30 September [ ]

(g) 7 October [ ]

(h) 14 October [ ]

(i) 21 October [ ]

The performance of this store thus [ ]. Again excluding the last week in March (in which Easter fell), the average weekly turnover in February and March 2008 was approximately [ ].

Other evidence

[162] Woolworths staff have considered possible responses to the roll out of Warehouse Extra stores in contexts other than sales and margin improvement meetings. For example, one document outlined the following strategies:

1. [ ]. [ ].
2. [ ].
3. [ ].
4. [ ].
5. [ ].
6. [ ].
7. [ ].

The document concluded with a summary:

[ ]. [ ].

[163] As well, a document headed Fresh Foods F07 Strategy (apparently prepared on 2 June 2006) recorded [ ]:

[ ]

It also noted that:

[ ].

[164] The evidence which the Commission gathered indicated that [ ].

The approach of the Commission

[165] The Commission did start with something of an assumption that an acquisition by Woolworths or The Warehouse would be likely to reduce competition:

> 193. As a general rule of thumb, a merger that reduces the number of competitors from three to two is, *a priori*, likely to reduce levels of rivalry to the detriment of customers. This is the case even if one of the competitors is small but likely to become a stronger competitor in the future. The effect of a merger on the possibility of new entry and/or likelihood of new entry might itself contribute to a substantial lessening of competition, where a merger reduces or eliminates the competitive constraint represented by new entry. In examining the competitive effects of a merger it is important to consider the impact on both existing and future competition. A merger that significantly reduces the potential for new entry or expansion in the future may enable the merged firm to raise prices, reduce quality, choice, service and innovation and/or it may dampen the incentives of firms left in the market to compete vigorously and/or it may increase the ability and incentive of firms to co-ordinate their behaviour.

[166] The Commission recognised that a number of retail outlets (such as Star Mart, the Mad Butcher and Bakers Delight) sell goods which are also sold in supermarkets but considered that as they did not offer "one-stop convenience" or have the other attributes of supermarkets, their constraint on supermarkets is quite limited. It also concluded, uncontroversially, that there were high barriers to entry into the relevant markets (for reasons associated with access to suitable sites, requirements for resource consents and economies of scale) and that there is no likely new entrant into the relevant markets other than the Warehouse.

[167] The Commission approached its analysis of likely future competition on the assumption that the initial performance of the Extra stores was not a reliable guide to future impact. As the existing Extra stores are in their formative stages, it will take some time for the Warehouse to come up with a format which will work well in local conditions. Further, the attempts by Foodstuffs and Woolworths to acquire the Warehouse may have both dampened the incentives for the Warehouse to develop the Extra stores and been a distraction for its senior management.

[168] The Commission analysed the market share gained by the Extra stores at Sylvia Park and Whangarei and referred to the internal Woolworths and Foodstuffs strategy papers [ ]. It also reviewed the actual responses.

[169] Particular attention was paid to what had happened at Sylvia Park. It will be recalled that the Foodtown, Pak'n Save and Warehouse Extra stores all opened around the same time. Although Foodtown is Woolworths' full service banner [ ], the Foodtown store at Sylvia Park [ ]. Initially, the Sylvia Park Pak'n Save [ ]. The Commission noted that Woolworths and Foodstuffs claimed that they were focussed on competition with each other at Sylvia Park rather than on the Extra store. But after referring to the limited evidence about Whangarei, the Commission concluded that the Warehouse Extra stores had already had an important competitive influence on supermarkets.

[170] The Commission addressed the overseas experience of supercentres, which it saw as supporting the view that supercentres generally have a strong competitive influence (in terms of price and service, including product range) in supermarket markets.

[171] The Commission then discussed the significance of the Warehouse as a "maverick", with a business model and incentives which differ from those of the incumbents. The purpose of the grocery section in Extra stores is to attract additional consumers to higher-margin general merchandise. It thus has an incentive to sell groceries at low margins or to provide a different service to that found in supermarkets. The Commission recognised that the Warehouse had not been a price leader in grocery but considered that having the lowest priced goods was not critical. This is because, as grocery purchasers switch to the Warehouse Extra stores, existing supermarkets will be forced into competitive responses such as reducing prices and improving levels of service.

[172] The analysis of the state of competition in the counterfactual concluded in this way:

> 281. The Commission concludes that both international experience of supercentres, and the experience of the limited time they have been

> operating in New Zealand are strong indicators that an independent The Warehouse will provide very important competition in the supermarket markets. This will arise, in part, as a result of the innovative approach The Warehouse supercentre concept brings to the market.

[173] The Commission also reviewed carefully the potential for non-coordinated and coordinated effects in the factual and counterfactual paying particular attention to the potential of the Warehouse, through its Extra stores, to limit such potential. In relation to non-coordinated effects, it concluded:

> 301. The Commission considers that in the factual the loss of an innovative competitor would also remove dynamic competitive pressure on Woolworths and Foodstuffs over time to improve their offerings by reducing prices, improving service and quality or being more innovative. In contrast, in the counterfactual, the presence of an innovative competitor is likely to spur The Warehouse, Woolworths and Foodstuffs to compete more vigorously with each other to further deliver lower prices, better quality, improved levels of service, and innovative new products and services to consumers.

Having reviewed the evidence, particularly as to [ ], the Commission concluded:

> 319. The Commission acknowledges the points made by Woolworths in its response. Nevertheless, it notes that a [ ], would not usually be found where there is effective competition. Nor would it be likely in a competitive market for a firm with something around 44% share of the markets [ ]. [ ] market conditions are conducive to conscious parallelism, price leadership and coordinated behaviour in general.

[174] It wrapped up its discussion in this way:

> 334. The Commission has therefore concluded that the loss of existing and potential competition from an innovative firm in circumstances where it is the only likely entrant for the foreseeable future, and the other resulting foreclosure effects for other possible acquirers in the future, would lead to a substantial increase in market power of the remaining incumbent supermarkets. As a result of the loss of this significant competitive constraint in the factual, there is a real risk that prices would be materially higher, and quality, service and innovation materially lower, than in the counterfactual through either or both non-coordinated or coordinated effects. A lessening of competition through non-coordinated effects would materialise through a reduction in the incentive for both Woolworths and Foodstuffs to compete vigorously because of the loss of an innovative competitor. A lessening of competition through coordinated effects will materialise through the increased ability and incentive of Woolworths and Foodstuffs to coordinate their

> behaviour on prices and possibly on other dimensions of competition.

The approach of the High Court

[175] The Court set out to quantify in price terms what would be a substantial lessening of competition. It concluded (at [150]) that price rises of 1% to 2% or less would not be reliable evidence of a substantial lessening of competition. In its view (expressed at [156]) price rises of somewhere above 1% to 2% and below 4% to 5% would be cause for concern. The Court, however, accepted that competition is also reflected in the range and quality of the goods and services.

[176] In the course of its analysis of the factual, the Court assessed the current state of competition between Woolworths and Foodstuffs. As part of this exercise, it examined conflicting evidence as to the discernible impact, if any, of the 2002 acquisition by Progressive of Woolworths NZ. That evidence showed price effects across the four regions examined of between approximately [ ] (according to Dr Williams) and [ ] (according to Professor Hausman). The Court concluded (at [181]) that the 2002 merger had, at worst, a small effect on supermarket prices, indicating that any consequential lessening of competition was not substantial.

[177] The High Court was generally unwilling to adopt any approach or theory which was not closely based on the established facts associated with what had happened in the aftermath of the launch of the Extra concept. This appears clearly from the following passage in the judgment:

> [231] We agree with the Commission that it was entitled to apply economic theory. But the theory must be applied with reference to the particular facts. It cannot be assumed that because 3:2 mergers often give rise to competitive concerns, that they do in all cases (and the Commission does not suggest otherwise). Similarly, while it is true that "a maverick", that is a non-typical, less-predictable competitor, can have a competitive impact out of proportion to its relative market size, the question is whether the characteristics of the Warehouse Extra and its competitive strategy and behaviour to date indicate that it has done so or is likely to do so.
>
> [232] On the evidence that is before us, we consider the overseas success of some supercentres is not particularly relevant. As the expert economists confirmed these have different models and different market conditions apply. For example, Walmart added new space to existing stores (rather than reallocating existing space as with the Warehouse Extra), was able to

> price below its competitors and the halo was experienced immediately. The overseas success of some supercentres tells us only that supercentres can in theory succeed, not whether the Warehouse Extra will be successful and provide a material constraint on Woolworths and Foodstuffs. …
>
> [233] Accepting that a 3:2 merger will often give rise to competitive concerns and that a maverick can have a competitive impact beyond what its market share may indicate, *what is now more relevant than these well established economic theories is what has happened following entry and what can be inferred from that.* We have more evidence about that than did the Commission. We also have the benefit of further econometric analysis and other evidence.
>
> (Emphasis added)

[178] The Court discounted the significance of [ ] made by Woolworths and comments in its internal documents. They saw this as showing that Woolworths thought it worthwhile to watch Warehouse Extra rather than as evidence of a material change in Woolworths' competitive strategy.

[179] The Court considered that the impact at Sylvia Park was difficult to gauge because all the stores are new and the shopping centre as a whole had not been particularly successful. It considered that the Warehouse Extra's market share was very small and that Pak'n Save [ ]. Prices at the Pak'n Save, [ ].

[180] At Whangarei, Foodstuffs had not reacted to the opening of the Extra store and the impact on Woolworths' prices to date had been [ ]. [ ]. [ ].

[181] The Court concluded that there had been no price decreases by Foodstuffs or Woolworths at Te Rapa. (As we have noted, and contrary to what was said in the judgment, there was no evidence as to pricing by Foodstuffs at Te Rapa.)

[182] Recognising that it was required to assess the competitive impact of an established (and not a fledgling) Warehouse Extra business, the Court concluded:

> [256] … *However there is nothing in the evidence that indicates that the Warehouse Extra would cause pricing impacts of 2% or greater in the local markets.* The Warehouse Extra does not aim to be a main player in food (it seeks to get to 3% of the market), it does not intend to be a price leader and it has diverted GM&A space for food to increase sales in the higher margin GM&A business which continues to be its main focus.
>
> (Emphasis added)

We note that the "3% of the market" referred to is a reference to national supermarket sales, not the local markets in which there are currently Extra stores.

[183] This reasoning led on to a further important conclusion:

> [257] These factors indicate that it is not a competitor that is likely to "shake things up a great deal in the process of trying to acquire a substantial market share, even if in the end its inroads are rather modest". The Warehouse Extra is different because its economic model is different but it does not intend to behave as a "maverick". Professor Hausman accepted that in view of its strategy not to be a price leader the Warehouse Extra was not likely to have an impact on coordinated effects. It may have some impact on non-coordinated effects as Professor Hausman considered but, in our view, that impact is likely to be minimal given the much greater constraint exercised by Woolworths and Foodstuffs on each other.

[184] The Court took the view that absence of discernible price consequences associated with the 2002 merger (which took out a major player) suggested that the competitive impact of a small player such as Warehouse Extra would not be material. While recognising that the one-stop convenience of Warehouse Extra was an innovation, it had not constrained Foodstuffs and Woolworths, a conclusion which was based on the limited market share gained by the Extra stores at Sylvia Park and Whangarei and the very limited impact of the opening of those stores on prices in Woolworths' and Foodstuffs' supermarkets.

[185] The Court then expressed the following conclusion:

> [261] For all these reasons we consider that … the Warehouse Extra [will not] provide a material constraint on Woolworths or Foodstuffs. The primary competition occurs between Woolworths and Foodstuffs. The constraint, such as it is, from independent retailers will continue. Woolworths and Foodstuffs will lose some custom to the Warehouse Extra, but it will not be at a level that will change the current focus they each have on competing with the other.

And, after discussing some other issues, the Court went on:

> [267] Because the Commission considered that the Warehouse Extra would provide important competition in the counterfactual which would not be present in the factual it concluded that competition in the local markets was likely to be substantially lessened if either Woolworths or Foodstuffs acquired the Warehouse. It concluded that competition from Warehouse Extra would make coordinated effects less likely, less effective and less stable in "the counterfactual" as compared with "the factual". It also considered that a lessening of competition through non-coordinated effects

would occur in "the factual" as compared with "the counterfactual". This was because there would be a reduction in the incentive for both Woolworths and Foodstuffs to compete vigorously with the loss of an innovative competitor.

[268] Because we consider that the Warehouse Extra will not provide a material constraint beyond the constraint that Foodstuffs and Woolworths provide to each other we consider that the difference in competition between "the counterfactual" and "the factual" is not likely to be material. We therefore consider that the loss of an independently owned Warehouse is not likely to have the effect of substantially lessening competition.

[269] In particular:

a) Any non-coordinated price increases from the loss of an independent Warehouse Extra is likely to be very small and less than a level at which we would have concern.

b) Any coordinated effects, if they occur, will not differ in any material way than if an independent Warehouse Extra were present.

c) Any loss of innovation through the loss of the supercentre concept is a *de minimus* [sic] loss. Further it is possible that the supercentre concept, if a viable one, would be continued in at least some locations. For example if Woolworths was the successful acquirer it may well 'knock down the wall' separating the Warehouse Extra from Foodtown at Sylvia Park and amalgamate the two stores.

The key differences between the approaches of the Commission and the High Court

[186] The difference in the conclusions reached by the Commission and the High Court reflects to some extent:

(a) Different interpretations of the evidence available to the Commission (particularly comments by Woolworths managers in internal strategy documents and the significance of the responses by Woolworths and Foodstuffs at Sylvia Park and in Whangarei);

(b) Developments between the Commission decision and the High Court hearing (for instance, [ ]); and

(c) Additional expert evidence, particularly as to the absence of significant price impacts of the 2002 merger, which was before the High Court and not the Commission.

But perhaps of greater significance was a difference in approach in terms of how likely competition in the counterfactual was to be assessed.

[187] The approach of the Commission was very much based on its assessment of the anti-competitive tendency of a takeover of the Warehouse by either Woolworths or Foodstuffs. This tendency was assessed, in large measure, by reference to general considerations, such as the likely impact of a 3:2 merger on competition in markets with high barriers to entry, the potential for non-coordinated and coordinated effects in the supermarket industry, the international success (in a number of instances) of supercentres, the strength of the Warehouse in terms of financial resources (including ownership of sites which could be used for Extra stores) and management expertise and the differences between its business model and those of the incumbents. This is not to say that it ignored the limited evidence of what had actually happened in relation to the Extra stores which had opened. Indeed it found in that evidence indications which it considered to be consistent with its views as to the likely impact of a substantial new entrant. But that evidence was of less significance than the structural analysis.

[188] In contradistinction, the High Court was primarily focused on the empirical evidence associated with the course of trading of the Extra stores and the responses (to the extent that there were any) of Woolworths and Foodstuffs. It looked for evidence that the emergence of the Extra stores had had a material impact on competition. Its conclusion that such an impact had not materialised was at the heart of the conclusion that elimination of the Extra stores was not likely to substantially lessen competition in the relevant markets. In saying this, we accept that the High Court judgment did, to some extent, address broader contextual and market structure considerations, but this was very much a subsidiary part of the exercise which very much focussed on "what has happened following entry and what can be inferred from that".

Our evaluation

[189] As we have said, a key difference between the Commission and the High Court was in the different weight that each gave to the theoretical concerns raised by a 3:2 merger in markets having the characteristics of those at issue, as opposed to, in particular, the empirical evidence concerning the 2002 acquisition and Extra's competitive impact since inception. This difference of approach was exacerbated by the binary approach which the High Court took to the test to be applied under s 66(3).

[190] Further, while the High Court recognised that competition in the relevant markets is reflected in all elements of the PQRS mix and not simply in price, the Court tended to focus on price effects in its analysis. In particular, Mallon J and Dr King proceeded on the basis that price rises of less than 2% would not be reliable evidence of a substantial lessening of competition, given normal price volatility, the difficulty of being confident that price changes of this level are not due to statistical error and doubts whether such price rises would be discernible to consumers. The Court recognised, however, that given low margins, small changes in price are very significant to supermarkets. For instance, all other things being equal, an across the board 10% price rise would produce an increase in profit of about [ ]. As well, those who run supermarkets think it worthwhile to make comparatively small adjustments to prices ([ ]) and necessarily assume that such adjustments will influence consumer behaviour.

[191] Mr Goddard placed considerable emphasis on the use of the word "substantially" in the phrase "substantially lessening competition" in s 66(3). We do not overlook that. We take the view that what constitutes a substantial lessening competition must in the end be a matter of judgment, although we accept, of course, that such a judgment must be informed by as much practical evidence as possible (see *Telecom* per Richardson J at 446). In the present context we are not prepared to commit ourselves to equating price increases of a particular level (or other precise metric in relation to other dimensions of competition) with a substantial lessening of competition. It is, however, important to recognise that changes in price which might not appear to be particularly large may well reflect the presence or absence of

what, from the point of view of the supermarkets, is substantial competitive constraint.

[192] Further, we do not share the High Court's confidence that the evidence of Extra's impact on Woolworths and Foodstuffs to date demonstrates that it is likely to have little competitive impact in the future. While we accept that the evidence shows little impact to date, we do not consider that evidence generated so soon after the Warehouse has introduced what is a new concept, both for it and for New Zealand markets, provides a reliable predictor of likely future impact. As noted earlier, the fact that the clearance applications of Woolworths and Foodstuffs were under consideration may have contributed to the level of competitive response from them. Nor do we share the High Court's confidence that, to the extent that there is competition between Woolworths and Foodstuffs at present, it can reliably be predicted that such competition will continue in the future absent Extra. We now address these points in more detail.

[193] We have already held that the case cannot be determined on the basis that the Extra concept will be abandoned. It follows that we conclude that there is "a real chance" or a substantial possibility of the Warehouse getting to the position where it has seven to ten Extra stores operating. This necessarily means that we approach the present issue from a materially different position to that of the High Court.

[194] This is not to say that we see as immaterial the reactions of Woolworths and Foodstuffs to the Extra concept. In the first place, Woolworths' internal documents reveal obvious concern about the potential competitive impact of the Extra stores. The pricing behaviour of Woolworths [ ]. The evidence was that [ ]. There are 150 Woolworths stores of which [ ]. As a result of this approach to pricing, [ ]. Likewise, it may not be entirely coincidental that the Sylvia Park Pak'n Save was so aggressive on pricing when it first opened. Also of moment is the [ ].

[195] It is true that the results achieved by the Extra stores were, up to July 2007, very disappointing. The Extra stores did not provide the competition that Woolworths had expected. Hence the decision was made not to change pricing in the Whangarei Countdown following the opening of the Extra store. But it seems to

us to be unsound to assess the competitive impact of Extra primarily by reference to its initial performance. Woolworths' internal documents [ ] which could result from better Extra performance and better performance is apparent in the post-July 2007 turnover figures. As to this, we note that the average weekly turnover of the Whangarei Extra store in July 2007 ([ ]) was approximately [ ]. For the months of February and March (excluding Easter), the average weekly turnover was [ ]. It might be thought to follow that this store now provides far more significant competition than it did in July 2007.

[196] Woolworths' internal documents show that [ ] and to some extent there had been responses, albeit of apparently modest proportions, by the time the appeal was heard in the High Court. In the context of improving performance by the Extra stores, more significant responses from Woolworths and Foodstuffs might be thought to be likely. Although the econometric evidence associated with the 2002 merger suggested that resulting price increases in the local markets that were studied had been either non-existent or modest (at most, in one case just over the High Court's 2% sensitivity threshold), they are not inconsistent with a store at the discount end of the PQRS continuum having an appreciable effect on prices in a local market, particularly if there is no Pak'n Save in that market.

[197] In this context, we are troubled by the comparative absence of information associated with the Te Rapa Extra store. The turnover figures available at the time of the hearing in the High Court covered only its first nine weeks of trading. Its closest competitor is a New World store. There was certainly evidence in the High Court that Woolworths had not responded with price decreases although it was maintaining a "watching brief". Given the timing of the opening (23 August 2007) in relation to the appeal proceedings in the High Court, it is perhaps not entirely surprising that, at least at the time of the High Court hearing, there had been no price response by Woolworths. As we have noted, however, the High Court's assertion that the evidence showed no price decreases by Foodstuffs was erroneous (as there was no direct evidence on the point, one way or another). As there is no Pak'n Save within the market as defined by the High Court, it seems plausible to assume that there will be some form of price response from the competing stores once the awkwardness associated with the present proceedings has been resolved. In short,

we consider that there is insufficient empirical evidence associated with this store to justify the conclusion that there is no likelihood that it will have a substantial impact on competition within the local market.

[198] The High Court concluded that the emergence of the Extra stores had not had a material impact on competition in the period up until October 2007. We do not differ from that assessment. But the absence of a material impact on competition associated with Extra up to 21 October 2007 does not establish such impact is not likely. As the Warehouse develops its business systems and refines its operating techniques, enhanced performance is likely. The updating evidence indicates that such enhanced performance has begun to emerge. At a point where Woolworths or Foodstuffs stores begin to lose appreciable business (say 10% of turnover) competitive responses (probably in terms of price but also perhaps in terms of service or range of products) become probable. That this is so is supported by [ ]. It also accords with common-sense.

[199] There is evidence that Woolworths and Foodstuffs compete to a reasonable extent at present, although, as the High Court said (at [197]), that should not be over-estimated. Given [ ], this reservation was soundly based. In any event the fact that Woolworths and Foodstuffs currently compete does not, of itself, mean that a clearance should be granted. The question whether that competition is likely to be maintained in the factual must be considered, as must the question whether there is likely to be greater competition in the counter-factual.

[200] We consider that the Commission was right to give weight to the theoretical concerns raised by a 3:2 merger in markets such as these, characterised by high barriers to entry. We accept Mr Gray's submission that in a small economy such as New Zealand's, markets are inevitably much more concentrated than in larger economies (see Evans and Hughes, *Competition Policy in Small Distant Open Economies: Some Lesson from the Economic Literature*, New Zealand Treasury Working Paper 03/31, Dec 2003). But in the present case there is a new entrant in the three markets under consideration, which is also a potential entrant to a number of other geographic markets. It has the experience, commitment, financial power and operational structures to make a strong attempt at entry. It seeks to establish a

market niche for itself through an innovative approach. Other potential entrants are not obvious and barriers to entry are high. The structural features of the relevant markets do not drive the incumbents to compete vigorously. To the extent that the existing competition reflects choices which the incumbents have made about how they will conduct their businesses, they may make different choices in the future.

[201] Mr Goddard emphasised, correctly, that having a presence in a market is not the same thing as being a material competitive influence in that market for competition law purposes. As a consequence, he said, while Extra was "on the radar" for Woolworths and Foodstuffs, it was not material in terms of the competitive process or competitive constraints within the relevant markets. However, we are not satisfied that at this early stage in the development of the concept it can safely be concluded that Extra will have no material impact on the competitive process in the markets at issue. Indeed, if the concept is successful (and we consider that to be a substantial possibility), we can see no reason why it would not have a significant effect on the PQRS packages offered by Woolworths and Foodstuffs in those markets. As we have said at [198] above, we consider it implausible that Woolworths and Foodstuffs will ignore Extra if it manages to build a reasonable market share.

[202] Mr Gray submitted that the Commission's concern about the possibility of coordinated effects in the factual was misplaced, given the way in which Foodstuffs is structured and operates. While we accept that those features may make coordination more difficult, we do not see them as removing it as a plausible possibility. What is at issue is the potential for coordinated behaviour *in the relevant markets*. Given the evidence that [ ], we do not see why coordination of the leader/follower type identified by the Commission is not possible even with Foodstuffs' structure.

[203] Mr Goddard said that because Extra does not intend to be a price leader, its presence in the markets would have no material impact on any existing potential for coordination. That is, the potential for coordination would be the same in the factual and the counter-factual. We do not agree. We accept that Extra is unlikely to be a price leader or to start a price war. However, if Extra offers a competitive PQRS

package, which we consider to be a reasonable possibility, Woolworths and Foodstuffs will be forced to respond in the relevant markets. Neither will be able to replicate Extra's offering involving general merchandise (given the advantages enjoyed by Extra), so other competitive responses, including price reductions, would be required. In this way, a successful Extra is likely to reduce the potential for collusion between Woolworths and Foodstuffs that would otherwise exist. Further, it follows from what we have said above that we agree with the Commission that, absent Extra (or the potential for entry by the Warehouse in relevant markets), Woolworths and Foodstuffs would have less incentive to compete vigorously with each other, so that the risk of non-coordinated effects is increased in the factual.

[204] The extent to which Extra's PQRS package, building on the availability of general mechandise in the same store as groceries, will be attractive to consumers is uncertain. The success of supercentres or hypermarkets overseas supports the proposition that this offering will be likely to be popular, but the evidence shows a need for caution about translating that overseas experience to New Zealand. The success of supercentres in the United States took some time to emerge and appears to have been attributed substantially to their ability to undercut traditional supermarkets on price, something which Extra does not intend to do. Woolworths argued that the convenience benefit of a one-stop shop supercentre is minimal when compared to a supermarket located a very short distance away from a Warehouse outlet, as is the case in Whangarei and Sylvia Park. In Te Rapa the nearest supermarket is a New World, which is about 800 metres from the Extra store there. The High Court concluded after its evaluation of the expert evidence on this subject that the one-stop shop offering of Extra had provided innovation but the empirical evidence had shown that this had not constrained Woolworths and Foodstuffs.

[205] We do not put the same weight on the empirical data as the High Court did, for the reasons we have already given. We see the foreclosure of the one stop shop innovation before it has had a chance to prove itself as a matter for concern, especially as this concept is the only realistic source of ongoing competition to Woolworths and Foodstuffs in the near future. While the competitive effect of supercentres in New Zealand markets will likely be at a considerably lower level than in the United States for the reasons identified above, we believe there is a real

chance that the concept will succeed, as it has in many other countries. If it does, Woolworths and Foodstuffs will have to compete not only with each other but with a successful operator of general merchandise stores offering a competitive but different offering to theirs and responding to different economic drivers (the need to stimulate the halo effect, rather than the need to make profits from its grocery offering on a standalone basis). That will be of most significance in Te Rapa where there is no nearby Pak'n Save and the nearest supermarket is some distance from the Extra store. Their response on price may not be of the magnitude that the High Court saw as competitively significant, but we consider that there is a real possibility that their response on all aspects of the PQRS package will be of real competitive significance.

[206] For these reasons as well, we consider that the Commission was right to reach the view that it was not satisfied that the acquisition is unlikely to substantially lessen competition. We agree that the empirical evidence is insufficient to outweigh its concerns about a duopoly in markets having the characteristics of those at issue.

[207] It follows that we disagree with the approach taken in the High Court. We also conclude that we are entitled to substitute our view for that expressed in the High Court judgment:

(a) We consider that the High Court was wrong in its approach to uncertainty. The Commission and thus the Court should grant a clearance only if satisfied that a substantial lessening of competition is not likely. In applying this test, it is open to the Commission or Court to decline a clearance and say that, "We are not sure and therefore we are not satisfied that there will be no substantial lessening of competition" (although we accept that it might be better to avoid using the word "sure" given its use in the criminal law as a synonym for proof beyond reasonable doubt).

(b) As is apparent, the High Court approached the case largely on the basis of "what has happened following entry and what can be inferred from that" (at [233]). We have a more substantial body of

information as to what has happened "following entry". But more importantly, we consider that the combination of the Court's approach to problems of uncertainty and its firm focus on what, after all, was very limited empirical evidence, resulted in it overlooking what we consider to be a real prospect of substantial competitive constraint imposed by Extra stores in one or more of the local markets in which they now operate.

(c) We see the points just made in the preceding sub-paragraphs as particularly relevant to Te Rapa, where the Extra store has performed much better since the High Court hearing and where, because of the current absence of a Pak'n Save, its competitive impact is likely to be greater than at Sylvia Park and Whangarei but in respect of which the empirical evidence is extraordinarily limited.

Disposition

[208] The corollary of our conclusions on the counterfactual are that we consider that the High Court was wrong to reverse the Commission and to grant clearances. Accordingly:

(a) We allow the appeal.

(b) We set aside the clearances granted.

(c) We direct Woolworths and Foodstuffs each to pay the Commission $24,000 in costs together with usual disbursements.

(d) We reserve to the Warehouse the right to seek costs.

(e) Costs of the proceedings in the High Court are to be fixed in that Court.

Solicitors:
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DLA Phillips Fox, Auckland for Second Respondents
Harmos Horton Lusk, Auckland for Third Respondent