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Statement of Preliminary Issues

Woolworths and Petstock

27 February 2023

Introduction

1. On 3 February 2023, the Commerce Commission registered an application (the Application) from Woolworths Group Limited (Woolworths) seeking clearance to acquire 55% of the shares in PETstock Pty Limited (PETstock[1]) (the Proposed Acquisition).[2]

2. The Commission will give clearance if it is satisfied that the Proposed Acquisition will not have, or would not be likely to have, the effect of substantially lessening competition in a market in New Zealand.

3. This Statement of Preliminary Issues sets out the issues we currently consider to be important in deciding whether or not to grant clearance.[3]

4. We invite interested parties to provide comments on the likely competitive effects of the Proposed Acquisition. We request that parties who wish to make a submission do so by **13 March 2023**.

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

The parties

The applicant - Woolworths

6. In New Zealand, Woolworths operates a national supermarket business through Woolworths New Zealand Limited (WWNZ) and its subsidiaries. It supplies grocery products through its wholly-owned Countdown and Metro supermarkets, its franchised FreshChoice and SuperValue stores, and online.[4]

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1 The Application defines PETstock Pty Limited as "PG" rather than "PETstock".
2 A public version of the Application is available on our website at: http://www.comcom.govt.nz/business-competition/mergers-and-acquisitions/clearances/clearances-register/.
3 The issues set out in this statement are based on the information available when it was published and may change as our investigation progresses. The issues in this statement are not binding on us.
4 The Application at [7.8].

7. Woolworths has also recently established a grocery wholesale business called New Zealand Grocery Wholesale, through which it wholesales grocery products to third party retailers.[5]

8. Relevant to this Application, WWNZ supplies a range of pet products, including food, accessories and healthcare products in its Countdown and Metro stores, its franchised SuperValue and FreshChoice stores and through its online grocery offering (including on the myCountdown app).[6]

The target - PETstock

9. PETstock is a specialty retailer of pet products, including wide ranges of pet food, cat litter, pet accessories and pet health products, together with advice and related services such as dog grooming, aquarium water testing, pet training and veterinary services.[7] It operates in both Australia and New Zealand. [8]

10. PETstock is the parent company of the PETspiration group of companies, and operates in New Zealand through its subsidiary PETstock NZ Limited (PETstock NZ).[9] PETstock NZ has:[10]

    10.1 15 brick and mortar retail "PETstock" stores; and

    10.2 three online retail channels: PETstock.co.nz, pet.co.nz, and petpost.co.nz.

The Proposed Acquisition

11. Woolworths has entered into share sale and purchase agreement with the owners of PETstock, under which Woolworths would acquire 55% of the shares in PETstock.[11]

12. Following completion of the Proposed Acquisition, the founders, Shane and David Young, and other existing PETstock shareholders, will retain a 45% equity investment in PETstock.[12]

Our framework

13. Our approach to analysing the competition effects of the Proposed Acquisition is based on the principles set out in our Mergers and Acquisitions Guidelines.[13] As required by the Commerce Act 1986, we assess mergers and acquisitions using the substantial lessening of competition test.

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5 The Application at [7.9].
6 The Application at [7.10].
7 The Application at [1.5].
8 The Application at [3.4]-[3.7].
9 The Application at [1.5].
10 The Application at [3.6].
11 The Application at [4.2].
12 The Application at [1.2].
13 Commerce Commission, *Mergers and Acquisitions Guidelines*, July 2019. Available on our website at www.comcom.govt.nz

14. We determine whether an acquisition is likely to substantially lessen competition in a market by comparing the likely state of competition if the acquisition proceeds (the scenario with the acquisition, often referred to as the factual), with the likely state of competition if the acquisition does not proceed (the scenario without the acquisition, often referred to as the counterfactual).[14] This allows us to assess the degree by which the Proposed Acquisition might lessen competition.

15. If the lessening of competition as a result of the Proposed Acquisition is likely to be substantial, we will not give clearance. When making that assessment, we consider, among other matters:

    15.1 constraint from existing competitors – the extent to which current competitors compete and the degree to which they would expand their sales if prices increased;

    15.2 constraint from potential new entry – the extent to which new competitors would enter the market and compete if prices increased; and

    15.3 the countervailing market power of buyers or suppliers – the potential constraint on a business from the purchaser's or supplier's ability to exert substantial influence on negotiations.

Market definition

16. We define markets in the way that we consider best isolates the key competition issues that arise from the Proposed Acquisition. In many cases this may not require us to precisely define the boundaries of a market. A relevant market is ultimately determined, in the words of the Commerce Act, as a matter of fact and commercial common sense.[15]

17. In the Application, Woolworths submits that the relevant markets are:[16]

    17.1 markets for the retail supply of speciality pet (predominantly "premium" pet) products in local areas (noting that online supply is also an option in these areas);

    17.2 markets for the retail supply of general retail pet products in local areas (noting that online supply is also an option in these areas); and

    17.3 a national market for the acquisition of pet products by retail suppliers.

18. However, Woolworths considers that it is ultimately not necessary to come to a concluded view on the appropriate market definition because the Proposed

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

15 Section 3(1A). See also *Brambles v Commerce Commission* (2003) 10 TCLR 868 at [81].

16 The Application at [9.25].

Acquisition is not likely to substantially lessen competition in any properly defined market.[17]

19. We will consider whether the markets submitted by Woolworths are the most appropriate markets for assessing the competitive effects of the Proposed Acquisition, or whether the competitive effects are better assessed with reference to an alternative market definition. For example, considering a broader market for pet products and focusing on closeness of competition between the parties.

20. We will also consider the appropriate geographic dimension of the relevant market/s and whether it is appropriate to consider different relevant markets for individual categories or groups of pet products (for example pet food, healthcare, or accessories).

Without the acquisition

21. We will consider what the parties would do if the Proposed Acquisition did not go ahead. We will consider the evidence on whether the without-the-acquisition scenario is best characterised by the status quo, or whether the parties would seek alternative options, for example, finding a different buyer for PETstock, or Woolworths expanding its activities in pet products.

Preliminary issues

22. We will investigate whether the Proposed Acquisition would be likely to substantially lessen competition in any relevant markets by assessing whether any horizontal unilateral, coordinated, vertical and/or conglomerate effects might result from the Proposed Acquisition. The questions that we will be focusing on are:

    22.1 unilateral effects: would any loss of competition between the parties enable the merged entity to profitably raise prices or reduce quality or innovation by itself?[18]

    22.2 coordinated effects: would the Proposed Acquisition change the conditions in the relevant market/s so that coordination is more likely, more complete or more sustainable?

    22.3 conglomerate effects: would the Proposed Acquisition increase the merged entity’s ability and/or incentive to leverage its position in one market to foreclose rivals in a related market?

Unilateral effects: would the merged entity be able to profitably raise prices by itself?

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

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[17] The Application at [9.28].

[18] For ease of reference, we only refer to the ability of the merged entity to “raise prices” from this point on. This should be taken to include the possibility that the merged entity could reduce quality or innovation, or worsen an element of service or any other element of competition, ie, it could increase quality-adjusted prices.

competitors) such that the merged firm can profitably increase price above the level that would prevail without the merger without the profitability of that increase being thwarted by rival firms' competitive responses. [19] A merger could also reduce competition if one of the merging firms was a potential or emerging competitor. In such a case, the merger may preserve the market power of the incumbent firm.

24. The parties overlap in the supply of pet products, including food, accessories (such as beds and toys), and healthcare products.

25. In the Application, Woolworths submits that the Proposed Acquisition would not be likely to substantially lessen competition any relevant market due to unilateral effects because in its view, specialty pet retail (in which PETstock operates) and general pet retail (in which it operates) stores operate in very different segments.[20] Woolworths further submits that:

    25.1 the only overlap between PETstock NZ and WWNZ is a very small sub-set of all pet products, and that, in relation to the limited number of pet products that they both supply, they are not close competitors;[21]

    25.2 PETstock NZ's strongest constraint comes from direct speciality pet rivals, such as Animates, Pet Essentials and Pet Central, as well as online specialty pet retailers,[22] whereas WWNZ's general retail pet products sales are most closely constrained by competition with PAK'n'SAVE, New World, Four Square, Costco and the Warehouse.[23] WWNZ also submits that other large scale retailers such as Bunnings have the ability to expand their presence in pet products and increase the constraint they impose on WWNZ;[24] and

    25.3 the Proposed Acquisition will not increase WWNZ's buyer power because supplier and product overlaps between PETstock NZ and WWNZ are limited and, in relation to the few common suppliers between them, PETstock NZ and WWNZ generally purchase different products and/or different pack sizes.[25]

26. We will consider:

    26.1 closeness of competition: the degree of constraint that WWNZ and PETstock NZ impose, or would impose, upon one another. To the extent that any constraint is, or would be, material, we will assess whether the lost competition (including the loss of any increased potential competition without the merger) between the merging parties could be replaced by rival competitors;

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19 Commerce Commission, *Mergers and Acquisitions Guidelines,* above n10 at [3.62].
20 The Application at [10.1(a)].
21 The Application at [10.1(a) – 10.1(b)].
22 The Application at [10.1(c)].
23 The Application at [10.1(d)].
24 The Application at [10.1(e)].
25 The Application at [10.1(j)].

26.2 remaining competitive constraints: the degree of constraint that existing competitors (including online competitors) would impose on the merged entity;

26.3 entry and expansion: how easily rivals could enter and/or expand;

26.4 countervailing power: whether customers (or suppliers) have special characteristics that would enable them to resist a price increase (or decrease) by the merged entity.

Coordinated effects: would the Proposed Acquisition make coordination more likely?

27. An acquisition can substantially lessen competition if it increases the potential for the merged entity and all or some of its remaining competitors to coordinate their behaviour and collectively exercise market power or divide up the market such that output reduces and/or prices increase. Unlike a substantial lessening of competition which can arise from the merged entity acting on its own, coordinated effects require some or all of the firms in the market to be acting in a coordinated way.[26]

28. In the Application, Woolworths submits that the Proposed Acquisition will not increase the potential for coordinated effects to arise in any market because:[27]

28.1 a large number of competitors with different business models will remain in each relevant market;

28.2 the parties are not each other's closest competitors;

28.3 the industry is highly dynamic; and

28.4 the parties do not have any material ongoing contractual or commercial interactions with other key competitors.

29. We will assess whether any of the relevant markets are vulnerable to coordination, and whether the Proposed Acquisition would change the conditions in any relevant markets so that coordination is more likely, more complete or more sustainable.

Conglomerate effects: would the merged entity be able to foreclose rivals?

30. A merger between suppliers (or buyers) who are not competitors but who operate in related markets can result in a substantial lessening of competition due to conglomerate effects. This can occur where a merger gives the merged entity a greater ability or incentive to engage in conduct that prevents or hinders rivals from competing effectively.[28]

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[26] Commerce Commission, *Mergers and Acquisitions Guidelines,* above n10 at [3.84].

[27] The Application at [11.1] – [11.2].

[28] Commerce Commission, *Mergers and Acquisitions Guidelines*, above n10 at [5.1]-[5.5].

31. We will consider whether the Proposed Acquisition would give rise to conglomerate effects. That is, for example, whether the merged entity would gain the ability and incentive to use anticompetitive bundling or tying strategies.

Next steps in our investigation

32. The Commission is currently scheduled to make a decision on whether or not to give clearance to the Proposed Acquisition by **3 April 2023**. However, this date may change as our investigation progresses.[29] In particular, if we need to test and consider the issues identified above further, the decision date is likely to extend.

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

Making a submission

34. If you wish to make a submission, please send it to us at registrar@comcom.govt.nz with the reference "Woolworths/PETstock" in the subject line of your email, or by mail to The Registrar, PO Box 2351, Wellington 6140. Please do so by close of business on **13 March 2023**.

35. Please clearly identify any confidential information contained in your submission and provide both a confidential and a public version. We will be publishing the public versions of all submissions on the Commission's website. If you make a submission and we do not acknowledge receipt of that submission within two working days, you should resubmit your submission.

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

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

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