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Sam Holmes and Susan Brown
Competition Branch
Commerce Commission
PO Box 2351
WELLINGTON 6140

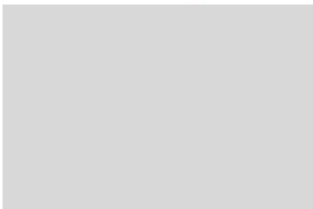
Email:
registrar@comcom.govt.nz
sam.holmes@comcom.govt.nz
susan.brown@comcom.govt.nz

Tēnā kōrua Sam and Susan

Statement of Preliminary Issues: proposed Foodstuffs merger

Attached are the comments that the New Zealand Food and Grocery Council wishes to present on the Commerce Commission's *Statement of Preliminary Issues: Foodstuffs North Island and Foodstuffs South Island.*

Ngā mihi nui



Raewyn Bleakley
Chief Executive

Statement of Preliminary Issues: Foodstuffs North Island and Foodstuffs South Island

Submission by the New Zealand Food and Grocery Council

19 February 2024

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PART A: PRELIMINARIES AND ANALYSIS

Introduction

1. The New Zealand Food and Grocery Council (**NZFGC**) welcomes the opportunity to comment on the Commerce Commission's (**Commission's**) Statement of Preliminary Issues (**SOPI**) dated 18 January 2024[1] and the underlying Notice seeking clearance for the proposed merger of Foodstuffs North Island Limited (**FSNI**) and Foodstuffs South Island Limited (**FSSI**) (the **Application**)[2]. We refer to the two Foodstuff entities collectively as "Foodstuffs" (**FS**) where appropriate.

2. NZFGC represents the major manufacturers, producers, and suppliers of food, beverage, and grocery products in New Zealand from the largest companies to emerging start-ups breaking into a highly competitive market and the companies that support them. Our members supply products that consumers purchase from the supermarket shelves every day, as well as being significant exporters. This sector generates over $40 billion in the New Zealand domestic retail food, beverage and grocery products market, and over $34 billion in export revenue from exports to 195 countries – representing 65% of total good and services exports. Food and beverage manufacturing is the largest manufacturing sector in New Zealand, representing 45% of total manufacturing income. Our members directly or indirectly employ more than 493,000 people – one in five of the workforce.

3. This is a precipitous decision being considered, a point which we wish to underscore to the Commission. It will have far-reaching consequences and should not be rushed. To attempt to apply the likely substantial lessening of competition test in a context which already lacks competition, and where supermarket pricing and cost of living continues to be top of mind for New Zealanders, public benefit must be proven beyond doubt.

4. The erosion of consumer buying power and choice in recent years has led to a number of market studies across fuel, building supplies, groceries, and banking. Yet during and following these studies, retail prices have continued their upward spiral, appreciating the context of exogenous externalities, but economically higher pricing has resulted in greater dollar margins delivered – not for the supplier or the Kiwi consumer. The very opposite of what is intended by these investigations themselves.

Overarching Comments

5. In summary, after analysing the available material and working through the legal framework, NZFGC submits that compared to the status quo:

    a. The proposal would reduce the number of national buyers from three-to-two.

    b. NZFGC Members see clear whole of system benefits in having more regulated grocery retailer (**RGR**) options to supply.

    c. Such a reduction is a substantial lessening in competition at retail and wholesale levels across grocery outlets of all sizes and brands plus liquor, pharmacy and fuel and public benefit cannot be found, given the perverse impacts and cost increases for supply.

[1] FSNI-FSSI-Statement-of-Preliminary-Issues-18-January-2024.pdf (comcom.govt.nz)
[2] FSNI-FSSI-clearance-application-14-December-2023.pdf (comcom.govt.nz)

d. Members are concerned that the concentration of national buyer power would lead to greater price pressures, placing them at risk, and a reduction in the supplier base which could lead to reduced choice for consumers and potentially higher prices. The pressures for suppliers may lead to cost cutting resulting from reduced profitability including in investment and innovation, sustainability mitigation efforts, offshore production considerations and consequences resulting from a non-viable market.

e. The Commerce Commission already confirms there is no (or poorly functioning) effective competition in the sector. Further consolidation does not improve this outcome for consumers.

f. The proposal would frustrate the regulatory intent of three quasi-regulated wholesalers and a time where the regime has only begun.

g. A merger would not only consolidate bricks and mortar, but brand buying power, particularly for FS private label (because the proposed merged entity will represent close to 60% of the grocery sector). Deranging to accommodate this leaves consumers with less choice. Further effects would include a loss of benchmarking and options.

h. Two RGRs who were two (not three) grocery wholesalers would be more powerful (and more vertically integrated).

i. This would give access seeker (wholesale customers) fewer options. They could be expected to need more scale for entry/expansion. Members see this as increasing barriers to entry.

j. The applicants have not shown how such benefits (if evidenced) would accrue to consumers. The clearance application is heavily redacted, and the claims seem hard to prove given the Commission's well-evidenced findings to date about the lack of competition, high barriers to entry, and high profitability of incumbents RGRs.

k. Cost savings of wealth transfers, or what might be better referred to as margin transfers, and efficiencies are not relevant in themselves or articulated.

l. There will be further reduced viability of a third-party entrant, and this also removes the option of breaking up the current arrangements where one entity could sell to an additional entrant.

m. Even if not a test for the Commission, further consolidation makes potential forced separation or divesture even more difficult to enforce should a government decide, it would be in the long term consumer benefit.

6. It is not clear that the status quo as described is even permitted under the *Commerce Act 1986* (**the** Commerce Act), and we recommend this be investigated first. Regardless, we recommend the Commission consider the "lost option" if the proposal is cleared to proceed. The status quo would be crystalised under the proposal.

7. Our members views and feedback are of critical importance for the Commission and clearly articulate the effect of this proposal and prior mergers. Even with the very tight timeframes available, we sought feedback from members. Responses were provided through a comprehensive survey, based on the SOPI framework. This attracted 70 unique company responses, the majority of whom supply all three RGRs, and from the

most senior executive, the Chief Executive or as delegated. These responses are set out in Part E.

8. There is a real responsibility on the Commission to satisfy itself there is not a real prospect of a more competitive counterfactual emerging. We recommend the Commission carefully identify and consider potential issues, a range of which we discuss in this submission and set out in Annex A.

Context for this submission

9. We note the background of the *Commerce Commission, Market study into the retail grocery sector* (the **Market Study**)[3], which we first submitted on in December 2020, the Commission's recommendations in its Final Report of 8 March 2022, and the recent regulatory reforms, which are only just being implemented.

10. Para 19 of the SOPI states *"we are not investigating the current state of competition in the grocery sector (including pricing and supply terms)"* but notes that the Market Study[4] and the *Grocery Industry Competition Act 2023* (**GICA**) are part of the proposed merger consideration. While correct, when an industry lacks competitiveness, any adverse impact (eg increase market power/barriers to entry) can have a disproportionate impact. Case law confirms the impact need not be large.

11. The Market Study found: (1) a (retail) market duopoly; (2) that the intensity of competition between the major grocery retailers was muted and did not reflect workable competition; (3) entry and expansion by other grocers was difficult; (4) the retailers' profitability appeared higher than expected under workable competition; (5) prices appeared high by international standards; (6) levels of innovation appeared low; (7) pricing, promotions and loyalty practices limited consumers' ability to make informed decisions; (8) competition was not working well for many suppliers due to an imbalance in market power.

12. The main question to NZFGC is 'does the proposal help or hinder addressing those issues?' There may be signals in the Commission's Market Study recommendations - namely: (1) improve conditions for entry and expansion; (2) improve competition for the acquisition of groceries; (3) improve consumers' ability to make informed decisions; (4) monitor and enforce competition issues in the grocery sector.

13. While the range of regulatory reform may be hoped to assist, it is far too early to tell what difference it will make over the relevant timeframe. We note that the rollout of grocery supply agreements (contracts to supply) has not gone smoothly nor as contemplated (as we discuss below) and is indicative of early days in the application of the regulatory expectations.

14. In considering that main question, we note the Commission's *Mergers and Acquisitions Guidelines*[5] state [emphasis added by NZFGC]:

    *"A lessening of competition is generally the same as an **increase in market power**…"* (Executive Summary at point 6)

    "we ask whether the merged firm's market power would increase relative to the merged firms' market power without the merger[31]" (Chapter 2.20, p12) and note *"A lessening of competition (which **includes a hindering and/or prevention of***

[3] Commerce Commission - Market study into the grocery sector (comcom.govt.nz)
[4] Market-study-into-the-retail-grocery-sector-Executive-summary-8-March-2022.pdf (comcom.govt.nz)
[5] Mergers-and-acquisitions-Guidelines-May-2022.pdf (comcom.govt.nz)

competition)[34] *– or an increase in market power –* ***may manifest in a number of ways.****"* (*Chapter 2.21, p12*) and
"The test ***captures the creation, preservation and enhancement of market power****." (Chapter 2* Footnote 31, p12).

15. These quotes provide useful insights for the analysis.

The applicants' core arguments

16. The proposed merger has been presented as changing little, driven by '*cost savings'* and *'efficiency gains'* to make FS a stronger competitor, with the expectation that consumers should ultimately benefit. While the applicants reject the Commission's findings in the Market Study[6], they nonetheless seem to suggest that regulation will ensure no competition concerns. They also argue the parties do not have 'overlap' therefore there are no competition concerns.

17. NZFGC is concerned at the suggestion that regulation designed to unwind market structure issues ensures 'no competition concerns' and this makes no sense to us. In particular, we note this does not accord with:

    a. the very recent Market Study and the newness of regulatory reforms designed with three RGRs; and

    b. the previous Government considered if *divestments* truly enhance competition[7] and

    c. the possibility of the current Government suggesting further reforms.

NZFGC member feedback

18. It was imperative to NZFGC that we accurately reflected the potential range of views and experiences within our membership, so we conducted a member survey, based on the SOPI.[8] Member responses indicated the following to be of most concern:

    a. this would be a three-to-two merger on the buy-side (ie a merger from oligopsony to duopsony)

    b. it would increase FS's market power, which is unwelcome due to the structural and behavioural factors issues identified by the Commission, including the downstream duopsony.

19. While we set out the survey responses with greater quantitative and qualitative detail in Part E, in summary members highlighted the following concerns:

    a. Differences in terms and negotiations: 96% say there are differences in the two FS entities operations, negotiations, or terms, 80% have different strategies between

[6] Commerce Commission - Market study into the grocery sector (comcom.govt.nz)
[7] Proposed approach to work on divestment in the retail grocery sector (mbie.govt.nz)
Provisional supermarket divestment cost benefit analysis and proposed (mbie.govt.nz) which includes the *Supermarket divestment options and cost benefit analysis* 4 October 2022 Summary report by Coriolis, Sense Partners and Cognitus.
Work on Divestment in the Retail Grocery Sector: Proposed Approach – Minute of Decision (mbie.govt.nz)
[8] These issues have been raised with us by members by formal and informal means, including a member survey.

the two entities, and 88% think the proposed merger will make it harder for suppliers to do deals directly with individual stores/groups of stores/banners.

b. Increased market power: 71% believe the status quo of three RGRs assists negotiations more than the proposal; 77% think the merged FS could have a greater ability to depress prices paid to supplier.

c. Other impacts: 76% have concerns about impacts in other parts of the supply chain and/or greater costs being imposed on suppliers.

d. No consumer benefit: 74% do not expect any merger-specific 'cost savings' (lower prices from suppliers) to be passed on to consumers and 55% think the proposal would make it harder for suppliers to negotiate pass-through.

e. Members also thought that the proposal would make new retail entry (or expansion by small/niche players) less likely with 74% believing it would make it harder.

20. This feedback, in identifying several major issues, highlights the need for due consideration of the description of the status quo and the potential impacts of enhanced market power, across all related markets, even where there is currently no overlap.

21. Many members are concerned at the apparent acceptance that the status quo is a valid counterfactual when there are self-evidently questions whether the arrangements within each cooperative could be perceived as 'cartel provisions' and are/or could be otherwise anticompetitive.

Recommended issues and options for consideration

22. NZFGC is of the view that the application and SOPI do not fully raise all issues requiring assessment. The Application seems framed as 'nothing to see', 'no real change', 'consumer benefit' and the SOPI does not appear to fully recognise the magnitude of potential impacts. Both suggest further consolidation that appear to frustrate the regulatory reforms. These include scrutiny of not two, but three, RGRs. The applicants have a wealth of sector information and significant resources which might have substantiated these claims but with significant portions of the Application redacted, NZFGC's comments are limited. Nonetheless, NZFGC recommends the Commission considers impacts in all relevant markets: considering horizontal, vertical, and conglomerate effects, against appropriate legal likely counterfactuals.

23. To do this we suggest the Commission:

a) **Conduct a full legal analysis of the parties' existing arrangements**: This must be step 1. If existing arrangements/conduct (eg the lack of entry into each other's markets, "over build") raise competition concerns and could be challenged or unwound, this must affect the counterfactual (ie it may not be the status quo).[9]

b) **Consider demand-side and wholesaling issues**: Even compared to the status quo, nationally this would be a 'three-to-two merger' on the buy/demand-side (a merger from oligopsony to duopsony). There would be one less alternative for

[9] Arrangements may raise questions of cartel provisions, other substantial lessening of competition and/or misuse of market power concerns. Summary of cartel prohibition, exceptions and criminalisation – October 2023, Commerce Commission - Woolworths New Zealand Limited (comcom.govt.nz), Commerce Commission - Foodstuffs North Island Limited (comcom.govt.nz) and Commerce Commission - Foodstuffs South Island Limited (comcom.govt.nz)

suppliers. The merged entity may seek to further rationalise ranges. In our view 'identity matters'. The merged entity may also act like an enlarged FSNI (cf. FSSI). Suppliers will be more vulnerable with fewer options as to who they supplied. While demand-side market power was seen as at worst a wealth or margin transfer and less likely to harm consumers, that has changed and the Commission – like most modern agencies – has real concerns about these issues[10]. The reduction in the number of RGR wholesalers from three-to-two, results in one less wholesaler with enhanced market power in (at least) two functional levels. The above factors can be expected to increase barriers to new entry/expansion by actual/potential retailers.

c) **Scrutinise cost savings and efficiency arguments**: The proposal is presented as a merger of complementary businesses sharing branding and already working together, to get efficiencies, which will be passed to consumers. As noted, that simply is not the perspective of NZFGC members. We recall no arguments were made in the Market Study Conference that FS lacked efficient scale. It is difficult to have confidence that any 'efficiencies' would be passed on, given the Commission's Market Study findings[11]. This suggests an authorisation application may be more appropriate as that is where applicants can satisfy the Commission that public benefits (including economic efficiencies) exceed any lessening of competition in relevant market/s.

d) **Test counterfactuals**: The proposal removes the potential (option) of more competition. While it may not appear likely that individual stores, groups of stores, or even one of the FS entities would exit to join a new entrant or start de novo, that may be due to current circumstances (which could change) and/or the existing arrangements between the parties (which as noted may be invalid and require full review). Any merger changes market structure, potentially with enduring results[12.] Indeed, if FS' objections to the Woolworths Progressive merger had succeeded, it seems unlikely the regulatory reform would have been needed[13]. Consider the loss of 'options': as noted by Dr Jill Walker: "*By altering market structure, the underlying conditions for competition, mergers may adversely affect efficiency and consumer welfare for many years, and such changes are not easily reversed*"[14]. Again, we would question whether the current arrangement is an appropriate counterfactual.

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[10] For example, in *Moana / Sanford* (2023) the NZCC considered whether Moana's proposed acquisition of Sanford's inshore fishing business could reduce competition to buy fish-harvesting services, driving down the price paid to independent fishers.

[11] Including that (1) that there was a market duopoly, (2) the intensity of competition between the major grocery retailers was muted and did not reflect workable competition, (3) entry and expansion by new grocers was difficult, (4) the retailers' profitability appeared higher than expected under workable competition, (5) prices appeared higher by international standards (6) levels of innovation appeared low, (7) pricing, promotions and loyalty practices limited consumers' ability to make informed decisions, (8) competition was not working well for many suppliers due to an imbalance in market power.

[12] The Commission declined clearance for the proposed Progressives Enterprises Ltd / Woolworths (NZ) Ltd merger in Decision No 448 (December 2001) under the "substantial lessening of competition test".

[13] Usefully summarised by Dr James Farmer KC in his blog dated 31 October 2022 referring to the challenge of the later clearance Decision 438 under the old market dominance test: *"It is ironic that the Privy Council 20 years ago upheld the Commission's clearance that allowed Progressive Enterprises (Countdown) to acquire the then third supermarket chain (Woolworths) (Foodstuffs v. Commerce Commission [2004] 1 NZLR 145)".*

[14] Dr Jill Walker, 'An Economic Perspective on Part IV', Chapter 3, Current Issues in Competition Law Vol 1, p 87 (The Federation Press, 2021).

e) **Consider if the proposal is more likely to result in consumers' benefit or detriments.** The applicants must *satisfy* the Commission that there is not a *real prospect*[15] of a substantially more competitive counterfactual in relevant markets than the proposal.

24. In examining the above areas, we suggest that the Commission consider the following ten questions as part of its consideration before it considers itself satisfied as to the proposed merger:

(1) Do the two FS entities really act as one head under the status quo?

(2) Will there actually be no real change from the status quo?

(3) Why is there no competition between the parties?

(4) Should the Commission not consider any (other?) potentially anticompetitive arrangements or conduct, or perceived illegal provisions, before determining impacts that the proposal would have? A broader review might lead to impacts on the status quo (eg removing barriers to entry and enhancing competition)?

(5) Is there no other realistic counterfactual than a (modified) status quo?

(6) Is it correct to say that there is no likely substantial lessening in competition when a merger creates a duopsony, reducing the number of buyers from three-to-two?

(7) Is it correct to say that there is no likely substantial lessening in competition when a merger reduces the number of wholesale suppliers from three-to-two?

(8) Would the proposal frustrate the legislative intent – and the new GICA regime – to remove the number of quasi regulated wholesale entities from three-to-two?

(9) Would the proposal increase market power and increase barriers to entry impacting all relevant markets (including retail)?

(10) Should the Commission not take a 'market-by-market' analysis, assessing all potentially impacted markets?

25. We discuss these matters in subsequent Parts to this Submission**.** **Annex A** contains more detail on each of these questions, with further sub-questions, which we suggest the Commission consider.

26. Finally, in support of the issues and options, we note that:

[15] *Woolworths Ltd v Commerce Commission* (2008) 8 NZBLC 102,128, at [122] (HC): *"… the correct approach is that we must assess what are the possibilities. …discard those possibilities that have only remote prospects …. We are to consider each of the possibilities that are real and substantial possibilities. Each of these … become counterfactuals against which the factual is to be assessed.*[58]"
[*Woolworths Ltd v Commerce Commission* (No 2) - [2008] NZCCLR 10 at paragraph 270]

At [270]: *"The correct approach was to assess real and substantial possibilities … including whether the Warehouse Extra concept was likely to continue. Both the prospect of it continuing and the prospect that it would have a "substantial" effect on competition had to be real prospects… for a … clearance to be declined. If in the factual, as compared with any of the relevant counterfactuals, competition was substantially submit then the acquisition would have a "likely effect" of substantially lessening competition."*

a. The s47 Commerce Act test must be applied consistently with the finding in *NZ Bus & Infratil v Commerce Commission*[16] that the competitive impact was "*minor*" but constituted a substantial lessening of competition.

b. In *Commerce Commission v Woolworths and others*[17] the Court of Appeal held that continuation of The Warehouse Group Limited's Extra (grocery) concept was a "*real possibility*" (ie a *viable counterfactual),* confirming the Commission's decision declining the retailers' applications to buy The Warehouse Group Limited.[18]

c. The Commission should consider if a s69B conference might be a better forum to consider the issues and if an authorisation application is more appropriate, as the arguments seem based on claimed efficiencies which *"tend to be most relevant in the context of an authorisation".*[19]

d. The Commission should consider if seeking a s26 statement may be appropriate, especially when the proposal may undermine the existing regulatory regime.

e. The Commission should consider if seeking a s174 (Commission must have regard to economic policies of Government) Grocery Industry Competition Act[20] statement may be appropriate, especially when the proposal may undermine the existing regulatory regime.

[16] New Zealand Bus Limited & Infratil Limited v Commerce Commission [2007] NZCA 502 Wilson J at [270]: *"More particularly, pre-acquisition competition between NZ Bus and Mana in tendering for a small number of routes is of itself sufficient to establish that substantial (in the sense of real) lessening of competition would result".* At [272] *"On the present facts, only very minor lessening of competition would result and the consequent detriment would be modest."*
[17] *Commerce Commission v Woolworths and others* [2008] NZCA 276
[18] Application-for-Acquisition-Clearance-Decisions-606-and-607-8-June-2007.pdf (comcom.govt.nz)
[19] para 3.118 of the Commission's (May 2022) *Mergers and Acquisitions Guidelines*.
[20] https://www.legislation.govt.nz/act/public/2023/0031/latest/whole.html#LMS743901

PART B: CONTEXT – LEGAL FRAMEWORK

27. Internationally, there are considerable concerns at agencies and governments about demand-side market power and lack of grocery competition. The following commentary on these concerns underscores the issues and options we have recommended the Commission examine in the current case. They also bring forward parallel examples from overseas and the conclusions from them.

Demand-side market power (buyer power harms)

28. Limitations in traditional competition policy, and the models used previously meant that the full harm of buyer power was not recognised. That is no longer the case:

    "… undue buyer power is a serious threat to the long-run achievement of a workable competitive economic process, but its abuse is inherently more difficult to control. At the very least, it is as serious a problem as seller power…"[21]

29. A range of competitive harms is now recognised from the existence and abuse of buyer power, which Carstensen[22] usefully describes as two categories (1) Exploitation of producers and (2) Use of buyer power to exclude competition.[23] The following focusses on the second category.

30. **Use of buyer power to exclude competition:** Powerful purchasers can engage in various exclusionary strategies to exacerbate their market power. Carstensen categorises these as follows: [24]

    a. exclusive buying

    b. inducing a supplier refusal to deal

    c. most-favoured-nation (MFN) and most-favoured-nation plus contracts

    d. predatory buying/over bidding

    e. indirect exclusion.

31. The US 2023 Merger Guidelines[25] also note:

    "A merger of competing buyers can substantially lessen competition by eliminating the competition between the merging buyers or by increasing coordination among the remaining buyers. It can likewise lead to undue concentration among buyers or entrench or extend the position of a dominant buyer. Competition among buyers can have a variety of beneficial effects analogous to competition among sellers. For example, buyers may compete by raising the payments offered to suppliers, by expanding supply networks, through transparent and predictable contracting, procurement, and payment practices, or by investing in technology that reduces frictions for suppliers. In contrast, a reduction in competition among buyers can lead

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[21] Carstensen PC. *Competition Policy and the Control of Buyer Power – A global Issue (New Horizons in Competition Law and Economics Series).* Edward Elgar Publishing, Cheltenham, UK, 2017. ISBN: 978 1 78254 057 https://doi.org/10.4337/9781782540588

[22] Carstensen PC. *Competition Policy and the Control of Buyer Power Chapter.* 2017, Chapter 4

[23] *ibid*, Chapter 4

[24] *ibid*, p98

[25] https://www.justice.gov/d9/2023-12/2023%20Merger%20Guidelines.pdf

to artificially suppressed input prices or purchase volume, which in turn reduces incentives for suppliers to invest in capacity or innovation."[26]

32. This can be seen in US caselaw. For example:

    "A … judge… blocked Penguin Random House's proposed purchase of Simon & Schuster, agreeing with the Justice Department that the joining of two of the world's biggest publishers could "lessen competition" for "top-selling books"[27]*.*

33. Relevantly (see discussion about *efficiencies* below):

    "In trying to get their merger approved, Penguin and Simon & Schuster claimed massive, but unverified cost savings"[28]

34. Other examples include the EU in *Carrefour/Promodès*[29]*.*

35. The Commission's *Mergers and Acquisitions Guidelines* state:

    "Buyer market power is… the mirror image of market power on the selling side.[107] *… it is the ability to profitably depress prices paid to suppliers to a level below the competitive price for a significant period of time such that the amount of input sold is reduced. That is,* ***the price of the product is depressed so low that (some) suppliers no longer cover their supply costs and so withdraw supply (or related services) from the market****.*[108] *Such an outcome reduces the amount of product being supplied damaging the economy."*[30]

    …

    We are interested in the ability of suppliers, in response to a decrease in the price of their product, ***to switch to*** *alternative buyers in sufficient quantities to render a hypothetical monopoly buyer's (a monopsonist's) price decrease unprofitable*

    …

    Other factors we consider… include whether:

    4.8.1 a new buyer would enter or an existing buyer would increase its purchases if prices decreased (see paragraphs 3.93-3.112 above);

    4.8.2 any suppliers have market power[11;0]

    4.8.3 it seems likely that suppliers will exit the market or otherwise reduce production, or will reduce investments in new products and processes, in response to any price decrease;

    4.8.4 buyers of the relevant product(s) have an incentive to restrict the quantity of inputs that they purchase, taking into account the impact on their profits in downstream markets and their ownership (see paragraph 3.126 above)[111]*; and*

    4.8.5 by reducing the amount it purchases, the merged firm may find it more difficult to access adequate supply of the relevant product in the long run.

36. So, for example, in *Aotearoa Fisheries Limited t/a Moana New Zealand; Sanford Limited* [2023] NZCC 25[31], the Commission considered if (SOPI and SOI [8.2]):

[26] https://www.justice.gov/d9/2023-12/2023%20Merger%20Guidelines.pdf p 26
[27] Judge blocks Penguin Random House-Simon & Schuster merger (cnbc.com) Published 31 October 2022
[28] When rhetoric confronts economic reality: Unsupported efficiency claims and unenforceable promises cannot save the book publishers deal | Brookings
[29] COMP/M. 1684 Carrefour/Promodès, 25 January 2000
[30] Mergers-and-acquisitions-Guidelines-May-2022.pdf (comcom.govt.nz) para [4.2], [4.4] and [4.8].
[31] Commerce Commission - Aotearoa Fisheries Limited t/a Moana New Zealand; Sanford Limited (comcom.govt.nz)

"…reducing the amount paid to the harvesters of fresh fish for harvesting services off the North Island, … could impact on these harvesters ability and incentive to harvest … for supply to downstream wholesale…".

37. The same considerations apply here, noting that in the Market Study, the Commission found many issues including: *"(8) competition was not working well for many suppliers due to an imbalance in market power."* The Commission concluded[32], in Chapter 8 of the Market Study its findings in relation to acquisition of groceries by retailers which are directly relevant to this SOPI:

    " Major grocery retailers are a key route to market for many suppliers. Most groceries in New Zealand are sold through the major grocery retailers' retail stores, so a supplier having its products stocked by a major grocery retailer is an important way to drive sales.*

    ** Many suppliers have limited alternative options available to sell their products other than to the major grocery retailers. With only two major grocery retailers in each island, which between them have a high share of the retail grocery market, in many instances there is only limited competition for the purchase of suppliers' products. We observe that, as a consequence, competition is not working well for many suppliers to the major grocery retailers.*

    ** Many suppliers have limited ability to negotiate with the major grocery retailers. Some suppliers – particularly large suppliers of well-known brands – will be in a relatively strong bargaining position compared to other suppliers. However, suppliers are typically significantly more dependent on retailers than the retailers are on suppliers. This leads to a bargaining power imbalance in many cases.*

    ** We have heard examples which suggest that in some cases major grocery retailers are using their strong negotiating position to:*

    ○ transfer costs and risks to suppliers, despite retailers being better placed to manage them;

    ○ reduce transparency and certainty over terms of supply; and

    ○ limit suppliers' ability or incentive to provide favourable supply terms to other grocery retailers.

    ** Suppliers' incentives to innovate and invest are likely to be adversely affected by this conduct in ways that ultimately harm consumers. For example, this could lead to reduced production or capacity, lower product quality and fewer new product offerings being available for New Zealand consumers. Other grocery retailers may face reduced access to supply of groceries, affecting their ability to enter or expand. There is a risk of prices rising in the future if some suppliers exit the market, reducing competition between the remaining suppliers.*

    ** Consumers may benefit from private label products through lower prices and greater choice. However, retailers of private label products can face conflicting incentives given they are both customers and competitors of branded suppliers…"*

Applying the Substantial Lessening of Competition test

38. In a merger, the applicant must satisfy the Commission that there is not a real prospect of a substantially more competitive counterfactual in relevant markets.

39. The current application is heavily redacted, so we are not able to test or comment on much of it. We question whether the level of redaction is appropriate given the magnitude of the impact on the regulatory regime the proposal will have. We consider that this

[32] Market-Study-into-the-retail-grocery-sector-Final-report-8-March-2022.pdf (comcom.govt.nz) (chapter 8, p324)

places an even greater responsibility on the applicant to make their claims and for the Commission to reach the requisite level of satisfaction.

40. Little impact is required for there to be a substantial lessening of competition. We note that in *NZ Bus & Infratil v Commerce Commission*[33] Wilson J described the competitive impact as '*minor*' but still found a substantial lessening of competition, and noted the parties could have sought authorisation (which also shares parallels with this situation). His honour noted (NZFGC emphasis added):

> *"[270] … "Substantial" is defined in s 2(1A) as "real or of substance", with the consequence that any lessening of competition which is more than illusory or transitory is caught by s 47. Accordingly, the minor competitive impact of the acquisition by NZ Bus of the shareholding of Mana Coach Services Ltd (Mana) which it did not already own was sufficient to bring the acquisition within s 47.* ***More particularly, pre-acquisition competition between NZ Bus and Mana in tendering for a small number of routes is of itself sufficient to establish that substantial (in the sense of real) lessening of competition would result.*** *As a matter of commercial reality, there is no way that, following acquisition, NZ Bus and Mana would each tender for the same route in the knowledge that the lower of their tenders would in all probability be accepted.*
>
> *[271] But that does not mean that the acquisition could not proceed. As a counterpoint to the adoption of the low "substantial lessening of competition" test, the Act in s 67 permits the Commerce Commission to authorise an acquisition which is likely to have the effect of substantially lessening competition if the public benefits resulting from the acquisition outweigh the detriments caused by the substantial lessening of competition. …*
>
> *[272] On the present facts,* ***only very minor lessening of competition would result*** *and the consequent detriment would be modest. NZ Bus would therefore not face a difficult task in establishing sufficient public benefit to outweigh that detriment. Greater efficiencies of scale in all the services of Mana and NZ Bus could well in themselves be sufficient to do so, as could rationalisation of their operations in the limited areas where they overlap.*

41. Section 2(2) of the Commerce Act provides that *"…unless the context otherwise requires, references to the lessening of competition include references to the hindering or preventing of competition."*[34]

Cost-savings and the role of efficiencies

42. Internationally, agencies are appropriately sceptical about claimed efficiencies (as opposed to 'cost savings') and pass through. There is no credit just for efficiency. Agencies have re-focused on innovation and variety and if these could be lost in demand-side mergers.

[33] New Zealand Bus Limited & Infratil Limited v Commerce Commission [2007] NZCA 502 Wilson J at [270]: *"More particularly, pre-acquisition competition between NZ Bus and Mana in tendering for a small number of routes is of itself sufficient to establish that substantial (in the sense of real) lessening of competition would result.* At [272] *"On the present facts, only very minor lessening of competition would result and the consequent detriment would be modest"*

[34] Commerce Act 1986 No 5 (as at 31 August 2023), Public Act 3 Certain terms defined in relation to competition – New Zealand Legislation

43. The US 2023 Merger Guidelines comment on "*Procompetitive efficiencies*" as follows[35]:

"The Supreme Court has held that "possible economies [from a merger] cannot be used as a defense to illegality."[67] Competition usually spurs firms to achieve efficiencies internally, and firms also often work together using contracts short of a merger to combine complementary assets without the full anticompetitive consequences of a merger.

Merging parties sometimes raise a rebuttal argument that, notwithstanding other evidence that competition may be lessened, evidence of procompetitive efficiencies shows that no substantial lessening of competition is in fact threatened by the merger. This argument asserts that the merger would not substantially lessen competition in any relevant market in the first place.[68] When assessing this argument, the Agencies will not credit vague or speculative claims, nor will they credit benefits outside the relevant market that would not prevent a lessening of competition in the relevant market. Rather, the Agencies examine whether the evidence[69] presented by the merging parties shows each of the following:

Merger Specificity. *The merger will produce substantial competitive benefits that could not be achieved without the merger under review.[70] Alternative ways of achieving the claimed benefits are considered in making this determination. Alternative arrangements could include organic growth of one of the merging firms, contracts between them, mergers with others, or a partial merger involving only those assets that give rise to the procompetitive efficiencies.*

Verifiability. *These benefits are verifiable, and have been verified, using reliable methodology and evidence not dependent on the subjective predictions of the merging parties or their agents. Procompetitive efficiencies are often speculative and difficult to verify and quantify, and efficiencies projected by the merging firms often are not realized. If reliable methodology for verifying efficiencies does not exist or is otherwise not presented by the merging parties, the Agencies are unable to credit those efficiencies.*

Prevents a Reduction in Competition. *To the extent efficiencies merely benefit the merging firms, they are not cognizable. The merging parties must demonstrate through credible evidence that, within a short period of time, the benefits will prevent the risk of a substantial lessening of competition in the relevant market.*

Not Anticompetitive. *Any benefits claimed by the merging parties are cognizable only if they do not result from the anticompetitive worsening of terms for the merged firm's trading partners.[71]*

Procompetitive efficiencies that satisfy each of these criteria are called cognizable efficiencies. To successfully rebut evidence that a merger may substantially lessen competition, cognizable efficiencies must be of a nature, magnitude, and likelihood that no substantial lessening of competition is threatened by the merger in any relevant market. Cognizable efficiencies that would not prevent the creation of a monopoly cannot justify a merger that may tend to create a monopoly."

44. In summary, in the United States, courts will not assume that monopsonists will pass-through profits to consumers[36]. For example, *United States v. Anthem, Inc.*, 428 U.S.

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[35] https://www.justice.gov/d9/2023-12/2023%20Merger%20Guidelines.pdf pp 32 and 33

[36] *United States v. Anthem, Inc.,* 428 U.S. App. D.C. 403 (2017) Antitrust Division | U.S. and Plaintiff States v. Anthem, Inc. and Cigna Corp. | United States Department of Justice

App. D.C. 403 (2017), where the District Court enjoined the merger of two health insurance companies which the Court of Appeals affirmed. Among other reasons, the Court of Appeals doubted that Anthem's claimed "*medical costs savings"* would actually be passed through to consumers, rather than *"simply bolstering Anthem's profit margin."* The Court said that the merger would result in the loss of a key buy-side competitor, creating *"upward pricing pressure"* and, if left unchecked, would increase (not decrease) consumer prices long term.

45. We consider that this is the approach to be taken here: there is no evidence that any claimed efficiencies will be 'passed-on' to consumers.

PART C: ANALYTICAL FRAMEWORK

46. This section discusses the application's key arguments, the impact of the proposal and counterfactuals.

Application's key arguments

47. Broadly, the application argues that the FS entities are not in competition on the buy side or sell side and that as a result:

    a. there will therefore be no competitive harm;

    b. there will be increased 'cost savings' and 'efficiencies', making it a better competitor; and.

    c. these should 'ultimately' be passed on due to the regulatory regime, expected new entry, expansion of The Warehouse Group and Costco (with no acknowledgement of the difficulties faced by new entrants such at Supie).

48. A core argument is that the proposal has no real impact because the parties are not 'in competition' and that this is status quo.

    a. a key question is why do they not compete, which goes to the counterfactuals.

    b. similarly, it is incorrect to suggest no competition or no harm to competition, when, for suppliers, this is a merger from oligopsony to duopsony.

        i. From the supply-side there is a very real loss in choice, benchmarking and changing competitive dynamics.

        ii. As a three-to-two merger there will be also concentration in wholesale supply - more powerful wholesalers enhances wholesale market power and makes market entry less likely.

        iii. The proposal can be expected to increase barriers to entry which can be expected to significantly reduce the likelihood of market entry/expansion.

SOPI Response

49. The SOPI does not, but should, consider further if the status quo counterfactual is correct:

    a. The Commission should question whether the arrangements that the parties are not "in competition" could be a "perceived cartel provisions" or other arrangement between the cooperatives which could be anticompetitive. This is a key threshold issue.

    b. Equally, the intragroup cooperative arrangements (for example the central holding of land and inability for cooperative members to exit) might be likely to substantially lessen competition as a prevention to switching barriers (creating a barrier to entry).

    c. Related to these points are the existing restrictive trade practices enquiries.

    d. Developments in any of the above could change the status quo counterfactual.

e. It is also important to consider the permanent structural change of a merger, and the significance of removing the 'option' of alternate counterfactuals. Particularly given the enduring impacts of the previous significant supermarket mergers.

f. A counterfactual could include a determination by one cooperative to enter the others market (particularly given that it could be argued absent the existing arrangements they would otherwise choose to compete or be likely to). As a variant one cooperative might decide to sell to a new entrant which would provide the platform for market entry. The proposal could also make further regulatory reforms more difficult.

50. We are not aware whether the Commission has investigated any perceived cartel provisions or anticompetitive arrangements (or related conduct) within or between the two FS entities, with the exception of the current investigation. Nor are we aware of it having examined the merger of the two FS North Island entities in 2013, nor more recent vertical acquisitions such as Leigh Fisheries.

51. This seems a critical omission, particularly given the recent market study. Regardless, the Commission clearly cannot form a view on this proposed merger without having first investigated those arrangements for perceived cartel provisions or other anticompetitive provisions and what changes if necessary, would ensure Commerce Act compliance. That would form the basis of a (potentially significantly) modified status quo-type counterfactual.

52. Regardless, given that <u>supply occurs at a national level</u>, it is incorrect to argue that (because they have agreed not to compete on the supply-side) that there <u>is no 'competition' for the acquisition of groceries</u>. Suppliers currently have three options to supply RGRs. Regardless, higher concentration would make suppliers more vulnerable to larger acquirers which could impose even more onerous terms and there would be the loss of the competitive and regulatory benefit of benchmarking the three RGRs. Suppliers experience different conduct, operation, and even in the approach to the GSA terms.

53. It is essential that '<u>cost savings</u>' through greater purchasing power are distinguished from operational '<u>efficiencies</u>':

a. <u>If 'cost savings' are extracted from suppliers by greater purchasing power, t</u>his could make vulnerable suppliers more vulnerable and could lead to a loss of choice and innovation for consumers. This could make barriers to entry/expansion even higher.

b. <u>To the extent that there are operational efficiencies,</u> it is not suggested that any RGR is subscale or cannot achieve minimum efficient scale. If there is the need for minimum efficient scale, this could make barriers to entry/expansion even higher. Efficiencies are not inherently pro-competitive. The arguments about efficiencies and enhanced competition are not substantiated.

54. Increased barriers to entry/expansion means the Commission should consider impacts on local grocery supply market.

Impact of the proposal

55. Compared to the status quo, the proposed merger would:

a. reduce the number of RGRs from three-to-two; and

b. reduce (regulated) wholesalers from three-to-two.

56. The proposed merger has the potential to have enduring impact in various adjacent markets throughout the supply chain.

57. This assumes that the status quo is the counterfactual. The test is a forward-looking one which must have regard to any existing conduct or arrangements which may be prohibited under the Commerce Act.

Counterfactuals

58. As noted in our introduction to this submission (Recommended issues and options for consideration) and in **ANNEX A** the Commission should:

   a. determine if the status quo is compliant with the Commerce Act and if not what the compliant arrangements would look like and how they might differ to the status quo.

      i. This must consider the internal arrangements of FSNI and FSSI.

      ii. It must also consider the arrangements between FSNI and FSSI.

      iii. Determine what those arrangements might look like if they were amended (if necessary) to ensure Commerce Act compliance, taking a forward-looking approach.

   b. identify other potential counterfactuals.

   c. then, test and clarify the difference between:

      i. That forward-looking Commerce Act compliant version of the status quo and

      ii. The most competitive realistic counterfactual.

59. While the Commission will traditionally separate out **restrictive trade practices** matters for separate consideration, to be completed after any clearance determination, we suggest that would be incorrect here:

   a. It risks the Commission granting clearance on an incorrect/prohibited modified status quo counterfactual.

   b. It would make permanent change to the market structure, effectively entrenching and allowing that conduct in perpetuity.

60. NZFGC is not suggesting that the status quo is necessarily in breach of the Commerce Act but given the applicants' submissions, we consider that it is not only appropriate, but also necessary for the Commission to investigate all relevant contract, agreements and understandings (**CAUs**), to determine their individual and collective effect including:

   a. Any perceived cartel provisions and/or otherwise anticompetitive intragroup arrangements (including between individual owner operators). For example, we understand that there is separation of land ownership from store ownership/management which may substantially lessen competition as it creates switching barriers (undermining entry barriers)

b. Why the two cooperatives do not compete, including the relevance of any perceived cartel provisions. Simplistically the lack of competition or such arrangements having that effect, might be perceived as cartel provisions preventing the possibility of competition between those entities.

c. The proper/corrected approach should be treated as the base counterfactual.

61. FSSI and FSNI are currently in competition on the buy/supplier side, and presumably they are also in competition on the "sell side" but for a presumed contract, arrangement, or understanding not to enter each other's geographic market.

62. Such a presumed contract arrangement understanding raises further questions of a perceived cartel provision.

63. While there may be a 'collaborative activity', given market concentration issues, there may be real questions as to whether an existing collaborative activity, or the proposed merger could substantially less competition.

64. There may also be issues around any *restraints*, and whether they exceed their legitimate scope at common law. Section 7(1) of the Commerce Act (Relationship with law on restraint of trade) provides that *"Nothing in this Act limits or affects any rule of law relating to restraint of trade not inconsistent with any of the provisions of this Act."* Provisions which are excessively broad, may of course have a chilling effect on competition.

65. In summary, the Commission will need to consider many issues including:

a. If the status quo is much the same as the proposal (as submitted).

b. If the status is not a valid counterfactual due to arrangements within each cooperative that raise Commerce Act issues.

c. If the status quo is not a valid counterfactual due to arrangements between the cooperatives that raise Commerce Act issues.

d. If the proposal the removes the possibility of a more competitive counterfactual (noting it is credible that, among other things) one or both entities (or some members) could be acquired and used as a springboard for new entry/expansion into each other's territory.

66. As noted by Dr Jill Walker:

> *"By altering market structure, the underlying conditions for competition, mergers may adversely affect efficiency and consumer welfare for many years, and such changes are not easily reversed"*[37]

[37] Dr Jill Walker, 'An Economic Perspective on Part IV', Chapter 3, Current Issues in Competition Law Vol 1, p 87 (The Federation Press, 2021).

PART D: MARKET ISSUES AND IMPACTS

67. Both FSNI and FSSI appear to be actively expanding, with big rollouts of new stores and distribution centres, which must increase barriers to entry for new players in the grocery sector.

68. FS also seems active in commercial land acquisition markets. The Commission currently has an ongoing investigation into the acquisition of land and the lodging of land and lease covenants by FSNI that may have had the purpose of impeding competition.

69. The Commission considered the conditions of entry and expansion by grocery retailers into the New Zealand grocery sector in 2007 when Foodstuffs (Foodstuffs Auckland, Foodstuffs Wellington, and Foodstuffs SI) and Woolworths NZ each separately applied for clearance to acquire The Warehouse Group. In the subsequent appeal, *Commerce Commission v Woolworths Limited and Others*, the Court of Appeal stated: [38]

    " [the Commission] 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."

70. It also noted that:

    "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. …Other potential entrants are not obvious and barriers to entry are high." [39]

Role and impacts of regulation

71. The GICA was enacted as part of the suite of reforms responding to the Commission's findings and recommendations in the Market study. The GICA's purpose is "*to promote competition and efficiency in the grocery industry for the long-term benefit of consumers in New Zealand."*

72. The GICA provides for the *grocery supply code*,[40] the purpose of which is to promote the purpose of the GICA by[41] promoting fair conduct, and prohibiting unfair conduct, between RGRs, related parties and suppliers, *promoting transparency and certainty about the terms of agreements and contributing to a trading environment in the grocery industry in which businesses compete effectively and consumers and businesses participate confidently.*

73. Section 18 of the GICA provides an overview of the wholesale regime. Essentially, a *voluntary framework* is imposed, with options to impose additional regulation.

74. The *purpose* of the wholesale regime is to promote competition and efficiency in the grocery industry for the long-term benefit of consumers in New Zealand by enabling wholesale customers to:

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[38] *Commerce Commission v Woolworths Limited & Others* [2008] NZCA 276, at [166].
[39] *Commerce Commission v Woolworths Limited & Others* [2008] NZCA 276, at [200].
[40] Grocery Industry Competition (Grocery Supply Code) Amendment Regulations 2023 (SL 2023/220) – New Zealand Legislation
[41] Grocery Industry Competition Act 2023 No 31 (as at 28 September 2023), Public Act 16 Purpose of grocery supply code – New Zealand Legislation

a. Have reliable and cost-effective wholesale supplies of groceries (either through wholesale supply provided by RGRs, directly arranging supply from suppliers or other channels, or any combination of those channels).

b. Have reasonable access to the benefits of the scale, and the efficiency, of operations of RGRs and their associated persons.

75. The GICA provides a framework to facilitate voluntary commercial negotiations between the regulated retailers and wholesale access seekers (Voluntary Framework). This requires RGRs to do a range of things including consider and negotiate wholesale supply requests in good faith and several related and many actions related to this consideration and negotiation.

76. RGRs are prohibited from engaging in conduct that has the purpose, effect, or likely effect of unduly hindering or obstructing a wholesale customer/supplier or a supplier from participating in a wholesale offering.

77. The GICA also provides processes to impose four types of additional regulation in case the Voluntary Framework is not effective.

78. Monitoring and reporting on the efficacy of the regime is, of course, a core part of the Grocery Commissioner's role. The annual reporting by the Commissioner and its contents are set out in s175 of the GICA.

79. It would seem that the proposed merger would be contrary to the achievement of all these expectations in the GICA and of the Commissioner's role to effectively report on the state of competition when it could be shrinking by the year.

Market conduct

80. The application puts great faith in the GICA and broader reforms but in our view it is far too early to know if the reforms will achieve their intended objectives. Suggesting further concentration is acceptable as there is now a regulatory regime in place is inconsistent with the objective of increased competition. This also is at odds with repeated public statements from the Grocery Commissioner and senior politicians, including the Prime Minister, that the new regime needs time to work.

    a. *"Things won't change overnight, but it's for the long-term benefit of Kiwi consumers, and I get really excited about that because I can see that this will make a difference for the ordinary Kiwi."* Grocery Commissioner, Pierre van Herdeen[42].

    b. *"But it's really about the long term, right, because that is what's going to benefit New Zealanders into the future."* Grocery Commissioner, Pierre van Herdeen[43].

    c. "*It's early days, we need to give them [The Commission and Grocery Commissioner] a good go."* Prime Minister Rt Hon Christopher Luxon[44].

    d. *"We are obviously looking at it as part of our coalition agreement, that we are going to review the Grocery Commissioner's powers… there might be some options around that to put in place... there is a continuum through from that you've got a*

[42] RNZ Interview, 29 September 2023
[43] Newshub Interview, 7 November 2023
[44] TVNZ Breakfast Interview, 1 November 2023

relatively new piece of legislation… but we're just working our way through that process." Hon Andrew Bayly [45].

81. GICA is still in its early days. We are now in the initial implementation period, where the RGRs ought to be adjusting their practices to comply with the provisions outlined in the Grocery Code of Conduct (the Code). The six month grace period was intended to give retailers time to update existing grocery supply agreements to align them with the Code if they were currently inconsistent, and offer these compliant terms to suppliers.

82. The Commission is aware that the three RGRs are taking different approaches, we are yet to see the full suite of documents constituting the grocery supply agreements for all RGRs and our legal counsel has recommended that suppliers wait to see all three 'offers' so that, among other things they are better placed to negotiate to the extent they can.

83. There are concerns surrounding the current terms, which we will raise briefly. With respect to timing, members may be presented terms appearing to be on a 'take it or leave it' basis with the suggestion of time pressure. Some members report being told they must sign before the end of the grace period or risk negative consequences. Documents appear to provide for RGRs to unilaterally vary some terms (inconsistent with the Code presumptions).

84. Some documentation appears to explicitly seek to automatically contract out of many or all such protections. Further to the GSA offers, some suppliers have received separate store agreements from individual stores. There is some confusion regarding that status of the store agreement, and the lack of clear content with blank template versions provided with no parties specified and a blank table, which suppliers are unclear whether they should populate and with what information.

85. The Code's starting point is that unilateral variations, set-offs, wastage payments, payments as a condition of being a supplier, payments for retailer business activities and funding promotions, are prohibited.[46] The above seems inconsistent with ***good faith*** obligations (eg ***honesty**, lack* of ***coercion***, ***transparency)*** and raises potential *Fair Trading Act 1986* (eg misleading as to rights). There are concerns that such behaviour described above is in breach of obligations *"not threaten a supplier with business disruption or termination of a grocery supply agreement without reasonable grounds.*"[47]

86. Our points here are as follows:

    a. There are different approaches by all three RGRs.

    b. The ability to compare is useful and has led to changes.

    c. We have concerns that the Code may not be being fully complied with.

    d. This suggests caution in extrapolating outcomes, especially when the Grocery Commissioner has yet to make his first report.

    e. The proposed merger necessarily impacts the efficacy of the regulatory regime, by reducing the number of regulated entities and the importance of this for benchmarking (we do not even know if this is permitted).

[45] RNZ Interview, 23 January 2024
[46] See p 3 Commerce Commission Fact Sheet
[47] Clause 23 Grocery Industry Competition Grocery Supply Code) Amendment Regulations 2023

f. The impact of the regime is untested.

g. The applicants have provided no evidence that the LST test would be met (likely, sufficient and timely).

87. We would also add our perspective (discussed in Annex A) that:

a. There is an inherent tension in the regulatory regime, which risks creating stronger vertically integrated wholesaler/retailers.

b. Seeking to address this, the regime specifically protects direct supply to new entrants rather than just via wholesaling.

c. The proposal would heighten entry barriers (enhance that market power, reducing chances of market entry setting a floor on downstream prices.

d. As such permitting the proposed merger would in fact undermine the regulatory regime.

88. In the balance of this Part, NZFGC uses the same headings as in the SOPI but we reverse the order of analysis as the upstream affects conduct and the downstream impacts consumers. It also parks the arguments that there is no overlap as this is because the parties have agreed not to compete.

Acquisition of grocery products

89. The Commission's background and stated impact of transaction (from the SOPI) on the acquisition of groceries comments on unilateral effects, depressed prices and a worsening of terms for suppliers.

90. The applicants' arguments as to why there is no lessening of competition has been covered in the foregoing Parts of this submission.

91. The issues the Commission will consider (from the SOPI) include closeness of competition, degree of constraint from suppliers to switch to supplying others, countervailing power and extent of product savings.

92. Negotiation to purchase products for retail can be significantly affected if the impact is national rather than regional. A supplier may negotiate different terms between FSSI and FSNI to the suppliers' advantage either in terms of value or volume or both. Any such advantage is non-existent in a merged entity.

93. We note from our review of the documents available the grocery supply agreements between FSSI and FSNI differ in several aspects. These differences would disappear in a merged entity that would concentrate power further.

94. Due to the use of FSNI or FSSI as wholesalers by small stores and dairies, refusal to fulfil orders at any time can immediately place immense pressure on these formats. Refusal to supply at a national level has greater impact than refusal at a regional wholesale level.

95. A South Island supplier may well struggle significantly more from negotiating with a national retail supplier than with a South Island owned and located retail business. This was evidenced in our member feedback and survey, some commenting that there was

more opportunity for South Island-based products under the status quo. There was concern that the proposed merger would remove the ability to make decisions and invest at the local level. Others noted that they have been unable to enter the North Island market and were concerned they would lose supply.

96. Our industry body counterparts in Australia, the Australian Food and Grocery Council (AFGC) published a 2030 study, which shows multiyear decline in research and development and CAPEX spend:

> "*Australia's food and grocery sector has been under pressure as profitability has declined and capital investment stagnated over the past decade. The unavoidable result has been being a stifling of innovation; spending on research and development in the sector has fallen in recent years to 2009/10 levels.*"[48]

97. The report warns:

> "*Indeed, if left without intervention and a strategic approach, there is a real risk that the current trend of offshoring manufacturing and importing increasing levels of high value-added food and grocery products could continue to the point where consumers will struggle to find high value-added products that are made in Australia.*"[49]

98. Further, under the public benefit test there are sovereignty concerns about the impact on investment and performance resulting from this proposal – detrimental impacts should local supply decline and imports increase. As noted previously, the pressures for suppliers may lead to cost cutting resulting from reduced profitability including in investment and innovation, sustainability mitigation efforts, offshore production considerations and consequences resulting from a non-viable market.

99. Our comments are (following the SOPI):

    a. [34] We consider that there is a real risk that the merged entity could profitably depress prices, further reducing incentives and the pace of development by suppliers. We also expect greater centralisation and reduced ability to negotiate with individual stores (among other things the merged entity will be stronger and bigger relative to any individual store).

    b. [35] We consider that the greater centralisation with one entity negotiating supply terms is likely to have the following impacts:
       i. Enhanced demand-side market power;
       ii. Reduced options for suppliers and greater risk to supply;
       iii. Greater risk of coordinated effects (accommodating behaviour) on the buy-side as the powerful purchasers will (1) have more similar costs structures; (2) the knowledge that suppliers have fewer options; (3) there will be a greater ability to know the (only) other main buyer's offer.

    c. [36.1] We have already noted that it appears that if the FS entities do not compete this seems to be because they have agreed not to compete which raises perceived cartel provisions and issues which the Commission should investigate.

[48] Sustaining Australia, Food and Grocery Manufacturing 2030, AFGC and EQ Economics, https://www.afgc.org.au/industry-resources/sustaining-australia-food-and-grocery-manufacturing-2030
[49] Sustaining Australia, Food and Grocery Manufacturing 2030, AFGC and EQ Economics, https://www.afgc.org.au/industry-resources/sustaining-australia-food-and-grocery-manufacturing-2030

i. As an aside we note the Commission's conclusions on *Anytime Fitness*[50] do not seem consistent with an acceptance of the status quo here.
ii. We consider that there is a *national market* and that the parties are in competition (or should be).
iii. Regardless, suppliers see them as different options which provides useful benchmarking and negotiation options, the removal of which would clearly enhance market power and reduce barriers to entry.

d. [36.2] Member feedback makes it clear the level of joint procurement is significantly overstated.

e. [36.2] It seems economically impossible to argue that there will be no impact on volume while also stating that downstream there will be enhanced competition. The statement is consistent with a cosy duopoly and indicates that consumers will get no benefit.

f. [36.3] 'Cost savings' are a wealth transfer, so to the extent this occurs the claimed rationale/benefit would exacerbate the harms identified in the Market Study. The downstream effect means that this shifts what is an exceptionally narrow margin from supplier to the supermarket profits.

g. [36.3] As set out above, 'efficiencies' are not relevant unless passed on to consumers. They certainly are not a defence to an anticompetitive merger. We are not aware of any evidence being provided to support this assertion. Member feedback indicates it will be harder for suppliers to negotiate pass through of prices reductions and specials for consumers.

h. [37.1] As outlined above (1) the wholesale prices/terms/ranging conditions of the cooperatives differ greatly; (2) 95.45% of members report using these differences in negotiations and members consider that the proposed merger would see the loss of a "material" constraint.

i. [37.2] Currently a supplier could supply to neither, one, or both FS cooperatives – the existing structure may particularly suit smaller domestic suppliers; the proposal self-evidently reduces those options for switching (and will have a flow on effect to negotiations with the other RGR which will be aware that suppliers have only one other main option).

j. [37.4] As noted above this refers to a wealth transfer (further jeopardising supply and suppliers) and un-evidenced efficiencies, for which there is no evidence that these would be passed on. In themselves these are of no use and the Commission should not be considering them unless there is clear evidence that this will be passed on. We suggest there is no such evidence.

100. Even though there is no supply-side overlap (due to existing arrangements) the proposal increases the risk of tacit/accommodating behaviour between the proposed merged entity and the remaining RGR as follows:

[50] Commerce Commission - Anytime NZ Limited (comcom.govt.nz) and Commerce Commission - Commission declines clearance for Anytime NZ Limited's collaborative activity clearance application (comcom.govt.nz)

a. Even with two more even competitors, with similar sizes etc nationally, they can be expected to have more common costs – this, and greater concentration can be expected to lead to greater risk of coordination.

b. The oligopsony plus duopoly with differentiated (not head-to-head) competition becomes a full two player market (duopsony plus duopoly).

c. It becomes easier for two competitors to monitor each other.

d. This also increases entry barriers, as fuller scale may be required for a new entrant (noting overbuild already).

Wholesale supply of grocery products

101. The Commission's background and stated impact of the proposal is that post-merger, the wholesale offerings of FSNI and FSSI would consolidate a single regulated wholesale business would result.

102. Issues the Commission should consider are the absence of existing competition between Trents and Gilmours for local wholesale customers, regional commercial wholesale customers, national commercial wholesale customers and a number of strong competitors (eg Bidfood).

103. The Parties each operate their own wholesale business. During the Grocery Market Study, the intent was to improve conditions for entry and expansion including measures to improve wholesale supply of a wide range of groceries at competitive prices.

104. NZFGC cannot see adequate evidence that reducing wholesalers improves conditions for entry and expansion. Supermarket owning wholesalers has led to market consolidation and higher pricing for all consumers. Further concentration with the proposed merger of the Parties cannot logically lessen market consolidation or reduce pricing for consumers.

105. As noted above we have many concerns about reducing the number of wholesale suppliers:

a. Most obviously it removes the options for (wholesale) access seekers from three-to-two.

b. So there would be reduced choice for access seekers, and likely a greater imbalance in bargaining power between the parties.

c. It would also seem to frustrate the regulatory regime, part of which is benchmarking.

d. It entrenches the market power in grocery to two large vertically integrated wholesaler/retailers.

e. It removes the possibility of more competitive counterfactuals, such as an independent wholesale or one of the merging parties being a springboard to new entry.

f. There may also be flow-on effects from upstream procurement – the Merged Entity would have both the ability and incentives to reduce its range and variety (to gain cost savings and efficiencies), especially if the parties have different suppliers at

present). This seems evidenced evidence by FSNI range reduction, supplier reductions.

g. There may also be margin threat of consolidation for non-grocery third party suppliers such as trucking and logistics, banking. While Merged Entity claim as examples of efficiencies they are not related to that but instead greater buying power of the Merged Entity:

   i. NZFGC notes that "Nationally the merged entity may be of a more similar size and cost structure to Woolworths."[51] The Application claims that the Proposed Merger would not be likely to substantially lessen competition and for retail supply this is because of a high degree of product and brand differentiation and the large number of products amongst other things. The brand differentiation across the duopoly is with private label and branded brand products. In the current retail market, private label products across the Parties could differ but under the Proposed Merger this would likely disappear. The impact maybe less choice for consumers and potentially no price advantage as products will need to be delivered nation-wide rather than within one or other island, at least for some products.

   ii. In relation to commercially branded products these are generally sold across the duopoly including into FSSI and FSNI except where the suppliers might be regional. If regional suppliers are squeezed out as a result of the Proposed Merger, then competition will be reduced and consumers will lose choice.

   iii. In relation to the acquisition of grocery products from suppliers, FSSI and FSNI may both issue tenders for **private label products** that suppliers can choose to negotiate either for supplying both or one or the other. This will possibly not be available under the Proposed Merger. Where the scale of supply might have been possible for a South Island supplier to achieve, this might not be possible for national supply.

   iv. We are surprised that the SOPI does not even mention potential impact in **private label** because the proposed Merged Entity will represent close to 60 percent of the grocery sector.

Retail supply of grocery products

106. The Commission states that in the supply of goods, unilateral effects may arise where a merged firm can profitably increase its retail or wholesale price above the level that would prevail without the proposed merger. Post-merger, with the retail offerings consolidated, the merged entity would operate, and input into the pricing and competitive strategies for a significantly larger group. Similarly, in the buying of goods, unilateral effects may arise where a merged firm can profitably depress prices paid to suppliers to a level below the competitive price for a significant period of time and that post-merger supply terms would be consolidated.

107. The Applicants claim that because there is no existing or potential competition between FSNI and FSSI there will be no lessening of competition. They claim that the Proposed Merger is not capable of lessening competition in any market for the retail supply of groceries. We disagree:

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[51] p11 SOPI

a. Again, the Commission should first consider if the arrangements within and between the parties are perceived as cartel arrangements or otherwise anticompetitive.

b. The consolidation/greater concentration structurally upstream would increase barriers to entry.

c. Greater centralisation could be expected, particularly if the Merged Entity were listed on a stock exchange or sold in its entirety.

108. NZFGC considers the capability exists from existing competitors and prospective competitors entering selected locations to impact FSSI or FSNI rather than the entire FS network. The geographic impact is important because FSSI deals with significantly more distant and less populous locations than FSNI.

Vertical and conglomerate effects

109. We suggest that far greater scrutiny is required considering the whole supply chain. As the above shows, we consider that the upstream aggregation will have downstream impacts.

110. Conglomerate effects may need to be considered as well. It appears that RGRs are engaging in (strategic) conduct eg:

a. Aggressive rollout of new stores which means new entry is less likely.

b. Increased private label (which in the case of the other RGR may be far more likely to be sourced overseas, impacting domestic New Zealand suppliers).

c. Competitive actions which individually do not substantially lessen competition (but collectively do) may be more likely.

d. Simply by virtue of greater resources, the merged entity may be able to resist regulatory influence (we note as an example the time the current investigations seem to be taking compared to the recent covenants case, particularly when the RGRs actions were systematic by a well-resourced entity).

e. 'Creeping acquisitions' may also be more likely.

PART E: MEMBER FEEDBACK

111. Our supplier members views and feedback are of critical importance, and clearly articulate the effect of this proposal and evidence around prior mergers. As noted, we sought member feedback on how they see market conduct now, and how they expect it to change under the proposal. We wanted to accurately reflect the potential range of opinions within our membership, so we conducted a member survey, based on the SOPI.[52] Of those asked, 70 suppliers completed the comprehensive survey and provided the insights on the proposal and its impacts. As respondents' information was provided anonymously, we are unable to provide business demography detail, it is worth the Commission noting that the majority supply all three RGRs. Only one survey was sent to each company, and sent to the most senior executive, the Chief Executive or as delegated. Further feedback was received from members outside of the survey as well, which has been included where appropriate.

The status quo and concerns about the proposal's impacts

112. Some members commented that it would be unlikely to markedly assist either way, or that it would be difficult to comment until more was known following outcomes from the retailer conversations. The majority of members shared recurring thematic concerns, that while there was some potential that the proposal could assist, it was more likely the centralisation of business also would create centralisation of power. This would reduce negotiation leverage, with a concern that there would be more at stake and leading to potential increases in cost of doing business for suppliers, and increased prices for consumers.

113. One member put it in these words, that now they have essentially three customers, if the proposed merger went ahead they would only have two. Others believed that the bigger the RGR, the more power the RGR would wield during negotiations, especially given the current experience of power imbalances. Another noted that status quo provides greater flexibility with negotiations, some commenting that there was more opportunity for South Island-based products under the status quo. There was concern that the proposed merger would remove the ability to make decisions and invest at the local level, with centralised decision-making limiting store level arrangements and promotion or display non-core ranged items. The concern is reflected in the consistency of the opposition – more than two thirds to as high as 90 per cent, to the questions asked.

114. Members highlighted the following concerns:

    a. Differences in terms and negotiations: 96% say there are differences in the two FS entities operations, negotiations, or terms, 80% have different strategies between the two entities, and 88% think the proposed merger will make it harder for suppliers to do deals directly with individual stores/groups of stores/banners.

    b. Increased market power: 71% believe the status quo of three RGRs assists negotiations more than the proposal; 77% think the merged FS could have a greater ability to depress prices paid to supplier.

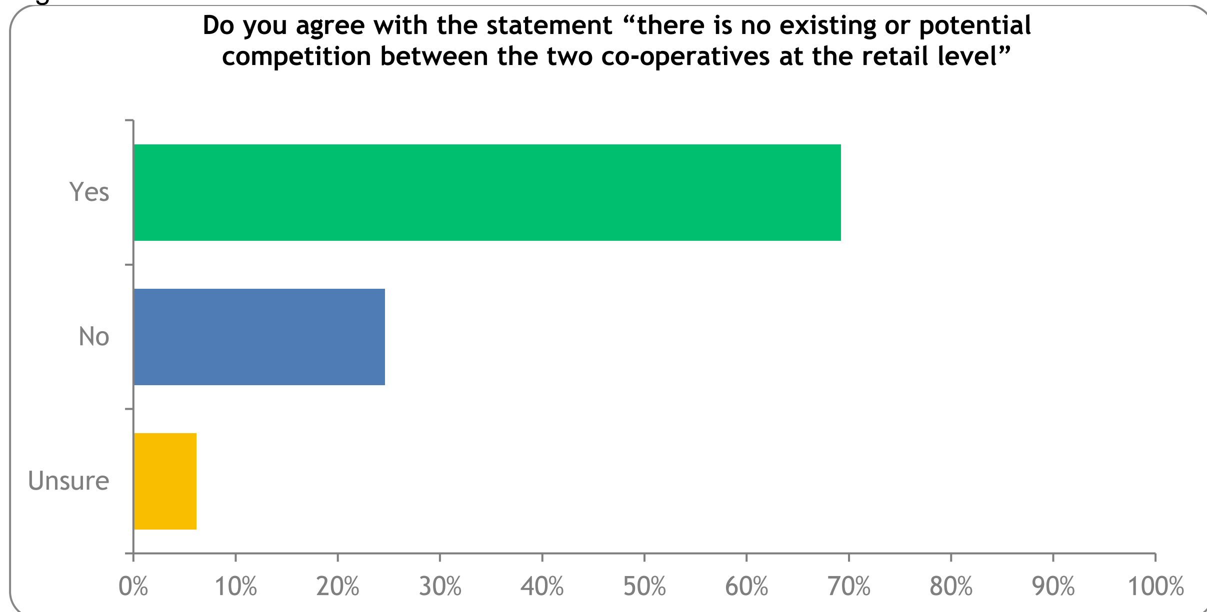
    c. Other impacts: 76% have concerns about impacts in other parts of the supply chain and/or greater costs being imposed on suppliers.

[52] These issues have been raised with us by members by formal and informal means.

d. No consumer benefit 74% do not expect any merger-specific "cost savings" (lower prices from suppliers) to be passed on to consumers and 55% think the proposal would make it harder for suppliers to negotiate pass-through.

e. Members also thought that the proposal would make new retail entry (or expansion by small/niche players) less likely 74% making it harder.

Figure 1



115. The clear feedback on differences between FSSI and FSNI is important. Of the 88%, a repeated theme was that they have completely separate relationships, programs, pricing, terms, agreements, strategy. Further, when asked about supply strategies, many provided evidence that they differed.

a. This seems inconsistent with the application: which implies that the proposal will simply internalise pre-existing arrangements (this goes to issue (1) namely: *Do the two FS entities really act as one head under the status quo?*

b. The corollary of this is that even if the status quo is fully compliant with the Commerce Act, there will (or at least could be) much more significant change than indicated. A core issue is what the merged entity would have the power to do.

c. Paragraph [a] also suggests far greater scrutiny is needed around the claimed operations and other factual statements must be tested.

Figure 2

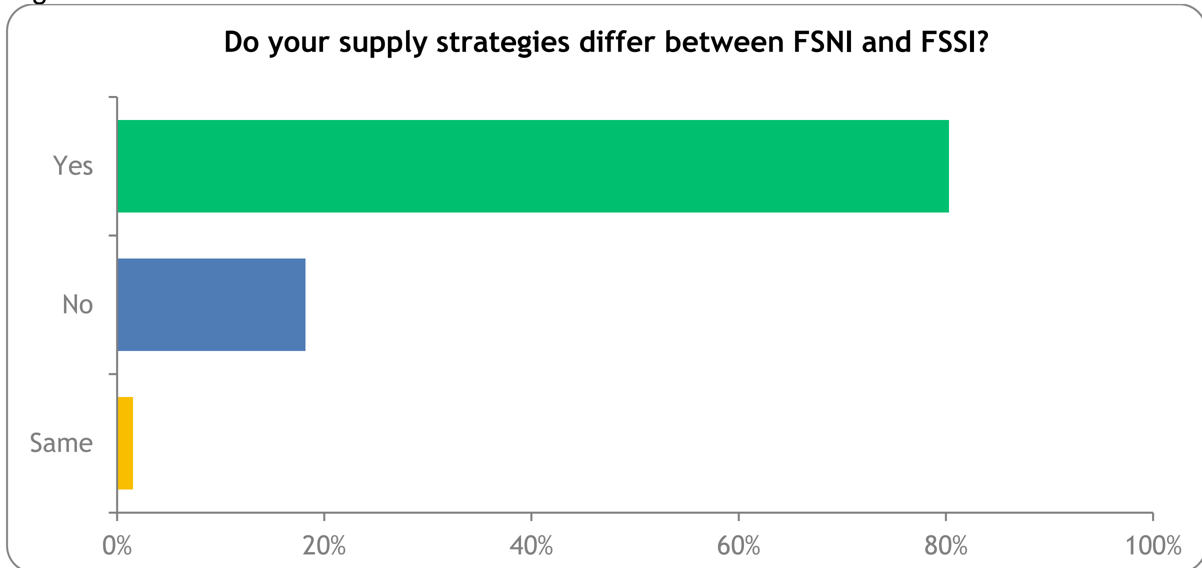
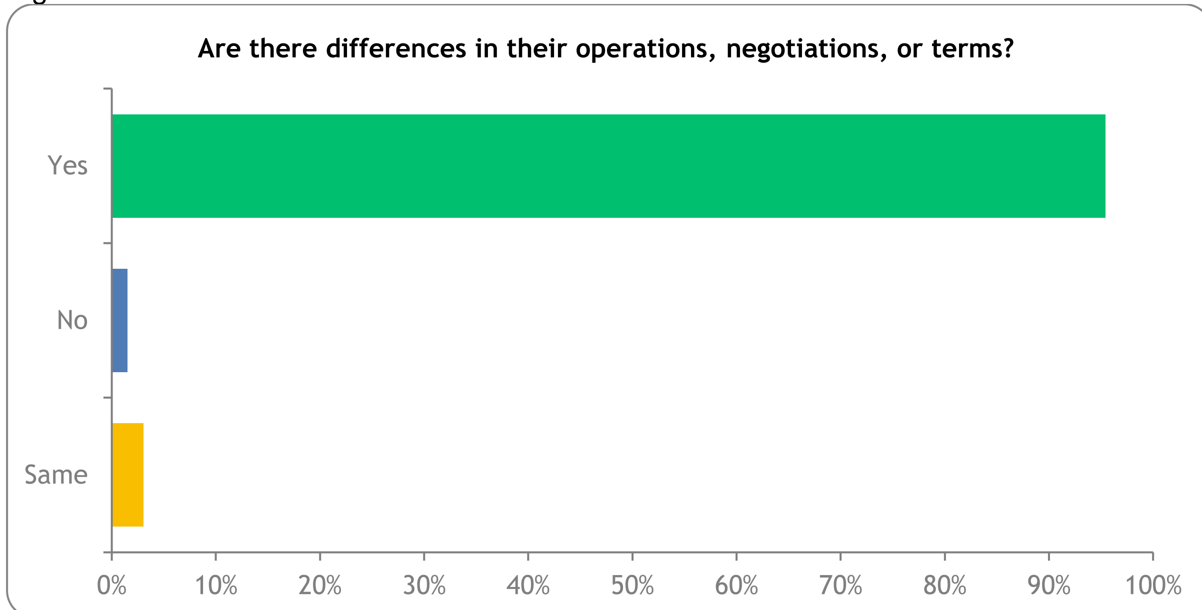


Figure 3



116. This should not surprise the Commission. Even in the context of the new regulatory regime and proposed merger, all three RGRs present different commercial offers and take different approaches to presentation and negotiation. For example:

   a. The *FSNI Grocery Supply Contract (excluding Fresh Produce) V1* (only part of the overall grocery supply agreement) is a dense, complex, 27-page document.

   b. FSSI's *Final Master Supplier Terms And Conditions* (only part of the overall grocery supply agreement) is only 11 pages long and more clearly drafted (but like its counterpart seeks to contract out of virtually all Code protections).

   c. FSSI represents its *Final Master Supplier Terms and Conditions on* a "take it or leave it basis" implying an obligation on suppliers to countersign when the obligation is on the RGR to ensure compliant terms.

117. Some of the differences reported by member respondents are:

a. 97% currently see a difference between the North and South Island approaches. Members noted the difference between the two RGRs, very different through range, new product development, margins, price, compliance and strategies. Some members noted different management styles, which they believed might account for the cultural difference between the two entities, centralised decisions of FSNI while FSSI allowed for greater supplier engagement options. Examples included that FFSI is more flexible about accepting new products, allowed greater store decision making such as store level deals.

b. 88% have more than one agreement or point of contact that dealt with both FSNI and FSSI. Members stated that they had completely separate relationships, programs, pricing, terms, agreements, strategy and worked with different people across the two RGRs.

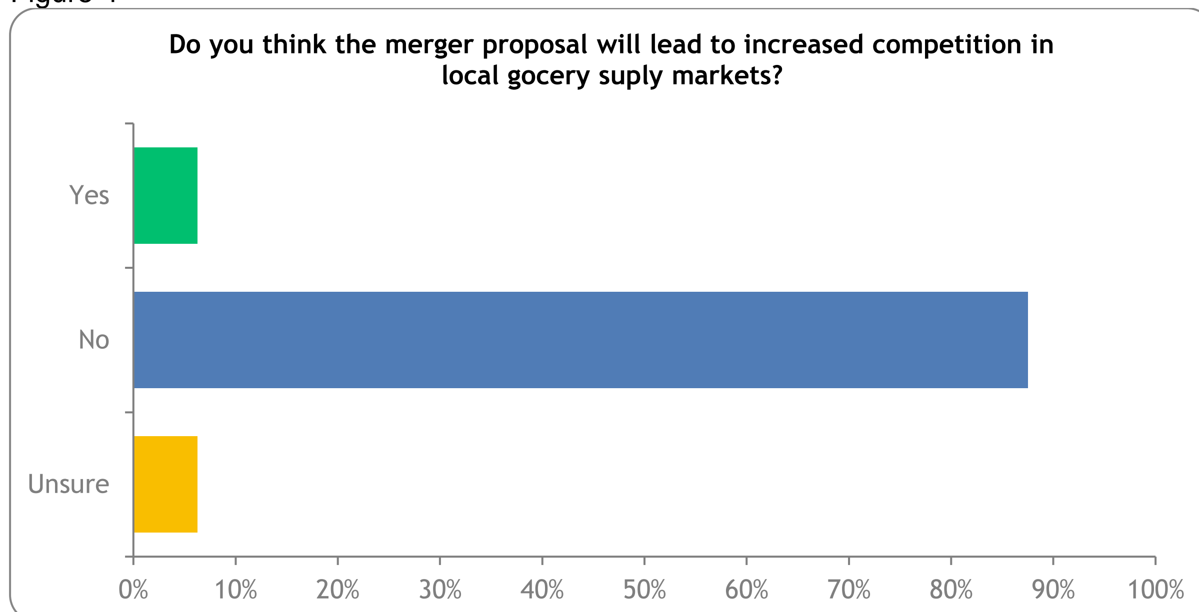
c. 81% said that their supply strategies differed between FSNI and FSSI especially with suppliers with operations across both islands and that they operated differently based on process efficiencies, ensuring optimisation given the pricing variations of the two RGRs. A common theme was that suppliers feared losing the current relationship with FSSI, that appeared to be on more relational terms and better ways of working. Reducing risk was another concern, that the status quo offers greater financial viability.

d. 96% said there were differences in their operations, negotiations, or terms, including that differences were across the cost price, terms, category reviews, promotional programmes, instore volumetric agreements and ranging. Some suppliers commented that they had found the respective procurement teams valued different things in negotiations.

e. 57% of members said that the differences helped in negotiations (30% unsure) and 45% used this difference in negotiations. The different business models, regional pricing, and ability to product performance were mentioned as part of these differences.

f. 77% dealt with individual owners/operators directly where possible, through field teams and department managers. There was a concern that this would cease under the proposal.

Figure 4



Increased market power, risk to suppliers (failure, reduced innovation)

118. Members reported as follows:

a. 88% thought under the proposed merger it would be harder for suppliers to do deals directly with individual stores/groups of stores/banners and suppliers indicated there would likely be greater centralisation given that the experience is that FSNI has become more centralised with a 'head office' model.

b. 77% thought the merged FS could have a greater ability to depress prices paid to suppliers, one member noting in their experience of the 2013 FS merger that this occurred.

c. 89% thought the merged FS could have more ability to impose other adverse non-price terms (eg deranging, merchandising charges). One member noted that the threat of deranging from the Merged Entity in market share terms demonstrates significant increase of power from the status quo.

d. 74% believed the status quo, having three RGR options, reduced risks more than under the proposed merger. In response to this question, members reiterated their view that the proposed merger creates significant risk for SME businesses, and that a FS Merged Entity with close to 60% market share gives significant leverage over suppliers, increasing the cost of business for suppliers and will skew the industry toward corporates that can outspend SMEs.

e. 73% believed the status quo, having three RGR options, provided suppliers with more options than under the proposed merger. Members noted that the status quo has three options to gain ranging in, to negotiate with, to spread risk as well as trial more products. The proposal could also lead to reduced product, price and promotional options for consumers as both Islands move into national ranging and promotions.

f. 71% believed the status quo, having three RGR options, assisted negotiations more than under the proposed merger, again, the comments echoing that the status quo

means that supplier have three customers now, if the proposed merger goes ahead they will only have two.

g. 67% were concerned the proposed merger could impact innovation by suppliers, such as reducing the incentives and/or pace of development. One example was where a new, innovative offer was accepted by one FS entity, but not by the other FS entity. After positive performance, the other FS entity accepted the range later. If the first FS entity had not accepted the innovation, the products would not now be on the market. Currently, there is diversity in commercial focus and concern that this will disappear if FS merge.

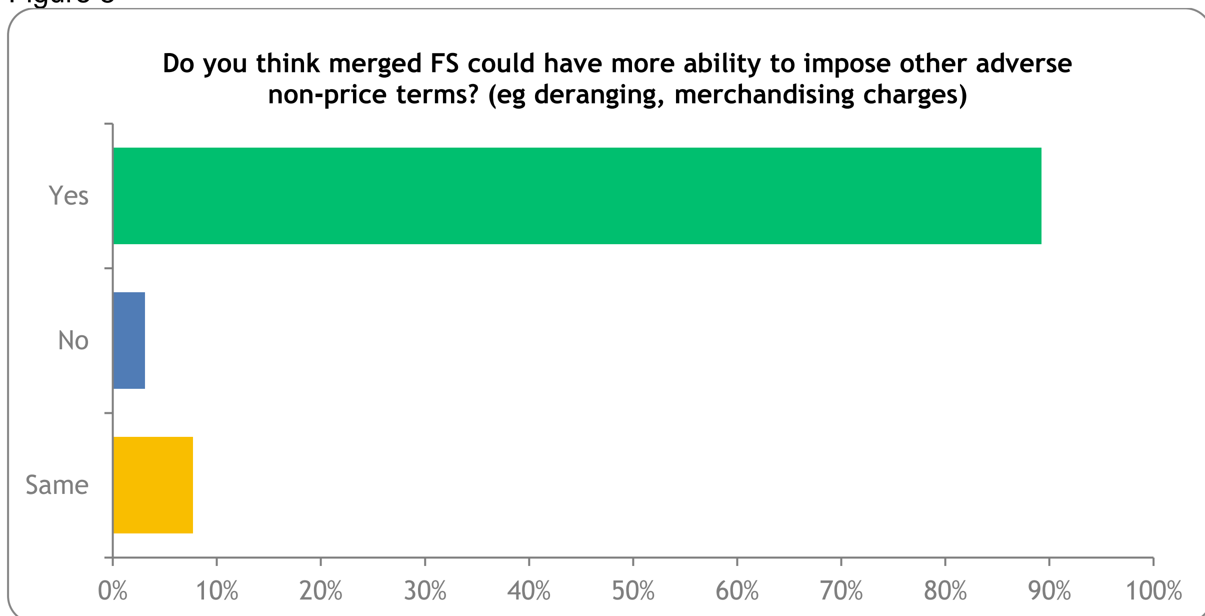
h. 71% thought as a result of this proposed merger there could be changes in the distribution centre arrangements that could adversely impact suppliers, such as increasing costs, and fewer options. Many noted the differences between the distribution centre costs and allowances between the two FS entities.

i. 71% currently saw competition between FS banners/stores locally and regionally.

j. 60% thought the merger proposal could impact supply, wholesale prices, to RGRs adversely and jeopardise supply including range, quality, and innovation, echoing the feedback above.

k. Of those that could comment, 53% said it had been harder following the 2013 FSNI merger, with higher prices. It was also noted that following the merger of Foodtown and Woolworths in the 2000s, the merger entity asked suppliers for improved terms (called 'best terms'). This cost suppliers margin which forced suppliers to either increase prices or go out of business. The margin issue was also raised following the 2013 merger of FSNI. Other impacts of the 2013 merger resulted in were significant range and promotional consolidation. While some things got easier, it consolidated the strength of the FSNI group exacerbating power imbalances. There was shared concern that the same could take place here.

Figure 5



Impacts in other markets/parts of the supply chain

119. Members reported as follows:

a. 76% had concerns about impacts in other parts of the supply chain and/or greater costs being imposed on suppliers.

b. Many believed there would be increased costs for freight, data supply, and over time could increase the cost of supplier distribution centre terms. Given that New Zealand is a small market, it requires higher distribution levels to be sustainable and this would be a concern under the Merged Entity.

No consumer benefit

120. Members reported as follows:

a. 74% did not expect any merger-specific 'cost savings' (lower prices from suppliers) to be passed on to consumers, with 20% unsure. Many commented here the concern that any cost savings by virtue of removing duplication will simply become a margin transfer onto squeezing suppliers. Some pointed to previous mergers and encouraged further scrutiny of what followed these mergers. Others believed that status quo negotiations are already shifting margin from suppliers to retailers have they not seen any reductions passed onto consumers.

b. Only 15% thought the proposed merger would not make it harder for suppliers to negotiate pass-throughs (ie specials/promotions etc) are passed on to customers.

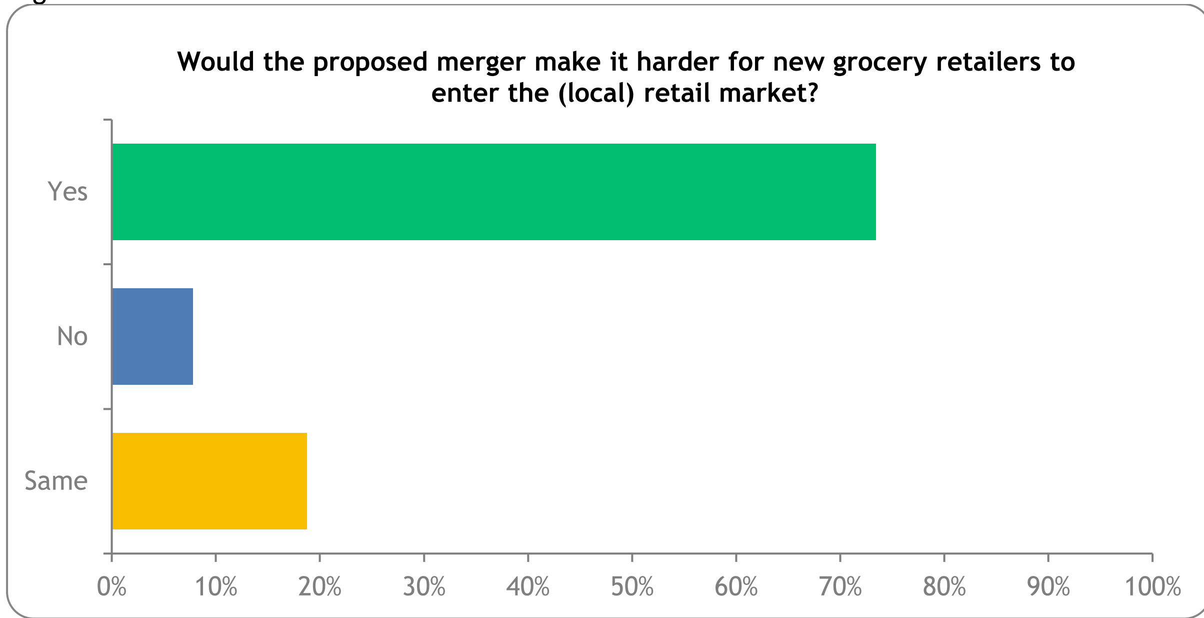
Reduced likelihood of new entry

121. Members reported as follows:

a. 74% thought that the proposed merger made it harder for new grocery retailers to enter. There was a concern that given recent changes that their logic in the belief of reducing an RGR would result in increased competition. Some commented that instead, there should be a sale of one of the FS entities to a different player altogether, and encouragement to open stores outside of current geographical boundaries.

b. Members believed that the proposal will further consolidate the grocery retail market into two powerful players. Some commented that for a new retailer to enter this market, current RGRs need to be broken up and that should the proposed merger go ahead, other consequences, including loss of the smaller players for new entrants to secure a manageable scope in which to start-up.

Figure 6



ANNEX A- ISSUES FOR CONSIDERATION

1. The application raises more questions than it answers. We recommend the Commission to consider the issues below.

2. We appreciate some of these issues are raised in the SOPI but have concerns that not all issues are covered in the SOPI, perhaps reflecting the framing of the application (rather than broader issues) and the demand-side nature of the proposal (notably in an industry with competition concerns only starting to be addressed by a new, nascent and untested regulatory regime).

3. For these reasons, we believe a more granular consideration is required. The Commission should also consider the overall impact of the proposal.

4. Only by doing that do we believe that the Commission can be relevantly "satisfied" that the proposal will not have, or be likely to have, the effect of substantially lessening competition in any markets.

The issues to be considered

5. **One**: ***Do the two FS entities really act as one head under the status quo?***

   a. Members observe different approaches in conduct and commercial offers.

   b. The Commission would recognise this having seen markedly different approaches to GSAs.

   c. Even in the new regulatory regime and proposed merger, all three RGRs present different commercial offers and take different approaches to presentation and negotiation.

   d. For example:
      i. The *FSNI Grocery Supply Contract (excluding Fresh Produce) V1* (only part of the overall grocery supply agreement) is a dense, complex, 27-page document.
      ii. FSSI's *Final Master Supplier Terms And Conditions* (only part of the overall grocery supply agreement) is only 11 pages long and more clearly drafted (but like its counterpart, seeks to contract out of virtually all Code protections).
      iii. FSSI represents its *Final Master Supplier Terms And Conditions on* a "take it or leave it basis" implying an obligation on suppliers to countersign when the obligation is on the RGR to ensure compliant terms.

6. **Two**: ***Will there actually be no real change from the status quo?***

   a. Firstly, there are questions as to whether the status quo is legally permitted in which case it cannot be the counterfactual.

   b. Secondly, the proposal must have impacts otherwise it would not be pursued, so there must be real clarity on differences between the status quo as well as other possible conduct not currently occurring and how that is likely to change (and remove other options).

7. **Three**: ***If this quote is correct, why is there no competition between the parties?***
   "*There is no existing competition between the two co-operatives at the retail level (whether the supply of groceries to customers, or the acquisition of groceries from*

suppliers) or wholesale level. Each co-operative focuses on competing within the island in which it is based."[53]

a. Could this be the result of any provisions of contracts, arrangements, or understandings that could be seen as perceived cartel provisions or otherwise raise competition concerns under part 2 (Restrictive Trade Practices) of the Commerce Act?

b. Has the Commission investigated this since the law change in 2017? If not should it not do so before the proposal is concluded, effectively immunising such conduct in future?

8. **Four**: ***Should the Commission not consider any (other?) potentially anticompetitive arrangements or conduct, or per se illegal conduct, before determining impacts that the proposal would have? As a broader review might lead to impacts on the status quo (including removing barriers to entry and enhancing competition)***?

a. Related to the issue Three above, has the Commission investigated whether the FS intra-group arrangements could raise similar concerns?

b. For example any exit barriers created by owning all land at the head office level, and other arrangements. Presumably make it harder for a new entrant to entice ad existing small retailer to a new retail chain) If not shouldn't it do so before the proposal is consummated, effectively immunising such conduct in future?

c. We note that the Commission recommended changes to address similar issues in the Retail fuel market study[54] to enable parties to change wholesale supplier, leading to the Fuel Industry Act "*rules governing contracts between wholesale fuel suppliers and their wholesale customers to allow greater contractual freedom for resellers to compare offers and switch suppliers.*"[55]

9. We suggest that it is only after the Commission has considered the above that it can have a proper view on the what the *forward-looking (legal) status quo-type counterfactual* might look like (also noting its current investigations) that the Commission can proceed to reach its views. But it must of course consider counterfactuals as well.

10. **Five**: ***Is there no other realistic counterfactual than a modified status quo?***

a. There is an obvious threshold questions as to whether removing the additional option, behaviour and benchmarking of the status quo would lead to even greater market power. This could be due to factors including increased size, increased vertical integration, greater "cost savings" (a further wealth transfer from challenged suppliers) and increased barriers to new entry and expansion.

b. Most obviously FSSI could decide to abandon its co-branding and any contractual provisions.

[53] FSNI-FSSI-clearance-application-14-December-2023.pdf (comcom.govt.nz) Para 3 Executive Summary

[54] Commerce Commission - Retail fuel market study recommends changes to benefit competition and consumers (comcom.govt.nz)

[55] Commerce Commission - The key features and our role under the Fuel Industry Act (comcom.govt.nz)

c. Or a potential new entrant could choose to acquire FSNI as its springboard into the North Island.

d. Conversely, less profitable owner-operators could band together as a new brand or move to a new entrant (although query whether the intra-group and inter-group arrangements prevent this).

e. It may be appropriate to seek a *section 26* Commerce Act (Commission to seek and have regard to economic policies of Government)[56] statement from the Minister as well.

f. Regardless, we ask if the proposal would remove the possibility of a more competitive counterfactual? Noting that unlike the status quo arrangements (which could be challenged or change), the proposed merger would lead to permanent structural change (and virtually all internal arrangements would be immune from challenge)?

11. **Six:** ***Is it correct to say that there is no (substantial) lessening in competition when a merger creates a duopsony, reducing the number of buyers from three-to-two***?

a. Could this be the result of any provisions of contracts, arrangements or understandings that could be seen as perceived cartel provisions or otherwise raise competition concerns under part 2 (Restrictive Trade Practices) of the Commerce Act?

b. If the Commission has not investigated this, it should consider doing so before the proposal is concluded, effectively immunising such conduct in future.

c. Relatedly, if the Commission has not investigated whether the "intra-group" arrangements could raise similar concerns, it might consider doing so before the proposal is concluded, effectively immunising such conduct in future.

12. **Seven*: Is it correct to say that there is no (substantial) lessening in competition when a merger reduces the number of wholesale suppliers from 3 to 2?***

a. Could this be the result of any provisions of contracts, arrangements or understandings that could be seen as "Cartel Provisions" or otherwise raise competition concerns under part 2 (Restrictive Trade Practices" of the Commerce Act?

b. Has the Commission investigated this? If not, shouldn't it do so before the proposal is consummated, effectively immunising such conduct in future?

c. Relatedly has the Commission investigated into whether the "intra-group" arrangements could raise similar concerns? If not, shouldn't it do so before the proposal is consummated, effectively immunising such conduct in future?

13. ***Eight: Would the proposal frustrate the legislative intent – and the new GICA regime – to remove the number of quasi regulated wholesale entities from 3 to 2?***

a. Is there a threshold question as to whether this is legally permitted?

[56] https://www.legislation.govt.nz/act/public/1986/0005/latest/link.aspx?id=DLM88258

b. More significantly, won't it undermine the legislative intent by creating more powerful vertically integrated wholesaler/retailers?

c. Key aspects of the new GICA regime include market monitoring (including strategic conduct (which we touch on below).

14. ***Nine:*** ***Would the proposal increase market power and increase barriers to entry impacting all relevant markets (including retail)?***

a. Our understanding is that the RGRs accepted (at the grocery sector market study conference) that they were not sub-scale, nor need a *minimum efficient scale* to compete. Yet the application seems predicated on claimed "costs savings" and "efficiencies"

b. If our understanding is correct then isn't the proposal at best competitively neutral but with real "downside risks"? In which case, given its findings in the Market Study into the grocery sector and the newness of the GICA and Code, how can the Commission be satisfied there would be no likely substantially lessened competition?

c. If our understanding is incorrect, then aren't the risks to competition even greater?

d. Put differently, given the potential risks to competition, does the current suggestion of "cost savings" (wealth transfers) and efficiencies mean that new entry would be materially less likely as a result of the proposal?

15. **Ten:** ***Should the Commission not take a "market-by-market" analysis, assessing all potentially impacted markets?***

a. We are concerned at the suggestion there be no proper inquiry due to lack of overlap (which as noted could be due to perceived cartel provisions or other arrangements that may substantially lessened competition, particularly given potential vertical effects in downstream markets (local grocery retail markets, where the parties claim (apparently unsubstantiated benefits).

b. As background, we do not know if the Commission ever considered the 2013 merger of the two North Island entities, or any other acquisitions which could raise concerns about *vertical*[57] or *conglomerate effects* (or the impact of "creeping acquisitions" or related conduct issues). The Commission is only now, and still, considering some issues[58], but potentially not all.

c. Wouldn't a merger of wholesale and retail (plus various other related markets) lead to enhanced market power at both levels? (NZFGC expressed real concerns that a wholesaling regime could have unintended consequences of enhancing market power at both wholesale and retail of a wholesaling regime[59]. We understand that this is why the regime has the flexibility that it does. W note that

[57] eg the acquisition of Leigh Fisheries by FSNI

[58] Commerce Commission - Woolworths New Zealand Limited (comcom.govt.nz) Commerce Commission - Foodstuffs North Island Limited (comcom.govt.nz) Commerce Commission - Foodstuffs South Island Limited (comcom.govt.nz)

[59] Castalia: ***Private Labels, Buyer Power and Remedies in the NZ Grocery Sector*** (August 2021) Food-and-Grocery-Council-Submission-on-Market-study-into-grocery-sector-draft-report-Attachment-

d. Wouldn't this enhanced market power *increase* barriers to entry in (for example) retail*?*

e. What about market trends and likely impacts such an enhanced ability to engage in strategic conduct?
   i. Noting the FS entities seem to be expanding 4 Square rollouts, which would seem to raise entry barriers given "***overbuild***" especially when such stores might be the most obvious means for market entry.

16. Similarly, there could be impacts on **private label**[60] (because the proposed merged entity will represent close to 60% of the grocery sector) for context it is worth noting that the New Zealand rebrand to Woolworths New Zealand may be a precursor to a greater level of (potentially foreign sourced) house brand/private label supply.

26-August-2021.pdf (comcom.govt.nz) for example Castalia are noted on page 16 that: *"… the wholesale measures identified by the Commission will not address buyer power, and some of those measures could conceivably increase concentration at the wholesale level. As a result, the costs and benefits of such measures would need to be carefully considered."*

[60] Castalia: ***Private Labels, Buyer Power and Remedies in the NZ Grocery Sector*** (August 2021) Food-and-Grocery-Council-Submission-on-Market-study-into-grocery-sector-draft-report-Attachment-26-August-2021.pdf (comcom.govt.nz)