



## ***Public Competition Assessment***

*5 November 2007*

### ***Wesfarmers Limited - proposed acquisition of Coles Group Limited***

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#### **Introduction**

1. On 22 August 2007, the Australian Competition and Consumer Commission (ACCC) announced its decision not to oppose the proposed acquisition of Coles Group Limited (Coles) by Wesfarmers Limited (Wesfarmers) (**proposed acquisition**). The ACCC was of the view that the proposed acquisition would be unlikely to have the effect of substantially lessening competition in local retail markets for the supply of hardware, home improvement, leisure and gardening products; local or regional markets for the retail of liquefied petroleum gas (LPG); or regional markets for the wholesale of LPG in contravention of section 50 of the *Trade Practices Act 1974* (the **Act**).
2. The ACCC formed its view on the basis of the information provided by the merger parties and information arising from its market inquiries. This Public Competition Assessment outlines the basis on which the ACCC has reached its decision on the proposed acquisition, subject to confidentiality considerations.

#### **Public Competition Assessment**

3. To provide an enhanced level of transparency and procedural fairness in its decision making process, the ACCC issues a Public Competition Assessment for all transaction proposals where:
  - a merger is opposed;
  - a merger is subject to enforceable undertakings;
  - the merger parties seek such disclosure; or
  - a merger is not opposed but raises important issues that the ACCC considers should be made public.
4. This Public Competition Assessment has been issued because Wesfarmers' proposed acquisition of Coles is considered to raise issues of interest to the public.
5. By issuing Public Competition Assessments, the ACCC aims to provide the market with a better understanding of the ACCC's analysis of various markets

and the associated merger and competition issues. It also alerts the market to the circumstances where the ACCC's assessment of the competition conditions in particular markets is changing, or likely to change, because of developments.

6. Each Public Competition Assessment is specific to the particular transaction under review by the ACCC. While some transaction proposals may involve the same or related markets, it should not be assumed that the analysis and decision outlined in one Public Competition Assessment will be conclusive of the ACCC's view in respect of other transaction proposals, as each matter will be considered on its own merits.
7. Many of the ACCC's decisions will involve consideration of both non-confidential and confidential information provided by the merger parties and market participants. In order to maintain the confidentiality of particular information, Public Competition Assessments do not contain any confidential information or its sources. While the ACCC aims to provide an appropriately detailed explanation of the basis for the ACCC decision, where this is not possible, maintaining confidentiality will be the ACCC's paramount concern, and accordingly a Public Competition Assessment may not definitively explain all issues and the ACCC's analysis of such issues.

## **The parties**

### *The acquirer: Wesfarmers Limited*

8. Wesfarmers is an ASX listed Australian company with diverse interests including home improvement and building supplies, coal mining, gas processing and distribution, industrial and safety product distribution, chemicals and fertilisers manufacture, insurance and rail transport.
9. The main Wesfarmers assets of relevance to the ACCC's assessment are:
  - Kleenheat – a producer and wholesaler of liquefied petroleum gas (**LPG**). Kleenheat sells LPG for use as an automotive fuel in Western Australia under its Kleenheat Autogas brand and sells automotive LPG in other states in partnership with Elgas under the Unigas brand. Kleenheat operates seven service stations under the Kleenheat brand. Kleenheat also sells leisure cylinders of 'traditional LPG'<sup>1</sup> throughout Australia for use in small barbeques and similar appliances under its Kwik-Gas brand.
  - Unigas – a joint venture between Kleenheat and Elgas. Unigas is a wholesale supplier and distributor of LPG to service stations and other retailers of automotive LPG. It also retails automotive LPG to motorists. Unigas operates in all Australian states and territories other than Western Australia.
  - Bunnings – a retailer of home improvement, home leisure and building products. Bunnings is the largest specialist retailer of these products and currently operates 181 stores throughout Australia, as well as three

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<sup>1</sup> See paragraph 27.

Houseworks stores in Western Australia. Bunnings also retails leisure cylinders of traditional LPG.

*The target: Coles Group Limited*

10. Coles is an ASX listed retailing company. Its businesses include the Officeworks, Target and Kmart chains, a range of liquor stores, the Coles and Bi-Lo supermarket chains and Coles Express, a chain of service stations.
11. The main Coles assets of relevance to the ACCC's assessment are:
  - Coles Express – a chain of Shell service stations operating throughout Australia. A significant number of Coles Express outlets retail automotive LPG, and traditional LPG in leisure cylinders.
  - Kmart – a chain of 168 discount department stores operating throughout Australia. Kmart retails general merchandise, including camping and fishing, automotive, do-it-yourself (DIY) and outdoor living products.

**The proposed transaction**

12. Wesfarmers proposes to acquire 100% of the shares in Coles. On 2 July 2007, Wesfarmers reached agreement with the board of Coles to put a cash and share offer to Coles shareholders by way of a scheme of arrangement. This proposal was updated on 9 August 2007.
13. Coles shareholders will vote on the proposed scheme on 7 November 2007.

**Market inquiries**

14. The ACCC conducted market inquiries with a range of industry participants, including competitors, potential competitors, customers, suppliers, industry bodies, and other interested parties.

**With/without test (counterfactual)**

15. In assessing a merger pursuant to section 50 of the Act, the ACCC must consider the effects of the transaction by comparing the likely competitive environment post-merger if the transaction proceeds (the “with” position) to the likely competitive environment post-merger if the transaction does not proceed (the “without” position).
16. In this instance, the ACCC considered a likely counterfactual to be the continuation of the current situation whereby all Coles assets are owned by a single owner. Another possibility was the sale of some assets of the Coles Group to another buyer (at the time of the assessment, possible bidders for parts of the group included Woolworths Limited). However, it should be noted that regardless of which counterfactual was adopted, the ACCC's view is that this acquisition would not be likely to lead to a substantial lessening of competition.

### **Areas of overlap**

17. Some of the product categories where Bunnings (Wesfarmers) is active as a retailer, such as garden products, tools, lighting and electrical products, overlap with those where Coles is active, mainly through Kmart, but also to a lesser degree through Coles supermarkets, Target, and Officeworks.
18. Wesfarmers and Coles are also both active in the supply of automotive and traditional LPG.

### **Hardware, home improvement, leisure and gardening products**

#### *Background*

19. The hardware, home improvement, leisure and gardening products retail sector covers a broad range of products. For example, Bunnings (Wesfarmers) has over 45,000 products available across its network. Product categories include hardware and building supplies, electrical and lighting, paint and paint accessories, housewares, kitchen and bathroom supplies, plumbing, hand and power tools, automotive, flooring, and gardening and outdoor supplies. Within the overall retail sector there are a number of different segments and distribution channels.
20. There are three main specialist retailers of hardware, home improvement, leisure and gardening products in Australia: Bunnings, Mitre 10 Australia Ltd (Mitre 10) and John Danks and Son Pty Limited (Danks). There are also a number of specialist retailers who are significant in regional areas, including Magnet Mart (primarily in the ACT) and Dahlsens, which operates primarily in regional Victorian areas and numerous small independent hardware and home improvement retailers. Some category specialists also retail a limited range of hardware, home improvement, leisure and gardening products, e.g. Supercheap Auto (automotive tools, power and hand tools, storage), Beacon Lighting, Barbeques Galore, paint specialists such as Wattyl and Dulux, and Reece (bathroom and plumbing).
21. Discount department stores such as Kmart and Big W also retail a number of related product lines. Supermarkets offer a very limited number of relevant product lines, for example lighting and some gardening products.

#### *Market definition*

22. The ACCC considered that the relevant markets in this matter included local retail markets for the supply of hardware, home improvement, leisure and gardening products.

### *Competition analysis*

23. The ACCC's inquiries indicated that the degree of overlap between the product offerings of Wesfarmers (Bunnings) and the relevant firms owned by Coles was relatively small. Market participants advised that, on average, only around 15-20 per cent of product types stocked by specialist suppliers of hardware and home improvement products are also stocked by Kmart. The comparable figure would be markedly smaller for Target, Officeworks and Coles supermarkets. For those product categories where there is some overlap, market participants advised that the relevant Coles businesses generally offer products which target a low price point (i.e. they tend not to offer top-of-the-range products).
24. Market participants also advised that, over the last few years, Kmart has reduced its emphasis on some of the product categories that overlapped with specialist hardware chains. For example, in July 2006, the (then) Coles Myer Group announced it was scaling down the Kmart Garden Centre concept, originally introduced in 1999.
25. The ACCC concluded that the relevant Coles businesses do not act as a strong competitive constraint on Bunnings at present, and the proposed acquisition is unlikely to substantially lessen competition in the relevant markets.

### **Liquefied petroleum gas (LPG)**

#### *Supply of LPG*

26. LPG is the generic name for certain mixtures of hydrocarbons, mainly propane and butane. It is produced either as a by-product of the oil refining process or by extraction from natural gas streams. Wesfarmers is the major producer of LPG in Western Australia. It does not produce LPG in the other states and territories.
27. The two main uses of LPG are as a fuel for transport (automotive LPG), and as a fuel for industrial, commercial and domestic applications (traditional LPG). Traditional LPG is in turn divided into a number of different uses: domestic, industrial, fork lift power, and leisure cylinders for use as fuel for barbeques and heaters. LPG can also be used by refineries and the petrochemical industry as a feedstock.
28. Wesfarmers supplies automotive LPG at the wholesale and retail levels in Western Australia via Kleenheat, and in the other states and territories via its joint venture with Elgas, Unigas. Coles Express service stations retail automotive LPG across Australia.
29. Traditional LPG is supplied at the wholesale level by Wesfarmers (through Kleenheat) in Western Australia. Bunnings and Coles Express both retail traditional LPG for leisure purposes, which is supplied in bottles (cylinders).

*Market definition*

30. Automotive LPG is a mixture of propane and butane, while bottled gas used for domestic purposes (such as cooking and heating) consists mainly of propane. For safety reasons, automotive LPG mixtures cannot be used for domestic purposes. The ACCC's inquiries indicated that the cost of bottled LPG is higher than automotive LPG, partly because its delivery in small cylinders increases per unit transport costs. Storage, dispensing and administrative costs are also more expensive for bottled traditional LPG than for automotive LPG, raising its relative overall cost. The ACCC concluded that there is very limited substitutability between traditional LPG and automotive LPG, both on the demand side and on the supply side. Accordingly, the ACCC defined separate product markets for traditional LPG and automotive LPG.
31. Market inquiries indicated that it is not commercially viable to transport large quantities of LPG from Western Australia to the eastern states, and vice versa. The ACCC therefore defined separate geographic markets for Western Australia and the other states and territories.
32. The ACCC concluded that the relevant markets in this matter included:
  - the market for **wholesale supply of automotive LPG** in Western Australia;
  - the markets for **retail supply of automotive LPG** in regional or local markets within Western Australia;
  - the markets for **wholesale supply of automotive LPG** in states and territories other than Western Australia;
  - the markets for **retail supply of automotive LPG** in regional or local markets in states and territories other than Western Australia;
  - the market for **wholesale supply of traditional LPG** in Western Australia;
  - the markets for the **wholesale supply of traditional LPG** in states and territories other than Western Australia; and
  - the markets for **retail supply of traditional LPG** at a regional or local level.

*Competition analysis – wholesale supply of automotive LPG in Western Australia*

33. Wesfarmers currently has a strong position in the production and wholesale supply of LPG in Western Australia. Some market participants expressed concerns that if Wesfarmers acquired the Coles Express retail outlets, it would have a substantial presence at both the wholesale and retail stages of the supply chain, and may therefore be able to diminish the ability of its downstream rivals to compete by:
  - wholesaling LPG to Coles Express retail outlets at cheaper prices than its other wholesale customers; and

- foreclosing supply to Coles Express' competitors at the retail level of the supply chain, in which case the ability of these retailers to source LPG from other channels may be limited.
34. Market inquiries indicated that alternative sources of supply in Western Australia were generally limited to those supplied by BP, and imports (or supply from the eastern states) were unlikely to constrain Wesfarmers.
35. However, the ACCC considered that Wesfarmers' ability to favour Coles Express post-acquisition was limited by the Shell/Coles Express alliance agreement at least for the term of the agreement given that Coles must obtain its LPG from Shell for the term of the agreement. Further, even if this alliance agreement was terminated (and Wesfarmers were to take over the wholesale supply of LPG to Coles Express), this would result in Wesfarmers displacing the existing supplier. The displaced supplies of LPG (as previously supplied to Coles Express) would become available to the rest of the market, thereby mitigating any anti-competitive impact.
36. In any case, given that the market share of Coles Express at the retail LPG level in Western Australia is far lower than the market share of Wesfarmers at the wholesale and production LPG levels, the ACCC considered that Wesfarmers would be unlikely to have any commercial incentive to foreclose supply to Coles Express' competitors at the retail level.

*Competition analysis – retail supply of automotive LPG in local or regional markets in Western Australia*

37. Kleenheat leases five outlets which retail automotive LPG in Western Australia, two of which are not in the vicinity of any Coles Express outlets.
38. Kleenheat's outlets in Albany, Bunbury and Rockingham are in close proximity to Coles Express outlets. However, the ACCC's inquiries found that in each location, there were a number of alternative retailers of automotive LPG which would continue to constrain the merged entity post-acquisition.
39. The ACCC concluded that consolidation of Kleenheat's and Coles Express' retail outlets in Western Australia was unlikely to substantially lessen competition given the number of alternative retailers in each location where an aggregation will occur.

*Competition analysis – wholesale supply of automotive LPG in the each state and territory other than Western Australia*

40. Wesfarmers supplies automotive LPG through Unigas in all states and territories other than Western Australia. Unigas is a joint venture between Kleenheat (Wesfarmers) and Elgas. Unigas is predominantly a wholesaler of LPG, supplying around 1,000 retail sites.

41. Market participants expressed some concern that the acquisition may lead to the integration of the Unigas network for the wholesale and retail distribution of automotive LPG with the Coles Express retail network. The ACCC considered whether this integration, if it were to occur, may provide Wesfarmers with the ability and incentive to influence Unigas to favour its own downstream operations to the detriment of independent retailers supplied by Unigas.
42. This issue was closely considered given that Unigas is currently the largest supplier of automotive LPG to independent retailers; that is, retailers not affiliated or integrated with one of the major oil companies. Effective foreclosure may therefore have the effect of either forcing independent retailers out of the market or encouraging their integration with a major player, thus leading to increased market concentration.
43. The ACCC's market inquiries indicated that in contrast to the situation in Western Australia, Wesfarmers is not the major wholesale supplier of LPG in the other states and territories. There were alternative wholesale suppliers of automotive LPG in each of the states and territories other than Western Australia, including Caltex, Shell, Mobil, BP, Origin, VitalGas and United Petroleum. In any case, as in the Western Australian wholesale market for LPG, the ACCC considered the Shell Alliance agreement between Coles and Shell would prevent integration between Unigas and Coles Express for the term of the agreement.
44. Market inquiries also indicated that there were relatively low barriers to entry into the wholesale LPG market. Relevant factors include:
  - the existence of various sources and suppliers of LPG, including Bass Strait, the Surat Basin, the Cooper Basin, the Shell, Caltex, BP and Mobil refineries, and the possibility of imports;
  - the short term nature of contractual arrangements between wholesalers and retailers; and
  - the potential for a new entrant to start on a small scale and successfully build its business.
45. The ACCC also noted that Elgas, a 50 per cent partner in the Unigas joint venture, was likely to act as a constraint against Wesfarmers favouring Coles Express sites to the detriment of retailers supplied by Unigas. Elgas would have an incentive to prevent such favouritism, as any preferential treatment of Coles Express by Wesfarmers would be likely to lead to a reduction in the profits of Unigas.

*Competition analysis – retail supply of automotive LPG in local or regional markets in each state and territory other than Western Australia*

46. Unigas has a small presence at the retail level outside of Western Australia, operating around 10 sites on a retail agency basis. Coles Express sites retail automotive LPG in each Australian state and territory.



47. The ACCC concluded that the horizontal aggregation of the Coles Express retail outlets and the 10 retail outlets currently operated by Unigas was unlikely to raise competition concerns given the number of alternative retailers in each location where an aggregation will occur.

*Competition analysis – traditional LPG*

48. There is some overlap in the wholesale and retail supply of traditional LPG through Wesfarmers' role as a producer of traditional LPG, Kleenheat's role as a wholesaler and retailer of traditional LPG, and Bunnings' and Coles Express' retail sale of leisure cylinders.
49. The ACCC noted that Bunnings is a retailer of leisure cylinders. Wesfarmers will not become vertically integrated in production, wholesale, and retail in this market as a result of the transaction; it is already active at each of these levels.
50. While the ACCC noted that the proposed acquisition would increase the market share of the merged firm in markets for the retail supply of traditional LPG, it formed the view that this is unlikely to pose significant competition concerns. In the retail supply of traditional LPG, the ACCC concluded that any attempts by Wesfarmers to raise its prices would be constrained by the presence of several other sizeable retail competitors, such that no substantial lessening of competition would be likely.
51. In the wholesale supply of traditional LPG, the ACCC examined potential vertical integration issues, in particular whether there is a risk of foreclosure by Wesfarmers in the supply of traditional LPG in Western Australia. The ACCC concluded that Wesfarmers is unlikely to have any incentive to foreclose supply given the competitive state of the retail market and the fact that a large proportion of sales lost by rivals would be unlikely to switch to Wesfarmers.

**Conclusion**

52. On the basis of the above, the ACCC formed the view that the proposed acquisition of Coles Group Limited by Wesfarmers Limited would not be likely to result in a substantial lessening of competition in any market in contravention of section 50 of the Act.