

COMMONWEALTH OF AUSTRALIA

COMPETITION AND CONSUMER ACT 2010

IN THE AUSTRALIAN COMPETITION TRIBUNAL

File No. 4 of 2013

**RE: Proposed acquisition of Warrnambool
Cheese and Butter Factory Company
Holdings**

**BY: Murray Goulburn Co-operative Co Limited
Applicant**

ACCC'S ISSUES PAPER

History of revisions

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Prepared by :
DLA Piper Australia
Solicitors
140 William Street
MELBOURNE VIC 3000

Telephone No: 03 9274 5470
Reference: Simon Uthmeyer

A	EXECUTIVE SUMMARY	1
B	INTRODUCTION.....	3
I	Background	3
II	Statutory framework.....	3
III	The proposed acquisition	5
C	LIKELY FUTURE WITH AND WITHOUT THE PROPOSED ACQUISITION	6
D	PUBLIC BENEFITS.....	8
I	Synergies.....	9
II	Increase in real value of exports	23
III	Substitution of domestic products for imported goods	30
IV	Other public benefits	36
E	PUBLIC DETRIMENTS.....	37
I	Markets in which to assess the competitive effects of the proposed acquisition	37
II	The competitive effects of the proposed acquisition	50
I	Acquisition of raw milk	50
II	Supply of bulk raw milk	65
III	Bulk cream	67
IV	Other products.....	70
III	Other detriments.....	79
E	WEIGHING THE BENEFITS AND DETRIMENTS.....	79
F	PERIOD OF AUTHORISATION.....	80

A EXECUTIVE SUMMARY

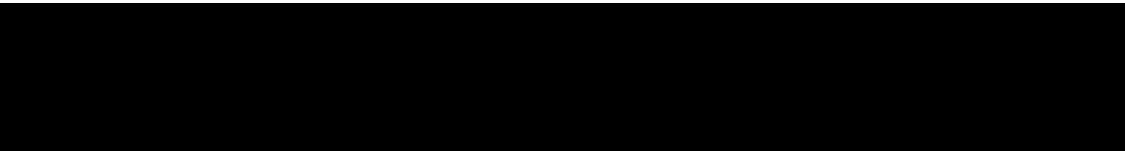
1. Issues for further consideration that are identified by the ACCC are shown in shaded boxes throughout this paper. The most significant issues raised are as follows:

Likely future with and without the proposed acquisition

- a. **Likely Murray Goulburn shareholding in WCB (Issue 1A)** – Murray Goulburn may acquire greater than 50%, but less than 90%, of WCB. This would appear to be material to the likelihood of Murray Goulburn achieving many of the claimed public benefits.

Public benefits

- b. **Overlap of efficiency benefits (Issue 2(b))** – Some of Murray Goulburn's claimed public benefits relating to synergies appear to overlap with each other and with claimed public benefits relating to an expansion in exports.
- c. **Efficiency benefits attainable without proposed acquisition (Issue 2(c))** – Some of Murray Goulburn's claimed public benefits relating to operational efficiencies may be able to be achieved through measures other than the proposed acquisition.
- d. **Methodology for calculating synergies (Issue 2(e))** – It is not clear that Murray Goulburn has used an appropriate methodology to quantify its claimed public benefits from synergies, particularly in estimating the effect of these synergies on its farm gate milk price. Some claimed efficiencies are excluded from the Tribunal's register, so it may not be possible to fully test their relevance or magnitude, given the restrictions on disclosure of such material.
- e. **Distribution of benefits (Issue 2(f))** – Murray Goulburn's estimates of the broader benefits of the proposed acquisition to the community may be overstated and its application does not consider any multiplier effects of the potential public detriments from the proposed acquisition.
- f. **Exports benefits attainable without proposed acquisition (Issue 3(c))** – It is not clear that the proposed acquisition will have a significant effect on the volume or value of Australian dairy exports. Both Murray Goulburn and WCB are shifting their product mix toward high value products in any case. Benefits in terms of obtaining relevance with international customers may be achieved through measures other than the proposed acquisition, such as joint ventures.
- g. **Quantification and cost of increased exports (Issues 3(d) and (e))** – Murray Goulburn has not quantified the claimed increase in the real value of exports and has not provided detail of the associated costs of achieving such an increase.

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- h. **Relevance of Fonterra in New Zealand (Issue 5)** – The parallels between the proposed acquisition and the experience of New Zealand’s dairy industry, should be considered further.
 - i. **Magnitude of public benefits (Issue 6)** – The magnitude of claimed public benefits from synergies is uncertain, but may not be substantial.
 - j. **Significance of capital restructure (Issues 7 and 27)** – The capital restructure proposed by Murray Goulburn may impact on the incentives that, according to Murray Goulburn, currently mean its profits are passed on to farmers in the form of higher milk prices.

Public detriments

- k. **Geographic market for raw milk acquisition (Issue 10)** – It may be appropriate to consider the competitive effects of the proposed acquisition in narrower geographic markets for the acquisition of raw milk than those proposed by Murray Goulburn.
- l. **Competition for raw milk acquisition (Issues 11, 12 and 13)** – Murray Goulburn and WCB are close competitors in the market(s) for the acquisition of raw milk, in relation to both price and non-price aspects of their offers. Other competitors may not provide a strong competitive constraint on Murray Goulburn post-acquisition.
- m. **Significance of cooperative structure (Issues 14 and 26)** – The incentives for Murray Goulburn to provide a compelling price and non-price offer to its farmer suppliers over time may be more likely to be provided through competition than through its cooperative structure.
- n. **Coordinated effects in raw milk acquisition (Issue 15)** – The removal of WCB from the market(s) for the acquisition of raw milk may increase the likelihood of coordinated effects in that market(s).
- o. **Supply of bulk raw milk (Issues 18 and 19)** – Murray Goulburn has not commented on competition in the market(s) for the supply of bulk raw milk, where WCB may be a significant competitor and Murray Goulburn may face limited competitive constraints post-acquisition.
- p. **Supply of bulk cream (Issues 22 and 23)** – Murray Goulburn and WCB may be close competitors in the supply of bulk cream in Victoria and South Australia, and Murray Goulburn may face limited competitive constraints post-acquisition.

Period of authorisation

- q. **Time period for authorisation of the proposed acquisition (Issues 31 and 32)** – Since market conditions, market structure and other relevant facts and competitive dynamics can change over time, the ACCC considers that it is appropriate for any authorisation to be granted for a specified time period, and that 12 months is likely to be an appropriate period.

B INTRODUCTION

I Background

2. On 29 November 2013 Murray Goulburn Co-operative Co. Limited (**Murray Goulburn**) filed an application with the Australian Competition Tribunal (**Tribunal**) under section 95AU of the *Competition and Consumer Act 2010 (the Act)* for authorisation of its proposed acquisition of Warrnambool Cheese and Butter Factory Company Holdings Limited (**WCB**) (**proposed acquisition**).¹
3. Pursuant to section 95AU of the Act, a person may apply to the Tribunal for authorisation of a proposed acquisition of shares or assets. Where authorisation is granted, the section 50 prohibition on acquisitions that are likely to substantially lessen competition does not apply to the proposed acquisition. Murray Goulburn is the first person to apply for authorisation pursuant to section 95AU.
4. To assist in the making of its determination, the Tribunal invited any interested parties to make submissions on Murray Goulburn's application by 18 December 2013 and directed the Australian Competition and Consumer Commission (**ACCC**) to provide an issues paper by 23 December 2013. This issues paper identifies and discusses the key issues the Tribunal may need to consider in making its determination.
5. The ACCC has used the structure of the Tribunal's Provisional Issues List² to present the issues it considers relevant to the Tribunal's assessment of the proposed acquisition.
6. Given the limited time between the ACCC's receipt of third party submissions and the provision of this paper to the Tribunal, it has not been possible to take into account all third party submissions.

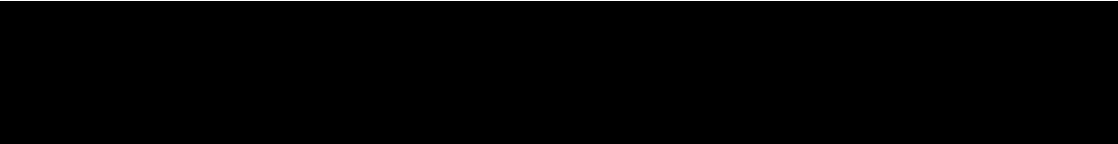
II Statutory framework

7. The Tribunal must not grant an authorisation unless it is satisfied in all the circumstances that the proposed acquisition would result, or be likely to result, in such a benefit to the public that the acquisition should be allowed to occur: section 95AZH(1). The Tribunal has determined the test to require it to identify and assess the public benefits and detriments likely to result from the proposed acquisition, and weigh the two.³ This test is known as the 'net public benefits test'.

¹ Available on the Tribunal's website: <http://www.competitiontribunal.gov.au/authorisations>. The document 'Form S' – *Application by Murray Goulburn for Merger Authorisation* is referred to below as 'Form S'.

² The Provisional Issues List was published on the Tribunal website on 11 December 2013. See <http://www.competitiontribunal.gov.au/authorisations/ACT-4-2013-provisional-issues.pdf>

³ See, for example, *Re 7-Eleven Stores Pty Limited, Australian Association of Convenience Stores Incorporated and Queensland Newsagents Federation* (1994) ATPR 41-357 (**Re 7-Eleven**) at 42,654; *Re Australian Association of Pathology Practices Incorporated* (2004) 180 FLR 44 at [91]-[93]; *Re Qantas Airways Limited* (2004) ATPR 42-027 (**Re Qantas**) at [144]-[149]; *Re Application by Michael Jools, President of the NSW Taxi Drivers Association* [2006] ACompT 5 (**Re Jools**) at [6]-[8] and [22]. The threshold test in section 95AZH(1) is identical to the

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8. In determining what amounts to a 'public benefit', the Tribunal must:
- a. regard as **benefits to the public** (in addition to any other benefits to the public that may exist):⁴
 - i. a significant increase in the real value of exports;
 - ii. a significant substitution of domestic products for imported goods; and
 - b. without limiting the matters that may be taken into account, take into account all **other relevant matters** that relate to the international competitiveness of any Australian industry.⁵
9. The term 'benefit to the public' is not otherwise defined in the Act.
10. In the context of section 90, the term has been interpreted broadly. The Tribunal has observed that benefits to the public include anything of value to the community generally or any contribution to the aims pursued by society including as one of its principal elements (in the context of trade practices legislation) the achievement of the economic goals of efficiency and progress.⁶
11. In order to be taken into account, benefits must be of substance and have durability.⁷ Any estimates should be robust and commercially realistic. The assumptions underlying their calculation must be spelled out in such a way that they can be tested and verified. Care must be taken to distinguish between one-off benefits and those of a more lasting nature. Appropriate weighting will be given to future benefits not achievable in any other less anti-competitive way, and so the options for achieving the claimed benefits must be explored and presented.⁸
12. Where public benefits do not easily allow of quantification, a qualitative judgment of the relative weightings of tangible and intangible factors can be undertaken.⁹ Where a benefit accrues only to one segment of the public, this might be given

threshold test in section 90(8) in relation to authorisations of conduct that would otherwise breach certain provisions of Part IV of the Act.

⁴ Section 95AZH(2)(a).

⁵ Section 95AZH(2)(b).

⁶ *Queensland Co-operative Milling Association Ltd and Defiance Holdings Ltd* (1976) 8 ALR 481 (**QCMA**) at 510. See also *Re Rural Traders Co-operative (WA) Ltd* (1979) 37 FLR 244 (**Re Rural Traders**) at 261-262; *Re 7-Eleven* at 42,677; *Re Australasian Performing Rights Association Ltd* (1998) ATPR 41-701 at 42,985, [294]; *Re Qantas* at [163]-[165]; *Re Medicines Australia Inc* (2007) ATPR 42-164 (**Re Medicines Australia**) at [107].

⁷ *Re Qantas* at [205]; *Re Rural Traders* at 262-263.

⁸ *Re Qantas* at [206].

⁹ *Re Qantas* at [208]-[209]; *Re Howard Smith Industries Pty. Ltd. and Adelaide Steamship Industries Pty. Ltd* (1977) ATPR 40-023 (**Re Howard Smith**) at 17,334.

less weight by the Tribunal.¹⁰ Any costs or detriments that are intrinsic to a public benefit must be taken into account.¹¹

13. 'Public detriment' is not referred to in section 95AZH, and is not defined in the Act. In the context of section 90, it has been given a broad interpretation. Public detriments have been held to encompass any impairment to the community generally, including any harm or damage to the aims pursued by society.¹² In many cases, the important detriments will be anticompetitive detriments, that is, the detriments that flow from the anticompetitive effect of the proposed acquisition. These latter detriments are assessed by reference to the markets in which the merger parties compete.
14. For a benefit or detriment to be taken into account, the Tribunal must be satisfied that there is a real chance, and not a mere possibility, of the benefit or detriment eventuating. While it is not necessary to show that the benefits or detriments are certain to occur, or that it is more probable than not that they will occur, claims that are purely speculative in nature should not be given any weight.¹³

III The proposed acquisition

15. Murray Goulburn seeks merger authorisation of its proposed acquisition of WCB. Murray Goulburn is offering to acquire all WCB shares via an off-market takeover bid. Its offer is subject to a number of conditions, including that there is no objection by the ACCC or authorisation is granted by the Tribunal. Murray Goulburn's offer is conditional upon it having a relevant interest in greater than 50% of WCB by close of the increased offer.¹⁴
16. According to its Bidder's Statement, Murray Goulburn is Australia's largest dairy food company. It receives and manufactures approximately three billion litres (or one third) of Australia's milk at six processing plants in Victoria (Cobram, Kiewa, Koroit, Leongatha, Maffra and Rochester) and one in Tasmania (Edith Creek). It manufactures and markets a full range of dairy and nutritional product types, including skim milk powder, full cream milk powder, daily pasteurised and long life milk, cheese, milk fat products, whey powders and milk proteins.¹⁵

¹⁰ *Re Howard Smith* at 17,334 and *Re Qantas* at [185]-[191]. See also *Re VFF Chicken Meat Growers' Boycott Authorisation* (2006) ATPR ¶42-120 (***Re VFF Chicken Meat Growers***) at [75].


¹¹ See *Applications of Southern Cross Beverages Pty Ltd, Cadbury Schweppes Pty Ltd and Amatil Ltd* (1981) ATPR 40-200 (***Re Southern Cross Beverages***) at 42,763, [11.8] in respect of a s101A review by the Tribunal.

¹² See, for example, *Re 7-Eleven* at 42,683; *Re Qantas* at [150].

¹³ *Re Qantas* at [156]. See also *Re Howard Smith* at 17,335; *Re Medicines Australia* at [109]; *Re Jools* at [48]; *Re VFF Chicken Meat Growers* at [83].

¹⁴ Form S, paragraphs 63 and 65(b).

¹⁵ Murray Goulburn Bidder's Statement relating to the proposed acquisition, 28 November 2013, page 21.

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17. According to its Target's Statement, WCB is Australia's fourth largest dairy processor with FY13 milk intake of almost 900 million litres, representing 10% of Australia's annual milk production. It owns and operates the Allansford dairy production plant, where it produces cheese, milk powder, whey protein concentrate, butter, cream and packaged milk. It also owns and operates a production plant at Mil Lel where it processes, cuts and wraps speciality cheeses.¹⁶

C LIKELY FUTURE WITH AND WITHOUT THE PROPOSED ACQUISITION


18. To assess the proposed acquisition for the purposes of the net public benefits test, the Tribunal has considered it useful to compare the likely future 'with', and separately, 'without', the proposed acquisition.¹⁷
19. This issues paper includes an additional issue to the Provisional Issues List, 'Issue 1A', which addresses the likely future *with* the proposed acquisition. The likely future *without* the proposed acquisition is then considered under 'Issue 1B'.

Issue 1A: What is the likely future with the proposed acquisition? How should the Tribunal make this assessment in light of the potential for Murray Goulburn to acquire less than 90% of shares in WCB?

20. As explained above, Murray Goulburn is offering to acquire all of the shares in WCB and this offer is conditional on Murray Goulburn acquiring greater than 50% of WCB shares. If Murray Goulburn were to acquire at least 90% of WCB shares, it proposes to compulsorily acquire the remaining WCB shares (**MG Full Ownership**).
21. It seems likely, therefore, that the future with the proposed acquisition would involve either MG Full Ownership or Murray Goulburn acquiring greater than 50%, but less than 90%, of WCB shares (**MG Partial Ownership**). The prospects of Murray Goulburn acquiring at least 90% of WCB may be more apparent at the time of the Tribunal's determination of this matter.
22. In a scenario of MG Partial Ownership, as opposed to MG Full Ownership:
- WCB directors, who are required to act in the best interests of WCB and its shareholders as a whole, would be required to take into account the interests of shareholders other than Murray Goulburn.

¹⁶ WCB Target's Statement relating to Saputo bid to acquire WCB, 12 November 2013, page 44.

¹⁷ *Re Application by Concrete Carters Association (Victoria) (1977)* ATPR 40-042 at 17459; *Re Queensland Independent Wholesalers Ltd (1995)* ATPR 41-438 at 40,920; *Re Media Council (1996)* ATPR 41-497 at 42,241; *Re Applications by the Australasian Performing Rights Association (1999)* ATPR 41-701 at 42936; *Re Australian Association of Pathology Practices Incorporated (2004)* (2004) ATPR 41-985 at 48535; *Re Medicines Australia* at [120].


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- b. Murray Goulburn may not be able to change the constitution of WCB or pass special resolutions, which require approval of 75% of votes cast.
23. In a scenario of MG Partial Ownership, then, there may be material impacts on the ability of Murray Goulburn to implement the operational measures required to achieve the public benefits identified in its application.

Issues for further consideration

1. Would MG Partial Ownership impact on Murray Goulburn's ability to achieve the claimed public benefits?
2. Would MG Partial Ownership impact on the anticompetitive detriments, if any, from the proposed acquisition?

Issue 1B: What is the likely future without the proposed acquisition? How should the Tribunal make this assessment in light of competing bids to acquire WCB by Saputo and Bega?

24. Murray Goulburn submits that, in the future without the proposed acquisition, it is "possible" that:
- a. the status quo will continue, with WCB continuing to operate as an independent business;
 - b. Bega will acquire WCB; or
 - c. Saputo will acquire WCB.
25. On 18 December 2013, Bega announced that its takeover bid for WCB would not be extended and would close on 20 December 2013.
26. Based on current information regarding the various bids, it appears that in the future without the proposed acquisition, the ownership of WCB could, as a matter of commercial reality, comprise:
- a. the 'status quo', i.e. no one shareholder holds a majority of shares in WCB; or
 - b. Saputo acquiring all WCB shares (similarly to Murray Goulburn, Saputo has stated that if it acquires at least 90% of WCB shares, it intends to compulsorily acquire the remaining WCB shares (**Saputo Full Ownership**)); or
 - c. Saputo acquiring greater than 50%, but less than 90% of WCB shares (**Saputo Partial Ownership**).

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27. The likely future without the proposed acquisition may be more apparent at the time of the Tribunal's determination in this matter.
 28. This issues paper proceeds on the basis that a reference to the status quo means the ownership of WCB remains such that no one shareholder holds a majority interest in WCB. However it does not necessarily mean that all market conditions (including the current structure of the WCB share register) remain as they currently are.
 29. Where the ACCC considers that the likely future with Saputo Full Ownership or Saputo Partial Ownership may differ in a material way from the likely future with the status quo ownership of WCB, it has noted this.

Issues for further consideration

3. Would Saputo Partial Ownership or Saputo Full Ownership in the future without the proposed acquisition, as opposed to the status quo, impact on the analysis of public benefits or public detriments resulting from the proposed acquisition?

D PUBLIC BENEFITS

30. By reference to the issues contained in the Provisional Issues List, Murray Goulburn submits that the proposed acquisition would result in (among other things):
 - a. a significant increase in the real value of exports (issue 3); and
 - b. a significant substitution of domestic products for imported goods (issue 4).
31. The ACCC considers that the claimed public benefits additional to these categories may be described broadly as operational synergies and are addressed under the headings of issue 2.
32. The ACCC has commented on issues 3 and 4 using the same sub-headings as those used in relation to issue 2.
33. The remainder of the ACCC's public benefits discussion follows issues 5 to 9 of the Provisional Issues List.

I Synergies

Issue 2: Synergies

Issue 2(a): In relation to the claimed synergies: What is the nature and extent of the claimed public benefit? Is it tangible, credible and real? Is it enduring and of substance?

Overview

34. Murray Goulburn estimates that synergies from the proposed acquisition will result in savings of [REDACTED] per annum,¹⁸ and that there will be a one off cost of [REDACTED]¹⁹ involved in realising these savings.
35. Parmalat submits that the claimed public benefits are highly speculative and it will be difficult for the Tribunal to be satisfied that they will eventuate. Parmalat submits that this is particularly the case for such a highly expensive acquisition.²⁰
36. WCB submits that Murray Goulburn's claimed public benefits are premised on the business, assets and operations of Murray Goulburn and WCB being 'combined' in a sense of complete (or near complete) integration.²¹ WCB considers this type of integration would be unlikely to occur in the event of MG Partial Ownership only.²² WCB submits that the public benefits associated with efficiencies under a MG Partial Ownership scenario are unlikely to occur.²³
37. In its application, Murray Goulburn does not distinguish between a full acquisition and a partial acquisition in calculating the claimed public benefits. If the Tribunal determines that MG Partial Ownership is a likely future with the proposed acquisition, it will need to consider to what extent, if any, MG Partial Ownership alters the likelihood and scope of the claimed public benefits.
38. Murray Goulburn's synergy estimates rely on the premise that Murray Goulburn will be vigilant over costs and realise synergies where they occur. To the extent that the proposed acquisition reduces the competitive discipline on Murray Goulburn to contain its costs (Issue 17), the size of the public benefit could be significantly diminished. Nonetheless, for the purposes of addressing Murray Goulburn's public benefit claims in this issues paper, an assumption has been made that Murray Goulburn will have an incentive to realise all potential efficiencies.

¹⁸ Form S, paragraph 386.

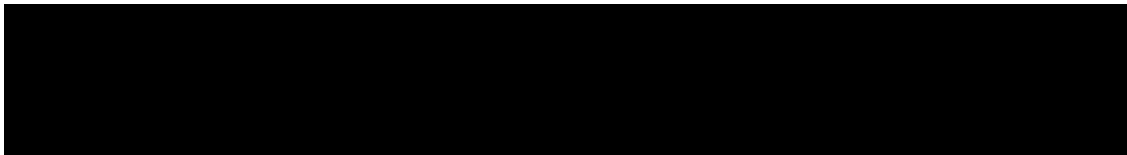
¹⁹ Form S, paragraphs 385-386; Statement of David Noonan, Annexure DMN10 [REDACTED].

²⁰ Parmalat submission to the Tribunal, 18 December 2013, page 8.

²¹ WCB submission to the Tribunal, 18 December 2013, paragraph 52.

²² WCB submission to the Tribunal, 18 December 2013, paragraph 54.

²³ WCB submission to the Tribunal, 18 December 2013, paragraph 66.



Synergies in transport and logistics

39. Murray Goulburn considers that the proposed acquisition will result in substantial savings from the improved efficiency of its transport operations, in particular through:²⁴

[Redacted]

a. consolidation of milk pick-up routes²⁵ – [Redacted]
[Redacted]

b. finished goods transportation costs²⁶ – [Redacted]
[Redacted]

c. reduced warehousing costs²⁷ – [Redacted]
[Redacted]

d. labour savings – [Redacted];
[Redacted];

e. [Redacted]
[Redacted]

f. increased use of more efficient technology – [Redacted]
[Redacted]

40. Parmalat submits that efficiencies from milk collection are likely and may deliver a further 0.1-0.2 cent per litre over the combined volume.²⁸

41. To the extent that the proposed acquisition reduces the real resource cost of transport and logistics across the two companies, then this represents a public benefit. On the other hand, cost savings resulting from increased bargaining power with [Redacted] are likely to be simply a transfer from these companies to Murray Goulburn (with no improvement in efficiency) and therefore may not represent a public benefit.

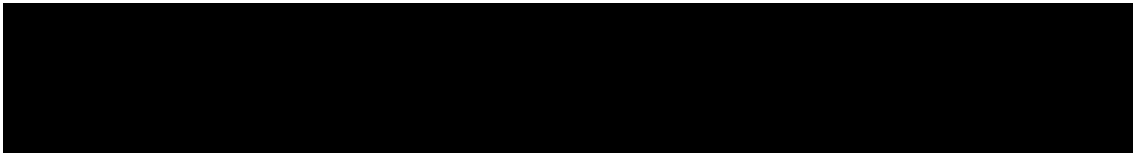
²⁴ Form S, paragraph 384(a).

²⁵ Statement of David Noonan, paragraph 27(a).

²⁶ Statement of David Noonan, paragraph 27(b).

²⁷ Statement of David Noonan, paragraph 27(c).

²⁸ Parmalat submission to the Tribunal, 18 December 2013, page 6.



42. The ACCC notes that, if Murray Goulburn does not achieve full control of WCB, there may be material impacts on its ability to implement these measures.

Synergies in processing

43. The efficiencies claimed by Murray Goulburn in relation to processing include:²⁹

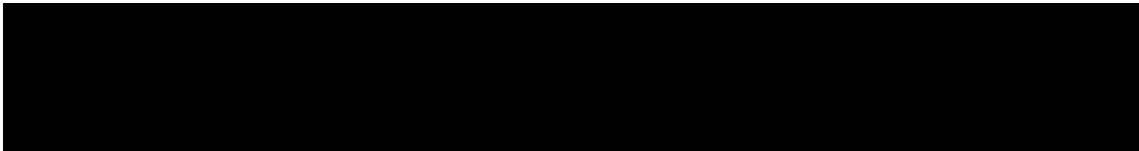
- a. consolidation of production at certain plants – [redacted]
[redacted]
[redacted];
- b. roll out of Murray Goulburn’s “Operational Excellence” program – in order to improve the efficiency of WCB’s Allansford plant;³¹
- c. reduced procurement costs – switching WCB’s purchases to Murray Goulburn’s supply agreements at a lower cost;³²
- d. labour savings – [redacted]
[redacted]
[redacted]

44. Many of the claimed possible savings from [redacted]
[redacted]
[redacted]
[redacted]
[redacted]
[redacted]
[redacted]³⁷

45. It is not clear whether it is feasible [redacted]
[redacted]

46. The ACCC considers the proposed acquisition may generate synergies in processing through plant consolidation and labour savings which represent a public benefit. The ACCC notes however that unless Murray Goulburn achieves full control of WCB, there may be material impacts on its ability to implement these measures.

²⁹ Form S, paragraph 384.
³⁰ Form S, paragraph 384(b)-(c).
³¹ Form S, paragraph 384(f).
³² Form S, paragraph 384(g).
³³ Form S, paragraph 384(e).
³⁴ Form S, paragraph 384(a)(7).
³⁵ Form S, paragraph 384(c).
³⁶ Form S, paragraph 384(d).
³⁷ Form S, paragraph 384(d).



Issues for further consideration

- 4. To what extent would the size of Murray Goulburn's claimed public benefits arising from the proposed acquisition be diminished due to any reduction in competitive discipline on it to contain its costs (see Issue 17)?
- 5. To what extent do each of Murray Goulburn's claimed synergies represent real resource cost savings? Or are they simply transfers to Murray Goulburn from improvements in its post-acquisition bargaining position?
- 6. To what extent are the claimed resource savings from the proposed acquisition real? What is the corresponding extent of the reductions in per unit capital and labour costs?
- 7. To what extent is MG Partial Ownership likely to affect the likelihood of the claimed public benefits arising?
- 8. What is the feasibility of all of the consolidation proposals [redacted] [redacted]?

Issue 2(b): In relation to the claimed synergies: Is it distinct from other public benefits claimed or does it overlap with one or more of the other public benefits claimed?

- 50. The ACCC has summarised what it considers to be the key categories of efficiency benefits in response to Issue 2(a).
- 51. In some cases Murray Goulburn appears to refer to the same benefit more than once. In particular:
 - a. Murray Goulburn refers to efficiencies from increased milk volumes in a number of places in its application.³⁹ These broad statements of the benefits arising from increased scale appear to encompass all of the more specific efficiency benefits in transport, logistics and processing from increased scale.⁴⁰
 - b. Murray Goulburn states that a larger milk pool will allow it to invest to upgrade its plants because it will receive a return on the additional raw milk processed. Where these additional returns arise from the efficiency benefits outlined above, this is not an additional public benefit.
 - c. Murray Goulburn refers to benefits associated with [redacted]
[redacted]
[redacted]
[redacted].

³⁹ Form S, paragraphs 381, 384(h).

⁴⁰ As outlined in Form S, paragraph 384.

Issues for further consideration

9. What is the extent of overlap between the claimed public benefits?

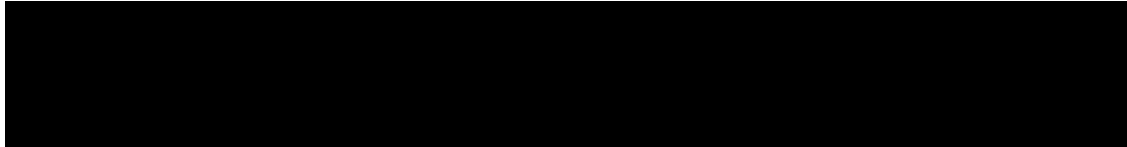
Issue 2(c): In relation to the claimed synergies: Does the claimed public benefit result from the proposed acquisition or is there a real chance that it would eventuate in the future without the proposed acquisition?

52. For some of the public benefits claimed by Murray Goulburn, it is not clear that the benefits arise specifically from the proposed acquisition. In particular, it is not clear that:
- a. the proposed acquisition will increase Murray Goulburn's milk pool by the full amount of WCB's current milk pool;
 - b. some scale benefits associated with an increase in the milk pool could not be achieved without the proposed acquisition; and
 - c. some of the operational efficiencies could not be achieved in other ways absent the proposed acquisition.

Murray Goulburn's milk pool

53. Many of the public benefits claimed by Murray Goulburn from transport, logistics and processing efficiencies arise from the assumed increase in the milk pool available to Murray Goulburn (and the associated scale efficiencies).
54. If the proposed acquisition were to proceed, suppliers of WCB may be expected to become suppliers to Murray Goulburn, but will retain the option of switching to other processors to the extent that there are viable alternatives available post-acquisition.
55. In this regard, WCB submits that it may be relevant to consider the historical milk intake of Murray Goulburn, WCB and other acquirers of raw milk. It indicates that over the ten year period since 2002, WCB has significantly grown its milk intake to nearly 900 million litres. By contrast, Murray Goulburn's milk intake has declined on average more than the industry average.⁴¹
56. Given the potential for supplier switching and having regard to these historical trends, the likely increase in Murray Goulburn's milk pool from the acquisition is uncertain.

⁴¹ WCB submission to the Tribunal, 18 December 2013, paragraph 60.



57. WCB also submits that, if the proposed acquisition results in MG Partial Ownership, it is unclear that any increase in Murray Goulburn's milk volumes would occur, since such volumes would still accrue to WCB (subject to agreement between Murray Goulburn and WCB).⁴²

Scale benefits associated with an increase in the milk pool

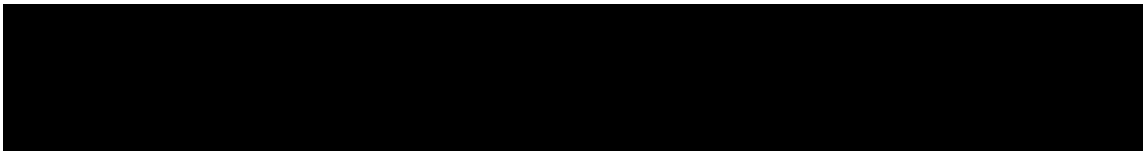
58. It is possible that scale benefits associated with an increase in the milk pool may be achieved absent the proposed acquisition. In this regard, WCB submits that it may be relevant to consider whether savings from more efficient milk pick up routes are merger-specific benefits or can be achieved in the future without the proposed acquisition, for example through milk swap arrangements or joint ventures between milk dairy processors to service routes to achieve similar efficiencies in milk collection.⁴³

Claimed operational efficiencies

59. It may be possible that a number of the claimed operational efficiencies could be achieved in other ways absent the proposed acquisition. For example, WCB submitted that the operational efficiencies which Murray Goulburn claims are likely to be achieved at the Allansford plant are likely to be achieved in the status quo as well, as WCB regularly undertakes reviews of its plant and operational efficiency and seeks to identify strategies that may improve its efficiency and overcome operational problems.⁴⁴

60. Additionally, Murray Goulburn nominates [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]⁴⁶ While labelled as a 'synergy', the ACCC understands this to be an identified investment opportunity by Murray Goulburn. It is unclear why such a profitable opportunity would not be pursued by WCB in the absence of the proposed acquisition (Issue 3).

⁴² WCB submission to the Tribunal, 18 December 2013, paragraph 59.
⁴³ WCB submission to the Tribunal, 18 December 2013, paragraph 66.
⁴⁴ WCB submission to the Tribunal, 18 December 2013, paragraph 69.
⁴⁵ Statement of David Noonan, paragraphs 35-36.
⁴⁶ Statement of David Noonan, Annexure DMN10.



Issues for further consideration

- 10. To what extent is the proposed acquisition likely to increase the milk pool available to Murray Goulburn, having regard to the ability of suppliers to switch and the decline in Murray Goulburn's milk volumes over time?
- 11. To what extent would any reductions in the anticipated milk pool affect the quantum of Murray Goulburn's synergy claims?
- 12. To what extent would MG Partial Ownership impact the milk pool available to Murray Goulburn?
- 13. To what extent could scale benefits associated with increased milk collection be achieved through other mechanisms absent the proposed acquisition?
- 14. To what extent could any efficiencies be achieved through means other than the proposed acquisition?

Issue 2(d): In relation to the claimed synergies: Would the proposed acquirer or others incur costs in achieving the claimed benefit? If so, what is the magnitude of such costs?

- 61. Murray Goulburn has acknowledged that some of the synergies it has detailed will [redacted] Murray Goulburn estimates this [redacted] [redacted]⁴⁸ This estimate is broken down into the following categories:⁴⁹

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

⁴⁷ Form S, paragraphs 385-386.

⁴⁸ Form S, paragraphs 385-386; Statement of David Noonan, Annexure DMN10 [redacted]

⁴⁹ Form S, paragraphs 385-386.



- 62. As these estimates are excluded from the Tribunal's register, it may not be possible to test their accuracy given the current restrictions on disclosure of such material.
- 63. The ACCC notes it is the net rather than the gross cost savings that represent the real economic benefit from the proposed acquisition. [Redacted]
[Redacted]
[Redacted]
[Redacted]
[Redacted]
- 64. If the future with the proposed acquisition does not involve an integration of the Murray Goulburn and WCB businesses, the costs associated with integrating the two businesses will not be incurred, but neither will the benefits.

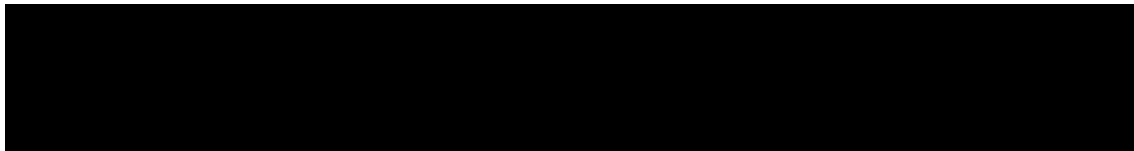
Issues for further consideration

- 15. Are the estimates of the costs incurred by Murray Goulburn in achieving the claimed synergies realistic?
- 16. [Redacted]
[Redacted]
[Redacted]

Issue 2(e): In relation to the claimed synergies: Has the claimed public benefit been quantified or is it readily capable of quantification? If the claimed public benefit has been quantified, are the methodology and assumptions that have been adopted reasonable?

- 65. As the descriptions of most of the claimed efficiencies are excluded from the Tribunal's register, it may not be possible to fully test their accuracy given the restrictions on disclosure of such material.
- 66. WCB submits that it is not in a position to comment on procurement savings as no details have been provided as to the type or level⁵⁰ and efficiencies derived from increased volumes.⁵¹
- 67. The discussion below focuses on the reasonableness of the methodology and assumptions for calculating the nominated synergies.

⁵⁰ WCB submission to the Tribunal, 18 December 2013, paragraph 70.
⁵¹ WCB submission to the Tribunal, 18 December 2013, paragraph 71.



Synergies in transport and logistics

68. Murray Goulburn estimates the likely synergies for farm to factory collection and transport of milk as being between [redacted]. Murray Goulburn's estimates of synergies are [redacted].

69. Murray Goulburn estimates the synergies from [redacted].

70. For the purposes of calculating the total synergies from the proposed acquisition Murray Goulburn has [redacted].⁵⁵

71. The size of the benefit will depend on the extent to which the Murray Goulburn and WCB inbound and outbound trucks travel at less than full capacity for some or all of their journeys and the improvement in utilisation arising from the proposed acquisition. Parmalat notes that WCB will already have significant efficiencies in milk transportation.⁵⁶

72. Similarly, the magnitude of the public benefit from reduced warehousing costs will depend on the extent to which Murray Goulburn [redacted].

73. It is unclear how Murray Goulburn has taken into account these factors in calculating the transport and logistics synergies from the proposed acquisition.

Synergies in processing

74. Murray Goulburn estimates the likely processing synergies as being between [redacted]. Murray Goulburn's estimates of synergies are [redacted]. The estimate includes [redacted].

⁵² Statement of David Noonan, paragraph 34.
⁵³ Form S, paragraph 384(a)(1).
⁵⁴ Form S, paragraph 384(a)(2).
⁵⁵ Statement of David Noonan, Annexure DMN10.
⁵⁶ Parmalat submission to the Tribunal, 18 December 2013, page 6.
⁵⁷ Figures calculated from Statement of David Noonan, Annexure DMN10, 'Warrnambool total tab' by subtracting the Farm to Factory Freight savings from the other cost items. This subtraction was done as the cost savings from farm to factory have been counted above.
⁵⁸ Statement of David Noonan, paragraph 34.
⁵⁹ Figures calculated from Statement of David Noonan, Annexure DMN10, 'Warrnambool total tab' by subtracting the Farm to Factory Freight savings and the outbound freight and distribution

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

75. For the purposes of calculating the total synergies from the proposed acquisition Murray Goulburn has [REDACTED]

76. Some of Murray Goulburn’s claimed cost savings appear to be based on the fact that it considers that it is likely that WCB has similar inefficiencies to Murray Goulburn prior to the roll out of its “Operational Excellence” program, and therefore the roll out of this program would generate efficiency improvements.⁶² Murray Goulburn considers that it can get operating savings of between [REDACTED] WCB submits that its Allansford plant is one of Australia’s most efficient dairy plants⁶⁴ and that it undertakes regular reviews of plant and operational strategies to improve its efficiency.⁶⁵ Therefore it is unclear as to the benefits that Murray Goulburn will achieve from rolling out the Operational Excellence program.

savings from the other cost items. This subtraction was done as the cost savings from farm to factory have been counted above

⁶⁰ Figures calculated from Statement of David Noonan, Annexure DMN10, ‘Warrnambool total tab’ by subtracting the Farm to Factory Freight savings and the outbound freight and distribution savings from the other cost items. This subtraction was done as the cost savings from farm to factory have been counted above

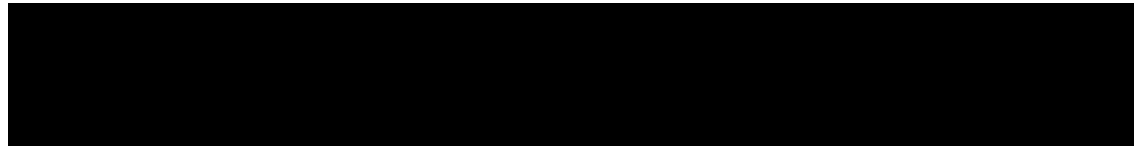
⁶¹ Statement of David Noonan, Annexure DMN10.

⁶² Form S, paragraph 384(f).

⁶³ Statement of David Noonan, Annexure, DMN10.

⁶⁴ WCB submission to the Tribunal, 18 December 2013, paragraph 13.

⁶⁵ WCB submission to the Tribunal, 18 December 2013, paragraph 69.



Other corporate savings

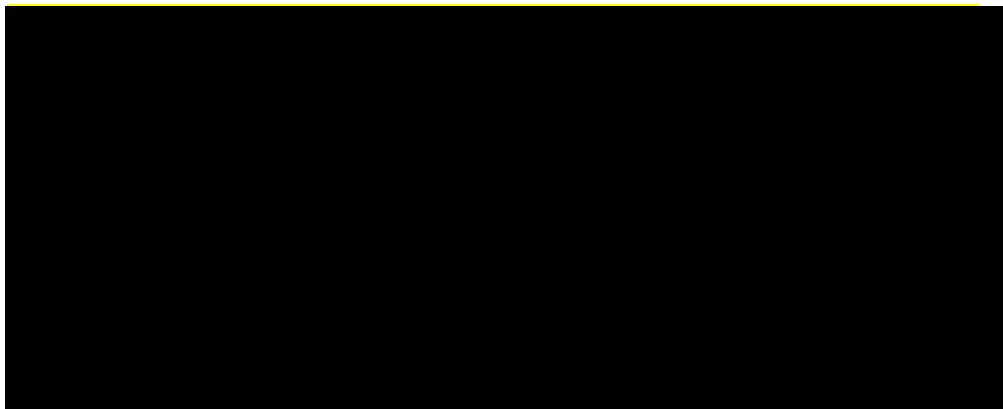
77. Murray Goulburn estimates the likely synergies from other [redacted] as being [redacted]. Murray Goulburn's estimates of synergies are [redacted]. The majority of this estimate stems from [redacted].
[redacted]
[redacted]
[redacted]

78. The remaining savings are classified [redacted].
[redacted]
[redacted]
[redacted]
[redacted]
[redacted]

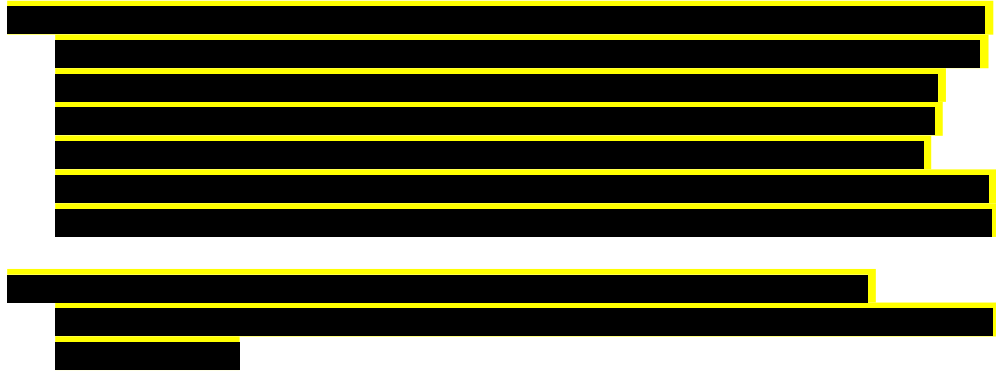
Calculation of effect of synergies on the milk price

79. Murray Goulburn contends that the synergies will flow through to increased milk prices of [redacted]. The closing price paid by Murray Goulburn for the 2013 season was [redacted]. Murray Goulburn performed this calculation by [redacted].
[redacted]
[redacted]

80. The ACCC notes the following in relation to these calculations: [redacted].
[redacted]



⁶⁶ Statement of David Noonan, paragraph 34.
⁶⁷ Statement of David Noonan, Annexure DMN10, [redacted].
⁶⁸ Statement of David Noonan, Annexure DMN10, [redacted].
⁶⁹ Statement of David Noonan, Annexure DMN10, 'Warrnambool total' tab.



Issues for further consideration

17. Are the methodology and assumptions adopted by Murray Goulburn for calculating the extent of synergies robust?
18. Are the methodology and assumptions adopted by Murray Goulburn for calculating the effect on the milk price robust?

Issue 2(f): In relation to the claimed synergies: Who are the beneficiaries of the claimed public benefit? Will the benefits flow through to the broader community?

81. Murray Goulburn submits that because of its cooperative structure, and approach to setting its farm gate milk price, the increased profitability that it is likely to achieve as a result of the proposed acquisition will enable it to offer significantly higher milk prices to its farmer suppliers than it would otherwise be able to.⁷⁰ Murray Goulburn submits that this will be received by all suppliers to the combined entity, including potentially all 500 current suppliers to WCB.⁷¹ In total this will affect approximately 3,000 suppliers.
82. The public benefits in this section arise from the (net) resource savings generated by the proposed acquisition. To the extent these are paid to farmers via a higher milk price this is relevant to the distribution of the benefits but is not an additional public benefit.
83. Murray Goulburn submits that these benefits are likely to be more broadly shared because it is possible that an increase in milk price will likely be spent by suppliers in the regional areas where they operate, providing a benefit to the economies of those regions.⁷²
84. Murray Goulburn further notes that the proposed acquisition could result in a significant increase in dairy farming and dairy processing economic activity, with a multiplier effect that will increase both employment and income, particularly within Victoria and South Australia. It submits that an appropriate economic impact multiplier for dairy farming/agricultural activity indicates that an increase of \$1 in economic activity in the primary sectors (i.e. dairy farming and dairy

⁷⁰ Form S, paragraph 403.

⁷¹ Form S, paragraph 407.

⁷² Form S, paragraph 408.

processing) will result in a total increase in economic activity of approximately \$2-\$3.20.⁷³ No source has been provided for these multiplier estimates.

85. The Murray Goulburn submission regarding the effect of milk prices on dairy farming activity appears to rely on the assumption that the supply of milk is elastic such that higher farm gate milk prices are likely to significantly expand the production of dairy products. The ACCC considers that the Tribunal may wish to give further consideration to the extent to which such an expansion is likely given the magnitudes of the claimed price increase arising from the proposed acquisition, the value of alternative uses of the land, and that the marginal productivity of dairy farming is likely to decrease if it is extended into areas with less suitable land or climate conditions.
86. To the extent that the proposed acquisition results in increased milk prices or dividends, there may be some 'second round effects' in terms of increased spending in rural communities. However, the ACCC cautions against the use of unconstrained multipliers in evaluating the magnitude of public benefits. There are a range of assumptions implicit in these multipliers including that extra output can be produced in one part of the economy without diverting resources from other activities.⁷⁴ To the extent there is a diversion (for example, any expansion in milk production would come at the expense of other economic activities) this will overstate the economic impacts.
87. If the Tribunal were minded to consider such a 'general equilibrium analysis' of the proposed acquisition, it would seem relevant to take into account all the shifts in production and consumption likely to arise from the acquisition, including any job losses and anticompetitive effects (Issues 11-29).

Issues for further consideration

19. Is dairy farming activity in the relevant region highly responsive to changes in the milk price? In particular, would a small increase in the farm gate milk price be likely to result in a significant increase in dairy farming activity?
20. Is it appropriate to apply a multiplier to the benefit from any increase in the milk price arising from the proposed acquisition? If so, is it appropriate to apply a multiplier to the other potential economic effects of the acquisition?

⁷³ Form S, paragraph 410.

⁷⁴ ABS, 'Limitations of input-output multipliers for economic impact assessment', ABS Catalogue 5209.0.55.001 - Australian National Accounts: Input-Output Tables - Electronic Publication, Final release 2006-07.

Issue 2(g): In relation to the claimed synergies: Are there public detriments intrinsic to the claimed public benefit?

88. WCB submits that consideration should be given to whether a reduction of head count from the rationalisation of administration and transport personnel might constitute a public detriment, for example through job losses, and the multiplier effects associated with those job losses.⁷⁵
89. The ACCC refers the Tribunal to its comments above as to the likely flow-through effects of the proposed acquisition.

Issues for further consideration

21. Are there any other public detriments intrinsic to Murray Goulburn's claimed public benefits?

II Increase in real value of exports

Issue 3: A significant increase in the real value of exports

Issue 3(a): In relation to the claimed increase in the real value of exports: What is the nature and extent of the claimed public benefit? Is it tangible, credible and real? Is it enduring and of substance?

90. Murray Goulburn claims that the proposed acquisition will significantly increase the real value of exports.⁷⁶ Murray Goulburn submits that this will be achieved through allowing it to:
- a. leverage its existing relationships with premium customers to offer more innovative products, which attract higher price premiums⁷⁷
 - b. use its increased scale to optimise its product mix. This includes producing a greater proportion of higher value products⁷⁸ which attract a price premium over base commodities⁷⁹ and are less susceptible to price fluctuations in the market.⁸⁰ As a result, Murray Goulburn's exposure to price volatility in commodity markets will be reduced.⁸¹
91. Murray Goulburn submits that there is a limited window of opportunity to increase exports from Australia as most large dairy firms in the US and EU are gearing up for export growth. Consequently, Australia would lose its relevance in the global dairy industry if it does not increase production and increase share growth in next decade.⁸²

⁷⁵ WCB submission to the Tribunal, 18 December 2013, paragraph 66(b).

⁷⁶ Form S, paragraph 393.

⁷⁷ Form S, paragraph 393.

⁷⁸ Form S, paragraph 390.

⁷⁹ Form S, paragraph 361.

⁸⁰ Statement of Maldwyn Beniston, paragraph 122.

⁸¹ Form S, paragraph 391.

⁸² Statement of Maldwyn Beniston, paragraph 31.

- [REDACTED]
92. The ACCC accepts that if synergies arising from the proposed acquisition were to expand dairy exports then this constitutes a public benefit under the Act (see issue 3(b)). However, the ACCC notes that this relies on both Murray Goulburn having an ability and incentive to realise any synergies and an incentive to use these benefits to increase the milk price to expand production. To the extent that the proposed acquisition reduces the competitive discipline on Murray Goulburn to contain its costs and to offer keen prices to farmers (Issue 17), the ACCC considers that the size of the public benefit could be diminished or even reversed. Nonetheless, for the purposes of addressing Murray Goulburn's public benefit claim in this issues paper we have assumed that Murray Goulburn realises all available efficiencies and expands production (and exports) through increasing its purchases of raw milk.
93. Under Issue 3(c) the ACCC considers the potential for the proposed acquisition to expand the supply of high value products and to increase customer confidence in Murray Goulburn, including the extent to which these changes might arise in the absence of the proposed acquisition.

Issue 3(b): In relation to the claimed increase in the real value of exports: Is it distinct from other public benefits claimed or does it overlap with one or more of the other public benefits claimed?

94. The ACCC assumes that Murray Goulburn would be a price taker in dairy export markets for most products. [REDACTED]
[REDACTED] Even for more specialised or tailored products, Murray Goulburn would be competing with a host of other potential suppliers in order to supply these products.
95. As discussed under Issue 2, Murray Goulburn claims that the proposed acquisition will result in efficiencies, reducing their marginal costs of supply. The benefits achieved through these cost reductions at current production levels were counted as efficiency benefits under Issue 2. These benefits should not be counted twice. To the extent that the reduction in the costs of supply lead to an expansion in exports at the market price, then there is an additional public benefit in Australia (increased earnings for Murray Goulburn) from these increased exports. The distinction between these benefits is illustrated in Future 1 below (based on the decrease in Murray Goulburn's short run marginal cost).

⁸³ Dairy Australia's Australian Dairy Industry in Focus 2013, 18 and Confidential Annexure MB16.

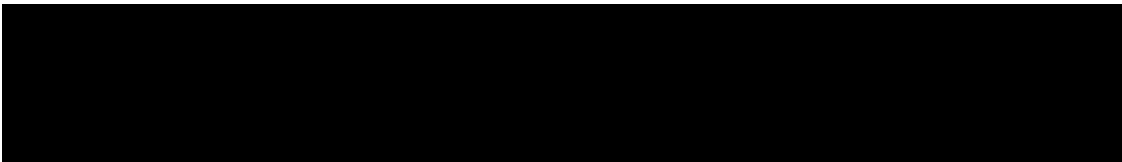
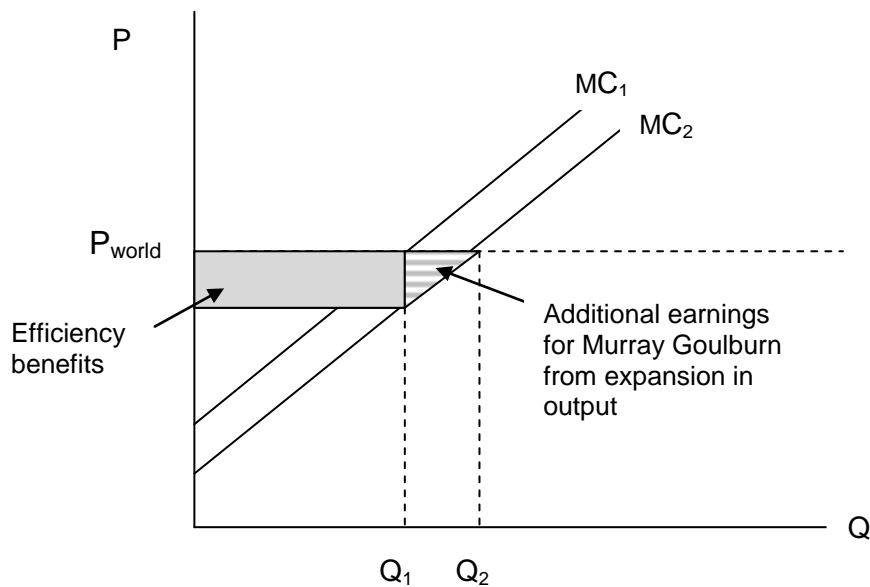


Figure 1 Increase in Murray Goulburn's exports from efficiency improvement



Issues for further consideration

22. To what extent would a reduction in Murray Goulburn's costs of supply lead to an expansion in exports at the market price?

Issue 3(c): In relation to the claimed increase in the real value of exports: Does the claimed public benefit result from the proposed acquisition or is there a real chance that it would eventuate in the future without the proposed acquisition?

Expansion in exports of high value products

96. Murray Goulburn submits that the proposed acquisition will allow the merged firm to change its product mix, expanding its export of high value nutritional products.
97. The ACCC suggests the Tribunal consider to what extent these benefits could occur irrespective of the proposed acquisition.
98. Murray Goulburn indicates that it is increasingly focussing on producing higher value and specialty ingredients, as they provide higher margins and reduce exposure to the more price volatile commodity products.⁸⁴ Murray Goulburn submits that it currently has capacity to produce approximately [REDACTED]
[REDACTED]⁸⁵ Murray Goulburn projects it will exceed its current capacity by around November 2014 and [REDACTED]

⁸⁴ http://www.mgc.com.au/media/4860/130802_Devondale-Danone-media-release.pdf

⁸⁵ Form S, paragraph 329; Statement of Maldwyn Beniston, paragraphs 110-111.

[REDACTED]

[REDACTED]

99. This suggests that Murray Goulburn is likely to produce more high value products even without the proposed acquisition. However, Murray Goulburn submits that the acquisition will allow it to [REDACTED]

[REDACTED]

100. [REDACTED]

101. It is not clear that Murray Goulburn is uniquely placed to develop the relationships necessary to grow the supply of high margin products. In this regard the ACCC notes that smaller processors including WCB have been successful in entering into joint ventures to support production and exports of these products:

- a. In 2007 WCB entered into a joint venture with Royal FrieslandCampina to manufacture nutritional and functional ingredients at WCB's Allansford plant;⁹⁰
- b. WCB is currently constructing a new lactoferrin plant on its Allansford site underpinned by a technology and services agreement with Tatua. Tatua will also assist WCB with sales and marketing initiatives;⁹¹ and
- c. [REDACTED]

102. Similarly, smaller processors have had success in engaging with major global customers. For example, WCB has an arrangement to supply Mitsubishi Corporation with premium milk powder.⁹³ Consistent with this, WCB notes its strategy under the status quo is to build a portfolio of higher margin products, including selected specific nutritional products.⁹⁴

⁸⁶ Form S, paragraph 388; Statement of Maldwyn Beniston, paragraphs 132-139.

⁸⁷ Form S, paragraph 331.

⁸⁸ Form S, paragraph 389.

⁸⁹ Statement of Maldwyn Beniston, paragraph 135.

⁹⁰ WCB submission to the Tribunal, 18 December 2013, paragraphs 26 and 75.

⁹¹ WCB submission to the Tribunal, 18 December 2013, paragraphs 29 and 75.

⁹³ WCB submission to the Tribunal, 18 December 2013, paragraph 29(a).

⁹⁴ WCB submission to the Tribunal, 18 December 2013, paragraph 75.

- [REDACTED]
103. If Saputo were to acquire WCB (whether through Saputo Full Ownership or Saputo Partial Ownership), it would seem to have the scale and international presence to engage with global customers. Murray Goulburn suggests that the combined Saputo/WCB having only two offices in Asia (Hong Kong and Japan) compared to Murray Goulburn/WCB's four would limit Saputo's capacity to take advantage of growing nutritional product demand.⁹⁵ The ACCC is uncertain at this stage about the importance of international sales offices in building customer credibility. To the extent offices are important to exploit profitable supply opportunities, it seems likely that Saputo would be in a position to establish such offices as required.

Issues for further consideration

23. To what extent would Murray Goulburn and WCB pursue strategies to expand the supply of exports of high value products in the absence of the proposed acquisition?
24. Is scale necessary to attract international customers for high value products?
25. To what extent might joint ventures (or other means besides the proposed acquisition) allow smaller processors to tap into the export markets for high value products?
26. How important is in-market sales capability in developing customer relationships?
27. What are the barriers to processors developing an in-market sales presence?

Role of scale in ensuring relevance to customers

104. Murray Goulburn submits that the increased scale from the proposed acquisition will establish Murray Goulburn as a significant Australian export company.⁹⁶ It indicates that scale is important to enhance Murray Goulburn's brand⁹⁷ and to ensure relevance to international customers.
105. Murray Goulburn submits that its supply constraints have caused reputational damage to Murray Goulburn's brand.⁹⁸ It notes that [REDACTED]

[REDACTED]⁹⁹

⁹⁵ Form S, paragraph 420.

⁹⁶ Form S, paragraph 395.

⁹⁷ Form S, paragraph 398.

⁹⁸ Statement of Maldwyn Beniston, paragraph 94.

⁹⁹ Statement of Maldwyn Beniston, paragraph 94.

106. It is unclear to the ACCC on the information provided that the supply reliability issues experienced by Murray Goulburn would be moderated by its increase in scale – since the base of customers it serves will likely grow proportionately after acquiring WCB.
107. Further, the ACCC is not currently aware of any evidence to support the proposition that scale is integral to customer perceptions in export markets. Indeed, smaller suppliers such as WCB are successful exporters. Almost half (46%) of WCB's sales are exports¹⁰⁰ and it has grown its exports by 100% by value over a ten year period.¹⁰¹ WCB was awarded the Victorian Regional Exporter of the Year in 2012.¹⁰² As noted above, WCB has also been successful in using joint ventures to expand its export presence.

Issues for further consideration

28. Do dairy processors require scale to have credibility or relevance with international customers? If so, how significant is scale in this regard?
29. To the extent that scale is required to have credibility or relevance with international customers, can it be achieved through means other than the proposed acquisition, such as a joint venture?

Issue 3(d): In relation to the claimed increase in the real value of exports: Would the proposed acquirer or others incur costs in achieving the claimed benefit? If so, what is the magnitude of such costs?

108. To the extent that Murray Goulburn would be required to convert or invest in additional production facilities, develop its presence and/or customer relationships in export markets, such as setting up in-market offices and distribution arrangements, these would represent costs required to be incurred to achieve the claimed benefit.
109. Based on the information provided by Murray Goulburn, it is difficult to quantify the likely magnitude of such costs.

¹⁰⁰ WCB Target's Statement relating to Saputo bid to acquire WCB, 12 November 2013, page 46, available at <http://www.asx.com.au/asxpdf/20131112/pdf/42kscxqx7q7yz.pdf>.

¹⁰¹ WCB submission to the Tribunal, 18 December 2013, paragraph 83.

¹⁰² <http://www.business.vic.gov.au/operating-a-business/export/events/awards/governor-of-victoria-export-awards/previous-winners>

Issues for further consideration

30. Are there any additional costs that Murray Goulburn would incur in expanding its presence in export markets.

Issue 3(e): In relation to the claimed increase in the real value of exports: Has the claimed public benefit been quantified or is it readily capable of quantification? If the claimed public benefit has been quantified, are the methodology and assumptions that have been adopted reasonable?

110. The claimed public benefits have not been quantified.

Issues for further consideration

31. Are the public benefits relating to an increase in the real value of exports capable of quantification? If so, by what methodology and with what assumptions should they be quantified?

Issue 3(f): In relation to the claimed increase in the real value of exports: Who are the beneficiaries of the claimed public benefit? Will the benefits flow through to the broader community?

111. To the extent the Tribunal accepts there are some additional public benefits from the proposed acquisition in relation to increased exports, these would appear to accrue to Murray Goulburn.
112. Murray Goulburn submits that this increased profitability will result in it offering higher raw milk prices to farmers than it otherwise would have and that the resulting increase in dairy farming and processing activity will have a multiplier effect on employment and income in regional communities.¹⁰³
113. The ACCC refers the Tribunal to its comments under issue 2(f).

Issue 3(g): In relation to the claimed increase in the real value of exports: Are there public detriments intrinsic to the claimed public benefit?

114. The ACCC is not aware of any public detriments intrinsic to the public benefit of an increase in the real value of exports at this time.

¹⁰³ Form S, paragraphs 403-410.

III Substitution of domestic products for imported goods

Issue 4: A significant substitution of domestic products for imported goods

Issue 4(a): In relation to the claimed substitution of domestic products for imported goods: What is the nature and extent of the claimed public benefit? Is it tangible, credible and real? Is it enduring and of substance?

115. The ACCC notes that Murray Goulburn has not specified which products are currently imported. While some processed and semi-processed products may be imported, the ACCC notes that a number of products (such as raw milk and bulk cream) are unable to be imported due to their perishable nature.
116. Murray Goulburn claims that imports have grown as domestic milk supply has fallen. Over time, the efficiencies and economies of scale available to it through the proposed acquisition will increase its domestic sales and reverse the fall in milk supply.¹⁰⁴ Murray Goulburn contends that this will lead to a significant substitution of domestic products for imported goods.¹⁰⁵
117. If Murray Goulburn could establish that the improvements in scale arising from the proposed acquisition would be likely to expand domestic supply and reduce imports then this constitutes a public benefit under the Act.

Issue 4(b): In relation to the claimed substitution of domestic products for imported goods: Is it distinct from other public benefits claimed or does it overlap with one or more of the other public benefits claimed?

118. The benefits in relation to import substitution are dependent on the efficiencies from the proposed acquisition. The benefits achieved through these cost reductions at current production levels were counted as efficiency benefits under Issue 2. Therefore, as for the discussion of expanded exports (Issue 3(b)), the ACCC considers it is only the increase in welfare from any expansion in domestic supply, if substantiated, that should be counted as a public benefit.
119. To the extent that the proposed acquisition reduces Murray Goulburn's costs and expands its production, the resulting increase in the supply of processed dairy products can be supplied domestically and exported. However, the public benefit from the total expansion of supply should not be counted under both exports (issue 3) and expansion of domestic supply (issue 4); rather it should be apportioned between the two as relevant.

¹⁰⁴ Form S, paragraph 392.

¹⁰⁵ Form S, paragraph 392.

Issue 4(c): In relation to the claimed substitution of domestic products for imported goods: Does the claimed public benefit result from the proposed acquisition or is there a real chance that it would eventuate in the future without the proposed acquisition?

120. In relation to Murray Goulburn's claim that the merger will reverse the fall in the milk supply, the ACCC notes various information that suggests that milk volumes are increasing in any case:
- a. The Phillips report considers that national milk production is showing signs of consistent recovery.¹⁰⁶
 - b. The data contained in the [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
 - c. Dairy Australia forecasts that Australia's fresh milk production will rise from 9.2 million litres in the FY2013 season to between 9.3 and 9.5 billion litres for FY2014¹¹⁰ and between 9.8 and 10.2 billion litres by FY2016.¹¹¹
121. The ACCC considers that to the extent that this increase in the milk supply is likely to occur without the acquisition then this should not be taken into account in assessing the public benefits of the proposed acquisition. This is discussed further under Issue 2.
122. The ACCC notes the views in the Phillips report that the significance of the proposed acquisition on dairy production will be difficult to quantify or isolate as it will occur in parallel with other market, climate and exchange rate developments.¹¹²

Issue 4(d): In relation to the claimed substitution of domestic products for imported goods: Would the proposed acquirer or others incur costs in achieving the claimed benefit? If so, what is the magnitude of such costs?

123. The ACCC refers the Tribunal to its comments under the issue 2(d).

¹⁰⁶ Expert report of Chris Phillips, paragraph 57.

¹⁰⁷ Statement of Robert Poole, Annexure RAP16.

¹⁰⁸ Number calculated from data contained in Statement of Robert Poole, Annexure RAP16.

¹⁰⁹ Number calculated from data contained in Statement of Robert Poole, Annexure RAP16.

¹¹⁰ Dairy Australia's September 2013 Situation and Outlook Update, 5.

¹¹¹ Dairy Australia's May 2013 Situation and Outlook, 5.

¹¹² Expert report of Chris Phillips, paragraph 221.

Issue 4(e): In relation to the claimed substitution of domestic products for imported goods: Has the claimed public benefit been quantified or is it readily capable of quantification? If the claimed public benefit has been quantified, are the methodology and assumptions that have been adopted reasonable?

124. Murray Goulburn has not sought to quantify its claim.

Issue 4(f): In relation to the claimed substitution of domestic products for imported goods: Who are the beneficiaries of the claimed public benefit? Will the benefits flow through to the broader community?

125. To the extent that the Tribunal accepts there are some additional public benefits from the proposed acquisition in relation to increased substitution of domestic supply for imported goods, these appear to accrue to Murray Goulburn.
126. Murray Goulburn submits that this increased profitability will result in it offering higher raw milk prices to farmers than it otherwise would have and that the resulting increase in dairy farming and processing activity will have a multiplier effect on employment and income in regional communities.¹¹³
127. The ACCC refers the Tribunal to its comments under issue 2(f).

Issue 4(g): In relation to the claimed substitution of domestic products for imported goods: Are there public detriments intrinsic to the claimed public benefit?

128. The ACCC is not aware of any public detriments intrinsic to the claimed public benefit.

Issue 5: What other matters that relate to the international competitiveness of the Australian dairy industry (or any other industry) should the Tribunal take into account in assessing the benefits to the public likely to result from the proposed acquisition?

129. The matters discussed under issues 2 to 4 above relate to the international competitiveness of an Australian industry. In addition, the ACCC considers that the matters discussed below under public detriment (i.e. issues 10 to 27) are relevant to the international competitiveness of an Australian industry, since they relate to the level of competition between firms in the relevant domestic dairy markets and therefore the costs, prices and outputs of those markets.

Relative position of Australian and New Zealand dairy industries

130. Murray Goulburn suggests that the relative positions of the Australian and New Zealand dairy markets may be relevant to considering the effect of the proposed acquisition on international competitiveness.

¹¹³ Form S, paragraphs 403-410.

131. Murray Goulburn has submitted data on the growth in milk production in Australia and New Zealand between FY2002 and FY2012.¹¹⁴ Australian milk production has declined over the period (from 11.271 billion litres to 9.48 billion litres)¹¹⁵ while New Zealand's has increased significantly from 13.067 billion litres to 19.129 billion litres.¹¹⁶ Australia's share of the global export market declined from 15% to 8% during this period.¹¹⁷
132. Murray Goulburn is of the view that the flourishing of New Zealand's dairy industry is largely attributable to the formation and growth of Fonterra.¹¹⁸ Murray Goulburn considers that Australia is similarly conducive to success in export markets but does not currently have the scale efficiencies or manufacturing technology and has not had the growth in raw milk production that has been occurring in New Zealand.¹¹⁹ The proposed acquisition would provide Murray Goulburn with improved scale to serve the needs of global food companies.¹²⁰ This position is supported by W.B Hunter Group.¹²¹
133. Parmalat submits that Fonterra is not a valid or relevant comparison due to the particular circumstances and recent histories of the dairy industries in New Zealand and Australia:
- a. Fonterra started with global competitive advantages, eg being a monopoly approved by the government with established customers, brands and markets,¹²² and having unique climatic conditions that enable it to be the world's lowest cost milk producer.¹²³
 - b. By contrast, Australia's dairy exports were subsidised in the 1980s and 1990s, regulated milk marketing was removed in all Australian states in July 2000, most of the 12% fall in milk production in Victoria was in northern Victoria and related to drought and irrigation water restrictions and Tasmanian milk production has increased steadily since 1999/2000 by 25%.¹²⁴
134. Similarly, the Phillips report notes that the decline in milk production in Australia can be linked to a range of factors including natural resource availability and major climatic events; government pricing policies for milk (before 2000); other domestic government policy developments; and external shocks that affected industry returns, profitability and confidence.¹²⁵

¹¹⁴ Form S, paragraphs 75-87.

¹¹⁵ Form S, paragraph 78.

¹¹⁶ Form S, paragraph 84.

¹¹⁷ Form S, paragraph 86.

¹¹⁸ Statement of Maldwyn Beniston, paragraph 72.

¹¹⁹ Statement of Maldwyn Beniston, paragraph 75.

¹²⁰ Expert report of Michael Norgate, paragraph 3.6.1.1.

¹²¹ W.B. Hunter Group submission to the Tribunal, 11 December 2013.

¹²² Parmalat submission to the Tribunal, 18 December 2013, pages 2-3.

¹²³ Parmalat submission to the Tribunal, 18 December 2013, page 4.

¹²⁴ Parmalat submission to the Tribunal, 18 December 2013, page 3.

¹²⁵ Expert report of Chris Phillips, paragraph 44.

Issues for further consideration

32. To what extent does New Zealand provide a relevant case study for the effects of the proposed acquisition, having regard to:
- all features of the market that may affect milk production and international competitiveness across the two countries – for example, differences in climatic conditions, cost structures, comparative advantage in dairy farming, and taxation;
 - whether the growth in New Zealand’s milk pool under Fonterra necessarily implies an increase in Murray Goulburn’s milk pool is likely to improve Australia’s international competitiveness; and
 - any economic costs from Fonterra’s position as a monopoly purchaser of milk (including the regulations that have been necessary in the absence of effective competition)?

Issue 6: What is the magnitude of the public benefits identified as resulting from the proposed acquisition?

135. The magnitude of the public benefits associated with the claimed cost savings and efficiencies discussed under Issue 2 are likely to be impacted by both their quantum and their likelihood of occurring. Based on the information provided by Murray Goulburn in its application, the likely public benefits flowing from synergies appears uncertain, having regard to the [REDACTED], and the fact that some of the claimed cost saving categories are likely to be transfers rather than a real resource cost saving. In some instances it is also unclear as to the feasibility of all the proposed cost savings being achieved even assuming MG Full Ownership.
136. Murray Goulburn’s estimates of the total savings from the proposed acquisition [REDACTED] Even at the higher end of this range this represents a modest saving in comparison to [REDACTED] It is also a modest saving in comparison to [REDACTED]
137. The expansion in Murray Goulburn’s exports and/or domestic sales (import substitution) from improvements in efficiency following the merger is limited by the modest size of the likely efficiency gains. For the other claimed public benefits in terms of increasing relevance with international customers and expanding production and exports of high value nutritional products, it is unclear that these benefits could not be realised in the future without the proposed acquisition. In addition, if Murray Goulburn did not acquire 100% of WCB, this would appear to be material to the likelihood of it achieving the claimed public benefits.

Issues for further consideration

33. What is the magnitude of the public benefits identified as resulting from the proposed acquisition?

Issue 7: What is the impact, if any, of Murray Goulburn's proposed capital restructure on the benefits likely to result from the proposed acquisition?

138. Murray Goulburn submits that it has undertaken a review of its capital structure to investigate the most effective and efficient capital structure which will permit it to invest in the capacity and capability of existing plant operations and capitalise on growth opportunities, particularly in emerging export markets.¹²⁷ The announcements by Murray Goulburn to date suggest that investors will be offered non-voting equity via a listed unit trust.
139. Murray Goulburn states that the principal objectives of the proposed restructure are to:¹²⁸
- a. retain the co-operative structure and 100% Australian dairy farmer control of Murray Goulburn;
 - b. underpin Murray Goulburn's goal of an increase in farm gate returns of \$1 per kg of milk solids (more than seven cents per litre) over a five year period from 2012 to 2017;
 - c. provide Murray Goulburn supplier/shareholders with an observable market price for their Murray Goulburn shares, consequently strengthening farm balance sheets; and
 - d. provide access to additional sources of capital to meet the co-operative's investment plans and deliver improved returns.
140. Murray Goulburn notes that the proposed restructure is subject to a comprehensive review process with supplier/shareholders and further development with consultation meetings with its supplier/shareholders commencing in December 2013, with a further round of consultation in March 2014. Murray Goulburn submits that depending on the outcome of those meetings it is presently intended to put the proposed restructure to shareholders at an Extraordinary General Meeting in 2014.¹²⁹

¹²⁷ Form S, paragraph 32.

¹²⁸ Form S, paragraph 33.

¹²⁹ Form S, paragraph 34.

[REDACTED]

141. The ACCC notes that Murray Goulburn has placed significant weight on the incentives created by the ownership structure on the pass through of profits to farmers in the form of higher milk prices (Issue 14). The ACCC refers to the discussion under Issue 14 and notes that the proposed capital restructure will alter these incentives. [REDACTED]

142. The extent to which the incentives will change will depend on the ultimate form the capital restructure takes - which Murray Goulburn has publicly stated will not be known until at least March 2014. The form of the restructure is subject not only to a "comprehensive review process with suppliers/shareholders and further development" but is also subject to approval by the shareholders of Murray Goulburn at an extraordinary general meeting which is planned for May 2014. As a result, the proposed capital restructure gives rise to considerable uncertainty about the likely future with the acquisition. Relevantly, it is not clear how board representation will alter, nor how pressure from investors for dividends will be balanced against Murray Goulburn's plans to increase farm gate prices. The proposed restructure and resulting uncertainty may impact on the weight given to the submission that Murray Goulburn's ownership structure provides incentives to pass through profits to farmer supplier/shareholders.

Issues for further consideration

34. What are the likely relevant characteristics of the proposed restructure? How should this be factored in to the analysis?
35. What is the likely effect on the cooperative's incentives if it were to complete a capital raising?

IV Other public benefits

Issue 8: Is there a real chance that any other public benefits will result from the proposed acquisition?

Issue 9: If so, what is the nature and extent of those public benefits?

143. To the ACCC's knowledge, no other public benefits of the proposed acquisition have been identified to date.

¹³⁰ Statement of Robert Poole, paragraph 264(b).

E PUBLIC DETRIMENTS

144. Murray Goulburn submits that there are no meaningful material public detriments (anti-competitive or otherwise) associated with the proposed acquisition.¹³¹
145. The ACCC's assessment of the likely public detriments from the proposed conduct follows the headings in the Tribunal's Provisional Issues List.
146. The ACCC is not aware of any basis on which any competitive effects that may result from the proposed acquisition would be different when assessed against a future with Saputo Full Ownership or Saputo Partial Ownership, as opposed to the status quo.

I Markets in which to assess the competitive effects of the proposed acquisition

Issue 10: What are the relevant markets in which to assess the competitive effects of the proposed acquisition?

Issue 10(a): Is there a single market for acquisition of raw milk in Victoria, South Australia and the Riverina region of New South Wales? Or are there separate regional markets for the acquisition of raw milk?

Market definition – geographic dimension

147. Murray Goulburn submits that the relevant geographic market for the supply and acquisition of raw milk is Victoria, South Australia and the Riverina region of New South Wales (the **South East Region**), on the basis that any purchaser of raw milk in any dairy locality throughout this region would be unable to profitably engage in a small but significant reduction in price as against dairy farmers.¹³²
148. The ACCC accepts that if it would be profitable for farmers to switch to supplying processors in other parts of the South East region in response to small but significant non-transitory decrease in price (**SSNDP**) below the competitive price in their local area then it would be reasonable to conclude that the South East Region is the relevant geographic dimension of the market in which the parties' acquisition of raw milk overlaps.
149. Murray Goulburn refers to the fact that in response to a small but significant reduction in price, dairy farmers could economically transport their milk to other localities within the South East Region because the incremental cost of doing so would be less than 10% of the raw milk price, and in many cases, less than 5%.¹³³

¹³¹ Form S, paragraphs 375 and 376.

¹³² Form S, paragraph 183.

¹³³ Form S, paragraph 183(f).

[REDACTED]

150. The ACCC understands that there would need to be a number of farmers in a local area willing to switch to a new processor before it would become viable for the processor to send a tanker to that area to collect the milk.¹³⁴

151. Even where there are a sufficient number of farmers willing to switch supply, transport costs may represent a barrier to a farmer switching to supply processors outside of the geographic region in which their farm is located.

[REDACTED]

[REDACTED] The costs from South Australia to these regions would be higher due to the greater distances. These costs appear significant relative to the current farm gate price of raw milk of [REDACTED]

[REDACTED]¹³⁶

152. Fresh milk processors may be more likely to acquire milk from further away than bulk milk processors. Bulk milk processors may be more concerned to minimise transport costs due to their exposure to world dairy prices, whereas fresh milk processors may find it viable to transport milk further due to their need to acquire sufficient milk supply throughout the year.

153. Murray Goulburn refers to the fact that all dairy processors in the South East Region offer the same milk price structure as supporting a broader geographic market dimension.¹³⁷ Murray Goulburn's current Milk Payment System, which offers farmers in its North, West and Gippsland regions the same milk price structure, was introduced in 2013.¹³⁸

154. Murray Goulburn refers to the fact that significant volumes of raw milk are transported between the various dairying localities throughout this region by Murray Goulburn and its competitors.¹³⁹ However, WCB states that it sources raw milk from suppliers located in south west Victoria (stretching from the Bellarine Peninsula to the South Australia border, as well as Ballarat and the surrounding area), south eastern South Australia and central South Australia and does not actively seek suppliers, including for milk swap arrangements, outside these regions.¹⁴⁰

155. Murray Goulburn also refers to the fact that significant volumes of raw milk are swapped across and within the dairying localities in Victoria and the Riverina region.¹⁴¹ To the extent that milk swaps provide a farmer in one region with the ability to contract to supply a processor in a different region, this would tend to support a broader geographic market definition. However, the choice that milk swaps provide to farmers is likely to be limited by factors such as the need for an appropriate processor who is willing to be a counterparty to the swap. Based on the volume of milk acquired by Murray Goulburn across Australia during the 2013 financial year¹⁴² and the volumes it estimates it will swap with other dairy

¹³⁴ See Statement of Mark McDonald, paragraph 22.

¹³⁵ Statement of Mark McDonald, statement, Annexure MM06.

¹³⁶ Expert report of Christopher Pleatsikas, paragraph 127.

¹³⁷ Form S, paragraph 183(e).

¹³⁸ Form S, paragraph 205.

¹³⁹ Form S, paragraph 183(c).

¹⁴⁰ WCB submission to the Tribunal, 18 December 2013, paragraph 96.

¹⁴¹ Form S, paragraph 183(d).

¹⁴² Statement of Robert Poole, paragraph 112.

[REDACTED]

processors during the 2014 financial year,¹⁴³ MG appears to swap around [REDACTED] of the milk it acquires.

156. Accordingly, there may be narrower geographic markets for the acquisition of raw milk based on the location of processor facilities and the farming regions that supply them, such as:
- a. south west Victoria (stretching from Bellarine Peninsula to the South Australian border, as well as in Ballarat and the surrounding area);
 - b. south east South Australia (including Mt Gambier); and
 - c. central South Australia (including Murray Bridge, Meningie and the Fleurieu Peninsula).

Product dimension

157. The ACCC understands Murray Goulburn's position to be that there is a single product market in which raw milk is acquired, regardless of whether the raw milk is acquired for use in fresh milk products or bulk milk products.
158. The ACCC agrees that there is likely to be a single product market regardless of the use for which the raw milk is acquired. However, differences in the uses for which raw milk is acquired may be relevant to the closeness of competition between different processors (see further Issue 13 below). In particular, the price structure offered by different dairy companies is affected by the products a company produces and the customers it supplies, such as whether it predominantly supplies fresh milk products (like Parmalat and Lion) or whether its business is export-focussed (like WCB and Burra Foods).¹⁴⁴ See further paragraph 231 below.

¹⁴³ Statement of Robert Poole, paragraph 156.

¹⁴⁴ Murray Goulburn, Further response to ACCC Information Request, 15 December 2013, paragraph 137.

Issues for further consideration

36. What is the average distance within which the majority of raw milk processed by a processing facility is acquired from farmers?
37. Does this distance vary significantly between processors, facilities or regions?
38. To what extent does the practice of 'milk swaps' provide a dairy farmer in one region with the option to supply to a milk processor located in another region?
39. To what extent do dairy processors currently transport raw milk between their own facilities? Would this be likely to increase in the event of a SSNDP in the price of milk in a particular region?
40. In the event of a SSNDP by a milk processor in a particular region, what factors (such as transport costs) may limit the ability of a farmer to supply raw milk to a processor with facilities located in a different region?
41. Having regard to those factors, would it be feasible for a farmer to switch supply to a processor located in another region in the event of a SSNDP?
42. Prior to the introduction of its Milk Payment System, did Murray Goulburn pay different prices for raw milk in different regions of Victoria?
43. What were the reasons for the introduction of the Milk Payment System?
44. Do other processors who acquire raw milk in different regions of Victoria, such as Fonterra and Bega, pay different prices for raw milk in those different regions?
45. Is there any evidence that Murray Goulburn responds to these different prices?

See discussion above under Issue 10(a) regarding the meaning of 'SSNDP'.

Issue 10(b): Is the market or markets in which dairy processors acquire raw milk from farmers distinct from the market or markets in which dairy processors supply bulk raw milk to food manufacturers? If so, what is the geographic scope of the market or markets for supply of bulk raw milk to dairy product manufacturers?

Functional dimension

159. Murray Goulburn submits that there is a single market for the production and supply of raw milk by dairy farmers, dairy processors and milk brokers to dairy processors, milk brokers and other industrial customers such as food manufacturers.¹⁴⁵

¹⁴⁵ Form S, paragraph 184.

- [REDACTED]
160. The Pleatsikas report further explains that this market includes both the function of acquiring raw milk and the function of supplying raw milk and that there is no economic rationale that would justify separating these two functions into separate markets.¹⁴⁶
161. The ACCC's view is that it may be appropriate to define separate functional markets for:
- a. the acquisition of raw milk from farmers; and
 - b. the supply of bulk raw milk by milk processors and brokers to downstream dairy manufacturers.
162. The ACCC understands that bulk raw milk is supplied to downstream dairy manufacturers in unprocessed form, typically in tankers.¹⁴⁷ [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
- [REDACTED]
163. There are a number of factors which may limit the ability of downstream dairy manufacturers to acquire raw milk directly from farmers. For example:
- a. the difficulty of coordinating the collection of milk, including managing relationships with farmers;
 - b. the costs of investing in a transport fleet including prime movers and tankers, plus milk-testing equipment; and
 - c. difficulty in managing the seasonal supply of milk.
164. A downstream dairy manufacturer's acquisition of raw milk would therefore need to be on a sufficient scale to make it less costly than purchasing raw milk from a processor. This scale is likely to be a particular barrier for smaller manufacturers, but may also limit the ability of larger food processors to engage in the direct acquisition of milk.
165. To the extent that it is not feasible for downstream dairy manufacturers to collect milk directly from farmers, they would have to acquire raw milk from processors such as Murray Goulburn, Fonterra, Parmalat and Lion, or from a milk broker. In this sense, the ACCC considers that the economic activity of farmers when supplying raw milk to processors may be regarded as functionally distinct from the economic activity of processors when supplying bulk raw milk to downstream dairy manufacturers, and that this may therefore constitute a different functional level of a supply chain, and therefore a distinct market for the purposes of competition analysis.

¹⁴⁶ Expert report of Christopher Pleatsikas, paragraph 115.

¹⁴⁷ Statement of Maldwyn Benniston, paragraph 41.

¹⁴⁸ Form S, paragraph 168.

Geographic dimension

166. Since it is Murray Goulburn's submission that the market for the supply of bulk raw milk is the same market as that for the acquisition of bulk raw milk, it therefore submits that the geographic dimension of the market in which raw milk is supplied to downstream dairy manufacturers comprises the South East Region.¹⁴⁹
167. The perishable nature of raw milk and the transportation costs relative to the value of the product may indicate that the geographic dimension of this market may be confined to a narrower region such as western Victoria and eastern South Australia.

Issues for further consideration

46. Is there a significant class of manufacturers who currently manufacture dairy products but do not acquire raw milk directly from farmers?
47. In the event of a SSNIP, would it be feasible for these downstream dairy manufacturers to commence acquiring raw milk directly from farmers?

Issue 10(c): Is there a single market for the supply of processed and semi-processed dairy products that is at least state wide, and is probably national? Or are there separate markets, predominantly national, for the manufacture and supply or wholesale supply of each of the following products: pasteurised milk, flavoured milk, powdered milk products, bulk cream, packaged cream, packaged and bulk cheese, packaged and bulk butter and whey products? If there are separate markets, what is their geographic dimension?

Overview – product dimension

168. Murray Goulburn submits that there is a market, or markets, for the supply of processed and semi-processed dairy products that is at least state wide, and is probably national, because:
- a. there is substantial supply-side substitutability between all processed and semi-processed milk products; and
 - b. in response to a SSNIP in any particular processed or semi-processed dairy product (apart from perhaps very high margin products such as nutritional products or lactoferrins), existing dairy producers, or at least a relevant proportion of their volume, would likely be able to shift sufficient production in a relatively short period of time to the product whose price was increased so that the price increase would be unprofitable.¹⁵⁰
169. The ACCC understands that while there is significant process commonality at this initial stage of the production process – including collecting raw milk from farmers, testing raw milk for harmful organisms and pasteurising the raw milk

¹⁴⁹ Form S, paragraph 183.

¹⁵⁰ Form S, paragraph 189.

through heat treatment to remove pathogens¹⁵¹ – different equipment is still required to produce different products such as butter, cheese and milk powder.

170. The ACCC understands that most bulk milk processors have capacity to produce the key bulk milk products (e.g. butter, cheese and milk powder) and most fresh milk processors have the capacity to produce the relevant fresh milk products (e.g. drinking milk, flavoured milk and yoghurt).¹⁵² However, it does not appear that bulk processors all have the relevant equipment to produce the full range of bulk products at each of their plants.¹⁵³
171. If a dairy processing plant has been built to produce certain types of dairy products, it is difficult to transform the production capabilities of that plant to produce other types of dairy products.¹⁵⁴ Therefore the ACCC considers that supply side substitutability between products will be limited by the extent to which other processors have the necessary equipment and spare production capacity to respond quickly to changes in the relative price of particular product.
172. WCB submits that there is unlikely to be sufficient supply side substitutability to lead to the identification of a unified market for the supply of processed and semi-processed dairy products.¹⁵⁵
173. Murray Goulburn also submits that there is a degree of demand-side substitutability between processed and semi-processed dairy products, providing the following examples in support of that contention:
- a. Ice cream producers consider milk powders, especially full cream milk powder, to be a substitute for bulk cream when making ice cream products;
 - b. Some consumers may consider UHT milk to be a substitute for daily pasteurised milk; and
 - c. Some industrial customers may consider milk powders to be a substitute for bulk processed milk.¹⁵⁶
174. The ACCC does not consider that there is any significant degree of demand side substitutability between dairy products such as milk, butter, cheese and cream. While there may be some limited substitutability at the margins, for the majority of customers, different dairy products are not closely substitutable.

¹⁵¹ Form S, paragraph 190(a).

¹⁵² Statement of Keith Mentiplay, paragraph 57.

¹⁵³ Statement of Keith Mentiplay, paragraphs 59-81.

¹⁵⁴ Statement of Keith Mentiplay, paragraph 89.

¹⁵⁵ WCB submission to the Tribunal, 18 December 2013, paragraph 100.

¹⁵⁶ Form S, paragraph 188.



Separate product markets

175. In the alternative, Murray Goulburn submits that there are the following downstream product markets in which the activities of Murray Goulburn and WCB overlap:
- a. the market for the manufacture and wholesale supply of pasteurised milk in Victoria;
 - b. the market for the manufacture and wholesale supply of flavoured milk in at least Victoria, and probably nationally;
 - c. the national market for the manufacture and wholesale supply of powdered milk products;
 - d. the market for the manufacture and supply of bulk cream in Victoria and South Australia;
 - e. the national market for the manufacture and wholesale supply of packaged cream;
 - f. the national market for the manufacture and wholesale supply of packaged and bulk cheese;
 - g. the national market for the manufacture and wholesale supply of for the supply of packaged and bulk butter; and
 - h. the national market for the manufacture and wholesale supply of whey products.¹⁵⁷

Market for the supply of pasteurised milk

176. Murray Goulburn submits that, if there is not a single product market for processed and semi-processed dairy products, there is a market for the manufacture and wholesale supply of pasteurised milk in Victoria.¹⁵⁸
177. The ACCC considers that this is an appropriate market definition.
178. The ACCC considers that there may also be a separate market for the supply of bulk processed milk. However, Murray Goulburn submits that WCB does not currently supply bulk processed milk to customers located in Australia.¹⁵⁹ Accordingly, the ACCC does not propose to further address this potential market in this Issues Paper.

¹⁵⁷ Form S, paragraph 173.

¹⁵⁸ Form S, paragraph 173.

¹⁵⁹ Form S, paragraph [153].



Market for the supply of flavoured milk

179. Murray Goulburn submits that, if there is not a single product market for processed and semi-processed dairy products, there is a market for the manufacture and wholesale supply of flavoured milk in at least Victoria, and probably nationally.¹⁶⁰
180. The ACCC considers that this is an appropriate market definition, although the ACCC considers the geographic dimension may be Victoria rather than national given that flavoured milk is more perishable than products such as cheese, butter and milk powder.

Market for the supply of powdered milk

181. Murray Goulburn submits that, if there is not a single product market for processed and semi-processed dairy products, there is a national market for the manufacture and wholesale supply of powdered milk products.¹⁶¹
182. The ACCC considers that this is an appropriate market definition.
183. The ACCC understands that milk powder has a significantly longer shelf life than products such as fresh milk and cream, enabling it to be transported across state borders, stored and readily imported and exported.

Market for the supply of bulk cream

184. Murray Goulburn submits that, if there is not a single product market for processed and semi-processed dairy products, there is a separate product market for the manufacture and wholesale supply of bulk cream in Victoria and South Australia.¹⁶²

185. The ACCC considers that this is an appropriate market definition, noting that bulk cream is a perishable product¹⁶³ and 
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Market for the supply of packaged cream

186. Murray Goulburn submits that, if there is not a single product market for processed and semi-processed dairy products, there is a national market for the manufacture and wholesale supply of packaged cream.¹⁶⁵
187. The ACCC considers that this is an appropriate market definition.

¹⁶⁰ Form S, paragraph 173.

¹⁶¹ Form S, paragraph 173.

¹⁶² Form S, paragraph 173.

¹⁶³ Statement of Maldwyn Benniston, paragraph 41.

¹⁶⁴ Statement of Maldwyn Benniston, paragraph 58.

¹⁶⁵ Form S, paragraph 173.

188. Murray Goulburn states that because fresh cream has a shelf life of 12-14 days and requires refrigeration, it is not suitable for transportation over long distances.¹⁶⁶ The ACCC understands this to mean that fresh cream is not suitable for international transport, but can be (and is) transported nationally.

Market for the supply of packaged and bulk cheese

189. Murray Goulburn submits that, if there is not a single product market for processed and semi-processed dairy products, there is a separate national market for manufacture and wholesale supply of packaged and bulk cheese.¹⁶⁷
190. There are many different types of cheese manufactured and sold in Australia. However, the ACCC understands that the primary area in which Murray Goulburn and WCB overlap is in the manufacture and supply of standard cheddar or 'everyday cheese' (as opposed to speciality cheese). Accordingly, given the purposive nature of market definition, the ACCC considers that standard cheddar is the relevant product market to consider. The ACCC does not believe that this is inconsistent with Murray Goulburn's position.
191. The ACCC understands that cheese can be transported across state borders, stored and readily imported and exported. Accordingly, the ACCC considers that the geographic dimension for the wholesale supply of cheese is likely to be national.
192. The ACCC understands that:
- a. cheese supplied to wholesale customers in packaged form is supplied in a retail pack that is suitable for distribution through retail outlets such as supermarkets and delis to consumers;
 - b. bulk cheese is supplied in a form that is not suitable for consumers due to its size (e.g. 20kg blocks)¹⁶⁸ and is either:
 - i. used as an ingredient by food manufacturers and food service industry; or
 - ii. delivered to customers who 'cut and wrap' the cheese for subsequent sale under their own brands.
193. Demand-side substitutability between packaged and bulk cheese may be limited as a retailer is unlikely to switch from acquiring packaged cheese products to acquiring bulk cheese in response to a SSNIP. Similarly, food manufacturers, food service customers and 'cut and wrap' firms are unlikely to switch to acquiring packaged cheese products (as the cost per kilogram would presumably be substantially higher). On the supply-side, the ACCC understands that each of the dairy producers in the market, including the merger parties, have some internal 'cut and wrap' capability and are therefore able to produce packaged as well as bulk cheese. A potential impediment to a dairy processor expanding their supply of packaged cheese is having a recognised brand to attract final customers. On the other hand, dairy processors producing packaged cheese are likely to be able to readily switch to supplying bulk cheese, if they

¹⁶⁶ Statement of Peter Scott, paragraph 153.

¹⁶⁷ Form S, paragraph 173.

¹⁶⁸ WCB submission to the Tribunal, 18 December 2013, paragraph 16.

have the capacity available to do so. A 'cut and wrap' firm seeking to substitute into cheese manufacturing would face the barriers to entry discussed under Issue 16.

194. The ACCC considers that it may be more appropriate to consider separate markets for bulk and packaged cheese, but recognise that dairy processors producing packaged cheese (excluding firms that merely 'cut and wrap' bulk cheese) are likely to face relatively low barriers to expanding to supply bulk cheese providing they have excess capacity. Given that there appear to be a significant number of suppliers of wholesale packaged cheese, the ACCC's comments will focus on the supply of bulk cheese (where there appears to be greater concentration), noting that reduced competition in the supply of bulk cheese may impact competition downstream in the supply of wholesale packaged cheese.

Market for the supply of packaged and bulk butter

195. Murray Goulburn submits that, if there is not a single product market for processed and semi-processed dairy products, there is a separate national market for the manufacture and wholesale supply of packaged and bulk butter.¹⁶⁹
196. The ACCC considers that this is an appropriate market definition.
197. The ACCC understands that butter has a relatively long shelf life, enabling it to be transported across state borders, stored and readily imported and exported.
198. As with bulk cheese, the ACCC understands that manufacturers of bulk butter may either supply it in bulk form or packaged wholesale form. Similarly to bulk cheese, there are companies that acquire bulk butter and 'cut and wrap' it for domestic or overseas sale under their own brands.

Market for the supply of whey products

199. Murray Goulburn submits that, if there is not a single product market for processed and semi-processed dairy products, there is a national market for the manufacture and wholesale supply of whey products.¹⁷⁰
200. The ACCC considers that this is an appropriate market definition.
201. The ACCC understands that whey products have a relatively long shelf life, enabling them to be transported across state borders, stored and readily imported and exported.

¹⁶⁹ Form S, paragraph 173.

¹⁷⁰ Form S, paragraph 173.

Issues for further consideration

48. What factors (e.g. equipment costs, capacity limitations, relative profit margins) may limit the ability of a manufacturer of one type of dairy product to readily switch to supplying another dairy product, in the event of a SSNIP in the price of the second product?
49. Is the evidence of supply-side substitutability provided by Murray Goulburn (such as process commonality and the range of product-specific equipment that dairy processors already possess) sufficient to conclude that there is a single market for the manufacture and supply of all processed and semi-processed dairy products (excluding high margin ingredients)?
50. To what extent would dairy processors that currently manufacture and supply packaged cheese (such as Fonterra and Bega) be likely to increase their supply of bulk cheese in response to a SSNIP in the price of bulk cheese?
51. How significant are the barriers to dairy processors that currently manufacture and supply packaged cheese expanding their supply of bulk cheese?

Issue 10(d): Is there a separate market, or markets, for the supply of high margin dairy ingredients, such as nutritional products and lactoferrin?

202. Murray Goulburn submits that there may be a separate market (or markets) for the supply of high margin dairy ingredients, such as nutritional products and lactoferrins, due to limited demand-side and supply-side substitutability between these products and other dairy products.¹⁷¹ It submits that the geographic scope of these markets is likely to be global, a part of which is in Australia.¹⁷²
203. The ACCC accepts that it is appropriate to define separate market(s) for these products. It considers that it is appropriate to consider the impact of the proposed acquisition for the supply of these products in Australia, taking into account the effects of exports and imports on market outcomes.
204. WCB submits that defining a single product market for 'high margin dairy ingredients' is too broad and there are likely to be separate product markets for each of lactoferrin and instant formula base powder.¹⁷³

¹⁷¹ Form S, paragraphs 197-198.

¹⁷² Form S, paragraph 199.

¹⁷³ WCB submission to the Tribunal, 18 December 2013, paragraph 101.

Issues for further consideration

52. What is the degree of demand-side and supply-side substitutability between different categories of high margin products?
53. Is it more appropriate to define separate markets for lactoferrin and instant formula base powder (and any other relevant categories of high margin dairy ingredients)?

Issue 10(e): Is there a market or markets for the supply of ancillary services to dairy farmers, such as sales of supplies, equipment and technical advice?

205. Murray Goulburn submits that there may be a separate market or markets for the supply of ancillary services, such as supplies, equipment, technical advice and financial services, to farmers. Murray Goulburn submits that this market or these markets are likely to be regional or state wide, given the existence of Murray Goulburn stores throughout the dairying region in south eastern Australia.¹⁷⁴
206. The ACCC considers that these may be relevant markets for the purposes of assessing the proposed acquisition. Alternatively, it may be more relevant to consider the provision of these services in the context of the market(s) for the acquisition of raw milk.
207. WCB submits that dairy processors generally offer these types of ancillary services to dairy farmers in order to enhance their relationship with their suppliers and to improve on-farm productivity.¹⁷⁵

¹⁷⁴ Form S, paragraph 199.

¹⁷⁵ WCB submission to the Tribunal, 18 December 2013, paragraph 102.

Issues for further consideration

54. Is it appropriate to separately analyse effects on competition in the supply of ancillary services to dairy farmers, or should any such effects be analysed as part of the effects on competition in the acquisition of raw milk?

II The competitive effects of the proposed acquisition

Acquisition of raw milk

208. The ACCC suggests the Tribunal consider whether the proposed acquisition will reduce competitive pressure on Murray Goulburn in the acquisition of raw milk, and what associated effects this may have on efficiency and welfare.
209. In particular, the ACCC suggests the Tribunal consider:
- a. whether the proposed acquisition will give Murray Goulburn the ability and incentive to reduce the prices for raw milk below the competitive level; and
 - b. the potential loss of broader benefits from competition for the acquisition of raw milk.
210. In an effectively competitive acquisition market, the threat of losing suppliers to competitors spurs firms to present high quality offers to their suppliers (in terms of price, service and innovation), to keep pace with supplier preferences, and to keep costs low (so as to be able to pay market prices). If the removal of WCB as an independent alternative for suppliers were to meaningfully reduce this competitive discipline, then the welfare of farmer suppliers may be reduced.
211. In addition to considering the changes in market structure and dynamics that may occur with the proposed acquisition, the ACCC suggests that the Tribunal have regard to whether Murray Goulburn's cooperative structure will provide an adequate substitute for competition in protecting the interests of suppliers (issue 14).


Issue 11: What are the nature and extent of existing rivalry or competition between Murray Goulburn and WCB in the market(s) for the acquisition of raw milk?

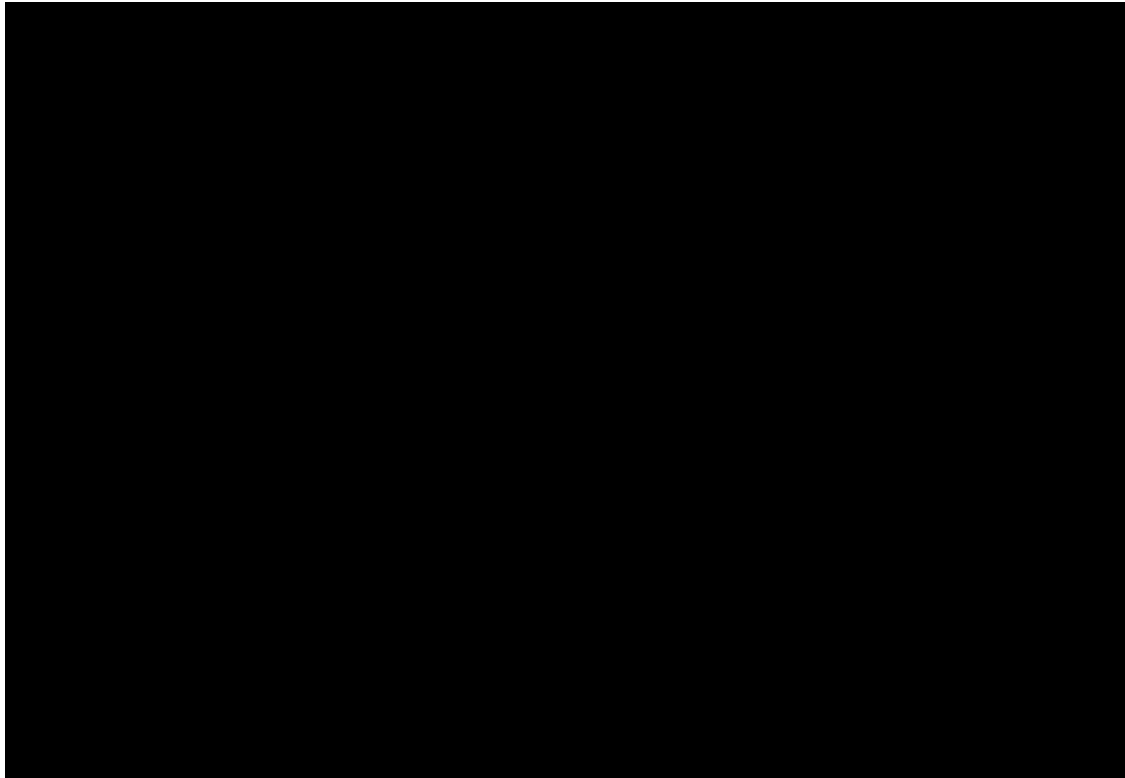
Market concentration


212. Murray Goulburn notes that the proposed acquisition will significantly increase concentration in the acquisition of raw milk in the South East Region.¹⁷⁶

¹⁷⁶ Form S, paragraph 291.



213. Murray Goulburn has provided confidential information as to the volume of raw milk acquired by dairy processors and milk brokers during FY2013.¹⁷⁷ The ACCC has used that information to calculate the following market shares in respect of the geographic regions (as defined by the Murray Goulburn data) in which Murray Goulburn and WCB overlap (excluding the Northern Victoria/Riverina region 



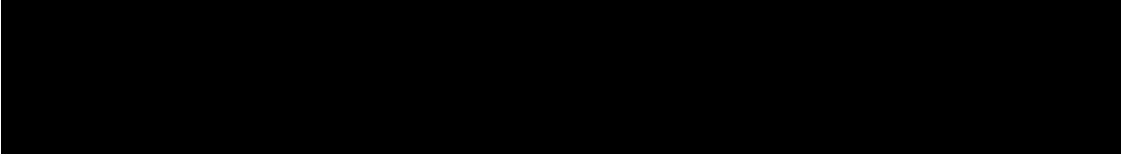
- 214. In light of this market concentration, if the relevant geographic markets are western Victoria and South Australia (or narrower), Murray Goulburn and Warrnambool are particularly close competitors in those markets.
- 215. If the Tribunal concludes that the geographic dimension of the relevant market in which raw milk is acquired is the broader South East Region (as Murray Goulburn contends), the proposed acquisition will still (as Murray Goulburn has noted) significantly increase concentration in this market 
- 216. Further, given factors such as transport costs, processors with factories located close to one another are likely to be closer competitors in the acquisition of raw milk. This means that, even if the relevant market is the South East Region, Murray Goulburn and WCB are likely to be particularly close competitors in that market.

¹⁷⁷ Form S, paragraph 221.

¹⁷⁸ The Dairy Farmers Milk Co-operative was acquired by Lion (then National Foods) in 2008.

See <http://www.dairyfarmers.com.au/our-story/our-history/>


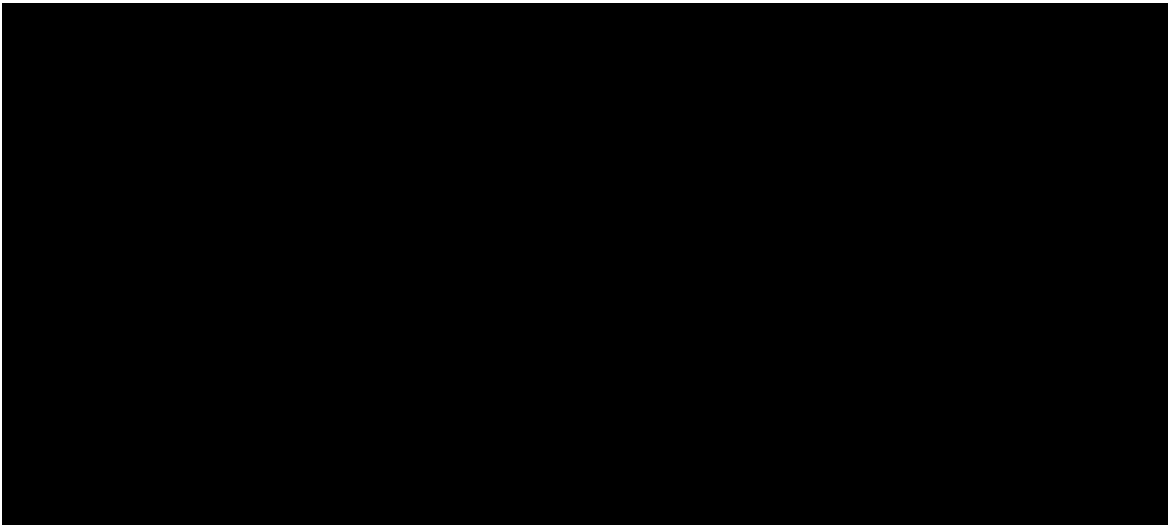
¹⁷⁹ Form S, paragraph 285.



217. WCB submits that:

- a. in south west Victoria, WCB's two largest competitors for the acquisition of raw milk are Murray Goulburn and Fonterra and to a lesser degree, Bega, Lion and UDP;
- b. in south east South Australia, WCB's largest competitors for the acquisition of raw milk is Murray Goulburn and to a lesser degree, Fonterra and UDP; and
- c. in central South Australia, WCB's largest competitors for the acquisition of raw milk are Murray Goulburn, Lion, UDP and Parmalat.¹⁸⁰ However, as noted at paragraph 158, Lion and Parmalat may provide less of a competitive constraint than bulk milk processors.

Switching by farmers

218. Murray Goulburn submits that WCB principally competes for the acquisition of raw milk, but has not specifically addressed the issue of whether WCB should be considered a vigorous and effective competitor in the acquisition of raw milk.¹⁸¹
219. Murray Goulburn submits that the data showing the proportion of additional raw milk that Murray Goulburn obtained from farmers who previously supplied WCB, and the proportion of milk volumes it lost to WCB, over the last three years, indicate that WCB is not Murray Goulburn's closest competitor in the acquisition of raw milk.¹⁸²
220. The ACCC has prepared the following table based on the farmer switching data provided by Murray Goulburn:¹⁸³
- 
- 

¹⁸⁰ WCB submission to the Tribunal, 18 December 2013, paragraph 104.

¹⁸¹ Form S, paragraph 349.

¹⁸² Form S, paragraph 292(c).

¹⁸³ See Statement of Robert Poole, Annexure RAP16.

- [REDACTED]
221. In the ACCC's opinion the relative numbers of farmers switching between Murray Goulburn and other processors supports a view that both WCB and Fonterra are close competitors of Murray Goulburn in the acquisition of raw milk.

Issues for further consideration

55. To what extent does WCB compete vigorously with Murray Goulburn to acquire raw milk, on both price and non-price terms?
56. Is there a significant proportion of farmers for whom Murray Goulburn and WCB are each other's closest competitors in acquiring raw milk?

Issue 12: To what extent do farmers currently benefit from the price and non-price competition between Murray Goulburn, WCB and other competitors to acquire raw milk?

222. Murray Goulburn submits that:
- a. it offers farmer suppliers in its North, West and Gippsland regions the same milk price structure, regardless of where they are located
[REDACTED]
 - b. it principally sets its milk price based on the amount it considers it can return to farmer suppliers, after allowing for a [REDACTED]
[REDACTED] However, it also has regard to competitor milk pricing from time to time. If Murray Goulburn observes that competitors are pricing above its current base milk price, or have "stepped up" their milk price before Murray Goulburn, Murray Goulburn's management may recommend to the Board that it bring forward any planned "step-up", subject to its budget allowing for it;¹⁸⁵

¹⁸⁴ Form S, paragraphs 205-206.

¹⁸⁵ Form S, paragraphs 217-218.

- c. its competitors in the North, West and Gippsland regions offer milk price structures to dairy farmers that are similar to, but not identical to, Murray Goulburn's milk payment system.¹⁸⁶
223. The ACCC notes that Murray Goulburn's Milk Payment System was only introduced in 2013.¹⁸⁷ Because pricing policies can be changed, they are not necessarily a reliable indication of how firms will behave in the future, particularly if market conditions change.
224. WCB submits that it has consistently offered a raw milk price that is equivalent to or higher than the raw milk price offered by Murray Goulburn since 2007.¹⁸⁸
225. To the extent that WCB offers a different payment structure or different non-price benefits from Murray Goulburn, some farmers may value this because it may enable them to receive greater total value for their raw milk. If Murray Goulburn is likely to cease offering this different payment structure or non-price benefits post-acquisition, and no other processor is likely to provide a replacement, then some farmers may be worse off. This potential competitive detriment exists regardless of whether the evidence indicates that Murray Goulburn currently responds to competition from WCB – it is based on the loss of choice for farmers, in circumstances where there are significant barriers to entry and expansion.

Issues for further consideration

57. How does the price paid by WCB for raw milk compare with the price paid by Murray Goulburn and by other competitors in western Victoria and South Australia?
58. How do the non-price benefits provided by WCB to farmers compare with those provided by Murray Goulburn and other competitors?
59. In what respects does WCB's pricing structure vary from Murray Goulburn's? To what extent does this currently benefit farmers?
60. Assuming Murray Goulburn did not maintain WCB's alternate pricing/benefits structure post-acquisition, what effects would this have on farmers? How significant are those effects?

¹⁸⁶ Form S, paragraph 224.

¹⁸⁷ Form S, paragraph 205.

¹⁸⁸ WCB submission to the Tribunal, 18 December 2013, paragraph 105.

[REDACTED]

Issue 13: Will the remaining competitors in the market(s) for the acquisition of raw milk exert a strong competitive constraint on the merged entity?

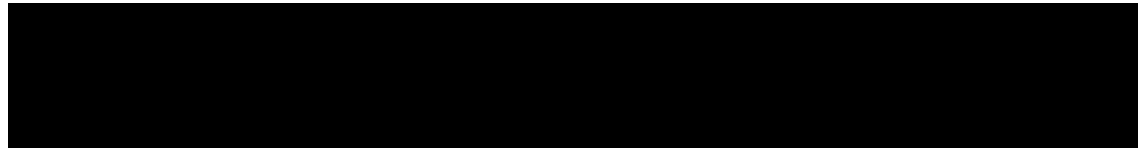
226. Murray Goulburn submits that there will continue to be effective constraints against it exercising monopsony power against dairy farmers when acquiring raw milk, for reasons including:
- a. despite the increase in concentration, there will continue to be a large number of alternative buyers of raw milk, including many with excess processing capacity that should facilitate their ability to profitably increase purchases of raw milk;
 - b. farmer switching data indicates that Fonterra is Murray Goulburn's most significant competitor in the acquisition of raw milk; and
 - c. the presence of dairy brokers such as ACM, and potential entry from new dairy brokers, potentially represents a significant constraint on Murray Goulburn in the acquisition of raw milk from dairy farmers.¹⁸⁹
227. Post-acquisition, the remaining competitors to Murray Goulburn in the South East Region who are of significant size (in terms of volumes acquired) would be Fonterra, Bega, Parmalat, Lion and (to a lesser extent) United Dairy Power (UDP). However, as discussed above (and regardless of the geographic market definition adopted), the extent to which it is viable for farmers to supply each of these processors is likely to vary from region to region.
228. It is important to consider whether competing processors would have the capacity and the incentive to acquire significantly increased volumes of milk in western Victoria and South Australia, in the event that Murray Goulburn sought to impose a SSNDP of raw milk. Murray Goulburn submits that a number of its competitors have excess capacity and are seeking to increase their raw milk acquisition.¹⁹⁰
229. Fonterra has two remaining plants in western Victoria at Dennington and Cobden¹⁹¹ and none in South Australia. Analysis of the farmer switching data provided by Murray Goulburn (see Issue 11 above) indicates that [REDACTED]
[REDACTED]
[REDACTED] However, this does not indicate whether Fonterra would be in a position to significantly increase the volumes of milk it acquires in western Victoria and South Australia in the event of a SSNDP.

¹⁸⁹ Form S, paragraph 292.

¹⁹⁰ Murray Goulburn, Further response to ACCC Information Request, 15 December 2013, paragraphs 58-60.

¹⁹¹ See <http://www.fonterra.com/global/en/About/Our+Locations/Australia/Stanhope>.

Fonterra's plan at Cororooke in western Victoria is due to close next year. See <http://www.standard.net.au/story/1831311/end-near-for-cororooke-dairy-factory/>.



230. Bega commenced acquiring raw milk in south west Victoria in 2010. Its Victorian milk processing plants are located at Coburg and Tatura. It does not have a milk processing plant in south west Victoria. [REDACTED]
231. In relation to potential constraint from Lion and Parmalat, the ACCC understands that:
- a. milk production in Victoria and (to a lesser extent) South Australia is seasonal¹⁹⁴ due to factors such as the cooler climate and lack of irrigation. This may limit the ability of farmers in these regions to supply fresh milk processors such as Lion and Parmalat, who require flatter year-round milk production. To the extent flat milk supply is possible, the ACCC understands it may take several years to alter the calving patterns of the cows to achieve it,¹⁹⁵ and
 - b. to the extent that they do acquire milk in these regions, fresh milk processors such as Lion and Parmalat may be limited in their ability to increase their acquisition of raw milk due to the relatively flat demand for fresh milk products in domestic markets.
232. Analysis of the data on farmers switching away from supplying Murray Goulburn's Koroit plant [REDACTED]

¹⁹² See Statement of Robert Poole, Annexure RAP16.

¹⁹³ Statement of Keith Mentiplay, paragraph 75.

¹⁹⁴ Dairy Australia, 'Australian Dairy Industry in Focus 2013', p34, available at <http://www.dairyaustralia.com.au/~media/Documents/Stats%20and%20markets/In%20Focus/Australian%20Dairy%20Industry%20In%20Focus%202013.pdf>.

¹⁹⁵ The ACCC understands that cows can only be milked in the period after calving, so farmers who supply milk year-round must manage the calving cycles of their cows accordingly.

¹⁹⁶ Statement of Robert Poole, Annexure RAP16.

- [REDACTED]
233. Milk brokers such as UDP acquire milk directly from farmers, and therefore represent at least a potential supply alternative for farmers.
234. Murray Goulburn's application also refers to Australian Consolidated Milk Pty Ltd (ACM) as another milk broker. [REDACTED]
[REDACTED]
[REDACTED]¹⁹⁷ Murray Goulburn states that ACM has to date 'acted as a consolidator and broker of milk for niche players and markets which are not core business for most incumbents'.¹⁹⁸
235. Given the relatively limited market presence of brokers, the degree of constraint they are likely to provide is an issue that warrants further consideration.

Issues for further consideration

61. What level of competitive constraint do processors that acquire raw milk from farmers in the western Victoria region – in particular Fonterra – provide?
62. What level of competitive constraint do processors that acquire raw milk from farmers in South Australia – in particular Lion – provide?
63. If the relevant geographic market is the South East Region, what level of constraint do other processors in the South East region provide?
64. How difficult would it be for farmers that currently supply milk to a bulk milk processor (e.g. Murray Goulburn, WCB or Bega) to switch to supplying a fresh milk processor (e.g. Lion or Parmalat)?
65. Are milk brokers such as UDP and AMC a viable alternative to supplying directly to a milk processor for most farmers?

Issue 14: Does Murray Goulburn's cooperative status impact on the way it is likely to act in the future in the market(s) for the acquisition of raw milk, in particular in relation to prices paid for raw milk? If so, how and to what extent?

236. The ACCC considers the Tribunal should have regard to whether and the extent to which Murray Goulburn's cooperative status might:
- limit the ability and incentive for Murray Goulburn to exercise any increase in monopsony power from the proposed acquisition by reducing the farm gate milk price; and

¹⁹⁷ Form S, paragraph 221.

¹⁹⁸ Murray Goulburn, Further response to ACCC Information Request, 15 December 2013, paragraph 92.

- b. provide a substitute for the discipline of competition in incentivising Murray Goulburn to innovate, keep costs low and meet its suppliers needs over time.

Murray Goulburn's incentive to exercise monopsony power

237. Murray Goulburn submits that its co-operative structure is likely to have a protective influence on the price Murray Goulburn offers to dairy farmer suppliers, particularly given its stated business objective of increasing the farm gate milk price, and the control that farmer suppliers have over Murray Goulburn.¹⁹⁹ Murray Goulburn's application also refers to:
- a. the objects of the company, as set out in its constitution – which includes the acquisition and processing of raw milk from its shareholders,²⁰⁰
 - b. the allocation of shares – including the fact that only dairy farmers who currently supply Murray Goulburn with raw milk may hold ordinary shares and that the Board is obliged as far as practicable to ensure that the ratio between each farmer's ordinary shares and milk volumes in litres) is 1:5,²⁰¹
 - c. the composition of its board of directors – the majority of which are farmer suppliers from across the supply regions,²⁰² and
 - d. the incentives of its senior executives and managing director – which are dependent in part on the farm gate price of raw milk.²⁰³
238. The ACCC considers that a key determinant of whether the cooperative structure eliminates the incentive for Murray Goulburn to exercise any increase in its monopsony power will be the relative preferences of the decision makers and shareholders for company profits compared to higher raw milk prices.
239. In relation to the incentives of the various relevant parties (shareholders, farmer suppliers, directors and senior executives), the ACCC makes the following observations:
- a. Different groups of shareholders are likely to have different preferences for higher dividends compared to milk prices. For example, farmers who have supplied Murray Goulburn for longer may have accumulated higher shareholdings relative to the volume of milk supplied in a season and therefore may benefit from an increase in dividends more than newer suppliers, who are likely to have lower relative shareholdings and therefore would presumably benefit more from an increase in the farm gate price.
 - b. The composition of the Murray Goulburn Board indicates that the directors would be likely to seek to increase the total remuneration paid to suppliers. However, depending on their personal interests and the interests of their constituents (i.e. the suppliers in the region that a director represents), the directors may not necessarily favour an increase in the farm gate price over an increase in dividends.

¹⁹⁹ Form S, paragraph 292(d).

²⁰⁰ Form S, paragraphs 15, 368(c).

²⁰¹ Form S, paragraphs 21-23.

²⁰² Form S, paragraphs 25-29, 409.

²⁰³ Form S, paragraphs 17, 368(c).

- [REDACTED]
- c. The proposed capital restructure may increase the divergence of interests amongst shareholders by increasing the proportion of shareholders who are likely to value dividends over a higher farm gate price. While Murray Goulburn has clearly stated that the capital restructure will not provide non-supplier shareholders with voting rights,²⁰⁴ it may affect decisions by the company as to how profits are returned to members, including the proportion that is returned to suppliers in the form of higher farm gate prices (issue 7).
 - d. A proportion of the remuneration of Murray Goulburn's senior executives depends on meeting the milk price budget (a target farm gate milk price) set by the Board at the beginning of each year.²⁰⁵ While those executives are therefore clearly incentivised to meet the milk price budget, the budget itself may not necessarily be set with the intention of maximising the milk price. Indeed, in determining the budget milk price for the year, a [REDACTED] is first removed from forecast revenues.²⁰⁶ Remuneration and incentives of executives are also subject to change.
 - e. The Managing Director's long term performance incentive is weighted equally between milk price growth and return on capital.²⁰⁷
240. Having regard to these factors it is unclear to the ACCC that Murray Goulburn's cooperative status would necessarily act to eliminate an incentive to increase its profits by reducing milk prices.
241. WCB submits that in assessing Murray Goulburn's incentives to increase the milk price it may be relevant for the Tribunal to consider Murray Goulburn's historical approach to pricing compared to its competitors (none of whom operate in accordance with cooperative principles). WCB's estimates indicate that it paid a farm gate price (per kg of milk solids) equal to or higher than Murray Goulburn's for each of the last seven years.²⁰⁸

²⁰⁴ See Statement of Robert Poole, Annexure RAP61.

²⁰⁵ Form S, paragraph 17(a).

²⁰⁶ Form S, paragraph 211.

²⁰⁷ Form S, paragraph 17(b).

²⁰⁸ WCB submission to the Tribunal, 18 December 2013, paragraph 78.

Issues for further consideration

66. To what extent could Murray Goulburn's members act to prevent it from decreasing farm gate prices?
67. To what extent are Murray Goulburn's suppliers likely to have divergent preferences in terms of higher dividends or higher raw milk prices?
68. To what extent are the Constitution of Murray Goulburn and the remuneration and other incentives of its senior management likely to prevent Murray Goulburn from decreasing farm gate prices?
69. To what extent would the proposed capital restructure affect the arguments made by Murray Goulburn as to the protective function of its cooperative structure?
70. Is there evidence of Murray Goulburn in the past prioritising higher milk prices over profits?
71. Would any protective influence afforded by the cooperative structure be sufficient to outweigh any potential reduction in efficiency (compared to the counterfactual) due to reduced competition for raw milk?

Is a cooperative structure a substitute for competition?

242. Murray Goulburn has not directly addressed the question of whether its cooperative status will be sufficient to spur Murray Goulburn to remain vigilant over costs and responsive to its suppliers' needs, in the absence of competitive pressure from WCB.
243. The ACCC is of the view that competition and the associated threat of losing suppliers to other competitors provide the strongest incentive for firms to deliver good outcomes for their suppliers.
244. The extent to which shareholders are able to monitor the performance of Murray Goulburn's board and executives, particularly with regard to the efficiency of its investments and operations is unclear. The loss of WCB as an independent competitor could act to compound any existing information asymmetries, by removing a competitive benchmark by which Murray Goulburn's performance could be assessed.

Issues for further consideration

72. To what extent does Murray Goulburn's executive remuneration and Board structure provide incentives for it to:
- a. operate the business efficiently;
 - b. undertake efficient new investments; and
 - c. respond to supplier needs?
73. Do farmer suppliers have good visibility of actions taken by the Murray Goulburn Board and Executives that may affect Murray Goulburn's offer to suppliers?
74. Would the loss of WBC as an independent competitor make it more difficult for Murray Goulburn's suppliers to assess whether they were receive a good (price and non-price) offer from Murray Goulburn?

Issue 15: Will the removal of WCB from the market(s) for the acquisition of raw milk increase the likelihood of coordinated effects in the market(s) for the acquisition of raw milk?

245. Murray Goulburn submits that:
- a. the proposed acquisition would not materially increase any potential for coordinated conduct in the acquisition of raw milk, due to the existence of many competitors apart from the merger parties;²⁰⁹ and
 - b. the significant efficiencies likely to be generated by the proposed acquisition may reduce or completely offset any incentive for the merged firm to raise downstream prices.²¹⁰
246. In its 'Further response to ACCC Information Request', Murray Goulburn sets out a framework for assessing the likelihood of a merger giving rise to coordinated effects and how that framework applies to the proposed acquisition.²¹¹
247. Coordinated conduct can occur in a range of forms, from muted competition through to tacit or explicit agreement between firms not to compete. Although firms may have the ability to engage in effective competition, they may not have the incentive if they recognise that any short-term benefits from competing will likely be eroded by lost sales once other firms respond. A merger may increase the risk of coordinated conduct if it increases the interdependence between firms in a concentrated market.

²⁰⁹ Form S, paragraph 369.

²¹⁰ Form S, paragraph 370.

²¹¹ Murray Goulburn, Further response to ACCC Information Request, 15 December 2013, paragraph 131 onwards.

248. The ACCC considers that, generally, the markets for the acquisition of raw milk exhibit some of the features which make markets more conducive to coordinated conduct, including:
- a. market concentration: post-acquisition there will be a small number of firms in each of the acquisition markets and barriers to entry are high (see Issue 16). By contrast, Murray Goulburn submits that it competes with a number of major dairy manufacturers in the South East Region.²¹² This appears to be due to the broader geographic market that Murray Goulburn contends.
 - b. the fact that raw milk is mostly a homogenous product: Murray Goulburn notes that while raw milk is ostensibly homogenous, processors may offer varied prices depending on the quality of milk acquired and the time at which it is acquired;²¹³
 - c. transparency in pricing: Although relatively complex due to the multiple components affecting the end price, the ACCC understands that milk prices paid by processors (by reference to benchmark butter fat and protein levels) are transparent due to publication in the Weekly Times and Dairy Australia, and due to milk swaps. Murray Goulburn submits that the pricing structures of Parmalat, UDP and Lion are private;²¹⁴ and
 - d. repeated interaction: processors interact on an ongoing basis by setting opening prices and subsequent step-ups throughout the annual milk season. The processors also interact with each other through milk swaps.
249. The ACCC also notes that there is some indication of a history of coordinated effects between Murray Goulburn and Fonterra. Murray Goulburn submits that Fonterra has an agreement with its suppliers, through the Bonlac Supply Company, to pay a guaranteed minimum price that is not less than that paid by the volume leading Victorian milk processor – which is Murray Goulburn.²¹⁵
250. The risk of coordinated conduct will be lower if there remains in the market a firm which is incentivised to compete vigorously and disrupt any attempt by the other firms at coordination.
251. Without the proposed acquisition, Fonterra faces the incentive to compete with WCB, so that it can attract and retain suppliers. Post-acquisition, without the competitive tension offered by WCB, Fonterra's only incentive would be to set its prices at the minimum level necessary to fulfil its commitment to at least match Murray Goulburn's price. Further, if Murray Goulburn is aware that Fonterra will simply match its price, the absence of an additional close competitor means that it has less incentive to offer farmers attractive prices. In this way, the absence of WCB could make Fonterra's coordination with Murray Goulburn easier, more complete, and more sustainable.

²¹² Murray Goulburn, Further response to ACCC Information Request, 15 December 2013, paragraph 132.

²¹³ Murray Goulburn, Further response to ACCC Information Request, 15 December 2013, paragraph 70.

²¹⁴ Murray Goulburn, Further response to ACCC Information Request, 15 December 2013, paragraph 134.

²¹⁵ Statement of Robert Poole, paragraph 237.

252. Other processors such as Lion, UDP and Bega have less potential to disrupt any coordinated conduct, due to the significantly smaller volumes of raw milk they acquire in western Victoria and South Australia. As noted under Issue 16 below, these processors may face barriers to expanding in these areas in a timely manner.

Issues for further consideration

75. Taking into account the factors referred to by Murray Goulburn and the ACCC as outlined above (plus any relevant third party submissions), would the proposed acquisition lead to a significant increase in the risk of coordinated conduct in the acquisition of raw milk?

Issue 16: What are the nature and extent of barriers to entry and expansion in the market(s) for the acquisition of raw milk?

253. Murray Goulburn submits that the following factors contribute to the existence of barriers to entry or expansion for a potential new dairy manufacturer:
- a. access to raw milk;
 - b. investment costs associated with construction of a new dairy processing plant; and
 - c. substantial lead times associated with construction of a new dairy processing plant.²¹⁶
254. Murray Goulburn also refers to lack of brand loyalty on the part of customers, and growing sales of private label products, as relevant factors.²¹⁷ It has also made further submissions in relation to barriers to entry in its response to an information request.²¹⁸
255. The ACCC considers that barriers to entry for establishment of a new dairy processing factory are likely to be high.

²¹⁶ Form S, paragraph 343.

²¹⁷ Form S, paragraphs 344-345.

²¹⁸ Murray Goulburn, Further response to ACCC Information Request, 15 December 2013, section 5.

256. In addition to the factors referred to by Murray Goulburn, the volume of raw milk that needs to be acquired to justify an investment in a dairy processing facility represents a significant barrier to entry. A potential new entrant milk processor would presumably have to attract a critical mass of suppliers from established reputable firms whose costs are largely sunk, while maintaining a raw milk price that allows it to compete in the downstream market for the supply of dairy products.
257. Barriers to expansion are likely to be significantly lower than barriers to new entry, but still considerable.
258. Murray Goulburn submits that, due to lower sunk costs, there may be potential for entry by new milk brokers.²¹⁹

Issues for further consideration

76. Is it likely that a new milk broker would enter, or an existing milk broker would expand, the acquisition of raw milk in South Australia and western Victoria?
77. Is such entry or expansion likely to be timely and on a scale sufficient to constrain Murray Goulburn?

Issue 17: Is the proposed acquisition likely to have the effect of lessening competition in the market(s) for the acquisition of raw milk?

259. Murray Goulburn submits that the proposed acquisition of WCB by Murray Goulburn will not generate any meaningful lessening of competition in the market for the acquisition of raw milk, and will be efficiency enhancing relative to the counterfactual scenarios.²²⁰
260. The ACCC considers that, in light of the issues referred to under Issues 11 to 16 above, there is potential for the proposed acquisition to have the effect of lessening competition in the acquisition of raw milk. While the proposed acquisition is more likely to have this effect if the relevant acquisition markets are more limited in their geographic scope, the proposed acquisition could also raise competition issues in a broader geographic market, such as the South East Region which Murray Goulburn contends.
261. It is unclear whether Murray Goulburn's cooperative status would act to eliminate any incentive by Murray Goulburn to increase its profits by reducing milk prices. Even if the Tribunal were to be satisfied that the cooperative nature of the company means that Murray Goulburn is not likely to decrease farm gate prices in order to increase profits, the ACCC considers there may be broader competitive detriments in terms of reduced pressure on Murray Goulburn to provide an innovative, high quality offer to attract suppliers, and to keep costs low.

²¹⁹ Form S, paragraph 292(b).

²²⁰ Form S, paragraph 275.

Supply of bulk raw milk

262. The ACCC suggests that the Tribunal consider whether the proposed acquisition will allow Murray Goulburn to exercise market power in the supply of bulk raw milk, particularly to downstream dairy manufacturers in western Victoria and eastern South Australia. This section outlines some issues that may be relevant to the Tribunal's consideration of these issues. The ACCC notes that Murray Goulburn does not accept that there is a separate market for the supply of bulk raw milk.

Issue 18: What are the nature and extent of existing rivalry or competition between Murray Goulburn and WCB in the market(s) in which they supply bulk raw milk to food manufacturers?

263. Murray Goulburn has not commented on competition in this market.
264. If the geographic dimension of this market is limited to a narrower region, such as western Victorian and eastern South Australia, the number of significant suppliers of raw milk would likely be significantly fewer, based on the volumes of raw milk acquired by processors in that region (see the market share table provided under Issue 11, above). In this narrower market, WCB is likely to be a significant competitor.
265. Even if the geographic dimension is broader, it is unclear to what extent there would be additional significant suppliers of bulk raw milk other than Murray Goulburn and WCB.

Issues for further consideration

78. Which dairy processors are the major suppliers of raw milk to downstream dairy manufacturers in Victoria and South Australia?
79. Is there any indication that Murray Goulburn and WCB are, or have been in the last few years, close competitors in the supply of raw milk to downstream dairy manufacturers?

Issue 19: Will the remaining competitors in the market(s) for the supply of raw milk to food manufacturers place a strong competitive constraint on the merged entity?

266. Murray Goulburn has not provided market shares for the supply of raw milk to downstream dairy manufacturers.
267. Aside from the merger parties, the other major acquirer of raw milk is Fonterra in western Victoria and Lion in South Australia. The extent to which these processors would constrain Murray Goulburn in the supply of bulk raw milk to downstream dairy manufacturers depends in part on whether it would be more profitable for them to use that milk in their downstream operations (and in Lion's case, whether its fresh milk operations would limit its ability to supply raw milk).

268. Bega only acquires small volumes of milk in these regions and may be more likely to use those volumes for its own downstream production. Parmalat is also a small acquirer in this region and may be less likely to compete in this market due to its fresh milk focus. UDP may be an actual or potential competitor in the supply of bulk raw milk.
269. In addition to these direct competitors, the merged entity may also be constrained in its ability to increase prices for the supply of bulk raw milk by competition in the markets for processed dairy product in which its customers compete. In particular, if there is strong competition in downstream markets, Murray Goulburn may not have an incentive to significantly increase the price of bulk raw milk because the loss of sales by its customers would render such a price rise unprofitable.

Issues for further consideration

80. What are the market shares in the market in which Murray Goulburn and WCB supply raw milk to downstream dairy manufacturers?
81. If, post-acquisition, Murray Goulburn sought to increase the price of raw milk supplied to downstream dairy manufacturers, what alternatives would those customers have?

Issue 20: What is the extent of countervailing power on the part of food manufacturers that acquire bulk raw milk?

270. As discussed under Issue 10(b) above, downstream dairy manufacturers may be unable to credibly threaten to bypass dairy processors and begin acquiring raw milk directly from farmers.

Issue 21: To what extent can customers of bulk raw milk in central and south east South Australia, and south west Victoria economically acquire milk from outside these regions? Is the proposed acquisition likely to have the effect of lessening competition in the market(s) in which the merger parties supply bulk raw milk?

271. As part of Murray Goulburn's submission that the relevant geographic market for the supply and acquisition of raw milk is the South East Region, it refers to the fact that significant volumes of raw milk are transported between the various dairying localities throughout this region by Murray Goulburn and its competitors.²²¹

²²¹ Form S, paragraph 183.

272. The ACCC considers that transport costs and the relatively low value of raw milk may limit the viability of bulk raw milk customers in eastern South Australia and western Victoria acquiring raw milk from outside these regions.

Issues for further consideration

82. What is the average distance, and maximum distance, over which bulk raw milk is supplied by Murray Goulburn and WCB to downstream dairy manufacturers?
83. Given transport costs, in the event of a SSNIP, could downstream dairy manufacturers in central and south east South Australia and south west Victoria feasibly acquire raw milk from outside these regions?
84. Having regard to the matters considered under issues 18-21, what impact is the loss of competition between Murray Goulburn and WCB in the supply of bulk raw milk likely to have on these customers?

Bulk cream

273. The ACCC suggests that the Tribunal consider whether the proposed acquisition will allow Murray Goulburn to exercise market power in the supply of bulk cream in Victoria and South Australia. This section outlines some issues that may be relevant to the Tribunal's consideration of these issues.

Issue 22: What are the nature and extent of existing competition between Murray Goulburn and WCB in the market(s) for the supply of bulk cream, particularly in Victoria and South Australia?

274. Murray Goulburn submits that there is no evidence that WCB could be described as a 'vigorous and effective competitor' in the supply of downstream dairy products,²²² but has not specifically addressed the extent of competition between Murray Goulburn and WCB in the supply of bulk cream.
275. Murray Goulburn and WCB may be close competitors in the supply of bulk cream in Victoria (particularly the western region) and South Australia, due to:
- a. the location of their factories, as bulk cream is perishable and therefore may deteriorate if transported over long distances; and
 - b. the fact that WCB as a bulk milk processor may have greater volumes of bulk cream available for supply, at least during off-peak seasons.

²²² Form S, paragraph 349.




Issues for further consideration

85. Is there any indication that Murray Goulburn and WCB are, or have been in the last few years, close competitors in the supply of bulk cream in Victoria and South Australia?
86. Are there customers of bulk cream for whom Murray Goulburn and WCB are the only realistic supply options?


Issue 23: To what extent would the merged entity have the ability to raise the price of bulk cream to customers in Victoria and South Australia?

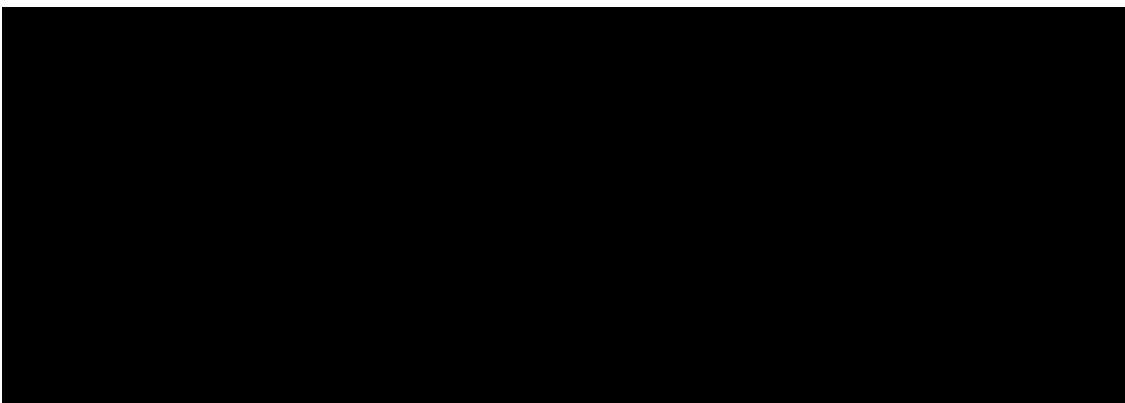
276. Murray Goulburn submits that:

- a. supply of bulk cream is fluid and varies significantly, depending on factors such as:
 - i. prices and production volumes for skim milk and its derivative products, as well as the prices for products that can be derived from cream, such as butter;
 - ii. international prices for butter and anhydrous milk fat (AMF), both of which are produced from cream²²³; and
- b. the market is competitive, 



²²⁴

277. Murray Goulburn has provided the following information in relation to market shares in the supply of bulk cream: 



²²³ Statement of Maldwyn Benniston, paragraph 54.

²²⁴ Statement of Maldwyn Benniston, paragraphs 51-53.


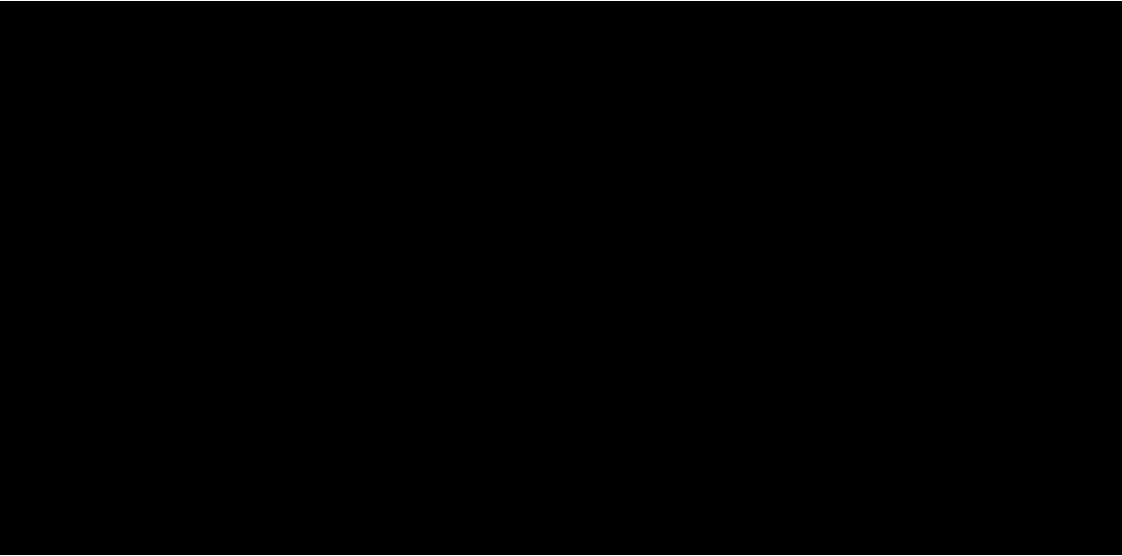
²²⁵ Form S, paragraph 243.

²²⁶ Form S, paragraph 152.

²²⁷ Form S, paragraph 152.

²²⁸ Form S, paragraph 275.

²²⁹ Form S, paragraph 243. The ACCC understands that this figure may be an error. See Statement of Maldwyn Benniston, paragraph 51.

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278. Murray Goulburn does not appear to have provided bulk cream market shares for the Victorian/South Australian market only (which is the relevant geographic dimension submitted by Murray Goulburn).
279. In relation to the ability of other bulk milk processors to constrain Murray Goulburn in the supply of bulk cream in Victoria and South Australia:
- a. Fonterra may provide a significant constraint, depending on its capacity to supply, in Victoria and South Australia and how much of that capacity it requires for downstream production and other ongoing commitments;
 - b. manufacturers and suppliers of wholesale packaged cream, such as Lion and Parmalat, may not be in a position to consistently supply cream into the bulk market if they do not have significant quantities of excess cream. They may be more likely to utilise the cream they produce for their own branded and private label downstream products, including yoghurt and dairy desserts;
 - c. milk brokers may facilitate the supply of excess bulk cream from processors to downstream dairy manufacturers, but may be limited in their ability to supply bulk cream, at least to the extent that they do not own their own manufacturing facilities.
280. As for the supply of bulk raw milk, the indirect constraint provided by downstream competition for processed dairy products (at least those made from bulk cream), may also be a relevant consideration.



Issues for further consideration

87. What are the market shares in the supply of bulk cream in Victoria and South Australia over the last 5 years (given the potential fluctuations in supply)?

Issue 24: Is the proposed acquisition likely to have the effect of lessening competition in the market(s) in which the merger parties supply bulk cream?

281. Please refer to the comments in relation to Issue 23.

Issues for further consideration

88. What types of customers currently acquire bulk cream from Murray Goulburn and WCB?
89. What impact is the loss of competition between Murray Goulburn and WCB in the supply of bulk cream likely to have on these customers?

Other products

282. Murray Goulburn submits that there is no evidence that WCB could be described as a 'vigorous and effective competitor' in the supply of downstream dairy products.²³⁰
283. It appears that the proposed acquisition will meaningfully increase Murray Goulburn's presence in the supply of cheese, butter and whey products. The ACCC suggests the Tribunal consider whether the proposed acquisition will give Murray Goulburn the ability to increase price or decrease quality for these products. This section outlines some issues that may be relevant to the Tribunal's consideration of these matters.
284. Based on Murray Goulburn's application, the ACCC understands that the aggregation from the proposed acquisition would be minimal for the supply in Australia of processed milk, flavoured milk, milk powder, packaged cream and high margin dairy ingredients.
285. At this stage, the ACCC considers that these products may be less likely to raise competition concerns and therefore does not provide a detailed list of issues in relation to these markets. However, to the extent that concerns are raised in relation to these products or new information comes to light, the ACCC may raise further issues with respect to these products.

²³⁰ Form S, paragraph 349.

[REDACTED]

Issue 25: For all other products, compared with the likely future without the proposed acquisition, is the proposed acquisition likely to lessen competition in the relevant markets? In particular:

a. What are the nature and extent of existing rivalry or competition between Murray Goulburn and WCB in relation to the supply or acquisition of the relevant products?

b. How significant are Murray Goulburn and WCB's competitors likely to be in constraining the merged entity in relation to the supply or acquisition of the relevant products?

c. What are the nature and extent of barriers to entry to, and expansion in, the supply or acquisition of the relevant products?

286. The ACCC addresses below issues 25(a) and (b) under separate headings relating to each of the identified markets. It then addresses issues 25(c) under a single heading below.

Market for the wholesale supply of bulk cheese

Nature and extent of rivalry between Murray Goulburn and WCB

287. Murray Goulburn has provided the following information in relation to volumes of bulk cheese supplied in Australia during FY2013, and the ACCC has calculated market shares accordingly: [REDACTED]

[REDACTED]

²³¹ Form S, paragraph 243.



288. [redacted] It appears that WCB may not have capacity to cut and wrap all of the bulk cheese it produces, and therefore supplies bulk cheese to 'cut and wrap' firms including Lion.²³³

289. Murray Goulburn submits that [redacted]
[redacted]
[redacted]
[redacted]
[redacted]

How significant are Murray Goulburn and WCB's competitors?

290. Fonterra is a large manufacturer of cheese, in Australia and New Zealand. Fonterra announced that it would invest \$6.5 million during 2012 to upgrade cheese making equipment at its Stanhope facility to increase cheese production.²³⁵

291. [redacted]
[redacted]
[redacted]
[redacted]

292. UDP recently acquired two processing plants from Lion in South Australia – at Jervois and Murray Bridge.

293. The ACCC understands that approximately 33% of the cheese manufactured in Australia by bulk cheese manufacturers is exported in bulk form and there are also exports of packaged products. In the event of a price increase, domestic competitors may be able to increase their supply of cheddar in Australia by altering their product mix and redirecting exports to supply domestic customers.

294. The ACCC also understands that manufacturers of dairy products may stockpile their long-life dairy products and release them in the market when there is a better price for them. If this is the case, an increase in price in the domestic market may trigger the release of any stocked cheese products, which may constrain a price rise in the short term.

²³² Form S, paragraph 72(f).

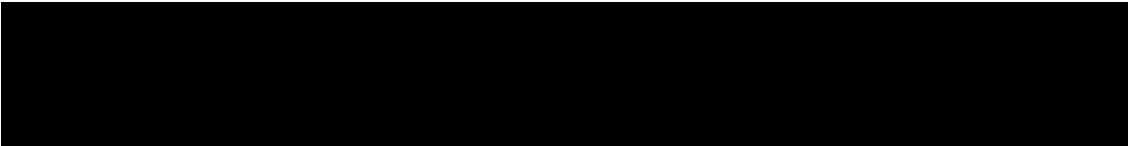
²³³ WCB submission to the Tribunal, 18 December 2013, paragraph 16.

²³⁴ Form S, paragraph 72(f).

²³⁵ <https://www.fonterra.com/au/en/About/Our+Locations/Australia/Stanhope> accessed 4 December 2013.

²³⁶ Form S, paragraph 243.

²³⁷ Statement of Keith Mentiplay, 0022.

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295. Murray Goulburn submits that imports of cheese are significant and increasing. In FY2013 Australia imported over 73,000 tonnes of cheese (about double the amount it imported in 2000), with imports making up about a quarter of Australian cheese consumption.²³⁸ In 2012/13, approximately 60% of the cheese imported into Australia was sourced from New Zealand. The remaining cheese imports came from Europe (over 25%) and the United States (nearly 15%).²³⁹
296. Cheese imported from Europe is generally speciality cheese rather than bulk cheddar.²⁴⁰ The ACCC understands that this may be due in part to tariffs applied to bulk cheddar imported from Europe, which would generally make such imports unviable. The ACCC understands that there is limited consumer acceptance in Australia for US-manufactured cheddar in its natural (as opposed to processed) form due to the different flavour profile.
297. Factors that may limit the ability of wholesale cheese suppliers to import bulk cheese (including from New Zealand) include:
- a. using imported bulk cheese may affect the branding strategy of the firm and the ability of the firm to market and label the cheese as 'Product of Australia' or 'Made in Australia'. However, in the case of processed cheese it may be possible to use imported bulk cheese but still label the finished product as 'Made in Australia', due to the extensive manufacturing process involved in the production of processed cheese;
 - b. freight costs and lead times would need to be considered and managed when importing dairy products; and
 - c. exchange rates are also likely to play a role in the decision whether to import bulk cheese.

²³⁸ Form S, paragraph 299.

²³⁹ Dairy Australia, 'Australian Dairy Industry in Focus 2013', p22, available at <http://www.dairyaustralia.com.au/~media/Documents/Stats%20and%20markets/In%20Focus/Australian%20Dairy%20Industry%20In%20Focus%202013.pdf>

²⁴⁰ Form S, paragraph 307.

Issues for further consideration

The proposed acquisition may potentially raise issues in relation to the supply of bulk cheese, which could have flow-on consequences in the wholesale supply of packaged cheese. While there are many wholesale suppliers of cheese who 'cut and wrap' cheese, the viability of a 'cut and wrap' firm depends on access to bulk cheese at competitive prices.

90. What supply options do bulk cheese customers currently have?
91. In the event of Murray Goulburn significantly increasing the price of bulk cheese, to what extent could those customers:
 - a. increase the quantity of bulk cheese they acquire from other Australian-based suppliers, having regard to issues such as potential capacity constraints faced by other bulk cheese suppliers; or
 - b. increase the quantity of imported bulk cheese they acquire (having regard to issues such as the freight costs, lead times and potential effects on 'Product of Australia' and 'Made in Australia' claims)?

Market for the wholesale supply of butter (bulk and packaged)

298. Based on the volumes of bulk butter supplied in Australia in FY13 (as provided by Murray Goulburn), the combined market share of Murray Goulburn and WCB would be [REDACTED]²⁴¹
299. The ACCC understands that butter, unlike cheese, is a homogenous product that does not differ significantly in its flavour profile, no matter which country it is sourced from. Therefore, depending on currency rates and shipping costs, imports are likely to be readily substitutable for butter produced domestically. However, as with bulk cheese, using imported bulk butter may affect the processor's ability to label the finished product as 'Made in Australia', a label which may provide a competitive advantage in some cases.

Issues for further consideration

92. Are other Australian suppliers of bulk butter, plus imports, likely to provide a sufficient degree of competitive constraint to Murray Goulburn, post-acquisition?

²⁴¹ Form S, paragraph 243.

Market for the wholesale supply of whey products

300. [REDACTED]²⁴²
301. According to Dairy Australia, the majority of domestic production of whey is exported.²⁴³ In the event of a significant increase in the price of whey, exports of whey could potentially be redirected to the domestic market, and to that extent would act as a competitive constraint.
302. Significant quantities of whey are also imported into Australia.²⁴⁴ Accordingly, the proposed acquisition appears unlikely to raise competition issue in this market.

Market for the wholesale supply of pasteurised milk

303. WCB submits that it has experienced recent success in increasing sales of its Sungold fresh white milk.²⁴⁵
304. The market shares provided by Murray Goulburn do not show the proportion of private label product that the merger parties supply, and therefore may not accurately indicate the relative significance of competitors in this market.²⁴⁶ However, given WCB's supply of pasteurised milk appears to be limited,²⁴⁷ and there are strong competitors such as Lion and Parmalat, the proposed acquisition appears unlikely to raise competition issues in this market.

Market for the wholesale supply of flavoured milk

305. Murray Goulburn [REDACTED] WCB supplies flavoured milk under its Sungold and Great Ocean Road brands.²⁴⁹ Murray Goulburn submits that the volumes of flavoured milk supplied by WCB are small.²⁵⁰

²⁴² Form S, paragraph 243.

²⁴³ Dairy Australia, 'Australian Dairy Industry in Focus 2013', page 27, available at <http://www.dairyaustralia.com.au/~media/Documents/Stats%20and%20markets/In%20Focus/Australian%20Dairy%20Industry%20In%20Focus%202013.pdf>.

²⁴⁴ Dairy Australia, 'Australian Dairy Industry in Focus 2013', page 46, available at <http://www.dairyaustralia.com.au/~media/Documents/Stats%20and%20markets/In%20Focus/Australian%20Dairy%20Industry%20In%20Focus%202013.pdf>.

²⁴⁵ WCB submission to the Tribunal, 18 December 2013, paragraph 124.

²⁴⁶ Form S, paragraph 234(iv).

²⁴⁷ Form S, paragraph 269.

²⁴⁸ Form S, paragraph 237.

²⁴⁹ WCB submission to the Tribunal, 18 December 2013, paragraphs 21-22.

²⁵⁰ Form S, paragraph 134.

306. WCB submits that it has experienced recent success in increasing sales of its Sungold flavoured milk.²⁵¹
307. Other major suppliers of flavoured milk include Parmalat and Lion.²⁵² Given their focus on the supply of fresh milk products, these companies are likely to be strong competitors in the supply of flavoured milk. Accordingly, the proposed acquisition appears unlikely to raise competition concerns in this market.

Market for the wholesale supply of milk powder

308. Murray Goulburn supplies:
- a. Devondale branded and private label milk powder in 2kg bags for grocery retailers; and
 - b. milk powder products to food service customers.²⁵³
309. Murray Goulburn is not aware of WCB supplying milk powder in Australia.²⁵⁴ WCB submits that it manufactures skim milk powder in Australia, but almost all of it is sold on the international market.²⁵⁵
310. According to Dairy Australia, only about 25–30% of Australia’s milk powder production is sold domestically.²⁵⁶ Accordingly, the ability for exporters to redirect supply into the domestic market may potentially constrain Australian prices. Significant quantities of milk powder are imported into Australia.²⁵⁷
311. In light of WCB’s export focus, and the availability of imports, the proposed acquisition appears unlikely to raise competition issues in this market.

Wholesale supply of packaged cream

312. Murray Goulburn manufactures and supply packaged cream under both its Devondale brand and as private label products.²⁵⁸ Murray Goulburn is not aware of WCB supplying packaged cream in Australia.²⁵⁹

²⁵¹ WCB submission to the Tribunal, 18 December 2013, paragraph 124.

²⁵² Form S, paragraph 235.

²⁵³ Form S, paragraph 142.

²⁵⁴ Form S, paragraph 143.

²⁵⁵ WCB submission to the Tribunal, 18 December 2013, paragraph 17.

²⁵⁶ Dairy Australia, ‘Australian Dairy Industry in Focus 2013’, page 25, available at <http://www.dairyaustralia.com.au/~media/Documents/Stats%20and%20markets/In%20Focus/Australian%20Dairy%20Industry%20In%20Focus%202013.pdf>.

²⁵⁷ Dairy Australia, ‘Australian Dairy Industry in Focus 2013’, page 46, available at <http://www.dairyaustralia.com.au/~media/Documents/Stats%20and%20markets/In%20Focus/Australian%20Dairy%20Industry%20In%20Focus%202013.pdf>.

²⁵⁸ Form S, paragraph 145.

²⁵⁹ Form S, paragraph 146.

- [REDACTED]
313. The market shares provided by Murray Goulburn do not show the proportion of private label product that the merger parties supply, and therefore may not accurately indicate the relative significance of competitors in this market.²⁶⁰ However, due to the presence of companies such as Lion and Parmalat, the proposed acquisition appears unlikely to raise competition issues in this market.

Market for the wholesale supply of high margin dairy ingredients

314. Murray Goulburn supplies a small volume of nutritional products in Australia.²⁶¹

315. WCB manufactures:

- a. Enprocal, a nutritional supplement for consumers;²⁶³ and
- b. other nutritional and functional ingredients through its Great Ocean Ingredients joint venture with Royal Friesland Campina.²⁶⁴

316. The ACCC understands that Burra Foods²⁶⁵ and [REDACTED] also produce nutritional products, although it is unclear whether they supply those products in Australia.

317. Murray Goulburn submits that, post-acquisition, there would be plenty of competitive constraint on Murray Goulburn in supplying nutritional and higher margin ingredients, given that these products are traded internationally, and there are a number of other suppliers of them.²⁶⁷

318. The ACCC considers that the high value of these products means they are more likely to be traded internationally, and therefore imports appear likely to provide a constraint to Australian manufacturers.

²⁶⁰ Form S, paragraph 238(viii).

²⁶¹ Form S, paragraph 154.

²⁶² Murray Goulburn, Further response to ACCC Information Request, 15 December 2013, paragraph 19.

²⁶³ WCB submission to the Tribunal, 18 December 2013, paragraph 24.

²⁶⁴ WCB submission to the Tribunal, 18 December 2013, paragraph 26.

²⁶⁵ Form S, paragraph 250

²⁶⁶ Statement of Maldwyn Benniston, paragraph 114.

²⁶⁷ Form S, paragraph 295.

Issues for further consideration

93. Is there any additional information to suggest the proposed acquisition would raise competition concerns in the supply of any of the above processed dairy products?

Issue 25(c): What are the nature and extent of barriers to entry to, and expansion in, the supply or acquisition of the relevant products?

319. Murray Goulburn submits that there are various factors that contribute to the existence of barriers to entry or expansion for a potential new dairy manufacturer.²⁶⁸
320. For the same reasons as set out in response to Issue 16, the ACCC considers that:
- a. barriers to entry for establishment of a new dairy processing factory are likely to be high.
 - b. barriers to expansion, although not as high as barriers to entry, are likely to be considerable.
321. The presence of a number of smaller firms that acquire semi-processed dairy products and manufacture (or cut and wrap) downstream dairy products such as cheese may indicate that barriers to entry in secondary manufacturing (at least on a small scale) are not as high as barriers to entry in primary processing. However, secondary processors rely on access to products supplied by primary processors, such as bulk milk, cream, butter and cheese.

Issue 26: Does Murray Goulburn's corporate structure as a farmer-owned cooperative impact on whether the proposed acquisition would have the likely effect of lessening competition in the relevant markets?

322. Refer to Issue 14, above.

Issue 27: What is the impact, if any, of Murray Goulburn's proposed capital restructure on the competitive effects of the proposed acquisition?

323. Refer to Issue 14, above.

²⁶⁸ Form S, paragraphs 343-345.

III Other detriments

Issue 28: Are there any other public detriments that are likely to result from the proposed acquisition?

Issue 29: What is the magnitude of any such detriments?

324. To the ACCC's knowledge, no other public detriments of the proposed acquisition have been identified to date.

E WEIGHING THE BENEFITS AND DETRIMENTS

Issue 30: After weighing the public benefits against the public detriments, is there a net public benefit such that the proposed acquisition should be allowed to occur? Over what period of time should public benefits and public detriments be measured?

325. In weighing the public benefits against the public detriments, it is relevant to take into account that merger authorisations lead to a structural change in the relevant markets that cannot be reversed. Unlike other conduct that may be authorised, such a change has an ongoing effect without any subsequent opportunity for a review of the effect of the authorised conduct on competition in the relevant markets.
326. As to the time period over which to assess the public benefits and public detriments, the ACCC in its informal merger review process considers the foreseeable future. It may be appropriate to take a similar approach in relation to a merger authorisation.

Issues for further consideration

94. Are there any factors particular to merger authorisations that impact on the appropriate approach to weighing public benefits against public detriments?
95. What factors are relevant to consideration of the appropriate time period over which public benefits and public detriments are to be measured?

F PERIOD OF AUTHORISATION

Issue 31: Should any authorisation granted for Murray Goulburn to acquire WCB be expressed to be in force for a specified time period?

Issue 32: If so, what time period is appropriate?

327. Murray Goulburn submits that a period of authorisation is not applicable in relation to the proposed acquisition.²⁶⁹
328. Market conditions, market structure and other relevant facts and competitive dynamics can change over time, so an assessment of the likely impact of a proposed acquisition in early 2014 may no longer be appropriate at a later date. Accordingly, the ACCC considers that a time limit on any authorisation granted to Murray Goulburn is appropriate.
329. Based on the ACCC's experience, 12 months is likely to be an appropriate time period.
330. WCB submits that the period of authorisation should end at the conclusion of the offer period under Murray Goulburn's current off-market takeover bid as set out in Murray Goulburn's Bidder's Statement and governed by the Corporations Act.²⁷⁰

Issues for further consideration

96. Is a 12 month period of authorisation appropriate?

²⁶⁹ Form S, paragraph 429.

²⁷⁰ WCB submission to the Tribunal, 18 December 2013, paragraph 132.