

PUBLIC VERSION

LIFE HEALTH FOODS/ CHALMERS ORGANICS

SUBMISSION OF LIFE HEALTH FOODS LIMITED ON STATEMENT OF UNRESOLVED ISSUES

17 MAY 2022

1. Introduction and executive summary

- 1.1 This submission is made by Life Health Foods NZ Limited (**LHF**) in response to the Commerce Commission's (**Commission**) Statement of Unresolved Issues dated 4 May 2022 (**SOUI**).
- 1.2 For the reasons set out below LHF submits that:
- (a) firm tofu and soft or silken tofu are not in the same product market;
 - (b) a meat alternatives product market that includes firm tofu best isolates the competitive constraints of the Proposed Acquisition;
 - (c) the Commission's preliminary view that firm tofu is not part of a meat alternative product market is against the weight of evidence;
 - (d) the customer dimension of the market includes Asian supermarkets and speciality stores; and
 - (e) the major grocery retailers would be likely to exercise market power.

2. Commission's approach to defining the product market is flawed

- 2.1 The Commission's preliminary view is that tofu is in a separate product market to other meat-alternative products.¹ It is not currently satisfied that meat-alternative products are a sufficiently close substitute for tofu.²
- 2.2 It is well established that identification of the relevant market is the first step in the assessment of present and likely competitive effects.³ Market is defined in the Commerce Act 1986 as "a market in New Zealand for goods and services as well as other goods and services that, as a matter of fact and commercial common sense, are substitutable for them."⁴
- 2.3 The way the Commission typically assesses substitutability is explained in the Commission's Merger and Acquisition Guidelines:

We use the hypothetical monopolist test as a conceptual tool to help us answer ...whether customers would switch sufficient purchases to alternative products ... (customer or demand-side substitution).⁵

This test asks whether a hypothetical sole supplier of a set of products...would profitably increase prices for at least one of the merging firms' products ...by at least a small, but significant, amount. This small, but significant, amount is often

¹ SOUI at [21.1].

² SOUI at [28].

³ *Re Queensland Co-operative Milling Association Ltd* [1976] 25 FLR 169 (Australian Trade Practices Tribunal), *Tru Tone Ltd v Festival Records Retail Marketing Ltd* [1988] 2 NZLR 352 (CA).

⁴ Commerce Act 1986, s 3(1A).

⁵ Commerce Commission New Zealand *Mergers and acquisitions Guidelines* (Commerce Commission New Zealand, Guideline, July 2019) (**Merger Guidelines**) at [3.17] and [3.16.1].

referred to as a SSNIP – a small, but significant, non-transitory increase in price. We generally use 5% as the SSNIP.⁶

Using the product market dimension as an example, we apply the hypothetical monopolist test by starting with the narrowest possible market in which the merged firm would supply at least one product.⁷

- 2.4 While the hypothetical monopolist test (**HMT**) is a tool for analysis and not a statutory requirement, it is recognised as an aid to assessing market dimensions.⁸ When the HMT is used it must be used correctly. In this case, the Commission has failed to do so: it has not applied the HMT to the narrowest possible market in which the merged entity would supply at least one product.
- 2.5 There is no dispute that the merger parties supply only firm tofu,⁹ and that neither of the merging parties supply soft or silken tofu.¹⁰
- 2.6 The evidence is clear (and the Commission accepts)¹¹ that firm tofu and meat-alternative patties and sausages are substitutable. Had the Commission correctly applied the HMT to the narrowest product that the merged entity would supply, being the supply of firm tofu, the relevant product market identified would be a market for meat alternative products. Soft or silken tofu is not part of that market as discussed below.
- 2.7 The Commission's error is clear and must be corrected. The HMT, properly applied, must result in a meat alternatives product market, as the Applicant contends.

Firm tofu and soft or silken tofu are not in the same product market

- 2.8 The Commission states¹² that:

“while it may be possible to use firm tofu as a substitute for meat-alternative patties or sausages in certain situations, it may not be realistic to use softer or silken tofu, and vice versa. For example, it is unlikely that meat-alternative sausages could be substituted for tofu in a traditional Asian meal.”

- 2.9 However, despite the Commission implicitly accepting that, on the demand-side, firm tofu and softer or silken tofu are not substitutable, the Commission has concluded that all categories of tofu fall within a single product market based on supply-side substitution:

“There appears to be little difference in the manufacturing processes to produce the different types of tofu, such that it is sufficiently easy to switch production between them, and so we consider that it is appropriate to include them all in a broad market for tofu”

- 2.10 The fact that it may be “sufficiently easy to switch production” is not in and of itself a basis for including soft and silken tofu in the same market as firm tofu. As the demand side analysis reveals, soft and silken tofu is a specialised product that serves a different consumer need to firm tofu.
- 2.11 As the Commission's own merger guidelines make clear, in undertaking a market definition exercise, the starting point is to consider the substitution possibilities on the demand-side before then analysing

⁶ Merger Guidelines at [3.18].

⁷ Merger Guidelines at [3.20].

⁸ *NZCC v Air New Zealand* (2011) 9 NZBLC 103, 318 at [175].

⁹ SOUI at [34], [67] and [69.1].

¹⁰ SOUI at [34.4].

¹¹ SOUI at [28.2].

¹² SOUI at [28.2].

the supply-side. Market definition is a tool to identify the area of overlap and competitive constraint facing the parties.

- 2.12 In this case, a focus on supply-side substitutability in relation to the different types of tofu does not properly identify the competitive constraint facing the merging parties. As the parties only supply firm tofu, the focus ought to be on the extent to which other products are likely to impose a constraint on the merged entity.
- 2.13 The purpose of market definition as an analytical tool is to best isolate the key competition issues that arise from a proposed acquisition. By including products that the merging parties do not supply in its market definition, the Commission distorts rather than isolates the key competition issues.

A meat alternatives product market which includes firm tofu best isolates the competitive constraints

- 2.14 A market which includes both firm tofu and other meat alternative products best isolates the competitive constraints that the merged entity will face post-merger.
- 2.15 It is clear from the evidence LHF has provided to the Commission that firm tofu is substitutable for other meat-alternative products. This is not surprising as firm tofu is the ingredient used by both merger parties in their meat-alternative patties and sausages, and the consumer's choice whether to buy patties, sausages or a firm tofu block is dependent simply on the meal which the consumer proposes to cook. It therefore follows that there is a single market for meat-alternative products that includes firm tofu, while soft or silken tofu comprises a separate market due to its specialised uses.
- 2.16 In addition to consumer preferences, the Commission places weight on the fact that in an interview an unnamed person provided feedback that some major grocery retailers stock meat-alternative products and tofu in different sections of the store".¹³ The number and type of store included in the description "some" is not disclosed.
- 2.17 The Commission's finding is against the weight of evidence. Both merger parties provided photographic evidence of product placement by the major supermarkets to demonstrate that tofu and plant-based alternatives were stocked in the same locations in major supermarkets and other retail outlets, and all compete for available shelf space.¹⁴
- 2.18 Attached as Appendix 1 are further photos of the tofu placements at a random sample of Countdown, New World, PAK'nSAVE and FreshChoice supermarkets in Auckland, Wellington, Tauranga and Nelson. Consistent with the evidence previously provided by LHF and Chalmers, all stock tofu and meat-alternative products in the same section of the store:

Supermarket	Is Tofu in the alternative meat section – Y/N?
1. Countdown Cable Car Lane WELLINGTON	Y
2. Countdown Quay Street AUCKLAND	Y
3. Countdown Metro Albert St AUCKLAND	Y
4. Countdown Nelson	Y
5. PAK'nSAVE Royal Oak AUCKLAND	Y
6. PAK'nSAVE Cameron Road TAURANGA	Y
7. New World Victoria Park AUCKLAND	Y
8. New World Metro Queen Street AUCKLAND	Y
9. New World Wellington City WELLINGTON	Y
10. New World Nelson City	Y
11. FreshChoice Epsom AUCKLAND	Y
12. FreshChoice Nelson	Y

¹³ SOUI at [27.2].

¹⁴ LHF Submission on SOI, 4 April 2022 at [2.2]; Chalmers Organics Submission on SOI, 4 April 2022.

- 2.19 Even more compelling is the name given to the product displays: **Health Food** (Countdown Quay Street), **Organic-Vegan-Plant-based** (New World Victoria Park), **Alternative Plant Based** (Countdown Metro Albert St), and **Vegetarian** (PAK'nSAVE Cameron Road).
- 2.20 The fact that the major grocery retailers place tofu and meat-alternative products in the same section and refer to the category as Health Food or Plant-Based or Vegetarian demonstrates that as a matter of commercial common sense, firm tofu and other meat-alternative products comprise a single product market and not the reverse as the Commission contends.
- 2.21 On the supply side the Commission identified that most suppliers cannot easily switch production between tofu and meat-alternative products¹⁵ for three reasons.
- (a) tofu uses different equipment and processes than meat alternative patties and meat alternative sausages;¹⁶
 - (b) tofu uses soybeans as its main input whereas other plant-based products can use a variety of input;¹⁷ and
 - (c) suppliers said they would need to make significant investments in new capital, processes, and staff to switch production between tofu and meat-alternative products.¹⁸
- 2.22 This is contrary to the evidence provided by the parties which shows that a supplier of tofu can easily and inexpensively switch to meat-alternative patties and sausages which use tofu as the base ingredient. As previously submitted, the capital costs are relatively low.¹⁹

3. Customer dimension of the market includes Asian supermarkets and speciality stores

- 3.1 The Commission's preliminary view is that the major grocery retailers (the two supermarket chains) are in a separate market to other customers such as speciality retail stores, foodservice providers and home delivery service providers.²⁰ The Commission includes Asian supermarkets in the "other speciality retail stores" category.
- 3.2 The merger parties have submitted that Asian supermarkets are the leader in the tofu category, selling a greater range and volume of tofu than the major grocery retailers, and to exclude the Asian supermarkets and other specialist stores from the relevant market defies commercial common sense. It appears the Commission has not yet spoken to the Asian supermarket operators about their tofu sales.²¹
- 3.3 Competition between Tai Ping and Countdown in Newmarket was given by Chalmers as an example of competition between the major grocery retailers and Asian supermarkets. The Commission discounts this as an exception - that while there may be a high degree of customer switching between Countdown and Tai Ping in Newmarket because of the closeness of the two stores and shared carpark, the Commission's current view is that "*for most consumers, tofu is unlikely to be considered a product that drives foot traffic to the point where a sufficient number of customers switch to purchasing tofu in speciality retailers, constraining the merged entity*".²²
- 3.4 The Commission relies on a conclusion in its Final Report on Market Study into the Retail Grocery Sector that the major grocery retailers "*uniquely meet consumer preference for a wide range of*

¹⁵ SOUI at [31].

¹⁶ SOUI at [31.1].

¹⁷ SOUI at [31.2].

¹⁸ SOUI at [31.3].

¹⁹ LHF SOI Submission [5.7]

²⁰ SOUI at [37].

²¹ SOUI at [43] – [45].

²² SOUI at [103].

*products at lower prices in a single location*²³, convenience is the most important driver of store choice, and most customers prefer to shop at a major grocery retailer, no matter the shopping mission.²⁴

- 3.5 While it is no surprise that consumers purchase most of their grocery requirements at one of the major grocery retailers and the most important factor is store location²⁵, the consumer research conducted by the Commission also identified that in addition to a regular “main shop” based on the convenience of using one grocery store to get all necessities in one place,²⁶ consumers regularly visit one or more stores, other than the main store, for specific products.²⁷
- 3.6 As previously discussed,²⁸ Asian supermarkets and speciality stores were identified by the major retailers in submissions to the market study as stores selling specific products that competed with the major grocery retailers in their specialist category.
- 3.7 The Commission also dismisses Asian supermarkets and speciality stores as being in the same market as the major grocery retailers because *“the number of speciality retailers that supply tofu varies in different parts of the country. For instance, Tai Ping operate a network of 11 Asian supermarkets but is only located in the Auckland region”*.²⁹
- 3.8 It is surprising that the Commission would exclude New Zealand's third largest supermarket chain (Tai Ping)³⁰ from the customer dimension of the market. Moreover, Tai Ping is not the only Asian supermarket in New Zealand; the photos in Appendix 1 of LHF in response to the Commission's RFI of 20 September 2021 show tofu stocked by Da Hua supermarket. The fact that Asian supermarkets or speciality stores may not have national coverage is not relevant; there is no region where major grocery retailers do not face competition from them.³¹
- 3.9 On the supply side the Commission would exclude Asian supermarkets from the customer dimension of the market on the grounds that suppliers would need to investment in equipment and infrastructure, the cost of which for some suppliers is high,³² such that only larger, and more efficient, tofu suppliers could supply on the scale required.³³ This was because the Commission states that the major grocery retailers:
- (a) impose greater requirements on suppliers;³⁴
 - (b) required greater volumes of product;³⁵
 - (c) placed high demands on suppliers including insisting on lower wholesale prices more support for promotions and marketing;

²³ Commerce Commission New Zealand *Market study into the retail grocery sector* (Commerce Commission New Zealand, ISBN no. 978-1-869459-91-8, March 2022) (**Market Study**) at [4.104].

²⁴ Market Study at [104].

²⁵ Market Study at [4.66].

²⁶ Market Study at [4.10.1].

²⁷ Market Study at [4.10.2].

²⁸ LHF SOI Submission at [3.8].

²⁹ SOUI at [105].

³⁰ <https://www.nz.co.nz/news/business/86166/supermarkets-with-asian-food-on-the-rise>.

³¹ <https://www.nzherald.co.nz/nz/new-zealanders-tuning-in-to-asian-food/DBYCCZ5YNNX6AXDRVGINHJHSHM/>.

³² SOUI at [45].

³³ SOUI at [39].

³⁴ SOUI at [38] and [43].

³⁵ SOUI at [47].

- (d) preferred to acquire supply of tofu from a small number of suppliers to allow them to promote their offering more easily;³⁶ and
 - (e) further information in a confidential attachment.³⁷
- 3.10 These barriers are overstated. As previously submitted³⁸ the evidence shows that it is not difficult for an existing supplier to increase the quantity and range of tofu products incrementally over time.
- 3.11 The fact that the major grocery retailers demand lower wholesale prices and more promotional spending, or prefer fewer suppliers is simply reflective of their countervailing power.

4. Major grocery retailers would be likely to exercise countervailing power

- 4.1 The Commission is not satisfied the major grocery retailers would be likely exercise their countervailing market power in response to an increase in price or reduction in quality by sponsoring new entry, giving favourable treatment to their own brands or making product selection choices that would effectively constrain the merged entity.³⁹
- 4.2 This is a surprising conclusion and inconsistent with the Commission's conclusions referred to above at [3.9(a)] to [3.9(e)]. It simply cannot be the case that the major grocery retailers would use their countervailing power to impose strict requirements on new suppliers but at the same time would not be likely to use their countervailing market power against the merged entity. This does not reflect commercial common sense.
- 4.3 The Commission's preliminary view is that the supermarkets would not be able to constrain the merged entity because smaller suppliers could not easily supply the major grocery retailers, and the major grocery retailers were unlikely to be able to sufficiently expand their private label offerings. Neither of these conclusions is supported by the weight of evidence.
- 4.4 The two the major grocery retailers offer their own private label tofu and meat-alternative products under the Macro and Pam's brands respectively. The major grocery retailers therefore also compete with the merged entity.
- 4.5 The Commissions preliminary view is that *"based on the evidence before us, we are not currently satisfied that the major grocery retailers would be able to preference their private label brands in a way that constrains the merged entity"*.⁴⁰
- 4.6 Private label Macro will be the next largest supplier of tofu to the merged entity post-merger. While Pam's is relatively minor share in Foodstuffs because it entered the tofu category less than six months ago, the positioning of private label at low price compared to branded products is evident.⁴¹
- 4.7 As previously submitted, retailer-backed private label sales (which include Woolworths and Coles) dominate the Australian market⁴² and are likely to do so in New Zealand. Significantly, Pam's was recently announced by Reader's Digest as the Most Trusted Vegetarian Food brand for 2022, despite having launched their plant-based range only in mid-2021, and tofu not until December 2021. Neither Bean Supreme nor Tonzu featured in the awards.⁴³

³⁶ SOUI at [46].

³⁷ SOUI at [48].

³⁸ LHF SOI Submission at [5.1].

³⁹ SOUI at [114].

⁴⁰ SOUI at [122].

⁴¹ <https://www.nzherald.co.nz/business/foodstuffs-announces-food-price-reduction-amid-soaring-inflation/2ZIVFQRE7SGAQ6POMNG73SLKSE/>.

⁴² LHF SOI Submission at [7.3] and Table 7

⁴³ <https://www.trustedbrands.co.nz/results.asp>

- 4.8 The wholesale prices the merged entity can charge the major grocery retailers are inevitably constrained by the retail prices set by the major grocery retailers for their own competing products. The evidence overwhelming shows that not only do the major grocery retailers have the incentive and ability to expand their private label products in the face of an unjustified price increase by the merged entity.

Appendix 1: Supermarket Aisle Tofu Photos



Figure 1 Countdown Cable Car Lane 13 May 2022; 280/284 Lambton Quay, Wellington Central, Wellington 6011



Figure 2: Countdown Quay Street; 11 May 2022; 76 Quay Street, Auckland CBD, Auckland 1010



Figure 3 Countdown Metro Albert St 10 May 2022; AMP Centre, Ground Floor, Lower Albert Street, Auckland 1010



Figure 4 Countdown Nelson; 16 May 2022; 35 Saint Vincent Street, Nelson 7010



Figure 5 PAK'nSAVE Royal Oak; 12 May 2022; 691 Manukau Road, Royal Oak, Auckland 1021

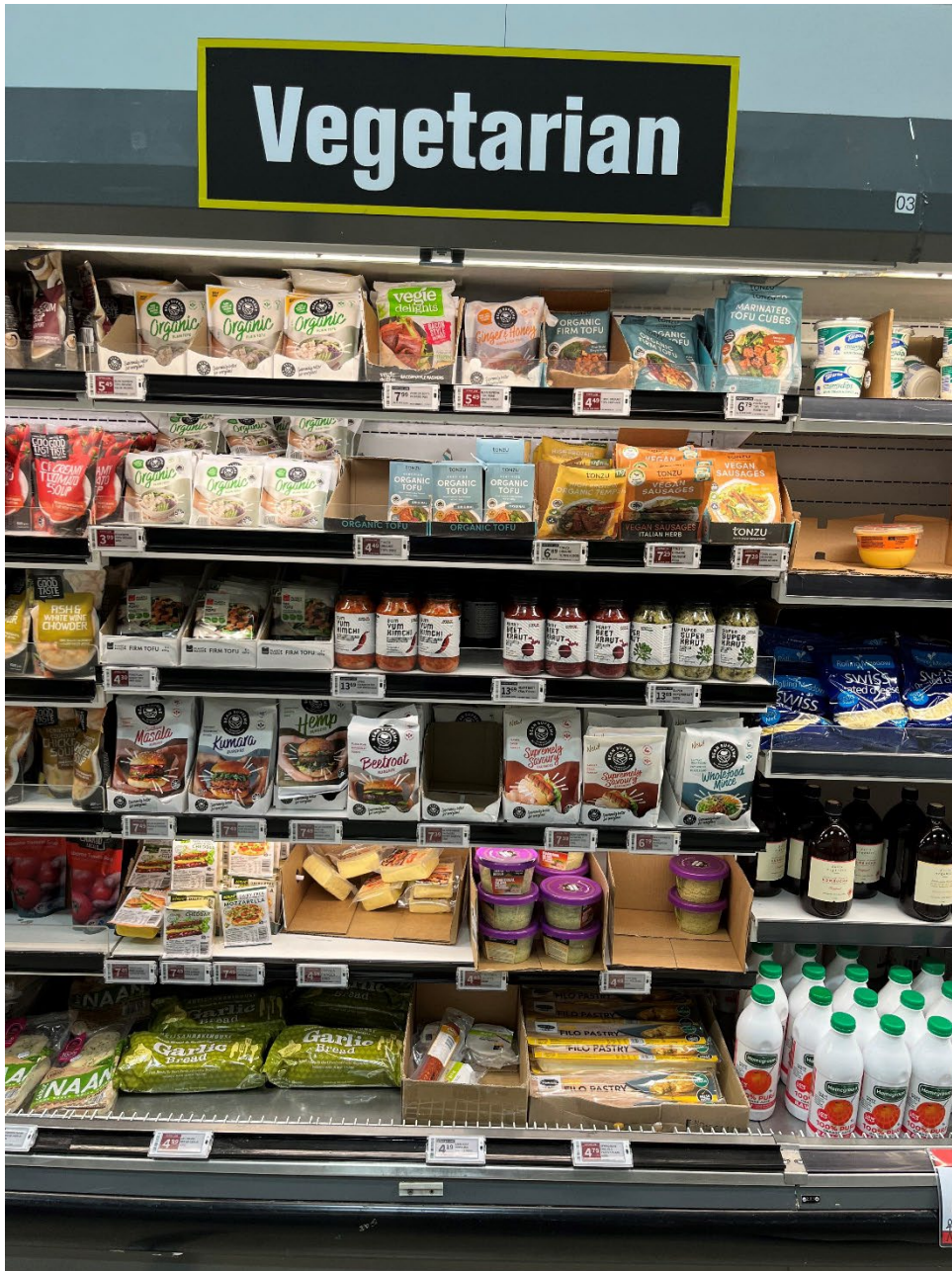


Figure 6 PAK'nSAVE Cameron Road; 14 May 2022; 476 Cameron Road, Tauranga 3110;



Figure 7 New World Victoria Park; 11 May 2022; 2 College Hill, Freemans Bay, Auckland 1011.

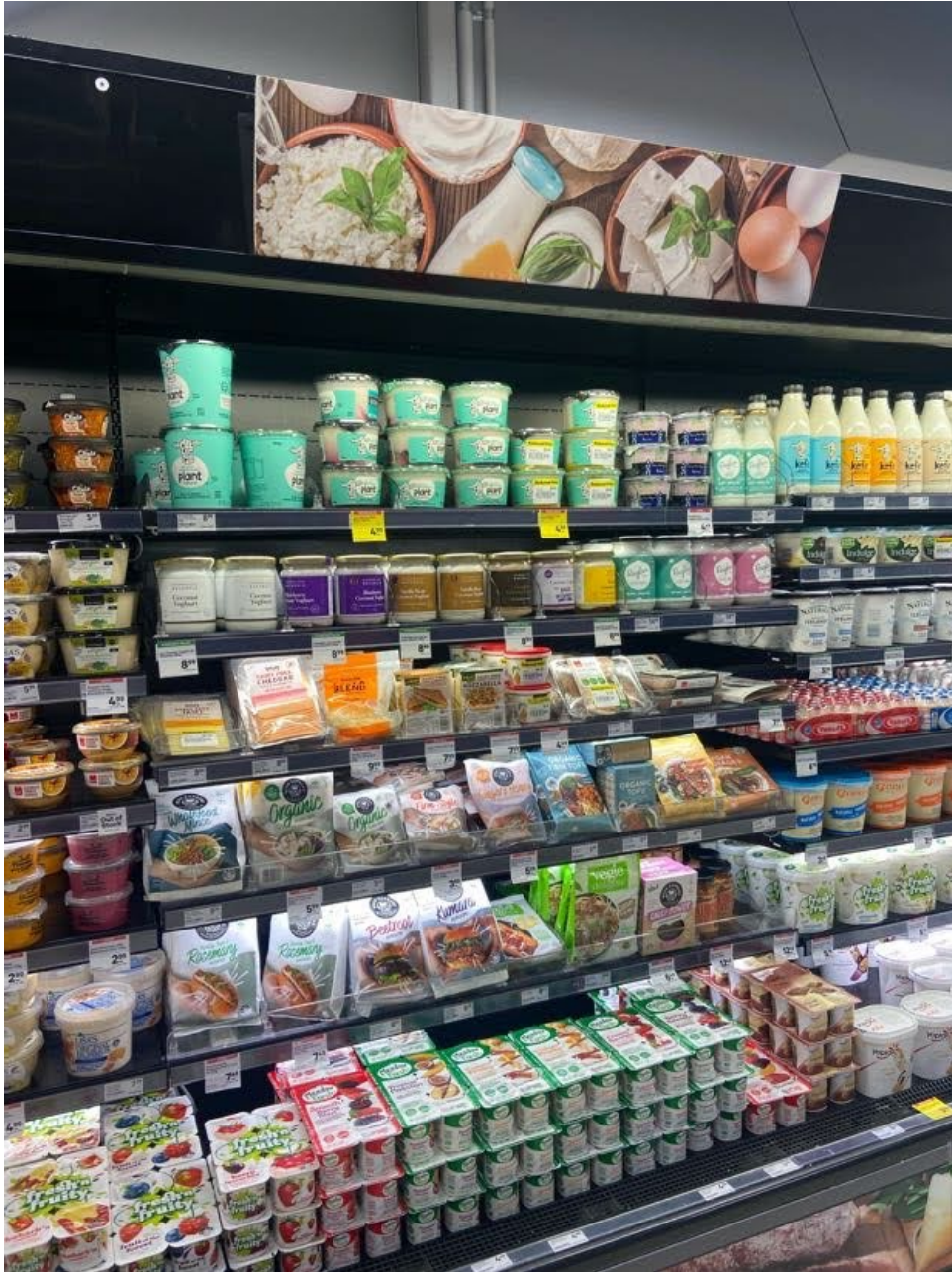


Figure 8 New World Metro Queen Street; 12 May 2022; 125 Queen Street, Auckland CBD, Auckland 0620



Figure 9 New World Wellington City; 15 May 2022; 279 Wakefield Street, Te Aro, Wellington 6011

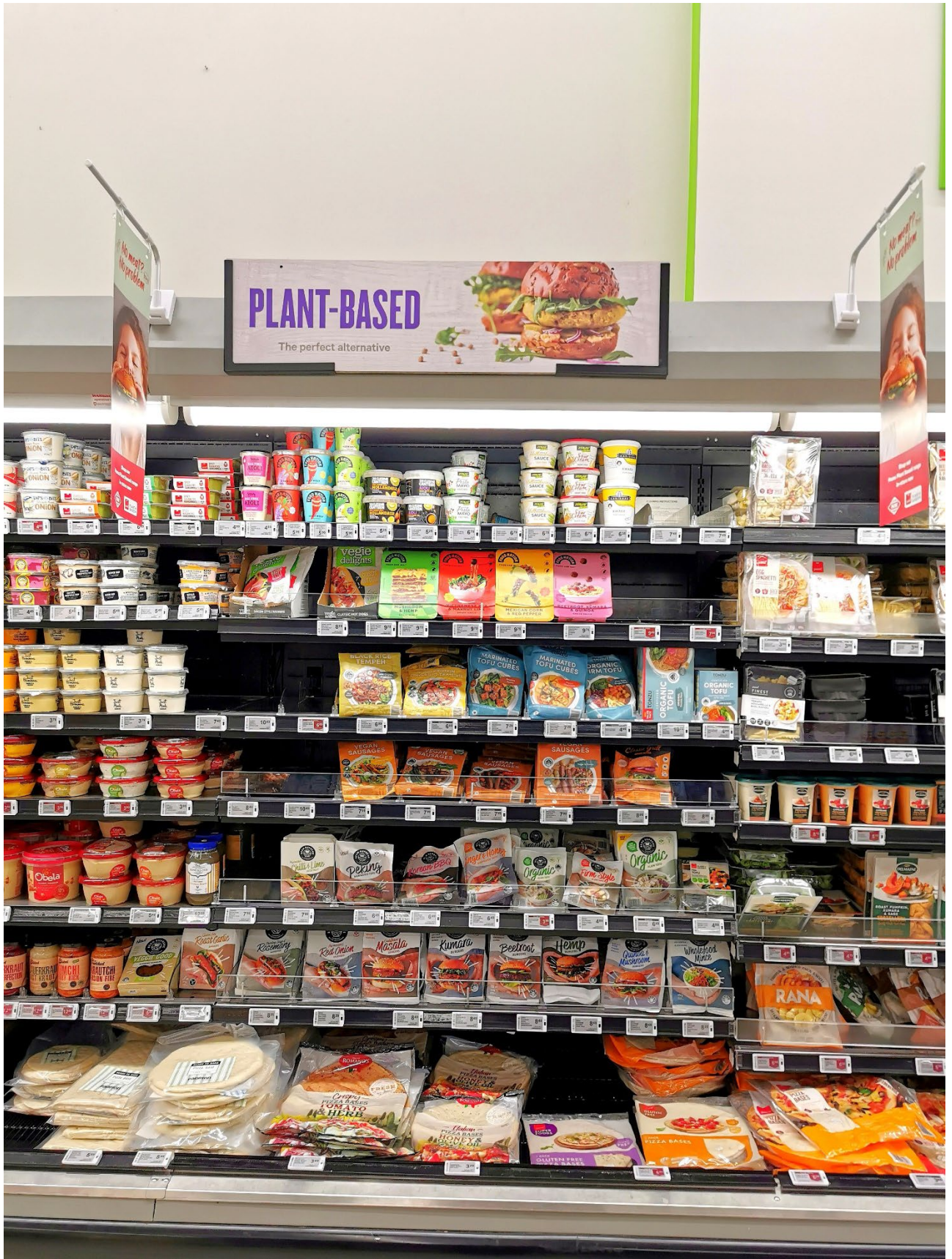


Figure 10 New World Nelson City; 16 May 2022; Cnr Vanguard &, Gloucester Street, Nelson 7010



Figure 11 FreshChoice Epsom; 12 May 2022; 223A Green Lane West, Epsom, Auckland 1051.



Figure 12 Fresh Choice Nelson; 16 May 2022; 69 Collingwood Street, Nelson 7010