Antitrust Chronicle

DECEMBER · FALL 2021 · VOLUME 3(1)

Retail Grocery Sector

CPI COMPETITION POLICY INTERNATIONAL

TABLE OF CONTENTS

LETTER FROM THE EDITOR

Dear Readers,

Few sectors are as vital to modern life as the grocery industry. Napoleon famously derided the United Kingdom as a "nation of shopkeepers." But in today's urbanized, industrialized world, shopkeepers provide the link between nourishment and the people who require it.

Grocery businesses, as a key part of the economy (and indeed life in the 21st Century), are therefore subject to detailed antitrust scrutiny. This scrutiny of shopkeepers is the focus of this edition of the Antitrust Chronicle.

Not unlike other sectors of the economy, grocery has seen great change over recent years. This is a result of multiple transformative trends: There has been a shift to online delivery services (accelerated by the recent pandemic), to mass-production of foods, and the growth of large multiples who enjoy massive economies of scale. All of the above complicates and emphasizes the need for careful antitrust review of conduct and M&A in the industry.

Yet not every antitrust authority has had the same approach, either over the decades or in relatively recent years. **Benoît Durand** underlines that competition authorities in Europe have adopted very different approaches to the competitive effect of mergers in grocery markets. Specifically, there have been substantial differences between the UK CMA, the German Cartel Office, and the French Competition Authority.

Indeed, as **Dimitri Dimitropoulos**, **Renée M. Duplantis & Loren K. Smith** highlight, particular consumer trends inform competition authorities' approaches to grocery markets. Though it may seem quotidian, grocery shopping is one of the more dynamic aspects of the economy, as reflected in changing consumer habits. Another key parameter in this dynamic, as **Henry C. Su** describes, relates to the format of grocery retailers, in particular as the format relates to their size, scale, and scope.

But the ultimate retail market is only part of the picture. Behind even the smallest grocery business, there is an intricate supply chain. As **Steve McCorriston** astutely points out, there is a complex interaction between the underlying supply chain and the retail sector that consumers end up interacting with. Of course, the ultimate goal of competition policy is to enhance competition – to the benefit of the consumer – in the most optimal way. How to do this is a complex calculus.

Andrew Taylor & Nick Warren point out that much of the competition law scrutiny of grocery businesses has focused on high-profile mergers. Yet also, the grocery sector has proved fertile ground for novel behavioral theories of harm, such as the hub-and-spoke cartel model that gained favor in recent years. **Ana Sofia Rodrigues, Catarina Tourais, Margarida Robalo Cordeiro, Mariana Dias, Marta Roch & Rafael Longo** delve deep into this theory of harm in their contribution to this Chronicle.

If any of this reveals anything, it is that competition authorities, consumers and market participants have a clear stake in monitoring antitrust developments as they relate to the grocery sector. Market studies, such as the one carried out in New Zealand and detailed by **Andy Matthews & Danny Xie** provide a prime example of such an initiative.

In short, the articles in this Chronicle provide an up-to-date snapshot as to how competition policy applies to the grocery sector. It is vital reading for anyone who needs to eat – whether they are a shopkeeper or not.

As always, thank you to our great panel of authors.

Sincerely,

CPI Team

SUMMARIES

08

Store Format and Buyer Power in Grocery Retail Competition

By Henry C. Su

Competition in grocery retail is not only about the pricing, quantity, and variety of goods offered for sale to consumers. Importantly, it also has to do with format — size, configuration, locations, physical vs. online, fulfillment and payment mechanisms, to name a few aspects. Manufacturers, producers, and wholesalers that supply goods to grocery retailers understand and appreciate the significant role that format plays in attracting, reaching, and persuading consumers. Accordingly, the market power that certain retailers wield on the buy side in negotiations with their suppliers may stem principally from the formats they present to consumers on the sell side, thereby constituting a byproduct of the competitive process. Calls for antitrust enforcers to curb supposed abuses by dominant grocery retailers should therefore take care to recognize and distinguish such procompetitive or competitively benign exercises of countervailing power from manifestly exclusionary and predatory acts aimed at hurting market rivals.

14

The Competitive Assessment of Mergers in Retail Grocery Markets: A Basket Case?

By Benoît Durand

This paper shows that competition authorities in Europe have adopted very different approaches to assess the competitive effect of horizontal mergers on retail grocery markets. Specifically, we highlight substantial differences between the UK CMA, the German Cartel Office, and the French Competition Authority. All these authorities have considered the effect of mergers between grocery retailers on local markets where the merging parties overlap, however, the method and scope of the competitive assessment they have developed vary significantly. The CMA has demonstrated willingness to apply a mechanistic approach, recently using an upward pricing pressure test in their investigations. This may lead to less discretion when compared with the approach taken by the German Cartel Office or the French Competition Authority, which appears more qualitative in nature despite heavy reliance on the degree of post-merger market concentration. Further, the CMA approach applies a very low threshold for intervention, while in contrast the Adlc has been significantly more lenient, in instances finding no competition concerns in local markets where the merged entity would have at least 50 percent market share.

22

Trends in Consumer Shopping Behavior and their Implications for Retail Grocery Merger Reviews

By Dimitri Dimitropoulos, Renée M. Duplantis & Loren K. Smith

Retail grocery mergers in the United States most often have been evaluated by the FTC. Through those investigations and litigations, FTC staff economists and experts have established one of the most detailed and well-understood programs of econometrics for merger evaluation. This program generally focuses on the estimation of measures of substitutability and price competition among proximate grocery store locations. In this article, we review the FTC's approach to retail grocery merger reviews and discuss how recent changes in grocery competition and consumer shopping behavior may significantly affect the way the FTC evaluates such mergers, especially in the post-COVID world.

29

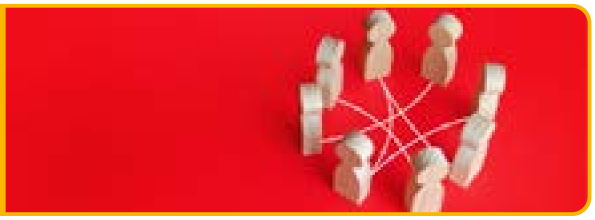
Pass-Through and Competition in the Food Sector: New Data, New Insights, Remaining Questions

By Steve McCorriston

Current pressures on food supply chains are associated with higher food prices but the extent of the pass-through to consumers will depend on how competition in the retail food sector. This contribution summarizes insights from recent research, a key feature of which is the use of large data on prices across retail food chains which forms the basis for a better understanding of competition in this sector. In addition to the focus on consumers, the contribution also points to concerns about how the retail sector may impact on suppliers with weak bargaining power a t the other end of the food supply chain.

SUMMARIES

34



Competition Issues in UK Grocery Retailing

By Andrew Taylor & Nick Warren

Over the past 20 years, grocery retailing has probably been the sector most investigated by the UK competition authorities. Given that three quarters of the grocery M&A deals that have been reviewed have been cleared unconditionally, this might be taken to indicate a fairly light touch approach to the sector. However, merger review decisions have played an important role in signaling the types of deals that are likely to be acceptable. The effectiveness of this signaling system appeared to break down quite dramatically in 2018 when the CMA prohibited a merger between the UK's second and third largest grocery retailers. Long-term trends in consumer behavior that had changed competitive dynamics in the sector, and new approaches by the CMA to assessing local market competition, had indicated that consolidation between the UK's larger retailers might receive regulatory clearance. However, this turned out not to be the case. Any large-scale consolidation in UK grocery retailing now looks some way off.

40

Hub-and-spoke Cases in the Portuguese Grocery Sector

By Ana Sofia Rodrigues, Catarina Tourais, Margarida Robalo Cordeiro, Mariana Dias, Marta Roch & Rafael Longo

Resale price maintenance ("RPM") restrictions may play an instrumental role in implementing collusive agreements downstream, in a hub-and-spoke arrangement. This is highlighted in two recent decisions by the Portuguese Competition Authority ("AdC") on two hub-and-spoke arrangements involving large grocery stores and beverage suppliers. In these cases, the AdC opted to pursue hub-and-spoke cases rather than pure RPM cases, as that would fail to capture the actual conduct of all firms involved, as well as the seriousness of the cartels fostered by the RPM restrictions. In particular, the decision to pursue these hub-and-spoke took into account the bargaining environment between each supplier and the retailers to explain how they had aligned incentives. When retailers hold significant buyer power over suppliers, they tend to put a downward pressure on supplier prices, so suppliers gain incentives to soften competition downstream in order to reduce that pressure. We provide some of the evidence used in these decisions and identify the key elements enforcers should consider when investigating potential hub-and-spoke arrangements.

47

The NZCC Market Study into Retail Grocery

By Andy Matthews & Danny Xie

The New Zealand Commerce Commission is currently undertaking its market study into the retail groceries sector. New Zealand has one of the most concentrated retail grocery sectors in the world with only two major grocery retailers. In this article we share observations on how New Zealand got to this situation and possible outcomes.

WHAT'S NEXT?

For January 2022, we will feature an Antitrust Chronicle focused on issues related to (1) **Predatory Pricing**.

ANNOUNCEMENTS

CPI wants to hear from our subscribers. In 2022, we will be reaching out to members of our community for your feedback and ideas. Let us know what you want (or don't want) to see, at: antitrustchronicle@competitionpolicyinternational.com.

CPI ANTITRUST CHRONICLES February 2022

For February 2022, we will feature an Antitrust Chronicle focused on issues related to the **Economics of Potential Competition**.

Contributions to the Antitrust Chronicle are about 2,500 – 4,000 words long. They should be lightly cited and not be written as long law-review articles with many in-depth footnotes. As with all CPI publications, articles for the CPI Antitrust Chronicle should be written clearly and with the reader always in mind.

Interested authors should send their contributions to Sam Sadden (ssadden@competitionpolicyinternational.com) with the subject line "Antitrust Chronicle," a short bio and picture(s) of the author(s).

The CPI Editorial Team will evaluate all submissions and will publish the best papers. Authors can submit papers on any topic related to competition and regulation, however, priority will be given to articles addressing the abovementioned topics. Co-authors are always welcome.

STORE FORMAT AND BUYER POWER IN GROCERY RETAIL COMPETITION

BY HENRY C. SU[1]

1 Henry C. Su is a partner at Bradley Arant Boult Cummings LLP. All views expressed here are his own and not necessarily those of Bradley or any of its clients. The author thanks James Langenfeld and Daniel Hosken for reviewing a draft and providing feedback.

I. INTRODUCTION

Recent calls for more vigorous antitrust enforcement throughout the American economy have flagged grocery retail as one sector warranting heightened scrutiny.[2] In particular, these calls have focused on the encroachment and rapid growth of hypermarkets like Walmart supercenters and e-commerce platform operators like Amazon (e.g. Whole Foods, Amazon Fresh) in the grocery retail business, and the threat that such ostensibly dominant retailers may pose to the continued survival of smaller independent grocers. They also urge increased attention to potential anticompetitive practices by dominant grocery retailers as buyers of goods, i.e. concerns about the acquisition and exercise of buyer power in this sector.

These voiced concerns about dominant retailers and buyer power are neither new nor particularly original.[3] And whether they are more compelling today than in the past remains to be seen. But in reexamining these concerns, it is paramount that we bear in mind two things: the pivotal role of format in grocery retail competition, and the crucial distinction — when examining buyer power concerns — between countervailing power that flows from the competitive success of a retailer's format and manifestly exclusionary or predatory exercises of market power that seek to disadvantage or injure rival retailers. Specifically, I make two basic points in this piece.

First, format defines and describes how a grocery retailer has chosen to market its goods to consumers and to draw consumers to its stores and, more broadly, to differentiate itself from the competition.[4] Nowadays, in addition to supermarkets, consumers can purchase grocery items from drug stores, mass merchandisers, convenience stores, club stores, dollar stores, supercenters, and even online stores. Notably, format can encompass attributes such as size, scale, and scope that we often associate with a dominant firm. But antitrust law does not penalize a firm for achieving a dominant position through business acumen, for example, and we should therefore take care not to scrutinize dominant grocery retailers based on their market status and success alone, lest we dampen the procompetitive and innovative incentives that spawn these formats, and risk depriving consumers of their potential benefits.

Second, the success of a particular format, and its differentiating factors in the marketplace, do not go unnoticed or unappreciated by manufacturers, producers, and wholesalers seeking to put their goods into retail channels. On the buy side, format can therefore confer countervailing power to a grocery retailer in its negotiations with suppliers. In other words, just as a retailer uses its format to market its goods to consumers and to draw consumers to its stores, it may be able to use that format to attract suppliers and to extract different, and perhaps more favorable, terms from them than its market rivals are able to do.

We should therefore carefully discern and distinguish, in bargaining settings, exercises of format-related countervailing power, which are likely to enhance consumer welfare, from other types of buyer power (e.g. monopsony power) and other exercises of buyer power (e.g. anticompetitive overbuying) that are understood to have harmful or questionable welfare effects. The grocery retail sector has been and remains a fertile ground for innovation and experimentation, as retailers test out not only different pricing strategies but also differing approaches to non-price dimensions like level of service, private label offerings, and assortment size and mix. Retailers may exercise countervailing power to garner supplier support for innovation and experimentation, which generally redounds to the benefit of consumers.

II. STORE FORMAT AND COMPETITION

In the United States, the evolution of the grocery retail sector as we know it today is principally a story about successive innovation in store formats.[5] Professor Paul Ellickson, who has written extensively on this subject, breaks down the evolution into four distinct eras: (1) the chain store

2 See, e.g. Nat'l Grocers Ass'n, Buyer Power and Economic Discrimination in the Grocery Aisle: Kitchen Table Issues for American Consumers (2021), https://bit.ly/30Unz6U; Letter from Peter Lurie, Pres. & Exec. Dir., and Laura MacCleery, Pol'y Dir., Ctr. for Sci. in the Pub. Interest, to Hon. Rebecca Slaughter, Acting Chair, et al., U.S. Fed. Trade Comm'n (Feb. 19, 2021), https://bit.ly/3HLbT79; Inst. for Local Self-Reliance, Report: Walmart's Monopolization of Local Grocery Markets (2019), https://bit.ly/3CMNhqW. I acknowledge that similar concerns have been raised and investigated in other countries, e.g. the United Kingdom and New Zealand, but such efforts are outside the scope of this piece.

3 See, e.g. Albert A. Foer, *Introduction to Symposium on Buyer Power and Antitrust*, 72 Antitrust L.J. 505, 505 (2005) ("The purchasing clout demonstrated by these large buyers, in may enhance the advantage they have vis-à-vis their own competitors. Retailers, such as Wal-Mart and Costco, apparently have such clout suppliers. Is this really something new? From an antitrust perspective, does it matter and should it matter?").

4 For a working glossary of store formats, see Richard Volpe, et al., Store Formats and Patterns in Household Grocery Purchases 3–5 (U.S. Dep't Agric., Econ. Research Serv., Econ. Information Bulletin No. 167, Mar. 2017), https://bit.ly/3d1BQRF.

5 See generally Paul B. Ellickson, *The Evolution of the Supermarket Industry: From A&P to Walmart, in* Handbook on the Economics of Retailing and Distribution, ch. 15, 368–91 (Emek Basker ed., 2016); Bart J. Bronnenberg & Paul B. Ellickson, *Adolescence and the Path to Maturity in Global Retail*, 29 J. Econ. Persp. 113, 115–23 (2015); John M. Connor, *Evolving Research on Price Competition in the Grocery Retailing Industry: An Appraisal*, 28 Agric. & Resource Econ. Rev. 119, 119–20 (1999).

revolution, pioneered by the Great Atlantic and Pacific Tea Company (more familiarly "A&P") in 1912; (2) the introduction of the supermarket format in 1930 by a Kroger employee named Michael Cullen, with offshoots like club stores and superettes in the late 1970s and early 1980s; (3) the advent of computerization and information technology (e.g. bar code scanner, scanning register, inventory management systems) in the 1970s and 1980s, and with such advances, radical increases in product variety, which in turn spurred ever larger formats (i.e. superstores and warehouses); and (4) lastly, the entry of Walmart into the sector with its supercenters in 1988. Here are two important takeaways from Ellickson's illuminating historical treatment.

First, each era featured quantum improvements and transformations in various aspects of the grocery retail business. For example, A&P first standardized the grocery store with an "economy" store format that sold its own branded goods (the precursor to what we now call private labels or store brands), and it took advantage of scale and scope economies by supplying its chain of stores with its own network of factories, warehouses, and delivery trucks. Not surprisingly, chain stores grew in number quickly under this model, becoming a dominant presence in the grocery retail sector and displacing many independent grocers, which simply could not offer as low of prices on goods. The chain store revolution thus provides a textbook illustration of Joseph Schumpeter's theory of creative destruction — an innovative business model supplanting what existed before, forcing incumbent businesses to adapt or perish.

Furthermore, despite the fact that competitive forces largely explain A&P's success (and that of Kroger's, Safeway, and American Stores, as well) and the concomitant demise of many small independent grocers, this revolution would precipitate a legal backlash that included the passage of the Robinson-Patman Act in 1936[6] and federal antitrust prosecution against A&P in the 1940s.[7] A&P would survive these legal and political challenges, however, and instead, it ultimately "became a victim of the creative destruction it had once meted out."[8] A&P's eventual demise foreshadows a similar fate for dominant retailers today, should consumers shift a significant proportion of their grocery purchases from in-store shopping to deliveries and pickups of orders made online. Indeed, the COVID-19 pandemic has provided a natural experiment regarding this question.

Second, each era reflects the sector's response to changing demographics and consumer preferences. For instance, as Ellickson notes, the supermarket format took root and proliferated because more shoppers had automobiles, which allowed them to travel further to stores and to carry more groceries, and refrigerators, which enabled them to buy and store more goods at home and therefore make fewer trips. Also, shoppers' tastes shifted to nationally branded consumer goods, which meant that supermarkets, in contrast to chain stores that primarily carried their own house brands, did not have to have their own manufacturing facilities, and could rely on consumer advertising to draw traffic.

The supermarket format thus illustrates another dynamic that we see playing out even today — experimentation with new retail models that respond to changes in where and how consumers are choosing to live, work, play — and to eat and drink. While there will always be, from time to time, specific business practices (as well as mergers) that may warrant antitrust scrutiny, the general progression in the retail grocery sector has been to advance store formats that promote consumer welfare by offering goods at lower prices, in broader range of quantities and greater variety, and with increasing convenience.

Accordingly, if and when antitrust enforcers investigate concerns about the dominance of a particular firm in the grocery retail sector, they should take care not to penalize that firm for adopting a format that has succeeded *because of the competitive process*, even if that success comes at the expense of smaller, less efficient rivals.[9] For example, Walmart's core advantage over its rivals, according to Professor Emek Basker, comes from its scale, which yields network economies that are unavailable to single-store retailers, and from its early and significant adoption

6 See, e.g. George J. Feldman, *Legislative Opposition to Chain Stores and Its Minimization*, 8 Law & Contemp. Problems 334 (1941).

7 *United States v. N.Y. Great Atl. & Pac. Tea Co.*, 67 F. Supp. 626 (E.D. Ill. 1946), *aff'd*, 173 F.2d 79 (7th Cir. 1949). For an ensuing debate about the merits of the government's case against A&P, *compare* Morris A. Adelman, *The A&P Case: A Study in Applied Economic Theory*, 63 Quarterly J. Econ. 238, 256 (1949) (viewing the Department of Justice as "fighting a nebulous bogey called 'buying power'" . . . [and] hav[ing] confused the maintenance of competition with the protection of particular competitors"), *with* Joel B. Dirlam & Alfred E. Kahn, *Antitrust Law and the Big Buyer: Another Look at the A&P Case*, 60 J. Pol. Econ. 118, 132 (1952) (viewing the Department of Justice's case as an attack on the systematic use of bargaining power to achieve unfair competitive advantages and to bring pressure to bear, selectively, on retail competitors"). For more recent criticism of this prosecution, see Timothy J. Muris & Jonathan Nuechterlein, *Antitrust in the Internet Era: The Legacy of* United States v. A&P, 54 Rev. Indus. Org. 651 (2019).

8 Marc Levinson, The Great A&P and the Struggle for Small Business in America 11–12, 270 (2011).

9 See *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 767 & n.14 (1984) ("For instance, an efficient firm may capture unsatisfied customers from an inefficient rival, whose own ability to compete may suffer as a result. This is the rule of the marketplace and is precisely the sort of competition that promotes the consumer interests that the Sherman Act aims to foster.") (quoting in the footnote from *United States v. Grinnell Corp.*, 384 U.S. 563, 571 (1966), and *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977)). As MIT economist Morris Adelman aptly pointed out in his critique of the A&P case, "no strong competitor, however pure and upright his methods (no claims are made for A&P), however beneficent his achievements, could avoid affecting adversely other competitors and even putting some of them out of business." Adelman, *supra* note 7, at 256.

of information technology, which facilitates its logistics, distribution, and inventory control.[10] Notably, although its entry into grocery ushered in a "new" era under Ellickson's timeline, what Walmart did was to assimilate and apply with greater fidelity and rigor retailing lessons from previous eras: economies of scale at the distribution level associated with operating a chain of stores, larger store sizes to accommodate greater product variety, and adoption of technologies to assist with managing store operations and tracking the movement of goods.

Moreover, there is evidence that Walmart's business model has benefited consumers. Empirical studies have shown that Walmart's entry into a local grocery retail market causes both a direct price effect (offering a lower price option) and indirect price effect (lowering prices at rival supermarkets) for shoppers, especially those who are price-sensitive.[11] There may also be nonprice effects; one study has found that Walmart's entry decreases stockout rates at nearby supermarkets, suggesting that some grocery competitors may respond by raising their quality (i.e. improving product availability) in lieu of lowering prices.[12]

The existence of these effects further counsels against initiating an antitrust investigation or enforcement based solely on a firm's market status and success. There needs to be some evidence of predatory or exclusionary conduct, or an agreement that unreasonably restrains competition, involving the dominant retailer in question.

III. STORE FORMAT AND BUYER POWER

In response to the preceding point, those seeking more vigorous antitrust enforcement in the grocery retail sector have called for an examination of a dominant retailer's exercise of buyer power with its suppliers in ways that may disadvantage smaller rivals.[13] This inquiry necessarily calls for a settled definition of "buyer power." According to Professor Zhiqi Chen, the term "buyer power" should be symmetric to the conventional definition of market power on the sell side, and it should be broad enough to encompass both monopsony power exercised against competitive suppliers and countervailing power (also called bargaining power) exercised against suppliers with market power.[14] There is ample economic literature on both species of buyer power and their differing welfare effects in the retail supply chain context.[15] This piece focuses, however, on countervailing power and, specifically, power that flows from various characteristics of a grocery retailer's format.

Retail, including grocery retail, is the last step in the supply chain — it puts goods in the hands (and mouths) of consumers. Hence retailers are in the business of moving goods to consumers, maximizing some combination of quantity, variety, and price under prevailing competitive conditions. As discussed above, format plays a critical role in achieving that business goal; it both attracts and drives shoppers to a particular retailer (e.g. through location, convenience, selection, services) and persuades them to buy some basket of goods (e.g. through placement, promotion, pricing, rewards).

10 Emek Basker, *The Cause and Consequences of Wal-Mart's Growth*, 21 J. Econ. Persp. 177, 179–80 (2007). See also Ali Hortaçsu & Chad Syverson, *The Ongoing Evolution of U.S. Retail: A Format Tug-of-War*, 29 J. Econ. Persp. 89, 104–05 (2015); S. Robson Walton, *Wal-Mart, Supplier-Partners, and the Buyer Power Issue,* 72 Antitrust L.J. 509, 514–18 (2005).

11 Emek Basker & Michael Noel, *The Evolving Food Chain: Competitive Effects of Wal-Mart's Entry into the Supermarket Industry*, 18 J. Econ. & Mgmt. Strategy 977, 979 (2009); Jerry Hausman & Ephraim Leibtag, *Consumer Benefits from Increased Competition in Shopping Outlets: Measuring the Effect of Wal-Mart*, 22 J. Applied Econometrics 1157, 1176 (2007). But see Peter Arcidiacono, et al., *The Competitive Effects of Entry: Evidence from Supercenter Expansion*, 12 Am. Econ. J: Applied Econ. 175, 203 (2020) (finding no evidence that supermarkets lower their prices in response to Walmart's entry and attributing their results to supermarket adherence to simple cost-plus pricing rules).

12 David A. Matsa, *Competition and Product Quality in the Supermarket Industry*, 126 Quarterly J. Econ. 1539, 1582–83 (2011).

13 See, e.g. Buyer Power and Economic Discrimination in the Grocery Aisle, *supra* note 2, at 8 ("Buyer-side market power exists when a purchaser can use its bargaining leverage to secure sub-competitive prices from its suppliers—i.e., prices or terms below those that would exist in a competitive market—or impose discriminatory terms on the purchaser's rivals—i.e., obtain price or supply concessions that are not available to its competitors.").

14 Zhiqi Chen, *Defining Buyer Power*, 53 Antitrust Bull. 241, 246–47 (2008). See id. at 247 ("*Buyer power* is the ability of a buyer to reduce price profitably below a supplier's normal selling price, or more generally the ability to obtain terms of supply more favorable than a supplier's normal terms."). See also Richard Scheelings & Joshua D. Wright, '*Sui Generis*'?*: An Antitrust Analysis of Buyer Power in the United States and European Union*, 39 Akron L. Rev. 207, 209–10 (2006). Scheelings and Wright further observe that if buyer power is broadly defined to encompass a buyer's ability to influence the terms of purchase, then the types of retailer practices that could be cited as evidence of buyer power are potentially endless. *Id.* at 237–38.

15 Chen, *supra* note 14 at 248 ("The distinction between buyer power and countervailing power is critical for the assessment of the likely effects of buyer power on consumer welfare and economic efficiency."). For relevant literature on monopsony power, see, e.g. Roger G. Noll, "*Buyer Power" and Economic Policy*, 72 Antitrust L.J. 589 (2005); Roger D. Blair & Jeffrey L. Harrison, *Antitrust Policy and Monopsony*, 76 Cornell L. Rev. 297 (1991). For relevant literature on countervailing power, see, e.g. David E. Mills, *Buyer-Induced Exclusive Dealing*, 84 Southern Econ. J. 66 (2017); John Kirkwood, *Reforming the Robinson-Patman Act to Serve Consumers and Control Powerful Buyers*, 60 Antitrust Bull. 358 (2015); Alberto Iozzi and Tommaso Valletti, *Vertical Bargaining and Countervailing Power*, 6 Am. Econ. J.: Microeconomics 106 (2014); Roman Inderst & Greg Shaffer, *Retail Mergers, Buyer Power and Product Variety*, 117 Econ. J. 45 (2007); Zhiqi Chen, *Dominant Retailers and the Countervailing-Power Hypothesis*, 34 RAND J. Econ. 612 (2003).

When a particular format succeeds, the retailer is of course not the only one who benefits. Manufacturers, producers, and wholesalers that supply goods to that retailer also indirectly benefit—through purchase and consumption of their goods by consumers and, more importantly, through access to consumers (often particular segments) and creation of (hopefully long-term) relationships with them.

It is therefore not hard to see how and why a successful format could confer bargaining power to a retailer in its negotiations with suppliers. Like a two-sided digital platform, a grocery retail format can exhibit indirect network effects — the more consumers there are on the sell side, the more attractive the format becomes to suppliers on the buy side. And vice versa, at least to some degree.[16] A format's attractiveness to suppliers can also be viewed as a form of derived demand: the more inelastic that downstream demand from some segment of inframarginal consumers is for goods sold through a particular format, the more valuable that format will be to suppliers seeking to reach that particular segment. Whether viewed as indirect network effects or principles of derived demand, what is important to keep in mind here is that these mechanisms principally result *from the competitive process*.

Competing grocery retailers present similar or differentiated formats to consumers, each in a bid to attract more consumers, or particular segments of consumers, to shop at its stores. They in turn leverage the comparative and relative success of their formats to attract more suppliers, or particular suppliers, to contract with them, and on terms that they prefer. In short, format-related buyer power is market power that typically arises from competition, and, in that respect, it should be distinguished from buyer power that arises, say, from a merger with a horizontal rival. Antitrust law rightly cares about the effects of the latter, but it should approach delicately concerns leveled about the former.

A key reason is that grocery retailers are apt to exercise format-related countervailing power in an effort to align suppliers, through contractual terms, with their business model. Such efforts are likely to be procompetitive and welfare-enhancing because they foster more vigorous downstream competition among retailers. For example, former Walmart chairman Rob Walton explained in an *Antitrust Law Journal* essay on buyer power that Walmart views its relationships with suppliers as symbiotic partnerships because, at the end of the day, they are both "selling to the same customer: the retail consumer."[17]

Walton added that "Wal-Mart's business is desirable to suppliers because we offer them the opportunity to make more money — by giving them tools to help them better manage their own businesses."[18] Walmart's perspective is consistent with some findings in the economic literature indicating that a retailer's exercise of countervailing power, at least under certain market conditions, can stimulate supplier innovation and efficiency.[19]

As a general matter, such findings make intuitive sense. Grocery retailers facing robust downstream competition are likely to turn to their suppliers for assistance and support with cost, variety, quality, and timing of delivery, which will preferably be consistent with and reinforce whatever format they are presenting consumers. For example, a grocery retailer with a supermarket format likely will make different demands of its suppliers than a grocery retailer with a convenience store format. The former presumably will want a greater variety of goods, and goods in a broader array of package sizes, than the latter.

On the flip side, suppliers bargaining with grocery retailers will have to decide not only the relative importance of a particular firm as an outlet for their goods in a given local market, but also the comparative value of a particular format in presenting their goods to consumers.[20] Indeed, if one retailer's format yields significantly greater incremental gains from each sale than another's, that may incentivize a supplier to devote more resources towards working with that retailer in order to maximize those gains. The greater the alignment between the retailer and its supplier, the greater are the potential gains that the parties can split.

A key observation here is that the incremental gains of sale, the division of which is the subject of supplier–retailer negotiations, are not necessarily fixed and static. Rather than walking away from the negotiation and accepting the disagreement payoff, each party may

16 Some consumers may care more about variety in suppliers for a particular good. Those who are loyal to a particular brand that the retailer carries may be indifferent.

17 Walton, *supra* note 10, at 519.

18 *Id.* In his essay, Walton proceeds to discuss examples of areas where Walmart seeks to align suppliers with its business model, e.g. quoting net-net prices and identifying opportunities to lower delivered costs. *Id.* at 519–21.

19 See Zhiqi Chen, *Supplier Innovation in the Presence of Buyer Power*, 60 Int'l Econ. Rev. 329 (2019) (finding that buyer power can enhance supplier incentives to engage in product innovation if demand elasticity is not too high); Christian Köhler & Christian Rammer, *Buyer Power and Suppliers' Incentives to Innovate (ZEW—Centre for European Econ. Research Discussion Paper No. 12-058, 2012) (finding that buyer power can stimulate supplier incentives to engage in product innovation if downstream price competition is high), available at* https://bit.ly/3xQFN5g; Roman Inderst & Christian Wey, *Countervailing Power and Dynamic Efficiency*, 9 J. European Econ. Ass'n 702 (2011) (finding that buyer power creates additional incentives for suppliers to reduce marginal costs).

20 See, e.g. Anthony J. Dukes, et al., *Channel Bargaining with Retailer Asymmetry*, 43 J. Marketing Research 84, 84–85 (2006).

realize that there are latent opportunities to increase the incremental gains, thereby making an agreement more attractive relative to its outside option.

IV. CONCLUSION

Size alone does not necessarily define a grocery retailer as dominant, and the fact that a grocery retailer is seen as dominant today does not guarantee that it will be dominant tomorrow. The past century of evolution in this sector has taught us that format plays a pivotal role in competition, allowing some retailers to capture an increasingly greater share of sales at the expense of their rivals, and that the introduction of a new format can lead to the creative destruction of incumbent business models that previously flourished. Indeed, we see these competitive forces at work today, as the coronavirus pandemic has forced consumers to rethink how and where they want to buy their groceries.[21]

For example, some consumers have opted to have their groceries delivered to them rather than to set foot in the store, and if this preference holds after the pandemic is finally over, it may well cause retailers to shift away from formats that are aimed at generating and accommodating significant consumer traffic. They may instead invest more in logistics, like delivery trucks and platforms for ordering groceries. As a result, formats that have made some retailers dominant today may not keep them in that market-leading position tomorrow.[22]

Any assessment of a grocery retailer's buyer power must account for and distinguish countervailing power that flows from that retailer's format. Buyer power is not just about the retailer's size. The more successful a retailer's format is in generating sales of a particular supplier's goods, the more attractive that retailer will be to that supplier, relative to its outside options. A supplier may see a retailer as an important channel for its goods, even if that retailer does not account for the majority of sales in a local market. Furthermore, in negotiation it is reasonable to expect a retailer to demand terms that will promote the success of its format, especially if downstream competition is robust.

For example, a retailer may want its supplier to quote prices that facilitate its own pricing strategy to consumers. Or it may want its supplier to respond more quickly to inventory levels, in order to minimize stockouts. Such exercises of countervailing power generally should be seen as procompetitive and welfare-enhancing because they seek to better align suppliers with a retailer's format, which leads to more vigorous downstream competition, and lower prices, higher quality, and greater selection for consumers. Suppliers stand to benefit too because better alignment may make the format more effective and thereby increase the incremental gains of sale that they bargain over with the retailer.

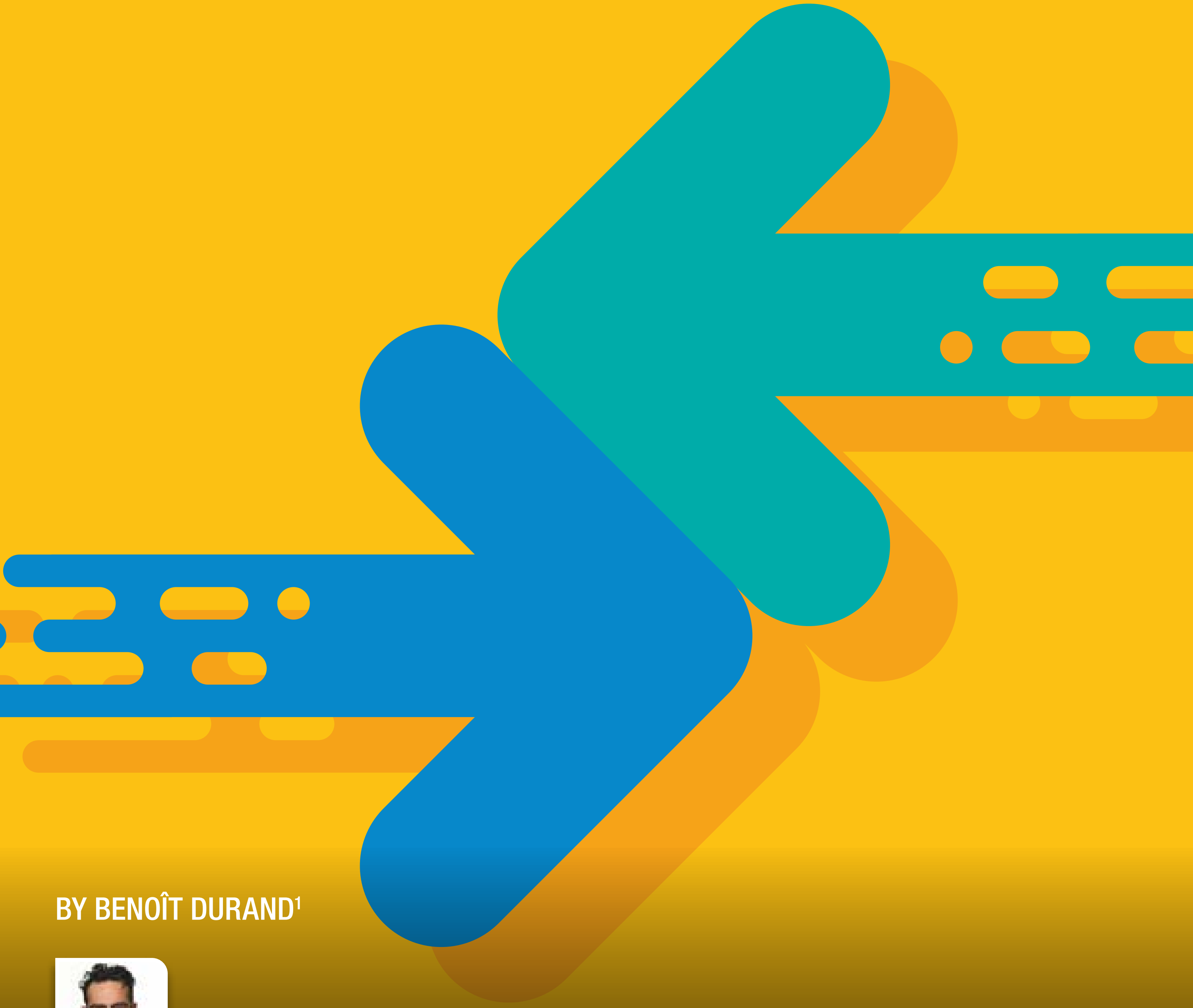
This essay neither dismisses nor discounts the possibility that dominant grocery retailers may engage in exclusionary or predatory tactics aimed at disadvantaging rivals, which the antitrust laws can and should address.[23] Nor does it address buyer power that may arise from retail mergers. But the exercise of format-related countervailing power deserves careful and thoughtful treatment by antitrust enforcers. Because retail formats differ from one another to varying degrees, the terms negotiated by retailers with suppliers may vary accordingly. Such differences generally do not constitute the type of economic discrimination that should concern enforcers. On the contrary, they are a byproduct of the competitive process and an essential feature of format competition, allowing retailers to better differentiate themselves from their market rivals. If misdirected or misapplied, antitrust enforcement could dull the intensity of format competition and dampen the market incentives to engage in format-related innovation.

21 See Shira Ovide, *Tech Shakes Up the Supermarket*, N.Y. Times: On Tech (updated June 17, 2021), https://nyti.ms/3y8Sg4E.

22 Accenture recently reported that consumers "now value convenience, inspiration, community and sustainability," suggesting there will be windows of opportunity for local independent grocers to distinguish themselves from national giants. Jen Pritchard & Matt Jeffers, *Retail Consumers Seek a Different Grocery Experience*, Accenture Retail Blog (Aug. 11, 2021), https://accntu.re/3py33kO.

23 See, e.g. Steven C. Salop, *Anticompetitive Overbuying by Power Buyers*, 72 Antitrust L.J. 669 (2005).

THE COMPETITIVE ASSESSMENT OF MERGERS IN RETAIL GROCERY MARKETS: A BASKET CASE?



BY BENOÎT DURAND[1]

1 Partner at RBB Economics. The author would like to thank Lachland Lindsay and Johanna Lunghini for excellent research assistance. The views expressed in this article are the author's own and do not reflect the view of RBB Economics..

I. INTRODUCTION

One major motivation behind retail grocery chains looking to merge is to achieve synergies, notably those associated with scale. Indeed, bigger size can generate significant cost advantages. In theory, such size advantage can be achieved organically, but constraints on growth, in particular planning authorization, often direct retail chains to finding mergers as the most practical way to generate cost reductions.

Cost advantages that stem from bigger scale span several dimensions. For instance, by grouping their purchases, two grocery retailers can obtain better deals from suppliers, notably through volume discounts. Such cost reductions can be passed on to consumers. Mergers between retail chains may also generate other types of savings, including around logistics and product assortment. These synergies can be significant and strengthen the competitive ability of merging parties. Indicative of this is the 2016 merger between Ahold and Delhaize, which generated €750 million in cost savings over three years, exceeding expected synergies.[2]

However, horizontal mergers can also give rise to more concentrated retail grocery markets. Hence, competition authorities may have concerns that these transactions could confer significant market power to the merged entity. This in turn may manifest in higher prices for the supply of groceries or, more globally, may worsen the retail offering.[3] This worsened retail offering may involve additions to price, diminished quality, a reduced range of products, and a narrowing of services delivered to customers.[4]

In Europe, mergers in the retail grocery sector are reviewed by national competition authorities, as these transactions typically concern only one country. Recently, authorities blocked or threatened to block some of the largest mergers between grocery retailers. In 2019, the UK Competition Market Authority ("CMA") prohibited the merger of Sainsbury's and Asda.[5] In 2016, Auchan and Système U abandoned their plan to merge after the Autorité de la concurrence ("Adlc") opened an in-depth investigation.[6] And in 2015, the German Bundeskartellamt ("BKartA") published its decision to block the acquisition of hundreds of Kaiser's Tengelmann stores by EDEKA.[7]

These decisions show that national competition authorities can intervene to preserve competition on retail grocery markets. However, behind these decisions, there are major differences in approaches to evaluate the risk these mergers pose to retail competition. Moreover, and crucially, there are significant variations in the threshold applied for intervention across jurisdictions, such that the same merger could have a very different fate depending on which authority reviews the transaction.

Some authorities, in particular the CMA, have developed a rather mechanistic approach to assessing the competitive effect of retail grocery mergers. A major motivation behind this is that, otherwise, some transactions may require the authority to conduct an in-depth investigation of hundreds of markets. By way of example, the CMA identified 537 local areas in which the merger between Sainsbury's and Asda may give rise to a substantial lessening of competition.[8] In this case the CMA heavily relied on the outcome of an upward pricing pressure test (GUPPI) to determine whether the merger would give rise to a substantial lessening of competition in local markets.[9] While there are good reasons to deploy a systematic, mechanistic approach when the number of grocery stores involved is very large, this algorithmic method fails to account for dimensions of competition that cannot be captured by quantitative tools. For instance, competition in retail grocery markets includes factors such as quality of service, which may involve investment to refit and refurbish local stores or spending on training for staff to improve the level of service. These factors are not taken into account in upward pricing pressure tests.

2 See https://www.grocerydive.com/news/grocery--ahold-delhaize-profits-surge-68-with-merger-savings/534814/ and https://www.aholddelhaize.com/media/8807/ahold-delhaize_q4fy18_summary-report.pdf.

3 Some competition authorities have also been concerned that mergers between two large grocery retailers would confer the merged entity significant buyer power, at the expense of suppliers.

4 The CMA refers to these price and non-price factors as "PQRS," for price, quality, range and service.

5 See https://www.gov.uk/government/news/cma-blocks-merger-between-sainsburys-and-asda.

6 See https://www.autoritedelaconcurrence.fr/en/communiques-de-presse/24-may-2016-retailing-sector.

7 See https://www.bundeskartellamt.de/SharedDocs/Entscheidung/EN/Fallberichte/Fusionskontrolle/2015/B2-96-14.html?nn=3591568. The German ministry of economic affairs, however, vetoed the decision, which de facto allowed the merger to go through. (See https://www.bundeskartellamt.de/SharedDocs/Entscheidung/EN/Fallberichte/Kartellverbot/2017/B2-31-17.html?nn=3600108.) However, that ministerial authorization was appealed before the Higher Regional Court of Düsseldorf, which declared the ministerial decision to be unlawful. (See https://www.vbb.com/insights/competition/merger-control/edekakaisers-tengelmann-german-merger-review-saga-comes-to-an-end).

8 See paragraph 3b, https://assets.publishing.service.gov.uk/media/5cc1434ee5274a467a8dd482/Executive_summary.pdf.

9 See https://www.rbbecon.com/publications/brief-60-sainsburysasda-and-the-cmas-guppi-decision-rule-on-the-money-or-basket-case/.

In sharp contrast, the BKartA claims to rely on a broad approach in its review of EDEKA's acquisition of around 450 Kaiser's Tengelmann stores, even though the transaction involved hundreds of stores. The BKartA expressly dismissed the "mathematical" approach, claiming to conduct a thorough assessment that accounts for several important factors, notably those related to market structure.[10]

Across jurisdictions, however, competition authorities do not consider post-merger local market entry or expansion by rival retailers as likely. This is despite recognition that competitors' reactions could maintain prices at the competitive level. In large part, the authorities can attribute this simplification to the fact that opening a new supermarket requires authorization from local authorities, which even if granted, might take significant time. In some local markets, however, such a possibility might exist, but to assess whether entry is likely and timely would require a detailed analysis in each market. While authorization for a new supermarket may not be forthcoming, it may be easier for a grocery store to open if a merger has reduced local competition. This new entry could significantly boost competition, and potentially apply downward pressure on prices. Furthermore, competitors may respond to a price increase by repositioning their product offering such that greater competitive pressure is applied on the merged entity. Such a move may also reduce prices.

II. DEFINING LOCAL MARKETS

All competition authorities consider that retail grocery markets are local, sometimes involving very small territories, which means that when large retailers notify a transaction, the regulatory review may involve an in-depth investigation of hundreds of markets. Authorities, however, have defined local markets differently. The CMA and the AdlC consider the catchment area of the merging parties' supermarkets as the relevant market, while the BKartA defines geographic markets around administrative boundaries.

A. Local v. Nationwide Competition

To assess the competitive effect of retail grocery mergers, competition authorities define local markets despite transactions involving nationwide retail grocery chains. The main reason why competition authorities focus on the competitive effect of grocery mergers in local areas is simply because consumer demand is mostly from the area in question.[11] Price sensitive customers are highly unlikely to travel long distances to find another grocery store if prices are raised at the supermarket they usually visit. These customers will typically consider local alternatives.

There is plenty of evidence that this is the case. For instance, the BKartA and the CMA report that the entry or exit of grocery stores has an impact on the revenue of local rivals.[12] Further, according to the CMA, its exit-store survey conducted in the *Sainsbury's/Asda* case shows that most customers of a given supermarket would not consider shopping in stores that are more than a 15-minute drive-time from the store in question.

Competition authorities have also noted that many aspects of competition are essentially local. That is, stores can flex local retail offerings to attract customers away from competing stores in proximity. For example, the range of available products at a store or the level of service offered may depend on the local competitive conditions. These parameters can be flexed by grocery retailers to improve their local offer in areas where competition is more intense. Even if part of a national retail chain, local stores may have a degree of control over their pricing, with the possibility of applying discounts to the price of some key items. Additionally, a retail grocery chain can decide to refurbish individual local stores to improve the layout and create new amenities, which will strengthen the local competitive position of these stores.

Some aspects of competition, however, appear to be set over a much broader geographic scope than local areas. In some cases, key parameters of competition are decided centrally and applied uniformly across all stores of a retail chain. In the UK, for example, the Competition Commission had determined that prices of major grocery retailers were largely uniform. That is, the price of goods is the same across all stores of a major retailer. On that basis, it has been argued that the effect of a merger will not be felt locally but across all stores of the merging parties,

10 See paragraphs 239 and 409 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

11 Andreas Mundt, President of the Bundeskartellamt, said in reference to the *EDEKA/Kaiser's Tengelmann case: "In this case the local market situation is the deciding factor. The argument that Kaiser's Tengelmann has a relatively low share of the national market misses the point. No one travels across Germany to go shopping, not even across a large city."* https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2015/01_04_2015_Edeka_Untersagung.html;jsessionid=581104F2EED97BC053C8762F522F79E9.1_cid371?nn=3591568.

12 See the CMA decision *on Sainsbury's/Asda* and the BKartA decision on *EDEKA/Kaiser's Tengelmann.*

whether the stores overlap or not.[13] In that context, it might be more relevant to define broader geographic markets, potentially nationally, as large brand chains compete nationally.

Competition authorities have resisted this argument. In large part this is because the main source of competitive constraint is essentially local, even if it is the case that prices are set nationally. One way to see this is to consider a simple hypothetical example. Consider that two retail chains, A and B, seek to merge, they set price uniformly, and their national market share is respectively 12 percent and 7 percent. If the geographic market is defined at the national level, in principle such a transaction would be unlikely to give rise to competition concerns. However, upon a closer look, the parties' stores overlap in a significant number of concentrated local areas in the west of the country, and in fact, in many local markets, this merger would lead to local monopoly. Further, if the two grocery retailers do not have many other stores elsewhere in competition with other retailers, then post-merger prices can be expected to increase to the monopoly level. An assessment at the national level would fail to see this.[14]

Equally, however, if prices are set uniformly, a narrow focus on the local analysis of mergers may overstate the effects of the transaction, failing to account for the competitive constraint exerted by rival grocery retailers. One way to see this is to use another simple example. Consider that two grocery retailers, C and D, seek to merge, and they respectively have 500 and 400 stores, but they overlap only in three local markets. The price set by chain C in all of its supermarkets is the result of the competitive constraint that its 500 stores face locally. In particular, if the 500 stores face intense local competition, then C's price will be set at a very low level. In this context, a merger that relaxes competition for only three stores is unlikely to affect nationwide prices significantly (assuming that the retail grocery chains continue to set price uniformly across all stores).

B. Defining the Boundaries of Local Grocery Markets

While competition authorities consider that markets are local, each has developed its own approach to define the boundaries of individual geographic markets. Importantly, none of these approaches are strictly in line with the hypothetical monopolist test, which is the method to define antitrust markets. In most cases, the geographic market is defined around a center point, and the boundaries are found using a radius from that center, either measured as a straight line in kilometers/meters or as drive-time, which looks at the car journey time of customers. As we explain below, however, not all competition authorities define the center point in the same way.

The German BKartA defines the geographic market around a regional center ("regionales Oberzentrum"), using either a 20 km radius or 20-minute drive-time.[15] Every postal code area that falls within this range is assigned to that relevant market. The BKartA thus splits Germany into many geographic markets – 345 to be exact.[16] That said, in the case of large cities over 500,000 inhabitants, the BKartA defines markets according to smaller territories, following the boundaries of boroughs ("Stadtbezirke").[17]

This approach is imperfect in several ways. First, it fails to account for the possibility that stores in differently defined geographic markets can compete. For instance, in large cities the BKartA follows the boundaries of boroughs yet stores in separate administrative territories can compete. Indeed, two stores in such close proximity that they are obviously competing for the same customers could still be separated into different geographic markets according to the rule applied by the BKartA. Equally, two supermarkets that are far apart from one another, for example a distance over 35-minute drive-time, may not compete, or not compete as closely as nearby stores, yet they would belong to the same geographic market.

Other competition authorities, such as the UK CMA and the French Adlc, have defined local markets using each supermarket as the center point. Specifically, each local market corresponds to the catchment area of the merging parties' stores, which means that the number of geographic markets will be very large if the grocery retailers have many supermarkets. They do not provide justification for this approach, which differs significantly from the one adopted by the BKartA, but we can conjecture that it might be more pragmatic to consider the competitive constraint exerted on a given grocery store by examining the number and identity of competing stores within its catchment area.

13 As indicated in the UK Competition Commission Final Report on the Groceries Market Inquiry at paragraph 4.98, "Tesco submitted that the prevalence of nationally set, and largely uniform, aspects of the retail offer for grocery stores indicates a national rather than a local geographic market." The Competition Commission also noted that most retailers set their prices uniformly, or mostly uniformly, across their store network. See Competition Commission, The supply of groceries in the UK market investigation, April 30, 2008.

14 Paul Dobson and Michael Waterson, "Chain-store pricing across local markets" *Journal of Economics and Management Strategy* (Spring 2005) 14, 1, 93-119.

15 See paragraphs 217 and 236 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

16 See paragraph 209 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

17 See paragraph 215 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

The size of the catchment area varies according to the size of the grocery store in question.[18] Large grocery stores have wide catchment areas, as people may travel greater distances to do their weekly shopping. Small grocery stores have small catchment areas. Competition authorities make such a distinction. For example, in the UK, the CMA considers that large stores are constrained by other large stores within 10 (15) minute drive-time in urban (rural) areas.[19] The rule is different for smaller stores. Medium stores are constrained by other medium stores within 5-minute drive-time and by large stores within 10-minute drive-time in urban area.[20] (The catchment area is broader in rural areas).

As noted, the size of the catchment area can vary depending on whether stores are in densely populated areas or in rural areas, which is clear from the rules set out by the CMA. Competition authorities, however, can go beyond the simple arbitrary split between rural and urban areas. The French Adlc considers reducing the boundaries of the catchment area depending on population density, which leads to a series of rules. The starting position is that the catchment area of a hypermarket is 30-minute drive-time and that of a supermarket is 15-minute drive-time.[21] However, for the 10 most populated cities in France, the rules become 20- and 10-minute drive-time respectively.[22] In the Paris region, the catchment area of grocery stores is smaller. In the close suburbs of Paris (known as la petite couronne), the authority uses 10-minute drive-time as the starting position.[23] In Paris, customers are expected to walk to do their grocery shopping as a very small proportion of residents own a car and the size of grocery stores is typically small. For Parisian stores greater than 400 square meters, the catchment area is defined by the territory within 500 meters of the store, and for smaller stores, the size of the catchment is based on a radius of 300 meters.[24]

This approach also appears to be imperfect. In theory, retail grocery stores compete if their catchment areas overlap. In practice, however, authorities consider that stores compete only if they are in each other's catchment area. This approach, while practical, is necessarily flawed for the following reasons:

- First, it may fail to identify some of the merging parties' stores that compete. Supermarkets with overlaps in their catchment areas but not located in each other's catchment area may compete for customers located in these overlaps. This means that grocery stores outside of the catchment area defined by the authority can exert a significant competitive constraint on the center store. A possible solution to this would be to adjust isochrones according to population center, though this would require detailed local information on population density.
- Second, it may lead to an overly narrow scope of analysis by misrepresenting competition conditions in local markets. If overlaps between catchment areas are not accounted for, the resulting analysis may be flawed. By failing to consider the competitive constraint exerted by stores outside the catchment, this analysis may be biased towards finding a lessening of competition.

III. ASSESSING THE COMPETITIVE EFFECTS OF MERGERS ON GROCERY RETAIL MARKETS

Depending on the extent of overlaps, and because geographic markets are defined narrowly, mergers between grocery retail chains can affect many markets. To address this large number problem, competition authorities typically deploy a two-step approach. First, they apply a filter to identify local markets which require further investigation; then, they assess the competitive effect of the merger in each of these markets.

In some mergers, the authority may have to investigate hundreds of markets even after the application of a filter. Interestingly, competition authorities have developed very different approaches when confronted with this issue. In *Sainsbury's/Asda*, the CMA relied almost solely on a mechanistic approach based on upward pricing pressure tests, which is calculated for all overlapping stores. In sharp contrast, the French Adlc and the BKartA's assessment is based largely on traditional concentration measures, such as market shares and the number of competitors. In *Casino/Monoprix*, the French Adlc relied on the Parties' market shares and the number of competitors' stores in each local market, while in *EDEKA/Kaiser's Tengelmann* the German BKartA considered the degree of market concentration in large cities, not focusing on any particular narrow geographic market.

18 In the 2008 groceries market investigation, the UK Competition Commission recalls that the catchment area is the area from which a store draws most of its customers. For example, the Commission shows that a majority of customers (more than 80 percent) shop at large stores within a 15-minute drive-time. See Final Report at paragraph 4.103.

19 Grocery stores that are greater than 1,400 square meters are named large stores by the CMA. The CMA considers that these stores are suitable for one-stop shopping.

20 The CMA defines medium stores are those which have a size between 280 and 1,400 square meters. Stores under 280 square meters fall in the convenience store category.

21 See paragraph 96 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

22 See paragraph 102 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

23 See paragraph 112 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

24 See paragraph 105 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

A. Screening Local Grocery Markets

Because the number of local retail markets that are potentially affected by a horizontal merger between two large grocery retail chains can be very large, competition authorities apply a filter based on concentration rules as a first step to screen out markets. This is done to ensure that they investigate the likely effect of a merger only in sufficiently concentrated markets. However, the concentration rules they apply vary substantially.

Until the *Sainsbury's/Asda* merger, the CMA (and the OFT before it) consistently used a simple fascia count. That is, if a merger resulted in a reduction of grocery chain fascia from four to three or fewer in the center store's catchment area, then the store in question was flagged for further inquiry; this occurred irrespective of the size of the merging parties in the affected market.[25]

In *EDEKA/Kaiser's Tengelmann*, the BKartA applied a simple market share threshold. It considers that the merger could restrict competition in every geographic market in which the parties' combined market share exceeds 25 percent in the overall retail food market ("Gesamtmarkt"), which includes full range grocery retailers as well as discounters.[26]

The French Adlc adopted perhaps the most convoluted set of filters to screen out markets where it is unlikely that the merger could result in competition concerns. This approach, which is set out in *Casino/Monoprix*, rests on a combination of rules based on market share and HHI thresholds. Market shares are calculated using the size of stores, or if possible store area dedicated to the supply of groceries. First, the Adlc applies a simple rule based on the dominance criterion. Every local market in which the parties' combined share exceeds 50 percent is investigated further.[27] Moreover, the Adlc considers that markets where the combined market share of the merging parties is between 45 and 50 percent and the following conditions apply also merit further inquiry:

- markets in which the HHI level is between 1000 and 2000, and the delta HHI (the increment in the HHI level caused by the merger) would be at least 250; or
- markets in which the HHI level is greater than 2000, and the delta HHI would be at least 150; or
- markets where the market share increment is at least 10 percent.[28]

For the city of Paris, which is viewed as different from the rest of the country, notably because most residents do not own cars and tend to spend less on each shopping trip, the French Adlc established a different set of rules to screen out markets. The Adlc decided that in markets where the merging parties' combined share is below 60 percent, where there are at least three competing fascia (with stores greater than 120 square meters) and at least half of the stores are in the hands of rivals, the merger would not raise significant competition concerns.[29]

B. Assessing the Competitive Effect of Retail Grocery Mergers

In principle, competition authorities investigate the competitive effect of a merger only in local retail markets where the merging parties overlap and the increase in market concentration is deemed sufficiently high, although the CMA, and to a lesser extent the BKartA, have considered the nation-wide effect of transactions. The approach that authorities have developed to predict the competitive effect of these mergers on numerous markets varies significantly, however.

The BKartA and the French Adlc relied mostly on market shares, though the threshold used by the Adlc appears significantly more lenient than that adopted by the BKartA.

For the *EDEKA/Kaiser's Tengelmann* merger, the BKartA first considered closeness of competition between the merging parties, but also their competition with rival grocery retailers in the wider food retail market, not focusing on any particular local market.[30] For each retailer the

25 See CMA, Retail mergers commentary, April 10, 2017, CMA62 at paragraph 3.35. The CMA has used the four-to-three fascia count threshold in mergers in the grocery sector. This was first used in *Safeway* (2003).

26 See paragraph 410 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

27 See paragraph 189 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

28 See paragraph 198 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

29 See paragraph 274 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

30 See paragraph 331 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

BKartA examined several characteristics, such as the size of stores, the range of goods, as well as the proportion of private labels in retailers' profit margins. In addition, the BKartA developed several data analyses, looking in particular at how retailers overlap in the supply of particular brands of goods, similarities in the baskets of their respective customers, as well as the impact of entry/exit on rival grocery retailers.[31] The BKartA concluded that the wider food retail market could be segmented between full-range grocery retailers and discounters, and within full-range retailers, the market can be further segmented. In particular, the BKartA found that a group of three major retailers, EDEKA, Kaiser's Tengelmann, and Rewe, are very close competitors. This led the BKartA to conclude that the merged entity would face competition from only one very close competitor: Rewe.[32]

Second, using a series of concentration measures, the BKartA determined whether the merger would result in a significant impediment to effective competition in local markets. The German authority did not examine each local market in any detail, but rather favored a broader overarching view. The BKartA took into account the market share of the merging parties in the overall food retail market, but also their market position in a narrower segment comprising full-range retailers.[33] For example, in Berlin, the BKartA found that in most districts of the city, the merging parties and Rewe have a combined market share of at least 50 percent in the overall food retail market.[34] Further, the authority found that in the narrower full-range retail segment, EDEKA, Kaiser's Tengelmann, and Rewe would together control about two-thirds of the market.[35] The BKartA concluded that the proposed transaction would lead to the loss of competitive pressure from Kaiser's Tengelmann as well as giving rise to dangerously high market concentration, especially given the reduction of three to two competitors in the full-range grocery retail segment.[36]

Concluding their analysis, the BKartA found that the merger between EDEKA and Kaiser's Tengelmann restricted competition in a series of markets, and in particular in large cities such as Berlin, Munich, and Düsseldorf.[37]

When conducting in depth investigation of markets flagged by its market concentration filter in *Casino/Monoprix*, the French Adlc mostly considered features of the local market structure in determining its overall findings regarding competitive effects. For instance, in two markets, Arles and St Raphael, despite the merged entity having a market share above 50 percent and a market share increment greater than 5 percent, the Adlc ruled out competition concerns on the basis that there were five competing fascia in the catchment area, which had many competing stores.[38] In Ajaccio, even though the merged entity would have a market share above 45 percent and it would face only two competing fascia, the Adlc found that the merger would not stifle competition. The reasons invoked for this decision are that two-thirds of stores are owned by rivals and one of the competing fascia, Carrefour, has a market share of 40 percent.[39]

In Paris, the Adlc applied a less interventionist filter than in the rest of the country. In spite of this, it had to investigate 47 local areas in greater depth for the *Casino/Monoprix* transaction.[40] The competitive assessment essentially boiled down to determining the extent to which hypermarkets (stores which dedicate at least 2,500 square meters for groceries) owned by rival grocery retailers across locations just beyond and inside Paris exert a competitive constraint on the merging parties' stores in Paris. Using the results of various analyses, the Adlc made downward adjustments to the merging parties' market share in some local areas to account for this particular constraint.[41]

Unlike the German BKartA and the French Adlc, which rely mostly on concentration measures (i.e. market shares and number of competitors), in *Sainsbury's/Asda* the CMA relied exclusively on the results of an upward pricing pressure test, namely the GUPPI, that is calculated for each market in which the merging parties overlap. The CMA found that the merger would give rise to a significant lessening of competition in markets where the GUPPI is above 2.75 percent when merger-specific efficiencies are accounted for, and above 1.5 percent without efficiencies.

31 See paragraph 259 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

32 See paragraph 325 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann,* 31.03.2015).

33 See paragraph 414 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

34 See paragraph 440 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

35 See paragraph 457 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

36 See paragraph 468 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

37 See paragraphs 2-5 of the decision (BKartA, B2-96/14, *EDEKA/Kaiser's Tengelmann*, 31.03.2015).

38 See paragraphs 191-192 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

39 See paragraph 200 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

40 See paragraph 275 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

41 See paragraph 353 of the decision (Autorité de la concurrence, 13-DCC-90, *Casino/Monoprix*, 11.07.2013).

These thresholds are particularly low, and lead to an adverse finding in many overlapping markets.[42]

The GUPPI is based on two inputs, the diversion ratio between the merging parties and their profit margin. The higher the parties' diversion ratio and the higher their profit margin, the greater the GUPPI will be. In past cases, diversion ratios were estimated using an exit-store survey. That is, customers shopping on the day of the survey at the center store were asked where else they would shop if the store in question were no longer in operation. On the basis of the surveyed customers' response, it was possible to estimate the proportion of customers who could consider switching to the other merging party.

In *Sainsbury's/Asda*, the parties overlapped in many markets, therefore conducting a customer survey in all these markets would have been not only costly but also time consuming.[43] The CMA developed an alternative approach, called the weighted share of shops (WSS), which assigns a weight to each store in the local market based on the brand, its size and its distance from the center store.[44] All else equal, if a store is large, closer to the parties' center store, or if it belongs to a brand seen as exerting a greater competitive constraint, it shall receive a higher weighting. For each local area considered, with one of the merging parties' stores at the center, the weights add up to 100 percent. These proportions were then used to compute the relevant diversion ratios between the merging parties.

In sharp contrast to the approach followed by the German BKartA and the French Adlc, the CMA did not rely on traditional concentration measures, such as the parties' market share and the number of competitors, as these may not adequately reflect the extent of the competitive constraint exerted by rival grocery retailers in each local market. Furthermore, through diversion ratios, the CMA took into account the competitive constraint exerted by discounters, such as Aldi and Lidl, which are not always included in the relevant antitrust market, as well as what it termed "out-of-market" constraints, which include bargain stores, specialist stores but also supermarkets located outside the immediate local areas (i.e. more than 10- or 15-minute drive-time from the center store).[45]

Unlike market shares or other concentration measures, this method takes into account the fact that rival local supermarkets apply a varying degree of competitive pressure on the center supermarket. In the *Asda/Sainsbury's* case, this manifested in greater weights for large Tesco stores than medium Waitrose stores at a given drive-time distance, for example.

The CMA found that the *Sainsbury's/Asda* merger would result in a significant lessening of competition in 537 local markets centered on the Parties' supermarkets.[46] Importantly, this represents about 40 percent and 50 percent of Sainsbury's and Asda's stores, respectively.

IV. CONCLUSION

As we have shown in this article, major competition authorities in Europe have not applied a consistent approach to predict the competitive effect of mergers on retail grocery markets. Crucially, the threshold for intervention varies substantially across jurisdictions. That said, they share an important, common feature: the result of the competitive assessment is based on a static analysis. This is because in each jurisdiction, authorities have found that there are significant barriers to expansion and entry in the grocery sector, therefore finding reactions from competitors appear quite unlikely. This implies that for mergers that lead to more concentrated local markets, unless the merging parties can convince the authorities that significant synergies would offset any predicted anti-competitive effects, the merger will be cleared only if the parties agree to divest stores to reduce or eliminate the overlap in the local markets at issue. The extent of the divestment package depends, however, on the threshold for intervention, which can be particularly low in some jurisdictions.

42 See RBB Brief 60, October 2019 for a more detailed discussion of the particularly low GUPPI thresholds adopted by the CMA in this case. (https://www.rbbecon.com/downloads/2019/10/RBB_Brief-60.pdf). It is worth noting that in its commentary on retail merger, the CMA appears to suggest that it find concerns when GUPPI is above 5 percent. See CMA, Retail merger commentary, April 10, 2017, at 5.14.

43 The Parties operate over 1,000 supermarkets across the UK. See paragraph 4.1.

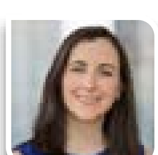
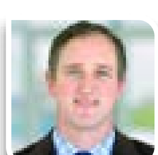
44 The CMA conducted an exit survey that covered 100 stores, 50 Sainsbury's and 50 Asda supermarkets. The results of the survey together with the finding of an empirical analysis on the impact of entry and exit has been used by the CMA to inform the weight in relation to brand, store size and distance from the center store.

45 Out-of-market constraints, such as non-supermarket stores, brands other than the supermarket chains analyzed, online retailers, and supermarkets outside of the catchment area, were allocated a 25 percent weighting in the estimation of diversion ratios.

46 See paragraph 8.90.

TRENDS IN CONSUMER SHOPPING BEHAVIOR AND THEIR IMPLICATIONS FOR RETAIL GROCERY MERGER REVIEWS

BY DIMITRI DIMITROPOULOS, RENÉE M. DUPLANTIS & LOREN K. SMITH[1]

1 The authors are all colleagues at The Brattle Group, with Dimitri Dimitropoulos being a Senior Consultant and Renée M. Duplantis and Loren K. Smith being Principals. The opinions expressed are those of the authors and do not necessarily reflect the views of the firm or its clients. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

I. INTRODUCTION

In the United States, retail grocery mergers most often are reviewed by the Federal Trade Commission ("FTC"). The FTC's economic and econometric evaluation of such mergers generally has been flexible enough to adapt to differences across retail grocery mergers with regards to relevant competitors and consumer preferences. However, recently, rapid technological advances and a global pandemic have significantly changed in the way consumers shop for groceries, which may force larger adjustments to the FTC's standard approach than previously have been required. In particular, the FTC may need to rethink its approach to product and geographic market definitions in light of, among other factors, the growing strength of competition traditional grocery stores face from wholesale club stores and online retailers. The FTC likely will also want to adapt its approach to market definition for retail grocery mergers to account for changes in consumer shopping behavior over the last decade, which have been further accelerated by the COVID-19 pandemic.

II. TRADITIONAL APPROACH TO RETAIL GROCERY MERGER REVIEW

The FTC has developed a standard approach to reviewing retail grocery mergers. Consistent with the analytical framework set forth in the *Horizontal Merger Guidelines*,[2] the FTC's approach generally involves evaluating the potential competitive effects of a merger for a set of overlapping products and geographies. For grocery retail mergers, this involves identifying merging party stores that are competitors in plausible geographic markets and then assessing the potential for increased prices arising from the consolidation of stores in those markets.

A. Product Market Definition

Grocery retailers can be differentiated across many different dimensions, including product offerings, pricing, store size, accessibility, quality, convenience, and shopping amenities made available to consumers. For example, some grocery retailers employ "High-Low" pricing strategies, where regular every-day prices are occasionally reduced to "featured prices" (which may be promoted in the store's weekly flyer). Other grocery retailers use "Every Day Low Pricing" or "EDLP" strategies where prices are maintained at "low" prices every day. The need for retailers to compete with Walmart, which employs an EDLP strategy, has increased the popularity of EDLP. Brand focus is another feature of grocery retailers that affects pricing strategy. For example, so-called "Hard Discounters" sell mostly private-label products at lower prices, while "Premium" grocery retailers offer rarer brands at higher prices.

In addition to pricing strategies and product quality, supermarkets can differ in (i) size, (ii) breadth of product offerings; (iii) store configuration, including the size of their produce, deli, meat, cheese, frozen foods and, increasingly, and prepared foods sections; (iv) convenience, including location, shopping hours, on-site parking and, increasingly, home delivery and online ordering options; and (v) shopping "experience," including the knowledge and level of service provided by store clerks and merchandisers, as well as amenities offered at the store.

Collectively, the features described above make up a grocery retailer's "format," which is used in determining relevant product markets. Store format may affect the extent to which consumers consider grocery retailers to be substitutes if, when shopping, consumers consider more about their shopping experience than just where the items on their grocery lists can be found. Indeed, the FTC has written that "investigations have found a strong correlation between store formats and other evidence of competitive interaction, on the one hand, and customer substitution on the other hand."[3]

Consumers' considerations of substitutes to the merging parties' stores often can be found in merging parties' ordinary course documents, including, for example, surveys of customer shopping behavior (where the merging parties may try to estimate customer shopping frequency and share of wallet going towards competing banners), price-monitoring reports (where the merging parties may compare prices at their stores to those at competing stores), and real estate planning documents (which will often contain notes on the locations of proximate competing stores).

Historically, the FTC has limited relevant product markets to "traditional supermarkets," which it defined as full-line retail stores that "provide a distinct set of products and services for consumers who desire to one-stop shop for food and grocery products," by carrying a wide variety of grocery items and nonfood items across a broad range of product categories, typically with more than 10,000 different SKUs and at

2 U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, available at https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf.

3 U.S. Contribution to OECD, *Structural Issues in the Groceries Sector: Merger and Regulatory Issues -- Contribution from United States, September 23-24, 2015, available at* https://www.ftc.gov/system/files/attachments/us-submissions-oecd-2010-present-other-international-competition-fora/structural_issues_in_the_groceries_sector-lacf_2015.pdf.

least 10,000 square feet of selling space.[4] This definition excludes other types of stores that sell grocery products, such as neighborhood grocery stores, stand-alone specialty food stores (e.g. greengrocers, butcher shops and fish and seafood markets), convenience stores and wholesale clubs, on the basis that consumers shopping at traditional supermarkets would not likely to turn to these types of stores in response to a small price increase because none of these other stores "enable consumers to one-stop shop for food and grocery products."[5]

Since the early 2000s, the FTC has expanded the relevant product market to also include superstores (i.e. the supercenter format of mass merchandise stores that combine a supermarket under the same roof as the department store, such as Walmart Supercenters). However, in doing so, the FTC pointed out that only the supermarket portion of these superstores' sales (rather than their total sales across all product categories) would be relevant to its analysis of supermarket mergers.[6]

The FTC often has excluded wholesale club stores from the relevant product market, with some exceptions – e.g. Walmart's acquisition of Supermercados Amigo in Puerto Rico.[7] However, when making such exceptions, the FTC has been careful to note that its decision to include club stores in the relevant market was case-specific and did not represent a change in its general approach to supermarket mergers.[8]

On the other hand, the FTC has also defined markets that are narrower than all supermarkets. For example, the FTC limited the relevant product market to "premium natural and organic supermarkets" in connection with its review of Whole Foods acquisition of Wild Oats. In that case, the FTC argued that premium natural and organic supermarkets were so differentiated from conventional supermarkets (on account of offering a distinct set of products and services, including store ambience and amenities, to a distinct group of consumers) that the merging parties' customers were not likely willing to switch to conventional supermarkets in response to a small price increase.[9]

B. Geographic Market Definition

Geographic market definition for grocery retailers depends on consumers' willingness to travel, and how far apart (either in terms of physical distance or travel time) are alternative stores that consumers consider when making their decision about where to shop.

The FTC's approach to geographic market definition in the context of grocery mergers has evolved from evaluations of market concentration and competitive interaction over somewhat broad geographies to something closer to a store-by-store analysis. This evolution has been facilitated by the increased availability of customer draw data and sophisticated software tools. For example, while the FTC had concluded that geographic markets were as large as MSAs in the through the 1990s,[10] it more recently has alleged store-level markets ranging in size from one-tenth of a mile to up to ten miles around the merging parties' stores, depending on the consumer density of the area (e.g. urban, suburban, or rural).[11]

A common analysis of consumer willingness to travel looks at drawing catchment areas based on the distance within which the vast majority (e.g. 80 percent) of a store's customers reside.[12] This information often is available through grocery retailers' loyalty-card data (which

---

4 Federal Trade Commission Complaint, *In the Matter of Albertson's, Inc. and Buttrey Food and Drug Store Company, Inc., ¶1 and ¶15, available at* https://www.ftc.gov/sites/default/files/documents/cases/1998/12/9810134cmp.htm.

5 *Ibid. ¶¶15-18.*

6 Plaintiff's Memorandum of Points and Authorities In Support of Motion for Preliminary Injunction, *FTC v. The Kroger Co. and Winn-Dixie Texas, Inc., available at* https://www.ftc.gov/sites/default/files/documents/cases/2000/06/krogerbrief.pdf. Superstores are sometimes called "hypermarkets."

7 Federal Trade Commission Complaint, *In the Matter of Walmart Inc. and Supermercados Amigo Inc., available at* https://www.ftc.gov/sites/default/files/documents/cases/2002/11/walmartamigocmp.pdf. The FTC included wholesale club stores in the relevant product market because such stores commanded a large sale of Puerto Ricans' weekly grocery purchases and there was evidence showing that Puerto Ricans viewed club stores as substitutes for supermarkets.

8 See, e.g. Federal Trade Commission, *Analysis of the Complaint and Proposed Decision and Order to Aid Public Comment Wal-Mart Stores, Inc., and Supermercados Amigo Inc., available at* https://www.ftc.gov/sites/default/files/documents/cases/2002/11/walmartamigoanalysis.htm.

9 Federal Trade Commission Complaint for Temporary Restraining Order and Preliminary Injunction, *FTC vs. Whole Foods Market Inc., and Wild Oats Markets Inc.*, available at https://www.ftc.gov/sites/default/files/documents/cases/2007/06/070605complaint.pdf.

10 See, e.g. Federal Trade Commission Complaint, *In the Matter of Koninklijke Ahold NV, available at* https://www.ftc.gov/sites/default/files/documents/cases/1996/10/c3687cmp.pdf.

11 See, e.g. Federal Trade Commission Complaint, *In the Matter of Cerberus Institutional Partners V, LP., AB Acquisition LLC, and Safeway Inc., available at* https://www.ftc.gov/system/files/documents/cases/150127cereberuscmpt.pdf.

12 Care should be taken in interpreting the results from catchment areas analysis. Such catchment areas will contain the demand actually served by the stores (which is the result of competitive interactions), and therefore would be smaller than both the area that contains a store's addressable demand (which may, in certain cases, be more relevant to assess the area over which competition occurs) and the area in which the store's competitors reside.

can tie a consumer's purchases to a mailing address), or customer surveys (which often include background questions about a customer's address) conducted in the ordinary course of a grocery retailer's business.

C. Competitive Effects Analysis

In their analysis of the competitive effects of grocery retailer mergers, the FTC uses several standard tools, such as measures of market concentration, regression analyses, and upward pricing pressure metrics.

As a first step, the FTC typically will use Nielsen or other third-party data to calculate market shares (or competitor counts) in a variety of possible product and geographic markets. These market shares are then used as a screen to identify potentially problematic mergers.[13] In instances where data is not readily available, the FTC will instead assess the post-merger market structure by looking at the number of remaining competitors in a market. As discussed below, most of the divestitures that have been required in recent grocery mergers have occurred in putative geographic markets with less than 5 remaining competitors.

One approach to evaluating the likely competitive effects of a proposed grocery merger is to econometrically estimate the effects of prior acquisitions or entry / exit events on grocery prices or profitability.[14] Such analyses require detailed data on store entry, exit, and changes in store ownership, which can be combined with information on store pricing or profitability. For example, the FTC may use estimates of changes in store profitability following changes in local grocery market structures to estimate the likely competitive effects of a prospective merger where similar changes in local grocery market structures have been proposed.

In addition, the FTC frequently assesses the likely competitive effects of grocery mergers (and retail mergers more generally) using estimates of diversion ratios, upward pricing pressure metrics, and more formal merger simulations.[15] For example, as mentioned above companies collect detailed data about their customers through loyalty card programs. The FTC may combine these and other data to estimate diversion ratios, calculate upward pricing pressure metrics, or simulate merger outcomes.[16] However, because modeling competition among grocers often requires strong assumptions on demand characteristics, marginal costs, and the nature of competition among firms, such methods typically are used in conjunction with the other tools described above.

D. Remedies

Where feasible, the FTC often seeks to remedy potential anticompetitive effects of grocery mergers (rather than outright block the mergers) through the divestiture of stores in geographic markets of concern. Typically, the extent of the remedies sought depends on the extent of remaining competition in the marketplace, as well as the likelihood of significant entry by additional competitors into the relevant geographic markets.

The table below shows that between 2010 and 2016, the FTC's traditional analysis of grocery mergers resulted in no divestitures in markets that were categorized as 4 to 3 or greater. However, in the more recent transactions, the FTC has required divestitures in markets where there were as many as 6 other competitors.[17]

---

13 U.S. Contribution to OECD, *Structural Issues in the Groceries Sector: Merger and Regulatory Issues -- Contribution from United States, September 23-24, 2015, available at* https://www.ftc.gov/system/files/attachments/us-submissions-oecd-2010-present-other-international-competition-fora/structural_issues_in_the_groceries_sector-lacf_2015.pdf.

14 Brand, K. et al. (2014). "Economics at the FTC: Office supply retailers redux, healthcare quality efficiencies analysis, and litigation of an alleged get-rich-quick scheme." *Review of Industrial Organization, 45(4), 325-344; Hosken, D. S., Olson, L. M., & Smith, L. K. (2016). "Can entry or exit event studies inform horizontal merger analysis? Evidence from grocery retailing." Economic Inquiry, 54(1), 342-360; Hosken, D. S., Olson, L. M., & Smith, L. K. (2018). "Do retail mergers affect competition? Evidence from grocery retailing." Journal of Economics & Management Strategy, 27(1), 3-22.*

15 See, e.g. Statement of the Federal Trade Commission, *In the Matter of Dollar Tree, Inc. and Family Dollar Stores, Inc., July 13, 2015, available at* https://www.ftc.gov/system/files/documents/public_statements/681901/150714dollarstoresstatement.pdf.

16 Hosken, D., & Tenn, S. (2016). "Horizontal merger analysis in retail markets." In *Handbook on the Economics of Retailing and Distribution, pp. 250-286. Edward Elgar Publishing.*

17 Federal Trade Commission, Grocery/Supermarkets, available at https://www.ftc.gov/industry/grocerysupermarkets; Federal Trade Commission, Press Releases, available at https://www.ftc.gov/news-events/press-releases.

FTC Divestiture Orders in Recent Supermarket Merger Cases

Merger	Number of			Change in Market Structure					
	Target Stores	Divested Stores	Geographic Markets	2 to 1	3 to 2	4 to 3	5 to 4	6 to 5	7 to 6
Ahold & Delhaize (2016)	1,291	81	46	3	14	18	10	-	1
Albertsons & Safeway (2015)	1,332	168	130	13	42	43	27	5	-
Bi-Lo & Delhaize (2014)	154	12	11	2	9	-	-	-	-
Albertsons & United (2013)	51	2	2	-	2	-	-	-	-
Ahold & Genuari (2012)	24	1	1	-	1	-	-	-	-
Tops & Penn Traffic (2010)	79	7	5	-	5	-	-	-	-

Source: Federal Trade Commission, Grocery/Supermarkets, available at https://www.ftc.gov/industry/grocerysupermarkets; Federal Trade Commission, Press Releases, available at https://www.ftc.gov/news-events/press-releases.

Although many factors are considered in the FTC's review of grocery retailer mergers (as discussed above), it may be that the increased reliance on measures that quantify closeness of substitution on both product and geographic dimensions, like diversion ratios and upward pricing pressure metrics, have caused divestitures in markets that previously would have been considered sufficiently competitive based on structural metrics focused principally on geographic overlap. Regardless of the reasons for the increased number of divestitures in recent years, it is clear that merging parties will need to carefully consider the potential competitive implications of future grocery retailer mergers.

III. MORE RECENT DEVELOPMENTS

The supermarket industry has gone through significant changes in recent years, including with respect of how and where consumers shop. The FTC historically has resisted rapid changes to their methods. However, given the speed with which competition in grocery retail is changing, the FTC may need to reconsider its approach to market definition in grocery mergers to encompass the broader set of alternatives that consumers are increasingly considering as substitutes to "traditional supermarkets."

A. Superstores and Club Stores

Although large format retailers have been around for a while, the popularity of superstores and club stores as a substitute for traditional supermarkets has increased significantly in recent years.

In 1976, Price Club, which would eventually become Costco Wholesale, began operating as a wholesaler focused on selling to small businesses. Within a few years, the paid membership model emerged at Price Club and was adopted by Sam's Club in 1983.[18]

In 1988, Walmart opened its first supercenter, and Kmart and Target quickly followed. These supercenters brought grocery retailing, general merchandise, and pharmacies under a single roof. Over time, they added more functionality to the one-stop shop experience, including eye care centers, photo centers, and fast-food chains. By 2000, the supercenter format was so popular that Walmart had amassed more than 800 locations with 11 percent of US grocery industry sales, with its share of the market peaking at 26 percent by 2017.[19] Over the last decade, Walmart has continued to innovate by expanding its formats to include Neighborhood Walmart locations, which are smaller format grocery-only stores in urban areas or small towns that cannot support a supercenter.

Today, Walmart is ranked first by SuperMarket News's list of "Top 50" retailers by annual sales, with Costco not far behind at fourth. Indeed, Costco's sales of food and sundries ($91.9 billion) is larger than Albertsons total sales across all product categories ($69.7 billion).

18 Trinidad, K., History of the supermarket industry in America, Stacker.com, March 13, 2020, available at https://stacker.com/stories/3984/history-supermarket-industry-america.

19 SGA Design Group, The Evolution of Grocery Retail Architecture and Customer Experience Since 1960, April 3, 2018, available at https://sgadesigngroup.com/history-of-grocery-retail-architecture; Statista, Online and offline grocery market share of leading food retailers in the United States in 2017, available at https://www.statista.com/statistics/818602/online-and-offline-grocery-market-share-of-leading-grocery-retailers-us.

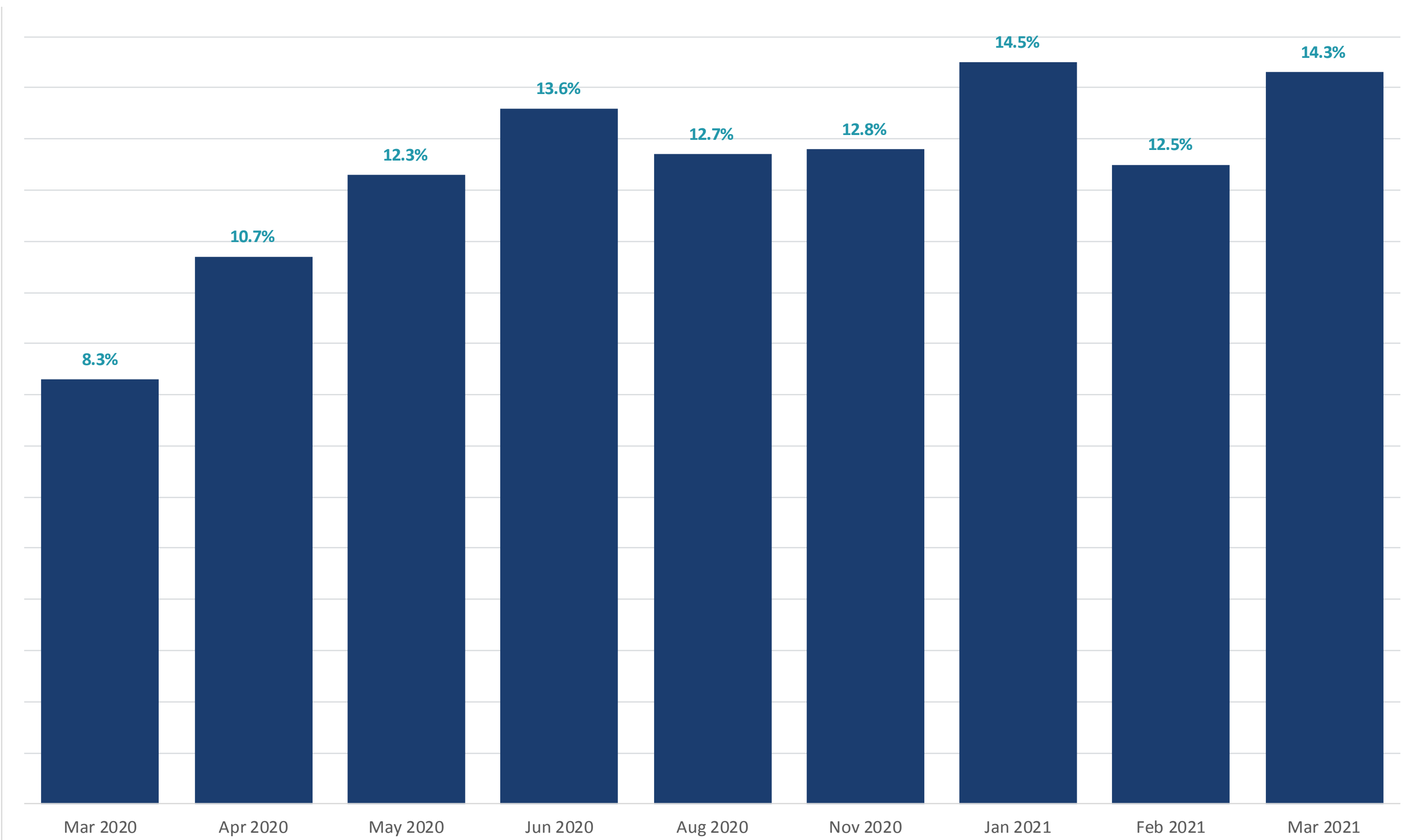
B. Online Grocery Sales and Grocery Retail in the Post-COVID World

Over the last three decades, the retail grocery industry also has seen the growth of online grocery sales. Peapod began providing online grocery services in 1989, when consumers would load software onto their computers to order groceries for delivery.[20] Today, Peapod is an "under-the-radar" giant in the grocery delivery business that pioneered many of the online grocery ordering tools used by millions of consumers today.[21]

Interestingly, while traditional grocers and superstores have been evolving to improve their online presence and capabilities, the world's largest online retailer, Amazon, has been moving in the opposite direction – establishing bricks-and-mortar networks to facilitate grocery delivery. Amazon began offering Amazon Fresh grocery delivery service in select markets to Amazon Prime customers in 2007. More recently, Amazon expanded its presence in the retail grocery industry with the purchase of Whole Foods in 2017 and the launch of Amazon Go, a cashier-less grocery store, in select areas in 2018.[22]

The COVID pandemic significantly has impacted the way that millions of consumers purchase retail products, including groceries. For example, as a result of lengthy COVID-related restrictions, US consumers were encouraged to purchase groceries online instead of in physical retail locations. In response, grocery retailers began offering online ordering and pick-up as well as online delivery options. The figure below from a report by McKinsey notes that e-commerce penetration in the grocery industry accelerated from approximately 4 percent of sales before the pandemic to 10-15 percent penetration in late spring 2020, with urban areas seeing penetration rates of as high as 20 percent.[23]

E-Commerce Penetration in Grocery



Source: Aull, Bill et al., "The State of Grocery in North America," McKinsey & Company, June 8, 2021, available at https://www.mckinsey.com/industries/retail/our-insights/the-state-of-grocery-in-north-america.

20 Trinidad, K., History of the supermarket industry in America, Stacker.com, March 13, 2020, available at https://stacker.com/stories/3984/history-supermarket-industry-america.

21 Dallke, J., Peapod's Quiet Quest to Win the On-Demand Food Fight, ChicagoInno, March 22, 2017, available at https://www.bizjournals.com/chicago/inno/stories/inno-insights/2017/03/22/peapods-quiet-quest-to-win-the-on-demand-food.html.

22 Trinidad, K., History of the supermarket industry in America, Stacker.com, March 13, 2020, available at https://stacker.com/stories/3984/history-supermarket-industry-america.

23 Aull, Bill et al., "The State of Grocery in North America," McKinsey & Company, June 8, 2021, available at https://www.mckinsey.com/industries/retail/our-insights/the-state-of-grocery-in-north-america.

These penetration rates have held steady through the pandemic, even as many areas of the US loosened pandemic restrictions, indicating that these industry changes may be here to stay. Indeed, recent surveys by Nielsen highlight that consumers' preferences for online ordering and delivery options are interchangeable with the preferences for in-store shopping at traditional grocery retailers.[24]

IV. THE FUTURE OF SUPERMARKET MERGER REVIEWS

As the supermarket industry continues to respond and change to consumer preferences for convenience through online offerings, and as those offerings remain frequent and predominant ways that consumers shop for groceries, the FTC should continue evaluating the extent to which online retail grocers competitively constrain traditional grocers. And previous experience indicates that they will, at least on a case by case basis. For example, as noted above the FTC's approach to the evaluation of retail grocery mergers evolved to include supercenters and, on at least one occasion, club stores as participants in the same relevant markets as traditional supermarkets. Hence, although so far there is little precedent for the inclusion of online retail as a significant competitive constraint in the evaluation of traditional grocery retail mergers,[25] given the rapid growth in the number of consumers conducting their weekly one-stop grocery shopping through online and non-traditional retailers (like Amazon) during the COVID pandemic, the FTC likely will need to consider expanding its relevant market definitions to include these options as significant competitive constraints on traditional grocery retailers.[26]

From an economics perspective, the types of data and analyses that are likely to be most useful in evaluating whether wholesale club stores and online grocery should be included in relevant product markets would be documents and data showing that consumers consider these options as substitutes to the merging parties stores. Direct evidence on customer preferences, such as surveys indicating how frequently the parties' consumers shop for groceries in non-traditional supermarket options or the share of consumers' grocery wallet that is accounted for by club stores and online grocery, as well as any switching analyses conducted by the parties in the ordinary course to assess the extent to which (and reasons for) their customers substituting to other non-traditional supermarket options, are a few examples of potentially useful evidence. If the parties' offer their own online shopping and delivery options, combining data on the parties' online sales and brick and mortar sales at the customer level (for example, by tracking purchases using loyalty cards) may be useful to gauge consumer willingness to shop for groceries online.

Indirect evidence of consumer substitution *vis-a-vis* the parties' price responses to non-traditional supermarket options may also be useful. For example, the parties' monitoring reports or price matching studies may provide insight into how closely they (or their consumers) compare pricing with club stores and online grocery. Insights can also be derived from an analysis of the parties' cross-channel pricing strategy. The extent to which parties apply similar prices across channels or adjust prices on one channel to changes in the other channel (when they are present both in store and online) can be informative on how the parties perceive (and react to) cross channel switching and competition.[27]

Additionally, case studies or more formal analysis of the effect from entry by a club store or the introduction of online delivery options into a local market on the parties' strategic decisions in that market may be useful. Of course, adjustments to geographic market definition likely would need to be factored into the analysis, as club stores tend to have larger catchment areas than traditional grocery stores, and online delivery can reach as far away as can be travelled by truck from a central fulfilment center.

Ultimately, the question is "how large is the competitive constraint imposed on the market by non-traditional supermarket options?" Greater substitution to other options will lower any incentive the parties would have to increase prices following a merger. Thus, to the extent consumers increasingly view club stores and online grocery as substitutes for traditional supermarkets, the more important they will become for the analysis of competitive effects from grocery mergers.

---

24 Nielsen, COVID-19 Elevated Convenience to a New Level, and That's How it Will Stay, July 28, 20201, available at https://www.nielsen.com/us/en/insights/article/2021/covid-19-elevated-convenience-to-a-new-level-and-thats-how-it-will-stay.

25 Of note is the French Competition Authority's decision in Fnac Group's acquisition of Darty, a rival appliance, electronics, and entertainment products retails, where it defined product markets to include both in-store and online sales channels. (See, e.g. Autorité De la Concurrence Press Release, Retailing of "Brown" and "Grey" Products, July 18, 2016, available at https://www.autoritedelaconcurrence.fr/en/communiques-de-presse/18-july-2016-retailing-brown-and-grey-products.)

26 Even though the FTC has not explicitly included non-traditional grocery stores in its market definition, they may have implicitly included them in mergers where the concentration appears high, but the FTC found no competitive effects.

27 These types of internal documents and evidence of cross-channel responses were integral in the FTC's decision to allow the merger of Office Depot and Office Max in 2013. See Statement of the Federal Trade Commission, *Concerning the Proposed Merger of Office Depot, Inc. and OfficeMax, Inc., November 1, 2013, available at* https://www.ftc.gov/sites/default/files/documents/closing_letters/office-depot-inc./officemax-inc./131101officedepotofficemaxstatement.pdf.

PASS-THROUGH AND COMPETITION IN THE FOOD SECTOR: NEW DATA, NEW INSIGHTS, REMAINING QUESTIONS

BY STEVE MCCORRISTON[1]

1 Professor, Department of Economics, University of Exeter, UK.

I. INTRODUCTION

In recent months, we have witnessed considerable pressure on food chains across many countries, these pressures emanating from a number of sources, both domestic and international. COVID-19 has had an obvious impact, most notably through logistics and labor shortages. Simultaneously, world commodity prices have increased; between September 2020 and 2021, the FAO food price index has increased by over 30 per cent. These changes have been reflected in higher domestic retail food prices, with food inflation exceeding headline inflation with particularly high food inflation recorded in developing and emerging economies. With these shocks to the food sector, attention turns to the functioning of food chains and how these shocks impact on consumers, an issue of particular concern to politicians given the regressive nature of higher food prices. But aside from the macroeconomic context, concerns also arise with respect to how competition in the food chain determines the pass-through of shocks. However, making progress on understanding the link between the pass-through and competition also provides important insights into competition issues in food retailing.

Competition in food retailing is complex: given the multi-product offerings that characterize food retailing and the vertically-related nature of food chains, competition is not solely related to horizontal issues (e.g. relating to prices across retail chains) but also how interactions between suppliers at other stages of the food chain can impact on competition between retail chains. This is not only an issue that is a challenge to anti-trust authorities but also to researchers who aim to provide insights into these issues.

In this article, we discuss some recent developments that shed new light on the link between pass-through and competition, referring to recent research involving retail price data from several countries. The research discussed is necessarily selective, the main thread relating to the recent use of large data sets that have been employed to provide new insights into how retail chains compete and pass-through commodity price shocks. We also extend the discussion to "state-of-the-art" models of multi-category, multi-chain models that go beyond studies that focus on price behavior in individual food categories. The research we comment on relates to data from the U.S., UK, France, and Germany.

Finally, some remaining issues are highlighted relating to the potential impact of retail food chains that deserve further attention from researchers, i.e. the impact on small scale suppliers including farmers at the other end of the food supply chain, an issue that will likely come to the fore as current pressures on supply chains weaken and lower commodity prices return.

II. CONTEXT

Although the drivers that are causing current pressures on supply chains are different, addressing competition issues in the food sector was one of the outcomes of the commodity crises of 2007-08 and 2011. The OECD Competition Forum addressed a wide range of issues covering seller power, consolidation, the entry of discounters, buyer alliances, buyer power and price transmission. These wide-ranging concerns have also challenged researchers addressing competition in the food sector but with no clear consensus about the potential harm related to high levels of concentration or the exercise of buyer power. In the context of developing and emerging economies, the entry and growth of retail food chains that has been recently experienced widens the concerns regarding competition that has been experienced in developed countries.

Within this context, the issue of pass-through and competition has been a continuing theme among researchers. As a broad rule-of-thumb, when markets are oligopolistic, pass-through can be less than what you would expect with competitive markets, the main mechanism for this relating to how firms adjust their mark-ups as costs change. With less than perfect price transmission, this may benefit consumers when higher costs lead to increases in retail prices; but part of the concern about competition is that cost decreases are not passed through thus harming consumers. Given the underlying volatility in commodity markets (what goes up comes back down, at least to some extent), part of the concern relating to food prices relates to this asymmetric effect (or the "rockets and feathers" phenomenon). Recent analysis of price transmission can also provide new insights into competition in the retail food sector.

III. MEASURING PASS-THROUGH

At one level, measuring pass-through in the food sector is both straightforward but lacking insights necessary to shed light on competition issues. Economists have employed a range of empirical methods to relate changes at one end of the food chain (or, in some cases, world market prices) to retail prices at the other. Yet, the use of aggregate (market level and monthly) data precludes detailed insights: "low" price transmission may infer the lack of competition in the food chain as is often claimed but cannot be substantiated. Moreover, aggregate data obscures details that reflect the complexity of food retailing including differences between branded products and private labels, the importance of vertical control in the food supply chain and differences in price adjustment across retail food chains. But access in recent years to scanner data (i.e. the prices of individual food items that are scanned at the check-out) provides the opportunity for more detail about pass-through and, in turn, how retail food chains compete. Together with the use of developments in quantitative methods, more sophisticated characterizations of competition in the food sector are beginning to emerge. We comment on some of these new insights below.

IV. BRANDED PRODUCTS VERSUS PRIVATE LABELS

Supermarket shelves offer wide choices of food products and an extensive array of alternatives even within food categories. As part of this array, there are branded products (supplied by often dominant food manufacturers) and private labels. Private labels are becoming increasingly important in food retailing with the proliferation of private labels being particularly high in European countries, most notably the UK. While initially, private labels were associated with more "value-end" food, they now encompass high-quality offerings at least on a par-or sometimes exceeding-branded products. What does the increasing proliferation tell us about competition in food retailing?

If markets are not competitive, firms can charge mark-ups and how these mark-ups change in the face of cost changes will determine the level of pass-through. But in the context of the food sector, the issue of double marginalization may arise i.e. if the food manufacturing sector is highly concentrated, there will be mark-ups at this stage of the food chain which will add to the mark-ups applied in the highly-concentrated retail food sector. But private labels can circumvent this double marginalization issue; as retail food chains have control over the supply of products that appear on the supermarket shelf, there is a single (not double) mark-up associated with private labels.

In recent research, it has been shown that the impact of cost changes to retail food prices will differ between the branded and private label products. But the link between product type and pass-through is potentially ambiguous as there is both a horizontal and vertical effect associated with private labels. On the one hand, the horizontal effect potentially weakens competition in the retail sector as the increasing pervasiveness of private labels may increase market shares of retail chains; on the other, private labels deal with the double marginalization issue and ameliorates the double mark-up issue which represents a pro-competitive effect. The former (horizontal) influence will serve to reduce price transmission, the other (the vertical effect) will increase it. What influence dominates is an empirical issue.

Recent research uses scanner data to measure the extent of price transmission. Employing data on bar-coded food items for a major retail food chain in the U.S., the authors find that private label products have higher levels of pass-through compared with branded food products; in other words, the vertical effect that diminishes double marginalization dominates the horizontal (increasing market share) effect. The implication arising from the higher pass-through to consumer prices suggests that the growing influence of retail chains over different stages of the food chain may be good for consumers. In a second part of their analysis involving competition among retail food chains in a specific location (Los Angeles), the authors confirm the higher pass-through of cost changes for private label products.

But a recent study of food retailing in the UK, using data for branded products for orange juice and coffee, comes to the opposite conclusion. What is different about the data used in this study is that the researchers match data for the identical food products across all major retail food chains in the UK. More directly, they account for how prices across competing retailers influence price transmission in specific chains, their control for competition across retail chains being more explicit than that allowed for in the U.S. study. They find that private label products have lower price transmission compared with national brands; if they do not account for the competitive influence of competing retail chains, their results would be consistent with the results for the U.S. This suggests that accounting explicitly for price competition across retail chains has an important bearing on the results. In sum, these results for the UK would imply more concern with the market share increasing effect associated with private labels. Moreover, they show that the pass-through varies significantly across retail chains; there is no single measure of pass-through and the variation in pass-through varies more across retail chains than it does across product type.

In short, there is no consensus on the insights relating to how different types of products relate to competition in retail food chains; at best, the link between pass-through, competition and product type seems to be context-specific.

V. ASYMMETRIC PRICE CHANGES

An issue associated with price changes at the retail sector is that price changes are asymmetric. Given that world commodity prices are noted for their underlying volatility (i.e. raw commodity prices go up as well as down), the concern is that cost increases are passed through (at least in part) to consumers but that cost decreases are not, or at least are not passed through to the same extent as the cost rise. While this issue has been of interest to economists for some time, recent research has again used detailed data to explore this issue. Asymmetric price transmission potentially harms consumers as it implies that retailers benefit at the expense of consumers as margins increase as costs fall, with price decreases not being commensurate with the change in costs.

Employing data for the retail coffee sector in France, researchers have confirmed that asymmetric price transmission exists. Moreover, the degree of asymmetric pass-through depends on the magnitude of the cost shock and that there are differences with respect to private labels and national brands. The underlying reason for the asymmetric price adjustment relates to consumer sensitivities: specifically, the results indicate that consumers are less sensitive to price increases than to decreases which implies more scope to pass-through rising costs. With consumers being less responsive to price increases, the scope for retail chains exercising market power is greater.

A different insight comes with the use of a large data set applied to the dairy sector in Germany. Allowing specifically for the timing of price adjustment, this study addresses the "rockets and feathers" phenomenon. However, the authors conclude that market power is unlikely to be the cause of asymmetric price adjustment. The more likely cause is so-called "menu costs" associated with changing prices.

VI. FURTHER INSIGHTS

Insights relating to competition across retail food chains has taken a significant step forward involving recent research where data extends beyond individual categories either within or across retail chains to multi-category, multi-chain studies, again with data relating to the U.S. and UK. The main feature of this recent research is that the focus is not on individual food products or product types (branded or private labels) but to shopping baskets and "types" of shoppers. Specifically, retail chains consider price changes involving products that constitute the range of products that shoppers buy in specific food retailers. Retail chains consider that a shopper (particularly a "one stop" shopper) may transfer their shopping basket to another retailer; the price responses of individual products (or product categories) therefore relate to prices both across products in the shopping basket but also simultaneously in the shopping basket in competing retail chains. What does this tell us about competition?

Two recent studies employ "state-of-the-art" methods, and data relating to food categories within a shopping basket both within and across retail chains; but they come to opposite conclusions about the implications for competition in a multi-category, multi-chain setting. In the case of the U.S., competition appears to become less intense across retail chains; the research using data for the UK, conclude that competition is more intense.

Using data for the UK retail food sector, the insights from the research indicate that in the context of a multi-category, multi-store setting that more appropriately characterizes competition between chains, "one stop" shoppers are more likely to mitigate the potential for higher prices (i.e. reduce the impact of market power). Specifically, raising the prices of one category in the shopping basket generates the demand complementarities both across categories and across stores. Since a higher price raises the possibility of losing a "one stop" shopper, retail chains must account for this possibility, and it is this mechanism that reduces the exercise of market power. This insight also has implications for anti-trust authorities insofar as they determine which type of shopper (i.e. a "one stop" or "multi-stop") is the focus of attention in determining price setting in the retail food sector.

The results from the U.S. study come to a different conclusion and therefore insights about competition between retail chains. Based on a framework similar to that employed for the UK, the presence of "one stop" shoppers tends to weaken competition between stores. This also provides insights about how retail chains retain shoppers. Practices such as promotions and offers have the purpose of retaining "one stop" shoppers and therefore a wider perspective of competition between retail chains.

Despite these differences, the over-arching outcome from these studies is to highlight the importance of looking beyond individual category pricing, to consider demand complementarities across categories and how retail chains compete given different "types" of shoppers.

VII. SOME REMAINING ISSUES

The context for this discussion of competition issues in the food sector has related to current cost increases associated with supply chain problems and the increase in world commodity prices. The issue of pass-through is important and, in addressing it, recent research has the potential to provide insights about the functioning of food supply chains more generally and competition in food retailing more specifically. Given the complexity of competition in food retailing, the use of more detailed data and more sophisticated methods offers the potential for new insights. But some issues remain unresolved and, arguably, researchers are looking at the wrong end of the supply chain for the effects especially if mark-ups in the retail sector are low; perhaps the burden of the shocks to the food sector will be felt elsewhere.

Rather than the focus being on the pass-through to consumers, to what extent does the pressure on food supply chains relate to "pass-back" to small scale producers and farmers at the other end of the supply chain? Addressing these issues involve their own complexities as the "pass-back" effect may relate not just to prices but involve a wider range of issues associated with unfair trading practices. This is a more challenging issue to address: when we are considering the potential impact on consumers, the focus is principally on determining the extent of retail price changes, the challenge being to have adequate data on retail food prices across retail chains to substantiate this issue. But when it comes to suppliers, the question of which metric to focus on, is less clear.

Firms that are dominant in the food chain can impact on suppliers with relatively weak bargaining power (whether they are farmers or other enterprises in other segments of the food chain) in a number of ways. These include, inter alia, terms of contracts, payment schedules, changing the terms of contracts and so on. Reflecting the concerns at this end of the food chain, in 2019 the European Union issued a directive relating to unfair trading practices. The issue of unfair trading practices had been on the policy agenda for many EU Member States for some time, the issue gathering more momentum around 2015 following declines in agricultural prices and the Russian import ban. In due course, the current pressures on supply chains will ease and world commodity prices drop back; the issue of the impact on suppliers from their weak position in the supply chain may again come to the fore.

In broad terms, the EU's Unfair Trading Practices Directive addresses two categories of unfair trading practices: (i) unilateral action by more dominant firms on weaker participants in the supply chain; and (ii) shifting risks to weaker participants. Specifically, the EU Directive prohibits ten so-called "black" trading practices including late payments, short-term cancellation and unilateral changes to contracts, commercial retaliation by the buyer and transferring risks to suppliers. A further six "grey" unfair practices related to return of unsold products, and payments for promotion and marketing would require the unambiguous agreement between the buyer and seller. Moreover, each EU Member State is obliged to have a dedicated national authority to deal with complaints relating to unfair trading practices and impose penalties. However, substantiating both the extent and impact of unfair trading practices on suppliers in the food chain remains a challenge.

VIII. SUMMARY

This discussion focused around recent pressures on the food supply chain and issues associated with competition in the food retailing sector. A challenge for researchers relates to addressing how competition impacts on consumers; more specifically, how increases in costs emanating from world commodity markets or associated with difficulties in the supply chain are passed-through to consumers. There has been significant progress on this issue in recent years due to the increased availability of large and detailed data sets relating to prices consumers pay for individual food items in supermarket chains.

But this data also allows researchers to provide new insights into competition in food retailing. This is important as competition in food retailing is complex relating to not only "horizontal" issues but also "vertical" issues and how these two dimensions of how the food retailing sector interact. In doing so, we have drawn on recent research using detailed consumer price data for the U.S., UK, France, and Germany. However, how retail food chains impact on consumers is only one side of the coin; addressing the impact of dominant buyers on suppliers in the food chain remains an on-going challenge.

COMPETITION ISSUES IN UK GROCERY RETAILING

BY ANDREW TAYLOR & NICK WARREN[1]

1 Andrew Taylor & Nick Warren are co-founders of Aldwych Partners.

I. INTRODUCTION

Over the past 20 years, grocery retailing has probably been the sector most investigated by the UK competition authorities. Since 2003, forty-three M&A deals involving grocery retailers have been reviewed by the Competition and Markets Authority ("CMA").[2] These have ranged from single store acquisitions to deals involving hundreds of supermarkets. During this time, grocery retailers have also been investigated for possible breaches of UK competition law and under the UK's market investigation regime.[3]

Around three quarters of the grocery deals reviewed by the CMA have been cleared unconditionally. This might be taken to indicate a fairly light touch approach. However, the CMA's decisions have played an important role in setting boundaries and signaling the types of deals that are likely to be acceptable. UK grocery retailers have, as a result, been able to shape their M&A activity so that, for the most part, competition clearance has been relatively straightforward.

The effectiveness of this signaling system appeared to break down quite dramatically in 2018 when the CMA prohibited Sainsbury's, the UK's second largest grocery retailer, from acquiring Asda, the UK's third largest grocery retailer. Long-term trends in consumer behavior that had changed competitive dynamics in the sector, and novel approaches by the CMA to assessing local market competition, had indicated that consolidation between the UK's larger retailers might receive regulatory clearance. However, this turned out not to be the case. While these underlying trends, which had informed Sainsbury's and Asda's expectations of a CMA clearance, look set to continue, any large-scale consolidation in UK grocery retailing now looks some way off.

II. CONSUMER BEHAVIOR AND RETAILER STRATEGIES

For readers unfamiliar with UK grocery retailing, there are around 7,500 large and mid-sized supermarkets and around 42,000 convenience stores across the UK. Ten major grocery retailers have outlets across Great Britain, namely Tesco, Sainsbury's, Asda, Morrisons, Waitrose, Marks & Spencer Simply Food ("M&S"), the Co-operative Group ("Co-op"), Aldi, Lidl, and Iceland.[4]

Tesco, Sainsbury's, Asda and Morrisons, the UK's four largest retailers, have store portfolios that include large and mid-sized supermarkets and smaller convenience stores. Their larger stores typically have a product range that includes general merchandise as well as food and drink, and petrol (i.e. gas) stations are often on site. Waitrose and M&S target the premium end of the grocery market, while the Co-op is largely focused on convenience stores. Aldi and Lidl, which have both grown rapidly in recent years, generally offer a more limited range of products at discounted prices, while Iceland specializes in frozen food.

As well as these national retailers, the UK has many independently-owned convenience stores. Around half of these stores are members of "symbol groups," such as Budgens, Nisa, Londis and Mace. The grocery wholesalers, which own and operate these symbol groups, supply member stores with food and drink and provide branding and other services.

In the years leading up to the COVID-19 pandemic, several long-term trends in consumer behavior were having a significant impact on the strategies of UK grocery retailers.

In particular, consumers were increasingly:

- conducting several smaller shopping trips each week rather than a single large weekly shop;
- turning to the fast-growing discount chains, Aldi, and Lidl, for part or all of their grocery needs; and
- buying groceries online for home-delivery rather than going to a store.

2 The start of the UK's modern merger control regime in 2003, following passage of the Enterprise Act 2002, is a good starting point for looking at the broad sweep of competition authority intervention in UK grocery retailing. However, even before this, the Competition Commission ("CC") looked in detail at the grocery retail market in 1999-2000, and reviewed major transactions, such as Morrisons' acquisition of Safeway in 2003. References to the CMA in this article should also be taken to include its predecessor agencies, the Office of Fair Trading ("OFT") and the CC.

3 One of the authors of this article led the CC staff team that conducted the 2006-08 groceries market investigation.

4 Not all these retailers have a presence in Northern Ireland. (Great Britain comprises England, Scotland, and Wales, while the United Kingdom includes Great Britain plus Northern Ireland.)

Grocery retailers responded to these trends in several ways.

- Tesco and Sainsbury's, and to a lesser extent Asda and Morrisons, expanded their convenience store portfolios.
- Larger grocery retailers rationalized their product range and focused even more on prices as the discounters, Aldi, and Lidl, continued to grow. In 2018, Tesco started a new retail brand "Jacks" to compete directly with Aldi and Lidl.
- UK grocery retailers developed and expanded their online offer. The UK's first online-only grocery retailer, Ocado, entered the market in 2000.

Much of the larger retailers' expansion into the convenience store segment came through organic growth, but there were also some significant acquisitions. These included Co-op's purchase of Balfour (2003), Sainsbury's purchase of Jacksons (2004), and Tesco's purchases of Adminstore (2004) and Mills (2011) – see Figure 1.

Figure 1: Grocery retailer M&A deals reviewed by UK competition authorities, 2003-21

Note:

(i) The number of stores acquired in each transaction is represented by the size of each circle. (Each acquired store is counted equally regardless of its size.)

(ii) Of the 35 transactions that were unconditionally cleared by the CMA, 33 were at Phase 1 and two at Phase 2. (The TDR and Issa Brothers' acquisition of Asda in 2021 is counted as an unconditional clearance as there were no conditions attached to the grocery retail element of the acquisition. TDR/Issa were, however, required to divest a number of petrol stations given their concurrent ownership of EG Group, a major UK petrol station operator.)

(iii) The October 2021 acquisition of Morrisons by the private equity firm Clayton, Dubilier & Rice ("CDR") is yet to be reviewed by the CMA. It seems likely that the grocery retail element of this acquisition will not encounter any merger control difficulties. CDR may, however, be required to divest some petrol stations given its concurrent ownership of MFG, the UK's largest petrol station operator.

More recently, Tesco's acquisition of Booker in 2017 and Co-op's acquisition of Nisa in 2018 further increased these retailers' exposure to the convenience store sector. Booker is the UK's largest grocery wholesaler and, at the time of its acquisition, supplied around 5,500 independently-owned convenience stores. It also operates several symbol groups. Nisa was supplying around 4,200 independently-owned convenience stores when it was acquired by the Co-op.[5]

In 2011, Asda acquired Netto, which was the UK's third largest limited range discounter after Aldi and Lidl. Asda is generally regarded as the grocery retailer that competes most strongly with Aldi and Lidl on price. However, its acquisition of Netto was not about acquiring a brand to compete more directly with the discounters (as Tesco has sought to do in establishing the "Jacks" brand), rather it repurposed the Netto estate into Asda branded stores.

In terms of online shopping, most UK grocery retailers have developed their online offer through in-house initiatives. Waitrose, however, worked in partnership with Ocado, the UK's online grocery retailer, until 2019, when M&S acquired a 50 percent share in Ocado's UK operations as a way of boosting its online presence. Waitrose has since had to rapidly develop its own standalone online presence.

III. THE CMA'S APPROACH TO GROCERY RETAIL MERGER CONTROL

Most M&A deals in UK grocery retailing, beyond the very small, qualify for review by the CMA. The "share of supply" test allows the CMA to review any transaction where the merged entity supplies 25 percent or more of a good or service in a significant part of the UK. A "significant part of the UK" can be quite small. For example, Slough, an urban area with a population of around 165,000, was found to be a "significant part of the UK" when the CC reviewed Tesco's acquisition from Co-op of a single supermarket in this town.[6]

The likelihood that CMA clearance will be needed means that its approach to assessing competition in grocery retailing plays a significant role in shaping the sector's deal making. The sector has had some reasonably clear guidance over the past 20 years due to the regulator's consistent approach to segmenting the grocery market by store size, product range and catchment area combined with its long-standing view on the acceptable number of competitors in a local market.

Much of the CMA's approach has been built on its observation of household shopping patterns, and in particular, the tendency of many UK households to conduct a single large weekly shopping trip. Based on this, the CMA has identified a separate product market that includes those stores large enough, in terms of their size and product range, to meet a household's weekly shopping needs. The CMA has settled on a floor space of 1,400m2 as the minimum size of a store that is large enough to compete for households' weekly shopping trips.

For stores smaller than 1,400m2, there is further differentiation between convenience stores and mid-sized supermarkets. UK retail trading law allows shops with a floor space of less than 280m2 to open for longer hours. This has provided a logical threshold for distinguishing between convenience stores, with their smaller product range, and mid-sized stores.[7]

Of course, a shopper looking to buy a small number of items which could be found in a convenience store could also purchase these same items at a mid-sized or large grocery store. As a result, the CMA has viewed the competitive constraint between stores across these three different size brackets as asymmetrical. Large stores act as a competitive constraint on mid-sized and convenience stores (as any shopping trip or "mission" that could be satisfied at a convenience or mid-sized store could also be satisfied at a large store), but it has concluded that the more limited product range at these small stores means that they cannot compete for shoppers carrying out a large weekly shop. Similarly, mid-sized stores are regarded as providing a competitive constraint on convenience stores, but not vice versa.

Layered on top of this segmentation by store size has been further segmentation based on the breadth of retailers' product range, where this is independent of the size of their stores. For example, the CMA has regarded the discounters, Aldi, and Lidl, which have a more limited product range and a larger proportion of own-label products, as providing less of a competitive constraint on those retailers that sell a

5 Direct ownership of grocery stores by both Booker and Nisa, before their acquisition, was very small for Booker and non-existent for Nisa. As a result, neither acquisition shows up significantly in Figure 1.

6 Competition Commission, *Tesco plc / Co-operative Group (CWS) Ltd store at Uxbridge Road, Slough*, November 2007. One of the authors of this article led the CC staff team that conducted the Phase 2 review of this acquisition.

7 The CMA has also occasionally considered the extent to which it should differentiate between convenience stores at the upper end of this size threshold versus smaller convenience stores. However, this has tended to be considered in the assessment of relative strength of competitive constraints within the market rather than defining separate product markets for smaller and larger convenience stores.

wider range of branded and own-label goods (e.g. the UK's four largest grocery retailers, Tesco, Sainsbury's, Asda, Morrisons). The CMA has similarly regarded M&S for much of the past 20 years as providing a more limited constraint on other grocery retailers due to the predominance of own-label goods in its product range.

In terms of the geographic market, the CMA has consistently found that convenience, mid-sized and larger stores serve progressively larger catchment areas. These tend to be around 5, 10, and 15 minutes' drive-time respectively, with larger catchment areas in rural areas compared to urban conurbations.

The end result has been a fairly clear set of "rules of thumb" that retailers could apply when assessing the CMA's likely attitude to an M&A deal. For example, a large supermarket operated by one of the UK's four largest retailers would be regarded as providing a meaningful competitive constraint on other large supermarkets, mid-sized stores, and convenience stores within a 15-minute drivetime. Convenience stores would be regarded as providing a competitive constraint on other convenience stores within a 5-minute drivetime, and not on any larger stores within that catchment area. Mid-sized supermarkets operated by one of the UK's four largest retailers, would be regarded as constraining other mid-sized supermarkets and convenience stores within their catchment area. However, mid-sized supermarkets operated by one of discounters (i.e. Aldi or Lidl) would not be regarded as providing a competitive constraint on a mid-sized supermarket operated by one of the UK's four largest retailers.

When the CMA has then reviewed a grocery retail M&A deal, it could be expected to conclude that there would be a realistic prospect of a substantial lessening of competition ("SLC"), the formal test for making an adverse finding in a merger control case at Phase 1, in those markets where the number of competitors would decline to fewer than four because of the transaction.

IV. HAS CHANGING CONSUMER BEHAVIOR ERODED THE CMA'S APPROACH?

The CMA's approach has acted as a brake on consolidation between the UK's four largest grocery retailers, which between them operate most of the UK's large supermarkets, while allowing retailers with portfolios of mid-sized and convenience stores, or which offered a more limited product range, to be acquired. This includes, for example, Co-op's acquisition of Somerfield in 2009 and Asda's acquisition of Netto in 2011 as well as Morrisons acquisition of Safeway in 2003.

Questions about the CMA's likely attitude to potential consolidation between the UK's largest grocery retailers started to emerge in the lead up to Sainsbury's announcement of its plan to buy Asda in 2018.

The declining importance of households' weekly shopping trip suggested that smaller stores might be placing a more meaningful competitive constraint on larger supermarkets. Rapid growth by Aldi and Lidl suggested that their stores were also competing strongly with other grocery retailers for shoppers, notwithstanding their more limited product range. The move to online shopping suggested that retailers could compete with one another over longer distances. Adding fuel to the emerging possibility of a change in the CMA's attitude was the CMA's adoption in 2015 of a new methodological approach to assessing local competitive constraints that could systematically consider both a wider range of competitors and store locations.

As set out above, the CMA's traditional approach had been to count the number of competing stores in each local market (as defined by store size, product range and catchment area). Where the number of competing retailers in a local market fell below four, this would generally be sufficient for an adverse decision in a Phase 1 review. In a more detailed Phase 2 review, the CMA would combine this count of competitors with a qualitative assessment of other relevant factors, such as the relative location of stores within a local market (and any that might be just outside of it).

This approach had two main shortcomings. First, decisions about which stores were in and out of the market could be quite binary. For example, a mid-sized Aldi store located next to a mid-sized Asda store would not be counted as a competitor (i.e. it would be regarded as placing zero competitive constraint on the Asda store), while a mid-sized Waitrose store located 10 minutes' drive-time away would be regarded as constraining the Asda store. Similarly, a mid-sized Sainsbury's located within the same geographic market as a large Morrisons store would be regarded as placing zero competitive constraint on the Morrisons store. This approach looked increasingly like it was lacking in nuance given changes in shopping behavior and the growth of the discounters.

Second, when it came to Phase 2 reviews, the qualitative assessment of factors such as the relative location of stores in a local market ran the risk of being inconsistent, either within a single transaction or between transactions, as the CMA had no systematic methodology for taking this into account. Our own experience of spending many hours with the CC staff team in the 2006-08 market investigation looking at large numbers of maps showing supermarket locations means that we can appreciate the potential for inconsistent judgements about relative competitive constraints when these were based on an ad hoc visual inspection.

In 2018, Sainsbury's and Asda took the view that the combination of: (i) changed consumer behavior, which suggested that both smaller stores and the discounters were a greater constraint on larger stores; and (ii) developments in the CMA's methodological approach, which could accommodate this development within CMA decision-making, were likely to be sufficient to secure clearance of a merger between them.

This, however, did not turn out to be the case.

Consistent with Sainsbury's and Asda's expectations, the CMA found that mid-sized stores provided a competitive constraint on larger stores, and the CMA also found that Aldi and Lidl, and to a lesser extent Iceland, provided a competitive constraint on Sainsbury's and Asda stores. However, even having found that Sainsbury's and Asda's stores faced a wider range of competitive constraints than previously accepted, the CMA still concluded that competition would be diminished in more than 500 local areas where Sainsbury's and Asda both had grocery stores (which was around 40 percent of all their stores) if the merger went ahead. The extent to which mid-sized stores and the discounters' stores constrained Sainsbury's and Asda, and their closest rivals Tesco and Morrisons, was simply not sufficient, in the CMA's view.

Moreover, in relation to online grocery retailing, the CMA concluded that this was a separate product market to in-store grocery shopping. It found that many customers who shopped online did so for specific reasons, such as being unable to transport bulky items or not being able to easily attend a physical store. For these customers, shopping in-store would be a poor substitute for shopping online. Having reached the conclusion that online grocery retailing constituted a separate product market, an adverse finding on the competitive effects quickly followed: around 90 percent of online groceries were sold by Tesco, Asda, Sainsbury's and Ocado in 2017, and Ocado lacked the national reach of the other three retailers.

Given the scale of the adverse findings in local grocery markets, together with additional adverse findings in relation to the potential for coordinated effects in both online and in-store retailing, the CMA concluded that it should prohibit the planned acquisition.

As a result, the CMA's decision on the *Sainsbury's/Asda* merger proposal can be seen as a continuation of its long-term position, even if its revised methodology permits a more nuanced approach to assessing competition between grocery stores.

V. LOOKING FORWARDS

Since 2019, grocery retailing in the UK, like in many other countries, has faced profound challenges because of the COVID-19 pandemic. Demand for groceries skyrocketed as pandemic-related lockdowns were put in place and eating out was no longer possible. Growth in online grocery shopping was turbo-charged. Shoppers reverted to large weekly shops, with even larger shopping baskets. Coming out of the pandemic, UK food and drink supply chains have become stressed because of labor shortages in a range of areas, including HGV (truck) drivers, meat production facilities, and fruit and vegetable picking.

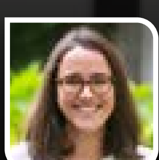
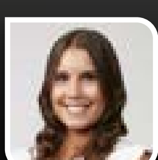
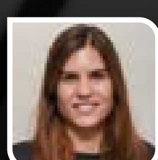
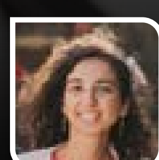
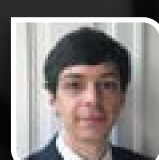
Two of the UK's largest grocery retailers, Asda and Morrisons, have been acquired by private equity firms. While neither acquisition has raised any concerns in relation to grocery retailing, Asda's acquisition by TDR and the Issa Brothers, who also jointly own EG Group, a major UK petrol retailer, have thrown up issues for the CMA in terms of competition between petrol stations. Around 30 stations had to be sold as a condition of achieving CMA clearance. CDR's acquisition of Morrisons, while not yet reviewed by the CMA, seems likely to raise similar issues.

The long-term shift to online shopping also looks set to continue. There are now several entrants into the UK and other European markets specializing in ultrafast delivery – the online equivalent of convenience shopping, including Getir, Gorillas, Jiffy, Zapp, and others.

Supply chain issues, private equity acquisitions of UK retailers and growth in fast-delivery groceries do not appear to have any immediate implications for the CMA's approach to assessing competition in the sector. As a result, the likelihood of any consolidation between the UK's four largest retailers in the short-term looks remote. However, all these developments point to a market that is more dynamic than ever. Retailers are going to keep developing their strategies as they respond to these challenges, and long-standing certainty on the part of the UK's competition regulator about the importance of competition between the largest UK grocery retailers seems unlikely to last forever.

HUB-AND-SPOKE CASES IN THE PORTUGUESE GROCERY SECTOR

BY ANA SOFIA RODRIGUES, CATARINA TOURAIS, MARGARIDA ROBALO CORDEIRO, MARIANA DIAS, MARTA ROCHA & RAFAEL LONGO[1]

1 Portuguese Competition Authority. The views expressed in this paper are those of the authors and do not necessarily represent the views of the institution.

I. INTRODUCTION

Hub-and-spoke arrangements have attracted attention from academics and antitrust authorities. These are cartels coordinated through indirect exchanges of information between suppliers and retailers and raise several questions related to the type of evidence that is consistent with the collusive agreement and the economic incentives of all firms involved.

In this article, we discuss two decisions adopted by the Portuguese Competition Authority (Autoridade da Concorrência, "AdC") on a number of large grocery chains and beverage suppliers for promoting downstream price coordination, in a hub-and-spoke arrangement. The theory of harm considered the negotiation context between the supplier and the retailers as a key element to explain the alignment of incentives between the supplier and the retailers. We describe the bargaining environment, the incentives of the different elements in the value chain and how and why they departed from a more standard supplier-retailer context. We also illustrate the conduct with some non-exhaustive examples of indirect exchanges of information between retailers and suppliers from the two AdC's decisions.

We discuss the relationship between resale price maintenance ("RPM") restrictions and hub-and-spoke arrangements. In the AdC's decisions, the RPM restriction played an instrumental role to implement and police the downstream collusive agreement. Nonetheless, pursuing a pure RPM case would fail to capture the actual conduct of all firms involved and the seriousness of the cartel the RPM facilitated.

We further discuss the burden of proof with respect to intent and awareness of the involved players. We conclude by identifying key elements that enforcers should pay attention to when investigating a potential hub-and-spoke arrangement.

II. HUB-AND-SPOKE CASES IN THE PORTUGUESE GROCERY SECTOR

On December 18, 2020, the AdC adopted two decisions[2] where it imposed a total fine[3] of circa €304 million on six large grocery chains, two beverage suppliers, a board member and a director for price fixing of the suppliers' products.

Both cases now sanctioned add to other investigations underway in the large retail sector. During 2017, the AdC carried out unannounced inspections in the premises of 21 legal entities. This led to the opening of 16 proceedings, more than a dozen of which concerning large retail. Currently, investigations have led to 9 Statement of Objections for hub-and-spoke practices sent to large food retailers and to suppliers of spirits and non-spirits, packaged bread and cakes, as well as personal care, beauty, and cosmetic products.

In particular, the AdC investigated whether several supermarket chains resorted to the vertical relations with their suppliers to promote downstream price coordination regarding the supplier's products, in a hub-and-spoke arrangement.

A. The Decisions

The first decision adopted by the AdC concerns price fixing between the main supermarket chains (Modelo Continente, Pingo Doce, Auchan and Intermarché), as well as a major beverage supplier (Sociedade Central de Cervejas, SCC).

The investigation determined that the distributors and the supplier concerted prices of several SCC products, such as beers, ciders, and sparkling water, for over 9 years, between 2008 and 2017.

In a second decision, the AdC fined the same four large grocery chains, as well as Lidl and E. Leclerc, for concerted pricing through spirits supplier Primedrinks. The scheme lasted for over 10 years, between 2007 and 2017, and involved various products in Primedrinks' portfolio, which includes wines, whiskies, gin, and vodka.

Through a common supplier, retailers coordinated their pricing strategies downstream, thus softening competition and harming consumers.

In both decisions, the AdC imposed an immediate halt to the practice, since it was not possible to rule out that the investigated behavior was still in place.

2 AdC Sanctioning Decision in Process PRC/2017/7, of December 18, 2020 and AdC Sanctioning Decision in Process PRC/2017/1, of December 18, 2020..

3 According to the Portuguese Competition Act - Law no. 19/2012, of May 8, 2012, fines can reach a maximum of 10 percent of the company's turnover in the last year of the practice.

B. Theory of Harm and Economic Incentives

The hub-and-spoke type of arrangement in these cases involves a supplier (the hub) and retailers (the spokes) forming a triangular scheme aimed at reducing competition at the retail level. These practices have elements of both vertical and horizontal conducts. Retailers, while not contacting directly with each other, pass on information to each other using a common supplier.

A key element in a hub-and-spoke investigation is to understand the incentives of both retailers and suppliers to participate in the collusive scheme.

The incentives for the retailers to participate in a hub-and-spoke arrangement tend to be more straightforward and similar to those of a "traditional" cartel: softening price competition and avoiding price wars to obtain higher retail margins.

A question often raised is how retailers and suppliers align their incentives such that collusion is sustainable.

In a vertical relationship between suppliers and retailers, it is often argued that suppliers wish to promote price competition downstream to avoid the problem of double marginalization. That is, the supplier does not want the retailer to price above the competitive level because that would imply a lower volume of sales and, hence, lower revenue for the supplier. This would put the incentives of suppliers and retailers into conflict.

However, this is not always the case, as this context abstracts that retailers may hold significant *bargaining power over suppliers*, which put a downward pressure on upstream margins.

Retailers holding significant buyer power *vis-à-vis* their suppliers tend to pressure suppliers to decrease supplier prices. By doing so, retailers aim at increasing their margins, but also to gain a competitive advantage over other retailers. As retailers try to decrease supplier prices to gain an edge over another, this may lead to lower supplier and retail prices.

Under significant buyer power and retail market concentration, suppliers would have an incentive to soften price competition at the retail level, avoiding reductions in the upstream margin.

For this reason, both retailers and suppliers may have their incentives aligned to soften price competition downstream.

As noted by the OECD (2019), in a situation where retailers pressure a supplier to obtain low retail prices or margins, suppliers can see a hub-and-spoke scheme as a way to avoid a reduction in their margins. In order to maintain both wholesale and retailers' margins, the supplier has incentives to facilitate a collusive scheme.[4]

Suppliers and retailers, therefore, solve their conflict of incentives by extracting welfare from consumers, while increasing their respective profit margins

Thus, the negotiation context, between the supplier and the retailers, can be a key element in a hub-and-spoke scheme and should be a main aspect of an antitrust investigation.

As in any antitrust case, evidence is also a key aspect on a hub-and-spoke, namely in terms of its consistency with the theory of harm and with the alignment of incentives of all involved firms.

C. The Evidence

In these investigations, the AdC seized mostly emails, within firms and between retailers and suppliers. The examples of evidence shown below are not exhaustive of the evidence gathered in the AdC decisions and are mainly to illustrate some of the points made.

The evidence in the AdC Decisions illustrates that suppliers, rather than being worried about reducing future retail prices and increasing sales, acted towards softening competition downstream to eliminate the bargaining pressure to wholesale prices and maintain margins (both upstream and downstream) (see Example 1).

4 OECD (2019) Roundtable on Hub-and-Spoke Arrangements – Background Note (available here).

EXAMPLE 1

Subject: FW: Increase in Sales Prices
From: [Price Analyst - Retailer A]
To: [Director - Retailer A]
"[…]
With the entry into force of the new price table and the new year, [Supplier] asked us to align our sales prices to the ones they currently recommend so that they can ensure the market also follows this increase.
We await your validation.
[Table with a list of 27 products from [Supplier] and their new sales prices]"

From: [Price Analyst - Retailer A]
To: [Director - Retailer A]
"[…]
I want to reinforce [Price Analyst]'s email, namely for [Product 1].
Considering that the [Supplier] has the alignment set up for tomorrow at a national level.
Therefore I appreciate an answer so I can increase the sales price.
[…]"

From: [Director - Retailer A]
To: [Price Analyst - Retailer A]
"[…]
This time only after [Retailer B] increases first."

Suppliers showed concerns over retail prices below recommended prices and asked retailers to increase retail prices, often following complaints from other retailers about competitors' retail prices being too low. Example 2 shows a retailer complaining, *"competition has the following products with a sales price inferior to the one of our store,"* to which the supplier responds, *"the store has committed to change it tomorrow,"* indicating that it contacted the second retailer in order to raise the retail price.

EXAMPLE 2

Subject: Competition prices
From: [Store Coordinator - Retailer A]
To: [Manager - Retailer A]
"[…]
I inform you that our competition has the following products with a sales price inferior to the one of our store.
I demand an alignment so we can follow them.
[…]"

From: [Director - Retailer A]
To: [Supplier]
"This Monday we must have a solution, as we can't have this more expensive."
[…]

From: [Supplier]
To: [Director - Retailer A]
"[…]
I only saw the email today. The sales person went to the store a while ago and called me now. The store has committed to change it tomorrow. When will you perform shopping again?
[…]"

AdC Sanctioning Decision in Process PRC/2017/7, of 18.12.2020, paragraphs 1065-1066, p. 262-264. Free translation made by the authors.

Evidence also shows that there was a cross-check mechanism in place with regular reporting between retailers and the supplier. Retailers used their vertical relationship with the supplier to promote the control and monitoring of prices in the market, as to ensure price alignment. Deviations from the intended retail prices were reported to the supplier, who engaged in efforts to correct them).

In addition, evidence shows instances in which retailers pressure, coerce or retaliate against the supplier – or vice versa – to guarantee a retail price "correction" from the deviant (competing) retailer and ensure an overall retail price alignment in the market.

The communications exchanged between the suppliers and the retailers show they pursued a common anti-competitive objective of aligning prices downstream. For example, in one of the emails, the supplier writes to one of the retailers: *"I understand your point of view, but this is a national strategy and we must be aligned with the other retailers."*[5]

At certain times, suppliers reimbursed discounts offered by retailers downstream, absorbing the impact of those discounts on their margins. This reimbursement was often a last resort strategy when the alignment was frustrated, as shown in Example 3, and presented in the form of threat and pressure on the supplier to ensure the collusive outcome.

EXAMPLE 3

Subject: Shopping Report of May 25 [Product 1]
From: [Retailer A]
To: [Supplier]
"[…]
Hereby I send [Product 1] shopping report.
Considering the prices charged by some retailers, we verify that our stores are uncompetitive.
We appreciate your attention and correction of this situation in the market.
Alternatively, and in last case, we request promotional conditions to the benefit our clients with the best prices.
Look forward for your feedback
[…]"

AdC Sanctioning Decision in Process PRC/2017/7, of 18.12.2020, paragraph 1047, p. 259. Free translation made by the authors.

Hence, the collusive scheme incorporated promotional periods in the downstream markets targeted for certain products, conditioning, however, the amounts of the discount and the implementation dates (as shown in Example 4). The evidence shows that retailers informed the supplier of the date in which they would be willing to change the retail price and requested the supplier to inform them of the dates in which their competitors would apply the agreed changes in the prices.

EXAMPLE 4

Subject: Promotional Cycle WATERS
From: [Supplier]
To: [Retailer A]
As discussed, here bellow is the time frame regarding waters.
Everything is confirmed regarding these dates. I will let you know should something change. Please check and provide some feedback, namely regarding [Product 1].
Please pay special attention to [Product 2], as it will take effect as from tomorrow (22/10.)"

From: [Retailer A]
To: [Supplier]
"We need the price movement regarding waters to occur on the 3rd (Monday). Can you guarantee this alignment?"

From: [Supplier]
To: [Retailer A]
"In accordance to what we have informed you, what we can guarantee is the 5th (always on Wednesdays)."
"Regarding [Product 3], and taking into consideration the usual promotions' constraints, please confirm that you can follow such movement on 11/11"

AdC Sanctioning Decision in Process PRC/2017/1, of 18.12.2020, paragraph 947, p. 206.
Free translation made by the authors.

5 AdC Sanctioning Decision in Process PRC/2017/1, of December 18, 2020, paragraph 969, p. 211. Free translation made by the authors.

Evidence also showed awareness of the practice as parties requested written conversations to be destroyed and to engage, preferably, in verbal conversations (Example 5).

D. The Legal Nature of the Arrangements

EXAMPLE 5

From: [Retailer A]
To: [Another group of employees from Retailer A]
"Good afternoon,
FYI.
It seems to me as an excellent recommendation.
In order to avoid the disclosure of this email I suggest that you destroy it and pass on (reinforce) the message verbally.
You should also be careful with all written documentation, whether it's emails' prints or meeting notes."

AdC Sanctioning Decision in Process PRC/2017/7, of 18.12.2020, paragraph 2113, p. 563.
Free translation made by the authors.

A hub-and-spoke arrangement constitutes a form of conduct that may fall within the scope of Article 9 of the Portuguese Competition Act, as well as Article 101 of the Treaty on the Functioning of the European Union ("TFEU").

In the Portuguese legal framework there is no provision referring specifically to hub-and-spoke arrangements. Similarly to any other type of collusion, in order to find that a hub-and-spoke arrangement constitutes an infringement under Article 9 of the Portuguese Competition Act and, if applicable, Article 101 TFEU, a number of conditions have to be met. In particular, there must be (i) an agreement or concerted practice between undertakings, or a decision by an association of undertakings; (ii) which has as its object or effect the prevention, restriction, or distortion of competition; (iii) with an appreciable effect on competition; and (iv) the verification of that appreciable effect on the Portuguese market.

The AdC analyzed the hub-and-spoke arrangements through the lens of a single concerted practice which comprehends both vertical and horizontal conducts and is typically implemented through an informal cooperation mechanism. In particular, through an indirect exchange of sensitive information between two or more competitors via a common contractual partner operating at a different level of the production/distribution chain.

Based on the AdC investigations, when assessing a potential hub-and-spoke arrangement, it is important to differentiate the information flow which is considered necessary and legitimate, as part of the vertical commercial relationship, from the situations in which competing economic operators use their common contractual partner as a way to achieve a coordinated market response.

Hence, qualifying a certain conduct as an illegal (vertical/horizontal) practice will essentially depend on the type of information passed along the supply chain.

III. POLICY DISCUSSION

A. The Relationship (and the Differences) Between RPM Cases and Hub-and-Spoke Arrangements

From an enforcement point of view, one of the challenges in investigating a hub-and-spoke practice is to understand the incentives of firms in maintaining supra-competitive margins at different levels of the supply chain, and the mechanisms used to curtail competition. In this assessment, it is important to let the strategies of the market players speak.

This is especially relevant in hub-and-spoke cases where vertical restraints play an instrumental role in the implementation of a horizontal restraint. One should carefully consider the features of the vertical restraint used as an instrument to implement an anti-competitive practice with a horizontal dimension.

In the two decisions by the AdC, hereby discussed, suppliers and retailers implement a hub-and-spoke arrangement to reduce competition downstream, where RPM plays an instrumental role. The retailers enjoyed bargaining power over the supplier and put a downward pressure on upstream margins. As a result, the supplier had an incentive to soften price competition in the downstream market so as to avoid reductions in its margin, upstream. This aligned the incentives of both suppliers and retailers: increasing retail prices would increase margins for suppliers and retailers, at the cost of consumer welfare.

The alignment of incentives between the supplier and the retailers provided a common anti-competitive goal and the conditions for a cartel agreement implemented via indirect exchanges of information. In this context, for the supplier, the incentives towards the maximization of margins prevail over the usual economic justification for vertical restraints.

The OECD, in its Background Note for the Roundtable on Hub-and-Spoke Arrangements,[6] finds that many RPM cases pursued by European agencies in recent years included elements of hub-and-spoke arrangements (§84). The OECD also highlights that in the EU, opting for an RPM may serve as a shortcut for competition authorities (§94).

However, getting the story right is important and consequential – in terms of the parties involved and the scheme and infringement at stake. In the case of the two decisions by the AdC, pursuing a pure RPM case would not reflect the actual conduct of all firms involved, nor the seriousness of the cartel the RPM fostered. Taking the most well-established decisional practice would fail to capture the circumstances in which the hub-and-spoke agreement occurred, where suppliers and retailers both played their part willingly and successfully, hampering competition and harming consumers.

B. The Burden of Proof with Respect to the Intent and Awareness of the Involved Competitors

The proof of this concerted practice entails a common (or shared) interest of the colluding undertakings, which encompasses the reduction of the uncertainty as to their future competitive conduct.

Therefore, for example, the information on the intended price point and on the timing of the price adjustments is of a strategic nature.

The evidence collected demonstrates each parties' contribution to the anti-competitive common objective, i.e. the alignment of their behavior in correlation with one another.

In these cases, each retailer is aware, or could reasonably have foreseen, that a similar interaction with the supplier is occurring in parallel in relation to the competitor retailers. This originates the common understanding necessary for the coordination.

IV. CONCLUDING REMARKS

Hub-and-spoke practices usually combine horizontal collusive behavior between competitors, aided by a firm at a different level of the supply chain that facilitates the implementation of the collusive scheme.

When investigating a potential hub-and-spoke, enforcers should pay special attention to (i) the negotiation context between suppliers and retailers and who is exerting margin pressure; (ii) the incentives of all firms involved; and (iii) whether the evidence shows a level of awareness of the retailers regarding the indirect exchange of information and that retailers are aware that their competitors are also following the agreed prices.

In our perspective, when the negotiation and the bargaining context, the aligned incentives and the evidence all tell a story that is consistent with a hub-and-spoke arrangement, there is no reason for not going forward with a hub-and-spoke concerted practice.

6 OECD (2019) Roundtable on Hub-and-Spoke Arrangements – Background Note (available at https://one.oecd.org/document/DAF/COMP(2019)14/en/pdf.

THE NZCC MARKET STUDY INTO RETAIL GROCERY

BY ANDY MATTHEWS & DANNY XIE [1]

1 Respectively, Principal and Law Clerk at Matthews Law, Auckland, New Zealand. **Disclosure: Matthews Law is acting for New Zealand Food and Grocery Council Incorporated, an industry body representing food and grocery suppliers**.

I. INTRODUCTION

The New Zealand Commerce Commission ("NZCC") is currently undertaking its market study into the retail groceries sector.[2] This is the NZCC's second market (competition) study. It was initiated by the Minister of Commerce and Consumer Affairs,[3] citing reasons that *"New Zealand has one of the most concentrated grocery retail sectors in the world"*[4] and *"[t]he market is of strategic importance to the New Zealand economy."*[5] The Government's press release describes the purpose of the market study as to *"ensure New Zealanders are paying a fair price for groceries"* and *"make sure we're not paying more than we should during the weekly shop."*[6]

The final report is due to be released on March 8, 2022.[7] A draft report is currently being consulted on which has a preliminary finding that competition is not working well for consumers or suppliers. The draft report identifies a range of possible recommendations from a code of conduct and voluntary changes to structural separation or divestment.

We are acting for New Zealand Food and Grocery Council Incorporated (NZFGC), an industry body which represents New Zealand's food and grocery suppliers. In this article we comment on:

- Why the NZ retail grocery sector is concentrated and how it got that way
- The types of behavior suppliers say they have experienced due to the imbalance of power
- How market boundaries should be defined and identifying competitors, including how consumer shopping behaviors factor into this
- Theories of harm regarding private labels, which makes supermarket customers and competitors
- The range of possible remedies identified by the NZCC

II. THE NEW ZEALAND RETAIL GROCERY SECTOR

New Zealand has two major grocery retailers: Woolworths NZ Limited ("Woolworths") and Foodstuffs Group ("Foodstuffs"). Woolworths is owned by major Australasian company Woolworths Group, while Foodstuffs consists of two co-operative groups, Foodstuffs North Island ("FSNI") and Foodstuffs South Island ("FSSI"). Between them they operate over 500 stores nationwide under numerous brands such as Countdown, Pak'n'Save, Fresh Choice, Super Value, New World, Four Square and Raeward Fresh. The New Zealand grocery market is estimated to be worth in the order of NZ$22 billion per annum.[8]

The draft report considered Woolworths and Foodstuffs appear to have a high combined estimated share nationally, finding *"most estimates ranged from 80% to 90% and the lowest estimates of their combined market share were from 70% to 80%."*[9] Both retailers are also vertically integrated (into wholesale and private label). New Zealand does not have any other independent wholesalers of a full range of groceries.[10]

---

2 The progress of the study can be followed on the NZCC's web page: https://comcom.govt.nz/about-us/our-role/competition-studies/market-study-into-retail-grocery-sector.

3 "Notice for a Competition Study into the Retail Grocery Sector" (November 17, 2020) *New Zealand Gazette No 2020-go5278* available at https://gazette.govt.nz/notice/id/2020-go5278.

4 "Cabinet paper: Initiating a Commerce Commission market study into supermarkets" (November 13, 2020) Office of the Minister of Commerce and Consumer Affairs at [18.1] available at https://www.mbie.govt.nz/dmsdocument/12272-initiating-a-commerce-commission-market-study-into-supermarkets-proactiverelease-pdf.

5 "Cabinet paper: Initiating a Commerce Commission market study into supermarkets" (November 13, 2020) Office of the Minister of Commerce and Consumer Affairs at [18.2] available at https://www.mbie.govt.nz/dmsdocument/12272-initiating-a-commerce-commission-market-study-into-supermarkets-proactiverelease-pdf.

6 New Zealand Government media release "Supermarkets announced as Government's second market study" (November 17, 2020) available at https://www.beehive.govt.nz/release/supermarkets-announced-government%E2%80%99s-second-market-study.

7 "Notice Amending the Public Release Date for the Final Report for the Competition Study into the Retail Grocery Sector" (September 24, 2021) *New Zealand Gazette No 2021-go4155* available at https://gazette.govt.nz/notice/id/2021-go4155.

8 See Draft report at [2.4] ("*In the year to December 2020, more than $22 billion was spent at supermarkets and grocery stores.*").

9 New Zealand Commerce Commission "Market study into the retail grocery sector: Draft report" (July 29, 2021) ["*Draft report*"] at [5.92] available at https://comcom.govt.nz/__data/assets/pdf_file/0025/260377/Market-study-into-the-retail-grocery-sector-Draft-report-29-July-2021.pdf.

10 Draft report at [6.128].

So how did New Zealand get to this high level of concentration?

New Zealand previously had a number of grocery retailers that over time consolidated to three major grocery retailers, which may not be unusual in a small jurisdiction. However Progressive Enterprises Limited ("Progressive") acquired Woolworths (New Zealand) Limited in 2002. At that time, the test for anticompetitive mergers was being changed from a "dominance" test (a very high level of market power equating to neo-monopoly) to the more orthodox "substantial lessening of competition" ("SLC") test.

Progressive lodged its clearance application to acquire Woolworths the day before the test was changed in 2001. The NZCC granted clearance under the more permissive "dominance" threshold. Foodstuffs challenged the clearance, arguing that Progressive's application should have been determined under the new "SLC" test because the Commission decision would occur when the new test came into effect. There were, unfortunately, no transitional provisions Foodstuffs failed in the High Court but succeeded in the Court of Appeal.

Progressive lodged a fresh clearance application. The NZCC declined clearance under the new SLC test. In the meantime, the Court of Appeal's decision was appealed to the Privy Council and the government passed legislation that clarified the dominance test applied to clearance applications (not determinations) made before the change in test – except Progressive's. Subsequently, the Privy Council (then NZ's highest Court of Appeal) held the NZCC was correct to consider the application under the old dominance test.[11]

The ultimate effect was that Progressive was allowed to acquire Woolworths in a 3:2 merger that the antitrust regulator had determined had the actual or likely effect of substantially lessening competition in relevant markets. Progressive was subsequently acquired by Woolworths Australia in 2005 and changed its name to Woolworths in 2018, leading us to the present-day duopoly. (There may be an argument that Woolworths Australia might have been the most likely market entrant, but we are not aware this was ever tested.)

Interestingly subsequently in 2007 a general merchandiser, The Warehouse Group Limited ("TWL"), made tentative steps into grocery. Both supermarket chains took a 10% stake in TWL and sought clearance to acquire more. The NZCC declined these proposed acquisitions, overturned by the High Court, but supported by the Court of Appeal. Ultimately TWL, did not advance beyond a nascent competitor.

III. BUYER POWER – ALLEGED HARMS

Suppliers have argued that the retail concentration means the two major retailers have duopsony power. NZFGC has submitted that suppliers cannot afford to lose even just one of the major retailers, as there is no meaningful alternative for those lost sales. The lack of alternative channels and imbalance in bargaining power is said to enable the major retailers to engage in harmful procurement practices.

Examples submitted by NZFGC include shifting risks and costs to suppliers (for example by requiring the supplier to cover costs of theft), requiring fees and payments from suppliers (for example display payments), bundling services (for example requiring suppliers to also use that retailer's own transportation services or requiring suppliers to buy retail data collected by the major retailers), retrospective variations to favor the retailer, threats of product deletion, unreasonably delaying or reducing payments, and demanding perks or free product as condition to stocking the supplier's product.[12]

FSNI has responded to these claims.[13] It submits *"relationships between FSNI and its suppliers are valuable and generally healthy."*[14] Woolworths has similarly submitted *"supplier satisfaction levels are high."*[15]

The draft report's preliminary conclusion is that:[16]

11 *Progressive Enterprises Limited v Foodstuffs (Auckland) Limited [2004] 1 NZLR 145 (PC).*

12 NZFGC "Submission on retail grocery market study preliminary issues paper" (February 4, 2021) at [174] available at https://comcom.govt.nz/__data/assets/pdf_file/0026/236942/NZFGC-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf.

13 Foodstuffs North Island "Submission on Market study into grocery sector draft report" (September 10, 2021) ["*FSNI submission*"] at Appendix D available at https://comcom.govt.nz/__data/assets/pdf_file/0034/265768/Foodstuffs-North-Island-Submission-on-Market-study-into-grocery-sector-draft-report-10-September-2021.pdf.

14 FSNI submission at [9.2(d)].

15 Woolworths New Zealand "Submission on retail grocery market study preliminary issues paper" (February 4, 2021) at 35 available at https://comcom.govt.nz/__data/assets/pdf_file/0030/236946/Woolworths-New-Zealand-Submission-on-retail-grocery-market-study-preliminary-isues-paper-4-February-2021.pdf.

16 Draft report at [9.13].

The lack of options for suppliers appears to allow the major grocery retailers to negotiate lower prices with, and push more risks and uncertainty onto suppliers than seems efficient. This can reduce suppliers' incentives to invest and innovate and can lead to suppliers exiting the market. In the long run, this can lead to lower quality goods, reduced choice, and a risk that prices will rise.

IV. NATURE AND SCOPE OF COMPETITION

The major retailers argue the retail sector is highly competitive. They argue that there is intense competition with the increase in "mission" shopping under which consumers shop more often. They argue that they are in competition with, convenience stores, meal kit providers, and takeaways and restaurants as competitors. They disagree that there is limited competition for the "main shop."

Foodstuffs submitted consumers engage in "mission shopping" and competition is driven by firms seeking to attract shopping missions.[17] An example they identify is the *"breakfast/family breakfast mission to fulfil a breakfast meal only."*[18] This "mission" could be achieved by the major retailers, specialist or boutique retailers, purchasing directly from suppliers, purchasing through regular subscription boxes, visiting convenience stores, and cafes and restaurants that serve breakfast and brunch. Accordingly, the number of competitors is abundant, barriers to entry are low, and competition is dynamic and nuanced.

The draft report found "grocery retailers compete with each other for specific shopping missions in local markets where consumers live and work."[19] It distinguished between three categories of shopping missions.

1. The first is the "main shop," a shop that takes place regularly "based on the convenience of using one grocery store to get all necessities in one place."[20] This is the traditional (what the major retailers seem to wish were historical) "weekly shop" that one would think of supermarkets for.
2. The second is a "secondary shop," a supplemental shop at a second grocery store to shop for specific products.[21]
3. The third is a "top-up shop," a quick shop for a small number of items.[22]

Suppliers, and indeed some of the suggested competitors, disagree that other food/convenience-related purchases are a strong competitive constraint even in the context of "mission" shopping. The draft report found the major grocery retailers had a combined estimated share of more than 90 percent for consumers' main shop.[23] Fringe retailers are not a strong constraint because they cannot offer the convenience of a main shop at a single location. The NZCC has expressed concern that the market shares have remained stable over time.

Meanwhile the major grocery retailers also had a high combined estimate market share of more than 80 percent for top-up shops.[24] Even for other "shopping missions," the major grocery retailers had the advantage of generally lower prices, greater range, and greater brand recognition.

Another interesting theory of competition was submitted on the draft report by marketing lecturer Robert Hamlin. He pointed out that the strategic unit of supermarket trade is the category:[25]

> *The consumer has planned to buy these categories before they arrive at the store – but typically they have not yet determined what products out of each of these categories they will buy. … Categories are run by supermarkets to maximise the profit (for*

17 Foodstuffs North Island "Submission on retail grocery market study preliminary issues paper" (February 4, 2021) ["*FSNI PIP submission*"] at [4.1] available at https://comcom.govt.nz/__data/assets/pdf_file/0027/236934/Foodstuffs-North-Island-Submission-on-retail-grocery-market-study-preliminary-issues-paper-4-February-2021.pdf.

18 FSNI PIP submission at [17].

19 Draft report at [4.27].

20 Draft report at [4.18.1].

21 Draft report at [4.18.2].

22 Draft report at [4.18.3].

23 Draft report at [4.92]

24 Draft report at [4.97].

25 Robert Hamlin "Submission on Market study into grocery sector draft report" (19 August 2021) ["*Robert Hamlin submission*"] available at https://comcom.govt.nz/__data/assets/pdf_file/0027/265752/Robert-Hamlin-Submission-on-market-study-into-grocery-sector-draft-report-26-August-2021.pdf.

the supermarket) generated by that category. The range of products and brands that are available within that category are simply units that are deployed exclusively by the retailer and at the retailer's pleasure towards that end.

One category may have several items, but while they *"look like they are competing, they are not in any natural manner."*[26] *"The net purpose of this is to ensure that per individual purchase, averaged over millions of such purchases, the consumer pays more … than they otherwise would do."*[27]

V. PRIVATE LABELS

Another complication to the retailer-supplier relationship is that supermarkets have increasingly started to supply their own "private labels" or home brands. With private labels, supermarkets become both customer and competitor. However, unlike other suppliers, supermarkets also control vital inputs such as control shelf space, retail data and retail pricing.

NZFGC submitted concerns on potential conflicts of interest.[28] Firstly, retailers receive sensitive commercial information from suppliers which suppliers would not normally supply to competitors. Secondly, retailers may not want competing, branded goods, to be priced below their private labels. Thirdly, retailers become competitors for vital shelf space and may have an interest in favoring the placement of their own private label products.

Fourthly, there may also be concerns about use of know-how and intellectual property belonging to the supplier. Retailers may have an interest in using this information to improve their own competing private label. They could require the supplier to manufacture the retailer's private label as a condition of supply, thereby increasing loyalty to the retailer's brand rather than the supplier's.

In a competitive market, competition might prevent these conflicting interests from creating adverse outcomes. Indeed, the draft report recognized *"[c]onsumers may benefit from private label products through lower prices and greater choice."*[29] However private label concerns arguably require greater scrutiny in the context of a duopsony. Similar concerns have arisen in the context of large online platforms such as Amazon and the Apple app store.[30]

VI. RANGE OF REMEDIES

The draft report's preliminary findings are competition is not working well for consumers and the retail grocery sector can be best described as a duopoly with a fringe of other competitors.[31] In line with the NZCC's prior fuels enquiry, at this stage the draft report only identifies options for recommendation, while the final report will likely have final recommendations.

The NZCC identified four groups of possible remedies to address the NZCC's preliminary views on the problems in the sector.

The first group of remedies is aimed at reducing barriers to entry, in particular relating to land and wholesale access. The NZCC identified wholesale barriers could be addressed either by improving supply through existing wholesale grocery channels, for example through voluntary commercial arrangements, enforceable access undertakings, a regulatory access regime, or operational separation, or by facilitating the entry of an independent wholesaler, for example by structurally separating the retailers' wholesale and retail business, or seeking Government investment. Land barriers could be addressed by changes to planning law and removal of restrictive and exclusivity covenants preventing use of potential retail sites. Again, this could be achieved voluntarily, or through regulatory intervention. Land banking could also be monitored.

The second group of remedies look at facilitating retail entry directly. For example, Government investment in a new entrant, or divestment of existing retail stores.

26 Robert Hamlin submission at 2-5.

27 Robert Hamlin submission at 5.

28 NZFGC "Comments on submissions on preliminary issues paper" (12 April 2021) at available at 21-22 https://comcom.govt.nz/__data/assets/pdf_file/0018/253143/NZFGC-Comments-on-submissions-on-preliminary-issues-paper-12-April-2021.pdf.

29 Draft report at [8.147].

30 See for example Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary Investigation of competition in digital markets: Majority staff report and recommendations (October 2020) at 282 https://judiciary.house.gov/uploadedfiles/competition_in_digital_markets.pdf?utm_campaign=4493-519.

31 Draft report at [9.8] and [9.10].

The third group of remedies seek to address the imbalance of power that exists between retailers and suppliers. Something that has been important to our client is advocating for the implementation of a mandatory and independent code of conduct, as has been implemented in the UK and Australia. The code would set minimum standards for retailer conduct in relation to suppliers. The draft report also considered the possibility of a generic regulatory regime in the Commerce Act allowing for the adoption and enforcement of industry codes, collective bargaining and use of the Fair Trading Act's new prohibitions against unconscionable conduct and unfair small trade standard contracts.

The fourth group of remedies addresses consumer information problems. The major retailers indicated they were already voluntarily undergoing the process of simplifying their pricing and promotional mechanisms. However other submitters considered a consumer information standard is needed to ensure a consistent minimum standard was kept to. Other possible reforms include mandatory unit pricing, price comparison websites and improving the clarity and transparency of loyalty programs terms and conditions and data collection. The Privacy Commissioner noted that data portability of loyalty program data would be desirable as to prevent data from becoming a barrier to entry in the future.

VII. THE CONFERENCE & NEXT STEPS

From October 20 to November 2, 2021, the NZCC held an online conference to consult with parties further. The major grocery retailers have argued strongly that the draft report's findings on excessive profitability and lack of innovation are incorrect, that the major grocery retailers face a number of constraints, and that in any event the NZCC should take a forward-looking approach (where Costco may enter, and internet shopping may be material). The major grocery retailers have expressed some support for a code of conduct between suppliers and the supermarkets, which may be modelled on the UK or Australian approach. They have also suggested that they may take action to remove some restrictive covenants on land and leases.

The conference has evaluated possible remedies such as wholesaling operational separation, structural separation, and divestment of some retail stores to facilitate entry. These are complex issues and have been the subject of heated debate. Already the study has generated an incredibly detailed draft report supplemented by independent expert reports and many lawyers and economists have been involved in the process. Post conference submissions are due by November 23, 2021.

CPI COMPETITION POLICY INTERNATIONAL