



## Statement of Issues

20 July 2023

### Coles Group Limited – proposed acquisition of two fresh milk processing facilities from Saputo Dairy Australia Pty Ltd

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#### Purpose

1. Coles Group Limited (**Coles**) proposes to acquire two fresh milk processing facilities in Laverton North (Victoria) and Erskine Park (New South Wales) from Saputo Dairy Australia Pty Ltd (**Saputo**).
2. This Statement of Issues:
  - gives the Australian Competition and Consumer Commission's (**ACCC**) preliminary views on competition issues arising from the proposed acquisition,
  - identifies areas of further inquiry, and
  - invites interested parties to submit comments and information to assist our assessment of the issues.
3. Statements of Issues do not refer to confidential information provided by the parties or other market participants and therefore may not fully articulate the ACCC's preliminary position.

#### Overview of ACCC's preliminary views

4. In considering the proposed acquisition, the ACCC applies the legal test set out in section 50 of the *Competition and Consumer Act 2010* (the **CCA**). In general terms, section 50 prohibits acquisitions that would have the effect, or be likely to have the effect, of substantially lessening competition in any market.
5. The ACCC divides its preliminary views into three categories, 'issues of concern', 'issues that may raise concerns' and 'issues unlikely to raise concerns'. In this Statement of Issues there are 2 "issues that may raise concerns" and 1 "issue unlikely to raise concerns".

### Issues that may raise concerns

- The ACCC's preliminary view is that the proposed acquisition may lead to Saputo exiting market/s for the acquisition of raw milk in NSW, therefore substantially lessening competition for the acquisition of raw milk in these market/s.
- The ACCC's preliminary view is that the proposed acquisition may substantially lessen competition by giving Coles the incentive and ability to foreclose or frustrate competitors at various levels of the dairy supply chain.

### Issues unlikely to raise concerns

- The ACCC's preliminary view is that the proposed acquisition is unlikely to substantially lessen competition for the acquisition of raw milk in market/s within Victoria.

## Making a submission

6. The ACCC invites submissions from interested parties, particularly on the following key issues:
  - Alternative acquirers of raw milk in NSW and how they compare to Coles and Saputo in relation to their geographic areas of operation, price and terms offered, and volumes acquired.
  - The ability of Coles to leverage its position in the dairy supply chain, and how this will change as a result of the acquisition.
7. Interested parties should provide submissions by 5pm on 3 August 2023. Responses may be emailed to [mergers@accg.gov.au](mailto:mergers@accg.gov.au) with the title: Submission re: Coles/Saputo processing facilities - attention Nicholas Wellfare. If you would like to discuss the matter with ACCC staff or have any questions about this Statement of Issues, please contact Nicholas Wellfare on 02 9230 3813.
8. The ACCC anticipates making a final decision on 14 September 2023, however, this timeline can change. To keep up with possible timing changes and to find relevant documents, interested parties should visit the Mergers Register on the ACCC's website at [www.accc.gov.au/publicregisters/mergers-registers/public-informal-merger-reviews](http://www.accc.gov.au/publicregisters/mergers-registers/public-informal-merger-reviews).

### Confidentiality of submissions

9. The ACCC will not publish submissions regarding the proposed acquisition. We will not disclose submissions to third parties (except our advisors/consultants) unless compelled by law (for example, under freedom of information legislation or during court proceedings) or in accordance with s155AAA of the CCA. Where the ACCC is required to disclose confidential information, the ACCC will notify you in advance where possible so that you may have an opportunity to be heard. Therefore, please identify any confidential information that is provided to the ACCC. Our [Informal Merger Review Process Guidelines](#) contain more information on confidentiality.

## **About ACCC ‘Statements of Issues’**

10. A Statement of Issues is not a final decision about a proposed acquisition. A Statement of Issues outlines the ACCC’s preliminary views and identifies further lines of inquiry.
11. A Statement of Issues provides an opportunity for all interested parties (including customers, competitors, shareholders and other stakeholders) to ascertain and consider the primary issues identified by the ACCC. It is also intended to provide the merger parties and other interested parties with the basis for making further submissions should they consider it necessary.

## **The parties**

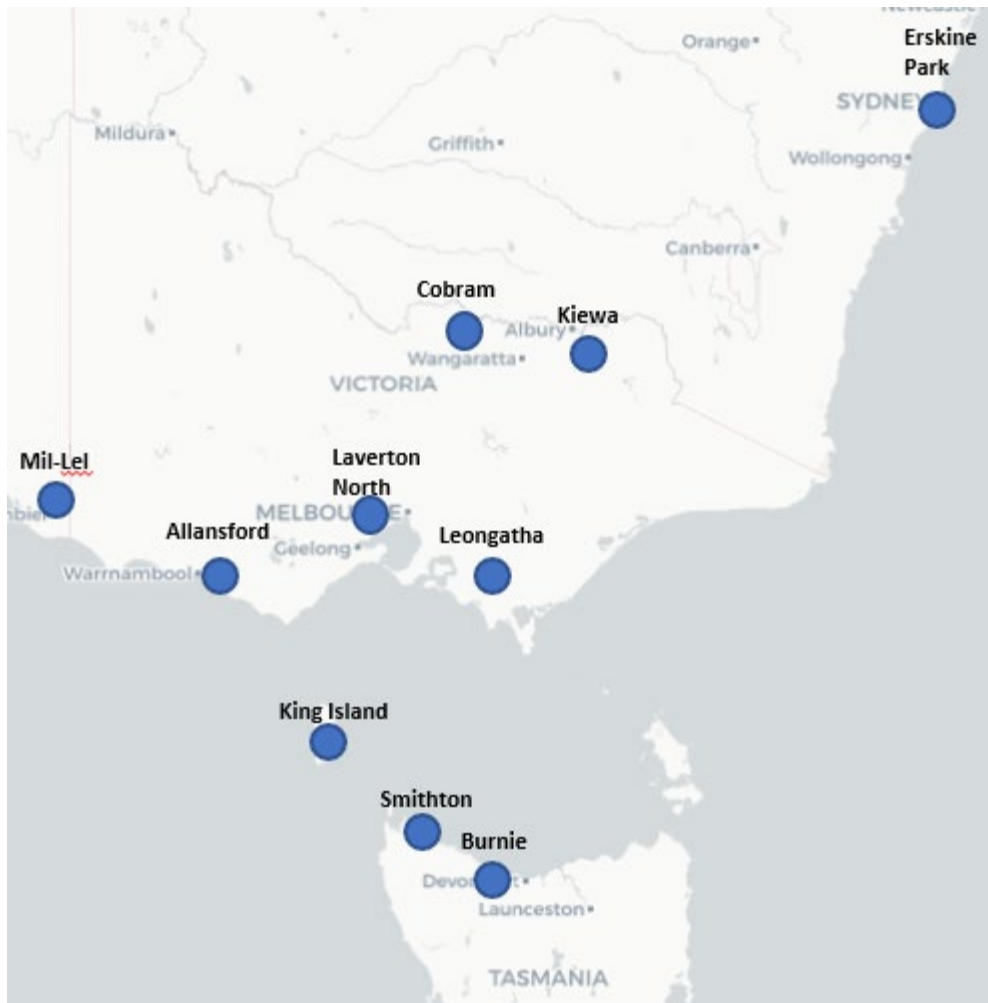
### **Coles**

12. Coles is a major supermarket chain and one of Australia’s largest grocery and general merchandise retailers. Coles supplies branded and own brand fresh milk products at the retail level through its supermarkets. Coles is the distributor for its own brand fresh milk to Coles stores, produced under arrangements with producers including Saputo. Coles does not currently own or operate any dairy processing facilities.
13. In NSW and Victoria, the raw milk that Coles acquires from dairy farmers is processed through Saputo’s processing facilities at Laverton and Erskine Park. Coles entered into an agreement to produce milk at these sites with Murray Goulburn in 2013.

### **Saputo**

14. Saputo is a wholly-owned subsidiary of Canadian based dairy product company Saputo Inc. Saputo is one of the largest dairy processors in Australia with 10 manufacturing facilities, including the Laverton and Erskine Park facilities that are being acquired by Coles. Saputo produces and wholesales a wide range of dairy products for the domestic market including fresh drinking milk, cheese, extended shelf-life milk and cream products, cultured products and dairy ingredients. Saputo products are sold under brands including Cheer, Devondale and Sungold

Figure 1: Map of Saputo processing facilities



15. Saputo acquired the Laverton and Erskine Park facilities as part of its 2018 acquisition of Murray Goulburn's assets. The facilities are state of the art, highly automated and were purpose built by Murray Goulburn to process Coles' private label milk with an initial contract entered into with Coles for a ten year period. Coles' private label milk production accounts for the majority of milk processed at this facility.

## The proposed transaction

16. Coles proposes to acquire Saputo's fresh milk processing facilities in Laverton North (Victoria) and Erskine Park (New South Wales).
17. The transaction does not include Saputo's raw milk supply contracts associated with these plants. The contracts Saputo holds with New South Wales (**NSW**) and Victorian dairy farmers are being retained by Saputo on current contractual terms. These contracts vary in length but are typically for one to two years. As part of the transaction, Saputo will enter a tolling arrangement with Coles meaning that Saputo's raw milk collected in NSW and Victoria will be processed by Coles at the plants in Laverton and Erskine Park. Saputo will continue to sell its branded drinking milk produced from raw milk collected in Victoria and NSW.

## Industry background

### Farmgate

18. Raw milk is produced at over 4,000 farms across Australia. Total milk production has been steadily declining over the last 10-15 years, along with a corresponding decline in the number of dairy farms and a move towards larger farming operations.
19. Farmers supply raw milk to processors (e.g. Saputo) and retailers that have entered toll processing arrangements with processors.<sup>1</sup> This raw milk is supplied under milk supply arrangements that must comply with the Dairy Code of Conduct, a mandatory industry code enforced by the ACCC. This Dairy Code of Conduct applies to the purchaser of the raw milk, so can apply equally to processors, supermarkets or milk aggregators. The price paid to farmers is individually negotiated and based on the milkfat and protein content of their milk but varies by purchaser and region.

### Processors and wholesale

20. Processors collect raw milk from farmers and process it into fresh milk (and other dairy products). Most processors are also wholesalers, supplying fresh milk under their own proprietary brands to a variety of retailers including supermarkets (e.g. Saputo's Devondale brand) – referred to as branded milk. Processors also process milk for retailers' own brand products (e.g. Saputo for Coles) – referred to as private label milk – and for a small number of wholesalers without processing facilities (e.g. businesses that contract Saputo to supply branded milk).
21. The major processors present in NSW are Saputo, Bega, Lactalis, a2<sup>2</sup>, and Norco. In Victoria major processors include Saputo, Lactalis, Bega, and Fonterra<sup>3</sup>.

### Retail

22. Processors and wholesalers supply fresh milk products to a variety of retailers including supermarkets. The ACCC's 2017 Dairy Inquiry found that supermarkets generally have significant bargaining power in their dealings with processors.

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<sup>1</sup> A toll processing arrangement in this circumstance refers to an agreement between a retailer and a processor whereby a processor is engaged to process the retailer's raw milk into a dairy product, typically private label.

<sup>2</sup> a2 sells a differentiated fresh milk product without the A1 protein that most fresh milk products contain.

<sup>3</sup> These processors are listed together for ease of reference, although the ACCC notes that the geographic dimension of markets for the acquisition of raw milk are regional, not state based.

## **Issue that may raise concern: reduction in competition for the acquisition of raw milk in market/s in NSW**

23. Significant concerns have been raised that the acquisition will remove the longer term incentive for Saputo to continue to acquire raw milk in NSW and that this will reduce the number of buyers dairy farmers are able to negotiate with for the sale of their raw milk.
24. The ACCC is concerned that the sale of these processing assets means that Saputo would no longer own any raw milk processing assets in NSW. Accordingly, in the medium term, this creates uncertainty about Saputo's continued acquisition of raw milk in NSW and whether it will refocus its raw milk acquisition to increase throughput in its processing facilities in Victoria. In support of this concern, the ACCC notes Saputo's public comments regarding its "Global Strategic Plan", its closure of other operations in Australia, and the decision to sell these state of the art facilities. Combined, these factors appear to indicate Saputo's commitment to streamline and consolidate its operations and lend support to the concerns that Saputo may eventually look to exit raw milk collection and processing in NSW. The ACCC is reviewing the arrangement between Coles and Saputo to better understand whether Saputo has a long term commitment to process raw milk in NSW.
25. Should the acquisition lead to Saputo exiting raw milk acquisition across NSW, the ACCC acknowledges that the geographic dimension of raw milk markets is not bounded by state borders, but instead is influenced by the location of processing facilities and the distance that raw milk can be transported. As a result, there are often multiple markets within a state. In relation to geographic market dimension, the ACCC's Dairy inquiry found that:
- Approximately 80 per cent of processors' raw milk purchases come from farms located within 150km of the processing plant, and
  - In excess of 95 per cent of raw milk is acquired from farms within 300km of the processing plant.<sup>4</sup>
26. Given the fact that NSW has numerous markets for the acquisition of raw milk, any exit of Saputo from NSW is likely to have differing levels of impact on competition within the different markets in NSW. The ACCC has not yet reached a definitive view on the relevant geographic scope of the raw milk acquisition markets in NSW. However, our initial investigations indicate that the competitive impact of any exit from NSW by Saputo would likely be felt most strongly by farmers closer to the Erskine Park facility in the Central NSW region.
27. If the acquisition does lead to Saputo either exiting the production of fresh drinking milk completely or alternatively significantly reducing it volumes, the ACCC's preliminary view is that the proposed acquisition may substantially lessen competition for the acquisition of raw milk in parts of NSW, in particular the Central NSW region. Although Saputo is retaining its existing raw milk supply

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<sup>4</sup> ACCC Dairy Inquiry, Final Report, April 2018, p 68

contracts with farmers, it is currently unclear what Saputo's long term plans are in NSW once its current milk contracts expire.<sup>5</sup>

28. Market feedback indicates that in these regions, apart from Saputo, the only major purchasers of raw milk are Coles and Bega. However, feedback also indicates that for a number of reasons, Bega is not considered a competitive alternative for raw milk acquisition when compared to Saputo and Coles. As a result, farmers in these regions raised strong concerns that, if Saputo were to exit NSW, they would only be left with Coles as the only viable purchaser of raw milk. The ACCC will continue to look closely at which processors are acquiring raw milk in NSW, in what volumes, what geographic regions, and at what price.
29. Concerns were also raised that Coles preferences larger volume farms, and accordingly its pricing offers are not as readily available to smaller farms. Therefore, there is strong concern that the impact on competition will disproportionately affect smaller farms in these regions of NSW who will have limited/no buyers if Saputo ceases to purchase raw milk. Farmers submit that Saputo is an important driver of price competition for raw milk for smaller farms.
30. Separately, the ACCC is also considering whether, in the event Saputo continues to acquire raw milk in NSW whether it will have long term security in relation to access to processing facilities. In particular, the ACCC is exploring whether following the sale of its Erskine Park facility it will be at risk of foreclosure and/or frustration of access to other processing facilities. If Saputo cannot gain access to facilities in NSW on commercially viable terms, it appears likely that it would decide to exit raw milk acquisition in NSW.
31. These concerns are being considered within the context of the total processing capacity at the Erskine Park facility, and whether it would be in Coles' commercial interest to no longer continue to provide access to Saputo and, if it did, what it would mean for Coles has to lose Saputo's volumes.

### **ACCC's preliminary views**

32. In summary, the ACCC is concerned that:
  - Saputo may exit the acquisition and processing of raw milk in NSW leading to a reduction in competition for the acquisition of raw milk in market/s within NSW, and in particular Central NSW; and
  - Even if Saputo intends to continue acquiring and processing raw milk in NSW, Coles may foreclose or frustrate Saputo through increasing processing prices or changing the terms offered.

The ACCC invites comments from market participants on its concerns in relation to the acquisition and processing of raw milk in regions of NSW. In particular market participants may wish to comment on the following:

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<sup>5</sup> If Saputo were to exit raw milk acquisition and processing in NSW, it is possible that it would continue to sell its drinking milk in NSW as depending on transport costs and shelf life it may still be possible to successfully transport processed drinking milk from other states.

- Alternative acquirers of raw milk in NSW and whether they provide a viable alternative, including in terms of pricing (including seasonal versus flat production incentives) and milk volumes.
- If Saputo were to continue to acquire raw milk in NSW what effect would the proposed acquisition have on the acquisition of raw milk in NSW.
- If Saputo ceased processing raw milk in NSW, could it continue to acquire raw milk in NSW and transport this to its facilities in Victoria? Would this make commercial sense?
- How would Coles fill excess capacity at Erskine Park if it were to foreclose Saputo.
- Absent the proposed acquisition, how will raw milk production and processing in NSW evolve over the next 5 years.

### **Issue that may raise concerns: foreclosure/frustration of competitors at various levels of the dairy supply chain**

33. The ACCC's preliminary view is that by Coles vertically integrating and taking ownership of processing facilities, the proposed acquisition may substantially lessen competition by enabling Coles to foreclose or frustrate competitors at various levels of the dairy supply chain. Following the acquisition, Coles may have the ability and incentive to consolidate its raw milk processing in NSW at Erskine Park and ship raw milk from other areas to increase throughput. This may:
- Increase Coles' bargaining power with other processors when negotiating Coles' private label milk contracts in other states of Australia, and in its bargaining for other processors branded dairy products; and/or
  - Impact on the competitive viability of other processors, by reducing the supply of available private label milk contracts.

#### **Increased bargaining power**

34. Strong concerns have been raised in market feedback that the proposed acquisition may significantly increase Coles' bargaining power in its negotiations with dairy processors for private label milk contracts in other states. The acquisition would do this by increasing the information available to Coles regarding the cost of production of white drinking milk. Market participants have submitted that this acquisition will provide it with information above and beyond what Coles is already privy to through its existing agreements, which, as found in the ACCC's Dairy Inquiry, can be extensive. Market participants have submitted that the depth of information gained through owning and operating the facility will be greater than that acquired through Coles simply being party to a private label or toll processing agreement.
35. The ACCC is concerned that Coles may be able to use this information in its negotiations with other dairy processors in other states and significantly reduce processors margins by reducing the amount Coles is willing to pay for third parties to process raw milk.



36. Any reduction in processors margins may lead to a substantial reduction in profits available in the industry and as a result may lead to lower investment in processing facilities and innovation with new dairy products, thus reducing competitive outcomes for consumers.
37. Strong concerns have also been raised that further squeezed margins at the processor level could lead to processors exiting the acquisition of raw milk for drinking milk, which could lead to lower farmgate milk prices, particularly in NSW and/or Queensland. Industry participants expressed strong concerns about the long term impact that this acquisition will have on the viability of the dairy industry.
38. The ACCC is continuing to consider if the proposed acquisition results in any change to the amount of information Coles currently receives as a result of its agreement with Saputo.

### **Competitive viability of other processors**

39. The proposed acquisition may give Coles the ability and incentive to process less of its private label milk at other processors' facilities in NSW and Queensland.
40. The ACCC's preliminary view is that following the proposed acquisition Coles may have the ability to process more of its private label milk at Erskine Park and Laverton given the capacity at these facilities. The ACCC also considers that Coles may have the incentive to consolidate the processing of its private label white drinking milk at Laverton and Erskine Park as they are newly constructed relative to other processing plants, and therefore are likely have a much lower marginal production cost than the facilities of many other processors.
41. In addition to the marginal production savings, it has been submitted to the ACCC that Coles would likely find cost savings in sourcing raw milk from lower cost milk production areas and transporting it to Erskine Park and Laverton. The ACCC has heard strong concerns regarding consolidation at Erskine Park in particular, given the significant cost differential between raw milk prices in northern NSW and Queensland versus Victoria. However, the ACCC understands that any savings in raw milk acquisition costs would have to be balanced against the additional costs of transport.
42. If Coles were to consolidate its processing to Erskine Park and Laverton and source the additional raw milk from low cost regions, then this would likely result in reduced raw milk volumes needing to be acquired in Queensland and Northern NSW. The lower volume of milk required by Coles in these regions would likely significantly impact the competitiveness and ongoing viability of processors in these regions if they are unable to negotiate alternative supply contracts. It may also reduce the number of processors competing for raw milk in Northern NSW / Queensland, and accordingly push down the price of raw milk in these regions.
43. Further, the consolidation of private label milk contracts to Coles' owned facilities may impact on the operations of competing processors. Strong concerns have been raised that it will result in less of a reliance from Coles on third party processors for a large amount of its private label white drinking milk. As a result, the ACCC has heard that processors will have less bargaining power in wider negotiations with Coles, particularly in relation to the retail price of private label

and branded goods, which may lead to reduced margins for these processors and damage their ongoing viability. The market is particularly concerned about the potential for further retail price reductions, particularly given the widely held belief that the acquisition of these facilities will result in cost savings to Coles due to the integration of the facilities into Coles' business. Strong concerns have been raised that any cost savings realised by Coles will be reflected in a reduced retail price for private label milk, which will in turn reduce the retail price and margins of branded milk, and impact on the viability of competing processors.

44. In completing its further assessment, the ACCC will look closely at what the proposed acquisition changes, particularly in relation to Coles' incentives and ability, noting that even absent the acquisition at the completion of existing private label contracts Coles may have the ability to reconfigure and consolidate its production.

### **ACCC's preliminary views**

45. In summary, the ACCC is concerned that the proposed acquisition may:
- Increase Coles' bargaining power with other processors for Coles private label milk contracts in other states of Australia, and in its bargaining for other processors branded dairy products; and/or
  - Impact on the competitive viability of other processors, by reducing the supply of available private label milk contracts.

The ACCC invites comments from market participants on its concerns in relation to Coles' ability to foreclose competitors at various levels of the dairy supply chain. In particular market participants may wish to comment on the following:

- The information that Coles will acquire as a result of the proposed acquisition and how this compares to the information it currently receives under its agreements with Saputo and other processors.
- How Coles can use any further information it received as a result of the proposed acquisition to increase its bargaining power with other processors, and how this differs from the negotiations that occur now.
- Whether Coles would have the ability and incentive to consolidate its white drinking milk processing at Erskine Park and Laverton. And in particular whether there are any significant barriers or risks to increasing the geographic breadth of the raw milk supply chain.
- If Coles were to move all of its white drinking milk processing from Queensland and Northern NSW, what impact would this have on farmers and processors in this region.
- Any alternatives options for processors in Queensland and Northern NSW to produce products other than drinking milk in order to fill available capacity if Coles were to consolidate the processing of its white drinking milk in Erskine Park and Laverton.

## **Issue unlikely to raise concerns: the acquisition of raw milk in Victoria**

46. The ACCC's preliminary view is that that the proposed acquisition is unlikely to result in a substantial lessening of competition in the acquisition of raw milk in Victoria.
47. The ACCC considers that there are a number of alternative acquirers of raw milk in Victoria that provide an alternative to Coles and Saputo. The ACCC also considers that the sale of the Laverton facility is unlikely to affect Saputo's ongoing presence in the acquisition of raw milk in Victoria, given it will continue to operate a number of other facilities there.

## **ACCC's future steps**

48. As noted above, the ACCC invites submissions from market participants on each of the issues identified in this Statement of Issues and on any other issue that may be relevant to the ACCC's assessment of this matter. Submissions should be emailed to [mergers@acc.gov.au](mailto:mergers@acc.gov.au) by no later than 3 August 2023.
49. The ACCC will finalise its view on this matter after it considers submissions invited by this Statement of Issues.
50. The ACCC intends to publicly announce its final view by 14 September 2023. However the anticipated timeline may change in line with the *Informal Merger Review Process Guidelines*. A Public Competition Assessment explaining the ACCC's final view may be published following the ACCC's public announcement.