



Public Competition Assessment

27 May 2011

Woolworths Limited - proposed acquisition of The Cellarmasters Group

Introduction

1. On 21 April 2011, the Australian Competition and Consumer Commission (ACCC) announced its decision not to oppose the proposed acquisition of The Cellarmasters Group by Woolworths Limited (**proposed acquisition**). The ACCC decided that the proposed acquisition would be unlikely to have the effect of substantially lessening competition in any relevant market in contravention of section 50 of the *Competition and Consumer Act 2010* (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 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 the proposed transaction 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 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. Public Competition Assessments outline the ACCC's principal reasons for forming views on a proposed acquisition at the time the decision was made. As such Public Competition Assessments may not definitively identify and explain all issues that the ACCC considers arise from a proposed acquisition. Further, the ACCC's decisions generally 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.

The parties

*The acquirer: Woolworths Limited (**Woolworths**)*

8. Woolworths is a listed public company and has interests in food and grocery, liquor, petrol, general merchandise and consumer electronics. It also has interests in the hospitality, gaming and hardware sectors. Woolworths is Australia's largest grocery retailer and liquor retailer and in FY 2009/10 it had revenue of \$51.7 billion.
9. Woolworths' Liquor Group includes Dan Murphy's (big box format stand-alone liquor stores); Woolworths Liquor (outlets attached to Woolworths and Safeway stores); and BWS (retail stand-alone liquor stores). Woolworths also owns Langton's Fine Wine Auctions (**Langton's**) (a consignment based online auction and fixed price exchange business for the sale of fine wine within Australia and internationally).
10. Until recently Woolworths' liquor businesses sold liquor only through bricks and mortar outlets and, apart from some limited online sales through Homeshop (Woolworths' grocery home delivery service) and Langton's,¹ did not make any liquor sales online. This changed on 8 March 2011 when Dan Murphy's began selling liquor online through www.danmurphys.com.au.

*The target: The Cellarmasters Group (**Cellarmasters**)*

11. Cellarmasters is a direct to home wine retailer and provider of contract bottling and wine making services with operations in Australia and New Zealand.

¹ The vast majority of wine sold through Langton's is done on a consignment basis, meaning the Langton's business provides the means by which sales are made (i.e. auction or exchange) but Langton's is not the vendor of the product. .

12. Cellarmasters sells wine through direct channels (i.e. wine plans, wine advisory services; inbound calls in response to catalogues and letters) and online. Unlike Woolworths, Cellarmasters has no bricks and mortar outlets.
13. Cellarmasters' businesses include Cellarmaster Wines Pty Ltd, which it describes as Australia's largest direct retailer of home-delivered wines; Dorrien Estate, a winemaking operation which produces a range of wine it distributes through the Cellarmasters direct channel; and a range of ancillary businesses including Vinpac International, Vi Packaging, Vi Services and Vi Logistics (collectively referred to as **Vinpac**) which provide wine services such as bottling, packaging, storage, filtration and testing.

The proposed transaction

14. On 25 February 2011 Woolworths announced its intention to acquire Cellarmasters from Archer Capital. On 2 May 2011, Woolworths announced that it had completed the acquisition.

ACCC review timeline

15. The following table outlines the timeline of key events in this matter.

Date	Event
01-Mar-2011	ACCC commenced review under the Merger Review Process Guidelines.
22-Mar-2011	Closing date for submissions from interested parties.
25-Mar-2011	ACCC requested further information from Woolworths. ACCC timeline suspended.
04-Apr-2011	ACCC received further information from Woolworths. ACCC timeline recommenced.
21-Apr-2011	ACCC announced it would not oppose the proposed acquisition.

Market inquiries

16. The ACCC conducted market inquiries with a range of industry participants including competing liquor and wine retailers, relevant industry bodies, suppliers, customers and other interested parties. Submissions were sought in relation to the substantive competition issues.

With/without test

17. 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 if the transaction does not proceed (the "without" position).

18. The ACCC considered it possible that in the absence of the proposed acquisition, Cellarmasters could continue to operate as a stand-alone business or it could be acquired by another party.
19. On this basis, the ACCC considered that the likely future state of competition without the merger would be similar to the state of competition prevailing at the time of the merger, and assessed the matter on this basis.

Areas of overlap

20. The operations of Woolworths and Cellarmasters overlap in the areas of wine retailing and the wholesale acquisition of wine in Australia.
21. Woolworths does not currently produce wine or supply any winemaking services (such as bottling or labelling). However, due to the vertically integrated nature of Cellarmasters' businesses, the ACCC also considered the effect of the proposed acquisition on wine production and supply of wine services in Australia.

Market definition

Retail

22. There were three main issues considered by the ACCC in determining the relevant retail market(s):
 - i. whether 'bricks and mortar' liquor retailers and online/direct liquor retailers are sufficiently close substitutes to be included in a combined market, or separate markets;
 - ii. whether the relevant product dimension of the market(s) should include sales of all liquor or should be confined to sales of wine only; and
 - iii. the relevant geographic market.

Are 'bricks and mortar' retailers and online/direct retailers close substitutes?

23. The ACCC received conflicting information regarding this issue. Some parties noted that there were common customers and common products for both types of retailers and this may suggest a degree of substitution between the two. Other parties suggested that there were differences in the types of customers of each type of retailer. For example, it was suggested that customers of bricks and mortar retailers made purchases on impulse whereas online purchases were more well-planned and were generally for larger quantities. It was also noted that purchases in bricks and mortar retail outlets gave instant access to the product whereas online purchases usually took a number of days to be delivered to the customer.
24. The information available to the ACCC suggested that there was some substitution between the different types of retailers, although bricks and mortar and online/direct retailers were not *close* substitutes.

25. The ACCC did not consider it necessary to form a concluded view on this issue, as it found that on either approach to market definition the proposed acquisition would not be likely to result in a substantial lessening of competition. This Public Competition Assessment outlines the ACCC's competitive analysis in the context of both possible market definitions, that is, a broader market that included both bricks and mortar and online retailers as well as a narrower market that included only online/direct retailers.

Is the relevant product dimension sales of liquor or sales of wine?

26. The ACCC has previously considered acquisitions in this industry in the context of markets for the retail sale of packaged liquor (including beer, wine and spirits). This is because many significant competitors in the industry, including Woolworths, Wesfarmers (Coles), Metcash-supplied banner groups and independent retail chains and stores, supply wine and other types of liquor to consumers. Potentially, this suggests supply-side substitutability between retailing of wine and of other types of liquor.
27. In the review of the proposed acquisition, the ACCC noted that while Woolworths is a retailer of liquor generally, Cellarmasters is focused on sales of wine only. The ACCC considered any competitive rivalry between the parties would be confined to sales of wine only. However, the ACCC recognised that the market may include retailers of liquor more generally because of supply-side substitutability.
28. The ACCC did not need to form a concluded view on this issue, as it found that on either approach to market definition the proposed acquisition would not be likely to result in a substantial lessening of competition. This Public Competition Assessment outlines the ACCC's competition analysis in the context of both possible market definitions, that is, a broader retail market for packaged liquor sales as well as a narrower retail market for wine sales only.

Geographic dimension of the market

29. As outlined in the *Merger Guidelines*, the ACCC takes a purposive approach to defining markets, and defining the relevant market in any matter always depends on the specific facts and circumstances.
30. Previously, the ACCC has generally considered acquisitions of liquor licences in the context of local markets (i.e. geographic markets which included retailers within a reasonably close proximity to the acquirer and the target). This is because the ACCC has found that the strongest competitive constraint on individual liquor stores will often come from other liquor stores within the local area, and in the context of considering acquisitions occurring within local areas, the local market will usually be the focus of the ACCC's analysis.
31. In its review of Woolworths' proposed acquisition of Langton's, the ACCC considered the likely impact on competition in a national market for online retail wine sales and auctions.

32. In assessing this matter, given Woolworths' extensive presence across Australia in terms of bricks and mortar retail operations and Cellarmasters' ability to sell and deliver nationally, the ACCC considered that the relevant geographic market was likely to be national. Nevertheless, this should not be taken to mean that the ACCC would not adopt a local geographic market definition in future matters in appropriate circumstances.

Conclusion – retail market

33. The ACCC considered it appropriate to assess the likely impact of the proposed acquisition on competition in each of the following possible retail markets:
- Market one – national retail packaged liquor sales (beer, wine and spirits) for off-premises consumption (i.e. through all sales channels including retail packaged liquor sales through direct channels, online, by auction and by bricks and mortar stores);
 - Market two – national retail wine sales for off-premises consumption (i.e. including retail wine sales through all sales channels); and
 - Market three – national retail wine sales for off-premises consumption made through direct and online sales channels (i.e. excluding bricks and mortar liquor sales).
34. As the ACCC ultimately concluded that the proposed acquisition was unlikely to substantially lessen competition irrespective of the market definition adopted, it was not necessary to form a concluded view as to the relevant market.

Wholesale bottled wine market

35. Woolworths, Cellarmasters and other wine retailers acquire bottled wine from wine producers which is then sold at the retail level of the industry. Market inquiries indicated that wholesale sales of bottled wine constituted a separate and distinct market from, for example, wholesale sales of other types of liquor.
36. Wine producers tend to supply wine to retailers across Australia, rather than to retailers located only in a particular region. Similarly, retailers do not appear to be limited in their ability to source wine from regions across Australia.
37. Accordingly, the ACCC considered it appropriate to consider the likely impact of the proposed acquisition on competition in a national wholesale bottled wine market.

Wine grape acquisition

38. Some market participants expressed concerns in relation to acquisitions of wine grapes. As these concerns related to possible flow-on effects from any lessening of competition in the wholesale bottled wine market, the ACCC did not need to define the relevant wine grape acquisition market precisely.

Wine production and wine services markets

39. Woolworths does not currently produce wine or supply services ancillary to wine production (such as bottling and labelling). Some market participants expressed concerns relating to Woolworths' ability to leverage retail market power into wine services or leverage market power in wine services (or wine production) into the retail market.
40. The ACCC did not consider it necessary to form a definitive view about the relevant wine production and wine services markets in order to explore those concerns.

Competition analysis

Retail markets

41. The ACCC considered the likely impact of the proposed acquisition on competition in each of the possible markets identified in paragraph 33.

Market concentration

42. The ACCC's review found that Cellarmasters has a very small share of the overall liquor market (around 1%) and the retail wine market (around 3%). However, if the market was defined more narrowly as an online/direct wine sales market, Cellarmasters had a more significant share (estimated at in excess of 20%).
43. Woolworths' share of the retail packaged liquor market or retail bottled wine market is estimated by market participants at between 25% and 40%. However, if the market was defined more narrowly as an online/direct wine sales market, Woolworths' share of the market is very small (less than 1%).
44. Accordingly, irrespective of the market definition adopted, the increase in market concentration resulting from the proposed acquisition would be very small.
45. Market inquiries indicated that the market shares of Wesfarmers (Coles) and the Metcash banner groups are significantly greater than Cellarmasters in the retail liquor or wine market.
46. Market inquiries also indicated that there are many retailers with a more significant share of the online wine retail market than Woolworths. These parties included Wesfarmers (Coles), Australian Wine Selectors, Gray's Online, Australian Wine Society, Get Wines Direct, Kemeny's Direct, Winestar and Wine People.

Competition from existing competitors

47. In the context of any possible retail market definition, Woolworths would continue to face strong competition from a range of significant sources post-acquisition. This includes Wesfarmers (Coles), Metcash banner stores, other banner groups, independent bricks and mortar liquor stores and online liquor and wine retailers.
48. Furthermore, Woolworths and Cellarmasters did not appear to be particularly close competitors in any possible retail market. In a retail packaged liquor or retail wine market (markets one and two as described in paragraph 33), Wesfarmers and Metcash are likely to be Woolworths' closest competitors. In an online wine retail market (market three as described in paragraph 33), Cellarmasters' main competitors are likely to be Australian Wine Selectors, Gray's Online, Coles (through Liquorland Direct and Vintage Cellars) and a range of online wine retailers. Woolworths has had a negligible existing online wine sales presence but has recently commenced online sales via Dan Murphy's.

Cellarmasters as a vigorous and effective competitor

49. Some market participants submitted that Cellarmasters was a particularly significant competitor due to its large customer database. It was suggested that the customer database gave Cellarmasters a competitive advantage over other direct and online wine retailers and that it would be difficult for new entrants to compete with Woolworths post-acquisition because of this. However, other market participants, including other online wine retailers, submitted that Cellarmasters' customer database did not provide it with a significant advantage because competing retailers had existing large customer databases of their own or could rent or purchase such databases at a cost.
50. The ACCC concluded that neither Cellarmasters' customer database, nor any other aspect of the Cellarmasters business, made Cellarmasters a particularly vigorous and effective competitor, in the context of any of the possible retail markets.

Barriers to entry

51. Market inquiries indicated that barriers to entry to small-scale online wine retailing are relatively low. This appears to be evidenced by the large number of online wine retailers present in Australia.
52. However, some market participants indicated that the barriers to expansion for small online wine retailers are significant and it is difficult for a small competitor to grow to a size capable of competitively constraining the merged entity. The most significant of these barriers was said to be the large sunk cost of advertising and marketing involved in growing customer awareness and to gain a customer database of a size that would enable the business to achieve the scale (and therefore buying power) and range of products necessary to compete with the merged entity.

53. The ACCC noted that there is a large number of existing online wine retail competitors and considers that this number is likely to continue to grow. Market inquiries provided evidence of recent new entry, proposed new entry and likely expansion by existing online retailers.
54. For these reasons, the ACCC considered that barriers to entry and expansion for online wine retailing are not insurmountable. While it may take time and not insignificant investment to grow to a significant size, the available evidence suggests that there are retailers making that investment.
55. The ACCC considers that expansion by existing online wine retailers and new entrants is likely to play a part in providing a competitive constraint on the merged entity.
56. In the event that Woolworths attempted to raise prices or reduce the quality of its product offering (e.g. reduce the range of wines it stocks), the ACCC considered that this would only accelerate the entry and expansion of other online retailers.

Conclusion – Retail

57. The ACCC concluded that the proposed acquisition is unlikely to lead to a substantial lessening of competition in any relevant retail market. This is due to the minimal increase in concentration that would result from the proposed acquisition and the competitive constraint on Woolworths that would come from multiple existing competitors and potential new entry and expansion (particularly for direct and online sales).

Wholesale bottled wine market

58. The ACCC considered whether the proposed acquisition would be likely to lessen competition in the national wholesale bottled wine market.
59. Market inquiries indicated that Woolworths possesses significant bargaining power in this market due to its very large retail presence.
60. Some market participants suggested that the proposed acquisition would provide Woolworths with even greater bargaining power in the wholesale acquisition of wine, particularly in dealings with particular wine producers that are heavily reliant on Woolworths and Cellarmasters. Further, some market participants suggested that the proposed acquisition would remove Cellarmasters as an alternative marketing channel for many small-scale wine producers that do not produce on a scale that makes them attractive as suppliers to Woolworths.
61. The ACCC closely considered these issues in its review and, in particular, whether Woolworths' bargaining power would be increased following the proposed acquisition to such an extent that competition in the wholesale market would be substantially lessened.

Increase in Woolworths' share of wholesale wine purchases

62. The ACCC considered that the proposed acquisition will result in only a very small increase in the value and volume of bottled wine acquired by Woolworths. This is due to two factors:
1. Cellarmasters represents only a small proportion of the wine sold at the retail level of the market (see the market concentration discussion, paragraph 42 above).
 2. The proportion of the wine sold by Cellarmasters which is sourced from independent wine producers is very small, since Cellarmasters sources a significant majority of its wine through its own wine production business, Dorrien Estate.

Are any wine producers heavily reliant on Woolworths and Cellarmasters?

63. The ACCC considered whether there were wine producers or groups of wine producers that were heavily reliant on both Woolworths and Cellarmasters as channels to the retail market(s). For any such producers, the proposed acquisition may have lessened the bargaining power they had in negotiating terms with Woolworths and/or Cellarmasters. In theory, in the absence of the proposed acquisition, such a wine producer could resist price pressure from Woolworths by threatening to sell through Cellarmasters instead (or vice versa).
64. However, market inquiries did not produce evidence that any wine producer is heavily reliant on both Woolworths and Cellarmasters. For those wine producers that currently sell to both Woolworths and Cellarmasters, the ACCC found that sales to Cellarmasters were not significant when compared with the volume of sales to Woolworths. The ACCC did not receive any evidence that suggested Cellarmasters was being used to constrain Woolworths' bargaining power with these wine producers.
65. Further, the ACCC also noted that other retailers including Coles and the Metcash banner groups, were likely to be better placed than Cellarmasters to be used by wine producers as a countervailing force on Woolworths due to their more significant scale.

Cellarmasters as an alternative route to market for smaller wineries

66. Some market participants suggested that Cellarmasters played an important role as an alternative route to the retail market for smaller wine producers. However, the ACCC's inquiries led it to conclude that it was not accurate to characterise Cellarmasters in this manner.
67. Cellarmasters predominantly acquires bulk wine and grapes to produce its own products and it currently acquires only a very small amount of third party bottled wine (particularly when compared with the volume of third-party produced wine acquired by other retailers). The third-party wine Cellarmasters does acquire is mainly supplied by larger wine producers rather than from small scale producers.

68. In any event the ACCC noted that there will remain many independent liquor retailers through which small wineries can sell bottled wine.

Conclusion – Wholesale

69. For these reasons the ACCC concluded that the proposed acquisition is unlikely to lead to a substantial lessening of competition in the national wholesale bottled wine market.

Possible flow-on effects to wine grape acquisitions

70. Since the ACCC concluded that the proposed acquisition was unlikely to result in a substantial lessening of competition in the wholesale bottled wine market, the ACCC considered that concerns in relation to acquisitions of wholesale wine grapes would also be unlikely. This is because the proposed acquisition does not create any concentration in wine grape acquisition (since Woolworths does not acquire wine grapes) and any impact on competition for acquisition of wine grapes would be a flow-on effect from an impact in the wholesale bottled wine market.

Wine services and wine production

71. The ACCC considered whether the vertical integration of Woolworths' retail liquor operations with Cellarmaster's interests in wine production and wine services would have a significant impact on competition in the possible retail markets, the wholesale bottled wine market, or any markets for the supply of wine services.
72. As outlined in the ACCC's *Merger Guidelines* an integrated or conglomerate firm will generally only be able to engage in foreclosure if it has sufficient market power at one or more functional levels within the vertical supply chain.² Such foreclosure will only be possible where the downstream rivals to the integrated firm face insufficient viable supply alternatives or where upstream rival firms lack sufficient actual or potential economic alternatives in the downstream market to sell their output.³
73. The ACCC examined whether the proposed acquisition could result in:
1. Retailers being foreclosed from accessing key wholesale wine inputs (bottled wine or wine services).
 2. Wine producers being foreclosed from accessing a key retailer in Woolworths
 3. Wine producers being foreclosed from accessing key inputs into wine production (wine services).

² ACCC *Merger Guidelines* 5.28, p.28

³ ACCC *Merger Guidelines* 5.30 and 5.31, p.28

74. The ACCC also examined related concerns regarding Woolworths increasing the amount of private label wine it sells and concerns relating to the information Woolworths might gain about its competitors and customers' production costs and practices.
75. The ACCC concluded that Woolworths' vertical integration into wine services and wine production was unlikely to result in a substantial lessening of competition in any market. In particular, market inquiries revealed:
- There are a significant number of existing competitors to Cellarmasters' wine services businesses and evidence of wine producers switching from Cellarmasters to alternative suppliers in recent years. It is not the case that retailers lack alternative wine services providers.
 - The proportion of wine produced by Dorrien Estate is very small. There are a range of competitors to Dorrien Estate which Woolworths' retail competitors could utilise if they were unhappy dealing with Dorrien Estate. In addition, there is at present a significant underutilisation of wine production facilities in Australia. In these circumstances it is likely that such facilities would have a strong imperative to increase production for new or expanding retail competitors.
 - While Woolworths has a strong retail presence, wine producers have several other existing bricks and mortar and online/direct wine retailers through which they can sell their wine. The likelihood of new entry (particularly online) will further provide alternative channels through which wine producers can sell wine.
 - Given Woolworths' strong position in the retail market, wine producers currently (and will likely in future) seek ways to avoid increasing their reliance on Woolworths. This will provide strong incentives to support alternative wine services providers and retailers.
 - Many wine producers have their own capacity to undertake the same wine services offered by Cellarmasters. While the issue of barriers to entry was not determinative in the review of the proposed acquisition, the ACCC has previously noted that barriers to entry to wine services are not high.⁴
76. The ACCC observes that Woolworths could increase the amount of private label wine it sells without vertically integrating into winemaking. Woolworths could simply have contracted with Dorrien Estate to produce private label wine on its behalf. In addition, while Woolworths may well seek to increase the amount of private label wine it sells and it may use Dorrien Estate to do this, market inquiries did not provide any evidence that this would result in a lessening of competition in any of the relevant markets.

⁴ See ACCC's review of Vinpac's proposed acquisition of Tarac Bottlers, 2002

77. The ACCC concluded that the vertical integration by Woolworths into winemaking and wine services is unlikely to lead to a substantial lessening of competition in any market. This is primarily because the conditions for foreclosure do not appear to exist in either the upstream or downstream market. That is, there will remain many options for sourcing bottled wine and wine services at the upstream level and many options for wine producers to sell their wine at the downstream (retail) level.

Conclusion

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