4 February 2021

Project Lead (Grocery Market Study)
Commerce Commission
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Email: www.comcom.govt.nz/groceries

Dear Sir/Madam

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

Yours sincerely

Katherine Rich
Chief Executive

Market study into the retail grocery sector: Preliminary issues paper

Submission by the New Zealand Food & Grocery Council

4 February 2021

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NEW ZEALAND FOOD & GROCERY COUNCIL

1. The New Zealand Food & Grocery Council ("NZFGC") welcomes the opportunity to comment on the Commission's Market study into the retail grocery sector: preliminary issues paper (the Preliminary Issues Paper) dated 10 December 2020.

2. NZFGC represents the major manufacturers and suppliers of food, beverage and grocery products in New Zealand. According to estimates by Coriolis Research (2019), 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 wider industry directly or indirectly employs more than 493,000 people – one in five of the workforce.

EXECUTIVE SUMMARY

Importance of this inquiry and the need to assess buyer power harm

3. This is an important inquiry. Retail grocery supply directly impacts the entire New Zealand economy, and we are all stakeholders. We are all consumers. Many are also manufacturers and growers. But many New Zealanders also rely on manufacturers and growers for their livelihoods, and there are direct and indirect impacts across the economy. The indirect and disperse impacts may be hard to assess but are nonetheless material.

4. The context and history of this enquiry is also significant. It spoke volumes that the Commission declined clearance for the proposed merger of Progressives Enterprises Ltd and Woolworths (NZ) Ltd in *Decision No 448* (December 2001) under the *"substantial lessening of competition test".* It was only legal technicalities that enabled the merger under the dominance (market control) test.

5. This last critical merger led to very high levels of market concentration in New Zealand, unique internationally, with a buy-side duopsony and sell-side duopoly. (Other options are "at the margin" as noted below.)

6. Buyer power issues are important, and the harms are increasingly recognised, as are competition issues in grocery supply. Retail market concentration and buyer power reinforce each other. For example, excessive buyer power can be used to create strategic barriers to entry in retail. Investigating use of buyer power is therefore key to understanding retail market outcomes. Since *Decision No 448*, the majors have consolidated power through a variety of conduct, including procurement practices and loyalty schemes. There has been no material market entry in two decades.

7. 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…"***[1]

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[1] 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

NZFGC submission

8. The distortions present in any other highly concentrated markets can be seen in our grocery sector. These issues are not unique to New Zealand. But New Zealand has a unique level of market concentration and it would be perverse to suggest we do not suffer the consequent harm.

9. NZFGC submits that:
   a. There is significant anecdotal evidence of exploitation of suppliers (producers) (see the detailed table at paragraph 174 of this submission**)**
   b. There has been considerable use of buyer power to exclude competition (exclusionary conduct) which usually manifests in the form of deleting or threatening to delete a supplier's product in the event of supplying minor newcomers to the market or offering differentiated products to current competitors;
   c. There is a range of harms flowing from the above, such as:
      i. For producers – squeezed margins resulting in under-investment, under-supply, and reduced innovation; with flow-on effects of reduced employment and export opportunities, potentially limited security of supply etc.
      ii. For consumers – reduced choice, variety, innovation, price, and other non-price competition.
      iii. For the broader economy – the loss of efficiency and opportunity expected from more dynamic competition.

High level comments on the Preliminary issues paper.

10. NZFGC commends the Commission for identifying many of the potential concerns in the Preliminary Issues Paper. NZFGC broadly agrees with the Commission's characterisation of the market and issues that it is looking at but submits that:

    a. Buyer power harms – the Commission should probe even more deeply on the direct and indirect harms from buyer power to critically evaluate attempts to minimise the harms, as well as potential (incorrect) arguments that any harms are negated by downstream competition. Given the importance of this aspect of the analysis we discuss buyer power harms further in the next section before proceeding to respond to the Commission's specific questions, using the Commission's numbering.

    b. The Commission looks more deeply at retailer profitability as an indicator of the state of grocery retailing, but explicitly considers the profitability of grocery store owners when assessing the state of retail competition. Retail analysts (for example, Citi) will regularly confirm to NZFGC that while in other markets (eg United Kingdom, Australia) the profitability of supermarkets can be analysed with readily available published financial information, this is challenging in New Zealand because the market leader is made up of two cooperatives and within those cooperatives members are not required by New Zealand law to publish financial accounts.

    Both cooperatives do publish annual reports, but a true reflection of the profitability of grocery retail in New Zealand can only be gleaned by considering the cooperatives as a whole including each grocery retail member. This is possible but the task is significant and beyond the resources of the NZFGC. It may require use of detailed section 98 notices to get the detailed forensic evidence. That said, media reports of supermarkets being *"worth tens of millions of dollars"*[2] may provide a simple clue.

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[2] Gibson A. "Supermarket 'musical chairs': 4 Pak'nSave, New World stores said to be changing hands". NZ Herald, 21 Jan 2021 https://www.nzherald.co.nz/business/supermarket-musical-chairs-4-paknsave-new-world-stores-said-to-be-changing-hands/RG54YKDZVVTDEF2THUCE5X6MNY/

c. ***The Commission also relies on a "first principles" analysis.*** Naturally, the Commission seeks evidence. Despite the genuine fear of suppliers and the genuine risk to their businesses as a result of being found to have spoken out, NZFGC is hopeful that there will be a level of new anecdotal and other evidence available. Over the years, NZFGC has collated examples shared by members also. However, as the Commission knows, given the concentrated nature of the industry, it will face significant challenges obtaining evidence. Much of the conduct is purposefully not committed to writing, and suppliers will be naturally reticent to comment on such a small market.

Equally there will be a complexity in assessing any data that the Commission gets and the issues could readily be obfuscated. For these reasons, it is important that the Commission remains guided by sound economic theory in identifying harms.

Grocery supply in New Zealand is a duopoly with a limited competitive fringe – in the absence of proof, the consequent expected harms should be assumed, rather than the Commission needing to "prove" harm, when clearly *"…competition in the grocery sector* ***could*** *work better for the benefit of New Zealand consumers."* [emphasis added].[3]

d. ***The Commission adds greater consideration to the inability of fringe competitors/new entrants to get access to product ranges or get access to product ranges at competitive rates.*** There is considerable anecdotal evidence to the effect that suppliers will be 'punished' if they are somehow seen as enabling a new entrant to offer competitive prices or ranges (this is an exacerbated version of what seems to be an implicit or explicit Most Favoured Nation (MFN) obligation in relation to supplying to the "other" major). A useful case study evidencing this point is currently playing out in New Zealand with the launch of The Honest Grocer, which lost numerous suppliers as a result of pressure applied by other retail.

e. ***The extent of competition and collaboration between franchisors and franchisees be clarified.*** The prevailing narrative is that the grocery retail market is dominated by two majors: Woolworths and Foodstuffs. This is consistent with commercial reality and the Commerce Act's 'look through' provisions which, in some circumstances, treat an entity as "in competition" if any of its interconnected bodies corporate is in competition. Suggestions that the market is sufficiently competitive because of *intra*-group competition between brands within Woolworths or Foodstuffs, is inconsistent with the context of grocery bundles and the fact that most pricing is decided centrally at head offices.

Any suggestion of treating each Woolworths and Foodstuffs entity as independent competitors, however, does raise interesting issues whether arrangements within the group breach ss 27 or 30. It would be helpful for the Commission, and Woolworths and Foodstuffs also, to clarify their position on this matter.

f. ***The Commission looks more closely at the role of loyalty programs***. These appear to involve significant 'coerced' use of customer data (eg New World's loyalty programmes offer significant discounts on some products but customers must agree to its terms and be on the mailing list to receive a benefit). It may not be clear how that data is used. Similarly, shelf advertised prices will be at the 'loyalty' price, with the true price appearing to be in (much) smaller font. These raise a number of competition, privacy and consumer protection issues. The use of consumer data is an increasingly

[3] Commerce Commission *Market study into the retail grocery sector: Preliminary issues paper* (2020) p4, para 3.

important and lucrative revenue stream for grocery retailers, which deserves greater scrutiny.

g. ***The Commission looks more closely at vertical and horizontal issues raised by private labels.*** While potentially offering some consumer benefits, they raise considerable detriments, which potentially outweigh benefits unless recognition of the issues – and appropriate safeguards – are in place. As discussed below, these raise issues of conflict of interest, misuse of information, and exclusionary conduct.

h. ***The Commission should examine how supermarket buyer power is being leverage into other markets, such as distribution and transport.*** Many suppliers are told that they need to use the retailer's primary freight model even though they could get it cheaper elsewhere, which would mean a supplier paying more, and ultimately would lead to higher grocery supply prices faced by consumers. While some larger suppliers may be able to push back on these types of demands from supermarkets, smaller suppliers are more likely to decide they have no choice but to use the retailer's vertically integrated freight services even though that means higher costs, rather than face threats of product deletion.

Buyer Power Harms

11. Limitations in traditional competition policy and the models used meant that the full harm of buyer power has not traditionally been recognised. However, that is no longer the case. A range of competitive harms is now recognised from the existence and abuse of buyer power, which Carstensen[4] usefully describes as two categories (1) Exploitation of producers and (2) Use of buyer power to exclude competition.[5]

12. **Exploitation of producers:** Harms here that we have identified from actual behaviour of large retailers include:

    a. ***shifting of risk and cost from supermarkets to suppliers***, including requiring suppliers to guarantee retailer margins and cover costs associated with risks that are managed by retailers (theft, wastage, overordering)
    b. ***extracting fees and payments from suppliers***, including slotting fees (which can be used to facilitate tacit collusion between retailers), and display payments (even when the product has not and likely will not be displayed)
    c. ***unreasonably delaying or reducing payments***
    d. ***retrospective variations to favour the retailer***
    e. ***demanding perks or free product***
    f. ***constant threats of product deletion or retribution***
    g. ***requirements to participate in uneconomic promotions***
    h. ***buyer-induced bundling*** – such as requiring suppliers to use retailer-owned or affiliated services even where this is more expensive and the potential (as yet unwritten) that suppliers might be being disadvantaged if they don't buy loyalty or Dunhumby data
    i. ***appropriation of IP to develop supermarkets' own private labels***
    j. ***inadequate health and safety measures*** for the protection of suppliers' workers in-store eg sales representatives and merchandisers (shelf stackers)

13. In sum, these practices squeeze supplier margins and reduce purchase prices below competitive market prices, likely also reducing total economic outputs, with (1) suppliers producing at sub-optimal levels, reducing incentives to invest in improved production (R&D,

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

innovation) and encouraging exit as fixed investments are consumed and not replaced; (2) discouraging entry at the margin.

14. As a result of the harmful buyer behaviour exhibited by supermarkets in New Zealand, supplier competition could look very different in future and may be characterised by:

    a. unsustainability of local manufacturers, as margins get squeezed by increased costs and risks. Not being able to earn a normal profit in the domestic market also means a supplier is unlikely to garner the resources to invest in an export growth strategy. In any case, being driven out of the domestic market by supermarket behaviour and then relying only on export or alternative channels denies the consumer of access to products they might otherwise prefer;

    b. hollowing out of multinationals' presence in New Zealand, with manufacturing being moved offshore, and local operations being minimised and confined to sales and marketing;

    prevalence of private labels, which face little competition, so less variety, lower quality and/or higher prices.

15. **Use of buyer power to exclude competition:** Powerful purchasers can also engage in various exclusionary strategies to exacerbate their market power. Carstensen categorises these as follows: [6]

    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.

16. We observe many of these types of behaviour by New Zealand supermarkets, raising strategic barriers to entry and expansion by potential entrants.

17. The potential harms have led to a range of measures being adopted across multiple jurisdictions such as grocery codes of conduct (eg UK and Australia), prohibitions on abuse of unequal bargaining power (eg Japan) and unfair trading practices in the business-to-business food supply chain (eg European Union). The ACCC has also taken legal action against both Woolworths and Coles in relation to alleged abuses of buyer power.

DETAILED COMMENTS

18. The following NZFGC comments largely reflect the headings in the Preliminary Issues Paper.

Overview of the New Zealand grocery sector

The Commission's description of the New Zealand grocery market is broadly accurate

19. At paragraph 26[7] the Commission describes the New Zealand grocery sector and at paragraph 26.5 notes "the two major retailers are vertically integrated into wholesale

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[6] *ibid*, p98
[7] Commerce Commission *Market study into the retail grocery sector: Preliminary issues paper* (2020) p8

distribution". We support this description. While Foodstuffs North Island and Foodstuffs South Island are separate cooperatives due to the fact that the cooperatives do not conduct business in each other's territory (there is no overlap in terms of competition or market activity), throughout New Zealand from the perspective of consumers and suppliers, there remains a duopoly/duopsony. The cooperatives work closely, share brands, information and banners and under the Foodstuffs New Zealand structure, often refer to themselves as just 'Foodstuffs' meaning both cooperatives under 'one head'. This is in fact acknowledged and recognised by Foodstuffs itself: "We have grown to become New Zealand's biggest grocery distributor…employing more than 30,000 people nationwide[8]."

20. Research shows that the numbers of stores across the banners as at December 2020 are as follows:

National	27/12/20
Total Supermarkets	455
Foodstuffs	200
New World	144
PAK'nSAVE	56
Countdown	184
Supervalue/Freshchoice	71

Source: Nielsen

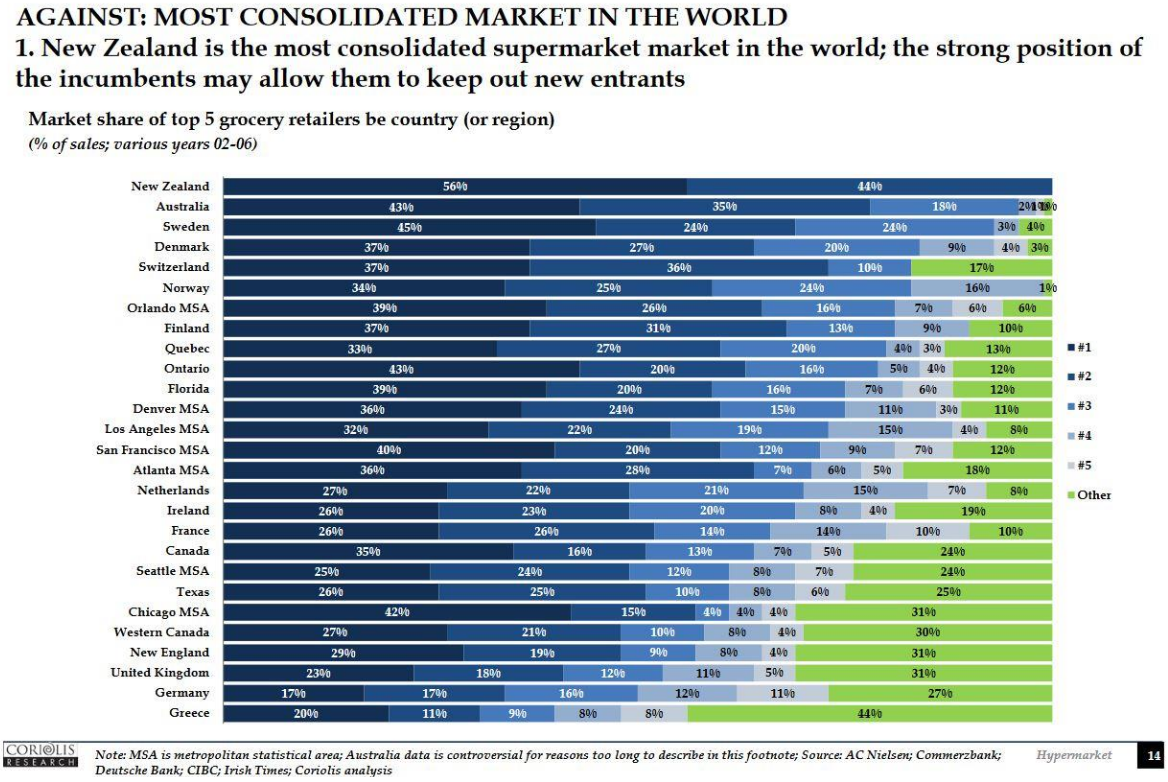
Both major grocery retailers are vertically integrated

21. NZFGC notes the two major retailers are also vertically integrated in relation to both wholesale and retail supply chain through transport and in retail products through the private label ranges that each supermarket promotes. Other vertical integration exists such as both Foodstuffs North Island and Foodstuffs South Island owning their own fishing companies and Foodstuffs South Island's own strategic plan they call out Vertical Integration. With regard to private label, this means, from a supplier perspective, retailers are both customer and competitor and from the perspective of the consumer, retailers are both seller and manufacturer.

New Zealand's supermarket market is the most consolidated in the world

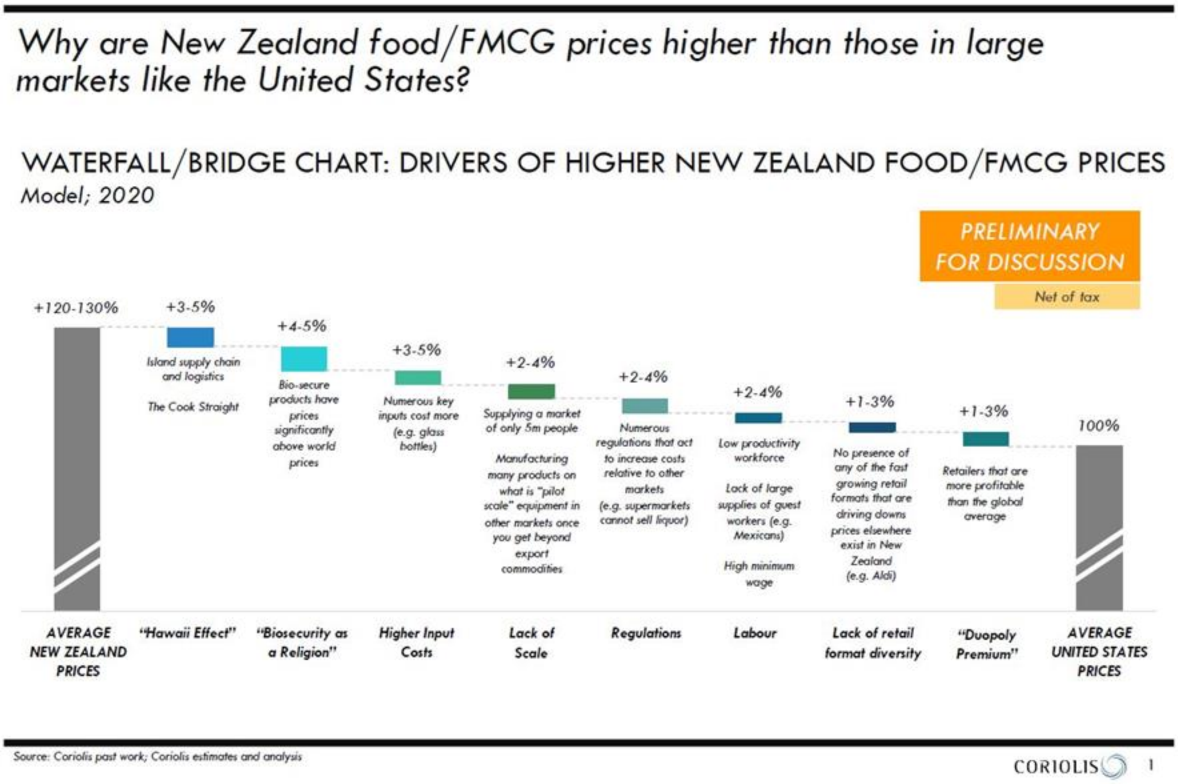
22. A graph from work done by Coriolis in 2007 for the Commerce Commission (see below) would be worth updating to cover major markets New Zealand identifies with such as the UK, Canada, United States, Australia and other countries.

[8] Foodstuffs New Zealand Website https://www.foodstuffs.co.nz/about-foodstuffs/who-we-are/

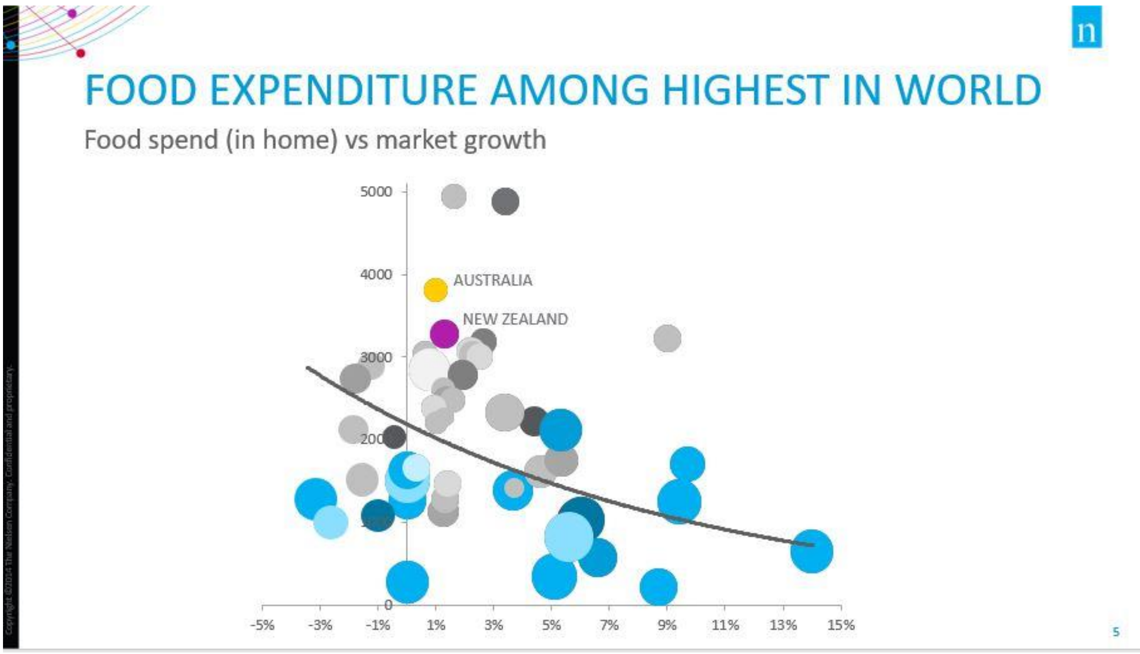


International research shows that New Zealand supermarket consumers pay a duopoly premium

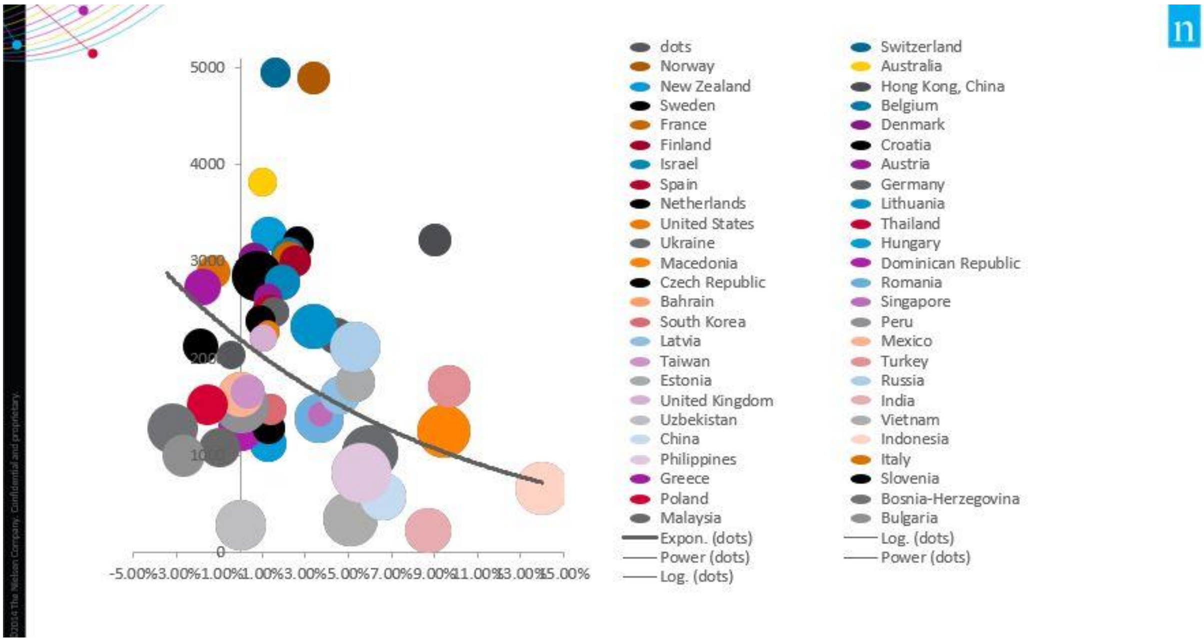
23. Coriolis has also recently attempted to do a visual explanation of why New Zealand's grocery prices are higher than the USA, which the Commission might find useful (see below). The 1-3% point gap attributed to the "duopoly premium" seems small, but it translates to multi-millions of dollars in high volume businesses and a significant comparative percentage difference when comparing retailers here with those in the Northern Hemisphere.



24. There are numerous anecdotes of prices of New Zealand products being higher in New Zealand than in Australia (eg New Zealand butter costs more in New Zealand than in Australia). The Commission may choose to conduct research to do updated comparisons of New Zealand prices versus prices in other markets in the developed world. According to work done previously by Nielsen in 2014, New Zealanders (and Australians) do spend more on food per annum than other markets.



Other countries detailed below:

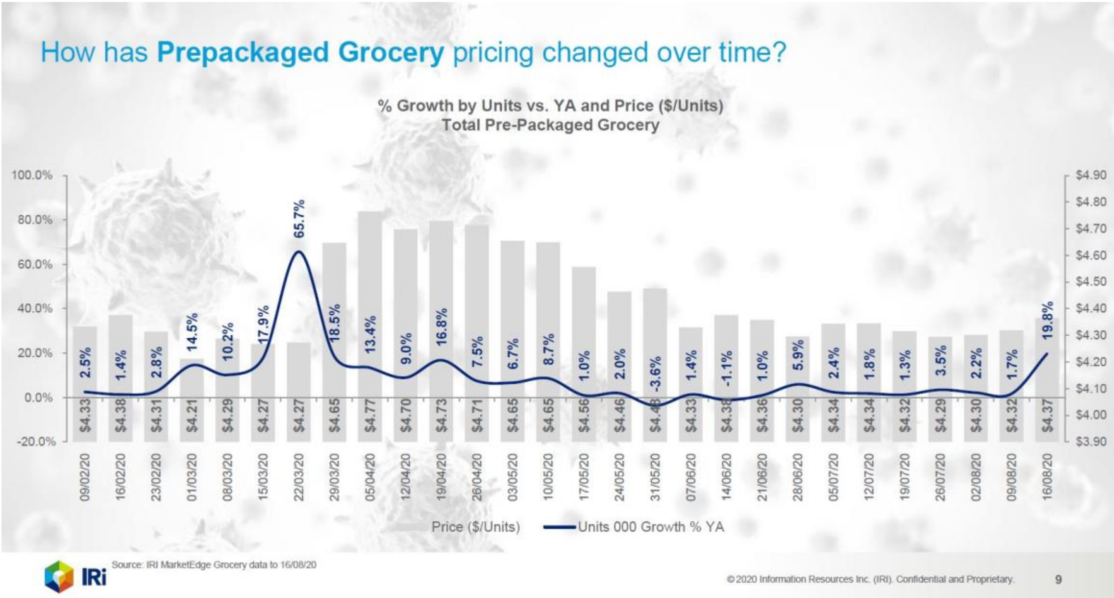


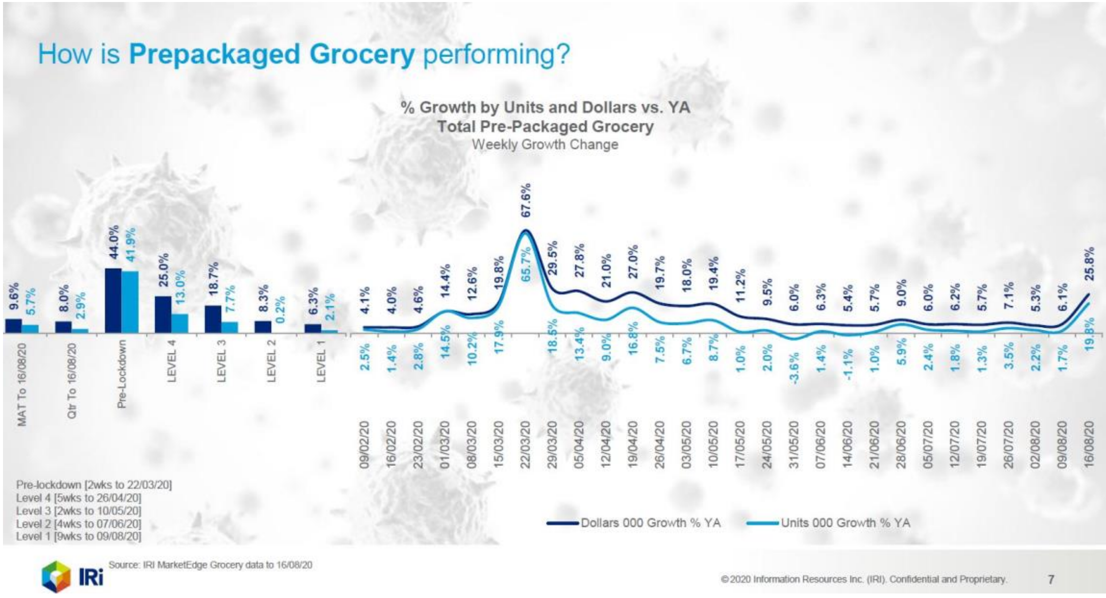
Trends observed over the past year require careful interpretation

25. We agree with paragraph 26.7[9] that "the COVID-19 pandemic has had a significant impact on the retail grocery sector". During the lockdown period, promotions were cancelled, and consumers were left paying full retail prices. Supermarkets faced increased costs and huge supply chain disruptions during the lockdown period and it is therefore difficult to ascertain whether the lack of promotions was also caused by the removal of fringe competition.

26. While some consumers complained about what they viewed as 'price gouging', shelf pricing remained the same during the COVID-19 period, and it was the absence of the same level of promotional activity (consumers view promotions/specials as the norm) which contributed to the perception that prices were higher than usual. The significance of this impact for consumers can be seen in the graphs below[10] with price of units (grey) increasing:

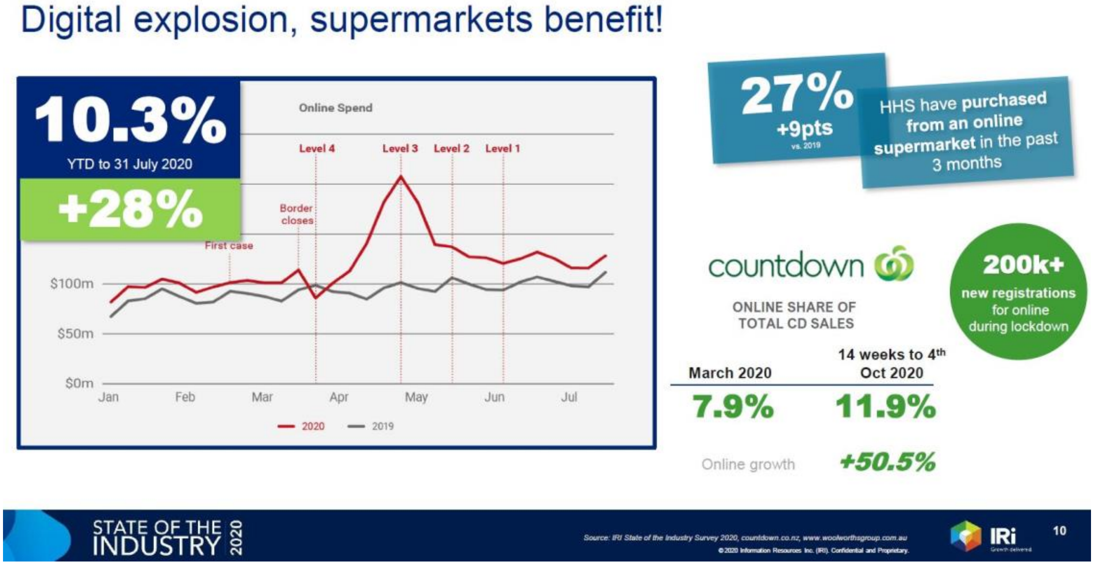
[9] Commerce Commission *Market study into the retail grocery sector: Preliminary issues paper* (2020) p8
[10] IRI presentation to NZFGC *State of the Industry* November 2020



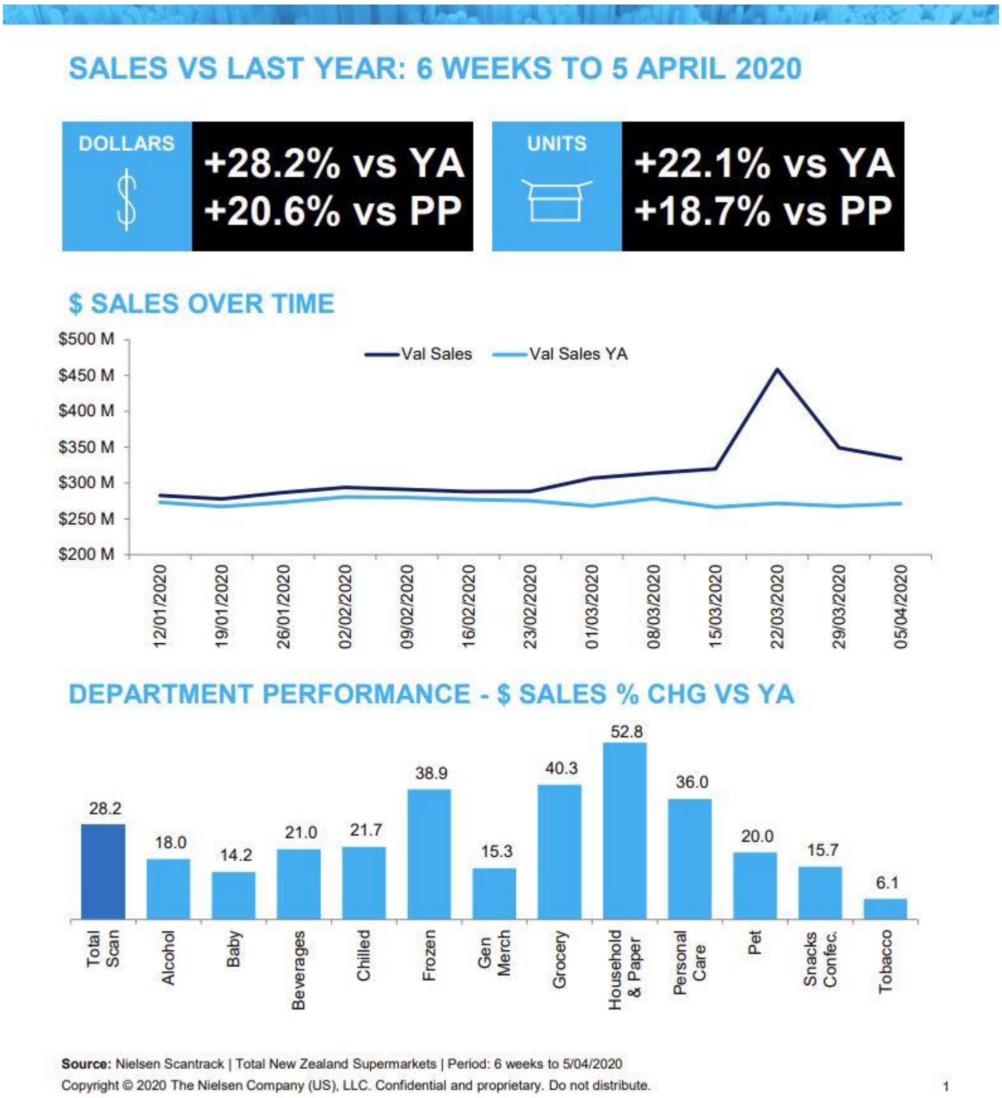


27. The increase in online sales was significant as a slide from a recent IRI presentation[11] below shows:

[11] IRI Presentation to NZFGC *State of the Industry*, November 2020



28. The following are graphs from Nielsen over a similar period with a breakdown of growth by supermarket category:



Supermarkets compete across a large portfolio of products

29. The Commission notes that the estimate of products (stock-keeping units, SKUs) carried by supermarkets is between 30,000 and 40,000 products. While this was true at one stage, we understand this could now be a significant overestimation and in any case there is variation across individual supermarkets within the two major chains with smaller supermarkets such as 4 Square carrying 8-10,000 SKUs. The number of products is significant because it appears that a strategy to reduce the number of product (and consumer) choices within categories is being actively pursued with suppliers.

Q1	Do you agree with our preliminary view on grocery products to be considered in the study, as described in paragraph 29 and Table 1? Why/why not?

30. The Commission's preliminary view is to focus on:
    - Fresh, frozen, packaged, processed and dry foods; and
    - Non-food items such as cleaning products and personal items.

    The Preliminary Issues Paper then details the product categories in scope within the range[12].

31. While understanding the Commission's point in that "*Given the large number of products sold by grocery retailers…we may need to use a sample of products or product categories to keep our analysis…sufficiently focussed*"[13], NZFGC would emphasise that the inherent power in supermarkets comes from their aggregated portfolios, not just specific categories of product. There is fringe availability of some products in some other channels, but supermarkets are the only places where all these products can be purchased together and at one time/visit. Nonetheless, the Commission needs to be aware that the same procurement and retailing behaviours apply to 'all' categories within the supermarket and any category within the supermarket can be the primary reason for the shopper to enter the store. Therefore, all categories/products need to be borne in mind in this study, otherwise these other categories stand to be disadvantaged.

32. Assessing competition issues across the broad portfolio of products has been recognised by the Commission and other policy-makers internationally. For example:

    - In Decisions 606 and 607 the Commission noted that:

      > *as noted in Decision 448, while the demand on a product-by-product basis is likely to vary considerably due to varying levels of "necessity" across products, the demand for the retailing of grocery items, taken together, is very likely to be price inelastic. As a result coordinated and non-coordinated price increases in the factual are likely to be profitable.*[14]

    - A recent contribution by the European Union (to the OECD) on the conglomerate effects of mergers also noted that:

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[12] Commerce Commission *Market study into the retail grocery sector: Preliminary issues paper* (2020) Table 1 p9

[13] *ibid*, p9

[14] Commerce Commission. *Decision Nos. 606 & 607 Determination pursuant to the Commerce Act 1986 in the matter of applications for clearance of business acquisitions involving: Foodstuffs (Auckland) Limited, Foodstuffs (Wellington) Co-Operative Society Limited, And Foodstuffs South Island Limited; and (separately) Woolworths Limited and The Warehouse Group Limited.* Commerce Commission, 8 June 2007. p54 Para 294 https://comcom.govt.nz/__data/assets/pdf_file/0030/75279/PUBLIC-VERSION-Decision-606-and-607.pdf

> *The combination of products in related markets may confer on the merged entity the ability and incentive to leverage a strong market position from one market to another by means of tying or bundling or other exclusionary practices*

and

> *By such limitations to the purchase options available to customers, the merged entity may shift demand towards its own products and away from products of rivals who only offer one of the two products in the bundle – which, if the shift is significant enough, may lead to a reduction in rivals' ability or incentive to compete. Such practices may also make entry to the market more difficult….*[15]

- The Commission considered the European Commission's approach to portfolio power in the past. In Decision 406, the Commission noted that the European Commission:

> *insisted that the merged firm give up the distribution of Bacardi in Greece, despite no aggregation occurring. Its reasoning was that the acquisition would leave a company with a strong portfolio of products across different product markets (whisky, gin, vodka etc), that could in itself lead to market dominance. An extended portfolio could increase the scope for "bundling", make more potent the threat to refuse to deal, and increase the ability to secure promotional support for secondary brands. These are all concerns identified by industry parties. These types of practices, among other things, could act as a barrier to entry and expansion as the merged entity could foreclose the market to new entrants or smaller suppliers trying to establish their brands.*[16]

Additions to product categories in scope

33. NZFGC considers that the alcohol category is significant in supermarkets along with their vertical integration into liquor stores and liquor wholesale. This comprises wine, beer and cider – the alcohol currently permitted for sale in supermarkets under the provisions of the *Sale and Supply of Alcohol Act 2012.* These alcohol products form a significant component of the supermarket product range (according to IRI in 2018 11% of Total Packaged Grocery Value)[17] and marketing and consolidation of the alcohol related market extends into ownership of liquor stores and convenience stores.

34. NZFGC considers that the petfood/pet supplies category is a significant grocery line in supermarkets. It is often a top sales category in purchasing by consumers and occupies significant shelf space in supermarkets. It is one of 12 'Super Category Value $ Sales' areas monitored by Nielsen. The Nielsen 'Super Category Breakdown' is as follows:

Super Category Breakdown Val $ Sales
Grocery
Chilled Food
Alcohol
Beverages
Snackfood Confectionery
Personal Care

[15] OECD. *Conglomerate effects of mergers – Note by the European Union*. Directorate for Financial and Enterprise Affairs Competition Committee, OECD. 10 June 2020. https://one.oecd.org/document/DAF/COMP/WD(2020)8/en/pdff, paras 11 and 14

[16] Commerce Commission. *Decision No. 406 Determination pursuant to the Commerce Act 1986 in the matter of an application clearance application involving: Lion Nathan Limited and Montana Group (NZ) Limited.* 8 December 2000 https://comcom.govt.nz/__data/assets/pdf_file/0030/72786/406.pdf p11, para 57

[17] IRI presentation to NZFGC. *State of the Industry*. 2018

Household Paper Tissues
Frozen food
General Merchandise
Pet Supplies
Tobacco
Baby Products

Q2	Does Table 1 appropriately reflect how products are categorised in the grocery sector?

35. Some of the classifications used by the Commission seem different to common current conventions. For example, ice cream would typically be considered a separate category and not included under "confectionary, nuts and fruit." Similarly, "non-alcoholic beverages" is very broad, capturing both hot and cold beverages. The Commission could consider using Nielsen top 25 or top 10 categories, or alternatively using the categories of grocery products set out in the Australian Food & Grocery Code of Conduct and adding alcohol as a category (which is not included in the Australian Code of Conduct).

36. We make the following additional comments on the Commission's Table 1:
    - Product category – Meat poultry and fish – should this mirror the 'fruit and vegetables' category and refer to 'fresh, frozen and canned'?
    - Product category – Bread and cereals – add noodles rather than including instant noodles in 'other grocery products' since there are long shelf-life soft noodles as well.
    - Product category – Milk cheese and eggs – add non-dairy/plant based milks such as the full range of plant based milks, yoghurts etc, not just soy milk (eg almond, oat, cashew, quinoa, rice coconut). Add infant formula and toddler milks. Note, 'preserved milk' is more generally described as 'long shelf life milk, cream etc.
    - Product category – Oils and fats – add other oils (sunflower, canola, etc) since these provide the consumer choice.
    - Product category – Food additives and condiments – add spices and gravies which are not necessarily covered in the product category description or the products listed.
    - Product category – Personal care – add sanitary protection.
    - Petfood/pet supplies products should be included as an additional category.
    - Wine, beer and cider should be included as an additional category.

37. The Preliminary Issues Paper foreshadows the prospect of using a 'sample of these products or product categories' on which to focus analysis of competition. We note the Commission has already considered the 'market baskets' used by sister organisations in Australia, UK and South Africa. The Commission could take a similar approach by focusing on certain key products when conducting a specific study/analysis, however there is a real risk that, if the Commission does not capture all the products in a supermarket's extensive portfolio, the results for the study/analysis may not be sufficiently accurate, for example, if the Commission only analyses loss-leading products. More importantly, there is the risk that identifying a market basket of goods will, in itself, create distortionary pricing as efforts are made to create favourable comparisons.

Q3	Are some product categories more competitive than others, either in terms of the acquisition of groceries from suppliers, or the supply of groceries to retail customers? If so please explain.

38. The competitive dynamics will differ across categories. For example, where there are particularly strong brands within categories, shoppers' brand loyalty means that the retailers have to compete more heavily on that brand in order to attract shoppers. There

may also be less competitiveness (in terms of the supermarkets' acquisition of groceries from suppliers) in the perishable products area including fresh produce or short shelf-life products such as bread. As explained by the ACCC:

> *the more perishable a product, the weaker the producer's position from which to negotiate favourable terms of supply with the buyers of their goods and the more vulnerable they are to take-it-or-leave-it terms from buyers or exploitative conduct*.[18]

In these case, the supply chain is more significant in terms of timing, the sales period is constrained by shelf-life and charges for wastage could be higher.

Q4	Are there any product categories we should consider in greater detail than others? If so which ones and why?

Differences in behaviour should drive the Commission's focus

39. We suggest that the Commission should focus primarily on **behaviours** rather than product categories. It is behaviours within the grocery sector – principally the behaviour of retailers – that drive the issues of concern within the sector. These behaviours influence every category but may be more prevalent in some categories than in others – for example, they are more prevalent in categories where retailers offer private label products and therefore operate as a competitor to, as well as customer of, their suppliers, creating a fundamental conflict of interest. However, it is not the product category that drives these outcomes.

40. To expand on the example of private label products, this is an area where supermarkets can increase profitability by applying requirements to (or threatening to refuse to deal with) competing branded products and advantage their private label products on price, shelf space, promotions etc. There have been documented instances where a retailer has declined the opportunity to take a supplier's product at a lower price for consumers because the retailer judges that such an offer to consumers would undermine their private label product by being cheaper to shoppers in the same category. In this instance due to the retailers' inherent conflict of interest the consumer is denied the opportunity to purchase goods at a lower price.

41. As noted above, wine, beer and cider, as part of the supermarket portfolio, should be included as a point of focus as this is a major category for pricing promotions. Similarly, petfood/pet supplies should be included.

Q5	If we do focus on certain product categories, are the factors set out in paragraph 34 appropriate to guide our focus? Are there any other factors we should also consider?

42. We agree that the products that do not have a significant proportion of sales through domestic channels other than retail grocery stores should be an area of focus. For example, there are only a certain number of retailers that can feasibly sell 500g packets of pasta whereas there are a great number of stores that can sell tissues (eg pharmacies, $2 shops, convenience stores, etc). Products where consumers have least choice of retailer, will often be the products for which retailers have stronger buyer power.

[18] ACCC. *Perishable Agricultural Goods Inquiry*. Canberra, 2020
https://www.accc.gov.au/publications/perishable-agricultural-goods-inquiry-report p2

Groceries are essential purchases for New Zealanders

43. We note the Commission intends to consider the supply of groceries for commercial consumption (such as restaurant and catering suppliers) to the extent this provides insights into understanding how competition works in the retail grocery sector.

Q6	Would considering the supply of grocery products to commercial customers assist in our assessment of competition in the retail grocery sector? If so, how?

44. Yes, because the supermarkets also own wholesalers delivering to commercial customers (Foodstuffs own and operate the wholesalers Trents and Gilmours). Our concern is that, while this could lead to stronger pricing benefits to commercial customers of Foodstuffs, if this leads to market consolidation, higher pricing for all consumers could be the end result.

45. Predatory pricing by retailers often leads to commercial (foodservice) customers bulk buying items from supermarkets which has the following impacts:
    - inflates promotional performance for the retailer
    - diminishes returns for independent foodservice wholesalers, and
    - erodes margins for suppliers due to inflated promotional investments.

    This in turn can lead to promotions being withdrawn by vendors due to inflated costs which serves to disadvantage the consumer.

46. Dairies (commercial customers) also buy from supermarkets (eg PAK'nSAVE) and are subject to the same terms by the supermarkets as domestic shoppers. Other small business channels such as impulse & convenience outlets (eg petrol stations, cinemas) might also be customers from the supermarket wholesalers. Externally these alternate channels are blurred and this should be considered by the Commission. In doing so, the Commission should consider that:

    i) many suppliers internally still treat grocery retail, food service and wholesale/distribution as distinct channels, and have structured their organisations to serve each channel in a distinct manner (eg different costs to serve, service offerings, MOQs, terms, etc), whereas

    ii) the existence of a small number of large buyers (ie customers), who have capability to operate across multiple channels, means they can blur the boundaries between the traditional channels and leverage their size to cherry pick the best terms, services and level of obligations on themselves from across all the channels. For example, suppliers tend to offer the best trading terms to customers in the grocery retail channel in return for the retailer implementing in-store activations, ensuring stock rotation and freshness, unpacking and checking stock on delivery, dealing with consumer queries etc; a retailer which also operates as a wholesaler can demand the trading terms for grocery retail to apply across its whole business, even though in the wholesale segment it is simply moving boxes and not providing any of the other services.

    Equally, the terms suppliers offer to food service channel customers tend to be less favourable than those offered to grocery retail, because the supplier provides a far greater service level to food service customers eg product demonstrations, a higher account manager:customer ratio, on-site training, etc; a retailer which also operates in the food service sector can demand the same level of services from a supplier while insisting on the preferential grocery retail terms.

47. As we comment elsewhere, we are aware that many New Zealand retail supermarkets already effectively operate as wholesalers. This is because not only food service businesses but also smaller retailers often purchase products from the large supermarkets

for resale to consumers in their own businesses, particularly where supermarkets are able – due to the favourable grocery retail terms from suppliers – to offer significant savings and discounts on promoted products, which further blurs the boundaries between channels.

48. We note in this regard that Woolworths Supermarkets Australia's proposed acquisition of 65% of the Australian food service distributor PDF, which is currently under merger review by the ACCC, has attracted a strong negative response from suppliers. We suggest the Commission has an opportunity now to ensure a similar situation is not able to arise in New Zealand in the future

Two major retailers operate nationwide in the New Zealand grocery sector

Q7	Is our description of New Zealand's major grocery retailers accurate?

49. Yes, broadly, although it underplays the level of coordination between the two Foodstuffs cooperatives and does not make the important point that these two cooperatives do not compete in each other's markets.

50. The Commerce Commission has previously recognised that New Zealand's grocery industry is dominated by two major grocery retailers in Decision 606:

    …The proposed acquisitions would restore a duopoly of two evenly-matched competitors that would make coordination easier…[19]

    Also, in the ACCC's report on its 2007 grocery inquiry it was recognised that:

    In some OECD member nations, including New Zealand and Austria, the grocery industry is dominated by two participants…[20]

    and further:

    With nearly all national supermarket sales attributable to Progressive and Foodstuffs, the impact of independent supermarkets in New Zealand is negligible… [21]

51. If *any* retailers under one head/banner are instead considered to be '*in competition'*, then that would suggest that the parties may be in breach of the civil (and in April 2021, criminal) provisions of the Commerce Act, unless *excepted* under that Act. To avoid obfuscation, we recommend that clarity be obtained from the majors on the exact scope of exceptions/defences they would rely on ***and*** *why the arrangements did not otherwise offend section 27 of the Commerce Act.* Coordination seems to cover a range of factors including purchase prices and terms, supplier/customer allocation, territorial allocation and exclusivity as well as a range of other factors, perhaps for example including collective boycotts.

Q8	What are the key characteristics of a supermarket, compared to other retail grocery stores?

[19] Commerce Commission, *op cit,* p vi. para E43

[20] ACCC *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*. July 2008. https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf, p41 [Key points]

[21] ibid, p64 para 3.7.1

52. NZFGC considers the key characteristics of a supermarket to be:
    - Extensive food and grocery product range
    - Location and density – suburbs and central
    - Checkout lanes not sales counter
    - Facilities for customers – width of aisles, trolleys, baskets, parking
    - Products on continuous shelving racks
    - Self-help – no sales staff and lower overheads as a result
    - Extended hours of operation
    - Geographic spread – chains, part of a recognisable chain brand

53. In essence, supermarkets provide a "full service" store where consumers can do a full weekly shop.

54. In other retail stores, the offerings might be more targeted (eg butchers, greengrocers etc), have fewer outlets (eg Moore Wilson's, Farro Fresh) and they are likely to have significantly less buying/bargaining power than Foodstuffs and Woolworths due to a lower buying quantity. It is true that some goods can be purchased elsewhere, but other options tend mostly to be small fringe players in limited parts of the market/regions and do little to compete with the two main sources for the main household shop. What supermarkets maintain is strong portfolio power.

There are also many other grocery retailers who primarily supply regional or local areas or specific product categories

Q9	How does our description of other grocery retailers in New Zealand fit with your understanding of the sector?

55. The description in the Preliminary Issues Paper of other grocery retailers in New Zealand fits with NZFGC's understanding of the sector. However, it is not just the specialist nature of other stores that limits their ability to constrain the major grocery retailers, but also the absence of economies of scale otherwise presented by a supermarket chain and the added costs that might then accrue for dealing with each (although the franchise arrangements of Foodstuffs appears to present similar costs).

56. Other grocery retailers are therefore only 'fringe competitors' of the major grocery retailers. This is noted in the Commission's Decisions 606 and 607:

    > *…these retailers do not offer the "one stop" convenience and other attributes of the main supermarkets, to be included in the market supermarkets operate in. The Commission acknowledges, as it did in Decision 438, the presence of specialist retailers and the tendency for them to be used for "top up" shopping. While in total, a lot of money is spent by consumers at these outlets annually, their constraint on supermarkets is however quite limited.*[22]

57. The Commission also noted, in an earlier decision, Decision 448, that:

    > *The Commission has considered Progressive's arguments regarding the market but remains of the view that specialist and convenience stores may provide limited constraint on supermarkets. In reaching this view, the Commission gives particular*

[22] Commerce Commission, *op cit,* p48, para 252

> *weight to the following two factors: 1) transaction costs, and 2) the current practice of supermarket chains*[23]

and further that:

> *The [UK] Competition Commission concluded that "the relevant economic market for the purposes of our investigation is the market for one-stop grocery shopping carried out in stores of 1,400 sq metres or more", which suggests that specialist and convenience stores were not in the same market as supermarkets.*[24]

58. With regard to meal bags or food bags, these tend to be targeted to a specific customer segment, which would generally include less price sensitive customers. They seem more appropriately characterised as substitutes for takeaways or family restaurants, than grocery shopping. It is unlikely that meal bag services will place a significant competitive constraint on supermarket pricing.

59. It is important to make clear in the diagram in the Preliminary Issues Paper[25] that Trents and Gilmours (which absorbed Toops) are part of the Foodstuffs cooperatives.

Q10	Are there any other grocery retailers or types of retailers we should have regard to in the study?

60. NZFGC considers the primary focus should be Woolworths NZ and Foodstuffs as they are the most significant operators in the supermarket trade and dominate the breadth of the food grocery trade.

The two major grocery retailers are vertically integrated into wholesale distribution

61. NZFGC concurs with the Commission that there are no large-scale, independent wholesalers of dry groceries (as in packaged groceries) in New Zealand.

Q11	How does our high-level summary of the supply chain in the New Zealand grocery sector (as shown in Figure 3 above) fit with your understanding of the sector?

62. NZFGC largely agrees with the Commission's high-level summary[26] of the supply chain in the New Zealand grocery sector. There are two omissions that should be added:
    - Private label products
    - Transport.

    Both the major grocery retailers have private label products and Foodstuffs purchased transport companies and now operate their own transport fleets.

63. We also suggest that the discussion in paragraph 50 of the Preliminary Issues Paper is expanded to allow for the direct to store model. We note that retailers also source directly from overseas in some cases.

64. In terms of vertical integration, domestic suppliers compete with the range of products produced for private label ranges. These add to supplier tension. Foodstuffs' purchase of

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[23] Commerce Commission. *Decision No. 448 Determination pursuant to the Commerce Act 1986 in the matter of an application for clearance involving: Progressive Enterprises Limited and Woolworths (NZ) Limited*, 14 December 2001. https://comcom.govt.nz/__data/assets/pdf_file/0016/73123/448.pdf para 14

[24] *ibid, para 62*

[25] Commerce Commission *Market study into the retail grocery sector: Preliminary issues paper* (2020) Figure 3 p15

[26] *ibid*, p15

transport companies (FSNI Transport Limited is a wholly owned subsidiary of Foodstuffs North Island)[27] and the additional vertical integration that ensues presents another mechanism for leverage over suppliers through requirements that suppliers use the Foodstuffs' transport network. For suppliers, this is likely to be a more costly option than using other firms. At the time of the expansion of the Foodstuffs transport network, many suppliers complained that having to exit existing arrangements to use the Foodstuffs transport operations was more costly and with less accountability for performance. Since then we are aware that if a supplier has moved from using a supermarket's transport, they have been told 'the cost would need to be made up from somewhere'. This seems like a threat that as a supplier has taken this business off the supermarket, it will be recovered in another way from the supplier.

65. The ACCC, in its grocery inquiry report, noted that: *"In New Zealand, although there are many different retail banner groups operating at the retail level, they are all supplied by only two wholesalers."*[28]

Q12	Are there any other key steps or participants in the supply chain which should be included?

66. Other than the transport, wholesaling, distribution centres and retailing, there are no other key steps in the supply chain which should be included. However, in relation to participants, we suggest that merchandisers be included as they are the 'frontline' for most suppliers and deal day to day with supermarkets and their owners and staff.

Some consumers' shopping habits may be changing with online shopping and meal kits growing in popularity

67. More shoppers are grocery shopping online and this increased significantly during the COVID-19 lockdown.

68. For some consumers, having been forced to shop online, the experience has become a habit increasing the growth for online supply in the sector.

Q13	In your view what impact (if any) have online shopping and meal kits had on the New Zealand grocery sector? What impact do you think these trends will have in the future?

Online shopping has the potential to increase the difficulties faced by retailers in competing with large established rivals

69. NZFGC considers the impact of online shopping has enhanced the scope/power of the two major grocery retailers by providing an alternative to the physical real estate checkout. This is giving rise to the 'dark stores' which have no retail display but are simply aggregators for order picking.

70. While it is possible for the online consumer to find alternative online suppliers for selected products, this requires time and analysis, factors that have a cost over potential benefit in a time poor environment. According to Adamowicz and Swait[29],consumers are "cognitive

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[27] Foodstuffs website https://www.foodstuffs.co.nz/about-foodstuffs/our-operations/

[28] ACCC *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*. July 2008. https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf p67, para 3.7.6

[29] Adamowicz WL, Swait JD. "Are food choices really habitual? Integrating habits, variety seeking and compensation in a utility-maximising framework". *American Journal of Agricultural Economics*, 95/1: 2020 p23 **https://doi.org/10.1093/ajae/aas078**

misers" and do not perform full evaluations of products across the estimated 200 choice decisions made per day on food.

71. Moreover, online shopping has made it more difficult for smaller retailers to compete with large retailers, given the financial investment and sophistication required to trade online. We note the developments in Australia with Woolworths Everyday Market Place 'omni-channel' offering, which could potentially be replicated in New Zealand in the future.

Meal kits are unlikely to have a significant constraining effect on supermarkets

72. Meal kits have allowed a limited number of consumers to be more creative in a time-poor world. We do not anticipate that meal kits will have any significant constraining effect on supermarkets.

73. Meal kits are likely to primarily appeal to a particular customer segment, delineated by socio-economic lines and geographic reach, rather than the mainstream, general population. Meal kit providers generally operate in the main urban areas in New Zealand. We note de Sena of Nielsen Australia[30] stated that meal kit shoppers tended to be affluent, younger, family shoppers. De Sena goes on to state that "HelloFresh and Marley Spoon customers shop less frequently in bricks and mortar supermarkets than the average shopper (-11%)" and that "If meal kits continue to grow and start to hit supermarket shopping occasions, it has the potential to impact one of the most important retailer success metrics, in-store traffic." However, we would expect that if the meal kits businesses grow significantly, this will create an opportunity for supermarkets in the development of a new category in which they may ultimately dominate.

74. Meal kits may be more appropriately characterised as substitutes for takeaways or family restaurants, than grocery shopping.

75. When NZFGC has asked retailers what the impact has been on their sales, the answer always given is that it was negligible. While the meal kit businesses are growing in scale they are fringe in terms of the total family shop which occurs at supermarkets. We do not see meal kits having any constraining effect on supermarkets.

Q14	Are there any other developments in how consumers purchase groceries which might impact competition? How should we take these into account in our study

76. NZFGC is not aware of other developments in this area but Wardle and Baranovic[31] stated for Australia that supermarket retail prices had met or outpaced inflation in recent years (at that time – 2009) while prices paid to producers had either stagnated or declined over the same period. We suggest the Commission could commission similar research in this area that would contribute to the data for New Zealand.

Q15	Do you agree that the study should primarily focus on traditional retail grocery stores?

77. NZFGC strongly agrees that the study should primarily focus on traditional retail grocery stores (together with the various delivery channels) since these dominate the grocery

[30] De Sena A. "Unlocking growth in meal kits: meet the Hello Fresh and Marley Spoon shopper". *Insights,* Nielsen Australia: 2018 https://www.nielsen.com/au/en/insights/article/2018/unlocking-growth-in-meal-kits/

[31] Wardle J, Baranovic M. "Is lack of retail competition in the grocery sector a public health issue?" *Australian Journal of Public Health* 2009 33/5 pp 477-481 https://onlinelibrary.wiley.com/doi/epdf/10.1111/j.1753-6405.2009.00433.x

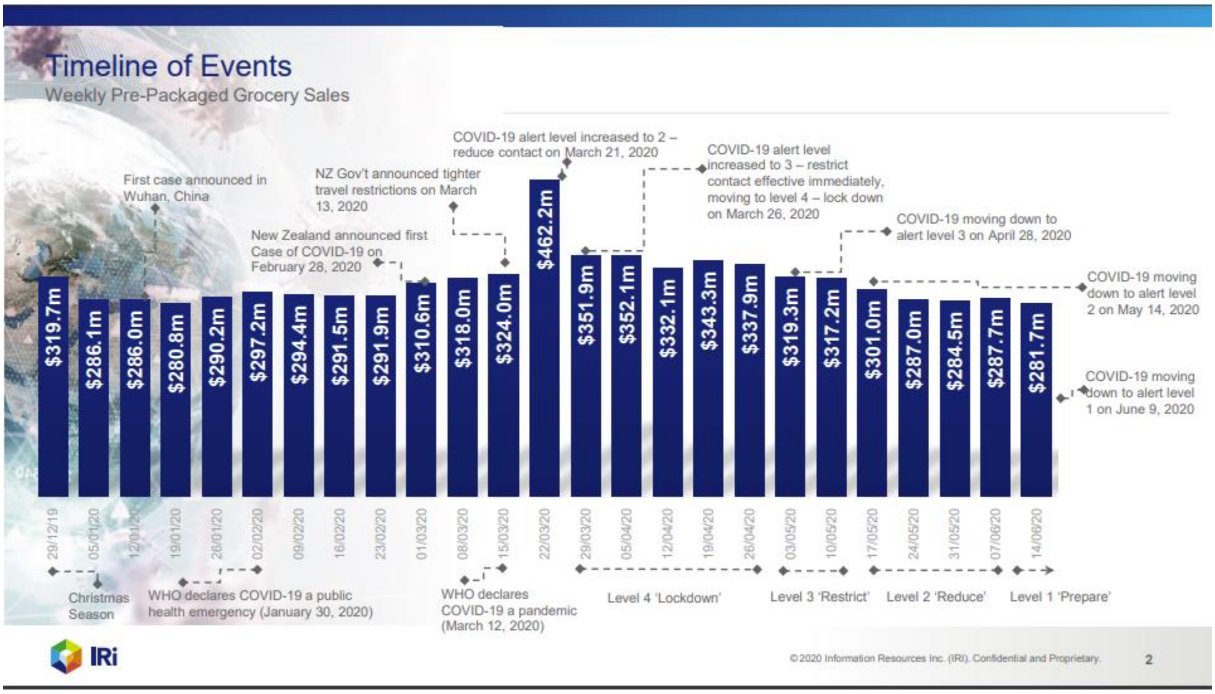
market in New Zealand. All non-supermarket access for individual items is insignificant to the unique portfolio power of the two supermarket networks.

The COVID-19 pandemic has had a significant impact on the retail grocery sector

78. The Preliminary Issues Paper states that some businesses who had not previously sold groceries to retail consumers began selling online during lockdown. It may be, that these services emerged as a means of survival or to leverage the sales channel rather than as major competitors to the two major grocery retailers. This is because:
    - their offerings remain significantly narrower (eg Service Foods Home does not supply infant formula, toddler milks or baby food)
    - choice of brand is very narrow (often only 3-5 brands per category)
    - provision can be conditional/more constrained (eg BidFoodHome has a minimum order of $200 and a delivery charge of $10 delivery plus GST; Service Foods Home has free delivery over $150)
    - they were utilising an existing model/platform for grocery that had not featured previously (eg Trade Me and Mighty Ape).

Q16	Are there any changes to the New Zealand grocery sector due to COVID-19 that we should consider in our study? If so, what are these changes and what effect, if any, are they likely to have in the future?

79. As noted earlier, it will be important for the Commission to interpret data relating to the lock-down periods with caution. We have been advised by Citi that COVID-19 market effects have distorted both revenues and costs making accurate analyses extremely difficult as the following illustrates[32]:.



80. Suppliers have nonetheless experienced supply agreement changes due to COVID –19 and during the period of price moratoria and concurrent changes to the Foodstuffs North Island Buying Model.

[32] IRI presentation.*NZ Thought Leadership*, 18 June 2020

Q17	Has COVID-19 changed the manner or frequency with which consumers shop? If so do you think that these changes have persisted, or will continue to persist, following the COVID-19 lock-down period? What effect might this have on smaller retailer?

81. NZFGC considers there are a range of changes that do not necessarily all result from the COVID-19 events. In relation to the manner of consumer shopping, online shopping globally was the major retail growth channel prior to COVID-19. The pandemic likely sped up that growth trend and has contributed to its persistence.

82. In relation to the frequency with which consumers shop, this could go either way – less frequent bulk shopping to maintain a store of supplies or more frequent shopping whenever there is gap in the pantry. As well, the requirement and then normalisation of the 'work from home' experience may well be increasing the frequency of shopping. Less frequent bulk shopping means shoppers increase the quantity they buy during one grocery run (buying more at one go), which also means demand is even more price inelastic than before as consumers would rather just buy/stock than wait for promotions/specials. This will only enhance supermarkets' market power.

83. Sales data as collected by Nielsen (scanner data) would assist in this area. Nielsen has data on frequency and spend per visit. Supermarkets themselves have a wealth of potentially richer data from loyalty programmes that could be used to examine changes in the purchasing patterns of consumers.

84. International research (Renner et al from Deloitte USA)[33] found that, in addition to shopping frequency, what consumers buy and what they value changed following the pandemic outbreak. Further examination of the impact of these types of changes could be valuable.

Q18	Has Covid-19 had any long-term impacts on other retailers (including specialist retailers) and their suppliers?

85. Most competing retailers that had to close during the COVID-19 lockdowns have reopened. There are anecdotal examples of butcher shops that closed permanently but NZFGC is not aware of data on this.

Potential issues we may consider during the study

Q19	Do you have any comments on our proposed high-level approach to the study as discussed in paragraphs 66 to 70 above?

86. NZFGC considers the four groupings of factors listed in the Preliminary Issues Paper paragraph 68[34] generally cover the areas we consider affect competition and note these are expanded on in subsequent sections.

87. The Preliminary Issues Paper paragraph 70[35] refers to the Commission's intention to consider competitive outcomes in the grocery sector focussed on:

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[33] Renner B, Baker B, Cook J, Mellinger J (2020). "The future of fresh: patterns from the pandemic" Deloitte insights, 2020. https://www2.deloitte.com/us/en/insights/industry/retail-distribution/future-of-fresh-food-sales/pandemic-consumer-behavior-grocery-shopping.html

[34] Commerce Commission *Market study into the retail grocery sector: Preliminary issues paper* (2020) p18

[35] *Ibid*, p18

- prices, choice, quality and innovation
- the margins and profitability of grocery retailers; and
- whether there are other outcomes that are not consistent with those expected in a workably competitive market.

88. Unlike the four groupings of factors listed in paragraph 68 of the Preliminary Issues Paper, the reference to "margins and profitability of grocery retailers" is not explored further in the Preliminary Issues Paper to the same extent. NZFGC is of the view that margins and profitability of the two major grocery retailers, when compared to major grocery retailers in comparable overseas countries and to inflation could help evaluate whether there is significant market failure in the grocery sector in relation to competition. We are particularly concerned that this area is thoroughly explored.

Q20	Would international comparisons of grocery prices and profitability of retailers provide insights into the level of competition in the retail grocery sector? If so, how should we undertake these comparisons? For example, which measures of profitability are relevant in this context?

International margin comparisons provide a useful tool for the Commission to evaluate market outcomes

89. International supermarket profitability comparisons are an essential component of the Market Study.

90. In order to do this the Commission must ensure uniform accounting standards are applied to the supermarkets analysed and look only at supermarket operations and not their associated operations**.** Using such a metric will provide a fact base to enable clear evaluation of how competitive the New Zealand marketplace actually is.

91. It is important that the Commission as an impartial adjudicator does this work and while the graphs which follow show limited available information NZFGC has been able to source it needs to be updated with New Zealand-specific information.

92. We understand this is most likely a laborious process however the outcome should eliminate such commercial impacts of geography, freight and other influences.

93. EBIT - Earnings Before Interest and Tax = Sales – All Costs / Expenses. EBIT then becomes the margin that the supermarkets earn. This margin is a direct reflection of the price consumers pay to access the food and groceries they wish to buy.

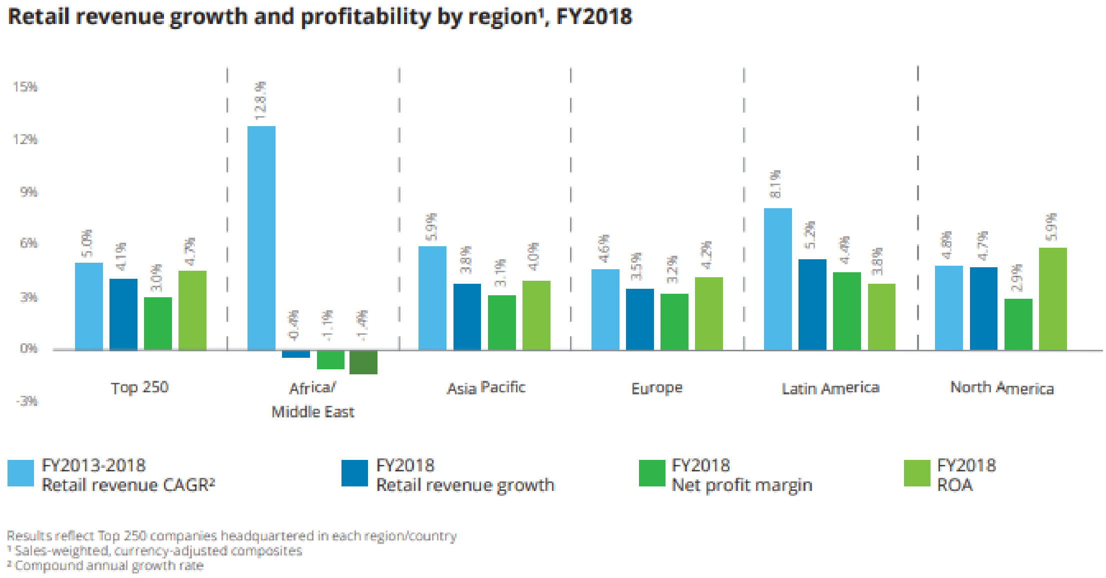
94. In short, high margin earns indicate the lack of competitive tension within a marketplace.

95. If there is minimal competition for customers margins are higher.

96. Retail analysts proffer that UK supermarkets generally make a 1-3% profit margin as a percentage of revenue, while in New Zealand it is between 3-5%. One member has told NZFGC that some Pak'nSave owners have remarked to him that they aim for 10% return. Whether this is accurate or simply bravado it is hard to judge when accurate data is not available. However, if this is current, it equates to supernormal profits for grocery businesses. We are firmly of the view that comparison of profitability of retailers across countries would provide insights into the level of competition in the retail grocery sector.

97. Retail revenue growth globally has been strong in recent years as indicated by the Deloitte Touche Tohmatsu data below. However, the Deloitte Global Powers of Retailing 2020

report states that “the fast-moving consumer goods (FMCG) product sector is the main contributor to the Top 250 metrics … [but] … recorded the lowest profitability among the product sectors, with a composite net profit margin of 2.0 percent”[36]. Deloitte notes that FMCG retailers have been employing strategies to deal with competition “such as greater focus on e-commerce, buy-online-pickup instore, cashier-less stores, opening more convenience stores, voice-enabled shopping, and doorstep delivery.”[37] All these are strategies applied in the New Zealand industry.

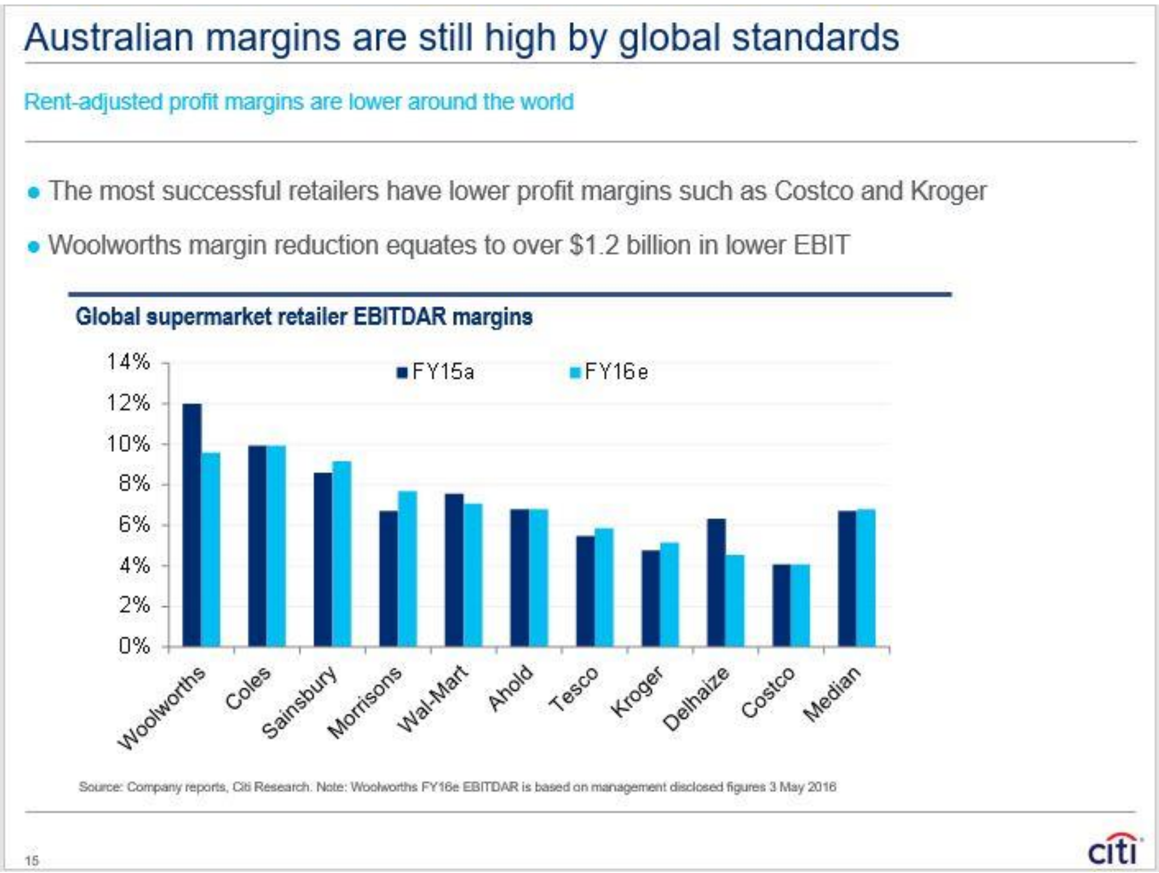


Source: Deloitte Touche Tohmatsu *Global powers of retailing 2020*. p23

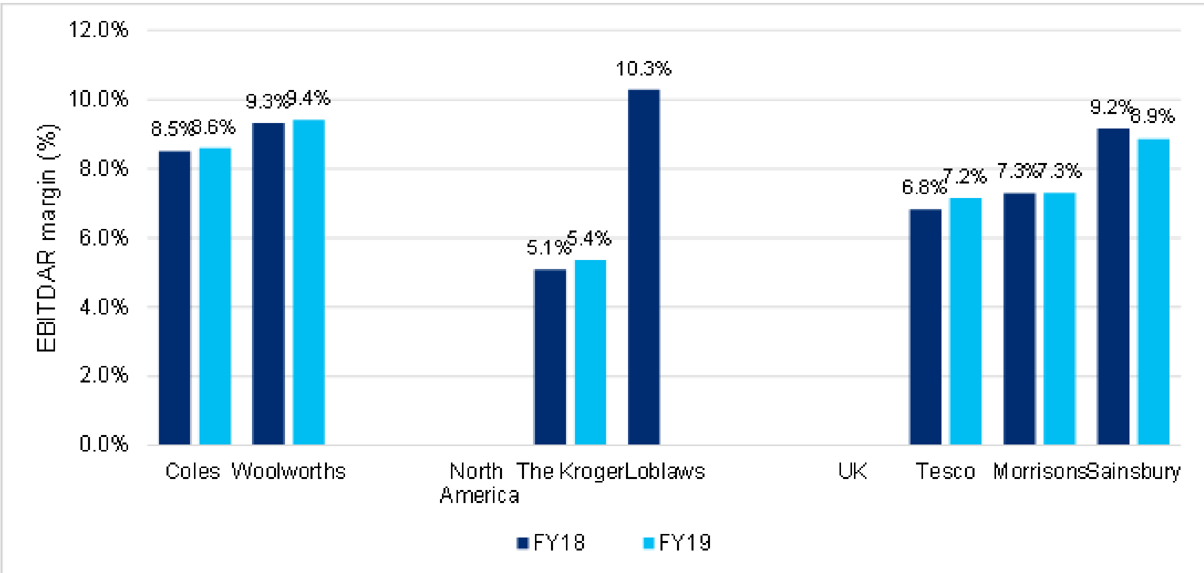
98. It is worthwhile to compare return on investment as well as more readily available measures of profit such as EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) information for New Zealand supermarkets with like businesses in UK, Europe, the United States, Canada, Germany and the Nordic region. It was widely accepted by industry and retail analysts pre-COVID-19 that Australian and New Zealand supermarkets are amongst the most, if not the most, profitable grocery retailers in the world.

99. For the Australian retail market profitability is clear, but for New Zealand, because of the lack of financial transparency for Foodstuffs owners, it is difficult to be categorical from observing publicly available financial data. However, suppliers and analysts looking at Woolworths published accounts, grocery prices and previous publications of the New Zealand Rich List where most newcomers are supermarket owners, have little doubt as to the higher profits enjoyed in the New Zealand grocery retail market. The Commission would need to collect financial data from retailers. The following figure illustrates retail margins for Australia in 2016:

[36] Deloitte Touche Tohmatsu Ltd. *Global powers of retailing 2020*. https://www2.deloitte.com/ph/en/pages/consumer-business/articles/global-powers-of-retailing.html p27
[37] ibid, p27



100. The following is an updated graph for FY18 and FY19 from Citi.



International price comparisons need to be interpreted in the context of different costs to serve

101. If the Commission uses international price comparisons, it will be important to account for variations in cost to serve (for example, transport, infrastructure, distance, labour costs) in in drawing conclusions. In fact, analysis of price-cost margins, rather than price comparisons alone would be more informative.

102. We note that it could also be useful to compare 'market baskets' such as the costs for 'branded baskets' and 'private label baskets'.

Competition at the retail level

Q21	How do major grocery retailers set their service offerings (such as price, quality, product range and opening hours)? For example, are prices set centrally, regionally and/or on a store-by-store basis?

103. Suppliers do not generally have visibility of how retailers set their prices and other service offerings, However, NZFGC understands that the two major grocery retailers set prices, quality, product range and opening hours differently due primarily to structural differences but hours do not differ significantly. Major grocery retailers also set their service offerings using algorithms that draw on data collected from their own customers or from another competing retailer.

104. For pricing, Woolworth's NZ is a single corporate entity affiliated with its Australian parent body; Foodstuffs North Island and South Island are cooperatives and oversee franchise-like arrangements by owner operators. Woolworths NZ sets prices centrally and Foodstuffs sets most prices at the head office level and others at the store level. Both have methods of analysing each other's pricing levels to just beat or match on relevant items thereby accommodating pricing behaviours accordingly. Suppliers report that retailers regularly point to promotions and pricing of their competitors in reviews and negotiations.

105. Product range decisions are largely centralised but there is some localisation depending on demographics and socio-economic factors. As Foodstuffs North Island continues its current tender process for selected categories where the expressed aim is to reduce 10 products down to 3 or 4 brands including private label, concerns in the supplier community increase.

106. Opening hours are also largely localised and heavily influenced by off-licence alcohol operating hours. The *Sale and Supply of Alcohol Act 2012* sets default maximum trading hours for off-license premises of between 7am and 11pm on any day. A local alcohol policy (LAP) can set different maximum permitted trading hours and a district licensing committee can issue a licence subject to more restrictive trading hours than national default hours or hours set out in LAPs. Nonetheless, these hours appear to align with the trading hours for the majority of supermarkets. Confirmation of this would need to be provided by the two major grocery retailers.

Q22	How closely do smaller grocery retailers compete with major grocery retailers? What are the main similarities and differences between them? Does this vary regionally and/or locally? Does it vary by product category?

107. We consider that there is limited price competition between the big grocery retailers and small grocery retailers. Many small retailers will purchase from their larger local retailer to achieve better pricing than they perceive could be achieved by going direct to the supplier or a wholesaler. In other words, the large grocery retailer acts as a wholesaler to smaller local grocery retailers. This may imply a lack of effective competition to the two main supermarkets at the wholesale/distribution point.

108. With regard to specialist suppliers, the likes of Moore Wilson's and Farro Fresh compete by offering more premium and artisan products. Others try to compete with location, but generally it is impossible for smaller grocery retailers to compete in the long term due to the inability to buy at the right price and sometimes get supply.

109. The difficulty for smaller grocery retailers to compete may, in part, be attributed to the "waterbed effect" discussed in Wardle and Baranovic[38] where major supermarkets dictate lower prices to their suppliers. This forces suppliers to recoup costs by charging higher prices for the rest of the market which pushes prices higher for smaller retailers, making them less competitive. This also artificially raises retail prices and limits consumer choice in the marketplace.

110. In the ACCC's report on its grocery inquiry, the ACCC noted that there had been proposals that *"aggressive loss-leader pricing by large retailers can inflict competitive damage on smaller, weaker retailers."*[39] In another ACCC report on consumer loyalty schemes, the ACCC noted that *"Loyalty schemes may be harmful to competition when they 'lock up' customers and introduce switching costs that increase barriers to entry and expansion for rival firms."*[40]

111. The geography of New Zealand can also preclude close competition in certain locations – there is only one supermarket in Stewart Island (Four Square) and only one in Haast Pass (On the Spot) where the competition for either is several hours away.

Q23	To what extent do grocery service offerings (such as price, quality, product range and opening hours) differ across the country? What are the causes of differences?

112. Suppliers do not have visibility of how retailers determine their service offerings by geographic location. From observation in the field, we believe product range is reasonably consistent across the main retailers (other than private label) although product range can be influenced at the margin by geography and consumer population. For example, the Stewart Island 4 Square carries locally caught frozen blue cod and the Spring Creek 4 Square north of Blenheim carries frozen whitebait. It can also be influenced by the consumer population in the same way (some products offered in Auckland regions to meet consumers' preferences).

113. We have commented on opening hours above, noting an apparent and considerable homogeneity in this area.

114. NZFGC is aware that in relation to price, all Woolworths and most Foodstuffs prices are set centrally, while for Foodstuffs, other prices are set by individual supermarket operators. This would create difference across the country.

115. In relation to quality, NZFGC is not aware of quality differences that are attributable to geography. There are differences among products within categories as there is in most retail businesses but these are attributable to supplier decisions (including private label supplies) made for a range of different reasons.

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[38] Wardle J, Baranovic M (2009). "Is lack of retail competition in the grocery sector a public health issue?" *Australian Journal of Public Health* 2009 33/5 p 478 https://onlinelibrary.wiley.com/doi/epdf/10.1111/j.1753-6405.2009.00433.x

[39] ACCC *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*. July 2008. p322 https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf

[40] ACCC. Customer loyalty schemes: Final report. December 2019. p89 https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF

Q24	What factors do consumers consider most important when deciding which grocery retailers to shop at, and which brands to purchase? How far will consumers travel to purchase groceries? Does this depend on where the consumer lives? Have any changes in consumers purchasing behaviour affected the distance or time they are prepared to travel or take in order to shop?

116. Store location (or distance) is a factor that is claimed to influence offline store choice greatly, with research suggesting that location explains up to 70 percent of the variations in the choice of grocery store.[41] [42] In fact there is a whole theory around store location and consumer behaviour.[43] One view is that the 'value-perspective' applied suggests that consumers may make an overall assessment of the store based on perceptions of what is received and what is given when choosing between grocery stores.

117. Hansen et al[44] suggest that the importance of distance decreases according to how much the consumer feels s/he will achieve, or plans to achieve, by visiting a particular store. Hence, a consumer who plans to spend a large percentage of her/his household budget in a particular store will be less influenced by the distance to the store than a consumer who plans to spend only a small percentage of her/his household budget at the same store.

Q25	Should we compare grocery prices across regions with New Zealand? If so, how should we undertake these comparisons?

118. This type of analysis would presumably be focussed on assessing whether prices varied across New Zealand, and if so, how much of the variation is explained by differences in cost and how much is due to differences in the extent of competition. While this analysis will capture differences in competition within New Zealand, the granular approach won't shine a light on concerning practices that occur nationally (eg, relating to centralised purchasing decisions).

119. As a result, while this analysis of prices across regions within New Zealand may have some value, we consider that the key comparative analysis should be international comparisons of retail margins and profitability.

Q26	Do you have any other views on competition in New Zealand's retail grocery sector which you would like to share?

120. The high concentration in grocery retailing and the strong buyer power of supermarkets reinforce each other. As a result, the two must be examined in tandem – examination of the effects of buyer power is crucial to understanding retail market outcomes.

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[41] Hansen T, Cumberland F, Solgaard HS "How the measurement of Store Choice Behaviour Moderates the Relationship between Distance and Store Choice Behaviour". International Marketing Trends Conference: Marketing Trends Conference, Paris, 17-19 Jan 2013.

[42] Litz RA, Rajaguru G Does Small Store Location Matter? A Test of Three Classic Theories of Retail Location. *Journal of Small Business and Entrepreneurship*. 21:4 pp477-492, 2012 https://doi.org/10.1080/08276331.2008.10593436

[43] Brown S. "Retail location theory: evolution and evaluation". *The International Review of Retail, Distribution and Consumer Behaviour*. 3:2, 1993 pp185-229 https://doi.org/10.1080/09593969300000014

[44] Hansen T, Cumberland F, Solgaard HS, *op cit*.

Are grocery retailers accommodating each other's behaviour?

121. NZFGC considers that 'accommodating behaviour' may either have obvious intent, or may have implicitly evolved over time, with the ultimate effect of increasing prices and limiting output so that profits for both firms are higher than they otherwise would have been. We have observed behaviour of both types. In what follows we have drawn on our observations of actual behaviour as well as our understanding of the market conditions that facilitates accommodating behaviour.

Q27	To what extent do you think there is accommodating behaviour between retailers in the New Zealand grocery sector? Please explain.
Q28	Which, if any, aspects of grocery retailers' offerings may be subject to accommodating behaviour (for example, location of store openings, prices, promotional schedules)?

122. NZFGC believes there is highly likely to be accommodating behaviour by the two major grocery retailers, based on the market structure, observed behaviour of supermarkets and retail market outcomes:

a. The structure and characteristics of the retail market – high concentration supported by entry and expansion barriers, as well as the ease of repeatedly observing pricing behaviour – is highly conducive to explicit or implicit coordination.
b. The major grocery retailers behave in ways that would be unusual in a competitive market, such as encouraging suppliers to coordinate promotions across retailers. We also observe behaviour that is entirely consistent with accommodating behaviour – watching their rival's prices closely through detailed data analysis is a fundamental of how the two major grocery retailers compete.
c. Retail grocery market outcomes in New Zealand are consistent with what would be expected in the presence of accommodating behaviour: supermarket pricing hovers around the same levels allowing retail margins that are starkly higher than in other countries with less concentrated grocery markets, and supermarkets focus on non-price competition (such as loyalty promotions).

The structure of the retail market is conducive to accommodating behaviour

123. As the Commission explained in Decisions 606 and 607[45], many competition factors which facilitate coordinated behaviour were present in the supermarket markets. The factors cited by the Commission include a highly concentrated market, high entry barriers, weak competitive constraints provided by fringe players, products insufficiently differentiated, consumer demand that is price inelastic, and low technological changes. These factors continue to be present:

a. The retail market continues to be highly concentrated.

b. As we discuss below in response to question 30, entry and expansion barriers continue to be high, with strategic barriers (such as effectively preventing access to products) further adding to underlying structural barriers (such as economies of scale and sunk costs).

c. While fringe players exist, including a range of specialty players, they do not appear to exert significant competitive constraint on the two large grocery retailers that provide broad portfolios of products as discussed above in response to questions 13 and 22.

[45] Commerce Commission, *op cit,* p54 para 294

d. With regard to product differentiation, as stated by the Commission in Decisions 606 and 607:

> *while supermarkets can be differentiated in several ways - for example, by location (spatially), by the combined price and quality of the service, or by convenience through breadth of offer - they may not be sufficiently differentiated to prevent coordination on prices. For example, a number of the products stocked by supermarkets are similar, if not identical.*[46]

e. As groceries are essential purchases, demand would continue to be inelastic with regard to price. This increases the likelihood that coordinated price increases will be profitable.

f. Technological change does not appear to be significantly disrupting the way in which supermarkets compete or breaking down entry/expansion barriers. While online retailing is increasing, it does not appear to be substantially reducing entry barriers and would make price monitoring even easier and less costly.

124. In relation to the 'threat of entry' and the role of strategic entry barriers, both the large New Zealand grocery retailers have applied pressure on suppliers to limit the access to products by the online provider, The Honest Grocer. This has taken a range of forms but commonly threats to delist products/product ranges are used. In this area, the large retailers effectively require an MFN arrangement, which prevents new entry or constrains the new entrant's operations and maintains high retail prices.

125. In the Commission's investigation into Progressive in 2014, the Commission noted that:

> *The most favoured nation clause appears to have been inserted by Progressive, not suppliers... Progressive staff indicated that the clause was driven by a desire to get competitive wholesale pricing and its expectation of getting the 'best price".*[47]

126. In a European Commission report on vertical restraints in the digital marketplace, the Commission noted that: *"…MFN-clauses used by online platforms may for example lead to the foreclosure of more efficient smaller platforms."*[48] Supermarkets coercing suppliers into ensuring new entrants cannot compete creates a 'de facto hub and spoke cartel' – or analogies at least. An example is the 2017 case lost by the ACCC but nonetheless demonstrating the seriousness with which the suspicion of cartel conduct is taken, due to its impact on consumers and the wider economy especially of an essential household product that is frequently purchased and used by Australian consumers.

127. As well as factors (a) to (e) discussed above, other factors specifically relevant to coordination that were identified by the Commission in Decisions 606 and 607 also continue to be relevant, including the ability to monitor prices which the Commission noted:

> *Woolworths and Foodstuffs sell many similar grocery lines on which they could coordinate prices…The incumbent supermarkets would be able to detect any*

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[46] Commerce Commission, *op cit,* p54 para 294

[47] Commerce Commission. *Progressive Enterprises Limited: investigation closure report*. November 2014. https://comcom.govt.nz/__data/assets/pdf_file/0033/94767/Progressive-Enterprises-Limited-Investigation-closure-report-20-November-2014.pdf p20 paras 112 and 113

[48] Laitenberger J. *Vertical restraints, digital marketplaces, and enforcement tools*. European Commission. ICN Annual Conference, New Delhi India 2018. https://ec.europa.eu/competition/speeches/text/sp2018_04_en.pdf

deviation from coordination because they constantly monitor each other's prices, and effective retaliation need only be in the form of the risk of temporarily abandoning the coordinated practices and reducing prices/ margins to pre-coordination levels.[49]

128. The increasing prevalence of online retailing would make price monitoring even easier and less costly.

Actual conduct exhibits features of accommodating behaviour

129. NZFGC has identified illustrative examples of accommodating behaviours:

a. **Products:** Many of the products in Foodstuffs and Countdown stores are identical. In the past Countdown attempted to develop differentiated pack sizes referred to as "exclusive packs" of popular brands. Foodstuffs placed immense pressure on suppliers not to supply Countdown with exclusive packs, threatening deletion and other actions and eventually this strategy was abandoned by Countdown.

b. **Promotions:** Retailers will regularly complain to suppliers if promotions "clash" i.e. happen at the same time, and will place pressure on suppliers not to allow this to happen, which is close to impossible to manage. There have been times when one retailer will complain to the supplier about another retailer's promotion.

Similar behaviour was identified in the Commission's investigation into Progressive in 2014, where the Commission noted that: *"The evidence indicated that Progressive and suppliers enter into quasi-exclusive promotion agreements. While talked about in terms of a 'no clash' policy or expectation, the effect of what is agreed is that where a supplier supports a Progressive mailer promotion, the supplier will not support another retailer to promote the same SKU at the same time as Progressive is promoting that product"*[50] and further that: *"In addition, Progressive takes steps if a clash occurs. For example, faced with a clash where it was being beaten on price, Progressive employees appeared in general to request further support from a supplier to match that price, for example by supplier funding. If that was not forthcoming, Progressive would consider whether to lower its retail price, and therefore reduce its margin."*[51]

NZFGC also observes that this is an area where accommodating behaviour can exist through the planning (i.e. frequency, price point, etc.) and the need for retailers to match each other without a margin impact.

It can be evidenced through the "expressed" or "implied" assertion by retailers to their suppliers that they will manage the promotional marketplace pricing and promotional slotting to ensure that retailers are not disadvantaged vs their competition and to "protect the margin" of retailers, which was the expectation which triggered supplier complaints about Countdown in 2014. Penalties could occur in the form of promotional cancellations, product deletions, etc. to suppliers who do not manage the promotional process according to the retailer's expectations which could then negatively impact the consumer.

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[49] Commerce Commission, *op cit*, p iv para E43

[50] Commerce Commission. *Progressive Enterprises Limited: investigation closure report*. November 2014. https://comcom.govt.nz/__data/assets/pdf_file/0033/94767/Progressive-Enterprises-Limited-Investigation-closure-report-20-November-2014.pdf p21 para 117

[51] *ibid*, p22 para 122

c. **Price increases:** Where one retailer will not take a price increase until the other retailer takes a price increase, this could be deemed to be coordinated behaviour.

d. **Retailers seeking margin compensation for price competitiveness:** Packaged groceries might be an area where this accommodating behaviour is more prevalent due to the limited number of retail outlets where these products can be sold such that suppliers are more dependent on the retailers for the sale of their products.

e. **Use of data to conduct sophisticated analysis of rivals' behaviour:** NZFGC understands that the two major grocery retailers use algorithms to track and anticipate what each retailer and others are doing. This is enabled through the detailed consumer purchasing data that is collected through customer loyalty cards and other methods.

f. **Loyalty programs:** NZFGC has not tracked loyalty promotions.

g. **Store locations:** In relation to location of store openings, property purchases or proposals reflect accommodation (eg Countdown and Foodstuffs purchasing adjacent properties in Adelaide Road, Wellington, but only Countdown proceeding with a store opening; a 17-year bid to open a Pak'nSave store in Glenfield by Foodstuffs'. Delays were attributed in large part to rival chain Progressive)

h. **Slotting fees:** As is evidenced in the table below para 174 in this submission, supermarkets charge a number of fees to suppliers including fees for shelf space. As is described in the economic literature, slotting fees can be used as a means to tacitly collude.[52] In essence, the slotting fees force suppliers to increase the unit prices charged to supermarkets, which in turn increases supermarkets' marginal cost, with the result that they compete less aggressively on prices, and benefit from the fixed fees received from suppliers.

Market outcomes are consistent with accommodating behaviour

130. As discussed in paragraph 96 above, New Zealand supermarkets appear to be earning supra-normal profits. While the estimated level might differ in degree, international comparisons show New Zealanders to be facing a duopoly premium.

131. In addition, firms that develop an understanding of not competing on price, often engage in strong competition on non-price features of supply. This allows the firm to attract customers, without breaching the implied agreement on price. The prevalent use of loyalty promotions by supermarkets in New Zealand, such as little gardens, collectable cards, knives, crockery and glassware etc, is very much consistent with the focus on non-price that would be expected in a duopoly with tacit collusion. This is analogous to the intense non-price focus on coverage that was prevalent during the mobile phone duopoly.[53]

Q29	To what extent do grocery retailers monitor or respond to one another's behaviour?

132. Retailers routinely monitor and respond to each other. They undertake price monitoring at least weekly for shelf and promotional pricing of their competitor. This was identified by

[52] Salvatore Piccolo and Jeanine Miklós-Thal, "Colluding through suppliers," The RAND Journal of Economics Vol. 43, No. 3 (Fall 2012), pp. 492-513.

[53] See Commerce Commission *A Review of Cellular Mobile Mark Entry Issues* (October 2006). https://comcom.govt.nz/__data/assets/pdf_file/0023/61970/final.pdf

the Commission in Decisions 606 and 607, where it was noted that *"The incumbent supermarkets … constantly monitor each other's prices…"*[54]

133. They also monitor each other's loyalty programmes and other non-price service offerings. Retailers will regularly complain to suppliers if promotions "clash" i.e. happen at the same time, and will place pressure on suppliers not to allow this to happen, which is close to impossible to manage.

Are features of New Zealand's grocery sector affecting the potential for retail entry and expansion?

134. NZFGC believes actions of the two major grocery retailers are affecting retail entry and expansion. Established supermarkets do not want new competition. As noted above, pressure on suppliers has been aimed at limiting the access to products by the online provider, The Honest Grocer. After agreeing to supply The Honest Grocer and supplying the new player, many suppliers have withdrawn products due to genuine fear that they risk other parts of their business. The founder of The Honest Grocer will confirm that he has lost many suppliers due to pressure applied to them not to supply. This is the result of The Honest Grocer going online with lower prices because as a retailer, it has lower margin expectations than the two major retailers.

Q30	What factors affect entry and expansion in the New Zealand grocery sector? How significant are these factors in affecting entry and expansion from retailers?

135. NZFGC believes that numerous strategic barriers limit entry and expansion. These include:

a. **Restricted access to products:** Large incumbent retailers effectively prevent entrants from having access to the full range of products by threatening suppliers with product deletion if they supply to entrants.

b. **Vertical integration in distribution networks:** Large incumbent retailers have vertically integrated distribution and transportation networks, limiting the options available to entrant retailers.

c. **Price competitiveness**: Securing product that will be price competitive with existing operators.

d. **Concentration of retail grocery outlets**: Density of those already in the market.

e. **Cost-effectiveness of setting up in New Zealand**: New Zealand is a small market, meaning significant market share gains have in the past been required for a new entrant to offset costs of entry given the scale required to effectively compete.

f. **Effects of private labels in limiting available product range**: Large incumbent retailers are increasingly growing their private label ranges. Where this ultimately leads to deletion of rival products, those products may well become unviable due to a lack of scale and entrant/smaller retailers will face a narrower product range, making those alternative retailers less attractive.

[54] *op cit*. pvi para E43

g. **Loyalty programs:** Both large incumbent retailers have established loyalty programs as well as promotional loyalty programs, which can discourage switching.

h. **Informational asymmetries:** A further factor is likely to be access to consumer data which the major supermarket chains have been collecting over a long period of time and are using to tailor offerings and increase profitability. Entrants do not have access to this valuable information.

i. **Land banking:** This has previously been well-established as a strategic barrier to entry and expansion.

136. The return on investment (how long will it take to pay back or break even), access to product supply from manufacturers and producers (attributed to supplier reluctance and/or pressure/threatening behaviour from incumbent retailers to their supplier base) and local knowledge might all limit access to market so that any new entrant has the appropriate categories to attract consumers.

137. As the Commission noted in Decisions 606 and 607[55]: *"…entry barriers are already high due to the difficulty in accessing suitable sites, obtaining resource consents and the presence of economies of scale...".* The types of strategic barriers identified above simply add to the structural and regulatory barriers that were already faced by entrant retailers.

Q31	To what extent does the size and geography of New Zealand affect the possibility of entry and expansion?

138. The population density that supports a sustainable supermarket business is fragmented outside of the primary locations in the north island being Auckland and its coastal surrounds. The remainder of New Zealand's population is very scattered meaning catchments for retailers are difficult to support an effective retailer to scale up.

139. More generally, it may be difficult for some suppliers to deliver due to tyranny of distance and small size of orders for small new retailers. It may also require a relatively high level of marketing investment to create awareness, and there is a high probability that a new entrant would require a significant investment into price points to attract consumers to a new retail business. This would come at significant expense to a new entrant.

140. All of this means that a very substantial capital outlay would be required to launch into the New Zealand marketplace in a meaningful way in order to capture the appropriate consumer catchments, invest in the land required and generate the revenue necessary to build a sustainable business model.

141. Nonetheless, while size and geography likely have some limiting effect on the number of market participants, there are numerous other comparable countries that have four or more supermarket chains (including discount stores) – for example, Ireland, Norway, Denmark and Finland.

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[55] *op cit* p54, para 294

Q32	Are there recent examples of actual or potential entry and expansion in the sector that we should be aware of? What are these?

142. We note the Commission has already identified the intentions of Costco to open a bulk-buy store in Auckland, which had been scheduled for April 2020 and is now delayed util later in 2022. One store in Auckland is unlikely to have a major impact.

143. The Warehouse's re-entry into grocery lines (without advertising its approach unlike the 'Warehouse Extra' offerings of 2008) may be an example. The Honest Grocer is currently in its launch phase in New Zealand.

144. In terms of specialty store, the Mad Butcher has 22 outlets across New Zealand and the Chemist Warehouse entered the New Zealand marketplace in 2019 and currently has four outlets.

145. There is the continued potential for Woolworths NZ and Foodstuffs to expand their convenience sector footprint with "express" offers under existing brands. This would further broaden themselves across multiple channels and purchase occasions.

146. While only limited entry has occurred, there are numerous potential entrants that have chosen not to enter. These include Aldi, Coles, Lidl and Kaufland.

Competition at the wholesale and supplier level

Q33	Are there existing wholesalers who are willing and able to supply new entrants to the retail market? Which product categories do these wholesalers supply?

147. Due to Foodstuffs vertical integration covering two wholesalers, Trents and Gilmours, New Zealand lacks competition in the foodservice area too.

Q34	Are there any barriers to entry and expansion at the wholesale level of the New Zealand grocery sector we should be aware of? If so how significant are they?

148. See above.

Q35	Do you have any other views on competition at the wholesale level of the New Zealand grocery sector we should be aware of? If so, how significant are they?

149. In the ACCC's report on its grocery inquiry, the ACCC noted that:

> *At the wholesale level, wholesalers and processors are subject to direct competition from vertically integrated MSCs. Accordingly, the ability of wholesalers and processors to raise prices is constrained by the MSC's ability to increase supply from their own supply chains...*[56]

and further that:

> *While the price paid by the MSCs broadly reflects the price in the wholesale markets, this is not to say that the wholesale markets set the price paid by the*

[56] ACCC *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*. July 2008. https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf p223

> *MSCs. The MSCs purchase around 50 to 60 per cent of all apples in any given week, mostly at the premium end of the range.56 As such, the purchasing patterns of the MSCs, which play a major role in setting demand for apples at the wholesale level, exert a strong influence over the wholesale price.*[57]

Is competition at the supplier level workable?

150. We note that the Preliminary Issues Paper[58] suggests that consumers can benefit from private label products through lower prices and greater choice. In theory this should be true. NZFGC suspects that in practice in New Zealand this does not generally occur.

Q36	Are there any factors affecting competition at the supplier level we should be aware of and consider during our study?

151. It is expected that two major grocery retailers will point to some categories where some suppliers have the ability to dominate some categories. It is correct that there are some suppliers that retain some brand power and can negotiate terms with supermarkets in a normal way. However, this is not the reality for most grocery suppliers many of which have no ability to negotiate due to New Zealand's market concentration. From their perspective they are price-takers (which may be the effect of supermarket-imposed MFN clauses), often settling for terms which are well below what would be expected in a more competitive market.

152. The market duopsony and gradual shift of margin, value, risk and power from manufacturer to retailer, which increased since the last major merger in 2000, creates the problem of consolidated categories. By this we mean that in order to supply the two major grocery retailers and deliver on those retailers' high margin expectations, it is the global firms with global scale that succeed. Often, this is non-New Zealand based manufacturing that can afford to supply them. With Foodstuffs North Island aiming to reduce the range in New World supermarkets for some categories from 10 choices down to 3 or 4 for consumers, this will only increase category consolidation further.

153. As is explained in the Consumers International report *The Relationship Between Supermarkets and Suppliers*:

> *It is difficult to estimate the scale of innovation which would have taken place in the absence of supermarket buyer power. But no independent commentator has ever contended that the scale of innovation has been enhanced by it, and it seems likely that there has actually been damage. After all, no rational company would invest serious funds in innovation when it knows (a) that it will not be rewarded for it, (b) that its IP rights will be flouted and (c) that it stands to be punished for objecting.*[59]

154. Concern about the reduction of choice is further emphasised by the fact that supermarkets may be replacing independent brands with their own private brands:

> *… supermarkets control what may and may not appear on their shelves. It is no longer simply an issue of rival independent suppliers competing for customers with a view to securing better display and location on supermarket shelves, but one in which*

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[57] ACCC *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*. July 2008. https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf p254

[58] Commerce Commission *Market study into the retail grocery sector: Preliminary issues paper* (2020). p26, para 107

[59] Nicholson C, Young R. *The relationship between supermarkets and suppliers: What are the implications?.* Consumers International, September 2012. https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf p14.

long-established brands are systematically replaced by retailers' own brands. Australia, the UK and Norway provide copious evidence of the rise and rise of retailers' own brands– though they are by no means the only countries to experience it.[60]

155. Supermarkets can act as "gatekeepers rather than passive transmitters of consumers' wishes" and influence the success and failure of brands to further their own interests "to the detriment of consumers and suppliers alike".[61] They "play a key role in shaping consumer demand and that, because of the power they wield in the marketplace, they have a strong influence over what consumers buy, and how and where they buy it."[62]

156. The UK Competition Commission also noted in its grocery market investigation that: *"The prices and margins that suppliers earn in supplying grocery retailers, wholesalers and buying groups can also indicate the presence of buyer power…"*[63]

Q37	What impact, if any, do private label products have on competition at the supplier level?
Q38	Do you have any other view on competition at the supplier level of the New Zealand grocery sector which you would like to share?

157. The offering of private label is important to retailers, but there are often conflicts of interest as from the suppliers' perspective they are both buyer and competitor. The European Commission is currently investigating the alleged anticompetitive effects of Amazon's dual role as a platform. The European Commission's preliminary view is that

"the use of non-public marketplace seller data allows Amazon to avoid the normal risks of retail competition and to leverage its dominance in the market for the provision of marketplace services in France and Germany – the biggest markets for Amazon in the EU. If confirmed, this would infringe Article 102 of the Treaty on the Functioning of the European Union (TFEU) that prohibits the abuse of a dominant market position non-public data from rivals to calibrate its own retail offers and strategic business decisions to the detriment of those rivals."[64]

(The European Commission has also opened a second antitrust investigation into Amazon's business practices that might artificially favour its own retail offers and offers of marketplace sellers that use Amazon's logistics and delivery services.)

158. The two major grocery retailers each favour their private label products and growth strategies for increasing private label no doubt exist. This raises, and continues to raise, serious confidentiality and intellectual property concerns where suppliers report developing new product innovations only to have it copied by the retailer for private label/home brand. In Decisions 606 and 607, the Commission noted that:

Supermarkets also use housebrands as a competitive weapon. When these brands gain significant market shares, the housebrand contracts are keenly tendered for by

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[60] ACCC *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*. July 2008. https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf p13.
[61] *ibid*, p2.
[62] Nicholson C, Young R. *The relationship between supermarkets and suppliers: What are the implications?.* Consumers International, September 2012. https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdfp2.
[63] Competition Commission. *The supply of groceries in the UK market investigation*. UK April 2008. http://www.ias.org.uk/uploads/pdf/Price%20docs/538.pdf, p158, para 9.10
[64] European Commission "Antitrust: Commission sends Statement of Objections to Amazon for the use of non-public independent seller data and opens second investigation into its e-commerce business practices" Press release, 10 November 2020: Brussels https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2077

the major suppliers, even though this gives the supermarkets the ability to drop prices and create extra leverage over the suppliers' own brands.[65]

159. Parallels are available in relation to Telecom/Clear and in Amazon preferencing. We favour the Commission taking a first principles approach in this area.

160. From the consumer's perspective a private label can be detrimental where a retailer rejects a supplier's lower priced offering or promotion because it could undermine the sales of a retailer's private label product where the retailer possibly earns a higher margin. This is recognised by the ACCC in its report on its grocery inquiry: *"…the ACCC considers that price competition would be distorted if retailers have reduced incentives to pass through to retail prices the competitive responses of branded product suppliers because of the growth of private labels."*[66]

161. With retailers preferencing their private label, coupled with range consolidation, consumers ultimately face less choice and potentially a lesser quality product.

162. As explained by Consumers International:

> *Given that shelf space is finite, branded goods are being increasingly squeezed out by retailers' own brands. It is profitable twice over for the supermarkets to do this. First, the promotion of their own brand products can be carried as part of their corporate promotional overhead, which implies substantial savings of indirect cost. Second, the closer control that supermarkets have over their own brand suppliers means that they can often achieve lower direct product costs too. Yet, as retailers' own brands have moved up market into premium and prepared foods, the prices they can command are often not far below those of independent, established brand owners.*[67]

163. The report also explains that:

> *In Australia, the loss of brands and rise of retailers' own brands has been comprehensively documented by CHOICE, a leading consumer watchdog. The evidence that CHOICE provides suggests that the removal of branded goods from supermarket shelves and their replacement by retailers' own brands is driven by the commercial interests of supermarkets rather than consumer choice*
> *… Potentially more damaging is the practice by supermarkets of demanding to know the future product plans of branded suppliers. When these are shared with retailers' own brand manufacturers in order to launch own brand products simultaneously with or ahead of the branded goods, it undermines the IP rights of the branded suppliers, and damages their profitability.*[68]

164. The ACCC also noted, in its grocery inquiry report, that:

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[65] Commerce Commission, *op cit*, p xx, para 343

[66] ACCC *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*. July 2008. https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf p318, para 14.5.3

[67] Nicholson C, Young R. *The relationship between supermarkets and suppliers: What are the implications?.* Consumers International, September 2012. https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf p7.

[68] Nicholson C, Young R. *The relationship between supermarkets and suppliers: What are the implications?.* Consumers International, September 2012. https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf, p7.

Vertical integration (i.e. backward integration or the production of their own private label products) by large buyers may be harmful to suppliers that are independent of the large buyer. Such backward integration—or a credible threat to do so—by the large buyer, and the associated foreclosure (or threat thereof) of the supplier by the large buyer, will generally improve a large buyer's bargaining position, which enables the large buyer to obtain a lower supply price and/or better other terms and conditions from the independent supplier"[69]

Q39	What are your views on the relative bargaining power of retailers and suppliers in the New Zealand grocery sector? How, if at all, does the relative bargaining power differ based on the specific retailers and suppliers involved?

The bargaining power of supermarkets is resulting in harmful procurement practices

165. Retail market concentration creates a huge imbalance in bargaining power between large retailers and suppliers. Retailers will often make the point that tough negotiations are all focused on ensuring the lowest prices to consumers. This may be the case in some circumstances, but the sorts of behaviour which have led to calls for a Grocery Code of Conduct in New Zealand are not those which are designed to deliver better choices and prices to consumers.

166. Retailers place excessive risks on suppliers which affect suppliers' ability and incentive to exist but more ominously, has created an environment within which the small New Zealand manufacturer/supplier struggles to survive, let alone invest, innovate or have the resources to execute an export strategy. This impacts food security for New Zealand.

167. Retailers transfer risks to suppliers through requiring guaranteed margins and/or making suppliers cover costs associated with risks that retailers manage such as theft, wastage and overordering. In addition, retailers use their bargaining power to demand payments for shelf space and displays (regardless of whether or not they are needed or delivered in-store). On top of increased risk and cost, suppliers also face unreasonably slow payment terms, requirements to participate in unviable promotions, and face demands for free product and personal perks.

168. When so many food and grocery suppliers are so dependent on the duopsony that the loss of one retailer can threaten their business, suppliers are compelled to agree to terms would not be required in a more competitive market. Many suppliers agree to these terms under threat that otherwise their products will be deleted or moved to less prominent shelf space.

169. The balance of power is shifting even more to the retailer, driven by their access to and use of internal data/insights. Several retailer "internal projects" are underway using such data, for example Food Stores North Island is requesting suppliers to meet certain margin requirements, and Pak'nSave is using data behind threatened product deletions on a store by store basis. Suppliers are unable to effectively counter such tactics without paying the very expensive costs to subscribe to receive each retailer's data, so retailers are forcing suppliers into a 'pay to play' model where payment is for data, and accessing the data is the only way suppliers can have any transparency of the demands being placed on them. This has pushed suppliers to use in-store media hubs and a number of suppliers say 'I know it is expensive but it helps us getting listed'.

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[69] ACCC *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries*. July 2008. https://www.accc.gov.au/system/files/Grocery%20inquiry%20report%20-%20July%202008.pdf p318, para 14.5.3

170. Retailers are increasingly using their new and expanding databases of information to extract more from suppliers than they previously have done, which creates an increasingly uneven playing field.

171. The retailer buyer power is also wielded to prevent supply to other retailers, effectively limiting entry and restricting retail competition. This has the flow-on effect of further entrenching buyer power.

172. Retailers also leverage their power by requiring suppliers to retailer-owned distribution services and transportation services, even where this is more costly.

173. While some retailers may be multinational companies, this does not automatically translate into bargaining power in New Zealand. In many instances they will have a relatively small presence in New Zealand and will be dependent on the supermarkets as a major distribution channel upon which they rely.

174. The table below identifies types of harmful procurement practices, supported by examples.

	Type of behaviour	**Who benefits**
1	**Shifting risk and cost from the supermarket to the supplier**	
1.1	Requiring a supplier to guarantee a retailer's margin regardless of price.	Retailer
1.2	Margin expansion – the practice of extracting higher margins from suppliers and at the same time increasing the on-shelf price.	Retailer
1.3	Tender processes where double and triple the trading margin is expected from suppliers.	Retailer
1.4	Demands for payments from suppliers for costs which are instead genuine retail costs e.g. staff costs for placing products on the retailer's shelf.	Retailer
1.5	Demands to pay for store theft, shrinkage and waste.	Retailer
1.6	Demands to pay for product damage not the fault of the supplier or risk deletion.	Retailer
1.7	Demands for retrospective payments from suppliers for previous financial years for perceived gaps in margin or other vague benefits the supplier is deemed to have received.	Retailer
1.8	Over-ordering and cancelling; overordering due to retailer forecasting errors and then returning the stock.	Retailer
1.9	One-sided contracts e.g. having no exit clause for suppliers; prohibiting suppliers from seeking legal or professional advice on tender documents without approval from the retailer.	Retailer
1.10	Retrospective variations to contracts to favour the retailer.	Retailer
2	**Extracting additional payments/fees from suppliers**	
2.1	Demands to pay a percentage of sales as a "display" payment when the product has not, and most likely will not, be displayed. Some larger suppliers extract agreements for displays in return, but most signed agreements are without any guaranteed activity from the retailer at all.	Retailer
2.2	Demands to pay for shelf space or floor space or risk deletion.	Retailer
2.3	Listing and ranging fees.	Retailer
2.4	"Auctions" and tenders for shelf space.	Retailer

2.5	Unreasonable claims for payment of services or credits dating back more than two years following “forensic audits”.	Retailer
2.6	Demands for payment of a % of sales for waste or damage which is over and above actual waste or damage.	Retailer
2.7	Introducing new and unbudgeted costs e.g. a product “neck tag” fee, a product recall fee or some other new cost	Retailer
2.8.	Negotiating a discount from the supplier for a consumer promotion and then not running the consumer promotion. While price is not discussed the negotiation takes place with the supplier intention and expectation that there will be activity in the market of some kind which benefits consumers.	Retailer, Consumer loss
2.9	Demands that a supplier uses the retailer’s transport system which is often more expensive, less efficient and less accountable. Threats of punitive action should a supplier wish to leave the retailer’s primary freight service.	Retailer
2.9	Demands to purchase retailer data eg. dunnhumby	Retailer
3	**Reducing or delaying payment to suppliers**	
3.1	Deducting a settlement or prompt payment discount despite making late payments.	Retailer
3.2	Slow and extended payment terms for goods; payments made months after the retailer has sold the goods; unreasonable payment delays. irrespective of undertakings as to timeliness in contracts.	Retailer
3.3	Unreasonably long payment terms for high volume goods. For example, a supplier sells product to retailer on 1 December and it sells on 2 December. The retailer pays the supplier 20 January and often later.	Retailer
3.4	A practice by some stores of regularly and significant claiming for short delivery of shipments (signed as received) when the supplier has no doubt the product has been delivered.	Retailer
3.5	Arbitrary deductions of large sums from remittance without consultation. There is little most suppliers can do to get disputed claims back.	Retailer
4	**Product deletion threats and other retribution**	
4.1	Constant threats of deletion as a default and “negotiation” shortcut.	Retailer
4.2	Threatening to move supplier’s product to a lower shelf to make it harder for consumers to secure other retailer benefits.	Retailer
4.3	Banning a supplier from promotional activity as a punitive measure for not complying with some other demand or activity.	Retailer, Consumer loss as there are fewer opportunities to buy those brands at a reduced price.
4.4	Rejection of all new product development as a punitive measure for not complying with some other demand reducing consumer access to products and innovation	Retailer, Consumer loss.
5	**Inducing supplier to refuse to deal with competitive retailers**	
5.1	Demands not to supply competitors with exclusive packs or other product variants.	Retailer
5.2	Threatening deletion of a product or applying other pressure if a supplier supplies products to another new entrant in the New Zealand market.	Retailer
6	**Requirements to participate in uneconomic promotions**	

6.1	Requiring suppliers to participate in promotions where the ROI is unclear or unlikely. See 2.9 regarding the purchasing of retailer data.	Retailer, in some cases consumer.
6.2	Demands that suppliers move to a "6 week on, 2 weeks off" promotional rotation which would mean in effect that all stock is purchased from the supplier at the promotional price.	Retailer, Consumers benefit only during the promotion "on weeks" when the lower price is passed on.
7	**Requirements to provide free products or perks**	
7.1	Demands for significant amounts of free product at store before accepting what should be, according to head office decision, a compulsory stocked line and on the shelf.	Retailer
7.2	Requests for petrol vouchers, restaurant meals, free product and other personal gifts either personally or for staff	Retailer, Personal
7.3	Free overseas travel and accommodation	Retailer, Personal
7.4	Demanding suppliers credit all stock after a punitive deletion.	Retailer
8	**Buyer-induced bundling**	
8.1	Requiring suppliers to use retailer-owned or affiliated services eg transport, distribution centres – even when this is a more expensive route to market.	Retailer
8.2	Requiring or pressuring a supplier to purchase retailer data and insights at significant cost.	Retailer
9	**Requiring collusive behaviour in supplier market**	
9.1	Rejecting offers from suppliers for lower priced goods for consumers because the offers would be cheaper than the retailer's private label product.	Retailer
9.2	Demands to know from a supplier information or details about retail competitor's promotional programme or pricing	Retailer
10	**Appropriating IP for supermarket's own brands**	
10.1	Copying or demanding the use of supplier's intellectual property for private label products and in some cases subsequently deleting the supplier's product.	Retailer
11	**Inadequate health and safety measures**	
11.1	Bullying of sales representatives, poor treatment of merchandisers leading to mental health concerns.	No one benefits.
11.2	Poor health and safety practices in store	No one benefits

175. In some countries, a Grocery Code of Conduct is in place addressed these types of behaviour, ultimately to the benefit of consumers through increased access to products, innovation, lower prices and choice.

176. Some, though not all, of the behaviours described above may be addressed by the "Unconscionable Behaviour" provisions, which are currently before the House, but that on its own is not sufficient to address the extreme imbalance of bargaining power between large supermarkets and their suppliers.

Q40	Is the relative bargaining power between retailers and suppliers impacting competition in the New Zealand grocery sector? If so, how?

The use of excessive buyer power is harming rather than improving consumer outcomes

177. As described in the following table from the Consumers International report, there are many negative effects on consumers of the types of procurement practices that we observe New Zealand supermarkets engaging in:[70]

EFFECTS OF ABUSE ON SUPPLIERS	EFFECTS ON CONSUMERS
Overall downward pressure on supply prices	• Threat to suppliers' viability may affect supply and over time push prices up and reduce choice • Suppliers forced to cut production costs (possibly ingredient quality, and may squeeze working conditions in intensive stages of production)
Additional costs to supplier	• In the long run, may result in higher consumer prices • In the short run, may result in higher consumer prices in non-supermarket outlets
Risk of stocking new products forced on to supplier	• Fewer new products, with potential knock-on effects on range and quality
De-listing	• Replacement of branded goods with retailers' own brand • Loss of choice and possibly of quality
Cost and risk of shrinkage and/or retailers' forecasting errors passed back to supplier	• Price, range and quality are all put at risk through reduced funds available to suppliers for investment and promotion
Adversely affects suppliers' cash flow	
Risk and cost of product changes borne by supplier, increasing costs and uncertainty	
Domino-effect demands for lower prices from other supermarket customers	• Consumers misled about sustainability of low prices
Competitors' costs are raised	• Affects the availability of products to other retailers • Reduction of store choice
Loss of IP rights, leading to a lower rate of innovation	• Lower rate of innovation and thus of product range

178. As a result of the harmful buyer behaviour exhibited by supermarkets in New Zealand, supplier competition could look very different in future and may be characterised by:

a. unsustainability of local manufacturers, as margins get squeezed by increased costs and risks. Not being able to earn a normal profit in the domestic market also means a supplier is unlikely to garner the resources to invest in an export growth strategy. In any case, being driven out of the domestic market by supermarket behaviour and then relying only on export or alternative channels denies the consumer of access to products they might otherwise prefer.

b. hollowing out of multinationals' presence in New Zealand, with manufacturing being moved offshore, and local operations being minimised and confined to sales and marketing;

c. prevalence of private labels, which face little competition, so less variety, lower quality and/or higher prices.

The harmful procurement behaviour that we observe arises from retail market concentration and has been previously recognised by the Commission

179. The behaviours of the two major grocery retailers are symptomatic of buyer/demand-side power and high market concentration. Despite the two major grocery retailers being present online, many suppliers are restricted by the retailers' restrictive supply terms such as MFN clauses and related behaviour. Online channels of the existing

[70] Nicholson C, Young R. *The relationship between supermarkets and suppliers: What are the implications?.* Consumers International, September 2012. https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf Table 3.

retailers may in fact create additional entry barriers and 'crowding out' or fighting other brands. Not surprisingly, suppliers want greater optionality to supply/distribute. The Commission's past 'determinations'/findings provide some 'evidence such as Decisions/ Determinations 606 and 607; TWL, and others.

180. In Decisions 606 and 607, the Commission noted that:

> *"Supermarket chains have been able to use their buying power in a range of ways:*
> - *They have an important impact on competition through the criteria they use for determining which brand they stock, and the position they accord it on the shelves. Criteria typically include discounts, special offers, promotional support and the promotional incentives offered by suppliers.*
> - *For some products the suppliers undertake the "merchandising", such as the refilling of the supermarket shelves for milk and bread on a daily basis, meaning that supermarkets have no stockholding or warehousing costs.*
> - *Supermarkets also use housebrands as a competitive weapon. When these brands gain significant market shares, the housebrand contracts are keenly tendered for by the major suppliers, even though this gives the supermarkets the ability to drop prices and create extra leverage over the suppliers' own brands.*
>
> *The supermarkets recognise that market share is important for their suppliers, and competition for prime shelf price is intense. Smaller suppliers have found access to supermarket shelves difficult because of their inability to match discounts offered by larger suppliers, and by an inability to supply the whole chain."*[71]

181. Suffice to say, both the major grocery retailers wield immense buying power. This allows them to extract margins which are high globally. Supplying supermarkets is complex and suppliers are faced with a complex array of deductions, discounts, rebates, levies, fees, slow payment terms and other requirements. This complexity and web of many financial contributions is symptomatic of New Zealand's high retail concentration. In a competitive market, suppliers would be able to reject, accept or negotiate. While a handful of firms with major brand power can negotiate, the rest of the supply community cannot.

182. The UK Competition Commission highlighted in its grocery market investigation that vertical integration into wholesaling further strengthens buyer power*:*

> *The extent of grocery retailers' vertical integration will also influence their buyer power. The fact that large UK grocery retailers have a vertically-integrated wholesaling function means that they control suppliers' access to final consumers. This 'access to market' is an important factor in influencing these retailers' buyer power with respect to suppliers*.[72]

Suggested approach to examining competition effects of excessive buyer power

183. NZFGC is of the view that the Commission should take a "first principles" approach, viz:

- More competition is better – as has been explained in previous Commission decisions

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[71] Commerce Commission, *op cit,* p66, para 343

[72] Competition Commission. *The supply of groceries in the UK market investigation.* UK April 2008. p157, para 9.7 http://www.ias.org.uk/uploads/pdf/Price%20docs/538.pdf

- There are difficulties in obtaining data due to confidentiality concerns
- Markets are complex
- A lack of transparency, for example, on financial disclosure, obscures clear analysis of outcomes.

The important fact is that it is improvement that is being sought and the need for the current structure to work better. NZFGC has seen vast improvement in the application of Code of Conduct in Australia and the UK to the extent that it is so clearly making a difference that both countries are making amendments to even further improve competition.

184. The UK Competition Commission noted in its report on its grocery market investigation that exercise of buyer power by grocery retailers may raise concerns if:

> *it allows retailers to impose excessive risks and unexpected costs on suppliers, which reduces suppliers' incentive or ability to invest and innovate. This could lead to reduced capacity, reduced product quality and fewer new product offerings, and ultimately, to a detriment to consumers. Therefore, when assessing the behaviour of grocery retailers in relation to suppliers in paragraphs 9.37 to 9.81, we particularly looked at the business (or supply chain) practices of grocery retailers that might transfer excessive risks or unexpected costs on suppliers and thereby reduce supplier investment and innovation, when compared with the levels of investment and innovation that would be observed in a well-functioning market.*[73]

185. The UK Competition Commission further found in the same report that:

> *the principal manner in which excessive risks or unexpected costs can be transferred from grocery retailers to suppliers is through retailers making retrospective adjustments to the terms of supply. We also conclude that there are circumstances where allocations of risk may be agreed up-front between a retailer and supplier, but that the extent of risk transferred to the supplier is excessive. We also have concerns regarding the transfer of risk from grocery retailers to suppliers in situations where this transfer creates a 'moral hazard'; that is, where the retailer has the ability to affect the degree of risk incurred, but as a result of the transfer, the retailer has less incentive to minimize that risk.*[74]

186. In Decisions 606 and 607, the Commission noted that:

"the buyer power of the supermarket chains, insofar as it exists and is not countered by supplier power, could impact on market outcomes in various ways, and could in some circumstances adversely affect competition and harm consumers:

- *Large buyers could extract lower wholesale prices from suppliers. If these buyers also have market power over consumers, they could maintain higher retail prices and pocket the difference to earn higher profits. However, lower wholesale prices could also be passed on to customers in lower retail prices, if retail competition were effective.*
- *The pressure to lower wholesale prices could impact on suppliers in various ways. They might become more efficient; they might attempt to raise wholesale prices to other retailers lacking in buyer power; or they might be discouraged from making investments in process and product innovation, as well as in maintenance, if expected returns are reduced.*

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[73] Competition Commission. *The supply of groceries in the UK market investigation*. UK April 2008. http://www.ias.org.uk/uploads/pdf/Price%20docs/538.pdf, p157, para 9.5
[74] *ibid* p173, para 9.84

- *Consumers could be harmed by higher retail prices and a lower rate of innovation and product quality, or benefit from lower prices and improved efficiency and investment."*[75]

187. The key criteria limiting competition in New Zealand are price, range and availability. As noted in the foregoing, the relative bargaining power between retailers and suppliers is impacting competition. This includes through retailer behaviour (ranging, pricing) which may cause supplier commercial difficulties in maintaining production and supply to the market more broadly. This leads to a lowering/reduction in competition and the potential loss of brand or product available to the consumer.

Q41	Is there any specific behaviour or conduct between retailers and suppliers we should consider in our study?

188. Yes. We refer the Commission to the detailed list of behaviour contained in the table at paragraph 174 of this submission.

189. NZFGC believes the Commission should examine closely the terms imposed contractually (and non-contractual threats such as delisting etc and the terms not in writing or implied). This would be expected to include retailer demanded discounts etc that are not linked to services (eg promotions etc) and costs imposed on suppliers such as stock loss or non-delivery charges. The basis for the application of such costs and the evidence and timeliness of information about them provided to the supplier also needs to be examined. This could be compared to terms applied in other competitive markets. Behaviours that may result in accommodating behaviour between the retailers (thus creating "de facto hub and spoke cartel") should also be looked at closely.

190. The existing Foodstuffs North Island Commercial Model trading discussion that has been underway since October 2019 should be reviewed and considered.

Q42	How relevant do you consider consumers' access to information is to our study?

191. NZFGC is concerned at the extent that consumer information is being used by retailers (for example via their loyalty schemes) with very limited benefit to consumers (see comments to questions related to loyalty cards). More importantly, suppliers are being pressured to pay for the data or be subject to penalties, a demonstrable exercise in market power. Therefore, consumers' access to information is very relevant to the Market Study.

Q43	How do consumers compare offerings across grocery retailers? Where do consumers access the information they need to make these comparisons (for example, advertising by grocery retailers, price comparison websites)?

192. NZFGC does not hold information about how consumers compare offerings across grocery retailers. However, insights are available from Hecht et al which reflects US consumer decision making and suggests consumers react to price promotions and prominent placement. These retailer strategies are effected by category management, slotting allowances, price discounts and advertising. If suppliers are excluded from or penalised by such decisions, the retailer can dictate not only supplier profitability but also survival.

Q44	How easy is it for consumers to compare product offerings once in store? What factors influence this?

[75] Commerce Commission, *op sit* p66 para 346

193. NZFGC does not hold information about how consumers compare product offerings once in store. However, product label information is available (ingredient listing and nutritional information, claims) for comparisons which may reflect on pricing. The ACCC's report on customer loyalty schemes noted that: *"Loyalty schemes can reduce the flexibility of consumers' buying patterns and responsiveness to competing offers, which may reduce competition… Loyalty schemes may also reduce price transparency in a market where it is difficult to compare the value of loyalty scheme rewards with competing price-based offers. This can result in consumers engaging in less frequent comparisons and making less informed purchasing decisions."* [76]

Q45	What strategies do New Zealand grocery retailers use when setting prices for their products, including promotional prices? What are the benefits and potential harms to consumers of these strategies?

194. For existing product lines, retailers typically benchmark themselves against other retailers (and other players within the category/segment) as primary requirement for price setting, meaning they all simply follow each other on pricing.

195. For new product lines, the initial price recommendation is made by the supplier, and we see this as beneficial to shoppers because it keeps prices relevant to the product being purchased (rather than just copying the other retailers' pricing). However, once the product line is established in-store, the homogenous pricing process is applied.

196. Potential harms of the retailers' approach to promotional pricing, including intense pressure for suppliers to fund promotions and requests to maintain retailers' margins even when on special, could include:

a. supplier margin erosion, causing suppliers to exit categories and/or not develop new ideas/opportunities.

b. impact on supplier sustainability to keep supporting these incredibly promoted prices, particularly for smaller suppliers. It would be interested to know what data is available on the number of smaller suppliers who exit the sector and/or narrow their range of available products in order to continue meeting retailers' demands that suppliers prop up their margins in the face of heavily discounted shelf pricing.

197. It has been suggested that a positive correlation between pricing and concentration lends credence to the view that rising concentration among grocery retailers is likely to cause higher prices to consumers, and, due to reduced sales, and adverse price effects on producers.

198. While discounts are seen as consumer positive, the practice of selective deep discounting or cost-selling can be harmful, as noted by Nicholson and Young, because the prominence given to the discounted items can "*mislead consumers into thinking that the prices of all products sold by a grocery retailer are lower than is really the case*".[77]

[76] ACCC. *Customer loyalty schemes: Final report*. December 2019 p89 https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF

[77] Nicholson C, Young R. *The relationship between supermarkets and suppliers: What are the implications?.* Consumers International, September 2012. https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf p13.

Furthermore, "*the cost of discounting can be (a) largely imposed on the supplier and (b) recovered through the pricing of other items.*"[78]

199. As a means of increasing shoppers in-store, promotions have been significant. Ritchie et al[79] undertook similar research in the UK on wine sold in supermarkets noting at the outset that "Most wine in the UK is sold in supermarkets and most of this on promotion." Pricing of alcohol on promotion benefits the overall consumer spend on the product and the supermarket with traffic. In other areas, some categories are deemed 'foot tracker builders' which will normally mean lower supplier margins (maybe). We wonder if there is a point that retailers use some categories to their strategic advantage rather than to to the advantage of the supplier (or consumer).

Q46	Why is the percentage of grocery products sold on promotion high in New Zealand relative to other countries? Does this benefit or harm New Zealand consumers?

200. Nielsen data confirms that around 60% of grocery items are purchased while on promotion. This is high compared to other markets and may have reduced due to movement towards EDLP (Every Day Low Price) offerings . For some categories the rate of purchases on promotion is higher eg 95% for wine and for butter. Access to this data by the Commission from the two major grocery retailers would demonstrate the significance of promotions.

201. The high percentage of promotions may be derived from a huge amount of promotional support that the suppliers provide to the supermarkets for their products to be sold through the supermarkets' shelves – which is indicative of supermarket's buyer power. Suppliers are under constant pressure to maintain the heavily promoted shelf prices while also meeting the retailers' margin expectations, which may be at the expense of the suppliers' margin sustainability. There is an unwritten need to promote products to stave off the constant threat of products being delisted or ranging reduced.

202. The Competition Commission's investigation into the supply of groceries in the UK market observed similar pressure for suppliers to provide promotions:

> *In relation to promotions (see paragraphs 15 to 18 of Appendix 9.1), based on the correspondence that we reviewed, we found that suppliers can come under intense pressure to agree to fund promotions, sometimes at very short notice. In some instances, this may be viewed as a negotiation tactic by a retailer to reduce the costs of wastage. In this way, a grocery retailer might shift the burden of some of the cost of over-ordering back to the supplier by requesting support for a promotion, which could be regarded as a transfer of the risk arising from over-ordering by the retailer. We observed some examples of suppliers providing 65 per cent of the funds for a promotion, and strongly-worded requests from a retailer for promotional support.*[80]

203. In terms of their effects on consumers, the Commission noted in its open letter to New Zealand retailers in 2017 that:

> *Consumers are attracted to discount sales and we know that discount sales can drive competition among retailers and value for consumers. However, when price claims are not accurate and discounts are exaggerated, consumers do not get the 'bargain' they*

[78] *ibid,* p13.

[79] Ritchie C, Elliot G, Flynn M "Buying wine on promotion is trading-up in UK supermarkets: a case study in Wales and Northern Ireland". *International Journal of Wine Business Research*. June 2010

[80] Competition Commission. *The supply of groceries in the UK market investigation*. UK April 2008. http://www.ias.org.uk/uploads/pdf/Price%20docs/538.pdf, p169-170, para 9.6.4

believed they were getting. It is also unfair to other retailers who are offering genuine special prices and pricing their goods accurately.[81]

Q47	How are pricing promotions funded? Do these typically result in lower margins to retailers or suppliers?

204. The supplier typically funds promotions and generally at a lesser margin to the retailer. In the past this was a retailer cost and then shared. Now promotions are all funded by the supplier at the retailers' demand. This is indicative of supermarkets' growing buyer power. In some cases, the retailers receive contributions for promotions that are not passed on to the consumer. In many other cases, retailers purchase goods at the promotional price that is then not passed onto consumers as the products are then sold at the 'recommended retail price'. As well, a retailer may occasionally choose to promote deeper to obtain a specific price point to achieve a particular outcome (eg share of trade, theme week, etc).

205. The funding of promotions is usually conducted in two parts:
- Promotional trading terms whereby monies are paid to the retailer to activate promotions, secure mailer slots, etc.
- Promotional discounts (often referred to as case or scan deals) which are then reflected as discounting off the recommended retail price to achieve a promotional retail price on shelf. In the main the promotional discounts are fully funded by the supplier but occasionally the retailer may elect to co-fund the activity to achieve an even lower price point for a sales/volume outcome.

206. These terms and discounts lead to reduced margins for the suppliers and increased margins for the retailers. They also do not include the additional costs encountered by suppliers to execute a promotional activity which can include (but not exclusive to):
- Additional promotional volume production capacity
- Working capital impact to hold higher inventory
- Additional field sales resource to implement and execute promotions in store at the point of purchase (I.e. sales reps and extra merchandisers)
- Point of sale materials.

Q48	How important are loyalty programmes in New Zealand's retail grocery sector? What impact, if any, are grocery retailers' loyalty programmes having on the sector?

207. Getting consumers to go into supermarkets on non-price terms is a key goal. Related to this are the loyalty programmes (such as airpoints), loyalty discounts (where customer receives a member discount for swiping their card and effecting handing over their purchasing data) and loyalty promotions (for example, promotions where customers can collect stickers as they spend to receive knives, glassware, crockery etc).

208. While loyalty programmes can provide benefits to customers, by reducing consumers' propensity to switch, they increase entry/expansion barriers for entrants or small retailers. This is of most concern in highly concentrated markets. In addition, the observation by Wicker[82] that loyal customers are more profitable than non-loyal customers, further indicates that loyalty programmes can make life more difficult for entrants/smaller retailers. Wicker's study found that loyal supermarket customers shopped more often and spent more when shopping.

[81] Commerce Commission. "Misleading pricing: an open letter to New Zealand retailers". May 2017. https://comcom.govt.nz/__data/assets/pdf_file/0019/90073/Misleading-pricing-An-open-letter-to-New-Zealand-retailers-11-May-2017.pdf

[82] Wicker KD. *A study of customer value and loyalty in the supermarket industry*. Capella University Dissertation. Proquest: Ann Arbor USA, Nov 2015. p ii

209. Many people are subscribed to multiple retailers' and banners' schemes. Increasingly, aside from loyalty promotions, the loyalty programmes of the large supermarkets are focussed on enabling access to customer data, shopping patterns and behaviour, which are an incredibly rich source of data. They allow retailers to understand who their shoppers are in a more significant way. This information helps the retailer to increase sales among existing shoppers because they know their purchase behaviour.

210. Loyalty programs have, in the past, been centred on purchase frequency and monetary spend, but increasingly they are being more focused on personalisation and use of data through one-to-one relationships with customers. The retailer pays nothing for the data but then proceeds to sell it to suppliers – often whether they want it or not.

211. In 2016, in response to an Australian Productivity Commission Inquiry on Data Availability and Use, the Australian Food and Grocery Council (AFGC) included the following in its submission:

> *In early 2012, as the current supermarket wars were intensifying, a Woolworths' spokeswoman summed up the value of loyalty card data: "In terms of what a retailer derives from the data, it's incredibly rich. We're seeing, for the first time, a pattern to customer decision making. So you see things like the regularity with which customers buy certain products or the degree they substitute one product with another. All this is incredible information to us and it informs our decisions about what we put on the shelves.*[83]

212. These shopper insights derived from loyalty card data, combined with broader transactional data, provide the retailer with the ability to undertake detailed analytics on classes of shoppers, the effectiveness of discounts and marketing campaigns, elasticity of demand, category and product trends, efficiency of shelf layout and the impact of new products. In turn, these insights can be marketed back to suppliers and used to inform negotiations with suppliers."

213. At the time of the AFGC's submission, an example was provided of the Supplier Connect program run by Woolworths, which offered data and insight packages to suppliers for which the retailer charged a minimum price of $135,000 ranging up to 0.7% of the Retail Sales Value of their products. This all derived from the detailed individual data provided through the loyalty program. Suppliers have no say over this pricing especially if it is a mandated purchase by the retailer. NZFGC is strongly of the view that such charges should be investigated.

214. Data provided by loyalty program members (or linked to particular credit or debit cards) delivers a marginal or zero direct reward to shoppers, the question asked was whether there was a mechanism to enable consumers to gain a greater benefit. The Productivity Commission was recommending giving consumers a joint right over their individual data as just such a mechanism – to extract greater value from their individual data profile by offering it to other retailers including online retailers.

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[83] Australian Food & Grocery Council. *AFGC Submission: Productivity Commission inquiry into data availability and use*. December 2016. https://www.pc.gov.au/inquiries?query=&f.Submission%20Type%7CD=post-draft&sort=relevance&sort=date&sort=date&sort=date&sort=date&sort=date&collection=productivity-commission-sub-web&f.Inquiry%7CT=data%20availability%20and%20use&f.Inquiries%20to%20show%7CH=all&f.Topics%7CM=consumers&sort=date&start_rank=41

215. If an individual's detailed data is held exclusively by a single retailer the consumer benefit will be restricted. It is only through the creation of a joint right over the data that the consumer benefit is maximised. Access to the data by multiple competitors within the market enables the consumer to get the best deal.

216. In the ACCC's report on consumer loyalty schemes, the ACCC found that:

In the case of supermarket loyalty schemes, while customer loyalty in this sector is currently limited, there is the potential for stronger exclusivity effects to occur in future as the major supermarkets seek to leverage their growing digital and analytical capabilities using extensive customer data." and further that: *"…Insights generated from this data may be shared with partners, including suppliers (for example a supermarket chain sharing insights with product suppliers), or sold to unrelated third parties.*[84]

Q49	To what extent do consumers base their purchasing decision on the benefits associated with loyalty programmes? Do consumers typically participate in more than one loyalty programme?

217. Retailer loyalty card programmes appear to be very popular with New Zealand consumers even though their offerings by way of direct discounts are very low or zero. This is also the Australian experience where savings are estimated to be 0.5%-1.5%, a figure in line with similar supermarket loyalty programmes in other developed markets including the USA, UK and Europe according to the AFGC. Examples of price benefits are common in both Countdown and Foodstuffs in New Zealand but discounts nonetheless are low. Even so, loyalty card prices are very prominent on supermarket shelves when they are available and the consumer has to look very closely to see in much smaller font the non-loyalty card prices.

218. Benefits other than price in loyalty card programmes could influence purchasing decisions. In the past these have included fuel discounts (now matched by other loyalty programmes such as the AA) or airpoints (generally limited to travel within New Zealand in the current environment). Promotional programmes have now taken greater precedence as is described in the foregoing.

219. NZFGC concludes that purchasing decisions are not generally based only on loyalty programmes but are a composite of factors including quality, product range and loyalty programs.

Q50	Are there any other specific features of loyalty programmes offered by grocery retailers we should consider in our study?

220. As noted above, use and exclusivity of consumer data and visibility of loyalty card pricing compared with the recommended retail price should feature in the Market Study.

221. The terms and conditions for loyalty programmes and their disclosure (especially around data) should be considered. In the ACCC's report on consumer loyalty schemes at, the ACCC found that:

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[84] ACCC. *Customer loyalty schemes: Final report.* December 2019 https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF p89 and p48

> *The privacy policies of Flybuys and Woolworths Rewards disclose that they continue to track the purchasing behaviour and transaction activities of loyalty scheme members even if they do not scan their loyalty card by automatically linking any payment card used by the member to their profile. The loyalty scheme is able to collect, use and disclose to third parties the same information as if the member had actively scanned their card—without the need to compensate members with points. In effect, these loyalty schemes are able to continue to collect valuable member data without providing members with loyalty points in circumstances where a consumer is unlikely to be fully aware of the practice.*[85]

222. Other conduct identified by the ACCC that may be substantially detrimental to consumers include:

> *…consumer consent or agreement to particular terms and conditions being included in long and complex contracts, or all or nothing click wrap consents, and providing insufficient time or information to enable consumers to properly consider the contract terms..."* and *"loyalty scheme operators unilaterally changing the terms on which goods or services are provided to consumers without reasonable notice, and without the ability for the consumer to consider the new terms…*[86]

223. The ACCC concluded that *"If consumers are not adequately informed about a loyalty scheme's policies, operations and terms and conditions, they will not be able to decide whether they wish to participate in the loyalty scheme and, if so, how to optimise the benefits of participation."*[87]

Q51	Are there any other issues not raised in this paper that could impact competition in New Zealand's retail grocery sector?

224. NZFGC would point to submissions we have made recently to the Ministry for Business, Innovation and Employment in relation to competition. For ease of reference, we have included these at Attachment A.

225. In terms of addressing the issues limiting competition, we recommend consideration be given to a mandatory grocery code of conduct. The Australian Code of Conduct, according to the AFGC, aims to deliver more contractual certainty in trading relations between suppliers and supermarkets, encourage the better sharing of risk and reduce inappropriate use of market power across the value chain. The Code sets out clear obligations to ensure key elements of Grocery Supply Agreements are discussed and agreed up front. It does not seek to impose overly restrictive rules on commercial negotiations, but rather provides commercial flexibility within a set framework of requirements and controls on behaviour. In other words, a Code of Conduct does not prevent retailers from making changes to their commercial arrangements with suppliers but rather sets out how they negotiate and the conduct they apply in the process.

226. According to Hexis Quadrant[88], in describing the New Zealand situation, "the recent behaviour shown by some members of the Foodstuffs North Island (FSNI) business should

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[85] ACCC. *Customer loyalty schemes: Final report*. December 2019 https://www.accc.gov.au/system/files/Customer%20Loyalty%20Schemes%20-%20Final%20Report%20-%20December%202019.PDF p65 para 4.4.4

[86] *ibid* p41 para 3.7.1

[87] *ibid* p42 para 3.8

[88] Hexis Quadrant "Does New Zealand need a Grocery Code of Conduct?". *Supermarket News* 27 August 2020. https://supermarketnews.co.nz/opinion/does-new-zealand-need-a-grocery-code-of-conduct/

be urgently addressed with the implementation of a similar code of conduct, and that the retailers in New Zealand should be held accountable by an independent government appointed ombudsman or regulator to ensure they do so fairly and equitably. Now is the time to create the change necessary for protection of the hard-working supplier base in New Zealand."

Attachment A

Discussion Paper – Protecting businesses and consumers from unfair commercial practices

Submission by the New Zealand Food & Grocery Council

25 February 2019

99-105 Customhouse Quay, Wellington, PO Box 25-420, Wellington 6146, NEW ZEALAND

NEW ZEALAND FOOD & GROCERY COUNCIL

1. The New Zealand Food & Grocery Council (**NZFGC**) welcomes the opportunity to submit to the Ministry of Business, Innovation and Employment (**MBIE**) on the issues raised in the *Discussion Paper: Protecting businesses and consumers from unfair commercial practices* (**Discussion Paper**).

2. The NZFGC is an industry association which represents the major manufacturers and suppliers of food, beverage and grocery products in New Zealand. This sector generates over $34 billion in the domestic retail food, beverage and grocery products market, and over $31 billion in export revenue from exports to 195 countries – some 72% of total merchandise exports. Food and beverage manufacturing is the largest manufacturing sector in New Zealand, representing 44% of total manufacturing income. Our members directly or indirectly employ more than 400,000 people – one in five of the workforce.

OVERARCHING COMMENTS – OUR SUBMISSION

3. The NZFGC supports Options Package 4 as described on page 8 of the Discussion Paper, which is comprised of (a) a prohibition of unconscionable business-to-consumer conduct; (b) a prohibition of unconscionable business-to-business conduct; and (c) a prohibition on unfair contract terms (**UCT**s) in business-to-business contracts (**the proposed measures**).

4. The proposed measures present a unique opportunity to strengthen New Zealand's statutory regime in its capacity to address abuses of buyer power, not only in the grocery retail sector but in many other concentrated markets in New Zealand. It is also an opportunity for New Zealand's government to send a definitive message to businesses about what kind of behaviour is acceptable in our trading environment, and to bring New Zealand's consumer and competition law regime into closer alignment with Australia's. More broadly New Zealand would be following international best practice.

5. The comments in this submission relate to business-to-business conduct in the grocery retail market, and include:

    a. Background to this inquiry and our submission.

    b. Challenges with these types of submissions in the New Zealand context.

    c. International context – growing concern regarding demand-side buyer power.

    d. New Zealand competition laws are ineffective.

    e. New Zealand's grocery retail market & examples of harmful conduct by supermarkets.

    f. Specific answers to Discussion Paper questions.

6. We would like to make clear that some of the behaviours given as examples are historic, i.e. last reported in 2014. Current efforts by supermarket management have made a positive difference to the supermarket trading environment and we appreciate the efforts made, but New Zealand law continues to allow certain sorts of behaviours which can easily be reverted to once again, hence it is important to reflect and address the overall market reality as experienced by suppliers.

DETAILED COMMENTS

A. Background to this inquiry and our submission

7. The proposed measures are necessary but unremarkable. Indeed, New Zealand is arguably an outlier in the absence of the measures set out in the Discussion Paper. Many other jurisdictions have comparable measures in place – recognising that there can be a range of conduct not captured by other laws (e.g. generic competition laws) that needs to be addressed.

8. MBIE's review should be seen in the context of:

    a. international norms;

    b. growing concerns about demand-side buyer power;

    c. specific concerns about supermarket buyer power; and

    d. New Zealand's existing market structure, which would be (and was) prohibited under the current competition law test.

9. Much is made in these types of debates in New Zealand about "chilling effects" and uncertainty. However, the proposed business-to-business measures should only impact entities with significant market power, or those conducting themselves in a particularly egregious manner – and would only require these entities to act in accordance with commercial norms in competitive markets.

10. The measures proposed in the discussion document are unremarkable internationally and should be non-controversial in that they would simply impose rules that most would expect to be set down in law (and often are in other jurisdictions). There is nothing to suggest that New Zealand is unique in not needing the same measures. If anything, many of the issues caused by demand-side buyer power are more acute in New Zealand due to our concentrated market structure and behaviour that can result as a consequence.

11. As with any law change, the proposed measures (if enacted) could well have some associated compliance costs. These are expected to be relatively low, and have to be weighed against the potentially very significant harms – the extent of which can only be estimated.

B. Challenges with these types of submissions in the New Zealand context

12. The NZFGC actively encouraged industry leaders across the grocery retail sector to submit in response to the Discussion Paper. However, understandably because of the professional and commercial risks involved, the fear of commercial retribution and the potential impact this could have on a business, has prevented many suppliers from feeling comfortable about making a submission directly. The fact that any submission would be subject to the Official Information Act 1982 is a contributing factor to this. The reality is that raising concerns regarding supermarkets' conduct is not a viable option where confidentially cannot be guaranteed. This can also be prohibitive to suppliers bringing causes of action or raising concerns when unfair conduct occurs.

13. In New Zealand's relatively small, tight-knit trading environment, even the risk of gossip or hearsay is enough to prevent suppliers from raising concerns. Suppliers cannot risk losing a commercial relationship with a supermarket - losing one customer when two

supermarket chains control approximately 95% of the grocery trade can often be a matter of commercial survival.

14. These challenges were demonstrated by the fact that the Commerce Commission (**Commission**) had to compel submissions in relation to its investigation of Progressive Enterprises, now known as Woolworths NZ, during its investigation. The reluctance of suppliers to speak out against supermarkets or minimising their evidence, would have resulted in incomplete information for the review. MBIE will face similar issues in its current review due to the impediments described above.

C. International context – growing concern regarding demand-side buyer power

15. The issue of control of buyer power (and abuses of this power), and how this may be addressed by policy and legal measures, is a growing global concern.[89] The result of this is that other jurisdictions are already considering adopting, or have adopted, measures which seek to control abuses of buyer power. Australian competition law has included some form of prohibition on "unconscionable conduct" since 1986.[90] The Australian UCT regime was expanded to protect small businesses in 2016.

16. Abuse of demand-side buyer power in the supermarket supply chain has increasingly been a specific concern internationally over the last decade – the result of which in many jurisdictions has been the adoption or use of measures analogous to those contemplated in the Discussion Paper.

    a. For example, both Australia and the United Kingdom (**UK**) have introduced grocery retail sector codes of conduct since 2009. The table below identifies where particular conduct by New Zealand supermarkets is expressly prohibited under the Australian Food & Grocery Code of Conduct (**FGCC**).

    b. The Australian Competition and Consumer Commission (**ACCC**) has taken legal action against both Woolworths and Coles in relation to alleged unconscionable conduct. In *ACCC v Coles Supermarkets Australia,* the Australian Federal Court found that "*Coles treated its suppliers in a manner not consistent with acceptable business and social standards which apply to commercial dealings. Coles demanded payments from suppliers to which it was not entitled by threatening harm to the suppliers that did not comply with the demand. Coles withheld money from suppliers it had no right to withhold.*"[91]

    c. In 2014 the European Commission (**EC**) adopted a Communication on tackling "unfair trading practices" in the business-to-business food supply chain.[92] Unfair trading practices are practices that deviate from good commercial conduct, are contrary to good faith and fair dealing and are unilaterally imposed by one trading partner on another. A subsequent 2016 Report from the EC on the same issue stated that, "*many Member States… have recently introduced legislative and enforcement measures that broadly meet the criteria for effective frameworks against unfair trading practices. In total, more than 20 Member States have introduced legislation*

[89] See Peter C. Carstensen's *Competition Policy and the Control of Buyer Power* (2017).
[90] Julie Clarke, *Unconscionable conduct: An evolving moral judgement* (October 2011). Can be accessed at: http://classic.austlii.edu.au/au/journals/PrecedentAULA/2011/71.pdf
[91] *ACCC v Coles Supermarkets Australia Pty Ltd* [2014] FCA 1405 at [1].
[92] See: http://ec.europa.eu/internal_market/retail/docs/140715-communication_en.pdf

or are planning to do so in the near future."[93] These legislative /enforcement measures vary between Member States.[94]

17. The reality is that currently New Zealand lacks many of the regulatory safeguards that are available in other jurisdictions. Some unfair commercial practices that would be likely be illegal overseas frequently go unreported and unpunished in New Zealand.

D. New Zealand competition laws are ineffective in managing business-to-business conduct

18. It is well accepted that there are significant shortcomings in New Zealand's competition law regime.[95] While the NZFGC sees benefits in improving section 36 of the Commerce Act (and will expand on this issue in our submission in response to MBIE's *Discussion Paper: Review of Section 36 of the Commerce Act and other matters*), there would remain significant impediments to relying solely on that, because

    a. Parties with market power in a position to abuse that power may argue that they do not have "substantial market power" for the purposes of the Commerce Act. For example, supermarkets may argue that they do not have "substantial market power" because they constrain each other. This can be seen by the fact that the Commission did not make a finding on "substantial market power" in its Progressive Enterprises investigation.[96]

    b. There would still have to be (likely) "substantial lessening of competition" in a relevant market - there may be issues with market definition and demand-side market power can be challenging in this respect (e.g. it can be hard to demonstrate the anti-competitive effects of downward pricing).

    c. There are related issues, such as confidentiality/retribution concerns (discussed in paragraphs 12-13 above), costs of enforcement and the burden of proof.

19. While traditional competition law theory assumes downward pricing to be good (i.e. the lower prices are passed on to consumers) or neutral (i.e. a simple wealth transfer from manufacturers to retailers), significant buyer power (particularly abuses of that buyer power) may inhibit New Zealand suppliers' ability to invest, expand and innovate. All these activities are important for firms to grow to a size large enough to have the capacity to succeed in export markets. Abuses of supermarket buyer power make it difficult for suppliers to generate a normal profit (the minimum level of profit needed to remain competitive in a market) which may then be invested in product development, innovation and exports. A good example from Australia would be the impacts on the dairy industry as a result of "$1 milk", which impacted the industry so badly that some farmers have stopped the production of milk and there is now a shortage of milk, pushing prices to the highest level. Supermarkets have recently raised prices of milk, but the effects on the industry will take some time to repair.

20. This in turn poses a long-term detriment to consumers - a decrease in investment, expansion and innovation by suppliers can result in lower competition between suppliers and higher prices, more limited choice and reduced product quality.[97] Many of these

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[93] See: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2016%3A32%3AFIN, page 2.
[94] See: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2016%3A32%3AFIN, page 5.
[95] See the Commission's submission to the Minister of Commerce and Consumer Affairs, accessed at: https://www.mbie.govt.nz/have-your-say/targeted-commerce-act-review/
[96] The investigation report can be found here: https://www.comcom.govt.nz/dmsdocument/12714
[97] Caron Beaton-Wells & Jo Paul-Taylor, *Codifying Supermarket-Supplier Relations – A Report on Australia's Food and Grocery Code of Conduct* (September 2017), para. 11 (*Codifying Supermarket-*

harms may be unknown, and difficult to quantify – this does not negate the need to have balanced protections in place. Furthermore, in many instances the benefit of downward pricing pressure is not passed on to consumers but instead is used to increase businesses' profits. When the ambition is to add value to goods and maintain a strong manufacturing base, New Zealand has seen the retrenchment or exit of many fast moving consumer goods companies linked to increased retail concentration.

E. The New Zealand grocery retail market

21. New Zealand grocery retailing is characterised by a supermarket duopsony comprised of two large-scale grocery retailers, Woolworths NZ and Foodstuffs (**supermarkets**). This duopsony was the result of a series of supermarket acquisitions in the late 90's and early 2000's, culminating in the acquisition of Woolworths (New Zealand) Limited by Progressive Enterprises Limited, which reduced the number of supermarkets in New Zealand from three to two. This merger occurred in 2001, while the current "substantial lessening of competition" merger test (found in section 47 of the Commerce Act 1986) was in the process of being introduced. The merger was actually declined by the Commission under the new "substantial lessening of competition" test[98] but ultimately allowed to proceed under the old "dominance" test[99] pursuant to a ruling by the Privy Council.[100] In other words, the Commission was not satisfied that the merger would not substantially lessen competition in the relevant markets in New Zealand.

22. New Zealand's two supermarket chains wield significant buyer power in their dealings with grocery suppliers, the majority of which rely on supermarkets to access end consumers. This imbalance exists despite the fact that many suppliers are relatively large, sophisticated companies.[101] In a duopsony, this level of demand-side buyer power goes beyond control of access to consumers - commentators have noted that "because of the power [supermarkets] wield in the marketplace, they have a strong influence over what consumers buy, and how and where they buy it. Supermarkets can be seen as *gatekeepers rather than passive transmitters of consumers' wishes, and their gate-*keeping role can work to the detriment of consumers and suppliers alike."[102]

23. At the outset NZFGC would like to make clear that work is being done by both supermarkets to improve and support positive supplier relationships. Progress has been made since 2014 when issues relating to the treatment of food and grocery suppliers and growers were considered by the Commerce Commission and debated in Parliament. New leadership has also meant a greater desire to work constructively on these issues.

24. NZFGC supports and appreciates this work, but in order to accurately make a submission on the subject of this consultation, it is important not to forget past instances.

Supplier Relations). Can be accessed at: http://law.unimelb.edu.au/__data/assets/pdf_file/0006/2463135/Deidentified-draft-Code-Report-with-chapter-breaks_LATEST_010917.pdf

[98] See: https://comcom.govt.nz/__data/assets/pdf_file/0016/73123/448.pdf

[99] See: https://comcom.govt.nz/__data/assets/pdf_file/0020/73073/438.pdf

[100] *Progressive Enterprises Ltd v Foodstuffs (Auckland) Ltd* [2002] UKPC 25.

[101] Catherine Nicholson, Consumers International & Bob Young, Europe Economics, *The relationship between supermarkets and suppliers: What are the implications?* (September 2012), page 2. Can be accessed at: https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf

[102] Catherine Nicholson, Consumers International & Bob Young, Europe Economics, *The relationship between supermarkets and suppliers: What are the implications?* (September 2012), page 2. Can be accessed at: https://www.law.ox.ac.uk/sites/files/oxlaw/the_relationship_between_supermarkets_and_suppliers.pdf

While not currently an issue, they remain in the negotiation 'toolbox' to be employed at a later stage. Primarily examples are given of activities which have occurred here but are explicitly ruled out in Australia or other jurisdictions.

25. Over the last 5 years NZFGC has received first hand reports of a number of clearly harmful practices. Some are historic issues last reported in 2014 but not since (marked with a (H)) and some are currently performed by New Zealand supermarkets either with head office direction or mandated by some individual store owners (in the case of supermarket chains which are cooperatives) which are not addressed by the existing regulatory regime, including:

    a. requesting retrospective payments to preserve margins (H);

    b. retrospective variations to agreements and ongoing renegotiation of agreements in place.

    c. refusing to accept price increases despite rising supplier costs;

    d. requiring increased contribution to supermarket promotions to offset any price increases undermining the effect of the price increase.

    e. margin expansion: denying a genuine price increase to a supplier while increasing the price to the consumer;

    f. penalising suppliers for promotions run with other retailers e.g. The Warehouse or for supplying certain products to other retailers . Likewise demanding compensation for perceived losses from other retailers' promotions and deducting it from payments to suppliers (H)

    g. cancelling scheduled supplier promotion programmes as a penalty thereby denying consumers the opportunity to buy those brands at the reduced price;

    h. unilaterally imposing additional costs (often promotional costs) or discounting items without prior agreement;

    i. refusing to pay agreed costs to suppliers (H);

    j. seeking payments for shelf space or shelf positioning not linked to promotions

    k. seeking payment for store theft, shrinkage or waste generally seen as retailer costs;

    l. individual stores making unreasonable demands for suppliers to supply merchandisers or to pay store staff to work in their stores;

    m. requiring free product over and above fair amounts for new product launches (H)

    n. requiring suppliers to use third party services e.g. transport companies where the company is owned or linked to the supermarket; (H)

    o. requiring suppliers to use a supermarkets distribution network and supply to distribution centres which is more expensive for suppliers delivering direct to store.

    p. unreasonable payment delays;

q. taking prompt payment discounts as of right although paying late (this has become the industry norm)

r. unilateral deductions from payments to suppliers (H);

s. delisting products with unreasonably short notice; particularly difficult when a product is imported in significant quantities. In some cases this has meant large quantities of packaging waste and write offs for suppliers. (H);

t. over-ordering or cancelling an order at short notice (H);

u. unreasonable demands to contribute to retailer marketing costs on threat of deletion (H);

v. requests for a suppliers' intellectual property e.g. product information when supermarkets are in competition with homebrand goods; potentially infringing on the intellectual property rights held by a supplier e.g. recipes;

w. unreasonable demands by stores for credits sometimes dating back years;

x. threatening or penalising suppliers (eg by de-listing products, re-allocating shelf space or cancelation of promotions) as a "negotiation" tactic; and

y. a minority of large owner-operated stores have a general culture of bullying, intimidation, or penalising suppliers for non-cooperation. Reports of mistreatment of merchandisers (low paid, mainly women), sales representatives and other company representatives is an ongoing concern. In extreme circumstances suppliers have had to move their staff due to concerns that poor treatment and its potential effects on mental health is a health and safety issue.

26. These behaviours are caused by a lack of competitive pressure on "powerful purchasers" which would normally constrain their conduct. This behaviour manifests in one-sided contracts (or no contracts at all), but also in related (and/or unrelated) abuses of highly asymmetric bargaining power. The table below:

a. sets out some examples of harmful conduct which have been practised by New Zealand supermarkets - these examples have been identified from patterns of behaviour that the NZFGC has observed over the past two decades (a notable rise in such behaviour occurred following the creation of the supermarket duopsony in 2001);

b. describes the resulting harm to suppliers and consumers; and

c. indicates where this conduct is expressly prohibited by the FGCC.[103]

1.	**Requesting retrospective cash payments**
Description of behaviour	• Supermarkets have asked suppliers for retrospective cash payments. These are often presented as compensation for "benefits" received by suppliers in the previous trading year that were not included in the agreed terms of supply between the parties.

[103] Can be accessed at: https://www.legislation.gov.au/Details/F2015L00242

	• Suppliers have reported feeling shocked and intimidated as a result of these requests, which are often raised verbally in meetings, with little to no prior warning and no scope for discussion or negotiation. • These requests for retrospective cash payments also sometimes relate to product "wastage" or "shrinkage" that occurs in-store or are the result of claims that historic invoices remain unpaid. The historical claims are particularly hard for suppliers to refute, due to personnel turnover or lost/destroyed files. • Clause 10 of the FGCC prohibits a retailer from varying a grocery supply agreement with retrospective effect. Clause 14 specifically prevents retailers from requiring a supplier to make any payment to cover wastage of groceries incurred at the retailer's premises.
Harm to businesses & consumers	• These requests often leave suppliers fearful of retribution if the money is not paid. • Unexpected costs can lead to lower than expected income for suppliers, and increased uncertainty regarding future costs which may be requested in the future inhibit suppliers' ability to plan or invest in product development, innovation and exports.
Examples	• A supermarket invited a supplier to a meeting and stated it was disappointed that in the previous trading year it had lost sales volume due to not pricing as competitively as its competitors. It further stated that as a result it required compensation of $1.8 million for "benefits" delivered to the manufacturer in the previous trading year. This sum was said to reflect money "owed" to the supermarket due to the supplier's product being below category average GP%. The supplier requested to view the supermarket's analysis but was denied. This request was never put into writing and, following debate in Parliament regarding "retrospective payments", was not pursued any further. • A similar meeting was held around the same time with a different supplier, who was asked for $2 million to compensate for benefits (including shelf facing, aisle ends allocated and other estimated costs incurred) received by the supplier in the previous trading year. These benefits were not part of the terms of supply originally agreed to. Again, the supermarket stated it was disappointed that it had not been as competitive in price as its competitors in this product category. Again, this request was never put into writing and, following debate in Parliament regarding "retrospective payments", was not pursued any further. • Suppliers have also reported being asked to make retrospective payments for losses incurred in-store, such as product wastage and theft. In one case the wastage cost constituted total losses for an entire category, then divided amongst all suppliers (meaning some suppliers may have been charged for wastage that did not relate to product supplied by them).

	• Suppliers have reported being routinely sent claims for promotion contributions (in the thousands of dollars) relating to promotions run up to 4 years in the past.
2.	**Refusing to accept price increases despite rising supplier costs**
Description of behaviour	• Many suppliers report that legitimate price increases requested are routinely refused, with little scope for negotiation. These price increases are often the result of rising input costs, and if not accepted frequently lead to suppliers operating at a loss. • Some suppliers report not having a price increase for up to 7 years.
Harm to businesses & consumers	• Where costs increase but price increases are refused, many suppliers are forced to supply products at a loss. This can often mean operating long-term is not viable. • When faced with increasing costs, suppliers may be forced to cut production costs (leading to reduced quality) or cease production (leading to reduced choice for consumers). • Suppliers have observed that prices are often raised to consumers despite the suppliers' price increases being rejected – leading to margin fattening by the supermarkets while the suppliers' businesses suffer.
Examples	• A supplier reported a supermarket refused price increases despite material increases in input costs – as this company supplies both supermarket chains at the same price, it was unable to raise its price with the other supermarket chain either, resulting in 40% - 80% of its total business being affected. In one product category the supermarket's refusal resulted in the supplier making a loss for each unit sold. • A supermarket refused a price increase request from a supplier, despite the supplier facing significant price increases in commodity ingredients for its product. The supermarket later increased the price of 18 of the supplier's products to consumers by up to 6%. • One supplier reported it had to consider halting supply to a supermarket after facing 20% cost increases. The supermarket originally agreed to but then reneged on a price increase, meaning that the supplier was making a loss on products supplied.
3.	**Unilaterally imposing additional costs (often promotional costs) or discounting items without prior agreement**
Description of behaviour	• Supermarkets frequently charge suppliers for costs that have not been agreed to in the terms of supply. These costs are often deducted from payments without prior discussion or negotiation with the supplier impacted. • Suppliers also often report that their products have been discounted heavily by supermarkets without prior agreement.

	• Clause 9 of the FGCC prohibits a retailer from unilaterally varying a grocery supply agreement without the consent of the supplier concerned. Clause 18 provides that a retailer must not (directly or indirectly) require a supplier to fund part or all of the costs of a promotion.
Harm to businesses & consumers	• Unexpected costs can lead to cash-flow issues for suppliers and can impact profits. This in turn can inhibit suppliers' ability to invest in growth or new product development. Again, ultimately the range of choices available to consumers can be impacted. • In cases where suppliers' products are continually and/or heavily discounted, consumers' perception of the value of products can be warped and consumer expectations of what a fair price is may change. This can be detrimental to suppliers where consumers' perception of value is disproportionate to the supplier's costs. • As with example 2 above, in the instances where costs are raised for suppliers but prices (to suppliers) paid by supermarkets are not increased, supermarkets are merely fattening their profit margin at the expense of the suppliers, with little to no discernible benefit for consumers.
Examples	• Due to underperformance of a certain product, a supplier agreed to a 50c discount for a supermarket so that the product could be put on promotion for customers. The supermarket decided not to run the promotion but kept the 50c reduction on all sales. The product continued to underperform and was ultimately delisted. • One supplier reported that all the products across a category were put on special by a supermarket and each supplier in the category was billed back their share of the discount, despite the suppliers not agreeing to this. No breakdown of sales was provided to suppliers and the cost was deducted from the suppliers' payment without agreement. • In one instance a supplier's product was continually put on "deep cut" promotions by a supermarket, which the supplier was forced to fund. The terms of supply between the parties stated that the supermarket did not have the right to unilaterally adjust or amend any part of the deal sheet submitted by the supplier. The supplier reported that the additional payments were crippling its business. The supermarket refused to relent and informed the supplier that it would not accept any new products unless further deep cut discounts were accepted. • Suppliers have reported a supermarket requiring that they use an Electronic Data Interchange, and later charging suppliers approximately $1000 per month for their use of it.
4.	**Refusing to pay agreed costs to suppliers**
Description of behaviour	• The terms of supply between suppliers and supermarkets frequently account for costs which the supermarket may owe the supplier.

	However, suppliers have reported that these agreed costs are often disputed by supermarkets or go unpaid.
Harm to businesses & consumers	• Non-payment of agreed costs can lead to cash flow issues when a supplier expected to receive payment but did not. There can be associated costs to a supplier relating to pursuing the unpaid amounts. This can often lead to greater uncertainty for suppliers who do not know when/if they will receive agreed payments.
Examples	• One supplier delivers to a supermarket daily. The supermarket would routinely claim that, as it had no physical proof of delivery (a "POD" form) that it did not have to pay for the products. This supplier at one stage had to write off approximately $5 million of payments after the supermarket claimed these products had not been delivered (due to lack of POD), even though they had. • Suppliers have reported that supermarkets often pay late but still take the early payment discount agreed in the terms.

5.	**Threatening or exacting "retribution" as a "negotiation" tactic**
Description of behaviour	• Suppliers have reported that supermarkets routinely threaten repercussions, including the cancelation of promotions, delistings, favouring competing suppliers, or using these measures as retribution for certain behaviour or responses, if the suppliers do not behave a certain way. • Often supermarkets follow through on these threats if the supplier attempts to negotiate or refuses to adhere with the supermarket's wishes. • Clause 16 of the FGCC prohibits retailers from requiring payment for better shelf space positioning. Clause 19 provides rules as to when retailers may de-list a product, and expressly states that "delisting as a punishment for a complaint, concern or dispute raised by a supplier is not a genuine commercial reason." Clause 26 provides that retailers must not threaten a supplier with business disruption without reasonable grounds.
Harm to businesses & consumers	• When threats such as these can be used by supermarkets at will, suppliers' bargaining power is significantly weakened. Such threats can carry real consequences for suppliers – for example, over 60% of all sales in New Zealand are made while products are on promotion; exclusion from promotions or catalogues can have a major impact on sales. • Threats to de-list also create uncertainty and impact on businesses' ability to plan for the future, including new product development. • When the supermarkets follow through on these threats, there can be a flow-on harm to consumers in the form of reduced choice,

	reduced innovation and new product development, and the missed opportunity of lower prices when products are not promoted.
Examples	• A supplier of food grocery products was told by a supermarket that, unless prices were lowered in one category, all of its products in another category would be moved to the bottom shelf. This threat was eventually followed through and the supplier lost a significant volume of sales. • A supplier was told by supermarket staff that it would face “repercussions” if it continued to pursue a price increase (which was needed in light of increased input costs), including suggestions it could affect ranging or lead to the supplier being dropped from some stores. • A supermarket demanded a price decrease from a supplier, citing a competing supermarket supplying the supplier’s products at a lower price. The supplier explained that this was because the competing supermarket was willing to accept a lower margin, and that it could not control the competing supermarket’s prices. When the supplier refused the price decrease, the supermarket responded by reducing shelf facings and decreasing catalogue exposure for all of the supplier’s products, rejecting new product development and excluding the supplier’s products from promotions.
6.	**A general culture of bullying, intimidation and retribution**
Description of behaviour	• Many suppliers express a fear of dealing with supermarkets, due to the far reaching and material potential repercussions of negotiating or raising concerns regarding supermarkets.
Harm to businesses & consumers	• Suppliers are extremely fearful of damaging their relationship with supermarkets due to the impact that this could have on their business. • This concern is even more material for businesses that deal with supermarkets operating in both New Zealand and Australia. The benefits of raising concerns with or resisting such supermarkets must be weighed with the real risk of having their business affected both in New Zealand and Australian markets.
Examples	• One supplier reported that, in the course of a negotiation, a supermarket staff member threw a pen that hit the supplier’s staff member. • One supplier reported that, in the course of a negotiation, it was chastised by a supermarket for attempting to elevate issues to senior management level. • Many suppliers have described their interactions with supermarkets as “bullying” and “intimidating.”

F. Specific answers to Discussion Paper questions

1. What types of unfair business-to-business contract terms are you aware of, if any? How common are these?
We refer to the examples given in our table above.
2. What impact, if any, do these unfair contract terms have?
We refer to the examples given in our table above.
3. Is government intervention to address unfair business-to-business contract terms justified? Why/why not?
Yes - we refer to the examples given in our table above, as well as paragraphs 18-26 above.
4. What types of unfair business-to-business conduct are you aware of, if any? How common is this type of conduct?
We refer to the examples given in our table above.
5. What impact, if any, does this conduct have?
We refer to the examples given in our table above.

6. Is government intervention to address unfair business-to-business conduct beyond existing legislative protections justified? Why/why not?
Yes – refer to paragraphs 18-26 above.
7. What types of unfair business-to-consumer conduct are you aware of, if any? How common is this type of conduct?
We note that this submission focuses on business-to-business conduct.
8. What impact, if any, does this conduct have?
See answer to Question 7.
9. Is government intervention to address unfair business-to-consumer conduct beyond existing legislative protections justified? Why/why not?
See answer to Question 7.
10. Do you agree with our proposed high-level objectives and criteria for assessing any potential changes to the regulatory framework governing unfair practices? If not, why not?
We agree with the high-level objectives but note that Criterion 3 needs to recognise accepted competition rules as well as the reality of the market structure in New Zealand. The proposed measures are not particularly prescriptive regulation and do not propose a departure from commercial norms.
11. Should a high-level prohibition against unfair conduct be introduced? Why/why not?
Yes – refer to our discussion above.
12. What are the advantages and disadvantages of Options 1A, 1B, and 1C (Refer to Annex 1 for more information)? Which option, if any, do you support?
The NZFGC also submitted in favour of adopting a prohibition on unconscionable conduct in 2016 in response to MBIE's *Targeted Review of the Commerce Act 1986* (attached as **Appendix A**). In that submission our position was (and remains) that a prohibition on unfair conduct should align with the analogous prohibition in the Australian Consumer law (ie Option 1A). Given that many of our laws are based on the Australian laws and the desire for Single Economic Market harmonisation, this option is attractive. In addition, we note that: • Option 1A was considered in 2012 for inclusion in the *Consumer Law Reform Bill*. The Commerce Committee decided, "it is prudent to wait until Australia has developed a body of authoritative case law on the matter before following suit."[104] As there is now Australian case law, there are grounds to revisit this. • The Commission can send "warning letters" regarding compliance with the FTA. The threat of these letters, including the possible associated reputational damage, can deter prohibited behaviour. • The test may still be hard to prove – "unconscionability" is a high standard. If the Australian approach of not defining "unconscionable" was followed, we would likely

[104] See Explanatory Note of the Consumer Law Reform Bill: http://www.legislation.govt.nz/bill/government/2011/0287/21.0/DLM4777800.html

adopt the Australian interpretation ie "unconscionable" conduct is more than "unfair" and must be "against conscience as judged against the norms of society."[105] • For example, in 2016 the Federal Court ruled that Woolworths' requests for urgent payments ranging from $4,291 to $1.4 million from suppliers were not "unconscionable." The Court found that, in the context of a retailer / supplier relationship where similar requests had been made before, that Woolworths' conduct was not "unconscionable."[106] • While it still may be difficult to prove a breach, the existence of the prohibition alone might impact business behaviour. Over time the NZFGC has noted a marked improvement in supermarket/supplier relations in the period following instances where abuses of supermarket buyer power have been raised by NZ politicians (eg Shane Jones MP's 2014 speech in the House of Representatives) or investigated by the Commission (eg the Commission's 2014 investigation into whether Progressive Enterprises may have breached the Fair Trading Act 1986 or Commerce Act 1986).
13. If unconscionable conduct were prohibited (Option 1A), should a definition of unconscionability be included in statute, and if so, how should it be defined?
See answer to question 12.
14. Is it appropriate to require businesses to act in good faith (as per Option 1C – see Annex 1)? Are there situations in which doing so could have negative economic outcomes?
See answer to question 12.
15. Are there any other variations on Option 1 that we should consider?
No.
16. If a version of Option 1 is selected, should it also extend to matters relating to the contract itself?
See answer to question 12.
17. Should any protection against unfair conduct apply to consumers only, consumers and some businesses (and if so, which ones?), or all consumers and businesses?
All consumers and businesses. See paragraph 20 above – in many contexts imbalance in bargaining power can exist between two sophisticated, similarly sized businesses.
18. If the UCT protections are extended to businesses, do you agree that the current consumer UCT provisions should be carried over without major changes? If not, why not?
Yes.
19. If the UCT protections are extended to businesses, should the FTA's 'grey list' for consumer UCTs be carried over 'as is'? Are there any existing examples of unfair terms that should be removed from the list, or any new examples that should be added?
The current FTA 'grey list' is largely analogous (except for one provision) to the corresponding 'grey list' in Australian Consumer Law, which was not changed when the

[105] See: https://www.accc.gov.au/business/anti-competitive-behaviour/unconscionable-conduct
[106] *Australian Competition and Consumer Commission v Woolworths Limited* [2016] FCA 1472

Australian UCT regime was expanded in November 2016. In our view, carrying the 'grey list' over as is provides a useful starting point for determining if a term is a UCT, but is not exhaustive (ie a term that is not on the 'grey list' may still be declared a UCT)
20. Should the protections against UCTs apply to consumers only (as at present), consumers and some businesses (and if so, which ones?), or all consumers and businesses?
The NZFGC considers that protections against UCTs should apply to all consumers and some businesses. We note that: • This option has the benefit of harmonisation with Australia and could build on New Zealand's existing UCT regime. • This option could help prevent prohibitive or unbalanced terms of trade being imposed on suppliers. • Under the current UCT regime the CC undertakes industry "reviews" of SFCCs in different sectors. These reviews have arguably been effective in compelling businesses to change terms in gym contracts, telecommunications contracts and energy retail contracts. A review of B2B contracts in the grocery retail sector could have a similar effect.
21. If the protections against UCTs are extended to businesses, should a transaction value threshold be introduced, above which the protections do not apply? If so, what should the threshold be?
Yes, A transaction value threshold would be analogous with the Australian regime where the "upfront price payable" under the contract is no more than $300,000, or $1 million if the contract is for more than 12 months.
22. Should there be penalties for breaching any new provisions regarding UCTs, and should there be civil remedies available, even if unfair terms have not previously been declared by a court to be unfair? How should any penalties and remedies be designed?
Yes, there should be penalties for breaching any new provisions regarding UCTs and civil remedies should be available. The penalties and remedies should be analogous with the Australian regime.
23. Are there other options to address unfair conduct or unfair contracts that we should consider? If so, what are these?
No.
24. Do you have a preferred options package? If so, which is your preferred package, and why?
The NZFGC supports Options Package 4 because there is no "one size fits all" solution to reducing the harm caused by abuses of buyer power - the best solution is a suite of complementary measures. The measures put forward in Options Package 4, if enacted, would strengthen New Zealand's competition and consumer law regime in that regard. For this reason the NZFGC also intends to submit in favour of amending section 36 of the Commerce Act in response to the Section 36 Discussion Paper. A commentator recently made this point in relation to the introduction of the FGCC, stating the FGCC *"was not seen as a complete solution to the problem of asymmetric bargaining power and the conduct to which it gives rise or that is, as a response to the exclusion of*

other possible responses and remedies." Instead, the FGCC was intended, *"to supplement and possibly bolster other relevant avenues under the Competition and Consumer Act 2010, specifically the provisions relating to misuse of market power, unconscionability and unfair contract terms."*[107] The NZFGC submits that the enactment of the measures in Options Package 4 would represent a definitive statement from the New Zealand Government about what kind of behaviour is acceptable, with the potential to improve our trading environment permanently. It may also embolden suppliers to raise concerns, complain or bring causes of actions regarding supermarket conduct where previously they may not have considered this a viable option.
25. Do you agree with our assessment of the impact of each package against the criteria? If not, why not? Do you have any further evidence on the costs and benefits of this option?
The NZFGC is aware of multiple multinational food manufacturers which have ceased production (or are contemplating ceasing production) in New Zealand. While factors such as globalisation and rising minimum wages have also contributed to this, the difficulties suppliers encounter when dealing with New Zealand's supermarkets have undoubtedly also played a part. The prevailing attitude is increasingly that New Zealand is not a place where fast-moving consumer goods can be profitably manufactured.

[107] *Codifying Supermarket-Supplier Relations,* para. 11.

APPENDIX A

NZFGC submission on the Targeted Review of the Commerce Act 1986 (dated 10 February 2016)[108]

NEW ZEALAND FOOD & GROCERY COUNCIL

10 February 2016

Targeted Commerce Act Review
Competition and Consumer Policy
Ministry of Business, Innovation and Employment
PO Box 1473
WELLINGTON

Email: commerceact@mbie.govt.nz

Dear Sir/Madam

Please find attached the submission that the New Zealand Food & Grocery Council wishes to present on the MBIE Issues paper *Targeted Review of the Commerce Act 1986* dated November 2015.

In summary we are in favour of the Commerce Commission having the same legal powers as the ACCC to give it greater ability to address potential future abuses should they arise and to ensure greater trans-Tasman alignment.

Please let me know if you have any questions.

Yours sincerely

[108] Can be accessed at: https://www.mbie.govt.nz/dmsdocument/2318-food-grocery-council-redacted-targeted-review-commerce-act-phase-one-submission-pdf

Targeted Review of the Commerce Act 1986: Issues Paper

Submission by the New Zealand Food and Grocery Council

10 February 2016

NEW ZEALAND FOOD & GROCERY COUNCIL

1. The New Zealand Food & Grocery Council (FGC) welcomes the opportunity to comment on the Ministry's *Targeted Review of the Commerce Act 1986: Issues Paper* of November 2015.

2. The FGC represents the major manufacturers and suppliers of food, beverage and grocery products in New Zealand. This sector generates over $34 billion in the New Zealand domestic retail food, beverage and grocery products market, and over $28 billion in export revenue from exports to 185 countries – some 61% of total merchandise exports. Food and beverage manufacturing is the largest manufacturing sector in New Zealand, representing 46% of total manufacturing income and 34% of all manufacturing salaries and wages. Our members directly or indirectly employ 370,000 people – one in five of the workforce.

OVERARCHING COMMENTS

3. The FGC wishes to focus its comments in this submission solely on the supermarket sector. Supermarkets are the main customers of our suppliers.

4. New Zealand has one of the most concentrated supermarket sectors in the world. Supermarkets wield substantial bargaining power over their suppliers. The FGC is concerned that in some instances supermarkets are using their bargaining power in a way that has the potential to harm the viability of a vibrant and competitive supplier market to the detriment of consumers.

5. Given:

   (a) the fact that there are only, effectively, two supermarket chains in New Zealand;

   (b) the behaviour exhibited by supermarkets towards suppliers in other parts of the world – where the market concentration is <u>less than</u> New Zealand; and

   (c) the admissions and allegations by and against the two major supermarket players in Australia (see paras 17-19),

   it is not unreasonable to conclude either that such conduct takes place in New Zealand (which goes unreported because of fear of consequences) or that there is fertile ground for such conduct in the future.

6. Supermarket conduct of this nature towards suppliers is against the long-term interests of consumers. Supermarkets' constant demands for lower supplier prices, coupled with supermarkets passing excessive risk and unexpected costs on to their suppliers, means that suppliers have no incentive to invest or to innovate. In the long term, consumers will face higher prices and less choice.

7. Under the status quo, s 36 of the Commerce Act is not operating to address abuses of market power in the supermarket sector. Such abuses by supermarkets have recently been referred to by the Australian Federal Court as "contrary to conscience", and significant penalties of A$10m have been imposed for that conduct in Australia already against Coles. In those proceedings, the ACCC chose to base its claim on a breach of Australia's unconscionability standard, rather than a breach of the Australian equivalent of s 46. The ACCC has recently initiated proceedings against Woolworths in relation to its treatment of suppliers under this unconscionability standard.

8. The FGC supports a move to an "effects test" and the removal of the "taking advantage" element in s 36, as well as the proposal to grant the Commerce Commission the power

to undertake market studies. The FGC is neutral on the alternative enforcement mechanisms identified in the Issues Paper.

9. However, the FGC is concerned that the proposals put forward by the Ministry in its Issues Paper do not go far enough to address potential abuses of market power in the supermarket sector. In response to Q20 of the Issues Paper, the FGC recommends that the Ministry also considers the introduction of an unconscionability provision and a supermarket code of conduct – both of which exist in other countries, including Australia. This would further harmonise the Trans-Tasman business environment, bring the powers of the Commerce Commission closer to those of the ACCC and provide more certainty for all involved in business trans-Tasman. Giving the Commerce Commission the same legal powers as the ACCC would give the regulator greater powers to address potential future abuses should they arise.

10. These overarching comments are expanded upon below. Answers to relevant questions posed in the Issues Paper are detailed in the attached **Appendix 1**.

SPECIFIC COMMENTS

New Zealand supermarket sector is highly concentrated

11. Around the world, consumers buy the vast majority of their groceries at supermarkets. In most countries the number of large supermarket chains can be counted on one hand. As a result, food suppliers are reliant on sales agreements with a handful of supermarket chains to get their produce into the pantries and onto the tables of consumers.

12. The New Zealand supermarket industry is among the most concentrated in the world. The two supermarket giants, Progressive Enterprises Limited (**PEL**) and Foodstuffs, collectively hold 96% of the supermarket retail market in New Zealand. By comparison:

    (a) In Australia, Coles and Woolworths hold a combined market share of 70%;[1]

    (b) In the United Kingdom, the top <u>four</u> supermarkets hold a combined market share of 72%;[2] and

    (c) In Canada, the top <u>three</u> supermarkets hold a combined market share of 63.4%.[3]

Supermarket conduct towards suppliers causes concern around the world

13. Because suppliers rely on selling their produce through supermarkets, there is a substantial imbalance of bargaining power between suppliers and supermarkets. Suppliers cannot risk losing a commercial relationship with a supermarket chain, given the high concentration of the supermarket industry in this country. Losing one customer can often be a matter of commercial survival.

14. Supermarkets can and do take advantage of their bargaining power. Supermarket supply chain practices have attracted the attention of competition regulators in New Zealand and internationally.

New Zealand

15. In New Zealand, the FGC has for many years fielded complaints and expressions of concern from its supplier-members about the behaviour of New Zealand supermarkets

1 Roy Morgan Single Source (Australia), April 2006 - March 2015.
2 Market share of grocery stores in Great Britain for the 12 weeks ending October 11th, 2015 <www.statista.com>.
3 Distribution of the supermarket and grocery store industry in Canada from 2010 to 2015, by market share <www.statista.com>.

that goes beyond usual robust business dealings. This behaviour mirrors that experienced in the other jurisdictions referred to in this submission.

Australia

16. In Australia the ACCC has been very active on these matters. It investigated and prosecuted allegations of unconscionable conduct by supermarket giant Coles. The conduct investigated was very similar to the complaints received in the past by the FGC. The Australian investigation led to Coles paying penalties of A$10 million in 2014 for unconscionable conduct towards its suppliers.[4] That conduct by Coles included the following:

   (a) Coles implemented an Active Retail Collaboration (ARC) program. When suppliers declined to pay the ARC rebate, Coles threatened that this would impact on Coles' decision about the ranging of the supplier's products; that Coles would not acquire new products from the supplier; that Coles would not provide the supplier with information it had previously been supplied with; and that it risked losing Coles' promotional activity for that supplier's products.

   (b) Coles demanded payments for purported profit gaps where this had not been previously agreed between suppliers and Coles.

   (c) Coles demanded retrospective payments for waste.

   (d) Coles required payment for late delivery where this had not been previously agreed with the supplier.

   (e) Coles imposed penalties for short deliveries of a supplier's product without prior agreement.

17. At the heart of the proceedings against Coles was a finding by the Court that Coles had a substantially stronger bargaining position relative to its suppliers; that Coles did not disclose sufficient information to suppliers; and that Coles exerted undue pressure and unfair tactics on suppliers.[5] Justice Gordon of the Federal Court noted:

> "Coles' misconduct was serious, deliberate and repeated. Coles misused its bargaining power. Its conduct was 'not done in good conscience'. **It was contrary to conscience. Coles treated its suppliers in a manner not consistent with acceptable business and social standards which apply to commercial dealings.** Coles demanded payments from suppliers to which it was not entitled by threatening harm to the suppliers that did not comply with the demand. Coles withheld money from suppliers it had no right to withhold."[6]
>
> "Coles' practices, demands and threats were **deliberate, orchestrated and relentless.**"[7]
>
> "Coles' conduct was of a kind which merits severe penalty. But for Coles making the admissions it has now made and acknowledging the gravity of its contravening conduct, the conduct and circumstances in which it was committed would have warranted imposing penalties at or close to the maximum the law permits".[8] [emphasis added]

18. In December 2015, the ACCC initiated proceedings against Woolworths for unconscionable conduct towards its suppliers. The ACCC alleges that Woolworths had developed a strategy to increase its profit performance by requiring "Mind the Gap" payments from suppliers.

4 *ACCC v Coles Supermarkets Australia Pty Ltd* [2014] FCA 1405.
5 See for example *ACCC v Coles* at [44], [50], [56], [62].
6 At [1].
7 At [201].
8 At [2].

> "The ACCC alleges that Woolworths had been seeking to urgently reduce what it anticipated would be a substantial profit shortfall by demanding payments from suppliers in its management-backed "Mind the Gap" programme.
>
> *"The ACCC alleges that, in accordance with the Mind the Gap scheme, Woolworths's category managers and buyers contacted a large number of the Tier B suppliers and asked for payments from those suppliers for amounts which included payments that range from A$4291 to A$1.4 million to "support" Woolworths.*
>
> *"Not agreeing to a payment would be seen as not "supporting" Woolworths"*, the watchdog said in a statement. It claimed that Woolworths sought approximately A$60.2 million from 821 suppliers through the scheme and ultimately netted A$18.1 million.
>
> *"The ACCC alleges that Woolworth's conduct in requesting the Mind the Gap payments was unconscionable in all the circumstances"* [ACCC chairman Rod Sims] said.
>
> *"A common concern raised by suppliers relates to arbitrary claims for payments outside of trading terms by major supermarket retailers. It is difficult for suppliers to plan and budget for the operation of their businesses if they are subject to such ad hoc requests".*[9]

The ACCC alleges that these requests were made in circumstances where Woolworths had a substantially stronger bargaining position to the suppliers, did not have a pre-existing contractual entitlement to seek the payments and either knew it did not have or was indifferent to whether it had a legitimate basis for requesting a Mind the Gap payment from the targeted suppliers.[10]

United Kingdom

19. In the United Kingdom, supermarket conduct towards suppliers has been reviewed in two reports by the Competition Commission, one in 2000 and one in 2008.[11] In the 2008 report, the Commission concluded that:

> Our review of emails between two grocery retailers (Asda and Tesco) and their suppliers during summer 2007, particularly our observations of their negotiating tactics, give the impression that Asda and Tesco have a strong position when negotiating with their suppliers. ... This may explain, for example, observations such as a supplier providing product at below cost or paying for promotions proposed by a retailer that would otherwise be difficult to explain.[12]

20. Over the course of their investigation, the Commission found that one-third to one-half of suppliers experience practices from supermarkets such as payment delays, excessive payments for customer complaints, and retrospective price adjustments.[13]

21. The Commission found that:

> Competition at the retail level leads grocery retailers to seek the best terms and conditions from their suppliers. The possession of buyer power by a grocery retailer allows grocery retailers to extract lower prices from suppliers than would otherwise be the case, and consumers benefit as a result of these lower wholesale prices being reflected in lower retail prices. **However, when, in the hope of gaining a competitive advantage, grocery retailers transfer excessive risks or unexpected costs to their suppliers through practices involving retrospective adjustments to supply agreements or giving rise to moral hazard on the part of the grocery retailer, this is likely to lessen suppliers' incentives to invest in new capacity, products and production processes. If unchecked, these practices, which are essentially a side-effect of competition between grocery retailers with buyer power, will be detrimental to the interests of consumers.**[14] [emphasis added]

9 Food Navigator Asia "Woolworths repeats 'Mind the Gap' demand while drawing heat from ACCC" <www.foodnavigator-asia.com> (16 December 2015).
10 "ACCC takes action against Woolworths for alleged unconscionable conduct towards supermarket suppliers" <www.accc.gov.au> (10 December 2015).
11 Competition Commission *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom* (2000); Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008).
12 Competition Commission *The supply of groceries in the UK market investigation* at [9.20]
13 At [9.60].
14 At [9.41].

Canada

22. Supermarket conduct towards suppliers came to the attention of the Canadian Competition Bureau in the context of a proposed acquisition. Loblaw, Canada's largest grocery chain, proposed to acquire Shoppers Drug Mart Corporation, Canada's largest drugstore chain. The Bureau took the view that the acquisition would increase Loblaw's market power vis-à-vis suppliers. According to the Bureau, this would lead to a substantial lessening or prevention of competition, higher wholesale prices for other retailers, and potentially higher prices for consumers.

In March 2014 the Competition Bureau reached a Consent Agreement with Loblaw to preserve competition in the market for the retail sale of pharmacy products and drugstore-type merchandise in Canada.[15] The Consent Agreement prohibited certain conduct by Loblaw towards its suppliers that the Bureau considered would reduce competition. This included agreements with suppliers that required suppliers to compensate Loblaw for a pre-determined profit margin; charging penalties related to short deliveries; and charging new supply chain penalties and fees to suppliers that supplied less than $4 million of products to Loblaw. The Agreement additionally required that Loblaw ensure that supply agreements are provided to suppliers in writing.

Section 36 currently inadequately addresses this conduct

23. Section 36 of the Commerce Act as it currently stands is not working to prevent supply chain practices by supermarkets of the kind referred to above that will have a long-term negative impact on prices and consumer choice. It is no coincidence that the ACCC relied on Australia's unconscionability provisions, and not the Australian equivalent to s 36, when bringing proceedings against Coles and Woolworths.

24. This is primarily because of the "purpose" element of s 36. Supermarkets' key driver is maximising revenue and profit. In the event that a supplier is treated badly, in most cases supermarkets will not have a purpose of restricting entry by individual suppliers, preventing or deterring suppliers from engaging in competitive conduct, or eliminating them. But that does not mean this sort of conduct by supermarkets is appropriate – as the Australian Federal Court has noted, such conduct is still "contrary to conscience".

Section 36, even if amended, will not address this conduct

25. While the FGC believes that amending s 36 so as to remove the "taking advantage" element and to include an effects test will go some way to improving the efficacy of s 36 generally, the FGC does not consider it will address the conduct of concern by supermarkets.

26. Removing the "taking advantage" element on its own will not address these concerns, as the "purpose" element is still problematic as set out above. Nor will the introduction of an effects test provide a panacea. If the supermarkets treat all suppliers in a market equally (badly), there will not likely be a substantial lessening of competition in the market in which these suppliers operate since all suppliers will be impacted similarly.

Supermarket conduct towards suppliers is against the long-term interests of consumers

27. Supermarket conduct towards suppliers as detailed above is detrimental to the long-term interests of consumers.

28. The extra payments demanded by supermarkets, coupled with the supermarkets' drive for ever lower prices, place significant pressure on supplier businesses.[16] If suppliers

15 "Competition Bureau review of the Proposed Acquisition of Shoppers Drug Mart Corporation by Loblaw Companies Limited: Position Statement" <www.competitionbureau.gc.ca>.

16 See Consumers International "The relationship between supermarkets and suppliers: What are the implications for consumers?" (September 2012) at 10.

cannot continue in business as a result, consumers will suffer from less product choice and higher prices in the longer term.[17]

29. When excessive risks and unexpected costs are passed from supermarkets to suppliers, suppliers are less likely to invest in new capacity or production or to develop new products.[18]

30. In some instances, where supermarkets control the likelihood of a risk eventuating, transferring risk to suppliers creates a "moral hazard": shrinkage, for example, can be reduced by better supermarket security and accounting policies.[19] Passing that risk to the supplier means there is no incentive on the supermarket to minimise that risk. This prevents the development of most efficient practices. Another example of minimising risk might be requiring suppliers to essentially guarantee the margin for the retailer.

The Ministry should consider a broader range of remedies

31. The FGC notes at section 1.2 of the Issues Paper and at Q20 that the Ministry remains open to submissions on the scope of the Issues Paper and other potential options. The FGC submits that the Ministry should consider a broader range of remedies to address the abuse of buyer power by supermarkets – in particular the introduction of an unconscionability provision, and the adoption of a supermarket code of conduct. The FGC also supports a market studies power for the Commerce Commission as already identified in the Issues Paper.

The FGC supports the adoption of an unconscionability standard

32. The FGC supports the introduction of an unconscionability standard as an avenue for addressing conduct that is unfair but that may not be caught within the current and proposed drafting of section 36 of the Commerce Act.

33. In Australia, sections 20-22 of the Australian Consumer Law[20] prohibit unconscionable conduct in trade or commerce. Those provisions are provided in the attached **Appendix 2**. Introducing a similar unconscionability standard into New Zealand law would bring us into closer alignment with Australia.

34. The Australian experience has shown that a statutory prohibition on unconscionable conduct is a greatly more effective way to control abuses of market power by supermarkets. It was successfully invoked by the ACCC against Coles and has subsequently been invoked against Woolworths.

35. An unconscionable conduct provision would ensure that those who benefit from an imbalance in bargaining power, would not be able to take advantage of that imbalance in a way that is contrary to conscience. It would provide a legal avenue for redress for suppliers who suffer as a result of such practices.

The FGC supports the adoption of a supermarket code of conduct

36. A supermarket code of conduct would help ensure that supermarkets treat their suppliers fairly. It would be a proactive and holistic approach to abuses of market power in the supermarket sector.

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17 At 13 – 14.

18 The UK Competition Commission concluded that investment and innovation by suppliers had been negatively impacted by supermarkets' supply chain practices: Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008) at [9.85]; Consumers International "The relationship between supermarkets and suppliers: What are the implications for consumers?" (September 2012) at 14.

19 Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008) at [9.47].

20 Competition and Consumer Act 2010 (Cth), Schedule 2.

37. In drafting and implementing a code of conduct, examples of codes of conduct that are already in place include the Australian Food and Grocery Code of Conduct and the United Kingdom's Groceries Supply Code of Practice. Both the Australian and UK Codes:

(a) Require grocery retailers to deal with suppliers fairly and lawfully;[21]

(b) Set out minimum obligations on grocery retailers when varying supply agreements;[22]

(c) Establish minimum standards of conduct by grocery retailers when dealing with suppliers, such as for payment, de-listing, and allocation of shelf space;[23]

(d) Require grocery retailers to provide staff training on Code compliance;[24] and

(e) Set out a dispute resolution mechanism.[25]

38. The FGC notes that the Australian Code has come under some criticism by suppliers.[26] Key criticisms include that it is voluntary; it does not include penalties for breach; it does not include any investigatory powers or the ability for suppliers to make an anonymous complaint; and it allows retailers to ask suppliers to agree to things that would otherwise be prohibited. The ACCC has already expressed concerns that supermarkets in Australia have not been complying with the Code.[27]

39. In light of this, the FGC submits that the United Kingdom approach to the Supermarket Code is the preferable way to go. Learning from the United Kingdom approach, a New Zealand code of conduct could:

(a) Apply mandatorily to large supermarkets, as determined by annual turnover;[28]

(b) Require supermarkets to appoint in-house code compliance officers and run code compliance programmes, including an annual compliance audit;[29]

(c) Establish an independent Ombudsman with responsibility for monitoring and enforcing the Code, including powers to receive anonymous complaints and investigate alleged breaches, and to initiate investigations itself to determine whether supermarkets are complying with the Code either generally or in respect of particular grocery items;[30] and

(d) Introduce penalties imposable by an Ombudsman for breach of the Code, alongside compensation orders.[31]

40. The FGC believes that the establishment of an independent Ombudsman is particularly important. In its 2008 report, the UK Competition Commission recognised that enforcement of the code could not rely on suppliers coming forward with complaints.

21 Food and Grocery Code of Conduct (Aus), para 28; Groceries Supply Code of Conduct (UK), para 2.
22 Food and Grocery Code of Conduct (Aus), para 7-10; Groceries Supply Code of Conduct (UK), para 3.
23 Food and Grocery Code of Conduct (Aus), Part 3; Groceries Supply Code of Conduct (UK), para 5
24 Food and Grocery Code of Conduct (Aus), para 28; The Groceries (Supply Chain Practices) Market Investigation Order 2009 (UK).
25 Food and Grocery Code of Conduct (Aus), Part 5; The Groceries (Supply Chain Practices) Market Investigation Order 2009 (UK).
26 Farm Weekly "Grocery Code faces its critics" (6 March 2015); Business Spectator "Why the ACCC is hounding Coles" (21 October 2014).
27 "ACCC concerned over implementation of the Food and Grocery Code" <www.accc.gov.au> (24 September 2015)
28 See Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008) at [11.276] – [11.290].
29 At [11.322] – [11.326].
30 At [11.332] – [11.376].
31 At [11.370] – [11.371]

Suppliers were not willing to identify themselves to the regulator for fear of consequences for their relationship with supermarkets.[32]

41. The same considerations apply in New Zealand. The Ombudsman should be able to receive anonymous complaints, as a form of information-gathering; and should be given powers to enable it to gain access to necessary information from affected parties.

The FGC also supports a market studies power for the Commerce Commission

42. A market studies power would have significant advantages over the current competition law enforcement mechanisms in the supermarket sector. It would allow the Commerce Commission to proactively investigate the supermarket industry (and other industries) when it becomes aware of concerns about practices in that industry.

43. Market studies are a common feature of competition authorities' toolkits internationally.[33] Notably, a number of jurisdictions have undertaken market studies into the grocery retail sector.[34]

44. The Commission's mandatory investigation powers under s 98 and s 98A should be available to the Commission when conducting market studies. This is particularly important in the supermarket sector, as the imbalance of bargaining power between suppliers and supermarkets means that suppliers are unwilling to bring a complaint to the Commission, or to give evidence to the Commission under a voluntary process. It will also allow the collection of evidence from other parties, such as the supermarkets themselves.

45. The Commission should be given the power to fashion a remedy to address any current or emergent competition concerns, and to that end should be able to make a broad range of recommendations at the end of a market studies investigation. We note, for instance, that at the end of its 2008 investigation into supermarkets the UK Competition Commission recommended a suite of remedies ranging from changes to planning regulations to the implementation of the Groceries Supply Code of Practice.[35]

46. The Government should be required to respond to any recommendations the Commission makes in the course of undertaking market studies.

32 At [11.350].
33 International Competition Network *Market Studies Project Report* June 2009.
34 In the United Kingdom: Competition Commission *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom* (2000); Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008).
In the United States: Federal Trade Commission *Slotting Allowances in the Retail Grocery Industry* (1 November 2003).
In Australia: Australian Competition and Consumer Commission *Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries* (July 2008).
In Norway: Nordic Competition Authorities *Nordic Food markets: A Taste for Competition* (November 2005); Norwegian Inquiry Commission for the Power Relations in the Food Supply Chain *The powerful and the powerless in the food supply chain* (April 2011)..
In Italy: Competition Authority *Report on the Distribution of Fruit and Vegetables* (June 2007).
In Austria: *Report on Food Distribution Sector* (June 2007).
35 Competition Commission *The supply of groceries in the UK market investigation* (30 April 2008).

APPENDIX 1 – RESPONSES TO SPECIFIC QUESTIONS IN THE ISSUES PAPER

Q20 Are there any other potential options that the Ministry should consider?

1. The Ministry should consider the introduction of a statutory prohibition on unconscionable conduct, as discussed above at [32] to [35].

2. The Ministry should consider the introduction of a compulsory Supermarket Code of Conduct, as discussed above at [36] to [41].

Q45 Do the approaches to market studies described in the Issues Paper align with a gap in New Zealand's institutional settings for promoting competition?

3. As discussed above at [42] to [46], the FGC believes that there is a need for a market studies power as described in the Issues Paper.

Q46 What procedural settings for a market studies power would best fit the identified gap, in terms of:

a. Who may initiate a market study;

4. The FGC believes that market studies should be able to be initiated by the body conducting the market study (the Commerce Commission), or at the request of the Government.

b. Who should conduct market studies;

5. Market studies should be conducted by the Commerce Commission. This is consistent with international practice.

c. Whether mandatory information-gathering powers would apply;

6. As discussed above at [44], the Commission's mandatory information-gathering powers should apply to market studies.

d. The nature of recommendations the market studies body could make; and

7. The Commission should be given the power to make broad and wide-ranging recommendations, so that the Commission is effectively able to design a remedy to any identified problems. This is discussed above at [45].

e. Whether the government should be required to respond.

8. The Government should be required to respond to any recommendations made by the Commerce Commission as a result of a market study.

APPENDIX 2 – UNCONSCIONABILITY PROVISIONS IN AUSTRALIAN CONSUMER LAW

20 Unconscionable conduct within the meaning of the unwritten law

(1) A person must not, in trade or commerce, engage in conduct that is unconscionable, within the meaning of the unwritten law from time to time.

Note: A pecuniary penalty may be imposed for a contravention of this subsection.

(2) This section does not apply to conduct that is prohibited by section 21.

21 Unconscionable conduct in connection with goods or services

(1) A person must not, in trade or commerce, in connection with:

(a) the supply or possible supply of goods or services to a person (other than a listed public company); or

(b) the acquisition or possible acquisition of goods or services from a person (other than a listed public company);

engage in conduct that is, in all the circumstances, unconscionable.

(2) This section does not apply to conduct that is engaged in only because the person engaging in the conduct:

(a) institutes legal proceedings in relation to the supply or possible supply, or in relation to the acquisition or possible acquisition; or

(b) refers to arbitration a dispute or claim in relation to the supply or possible supply, or in relation to the acquisition or possible acquisition.

(3) For the purpose of determining whether a person has contravened subsection (1):

(a) the court must not have regard to any circumstances that were not reasonably foreseeable at the time of the alleged contravention; and

(b) the court may have regard to conduct engaged in, or circumstances existing, before the commencement of this section.

(4) It is the intention of the Parliament that:

(a) this section is not limited by the unwritten law relating to unconscionable conduct; and

(b) this section is capable of applying to a system of conduct or pattern of behaviour, whether or not a particular individual is identified as having been disadvantaged by the conduct or behaviour; and

(c) in considering whether conduct to which a contract relates is unconscionable, a court's consideration of the contract may include consideration of:

(i) the terms of the contract; and

(ii) the manner in which and the extent to which the contract is carried out;

and is not limited to consideration of the circumstances relating to formation of the contract.

22 Matters the court may have regard to for the purposes of section 21

(1) Without limiting the matters to which the court may have regard for the purpose of determining whether a person (the ***supplier***) has contravened section 21 in connection with the supply or possible supply of goods or services to a person (the ***customer***), the court may have regard to:

(a) the relative strengths of the bargaining positions of the supplier and the customer; and

(b) whether, as a result of conduct engaged in by the supplier, the customer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; and

(c) whether the customer was able to understand any documents relating to the supply or possible supply of the goods or services; and
(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the customer or a person acting on behalf of the customer by the supplier or a person acting on behalf of the supplier in relation to the supply or possible supply of the goods or services; and
(e) the amount for which, and the circumstances under which, the customer could have acquired identical or equivalent goods or services from a person other than the supplier; and
(f) the extent to which the supplier's conduct towards the customer was consistent with the supplier's conduct in similar transactions between the supplier and other like customers; and
(g) the requirements of any applicable industry code; and
(h) the requirements of any other industry code, if the customer acted on the reasonable belief that the supplier would comply with that code; and
(i) the extent to which the supplier unreasonably failed to disclose to the customer:
   (i). any intended conduct of the supplier that might affect the interests of the customer; and
   (ii). any risks to the customer arising from the supplier's intended conduct (being risks that the supplier should have foreseen would not be apparent to the customer); and
(j) if there is a contract between the supplier and the customer for the supply of the goods or services:
   (i). the extent to which the supplier was willing to negotiate the terms and conditions of the contract with the customer; and
   (ii). the terms and conditions of the contract; and
   (iii). the conduct of the supplier and the customer in complying with the terms and conditions of the contract; and
   (iv). any conduct that the supplier or the customer engaged in, in connection with their commercial relationship, after they entered into the contract; and
(k) without limiting paragraph (j), whether the supplier has a contractual right to vary unilaterally a term or condition of a contract between the supplier and the customer for the supply of the goods or services; and
(l) the extent to which the supplier and the customer acted in good faith.

(2) Without limiting the matters to which the court may have regard for the purpose of determining whether a person (the ***acquirer***) has contravened section 21 in connection with the acquisition or possible acquisition of goods or services from a person (the ***supplier***), the court may have regard to:
(a) the relative strengths of the bargaining positions of the acquirer and the supplier; and
(b) whether, as a result of conduct engaged in by the acquirer, the supplier was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the acquirer; and
(c) whether the supplier was able to understand any documents relating to the acquisition or possible acquisition of the goods or services; and
(d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the supplier or a person acting on behalf of the supplier by the acquirer or a person acting on behalf of the acquirer in relation to the acquisition or possible acquisition of the goods or services; and
(e) the amount for which, and the circumstances in which, the supplier could have supplied identical or equivalent goods or services to a person other than the acquirer; and
(f) the extent to which the acquirer's conduct towards the supplier was consistent with the acquirer's conduct in similar transactions between the acquirer and other like suppliers; and
(g) the requirements of any applicable industry code; and

(h) the requirements of any other industry code, if the supplier acted on the reasonable belief that the acquirer would comply with that code; and
(i) the extent to which the acquirer unreasonably failed to disclose to the supplier:
  (i). any intended conduct of the acquirer that might affect the interests of the supplier; and
  (ii). any risks to the supplier arising from the acquirer's intended conduct (being risks that the acquirer should have foreseen would not be apparent to the supplier); and
(j) if there is a contract between the acquirer and the supplier for the acquisition of the goods or services:
  (i). the extent to which the acquirer was willing to negotiate the terms and conditions of the contract with the supplier; and
  (ii). the terms and conditions of the contract; and
  (iii). the conduct of the acquirer and the supplier in complying with the terms and conditions of the contract; and
  (iv). any conduct that the acquirer or the supplier engaged in, in connection with their commercial relationship, after they entered into the contract; and
(k) without limiting paragraph (j), whether the acquirer has a contractual right to vary unilaterally a term or condition of a contract between the acquirer and the supplier for the acquisition of the goods or services; and
(l) the extent to which the acquirer and the supplier acted in good faith.