



Public Competition Assessment

14 January 2010

Woolworths Limited/Lowe's Companies Inc - proposed acquisition of Danks Holdings Limited

Introduction

1. On 11 November 2009, the Australian Competition and Consumer Commission (ACCC) announced its decision not to oppose the proposed acquisition of Danks Holdings Limited (**Danks**) by a joint venture between Woolworths Limited (**Woolworths**) and Lowe's Companies Inc (**Lowe's**) (the **proposed acquisition**), subject to section 87B undertakings offered by Woolworths and Carboxy Pty Limited (**Carboxy**) and accepted by the ACCC on 11 November 2009 (the **undertakings**). The ACCC decided that the proposed acquisition, when considered in light of the undertakings, would be unlikely to have the effect of substantially lessening competition in any relevant market in contravention of section 50 of *Trade Practices Act 1974* (the **Act**).
2. The ACCC made its decision 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 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 the proposed acquisition is subject to enforceable undertakings and is considered to raise issues

of interest to the public.

5. By issuing Public Competition Assessments, the ACCC aims to provide the public with a better understanding of the ACCC's analysis of various markets and the associated merger and competition issues. It also alerts the public to the circumstances where the ACCC's assessment of the competition conditions in particular markets is changing, or likely to change.
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's 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

8. Woolworths and Lowe's proposed to acquire Danks through an incorporated joint venture bid vehicle, Carboxy, which is owned two thirds by Woolworths and one third by Lowe's.

Woolworths

9. Woolworths is a large Australian retailer whose businesses include the Big W chain of discount department stores, Woolworths and Safeway supermarkets, and electronics, liquor and petrol retailing chains.
10. Woolworths currently has a limited presence in the hardware and home improvement sector; it supplies a range of hardware products in its Big W discount department stores and a smaller range in its supermarkets.

Lowe's

11. Lowe's is a large, US-based hardware and home improvement retailer. Lowe's

operates over 1,600 ‘big box’¹ home improvement stores throughout the United States and Canada; Lowe’s has no Australian operations at present.

The target

Danks

12. Danks is an ASX-listed Australian company whose principal business is the wholesale distribution of hardware products and related services to independently owned and operated² hardware retailers including Danks member stores and other stores not affiliated with Danks.
13. Danks’ members operate stores under the banners of “Home Timber and Hardware”, “Thrifty-Link Hardware” and “Plants Plus Garden Centres” (together, **member stores**); Danks owns each of these brands. In addition to supplying member stores with a wide range of products, Danks provides its members with marketing and promotional services, retail support services and financial benefits (e.g. rebates) which are derived from the group’s buying power with suppliers. Members pay fees to Danks in return for these services. There are over 500 Danks members, accounting for the vast majority of Danks’ wholesale sales (over 90%).
14. The remainder of Danks’ sales are to over 900 independent hardware retailers (**non-member stores**).
15. Both the member and non-member stores supplied by Danks are generally small to medium format stores. For example, Thrifty-Link Hardware stores are generally smaller format stores, and Home Timber and Hardware stores are generally medium format stores.
16. Danks operates warehouses in Victoria, Western Australia, and New South Wales from which it distributes products to its customers.

Other key industry participants

Bunnings

17. Bunnings is the largest retailer of hardware and home improvement products in Australia. It operates 162 big box stores, 32 small format stores and 23 trade centres across Australia.
18. Bunnings is part of the Wesfarmers Group (**Wesfarmers**), an ASX-listed Australian company with business activities across a range of industries. In addition to hardware and home improvement operations, Wesfarmers operates supermarkets, liquor stores, discount department stores and office supply stores.

¹ While there is no single definition of what constitutes a ‘big box’ store, they are generally characterised by their large format and range of products. Additionally, they are generally considered to be ‘destination’ stores—that is, stores to which customers are prepared to travel specifically to visit.

² There is also one company-owned store in Katoomba, NSW.

Mitre 10

19. Mitre 10 supplies a network of over 400 member stores throughout Australia, all of which are independently owned.³ Mitre 10's members trade under the banners of "Mitre 10 Mega", "Mitre 10 Home & Trade", "Mitre 10 Solutions", "Mitre 10 Handy" and "True Value Hardware" (together, **Mitre 10 members**). Most of these stores are small to medium format stores with a few big box stores and some smaller convenience-based stores.
20. Mitre 10 operates as a wholesaler to its Mitre 10 members in a similar way to Danks, providing associated marketing and promotional services, retail support services and financial benefits in addition to the wholesale supply of hardware and home improvement products. Mitre 10 also supplies approximately 1100 non-affiliated hardware retailers. It has four wholesale distribution centres located in Queensland, Victoria, New South Wales and Western Australia.

Other smaller chains and independent retailers

21. In addition to the above retailers, there are a number of smaller chains of hardware and home improvement stores that tend to be regionally based. Examples include Dahlsens and Magnet Mart. There are also many independent hardware stores which are not members of any banner group.

Wholesale buying groups

22. Wholesale buying groups are made up of a group of independent hardware retailers and operate to combine the collective buying power of their members to negotiate discounts with suppliers on behalf of their members. Buying groups exist for a particular product (e.g. plasterboard) as well as for hardware supplies more generally. Examples of buying groups are HBT (Hardware and Building Traders) and Natbuild.
23. Buying groups differ from other participants operating at the wholesale level such as Danks and Mitre 10 in that the focus of buying groups is generally on buying arrangements. Services such as marketing or warehousing and distribution are not typically provided for members. Some retailers are members of both a buying group (such as Natbuild) and a banner group (such as Mitre 10).

The proposed acquisition

24. The proposed acquisition forms part of Woolworths' broader plans to enter the hardware and home improvement sector in Australia. In addition to the formation of the joint venture with Lowe's and the acquisition of Danks, Woolworths has announced plans to roll out a network of at least 150 big box home improvement stores.⁴ This is discussed further at 'With/without test' below.

³ This follows Mitre 10's decision to exit corporate-ownership of stores in 2009.

⁴ Woolworths press release, *Woolworths to enter \$24 billion hardware sector*, 25 August 2009.

ACCC's review timeline

25. The following table outlines the timeline of key events in the ACCC's review of this matter.

3 September 2009	ACCC commenced review under the Merger Review Process Guidelines.
24 September 2009	Closing date for submissions from interested parties.
16 October 2009	ACCC published a Statement of Issues outlining preliminary competition concerns. Former proposed date for announcement of ACCC's findings deferred to allow for submissions relating to Statement of Issues.
23 October 2009	Closing date for submissions relating to Statement of Issues.
11 November 2009	ACCC announced it would not oppose the proposed acquisition, subject to a court enforceable undertaking given by Woolworths and its joint venture to the ACCC.

Market inquiries

26. The ACCC commenced market inquiries on 8 September 2009. A range of interested parties were consulted including Danks member stores, other retailers, wholesale suppliers of hardware products, manufacturers, buying groups, building industry associations and other interested parties. The ACCC sought submissions in relation to each of the substantive competition issues outlined below.
27. Following publication of the ACCC's Statement of Issues on 16 October 2009, the ACCC conducted further market inquiries focusing on the issues identified in the Statement of Issues and received additional submissions on those issues.

Statement of Issues

28. The ACCC published a Statement of Issues on 16 October 2009 identifying a number of competition issues and seeking further comments in relation to those issues. In the Statement of Issues the ACCC stated its preliminary view that the proposed acquisition may be likely to lead to:
- i. reduced competition at the retail level in some local markets due to a reduction in the number of participants at the wholesale level (this issue was identified as an 'issue of concern' or 'red-light issue'); and
 - ii. discrimination against some Woolworths/Lowe's wholesale customers who are also its retail competitors (this issue was identified as an 'issue that may raise concern' or an 'amber-light' issue).
29. In relation to the first issue, the ACCC's preliminary view was that the proposed acquisition may result in a reduction in the level of competition between retailers in some local markets, particularly between Woolworths' big box stores and retailers supplied by Woolworths / Danks. In the future with the acquisition Woolworths would be the wholesale supplier to Danks supplied independent retailers, whereas these retailers would be supplied by an independent wholesaler in the future without the acquisition. The ACCC was concerned that as a result, depending on the number and type of other retailers and wholesalers and their

competitive response in each local market, consumers may face higher prices and/or lower levels of quality and service in some local markets.

30. In relation to the second issue, the ACCC's preliminary view was that the proposed acquisition may provide Woolworths with the ability and incentive to discriminate against some of its wholesale customers who are also its retail competitors. The ACCC was concerned that such discrimination would limit the ability of these stores to compete as effectively as they would have if Danks had remained independent of Woolworths, and it could potentially even result in their exiting the market(s).
31. The ACCC's ultimate findings in relation to each of these issues are discussed under the heading 'Competition analysis' below.
32. In its Statement of Issues the ACCC also indicated its preliminary view that Woolworths' presence in other retail sectors (groceries, liquor and petrol) would not be likely to provide it with advantages which could be leveraged into the hardware and home improvement sector such that it would lead to a substantial lessening of competition in any of the relevant markets. The ACCC did not receive any additional information to change this view after the Statement of Issues was published.
33. The Statement of Issues is available on the ACCC website at www.accc.gov.au/mergersregister.

With/without test

34. 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 acquisition proceeds (the "with" position) to the likely future competitive environment if the acquisition does not proceed (the "without" position).
35. In this matter it was clear to the ACCC that the likely future state of competition without the merger would not be the same as the state of competition prevailing at the time of the acquisition (i.e. the status quo). Woolworths and Lowe's do not currently have any significant operations in the Australian hardware sector, meaning there is virtually no overlap between their activities and those of Danks. Having regard to available information, the ACCC considered that this situation would be unlikely to continue without the acquisition, and should therefore not be used as the basis for a comparison with the likely competitive situation if the acquisition proceeds.
36. Based on the information provided by the merger parties and other information obtained during market inquiries, the ACCC considered that, in the absence of the proposed acquisition, it was likely that Woolworths would establish its own network of retail hardware stores and would make its own wholesaling arrangements to obtain supply for those stores. Further, the ACCC considered that Woolworths would not be likely to establish itself as a wholesale supplier to independent hardware retailers in the absence of this transaction.
37. The ACCC considered that in the absence of the proposed acquisition Danks

would continue as a wholesaler and a retail marketing group.

Timeframe over which competitive effects are assessed

38. As discussed above, in assessing a merger pursuant to section 50, the ACCC must consider the effects of the transaction by comparing the likely competitive situation with the proposed acquisition to that which would be likely to prevail without the proposed transaction. This requires a forward looking analysis into the effects or likely effects of a merger. In undertaking such an analysis, the ACCC will focus on the foreseeable future when considering market definition and each of the merger factors to determine whether a substantial lessening of competition is likely to arise.
39. If the particular characteristics of a market are such that any anti-competitive effects may be delayed until some time in the future, the ACCC will focus its assessment on the time from which the anti-competitive effects are likely to occur.
40. Having regard to the information available to it, including information concerning the future business plans and investment decisions of the merger parties, the ACCC considered that any competition concerns would be unlikely to occur immediately (given the lack of overlap in the operations of the acquirer and target) and instead would arise following the commencement of Woolworths' big box retail hardware operations. Accordingly, it is on this period that the ACCC's competition analysis focused.

Market definition

Retail markets

41. The ACCC considered the competitive effects of the proposed acquisition in local markets for the retail sale of hardware and home improvement products in the context of the following product categories:
 - i. tools and hardware
 - ii. bathroom and kitchen materials
 - iii. plumbing supplies
 - iv. paint and decoration
 - v. garden supplies
 - vi. timber and building supplies
 - vii. lighting and electrical
 - viii. outdoor living
 - ix. flooring and
 - x. storage and organisation.

Distribution channels

42. Hardware and home improvement products within these product categories are

supplied through a number of retail distribution channels including:

- multi-category hardware and home improvement retailers of various sizes such as Bunnings, Mitre 10 and Home Timber and Hardware
 - category specialists, which tend to cover a single or select range of product categories such as plumbing supplies, e.g. Reece and Tradelink
 - discount department / variety stores such as Big W, Kmart and The Reject Shop.
43. The ACCC recognised that it is not the case that each retailer selling products from a given category imposes an equally strong competitive constraint on all other retailers of those products. In particular, a competitor's location, price, product range, service and format are important factors in determining the closeness of competition between different retailers within a market.
44. Having said that, the ACCC considered it appropriate to include the various retail formats within the same market and then consider the effectiveness of the constraints imposed by particular retail formats in assessing the competitive impact of the proposed acquisition. This is discussed further under the heading 'Competition analysis' below.

Geographic dimension

45. The ACCC considered the relevant retail markets for the sale of hardware and home improvement products to be local geographic markets. The ACCC considered each market on a case-by-case basis, closely examining competition within 5km of a proposed big box store, and including participants up to 10km away where local circumstances meant this was appropriate.
46. Relevant factors taken into account in determining the precise size of the geographic market in any local area included travel times and the road network, any geographic barriers such as rivers, as well as the distance customers are willing to travel in order to shop at, and switch between, alternative stores. For instance, customers are often willing to travel further to a big box destination store than to a smaller convenience-based store.

Wholesale markets

47. The ACCC also considered the competitive effects of the proposed acquisition in regional markets for the wholesale supply of hardware and home improvement products to retailers.
48. The ACCC's inquiries indicated that retailers obtain their products from a combination of sources including wholesalers (via warehouses and direct from manufacturers through the use of 'chargeback' facilities⁵), buying groups and directly from manufacturers. Accordingly, wholesale supply was taken to include supply via each of these methods.

⁵ 'Chargeback' facilities allow retailers to source products directly from manufacturers while being invoiced for these products through a wholesaler such as Danks.

49. Stores usually obtain direct supply for products which are more efficiently delivered direct to store because they are difficult to handle (e.g. large or hazardous products) or because they are required in sufficient volumes to justify direct delivery.
50. The ACCC considered that vertically integrated wholesalers who also operate retail stores (e.g. Bunnings) form part of this market, as do independent wholesalers with no retail stores. While vertically integrated wholesalers / retailers like Bunnings do not compete to supply independent retailers, the prices charged by wholesalers like Danks and Mitre 10 to independent retailers are still constrained indirectly by the retail prices charged by Bunnings. To the extent that Bunnings competes with the independent retailers who are customers of these wholesalers, this puts pressure on the independent wholesalers to offer competitive prices in order to ensure that the retailers they supply do not lose sales to Bunnings.

Geographic dimension

51. The ACCC considered that markets for the wholesale supply of hardware and home improvement products to retailers exist on a regional scale, where these regions sometimes cross state borders or encompass more than one state or territory. Transit times and transport costs were the most significant factors in determining the geographic dimension of these markets.

Competition analysis

Background

52. As discussed above, the ACCC considered that there existed a degree of differentiation within the relevant retail and wholesale markets—this is discussed below.

Competition within retail markets

53. While there are various retail formats; the extent of competition between retailers of hardware and home improvement products varies.
54. The ACCC found that big box stores are generally each other's closest competitors given the similarity of their formats: i.e., large, one-stop-shop destination stores with a wide range of products. Medium format stores are the next closest competitors to big box hardware stores due to their wide product range (albeit smaller than that of a big box store) and generally competitive prices, followed by small format hardware stores which tend to have a smaller product range and a greater focus on convenience and service than price.
55. The ACCC found that, with some exceptions such as supplying certain trade customers, specialist retailers are not generally considered to be close competitive alternatives to multi-category or big box retailers, particularly for those customers who value the ability to shop for a range of products from multiple categories in one store.

56. In addition to hardware-focused retail stores, some discount department / variety retailers offer hardware products as part of a broader retail offering. Market inquiries suggested that while they provide a degree of competition by selling a limited range of entry-level products at low prices, such stores provide only a limited competitive constraint on hardware-focused multi-category or specialist retailers.

Competition within wholesale markets

57. Similarly, with respect to the relevant wholesale market, there are a range of supply options available to retailers from which to source their supply of hardware and home improvement products. The ACCC's inquiries demonstrated that the closeness of competition between wholesalers also varies based on their products and service offering.
58. While there are a variety of wholesale supply options for retailers and many retailers use some of these options (such as direct supply and buying groups) to complement wholesale supply from Danks or Mitre 10, the ACCC's market inquiries indicated that because of similarities in their product and service offering, Danks and Mitre 10 compete most closely with each other rather than with these other sources of supply.
59. The ACCC found that the extent to which other sources of supply, such as supply direct from manufacturers and buying groups, are close competitive alternatives to using a wholesaler such as Danks depends to some extent on the profile of the customer. The ACCC's market inquiries with retailers indicated that larger format retail stores, groups of stores with a common owner and those stores with an emphasis on trade sales are more easily able to obtain supply from alternative wholesale sources. This is due to the nature of the products being sourced and these retailers' ability to manage relationships with, and deliveries from, several suppliers.
60. For other retailers such as smaller, DIY-focused stores, these alternative sources of supply could not readily be used instead of wholesale supply from Danks or Mitre 10, partly because of the difficulty, cost and inconvenience of obtaining small quantities of products from a large number of suppliers, and partly because these retailers depend on the other services provided by these wholesalers.
61. Vertically integrated wholesale suppliers, e.g. Bunnings, while not competing directly with Danks and Mitre 10, provide an indirect competitive constraint on wholesalers via retail competition. As discussed under the heading 'Market Definition', to the extent that vertically integrated retailers compete in the same product and geographic retail markets as the independent retail customers of wholesalers of hardware and home improvement products, retailers and therefore wholesalers will lose customers to the vertically integrated suppliers if they are not competitive.

Importance of a wholesaler to retailers

62. While the ACCC's inquiries indicated that most retailers obtain products from a combination of sources, wholesalers provide customers with a range of services

and benefits which are not readily available elsewhere and which assist them to compete. These include negotiation with suppliers, central billing or chargeback facilities for a wide range of products, warehousing, store branding and other marketing services.

63. Market inquiries indicated that the independent stores which obtain most of their products direct from manufacturers or through buying groups (i.e. stores that make little or no use of a wholesaler such as Danks or Mitre 10) are predominantly trade-focused stores. For these stores, buying groups represent an attractive alternative to wholesalers for their primary supply as they tend to require larger volumes of a smaller range of mainly trade-focused products—often products which are more efficiently supplied direct to retail stores (for example, timber, cement and flooring).
64. The ACCC's inquiries further indicated that wholesalers are valued by some stores due to the range of products on offer via the warehouse or chargeback system. It would be difficult for such retailers, in particular those DIY-focused stores, to obtain competitive access to a similar range of products without access to a wholesaler such as Danks or Mitre 10. For example, the use of buying groups such as Natbuild and HBT would be likely to provide access to a more limited range of products from a more limited range of suppliers. This is consistent with buying groups being considered stronger wholesale substitutes for trade-focused stores than for DIY-focused stores.
65. The effect of minimum order requirements on small retailers was another factor supporting the importance of wholesalers for these stores. The ACCC noted that smaller stores have limited financial and storage capacity to meet the minimum order requirements of suppliers, which effectively lock smaller stores into either purchasing minimum volumes or paying a fee in the event that volumes below this minimum level are purchased.
66. While the ACCC's inquiries obtained a range of comments from market participants on the degree to which the services offered by a wholesaler such as Danks are valued by its customers, it is clear that some stores—in particular smaller retailers with a focus on retailing DIY-type products—not only value access to competitively supplied products but also value the additional services offered by a wholesaler.
67. The ACCC considered that such stores would be likely to face difficulties attempting to independently replicate these benefits; for example, individual stores are unlikely to be able to replicate the marketing and promotional support provided across the network of Home Timber and Hardware stores, including television advertising and catalogues with deeply discounted products to attract customers.

Reduced competition at the retail level due to a reduction in the number of participants at the wholesale level

68. As noted above, one of the issues identified by the ACCC in its Statement of Issues was whether a reduction in the number of wholesale competitors would

lead to a reduction in the level of retail competition in some local markets.

69. While the ACCC recognised it was unlikely that Woolworths would have operated as a wholesale supplier to independent hardware stores in the absence of this transaction, it considered that the acquisition of Danks' wholesale business would reduce the number of wholesale suppliers compared with the situation without this acquisition (where Woolworths and Danks would have both operated as wholesale suppliers to retailers, albeit that Woolworths' only wholesale customer could be its own stores).
70. Notwithstanding that Woolworths was unlikely to supply independent hardware stores in the absence of the proposed acquisition, the ACCC considered that the prices charged by wholesalers such as Danks and Mitre 10 are indirectly constrained by vertically integrated retailers with their own wholesale operations, such as Bunnings and Woolworths' big box stores. The mechanism by which this constraint occurs was described at paragraph 50 above.
71. In the factual world with the acquisition, Woolworths will set both the retail prices in its big box stores and the wholesale prices to its independent retail customers and would have the incentive to set those prices at levels that would maximise its overall profits, while taking into account the extent of competition from other retailers and wholesalers. The ACCC considered whether Woolworths' dual role as a wholesaler and a retailer was likely to result in a reduced level of competition at the retail level, both on a broad 'network-wide' basis and more particularly in those local areas where Woolworths supplies an independent retailer in close proximity to one of its new big box stores
72. The ACCC considered whether the common ownership and control of Woolworths' retail stores and its wholesale supply business for Danks member stores may result in prices being higher than they would have been if these businesses were separately owned and had an incentive to compete with each other.
73. In particular, the ACCC examined:
 - (i) the possibility that such price increases (or the absence of price decreases) may occur on a unilateral basis, with Woolworths setting its big box retail prices and its wholesale prices to Danks customers at levels higher than they would have been if Danks were not owned by Woolworths; and
 - (ii) the possibility that the acquisition may increase the likelihood of higher prices occurring on a coordinated basis. This concern could arise if other competitors in the relevant markets were to accommodate less vigorous competition by Woolworths/Danks by also keeping their prices above competitive levels, rather than setting competitive prices and seeking to win customers away from Woolworths/Danks. The ACCC examined whether the acquisition of Danks would make such coordination more likely by reducing the ability of Danks members to compete vigorously and disrupt any attempted coordination.
74. In addition to examining the risk that the proposed acquisition may lead to prices

being higher than they would otherwise have been, the ACCC also considered whether it may result in a reduction in the range of products offered for sale, less competition on store opening hours and/or a reduction in the level of in-store customer service.

75. In order to determine whether Woolworths would have an incentive to set higher prices or otherwise reduce the competitive offer of its big box stores and Danks wholesale business, the ACCC examined whether it would likely be profitable for Woolworths to engage in this behaviour.
76. Relevant factors for this assessment included the closeness of competition between Woolworths' big box stores and Danks supplied retailers, in both product and geographic space; the extent of competition from other retailers; the importance of a wholesaler to Danks' customers; the extent of competition from other wholesalers; and barriers to the entry and expansion of new wholesalers.
77. In examining the impact of the proposed acquisition on competition in the relevant retail and wholesale markets, the ACCC considered the closeness of competition between various retail formats. As discussed in paragraph 54, the ACCC's inquiries indicated that while there is competition between different format hardware stores, big box stores are each other's closest competitors. Information provided to the ACCC confirmed that Woolworths' big box stores are likely to be positioned to compete most directly with Bunnings (and other big box stores) and that Bunnings is likely to represent strong competition to Woolworths' big box stores and to react competitively to the entry of Woolworths' big box stores.
78. Further, the ACCC considered that Mitre 10 and other small to medium format retailers in each of the relevant local markets may disrupt any attempted unilateral or coordinated increase in prices by offering competitive prices and services to customers. While the ACCC received a range of comments from market participants on the extent to which Mitre 10 represents a viable alternative wholesaler to Danks, Mitre 10 retailers were generally considered to be vigorous competitors in the local markets considered, and were most similar to Danks member stores in terms of their formats and overall offer.
79. While Danks supplied retailers may compete most closely with other small and medium sized hardware retailers, their prices and service offerings are still constrained by the big box stores and they offer consumers a competitive alternative to those stores, albeit a differentiated one. In considering whether Woolworths' dual role as a wholesaler and a retailer was likely to result in a reduced level of competition at the retail level in the future with the acquisition as compared to the future without the acquisition, it was therefore important to consider the role and importance of a wholesale supplier for Danks customers, the extent to which Danks would be likely to assist those customers in providing a competitive response as a group to Woolworths' entry into big box hardware retailing if it remained independently owned and the alternative sources of wholesale services which would likely be available to those retailers if the acquisition proceeded.

80. The ACCC's inquiries indicated that through the provision of a range of services, a wholesaler such as Danks influences its members' ability to compete, including through its wholesale pricing, product range, timely delivery of products, group advertising and promotions and providing strategic advice to stores on how to compete. The ACCC found that the proposed acquisition would remove the incentive for Woolworths to provide support to Danks members directed at assisting them to compete with Woolworths' big box stores—an incentive which, in the absence of the proposed acquisition, Danks would have had.
81. However, as discussed above, it is generally the small retailers with a focus on retailing DIY-type products who most value the wholesale services provided by Danks and who would be most dependent on Woolworths/Danks rather than having alternative options. The importance of these stores for competition with big box retailers is limited compared to the larger retailers who would likely be less dependent on Danks to assist their competitive response to Woolworths entry.
82. As to the larger format Danks member stores, which are likely to compete more closely with Woolworths' big box stores because of their wider ranges and generally more competitive prices, information provided to the ACCC indicated that these stores are more easily able to obtain supply from alternative wholesale sources, as discussed at paragraph 59 above.
83. The ACCC received a range of comments on the importance of scale economies and the height of barriers to entry into the relevant wholesale markets. While the ACCC considered that entry of a new wholesaler or expansion of an existing market participant (such as Natbuild or HBT) to fully replicate the offer of goods and services previously supplied by Danks is unlikely, there was evidence that buying groups and emerging smaller wholesalers would have the ability to satisfy some customers' needs, and that some retailers and small chains operate their own wholesale operations (i.e. without using Danks or Mitre 10). These wholesale options will continue to exert a degree of competitive pressure on Woolworths as a wholesaler.
84. The undertakings offered by Woolworths (discussed under the heading 'Undertakings' below) remove barriers to any Danks store obtaining supply from other sources or exiting the group entirely. The ACCC considered that the undertakings would enable Danks members to support alternative wholesalers (and vice versa), thereby also lowering barriers to entry by new wholesalers or expansion by existing small wholesalers.
85. The ACCC also received a range of comments on whether Mitre 10, Danks' closest wholesale competitor, would be a viable alternative to Danks. A large number of member and non-member stores did not consider it a viable alternative for a range of reasons including its smaller range of available products, differences in its membership structure, pricing and the particular services offered to members. However, other interested parties considered Mitre 10 to be an adequate alternative to Danks and that it had the potential to improve its operations. The ACCC considered that Mitre 10's assets were likely to remain in the market and have the potential to provide an improved competitive offer to

Danks retail customers in the future.

86. While the ACCC found that the ability of Danks members to compete is influenced by their wholesale supplier, they are free to make their own decisions about the products offered for sale⁶ and the prices at which those products are sold, not all products are obtained from Danks and other supply options exist. The independent ownership and operation of Danks member stores⁷ further supports the limited ability or incentive for Woolworths to induce these stores to coordinate their behaviour with Woolworths' big box stores in a manner which would lessen competition.
87. When combined with the undertakings offered by Woolworths, these factors led the ACCC to form the view that common ownership and control of Woolworths retail stores and the Danks wholesale business was unlikely to result in a substantial lessening of competition through higher prices or a reduction in non-price competition relative to the situation without the proposed acquisition.

Discrimination against wholesale customers who are also retail competitors

88. As noted above, another issue identified by the ACCC in its Statement of Issues was whether Woolworths' dual role as a wholesaler and a retail competitor to Danks member stores may provide Woolworths with the ability and incentive to discriminate against or foreclose supply to Danks member stores in some local markets, and whether such behaviour may lead to a reduction in the level of retail competition in those local markets.
89. If implemented, such foreclosure strategies may substantially lessen competition by limiting the ability of those stores to compete as effectively in local retail markets as they would have without the proposed acquisition. This, in turn, may result in the closure of some stores or discourage new entrants to the market, thereby denying consumers the benefits that additional competition would bring.

Woolworths' incentive to discriminate against or foreclose certain wholesale customers

90. In the future with the proposed acquisition, Woolworths would have an incentive to discriminate against a store which is its wholesale customer (e.g. a Home Timber and Hardware store) only if this would increase its overall profits. In order for this to be the case, the additional profit earned by the Woolworths big box store as a result of customers switching their purchases from the Home Timber and Hardware store to the Woolworths store would need to outweigh the profits Woolworths would lose as a result of the reduction in its wholesale sales to the Home Timber and Hardware store.
91. Whether or not this is the case will depend on a number of factors, including the relative size of the profit margins Woolworths earns on retail versus wholesale sales, and the strength of competition Woolworths faces in each local retail market.

⁶ Except in limited circumstances including requiring promotional items be stocked.

⁷ There is one company-owned store in Katoomba, NSW

92. If Woolworths raises its wholesale prices to a wholesale customer (e.g. a Home Timber and Hardware store) which in turn is forced to raise its retail prices and therefore loses some customers, Woolworths' big box would gain some of those customers. However, if Woolworths faces a number of other strong competitors in the local retail market, it is likely that those competitors will gain a significant share of the sales lost by the Home Timber and Hardware store in question. Accordingly, the stronger the competition that Woolworths faces in a local retail market, the less likely it is that such a foreclosure or discrimination strategy would be profitable for Woolworths.
93. The ACCC noted that Woolworths may have varying incentives in the short term versus the long term. In the short term, while Woolworths is still establishing its big box network, it is likely to have an incentive to support the existing Danks wholesale business to the best of its ability and to maintain buying volumes, relationships with suppliers, obtain industry knowledge and other benefits from the wholesale operation. In the longer term, once Woolworths' retail network has reached sufficient scale, Woolworths' incentives may change as the value of supplying Danks customers becomes relatively less important compared with the growing value of retail sales through its own big box network.

Woolworths' ability to discriminate against or foreclose certain wholesale customers

94. A strategy by Woolworths to discriminate against or foreclose wholesale customers would most likely be successful if Woolworths is able to differentiate between customers and engage in such a strategy for particular customers in local areas where the competitive conditions are suitable.
95. If Woolworths is unable to differentiate between stores, then any discrimination or foreclosure strategy would have to either be applied to all stores supplied by Danks, or none. The ACCC found that discrimination against all stores would be unlikely to be profitable, as Woolworths would be likely to lose a higher proportion of sales in geographic areas where it faces strong competition and areas where no Woolworths big box stores exist, and that these losses would be likely to outweigh any gains from discrimination or foreclosure.
96. For this reason it was important for the ACCC to investigate whether Woolworths would have the ability to differentiate between Danks members in different areas.
97. The ACCC's inquiries indicated that Danks supplies different groups of customers (e.g. Home Timber and Hardware members, Thrifty-Link members and non-member customers) under different trading terms and, in particular, different rebate structures. The ACCC considered that while it would not be costless, there would be little difficulty in differentiating trading terms between customers if Woolworths decided to do so.
98. However, while the ACCC concluded that Woolworths would be in a position to offer different terms to different wholesale customers, the success of any attempt to use such a strategy to discriminate against or foreclose supply to wholesale customers would be undermined if these customers have strong alternative options for supply or if new competitive entry is possible.

99. As described above, while some hardware retailers do not need a wholesale warehouse as a source of supply, there are a number of retailers for whom a wholesaler is the most viable supplier of a range of products and other associated services. The ACCC's inquiries indicated that, without a wholesaler such as Danks, it would be difficult for these customers to viably replicate the services provided by Danks.
100. As discussed at paragraph 83 above, the ACCC's inquiries revealed a range of comments as to the ability of a new wholesaler to enter, or an existing market participant to expand, and effectively compete with Danks in the relevant wholesale markets.
101. The ACCC also received information indicating that the competitive constraint imposed by other wholesale suppliers would be strengthened if certain barriers to Danks members buying from parties other than Danks—or leaving the Danks group altogether—were removed. The ACCC considered that the undertakings offered by Woolworths and Carboxy would enable Danks members to support alternative wholesalers (and vice versa), thereby lowering barriers to entry by new wholesalers or expansion by existing small wholesalers.
102. In conclusion, the ACCC considered that, if faced with certain local market conditions following the roll out of a sufficient number of retail stores, particularly in areas where there are few competitors to Woolworths' big box stores and Danks member stores or where a Danks member store is a particularly close competitor to a Woolworths big box store, Woolworths may be likely to have an incentive to discriminate or foreclose supply.
103. However, the ACCC found that the Danks member stores that will have the largest competitive constraint on Woolworths' big box retail hardware offering (namely, the larger 'medium format' stores with large ranges and competitive prices), are also the stores that Woolworths is likely to be least able to discriminate against or foreclose.

Conclusion

104. The ACCC was concerned that the proposed acquisition would be likely to result in a substantial lessening of competition in some local retail markets as a result of:
 - The common ownership and control of Woolworths' retail stores and its wholesale supply business to Danks member stores resulting in higher prices, or a reduction in non-price competition, as compared with the situation if these businesses were separately owned.
 - Possible discrimination or foreclosure of supply to Danks member stores by Woolworths.

The degree to which competition would be likely to be lessened would depend on the specific characteristics of each local market and the alternative sources of supply for Danks member(s) in those local markets.

105. Woolworths and Carboxy offered undertakings to address these concerns. The ACCC considered that, having regard to the undertakings offered by Woolworths and Carboxy, the proposed acquisition would be unlikely to result in a substantial lessening of competition in any local market. The impact of the undertakings is described further below.

Undertakings

106. As noted above, on 11 November 2009 the ACCC accepted court enforceable undertakings offered by Woolworths and Carboxy (**the parties**) pursuant to section 87B of the Act. The undertakings were offered to address the ACCC's competition concerns arising from the proposed acquisition.

107. In summary, the parties have undertaken, for the next 10 years:

- not to require any Danks member to purchase products via the parties' warehouse or chargeback facility as part of a standard agreement;⁸
- not to prevent or hinder an existing Danks member from terminating the membership agreement;
- not to require an existing Danks member who wishes to terminate the membership agreement to reimburse the costs of painting, signage and certain building works if Woolworths has announced an intention to open a big box store within 5km from the existing Danks member's store;
- not to provide less favourable terms and conditions of supply of goods or services to any store located within a 5km radius of a Woolworths big box store than the terms and conditions enjoyed by similar stores supplied by the parties elsewhere;
- to ensure that the undertaking and its obligations are, on an ongoing basis, brought to the attention of the parties' hardware staff, and to provide a copy of the undertaking and a plain English summary to Danks members and all acquirers of product from Danks; and
- to engage an independent auditor approved by the ACCC to monitor and report on compliance with the terms of the undertaking.

108. A copy of the undertaking is available on the ACCC's website at the undertakings register (www.accc.gov.au following the link to public registers).

109. The undertakings offered by Woolworths and Carboxy and accepted by the ACCC aim to remove barriers to any Danks store obtaining supply from other sources while remaining a Danks member, as well as removing barriers that might prevent a Danks store exiting the group entirely. The undertakings thereby reduce the reliance of Danks member stores on Danks as a wholesale supplier.

⁸ A Danks member may, however, elect to enter into a variation of the standard contract that includes a provision requiring certain purchases from the parties. There are also limited circumstances whereby members must purchase certain products from Danks including where promotional items are required to be stocked.

110. The ACCC considers that the ability of Danks members to use and/or switch to other wholesale supply options, which is strengthened by the undertaking, reduces the risk of unilateral or coordinated price increases occurring as a result of the proposed acquisition. In the event that Danks members consider that their ability to compete is compromised by Woolworths' dual role as a wholesaler and a retailer, they will be free to obtain supply from alternative sources or exit the Danks group and join another wholesale supply group to enable them to compete more effectively.
111. The undertakings also remedy the ACCC's concern that the proposed acquisition would be likely to give Woolworths the ability and incentive to discriminate against some of its wholesale customers who are also its retail competitors, enabling these stores to compete as effectively in local markets as they would have without the acquisition.

Conclusion

112. On the basis of the above, including taking into account the proposed undertakings, the ACCC formed the view that the proposed acquisition would not be likely to result in a substantial lessening of competition in any relevant market in contravention of section 50 of the Act.