Public hearing – Melbourne

15 May 2008

Time: 10.00am – 5.00pm

Address: **ACCC Office**
Level 35, The Tower
360 Elizabeth Street
Melbourne

Room: Large View Room – Level 35

Witness	Submission	Summons
National Foods **Mr Mark McDonald** General Manager – Supply and Trading **Mr Michael Harley** Group Executive – Grocery Sales, Marketing and Innovation	133	Summonsed & compelled to appear by ACCC
Costas Group **Mr Kim Martin** **Mr Stuart Costa**	N/a	Summonsed & compelled to appear by ACCC
Mr Doug Chant Ex-potato farmer, current dairy farmer	N/a	No
Lunch		
Australian United Retailers Limited t/as Foodworks **Mr Peter Noble** Chief Executive Officer	90	No
Colonial First State **Mr Martin James** General Manager – Leasing **Mr Tony Gilchrist** Head of Development	N/a	Summonsed & compelled to appear by ACCC

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TRANSCRIPT OF PROCEEDINGS

AUSTRALIAN COMPETITION

AND CONSUMER COMMISSION

MR GRAEME SAMUEL, Chairman
DR STEPHEN KING, Commissioner
MR JOHN MARTIN, Commissioner

GROCERY PRICE INQUIRY HEARING

CONDUCTED AT: MELBOURNE CENTRAL TOWER, MELBOURNE

DATE: 10.07 AM, THURSDAY, 15 MAY 2008

MR SAMUEL: All right. Well, I think we'll start this morning's hearing. Commissioner King is just going to be about five minutes late, but has asked that we start before he arrives. And perhaps I can deal with the introductions before he comes. So my name is Graeme Samuel. I am the chairman of the Australian Competition and Consumer Commission and the chair of this public inquiry into the competitiveness of retail prices for standard groceries. I welcome you all and declare this hearing open. I am joined by Commissioner John Martin and, in due course, by Commissioner Stephen King, who are the other two presiding members of this inquiry. The inquiry has been convened under part 7A of the Trade Practices Act. It's held pursuant to a request from the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs, Minister Chris Bowen, which was received by the ACCC on 22 January 2008.

Details regarding all the matters to be taken into consideration by the inquiry are available on the ACCC website. I note that, at the moment, we have received over 190 public submissions to the inquiry as well as confidential submissions. The submissions cover a broad range of issues, and the ACCC will endeavour to take into account all relevant information that has been provided. The purpose of these hearings is to give the ACCC an opportunity to investigate in detail the key issues that have been raised. We have had hearings throughout Australia during April, with several hearings occurring in Melbourne throughout May and early June. I wish to emphasise that many witnesses at these hearings are not attending voluntarily, and have been summonsed to appear under section 95S of the Trade Practices Act. In particular, I should note that, in general, the ACCC has summonsed all supplier companies. Therefore, no conclusions can be drawn regarding a company's willingness to participate in the inquiry from the fact that a company is appearing at these hearings.

Some of the material covered in the hearing sessions will be confidential and commercially sensitive and, therefore, parts of the hearings will not be open to the public. Questioning will start in public, but sessions will move into a confidential phase when the questioning moves on to confidential material that relates to that particular witness. We have to be able to investigate issues that are commercially sensitive to witnesses without damaging the witnesses' competitive position and commercial relationships. We'll be questioning the organisations about the commercial relationships and about confidential documents that we have obtained through using our information gathering powers, and obviously that can't occur in public. In particular, where a witness has not made any submissions to the inquiry, and has been summonsed by the ACCC to attend these hearings, we must be able to hear certain evidence in confidence.

Transcripts of the public parts of the hearings are placed on our website. We may disclose some aspects of the confidential components of the transcript a while after the hearing if we consider that some of the material should be in the public domain, but we will consult with the relevant witness before doing this. Where there are industry associations or representative organisations who are attending voluntarily, it's more likely that most of the hearing sessions will be public. In terms of procedural issues, all witnesses will have received a document that outlines how we intend to approach these hearings. So I won't go through the procedural points in detail. I just want to emphasise that, although we're not taking evidence under oath at this hearing, it is a serious offence to give false or misleading evidence to the ACCC.

Now, as I mentioned earlier, the ACCC recognises that some witnesses will be asked to give evidence that, if disclosed, would damage their competitive position, or which may, for other reasons, be confidential. If a witness believes that a particular question, or a series of questions, are likely to require him or her to disclose such information, the witness should indicate an objection to answering the question on that basis. I'll then consider whether the inquiry should take evidence in private from that witness. I note that, although the ACCC is not utilising external counsel at this hearing, witnesses will be questioned by the ACCCs internal lawyers, Mr Damien O'Donovan and Ms Catherine Freeman.

Well, that concludes my preliminary remarks. I thank all the witnesses who are attending these hearings, particularly those who have been summonsed to attend. We do realise that you are busy people, and attending these hearings can be a significant imposition on you and your organisation. The first witnesses are from National Foods, and I'll hand over to Mr O'Donovan.

MR O'DONOVAN: We'll keep - we won't wait for Stephen?

MR SAMUEL: No, yes, we can proceed, yes, that's fine.

MR O'DONOVAN: All right. Can you just state for the record your names, the organisation you represent, and your role in that organisation?

MR HARLEY: Sure. Michael Harley. I am group executive for grocery, sales, marketing and innovation at National Foods Limited.

MR McDONALD: Mark McDonald, general manager of supply and trading for National Foods.

MR O'DONOVAN: Okay. And I might just get their legal representatives to introduce themselves as well.

MR McDONALD: Peter McDonald from Freehills representing National Food.

MS BRIGHAM: And Katrina Brigham, legal counsel for National Food.

MR O'DONOVAN: Okay. Now, firstly, can I confirm that you have been summonsed to give evidence here today?

MR McDONALD: Yes.

MR HARLEY: Yes.

MR O'DONOVAN: Okay. And you understand that under the Commonwealth Criminal Code it is an offence to give evidence at this inquiry that a witness knows is false or misleading or omits any matter or thing that which the evidence is misleading? Do you both understand that?

MR HARLEY: Yes, I understand.

MR McDONALD: Yes.

MR O'DONOVAN: Okay. All right. Now, just to begin with, could you describe National Foods, the business that it operates, the brands that it holds, and how – and where it participates at the retail level, at the processor level, and how it interacts at the farm gate?

MR HARLEY: Well, okay. I will certainly cover the first part; if you want to talk about the farm gate, you can cover that with Mark. National Foods manufactures and supplies milk, yoghurt, dairy foods, which is yoghurt desserts, etcetera, specifically cheese, cream and juice to the Australian market, but it also has operations through export in Asia and in New Zealand as well. Around 50 per cent of that, volume wise, is milk and primarily supplied within the Australian market. We supply both branded and private label products to the grocery trade and to, I guess, non-grocery channels of distribution as well. About – yes – about 60 per cent of our volume goes through major grocery customers, which include Woolworths, Coles and Metcash. About 55 per cent of that is milk, 80 per cent of our juice business, and around 90 per cent of our yoghurt or dairy business goes through those channels.

Our leading brands are sold nationally. King Island cheese, Tasmanian Heritage, Pura whole milk and modified milks and speciality milks, Big M, Farmers Union iced coffee, Masters flavoured milks, Yoplait yoghurts, and Berri/Daily Juice, Mildura, and a number of other smaller brands, and that’s – and we also supply private label milk, juice, and a small amount of cheese and yoghurt into the market as well. Do you want to cover off the supplies?

MR McDONALD: Certainly. Thanks, Mike. National Foods procures, on a strategic sourcing basis, about 1.2 to $1.3 billion worth of goods and services. By far, raw milk and dairy ingredients represents the vast majority of that spend. We procure around 1.1 billion litres of raw milk, and another 200 million litres worth of dairy ingredients. That would represent probably just on 15 or so per cent of Australia’s milk suppliers used by National Foods.

We procure milk from two major sources. One is via Direct Farm supply, and the other is via third party processes as part of our balancing arrangements. In addition to raw milk and dairy ingredients we purchase raw fruit in terms of oranges and apples domestically here in Australia. Other commodities in concentrates and other juices and other fruit preparation ingredients and packaging. So they're the sort of arrangements we have, to put you in perspective. But with respect to raw milk, as I said, we procure 500 plus farmers across Australia. We procure via almost all regions here in Australia outside of – excluding far north Queensland.

MR O'DONOVAN: Okay. Now, in terms of your farm gate milk procurement, dealing only in what's publicly available, how is the price of milk set at the farm gate?

MR McDONALD: The price of milk at a farm gate level is determined via a vast number of factors, but you look at the local supply and demand factors. And if you were to look at Australia across a few different regions, you'd probably now start to determine Australia is sort of - you look at it from a south-east Australia perspective, a northern Australia perspective, and a sort of western Australian perspective. In Australia's south-east the vast majority of milk in Australia is produced in this region.

Australia will be producing on average this year around 9.5 billion litres, and probably six plus billion litres will be in the south-east region, which is Victoria, South Australia and Tasmania. Most of that milk is utilised for commodities or manufacturing purposes. And some of it is – at least half of that is exported overseas. So international commodity returns is one of the prevailing factors that drive price in the south-east of Australia. Plus you'll have other domestic supply and demand factors at a regional level that may dictate prices as well.

We have recently had a very significant drought in Australia which the lingering effects are still with us. We have had lower rainfall impacting irrigation regions and things like that. So, in addition to traditional international returns, we have paid, for example, drought payments to farmers etcetera. So you'd have other factors driving prices as well. Looking north into, say, your south-east Queensland market, other factors influence prices such as the difficult growing conditions and the higher costs. So you'll have a different pricing mechanisms in those regions similar to what may happen in Western Australia as well. So it's local conditions, but the international pricing is one of the prevailing factors that drives pricing in Australia.

MR O'DONOVAN: Okay. And is there – I mean, there seems to be publicly available information about the farm gate price. Is it actually published or is that just released by market participants or Dairy Australia or?

MR McDONALD: Dairy Australia tends to provide the best guide as to what pricing exists in Australia, and that is used as a good guide as part of trends is what occurs in each region in Australia.

MR O'DONOVAN: Right. And how do they prepare their data?

MR McDONALD: I think it's based on submissions from each of the processes, and it's aggregated information.

MR O'DONOVAN: Right, okay. So they survey the market to find out what the market is doing?

MR McDONALD: It's part of a process, yes.

MR O'DONOVAN: Yes, okay. So then – and in terms of how it's negotiated at the farm gate level – just the mechanics of it – do most farmers have a choice of processes that they can seek prices from more than one processor?

MR McDONALD: Typical processors – typical process to determine which processor to supply occurs on an annual basis. Most farmers operate on a – and the milk industry operates on a financial year season. And usually the process to determine who you'll supply occurs at the start of such a season which is traditionally July through to June. So processors and suppliers tend to negotiate during this period. So many suppliers have the choice at that time.

MR O'DONOVAN: Okay. And, geographically, a processor is represented – is there more than one processor in most geographic regions into which a farmer sells?

MR McDONALD: In – the only region of Australia without one or more processors would be far north Queensland.

MR O'DONOVAN: Right.

MR McDONALD: Every other region has multiple processors.

MR O'DONOVAN: Okay. And do dairy farmers tend to be mobile between processors?

MR McDONALD: Absolutely. Absolutely. They can switch annually.

MR O'DONOVAN: Right. And what sort of – how common is it?

MR McDONALD: We would find on an annual basis, within in our own supplier profile, a number of farmers switching in and out.

MR O'DONOVAN: All right.

MR SAMUEL: What's the number mean, by the way? What percentage?

MR McDONALD: It depends. You will find that you could have, in some seasons, little change and then in some other seasons, quite a lot. It's a hard percentage to put in. We do find that there is strong – strong tension processes each - annually to ensure you can secure your supply. So, it's a very competitive market out there.

MR SAMUEL: Yes. I am still no - - -

MR McDONALD: The percentage of numbers?

MR SAMUEL: Just – are we talking five per cent or 30 per cent, or?

MR McDONALD: I couldn't put an exact number on it but you'd have to say it would be five to 10 per cent of suppliers can move and have moved in some seasons. Probably some more in others.

MR SAMUEL: Right.

MR O'DONOVAN: Would you be willing to give us a more accurate figure in a confidential session?

MR McDONALD: We could provide some details of suppliers that have changed hands from National Food – confidentially, please.

MR O'DONOVAN: Yes, sure. Okay. Now, then moving up the chain. In terms of what happens to milk at the processor level, can you just describe the form in which it arrives at the processor, the form in which it is ultimately sold.

MR McDONALD: Yes. Milk is collected off farm in quite a generic fashion. It's bulk milk, so it tends to be picked up by a milk collection tanker and it is – all farms would have a very typical pumping system into a farm vat. That is picked up by a milk collection of logistics company and that is sent to a factory, and all in raw form. All milk varies in terms of its composition, in terms of butter fat and protein and then from there it is put into a bulk silo. It has to meet temperature and quality parameters to ensure that it goes, firstly, into any given solo.

Typically you require, obviously, non-antibiotic milk temperature less than five degrees, and other quality parameters at that stage. From there it is processed, and as part of that process, it is utilised to manufacture the various milk varieties that National Foods and other organisations produce, whether it's a whole milk, modified milk or flavoured milk or processed into cheese or other dairy products. And that processing is the separation, filling and chilling and those types of things.

MR O'DONOVAN: Right. And in terms of - - -

MR SAMUEL: I just note that Commissioner King has just joined us, for the record.

MR O'DONOVAN: Right. In terms of ownership of the milk, it passes at the moment National Foods pick it up?

MR McDONALD: Yes, at the point of pick up.

MR O'DONOVAN: Okay. All right. And then in – and the finished products? Who has responsibility for delivery of the finished product to the end retailer?

MR HARLEY: I will take that question. In general we take – we continue to have ownership until it's actually distributed into the warehouse or the store, depending on whether we have a direct to store delivery mechanism or going through a regional distribution centre that - that our customers would have. Whether that's a Woolworths, a Coles, we operate differently in different states.

MR O'DONOVAN: Okay. Is direct to store delivery the most common form of delivery for National Foods?

MR HARLEY: It varies quite a bit depending on which customer and which state you're actually in. So, we have a lot that's direct to store but we also have a lot of product that's going through – I don't have the percentages with me but it's a fairly significant part that's both. Obviously with our business and what we call the independent grocery business, we deliver direct to store in all cases there. We don't deliver milk through Metcash. But in the case of Coles and Woolworths, it depends on the state that we operate in and the agreements that we have in place with them.

MR O'DONOVAN: Right. Okay. All right. Now, then in terms of generic milk, could you just give us a brief history of the introduction to generic milk into Australia? Who initiated it?

MR HARLEY: I might ask Mark to do that, because he was here at the time.

MR McDONALD: Yes. I started working with National Foods in 1998 and it was definitely on the shelves at that point in time. So, I think its origins, it would appear, I don't know exactly, but would be around the mid nineties. Apparently that's when the private label of generic milk was introduced. At that stage, it certainly wasn't in the great volume or the volume scale or what it is today.

MR O'DONOVAN: Okay. And do you know which company was – sought to introduce generic milk first?

MR McDONALD: I couldn't answer that question.

MR O'DONOVAN: All right. Okay. Now, in terms of the changes in market share, is that something that you're – between generic milk and branded milk – is that something that you're happy to talk about in a public session or would you prefer to talk about that in a private session?

MR HARLEY: I think on a generic basis we can cover, sort of, what's happened in the market, I guess particular since the earlier part of this decade which is when we've seen the major growth in grocery chains and particularly of private label milk.

MR O'DONOVAN: Sure. Okay. Well, then, in terms of the shift in the structure of the market, as shared between branded milk and generic milk, what's happened?

MR HARLEY: I mean, if we look through the records, which we did before we came here, at around 2000, around 25 per cent of the milk was in private label and at that time, the price differential between private label and branded milk was relatively small. But that's obviously – over time, it's actually changed quite substantially. If you – you'll have seen from our submission, to the point we are now with fresh milk in general, it's around about 50 per cent – 57 per cent of the total market now is in private label. If you look at the grocery chains specifically, and you look at whole milk specifically, which I guess is the least differentiated of the products sitting on the market because that's the product that's been around for many, many years, that sits at around 74 per cent of the total market now is in private label.

MR O'DONOVAN: And has that – is that entirely price driven? That shift in market share?

MR HARLEY: We would think that it is, yes, because the price gap between branded and private label has changed significantly over the last three or four years in particular.

MR O'DONOVAN: All right. Okay. Now, in terms of the retail pricing, we sent you some information from the Bureau of Stats, about price inflation over time in relation to milk. And the published data for the last five years from the ABS suggests there has been an average increase in the retail price of milk of 4.1 per cent each year.

MR HARLEY: Yes.

MR O'DONOVAN: I just was wondering whether you have any comment on that, and whether that is consistent with National Foods own figures about the increases in pricing in milk in that same period?

MR HARLEY: I think I'd like to separate out – I can comment - and I would certainly say that, from the information I saw, I concur with – obviously with the – what you found in those statistics. I think when we look at it, we would separate out the growth in price around our branded, or the branded market, versus the private label market. That data would seem to be more consistent with what we've seen in the branded market as we've – as we have tended to try and recuperate the costs that are coming in to the business. But if you had a look at private labels specifically, as I am unaware of what the basket of goods are that they are using to drive that, if you looked at private label, that would be significantly less than that. We would see it more at around about the two per cent.

MR O'DONOVAN: Right. Okay. Which would put it at close to, or less than, the CPI.

MR HARLEY: Yes.

MR O'DONOVAN: Yes. Okay. All right. Now, moving from the milk category to the broader dairy category, what is the relationship – is there a strong relationship between the pricing of milk and the pricing of other dairy products?

MR HARLEY: Yes.

MR McDONALD: From an imports perspective.

MR HARLEY: From an imports perspective, no difference. However, when you have a look at the other products, like cheese and yoghurts, etcetera, they tend to be manufactured more in the pool that's in the south-east of Australia, therefore, you know, you are sourcing from a different pool of milk and therefore the cost structures around that are a little bit different to, say, if you were buying product in Queensland or WA.

MR O'DONOVAN: All right. Now, I think all the other questions that I want to ask are likely to relate to confidential matters.

MR HARLEY: Yes.

MR O'DONOVAN: So, I might leave it there.

MR SAMUEL: Yes. I've got – we could go on. Have you got time? I just want to take you back to the initial comment on pricing and you talked about international pricing factors. But international pricing factors won't relate to market milk, will they? They would only relate to the manufactured milk product?

MR McDONALD: The distinction between market milk and manufactured milk finished at the time of deregulation, so what we've found is, that since that time, milk is one pool and it is price based on local supply and demand factors. So, if you're sitting here in Victoria, you will find that the prevailing milk price would be influenced by what are the returns that one could get on the international market place. However, we look at other factors, such as wanting to maintain flat supply which is our market milk need, so therefore you may have to have some differential pricing in different parts of the season to maintain a flatter curve relative to what a seasonal curve may deliver. So, there's other influences there but it does drive the price tenets.

MR SAMUEL: This is fairly important information, though, because what you seem to be suggesting is that whether it's market or manufactured milk, the pricing of the product at least at your completed processing end – if I can call it wholesale end just for current purposes – which will drive it back then to the farm gate price, is very much regulated by international prices for manufactured milk product.

MR McDONALD: I would say that it's heavily influenced, not regulated by.

MR SAMUEL: Yes, "regulated" is the wrong word to use. I am sorry.

MR McDONALD: Yes.

MR SAMUEL: Influenced, yes.

MR McDONALD: Yes. It is heavily influenced and you will find that today the returns for milk are well higher than what they were 12 to 18 months ago, directly attributable to the returns in the international market place. And that has driven up prices for farm gate.

MR SAMUEL: Well, I want to get to the farm gate price in a moment. But it's – what you are suggesting is that the manufactured milk, international manufactured milk yield – that is price yield – is affecting – starting at your level, the wholesale level, is affecting the price at which you can sell a product. It's, in a sense, export parity.

MR McDONALD: It is certainly influenced by it.

MR HARLEY: Yes.

MR McDONALD: Absolutely.

MR SAMUEL: Now, what's the extent of that influence? I mean, what is the movement away from the international, the export parity price, that you'd been looking at?

MR McDONALD: You will find that, say from Victorian pricing is a good example, the price increases that we've seen and the industry has seen over the last 12 months fairly and squarely attributable to the international returns growing, however, you will find that if – in the past, when the international returns were depressed, flat milk supply need was well above that pricing. So, you would probably find that it depends on the cycle of pricing and where the market sits and also the supply factor as well. We've had diminished supply in Australia, so you've got to look at all these different factors when determining price. But the international pricing does provide a solid influence in any given season.

MR SAMUEL: Right. Now, we are all well aware that southern New South Wales and Victoria are probably the prime areas for milk production. If you move in to northern New South Wales and south-east Queensland, you move in to less appropriate areas and you've said that, of course, pushes up the cost in terms of those areas. But what flexibility is there if you're working on international export parity pricing? What flexibility is there to take account of the less satisfactory areas and the costs associated with that in northern New South Wales and southern Queensland and maybe even northern Queensland in terms of farm gate pricing?

MR McDONALD: I think with those given regions, we may have seen some structural changes over the last couple of years that may see prices stay at a higher level that may not move around as much or commonly linked to what international prices may do in the future. They have certainly risen over the last couple of years, to reflect the lower volume out of those regions because of many factors, drought and other environmental factors. We have seen prices increase.

Our view will be that those prices will stay firm for the immediate future and not necessarily influenced by commodity prices. However, longer term, a Victoria plus freight model may be the price determinant that – again, we will need to see what the future holds there. But if you were to look at those regions, your south-east Queensland, northern New South Wales, will probably stay firmer and higher those prices, despite what may happen in a Victorian context in the immediate sense.

MR SAMUEL: And when you talk about the Victoria plus freight model, that's on the basis of producing – processing the milk in Victoria and then freighting it up to northern New South Wales, southern Queensland, as the case may be.

MR McDONALD: It may not be processed in Victoria. It may be collected in Victoria and freighted up and used as a raw ingredient, no different to farm milk, in the manufacturing of market milk.

MR SAMUEL: All right. Okay. What's the average pricing differential at farm gate between Victorian milk and – I am putting southern New South Wales, Bega and the like, in too, but perhaps that's not appropriate – but what's the difference between that and northern New South Wales and southern Queensland?

MR McDONALD: I will talk at an industry trend level.

MR SAMUEL: Yes.

MR McDONALD: Versus specifically, if that's okay?

MR SAMUEL: Yes.

MR McDONALD: You will find that the market here in Victoria would be ranging well above 40 to 45 plus cents a litre whereas the Queensland market will be that, sort of, 50 plus range on a cents per litre basis.

MR SAMUEL: Yes.

MR McDONALD: And depending on different contractual terms and conditions, prices may vary accordingly as well. So, you find that there is a large gap in what has been experienced in the past. If you refer to Dairy Australia information, you will find that prices in Queensland were in that mid thirties range whereas in New South Wales and Victoria, probably the early thirties range. So, that gap has certainly widened.

MR SAMUEL: Widened, yes. And that has reflected itself then in the processed milk price? The relative prices between southern and northern in terms of the – what I will call the wholesale price, if you like – the price of processed milk?

MR HARLEY: I think that's the price, for example, we would sell to a Woolworths, Coles or whatever you are looking at.

MR SAMUEL: Yes.

MR HARLEY: Yes. It depends. In a branded sense, yes, because obviously we try and align our branded pricing with – not completely, but a lot more with – market conditions where we are manufacturing. In the case of private label it depends because we tend to have contractual obligations and the type of contract that we have for private label may determine how much we can shift or not shift pricing on a regional basis or state wide basis and if you want to go into that any further I would rather cover that in the confidential session.

MR SAMUEL: Yes, we will do that in the private session. Yes. When you have talked about the potential movement of farmers between processors, I mean, in each state we are probably talking about no more than two processors aren't we? You have talked about multiple processors. I am trying to understand what "multiple" really means.

MR McDONALD: You need to probably go down to a region by region basis.

MR SAMUEL: Do you generally have more than two processors available, two choices, available in region by region?

MR McDONALD: If you look at Northern Victoria it is probably one of the most competitive milk regions in Australia if not the world in a sense that there are a lot of processors that could pick up - and pick up farmer's milk. In New South Wales you have got National Foods, Dairy Farmers, Bega, Milk Co, Fonterra as options. In south east Queensland, National Foods, Dairy Farmers, Parmalat, Milk Co as options as in northern New South Wales. Victoria; those names, so we have got Parmalat, National Foods, Murray Goulburn, Warrnambool Cheese & Butter, Fonterra, United Dairy Power and then a range of, probably, other smaller companies as well.

In Tasmania there is National Foods, Fonterra, Murray Goulburn. In South Australia you have got Warrnambool Cheese & Butter, Murray Goulburn, National Foods, Dairy Farmers, Seko, UDP. In Western Australia you have got Challenge Dairies, National Foods, Fonterra and Harvey Fresh. So in most regions there is more multiple processors to – for farmers to choose whom to supply.

COMMISSIONER KING: Can I just ask – how many of those options are realistic for a farmer? I mean, the processors have their pick up run and if I am a farmer sitting in Warrnambool region as a region and I decided, well, look I am not happy with my current processing contract. Processors don't send a truck from 50 kilometres away just to pick up my milk unless I was able to supply, presumably, the full load. How realistic are these alternatives? I mean is it really the case that I can be sitting there saying, I have got a choice of three or four. I have got my current one. I may be able to commence another one if I am willing to drop my farm price by enough and that's really the issue.

MR McDONALD: From what I understand and what we have seen most regions are very, very competitive and processors are willing to pick up milk in nearly all regions that I – National Foods picks up for logistics reasons and also for risk management purposes in three distinct regions in Victoria, for example, in Gippsland region, northern Victoria and also in western Victoria. And logistically they vary considerably. Gippsland region is closest to our Chelsea milk plant yet we still pick up farmers in the Colac region and out west. Now, logistically Gippsland is far closer, however, it is important from National Foods perspective to have multiple regions for many risk management purposes as well. So you have got to look at other factors as part of any milk logistics arrangements. Not just distance.

MR SAMUEL: And yet as it happens you said before, before Stephen King arrived, that the churn rate is probably about the 5 per cent, maybe up to 10 per cent mark, so that there is not a lot of change that's occurring between processors.

MR McDONALD: Yes. There is churn potential. I think I said we will probably want to talk about it in the confidential session.

COMMISSIONER KING: Probably the wrong expression to use in the context of milk. We might end up with a lot of cheese or cream, but anyway.

MR McDONALD: But the percentage, they disclose, I think we will talk about that in the confidential session and I will give you some exact experiences of National Foods.

MR SAMUEL: Yes. Now, the only other – the other question I just wanted to ask you in the context of farmers. To what extent are you experiencing collective bargaining?

MR McDONALD: National Foods has been at the forefront of collective bargaining and has - I have to think about this in terms of the number of collective bargain groups but we have relationships with collective bargaining groups nearly in – almost in all regions of Australia. One in Tasmania, two in New South Wales, one in Queensland, one in WA that's stagnant for the moment and we work with the South Australian collective bargaining group but they don't supply National Foods at the moment. So we have welcomed that process and work effectively with collective bargaining groups quite – and we see it as quite an efficient means of managing the supply relationship from our supplier and also processor perspective.

MR SAMUEL: Does it make the bargaining tougher for you?

MR McDONALD: It certainly – it has changed the dynamics of the relationships.

MR SAMUEL: Why is WA stagnant?

MR McDONALD: It is something you will have to refer to that collective bargaining group, that question.

COMMISSIONER MARTIN: I just had a question about the retail prices and drilling down a little bit what Damien asked you about the ABS numbers and I think you said that probably your brand labels might have gone up around that level, the 4.2 per cent or whatever it was, but the 70 per cent, as I understand it now of generics, you think has gone up a lot less.

MR HARLEY: Yes. And when I talk about our brand of products I am referring to the total market so it is not just in process.

COMMISSIONER MARTIN: Yes, yes.

MR HARLEY: We are talking about all the other channels as well. Yes, so that the private label products which is the vast majority of volume that's sold through grocery retail. It certainly has not gone up at the same level as what our brand products have.

COMMISSIONER MARTIN: And you thought about two - - -

MR HARLEY: Around about that. I haven't got the exact figures. I didn't do a calculation. But it was certainly significantly less.

COMMISSIONER MARTIN: So it would appear therefore - - -

MR HARLEY: And that's mostly, sorry to interrupt, but that's mostly been in the last, sort of, six to nine months.

COMMISSIONER MARTIN: That it has gone up that, yes. So the dollar differential or whatever it is now has really been accentuated in that period.

MR HARLEY: Yes.

COMMISSIONER MARTIN: Okay. What about other products? What has been the retail trends there in the yoghurts and the cheeses?

MR HARLEY: In yoghurt, private label, is a very, very small percentage of the total market. It is around 4 per cent. So it is not so relevant I guess. Although they are, obviously, lower priced. In cheese we don't play in the major part of the cheese market where private label participates. So it is a little bit difficult for me to comment. But with juice - - -

COMMISSIONER MARTIN: Well, more generally in the branded though what's - - -

MR HARLEY: In the – that continues to happen. If you look at the juice market and other markets we participate in is the gap between branded product and private label is certainly widening, going forward, as we are able to or we try to recuperate some of the cost increases we are seeing because not only have milk costs gone up but if you look at the cost of juice, because of the drought, supply of oranges, apples, etcetera in Australia have gone up significantly so we have tried to recuperate some of the cost increases that we have had. Not all of them. Private label haven't moved their pricing the same.

COMMISSIONER MARTIN: With the branded – those branded products, either yours or more generally, are you aware of what the ABS figures are showing and do you think it is a proper reflection of what is happening in the other dairy - - -

MR HARLEY: I am not aware so we would be – I can't really comment.

COMMISSIONER KING: I will just follow up on one of the questions, John. Just on the difference between - firstly I should apologise for arriving a bit late. I was in another meeting so also apologise if some of my issues have been answered by earlier information. Please just inform me and I will find out from the transcript later on. Just on, say, milk and yoghurt where you referred to the difference in the amount of private label product there is obvious significant and, I think you said in the major supermarket chains, up to 74 per cent whole milk private label. Yoghurt, you said, there was very little private label. In your opinion why has that sort of difference arisen? Why isn't there private label yoghurt and what factors have driven that difference? Why is there private label for milk so common and why is private label yoghurt not common?

MR HARLEY: On a general basis I think when you look through the market place, whether it is milk or eggs or bread or other staple products, and there is, I guess, less differentiation between a branded product versus a private label product. There tends to be much higher penetration of private label overall. Where if you go and look at – well, if we use yoghurt, for example, there is a lot of differentiation, there is a lot of innovation, there is a lot of support for branded products and the penetration of those categories and the consumption of those categories is relatively small compared to the main staple market. So I guess the trend, internationally, if you want to look outside of Australia is that private label will start to grow in those categories as well as retailers spend more time and effort and focus more on those categories to the same degree.

COMMISSIONER KING: If I can just then return just back to the import, sorry the international price issue, as the Chairman said that's obviously a key issue and I must confess I am still somewhat confused by this. And, again, apologies if this was partly covered beforehand. The manufactured product that is exported from Australia, now, that is – milk powder is one.

MR HARLEY: Cheese.

COMMISSIONER KING: Cheese. Long life milk.

MR McDONALD: Essentially, if you look at the product make up Australia produces 9.5 bin litres, 2 bin litres are consumed as everyday drinking milk. So the other seven to seven and a half billion litres is converted into some form of manufactured product. Now, that manufactured product may be cheese, it may be skim milk powder and it may be butter or it may be skim milk concentrates. It may be yoghurt. But of that seven and a half billion litres of consumption half of that is essentially exported and the parity issue essentially says that, look, you could earn as a processor sell it overseas and earn X dollars. That's essentially – it's the best return for commodities and that's one of the influences of value here in south east Australia.

COMMISSIONER KING: So if I was to look at the margin that you make and I just want a general level here, not for specifics, but if I was to look at the margin that you make on your range of domestic milk products versus the margin that you make on exported cheese products or exported powdered milk type products intuitively I would have thought the margins would be higher on domestic milk. Is my intuition wrong and if so why is it wrong?

MR McDONALD: I think in terms of margins we will probably talk about that in a different, in the confidential sessions, but National Foods doesn't export skim milk powder. So it doesn't play in a lot of commodities internationally outside of branded.

COMMISSIONER KING: So they just focus on the cheese products that - - -

MR HARLEY: Which again is a very, very small volume. So we are not a major commodity supplier either domestically or internationally. We have a very small international cheese business which is essentially excess capacity that we have whereas there are other manufacturers who focus far more on supplying commodity product into the international market.

MR McDONALD: So our business is drinking milk, essentially, or graded milk, and therefore we can't necessarily swing between branded milk one week or send it overseas. That's our issue.

COMMISSIONER KING: Which is what I thought which then makes me think, well, why is this international price so important for you? If you can't really swing between them. Now, if the international prices moved up on these manufactured products why are we seeing that reflected in domestic milk prices?

MR McDONALD: Well, it is essentially to – it is part of the major influence of your input prices for your order. That's the issue.

MR HARLEY: So – and it comes back to competition. At the moment, you know, there is competition sitting in the procurement of farm gate milk. It can be us buying it or it can be our competitors buying it. Those competitors either can be other domestic milk suppliers or they can be people who supply the international commodity market. So the farmers can get more money for buying milk from a co-operative or another manufacturer that then goes and sells it overseas. Then that's what will move them in terms of supply and we have to compete with them to get the milk because – and not only do we have to compete with them to get the milk through the high peaks of the season where the cost of production is lower because they feed on grass, etcetera. We have to maintain that relationship with them on that 365 days of the year because we need to supply the market on 365 days of the year.

COMMISSIONER KING: Okay. So the swing, if I can call it that, between domestic and international isn't within an individual processor so much as the swing occurring at the farm gate between two different processors.

MR HARLEY: Absolutely.

COMMISSIONER KING: Okay. Understand. Thank you

MR SAMUEL: All right. We go into private session. So all those not connected with the ACCC or National Foods if you could vacate the room please.

CONTINUED IN TRANSCRIPT-IN-CONFIDENCE

CONTINUED FROM TRANSCRIPT-IN-CONFIDENCE

RESUMED **[11.48 am]**

MR O'DONOVAN: Okay. Could you just state for the benefit of the transcript your full name, the company you represent and your role within that company?

MR MARTIN: Kim Llewellyn Martin. I work for Riverside Australia which is part of the Costa group of companies and I work in the role of business development.

MR COSTA: Stuart Costa, also with the Costa group, specifically the Divisional Manager of Riverside Australia within that group.

MR O'DONOVAN: Now, have you been summonsed to attend here today?

MR MARTIN: Yes.

MR COSTA: Yes.

MR O'DONOVAN: And do you understand that it is an offence under the Criminal Code to give evidence at this inquiry that you know is false or misleading or remits any matter or thing without which the evidence is misleading?

MR MARTIN: Yes.

MR COSTA: Yes.

MR DONOVAN: All right. Could you just state, broadly, first what the Costa group, as a whole, does?

MR COSTA: Okay. Broadly speaking, Costa Group is broken up into a couple of different areas. Specifically into logistics and then in growing and trading. Logistics where we have some warehousing operations, both here and abroad, that manage the distribution of primarily fruit and vegetables to major retailers but also extended into other products in some areas and then on the growing side we have substantial growing operations in Australia in the areas mainly of grapes, blueberries, obviously in horticulture, tomatoes, potatoes, lettuce, broccoli, mushrooms and then also have some trading operations whereby we have wholesaling arrangements or, yes, across the country basically.

MR O'DONOVAN: Okay. So does Costa have parts of its operations that operate in the wholesale markets?

MR COSTA: Yes. Yes.

MR O'DONOVAN: But that's not your part of it?

MR COSTA: No.

MR DONOVAN: So can you tell us specifically which part of the business Riverside deals with in your part of the business?

MR COSTA: Yes. With the growing and wholesaling of what we call brassicas or lettuce. So they are – brassicas are just a family or group of vegetables which is made up of broccoli and cauliflower and cabbage. But we grow and market product predominantly to the major retailers.

MR DONOVAN: So your two biggest customers would be Coles and Woolworths?

MR COSTA: Correct.

MR DONOVAN: Do you deal with Metcash at all?

MR COSTA: No.

MR DONOVAN: Are there any other significant customers who are worth mentioning?

MR COSTA: If you group the wholesale markets together as a customer then they would be but there are a number of – that make them up across – around Australia.

MR DONOVAN: Okay. So you sometimes do sell to wholesalers operating within the market?

MR COSTA: Yes.

MR DONOVAN: But not always the Costa, the division of Costa's that operates in the wholesale market?

MR COSTA: Yes. No. Those areas are specifically focussed on particular product groups and not necessarily the ones that we are involved in.

MR DONOVAN: So in terms of the product that is supplied to your customers what proportion of it is actually grown by Riverside?

MR COSTA: In the vicinity of 30 per cent I would think.

MR DONOVAN: And the other 70 per cent? Is that bought at arm's length from other growers or do you have contract growers or what arrangements do you have with growers to fill the other 70 per cent?

MR MARTIN: We have a number of different arrangements. We're involved in primary production ourselves, we also have joint venture farming operations with growers, and then we also act as a merchant, so we have a number of different models that are active.

MR O'DONOVAN: Okay, sure. And in relation to a joint venture, how would a joint venture operate?

MR MARTIN: A joint venture operation could be where we partly fund the cost of the growing of the vegetables and take responsibility for the marketing of the product; another joint venture that we have is one where we have invested in the processing of vegetables, so it's taking the product further than just whole: it's taken into a processed state, and our role in that is the processing area, so it's a joint venture with the grower, and we're the processor, and then we market the product to Woolworths or Coles in this situation.

MR O'DONOVAN: Okay. And then the merchant transactions, how - firstly, what proportion of the stuff that you supply to customers would come through these merchant transactions with growers?

MR MARTIN: I think it would probably be 70 per cent, it would be whatever wasn't in our primary production side, so it will be the balance of that: it will be 60 to 70 per cent.

MR O'DONOVAN: Okay. So the joint venture component is quite - is, relatively speaking, quite small?

MR MARTIN: Yes, I think it's captured in that 30 per cent - - -

MR COSTA: Yes, yes, it's more - it's a part of that 30 per cent.

MR O'DONOVAN: Right, okay. All right, now, just in terms of the growing operations, are the costs of the growing operations increasing?

MR MARTIN: Absolutely.

MR O'DONOVAN: Okay. Can you just describe what the major costs are?

MR MARTIN: Well, fuel, fertiliser, and water. I mean, every day in the paper you will read something about one of those going through the - through the ceiling, and fuel, of course, spreads over all input costs because of the transport factor. One of the things with growing fresh produce is it's specific to a climate, so you can't just move your growing region close to where your market is; you may need to be located in the west of the state, in the north of the state, in the north of the country for that climatic reason so it can produce the crop, so, therefore, fuel costs really impact severely on getting your input costs to the farm at a low cost and getting the product to the market.

MR O'DONOVAN: Yes, okay. And in terms of your ability to pass those increased costs up through the chain, have you been able to pass all of those costs through?

MR COSTA: It's a really difficult question to answer because the industry doesn't work that way, so it's not - it's like I said, I think, in our discussion last week, we don't work in a - or live in a cost plus industry, so - and it's actually something, if you speak to a lot of people in the industry, it's a bit of a sore subject, because, say, for example, when fuel costs increase, we will receive a advice from our transport companies that "as such, so will our fuel levies," and so they're able to pass the costs on.

We're not necessarily able to do the same with our customers, so what normally happens is - and it will take a period of time - it will have an impact on production, it will have an impact on supply, and, therefore, because prices are generated through - simply through supply and demand, that - well, everyone hopes that it will then be reflected down the track, but, you know, we have gone through a period, like Kim just indicated, of escalating costs at a rate, you know, that we probably haven't experienced before: that hasn't necessarily reflected in the price of all of the products. You know, I think that there has been some talk, I think, of late, of where the products have gone up. I don't know that's necessarily the case with all products.

MR MARTIN: Having said that, with our - with one of our fixed price models that we do have - so we have market prices and fixed prices - we were just recently able to successfully negotiate the price upwards because of these types of pressures, so it has been accommodated in that case.

MR O'DONOVAN: Yes, okay. So then in terms of how you set your wholesale price, noting that it's not a cost plus model, is there a relationship between the price that you negotiate with your major customers and what is happening in the wholesale markets, and the published prices there?

MR COSTA: That's where the conversation starts, so, like, it's a very competitive industry, so - and largely - there are some exceptions - but, largely, they take the shape of they're weekly negotiated, and, if not, negotiated a couple of times a week, but the conversation will always start with what the product in its rawest form is attracting in the wholesale market, or the closest wholesale market, yes, and then it will flow on from there. And that - sometimes the finished price might end up very close to that, or it might be poles apart, depending on the negotiation.

MR O'DONOVAN: Right, okay. Are there any factors in that which you're happy to talk about publicly?

MR COSTA: Well – yes, well, there's some very big ones now. I mean, you have only got to walk into a supermarket now to see the huge difference between the way that a product is displayed now to how it was even five years ago, and that is because now a lot of the - with the introduction of one touch retailing, or the returnable plastic crate, you know, a lot of the cost that was previously incurred at store level is passed back down the line, so that's where I said before that your conversation will normally start on what the raw product is in the market, but that is now a very different product to what is sold to the retailer, in a lot of cases, because of, you know, whether it's packaged or it's, you know, the unit of measure is very different.

MR O'DONOVAN: Okay. So when you say that is the start of the conversation, you then try and explain what you have added over and above just the raw product, in terms of supply to them, so - - -

MR COSTA: Yes, yes, absolutely, but also the unit of measure for a standard box of broccoli might be 8 kilograms, for example, and that's what is traditionally sold in the wholesale market, but what the retailer might buy might be 10 kilo, it might be 7 kilos, so, you know, it's not always because of what packaging or what we have done: it's more to do with just bringing it back to relative terms, I suppose – comparison.

MR O'DONOVAN: But, generally speaking, is - and, you know, deal with this question at whatever broader level you are happy to deal with in public - is the kinds of published data that is available about wholesale price in the wholesale markets, does that roughly reflect what the major retailers are paying for fresh fruit and veg?

MR COSTA: See, I'm not even necessarily able to answer that question because I don't - I'm often a bit sceptical about the information that is published in - see, you're talking about the daily pricing that is published by the individual markets. You know, I think that sometimes that information is a little bit misleading, because there are so many varying - you know, the quality variations are not necessarily picked up in that.

There are - but also, you know, that's information that is - it's to a target audience, so I don't know that that - sometimes that that's information that a wholesaler in a given market might want that sort of information to go back to the growers, for example. I mean, I don't know. I can't comment, because I don't - I don't look at them myself, so I don't - I couldn't tell you how close that that is to what the major retailers pay, because I don't - I don't pay any attention to them.

MR O'DONOVAN: Right. Sure. You said earlier that that's where the conversation starts, with the - what is happening in the wholesale market.

MR COSTA: Yes.

MR O'DONOVAN: So are you saying you don't specifically read those Ausmarket reports?

MR COSTA: No.

MR O'DONOVAN: So how do you - what market intelligence do you rely on for what is happening in the wholesale market?

MR COSTA: Because we have people - we have people around the country, we certainly - our customers have people in every one of the markets, but we're also servicing those wholesale markets, like I said earlier, so, you know, we have a fairly close - keep a close eye on them, but, yes, through other avenues, rather than the market reports.

MR O'DONOVAN: Right, okay, and do you think that the market intelligence you're getting is more accurate than you can get from the Ausmarket reports?

MR COSTA: I couldn't comment. I'm not sure. I mean, we think that we have got pretty good information coming from the markets.

MR O'DONOVAN: Sure, okay. But that's - but it's your market intelligence that is the starting point for your conversation with your customers?

MR COSTA: Ours and theirs, yes.

MR O'DONOVAN: Yes, okay. All right, so then, in terms of the relationship that you have with these - with the big retailers, are they formalised? Do you have a formal relationship set down in writing somewhere that you can say, "I have got this Coles contract, I have got this Woolworths contract"?

MR COSTA: I don't know that we - - -

MR MARTIN: Contracts don't exist in that form, but what guides us to our production is that we have a, like, a schedule of production, that we are going to supply them with - through a given period, and that could be in the form of actual units, or it could be in the form of percentage of their total sales. It's given out either way. So we have a history - because we have been supplying them over many years, we have a history of understanding of how many iceberg lettuce will be sold in the month of January, and what influences the sales through that period, so we work from year to year, and they advise us as to whether we have increases or decreases given on, you know, what is happening in their sales. Maybe the products that we're supplying are losing market share to another category. So all of these things taken into consideration, we get good guidance on, basically, how many plants to go and put in the ground, either on our own farms or with our suppliers.

MR O'DONOVAN: Right, okay, so at the - whatever the right time is for planting a lettuce, you will - before you do it, you go and talk to your major customers and say - - -

MR MARTIN: Yes.

MR O'DONOVAN: - - - what sort of volumes?

MR MARTIN: Well in advance. Well in advance.

MR COSTA: If you look at our products, they will break them down into seasons, and prior to that season, you will have a - you will be given a guide, or they might call it a commitment, or they might call it a percentage of market share, or, yes, of what they intend on purchasing, so therefore, what we have to go out and source or have to go out and grow, but that will still vary for a number of reasons.

MR O'DONOVAN: Right, okay, so it's not a firm - - -

MR COSTA: But it's certainly not a contract though. It's certainly not a contract.

MR O'DONOVAN: - - - it's not a firm - it's not a firm commitment, but it does indicate to you how many lettuces you ought to be growing?

MR COSTA: Yes.

MR O'DONOVAN: Okay. And then the decision of how many to grow is, obviously, your decision - - -

MR COSTA: Yes.

MR O'DONOVAN: - - - and with a view to making a good margin on what the volumes you think are likely to be?

MR MARTIN: And risk. I think managing the risk of supply. Because we're such a large part of the categories that we're involved in, we have a big responsibility to deliver, so we have to manage our growing risk, which is very real, very real, every day; you know, you have got exposure to the climate, so that's how we allocate. We don't have farms in every growing region, so we don't grow it all our self, not that we necessarily would, but that's how we allocate it round, based on risk.

MR O'DONOVAN: Right, okay. And then how is that then passed down to your growers? How do you - do you give the same indications to your growers, or - based on what you have been told by your customers?

MR MARTIN: Yes. But the growers will be informed of what the commitment or the schedule is for that period, and, you know, if they're supplying us with 10 or 15 per cent of the lettuce for that period, that's how we talk in terms: numbers of plants that need to go in the ground. It comes back down to seed going into nurseries, into trays. That's what you extrapolate it all back to, because, you know, the gestation period for some of these crops is up to six months when we're talking cabbage: it's a long time out.

We're already looking at next summer's iceberg lettuce and things like this now, so it's a long period, and there is a lot that can change in the retail environment between now and then. So the seed goes in the trays in good faith that everything should be, but just within the supermarket category in the area where we work, in fresh produce, you know, things are changing: there's different products that are taking market share from the traditional lines, and that's all evolving.

MR O'DONOVAN: Okay. So as far as the start of the season goes, you have got indicative volumes, or at least indicative market shares, and you can presumably do your own assessment of volumes at that point, is that right, if you have got a market share suggestion?

MR COSTA: Yes, you can, but, like Kim said, you have got to - we have an obligation to fulfil those, so, therefore, if we have a - if a growing region has a problem, then we have a - you know, we have to still be able to meet that commitment, so there are a number of things that come into it, not just that commitment or that market share that come into what we go out and try and grow, or have grown for us.

MR O'DONOVAN: Okay. Now, when you say you have an obligation, you don't mean you have got a contractual obligation - - -

MR COSTA: No, no.

MR O'DONOVAN: - - - that they'll sue you if you don't supply?

MR COSTA: No, no, no, no, no, no.

MR O'DONOVAN: But - so tell me about the form of obligation which you feel you're under in terms of supply?

MR COSTA: When we're talking to the retailer about what we're going to do for a coming season, then we - the basis for that is our performance for the previous season; so if we have under-fulfilled, or we have not met our commitment for that previous period, then, you know, it's a bit of a stretch to think that you are going to get similar volumes for the coming period.

MR O'DONOVAN: Right, okay. So the likely consequence is they will shift their business to someone who they perceive as more reliable?

MR COSTA: I think that that would be fair enough.

MR MARTIN: Yes, that would be the way it happens, I think. And, also, because it's - you know, the cost of compliance is always increasing in the food chain - it doesn't matter where you sit - I think the rules are getting tougher, and the goal posts are getting a bit closer together, and so that, to us, means additional overhead costs, you know, when it comes to the various levels of assurance and governance that you have to have in place in your business, so that's there, regardless of whether you have got the sale or not. So if you set your business up to supply a large amount of lettuce, and it's not coming through, you do need to generate it from somewhere to protect what you have put in place.

MR O'DONOVAN: Okay. And in terms of outside alternatives, it the big retailers cut back, are there other big customers that you can pick up if - - -

MR COSTA: Yes, Aldi are a very big customer now, and, you know, the independents are certainly, collectively, are very large, and there is a number of large retailers out there. It's more a point of what business are you going to be in. I mean, we're located in growing regions; that is what our business is, but we could go and take a position in any or all of the wholesale markets at the same time, and have closer access to the independent retailers that are around the country, so there are options. We're pretty comfortable with where we're at at the moment.

MR O'DONOVAN: Right. So in terms of your preferences, it's to meet the commitments to the major retailers and maintain the volumes with them?

MR MARTIN: Yes.

MR COSTA: Yes, absolutely.

MR O'DONOVAN: Yes. Okay, so then you have this discussion at the beginning of the season and then as things start to grow or start to ripen, and presumably there is a point in time at which orders become firm. When do they start firming up?

MR COSTA: About the day that it has got to be loaded, would be the day that they're really firm, but they start to firm up, would be - trying to think, today is Thursday, today we would have a pretty good guide of what is happening next week.

MR O'DONOVAN: In terms of volume and price?

MR COSTA: In terms of volume - yes.

MR O'DONOVAN: Okay. Are those the two - they're the only two things that really need to be sorted out?

MR MARTIN: It's very hard - because of the perishability, it's very hard to do anything much before, you know, the actual order. If an order is imminent, that's the time when, "Now, what is the volume and what is the price?" To decide that prior is really - is of no value of importance, because it changes. It's the variability that is creating the price movements, so - - -

MR O'DONOVAN: Yes, okay. And then - so for the stuff that is going to be delivered on Monday, at what point then do you fix the firm price and volume agreement where you actually do have an enforceable contract?

MR COSTA: That would be all - in 99 per cent of the cases, that would already be done today - by today, so between Wednesday and Thursday of the week prior, it would be done. It would only be a very rare occasion that that conversation would carry over to Friday.

MR O'DONOVAN: Right, okay.

MR COSTA: But certainly well in advance of Monday.

MR O'DONOVAN: Right. And is then - do you have an agreed price for the whole of the week - for all of next week?

MR COSTA: It's everyone's goal for the price to be able to be carried through the week, but there are occasions when, either from our end, or from the retailers' end, that another conversation will take place early next week, or early in the week, for that price to change in the latter part, but everyone would like to, you know, hold the price for the week. That's the goal anyway.

MR O'DONOVAN: Okay. So if the goods are despatched - say, you have agreed a price today, and the goods are despatched on Monday, and delivered and accepted in the DC, you will - are you certain that you will get the price that was agreed today for that order?

MR COSTA: Yes.

MR O'DONOVAN: Okay. But the might ring back on Tuesday and say, "Look, for tomorrow, we need to make a change"?

MR COSTA: It changes a lot because - and I - if I try and give you an example, as from next week, all of the lettuce that we will be selling into Victoria will be coming from Queensland, so it will be despatched from our Queensland operation, so it's two days prior, so we will load that on the truck, say, for the product that arrives on Monday, it will be loaded on Saturday. Now, there are occasions when a conversation might take place about changing the price for a product that has already been despatched, however, that would only be acceptable if - if that was okay by us, or equally okay by them. I mean, we have - we have an understanding that, you know, negotiations only take place for product that hasn't yet been loaded - hasn't yet been despatched. But for me to say that, you know, that we don't talk at other times about product that has been loaded then that wouldn't be true. I mean, those discussions take place, yes, but they - it has got to be mutually agreed upon.

MR O'DONOVAN: Okay. And if you are having a discussion, after despatch, firstly, why are you having a discussion about price after despatch?

MR COSTA: Well, in particular, we are - say, if it's prompted by us, there is one of two reasons, and that is that either the market has lifted in that earlier part of the week, and we would like to talk about trying to get more money for it, simply for one of two reasons: we either just simply want to get the money that we believe it's worth, or equally we want to try and slow demand back a little bit to try and reflect what supply is. But, just as often, it happens the other way, where we want to try and stimulate some demand, so, you know - and really the same in reverse would happen with them, where they would contact us.

MR O'DONOVAN: And so you would want to stimulate demand because you find you have got more product ripening, and you're going to run into an over-supply problem if you don't get it moved at the retail level?

MR COSTA: Yes, but not only that. I mean, it might be awfully cold in Victoria, not a lot of people are buying lettuce, but it doesn't stop it growing, so that happens equally.

MR O'DONOVAN: Right, okay. And from the retailers' point of view when will they initiate - what is your impression of when they will initiate discussions with you about products being despatched, that they want to say, "We're not happy with that price anymore"?

MR COSTA: Sorry, when or why?

MR O'DONOVAN: Why - - -

MR COSTA: Why would they?

MR O'DONOVAN: Yes, why would they be ringing you up asking for a new price after despatch?

MR COSTA: Okay. Similar reasons, so they would want to try and get more product moving, but there are occasions where they might be faced with some competition so it might help them be able to meet the competition that's out there. They're really the reasons. I mean, they could go to market on Monday morning and the price of lettuce has eased, for example, or the price of whatever products in question has eased, and they want to have a conversation about making sure that they're competitive so - - -

MR O'DONOVAN: Right. And is it, generally speaking, that each of you would ask for a change as often as the other, or does it tend to be they ask for a reduction a lot more than you ask for an increase?

MR COSTA: It depends on who you are, but I think if you ask them, they would say that we probably ask for it a bit more, and if they're not in the room, then I would probably agree with them, but - yes, I don't know. I mean, we're probably as bad as each other.

MR O'DONOVAN: But it's not all a one way streak with them just saying, sorry, you have got to give it to us cheaper today?

MR COSTA: No.

MR MARTIN: No, no.

MR O'DONOVAN: No, okay. All right, then - so then when it's delivered at the DC, they then have the option of rejecting if it's not within spec, is that right?

MR COSTA: Yes.

MR O'DONOVAN: Okay. Now, how often does that happen?

MR MARTIN: Not very often at all.

MR O'DONOVAN: Right, okay.

MR MARTIN: Maybe, overall, one per cent - less than one per cent.

MR COSTA: The target is less than one. It's probably less than two per cent, but it's - - -

MR MARTIN: It's a very low figure.

MR COSTA: - - - one or two per cent.

MR O'DONOVAN: Okay. And do you have concerns that project being rejected is being rejected for reasons other than specification: that it's price driven?

MR COSTA: No, no. No, I can confidently say that I have never had a concern over it being price driven. I might have, at times, questioned their interpretation of that specification, as compared to ours, but certainly I have never been in fear that it has been rejected for anything other than quality reasons.

MR O'DONOVAN: Okay. All right, well, then turning to - sorry, and then what - once it's rejected, what then happens to the product?

MR COSTA: Yes, we will either bring it back and repack it, or bring it back and dump it, or bring it back and donate it, or ask a - you know, if it's in a state, ask a wholesaler that we have a relationship with to see if he can try and recoup some money for that product, but, you know, the clock is ticking so you got to act pretty quickly, so yes - I mean, the products will normally be rejected because of, you know, there will be some form - some sort of, obviously, a defect, or it's been a problem in transit, or there might be a temperature issue, so it's very rare that that product can be salvaged and given back to the same customer. More often than not, it's something that we have got to, you know, look at putting back through either the wholesale market or disposing of.

MR O'DONOVAN: Right. And do their packaging requirements make it more difficult for you to sell into the wholesale markets?

MR COSTA: Absolutely.

MR MARTIN: Adds costs.

MR COSTA: Absolutely.

MR O'DONOVAN: Right.

MR COSTA: Adds cost, but also, in some cases, it's packaged under their brand, so you can't - you can't - previously the product was the same - it was the same box that went to everybody, so now it's a bit different.

MR O'DONOVAN: And when you say that, you mean they have gone into, you know, Woolworths plastic bags?

MR COSTA: Yes, or a Coles crate. Now, they're in Shep Coles plastic crates, or Shep crates, or it might be in a Coles or a Woolworths bag or pack of some description.

MR O'DONOVAN: Okay. And so in terms of what you - what Riverside has done to the product, when it has come in - does it come in from growers, packed in those containers, or is it part of your function to actually convert it into the form that retailers want it in, in terms of packaging and containers?

MR MARTIN: It comes in - it comes in in a range of different packaged formats. Some of it, it comes in knowing what the end destination is going to be; some of it comes in and it's processed. We actually have a processing facility - a couple of processing facilities, where the product actually comes in, in bulk, and is partly processed, and packaged into Coles or Woolworths packaging, and then it goes out, so - but quite a large percentage does come in, in the supermarket's packaging, does arrive at the - at our facility.

MR O'DONOVAN: Right, so that has already been done by the grower?

MR MARTIN: Yes.

MR O'DONOVAN: Right, okay. All right, well, then going back to the grower relationship, if a grower has these packaging - this ability to pack for the major supermarkets, why do they deal through you guys?

MR COSTA: Yes, it's pretty good question. I mean, there are a couple of reasons. One is because a grower might be packing it, however, may not have the ability to cool the product adequately, or to do everything, so it's a - and just to help you understand that: I mean, there are some growers that just grow, and that's all they do, like, they literally do not even have a cool room or a cool store; they don't have the ability to manage the stock levels that are required to be able to satisfy the demand for the retailer, but equally some of it has got to do with scale.

You know, retailers are more and more looking to deal with fewer larger businesses, rather than, you know, a large amount of smaller growers, for example. It is more difficult for a single grower - which is exactly what we have found, and it's exactly why we don't grow 100 per cent of what we sell - it's very difficult for a grower to manage that risk, manage the supply risk on behalf of the retailer, because of the multitude of locations that are needed. It's different if you're looking at, say, like our - the tomato operation that the Costa Group have, it's protected cropping, it's grown under glass. Now, the rest of it is out there in the elements.

MR O'DONOVAN: So, in some ways, you consolidate supply and coordinate distribution is the key function you perform for the supermarkets. That's why they - rather than having to do that function themselves with a multitude of growers, they can just deal with you?

MR COSTA: I think it would be fair to say it's one of the key functions of. I don't know - I don't know that I would necessarily say that it's any more or less important than a number of functions, but it's one of the key functions that we perform.

MR O'DONOVAN: Right. But it's certainly one that you perform over and above what the growers that supply you perform?

MR COSTA: Yes, yes.

MR O'DONOVAN: Okay. So then once - so in terms of communicating then with the grower, do you have a specific supply contract with the grower at the start of the season, or what have you provided to the grower in terms of what they - - -

MR COSTA: Yes, we don't - with our external growers, we probably don't necessarily provide them with a lot more detail than what we receive ourselves. I mean, most of these are long standing relationships that we have had, you know, so we will certainly communicate with them, prior to the commencement of where they have to sow the crop, about what our expectations are and what we're looking for. And they will often just use that as a guide as to what they're doing with their business, because there are some growers that will supply us exclusively, but that is probably more the exception than the rule.

MR O'DONOVAN: Okay. And so what other avenues - the growers that supply you, what other avenues would they be taking advantage of in terms of disposing of their product?

MR COSTA: Yes, they will supply our competitors, they will supply - - -

MR O'DONOVAN: And when you say competitors, other people who perform the same role for the major supermarkets as you guys?

MR COSTA: Yes, yes. In some cases, they will actually have a commitment, say, with one of the retailers themselves, but then - but it's not able - but they still need some assistance in selling the remainder of their crop or their whole crop. Some of them will go to their local market themselves and have a - what we call a stand in one of the wholesale markets, where they will be selling to the independents themselves, so I think that pretty much covers what - I mean, they might service some processors. I mean, it could be - - -

MR MARTIN: The other thing, too, to keep in mind, these are all annual crops, and that is to say that the grower doesn't always grow 100 acres of lettuce every year. It's not like a treed crop where the trees are in the ground for 15 or 20 years and that's the crop. They can vary what they want to grow too, based on the resources that they have. Some crops are more expensive to produce than others; water is a big issue with growers, and certainly steers towards what crops they will be growing, so even though we have long standing patterns, the growers aren't always looking to grow the same - exactly the same crops year on year: they're looking at upping and downing, you know, increasing and decreasing the volumes as well themselves for different reasons, so it's a little bit different to perennial treed crops and stuff.

MR O'DONOVAN: Okay. So they obviously have to make their own judgments about how much and of what they want to grow?

MR MARTIN: Mm.

MR O'DONOVAN: And when they have made that decision, when do you start talking to them about prices and volumes, trying to firm those figures up for your - out of your supply?

MR MARTIN: I think the volume is well understood, that this is what we're going out to achieve, last year's sales plus or minus some. So we can extrapolate that back into what the grower needs to know, which is how many seeds of which variety he needs to be putting in the nursery at a specific time to achieve those harvest dates. So we're already talking volumes indicative. You know, this is what it could look like. But the price really doesn't happen again until we're in that actual window of the sale, otherwise, you know, we'd be talking a price that isn't going to be relevant.

MR O'DONOVAN: Yes. Okay. Well, if you're – say you were talking to fix a price with one of your customers today, will you have already spoken to your growers and given an indicative price or a firm price? What will you have given a grower today, if you're discussing price with a major supermarket?

MR COSTA: They will have an understanding of where the price discussion is today, but equally have an understanding that the price is not confirmed until the product is received.

MR O'DONOVAN: Yes. From then.

MR COSTA: Products - - -

MR O'DONOVAN: Or received by the supermarket.

MR COSTA: By the supermarket. Sorry.

MR O'DONOVAN: Right. Okay. So you will give them as much indication as you can of what you think the price is going to be. Prior to despatch from there?

MR COSTA: Well prior to despatch. I mean, that conversation could be happening now for what we believe the price is looking like for the next month.

MR O'DONOVAN: Okay.

MR COSTA: I mean, we'll have an idea, but we won't be able to firm that up until, you know, the actual sale is made. But, obviously, the closer we get, the firmer that we can be about where the price is going to be.

MR O'DONOVAN: Right. And so in terms of them making a choice whether or not to send to you or to a competitor or to a wholesale market, again they'll just be – they'll get indications, or make their own assessment of what's available in the – what might be available in those other avenues. Is that the decision that they have got to make?

MR COSTA: It's the decision that's available to them, so there are some that will take that – go down that path. There are others that will just simply try and hold us accountable to what they believe that the right value is, and leave the negotiation with the supermarket up to us. Yes. But, I mean, there are – like I said earlier, there's no contract between us and the grower at the same time. So the grower can choose to supply the product through us or not.

MR O'DONOVAN: Right. So but you need to – if you have an indication of volumes from a customer, you have got to get it from somewhere, so you have got to persuade someone to despatch enough of their product to you. Is that easy or difficult to do? And does it depend on the indicative price?

MR COSTA: We have been in the business a long time, so it's actually not – it's not – I think it would be very difficult if you were just starting in the business. But we have been in the business a long time, and been dealing with the same growers for just as long. So, you know, it's not an overly difficult process. But at the same time, the grower will still wish to remind us that, you know, that we are – we have a very – we have a critical role, I suppose, to play in the – in terms of negotiating the value for their – for their products. So - - -

MR O'DONOVAN: Okay.

MR COSTA: Yes. The conversations still take place, but they – but they're not – these are not – this is not a new relationship, I suppose.

MR O'DONOVAN: Yes. All right. So then – so product is despatched with an indicative price discussed, but nothing more than that.

MR COSTA: Yes. Despatched from the grower? Sorry.

MR O'DONOVAN: Yes. Despatched from the grower to you.

MR COSTA: Okay. Yes. Yes, despatched from – where Kim spoke before about volume, just you have got to remember also that growers have an expectation that they will harvest whatever is mature.

MR O'DONOVAN: Yes.

MR COSTA: That doesn't always meet what demand there is for that product on any given day. So, you know, you get a much clearer and a much firmer pricing guide from the supermarket than you do from a wholesale market. That will vary much more readily than what you get from the supermarket. So if you're in a situation – particularly when the products that we handle, which are very volatile, so the shelf life is very small, so you – we actually can't sit on that product, we can't hold that product for very long, that there are – what product that we have to put through the wholesale markets will vary. So if you're in a period of oversupply, then obviously there is much more product going through the wholesale markets than otherwise, because it's not a preferred avenue, not for our business, of supply.

So it is a – so the conversation about volume with that grower will often be not necessarily about what we want, but will often be about what's coming. So what needs to come out of the ground and, therefore, we have got to be able to manage that with the customers that we have got, and the orders that we have got, and understanding that the grower wants to go out again tomorrow and cut again.

MR O'DONOVAN: Right. Okay. So he will tell you what he's likely to harvest and despatch to you.

MR COSTA: Mm.

MR O'DONOVAN: Okay. And that informs your discussion with the supermarket.

MR COSTA: And the wholesale market, and all of our discussions.

MR O'DONOVAN: Okay. All right. So then the goods arrive with you from the grower. At that point can you reject it and send it back, because the quality is not there?

MR COSTA: Absolutely.

MR O'DONOVAN: Okay. And does that happen?

MR COSTA: It does. It does happen. One of the roles that we play is because of – and it's – and it's one of the reasons that we have a variation of customer base, is to be able to manage that product. So if that product has come in and we believe that we could still manage it through the system, however not to, you know – maybe all it's done is by – by it coming in and not being of the quality that we would like, maybe all it's done is it's eliminated the options for that product. So rather than it being able to go to any customer on a given day, maybe it can only go to the wholesale market, or maybe it can only go to, you know, to a local customer or something like that.

MR O'DONOVAN: Right. Okay.

MR COSTA: It's not – it's not a hard and fast rule with us that it's rejected and sent back to the grower and it's his problem.

MR O'DONOVAN: Right. Okay. And so will you tell a grower if it's destination has changed because of the quality?

MR COSTA: In most cases we're actually located where are growers are. So that grower will often bring the product in, so we'll often be having that conversation with them directly or, you know, there are occasions where we're not situated in the same place as the grower, but certainly the grower will be – you know, it's in our best interests. We have a relationship we have to be able to maintain, so the grower will have a very good understanding as to why we don't – we're not – we're no different to what I said. We don't reject product because we're not happy with the price that the grower is supplying us at or anything like that.

MR O'DONOVAN: Right. Okay. So then the product comes in, and then is it necessary then to – in order to meet an order and the packaging requirements to then, sort of, handle and mix and just produce what you want to deliver to the supermarket, with the result that there comes a point where you can't really tell whose is whose and what's what?

MR COSTA: We – we have – yes. We – we have to – we have to, just through our compliance, still be able to tell whose product is whose and where it went and what happened to it. But sometimes it goes out the front door in a very different size and shape than it came in the back door. You know, we will often have a product come in to one of our facilities and we – you know, we wouldn't even at the time have an idea as to how we're going to sell that product.

MR O'DONOVAN: Right.

MR COSTA: That happens through the course of managing your stock levels and managing your orders and trying to stimulate demand and – it's a very – it's hard to understand, but I'll just try and give you an example. We handle a lot of cauliflower, and we will sell that cauliflower in any one of six or seven different ways, and – and really, there are times where we will have five times – you know, five – 10 times what our demand is coming in through the business, and so we have got to be able to manage it, hold that product, manage it, and, you know, it could be cut, it could be wrapped, it could go out whole. Yes.

MR O'DONOVAN: Right. But even with all that processing that goes on, you still know when it goes out whose product it is.

MR MARTIN: Yes.

MR COSTA: Yes.

MR O'DONOVAN: Right.

MR MARTIN: You have to ensure traceability to the – to the end user. So if there's a – if there's a customer complaint, if there's an issue, you have got to be able to trace back to where it actually was grown in a particular field.

MR O'DONOVAN: Right.

MR MARTIN: So that's the sort of visibility that - - -

MR O'DONOVAN: Okay. And is that being imposed by your customers, or is that something that you wanted?

MR COSTA: It started out that way.

MR MARTIN: It's pretty much industry standard now.

MR COSTA: But it certainly started out, like, quality assurance and the like, and traceability certainly started being driven from the retailer.

MR O'DONOVAN: Right.

MR COSTA: Yes. But now I don't think that anyone could say with any level of comfort that they have any level of control over their business if they didn't have one.

MR O'DONOVAN: Right. Okay. All right. So then at the point of – at the point at which you agree – so immediately prior to despatch you agree a price with the supermarket. What does that do in term of crystallising the grower's price?

MR MARTIN: Well, in many cases the grower's been paid, his price has been decided, because we're – we're a merchant. We take title to the product. Upon the specification of the product being met, it's ours.

MR O'DONOVAN: Okay. Right. So once – so on delivery, if it's not rejected, you take title.

MR MARTIN: Absolutely.

MR O'DONOVAN: Okay.

MR MARTIN: If – if there's a latent quality issue which shows up later, which can happen, you know, with horticultural product lines in our – in our terms with the growers we do – we can actually send the product back to the grower. So if the product was always going to fall below the specification, but it wasn't visible at the point that we took title to it, we can still return that product back. Not – that does not happen. I don't know that that's actually happened since I have been working – yes, but that's the way the rules are set up, you know, that the – there is a process for – for handling those types of issues.

MR O'DONOVAN: Okay. So having taking title is – at what point is price fixed normally? The most common.

MR MARTIN: When it's delivered. When it's accepted. When the product is accepted into our warehouse.

MR O'DONOVAN: Right. And how is – now, at that point in time, as I understand it, you don't have a contract with the retailer, a firm contract in terms of price.

MR MARTIN: No.

MR O'DONOVAN: Okay. So you're taking the risk.

MR MARTIN: Absolutely.

MR O'DONOVAN: Okay. So how do you decide – how do you set the price that's – so is it – is there a documented price that's agreed with the grower at the point of delivery?

MR MARTIN: The price is set when the product is received into the distribution centre, when it meets the specification. That's the – and the price that is being – whatever the price is for the week, that would be the price that that grower would receive, depending on where the product had come from.

MR O'DONOVAN: Right. Okay.

MR MARTIN: So he would have his price for that delivery, and we may not sell that product until the following week. So if it's bridging across – and it seems that the prices in the retail – at retail, you know, vary from – from week to week. That's how the pattern moves. So it could – we could actually be looking at a – even at times a lower price than what we have paid for the – for the product.

MR COSTA: Yes, but equally, just to understand the complexity of that, is where we will receive 1000 units from a grower, and that might go to four different states. I mean, it could be despatched to – it might all go to the one customer, but all in different states, or at the same time it could go – some of it go out in, you know, different forms and the like. So, I mean, it's a – yes. It's – it doesn't necessarily come back to that the 1000 come in and the 1000 all have the same home at the same price. It will often be where a percentage of that consignment will be paid off this sale, and a percentage of this sale.

MR O'DONOVAN: And when you say "paid off" is it a – what you got minus a percentage?

MR COSTA: Yes. Yes. What we got, minus some packaging, minus some freight, minus some rebates, minus a percentage, effectively.

MR O'DONOVAN: Yes. Okay. Which seems to be – so if that's the – if that's how you charge, then it's hard to say that you could agree that at the point at which the goods are accepted; that you can't – the price can't actually be set at that point, can it?

MR COSTA: Sorry. The price can't be set where?

MR O'DONOVAN: At the point where it's delivered to your – to your distribution centre or - - -

MR COSTA: No. No. No, but we're talking about – it's only on very, very rare occasions where the product will be rejected.

MR O'DONOVAN: Yes.

MR COSTA: So – and it – and it's – it happens more often, but it doesn't happen that often where a price will change in a given week. So, you know, growers will often bring product in and not have any more than a price guide. However, you know, if a grower wished to find out what a product was worth upon despatch, then, you know, it would be very rare that we couldn't give them a very firm indication on what that was.

MR O'DONOVAN: Right.

MR COSTA: I mean, we're talking about rejections happen in less than 2 per cent of occasions. So – but I understand when we – when we service a wholesale market we don't get the same level of surety than we do off a supermarket. So we'll get an understanding that, okay, the market today in Brisbane on lettuce is $12.

MR O'DONOVAN: Yes.

MR COSTA: Okay? So if we give them a product that is of – of the accepted quality than – and the market, when it arrives, is still $12, then we will be returned off a $12 sale less commission. However, there are a lot of factors that can change that. I mean, we're talking – if we load it out of Victoria it's two days away for one, so the market might be very different. You know, the quality might get up there and it might exceed or it might not meet their expectations. So – yes. We – it would be very fair to say that the level of surety that we can talk to a grower over pricing differs depending on who we're sending it to, and certainly we can talk with a lot more confidence if it's going to the supermarkets than we can otherwise.

MR O'DONOVAN: Sure. But in terms of when the grower has brought it in, it's been accepted as being, you know, acceptable for ultimate destination of a supermarket, when the grower drives away does he know that his price will be what you sell it for at the supermarket, minus a percentage, minus your costs?

MR COSTA: Yes.

MR O'DONOVAN: Or does he know that he's being paid X dollars a kilo for - - -

MR COSTA: No, the first one.

MR O'DONOVAN: It's the first one. Okay. So then you then negotiate with the retailer, and then – and fix the end price with them.

MR COSTA: Yes.

MR O'DONOVAN: Okay. And then the grower's price is then priced off.

MR COSTA: Yes. There's no hard and fast rule though. Like, we will sometimes be fixing that price and fixing that quantity yesterday, but the product actually doesn't come in until today.

MR O'DONOVAN: Yes.

MR COSTA: So it's not always that that product is coming out of our cool room. It's sometimes coming straight out of the paddock.

MR O'DONOVAN: Yes.

MR COSTA: It will differ, depending on supply and demand. But - - -

MR O'DONOVAN: Yes. I mean, I just need to understand - - -

MR COSTA: Yes.

MR O'DONOVAN: - - - and understand the formula for the pricing. So then if that product is then – once you have agreed the price, is then shipped to the supermarket, and if the supermarket rejects it - - -

MR COSTA: Yes.

MR O'DONOVAN: - - - what happens in respect of – what happens to the grower, in terms of liability for that product?

MR COSTA: It's – more often than not it becomes a negotiation. It becomes an understanding where, you know, like I mentioned a couple times, we have long-standing relationships with our growers who understand and agree with the direction that our business is heading. So what they try and do is to position themselves equally where we believe that we need to be positioned for the future of the business. So what will happen is that more often than not when that happens is that we'll sit down with the grower and talk about the best course of action for that product, and therefore, ultimately, that conversation's got to come back to the price, and there will be a level of sharing that happens with the loss that's incurred.

MR O'DONOVAN: Okay. So - - -

MR COSTA: But there's no hard and fast rule to that. So sometimes – sometimes we'll wear all of that loss. Sometimes we'll wear none of it.

MR O'DONOVAN: Right.

MR COSTA: Like, it does – but more often than not it ends up being somewhere in the middle.

MR O'DONOVAN: Okay. So in the – when you said before that you took title to the goods, in – at least in a practical sense that's not really right, because you can pass the cost of rejection back to the grower in some cases.

MR COSTA: Yes.

MR MARTIN: In the terms of – between the business and the grower, that's allowable. If there's a latent quality issue that shows up in the supermarket that – that's allowed. That's understood. They're agreed terms.

MR O'DONOVAN: Yes.

MR MARTIN: So that – yes. That – that's a process that's been put in place to deal with that issue, if – if it occurs.

MR O'DONOVAN: Right. Okay.

MR MARTIN: Doesn't happen very often.

MR O'DONOVAN: Right. But just to be clear, in – from Riverside's perspective, it is buying the goods from the grower on its own account, not as agent for Coles or Woolworths.

MR MARTIN: Not as – no, we're a merchant.

MR COSTA: It's our responsibility.

MR MARTIN: We're a merchant.

MR O'DONOVAN: Yes.

MR MARTIN: We also have fixed pricing models. We have spent a lot of time talking about the market prices here this morning so far, but we also have prices that are negotiated the other way, but basically a cost plus arrangement, where the prices don't vary, that they're fixed to the grower, and the margins are fixed to – to the joint venture, and to the investment as well. So they don't vary. They're a solid agreed – in this case that I'm talking about, it's actually a year-round price. It just continues the same – they're for processed – processed products.

MR O'DONOVAN: Right. So then in terms of – the product that then is rejected, if you decide to sell that through the wholesale markets, how is the – how is the price back to the grower then determined?

MR COSTA: After the product has been rejected and we have been put it into the wholesale market. Well, the grower will understand at the – at the date of – at the time that it happens that the product has been rejected, and this is our – this is the course of action that we have taken. If it happens where we have made the decision to do that, then we'll simply say to the grower, "So there's been a problem. This is what we're doing with that product. We'll see what happens, and then we'll come and talk to you about the outcome."

Sometimes it will happen though where it's the grower that will actually say, "Okay. Well, let's place the product over here," or, you know, to do something with that product. But – but the problem is that then it goes to the wholesaler. The wholesaler has to wait until the next market, where if a rejection happens on a Friday, Saturday or Sunday, then that's obviously the Monday market. So they don't always sell it on the day, and it becomes a prolonged exercise. But – yes. That – that price is often not then confirmed for days.

MR O'DONOVAN: Now, how often would a grower say to you, "Look, you took title in the goods. They were fine when I delivered them. Something must have happened at your end. You're going to wear the whole lot." Does – how often?

MR COSTA: I don't really know the answer to that. In percentage terms, I'm not sure. It does happen though. So it's – it's in the minority. So it might be 10 per cent of the time. There actually might be occasions where we don't even take it back to the grower, and we just say, "Well, we did take responsibility for them," and therefore, you know, we have got to cop our role back, I suppose. But – so that does happen.

MR O'DONOVAN: And growers that do that, is there a consequence for them?

MR COSTA: No. We all do business with people that make our job easy. Every one of us. So the consequence would be that our preference would be to align ourselves with people that make our job easy.

MR O'DONOVAN: Right.

MR COSTA: We – there are growers out there that make our jobs more difficult than others do. So we naturally try and align ourselves with them. But I don't think that that'd be any different to any industry.

MR O'DONOVAN: Sure. But by that - - -

MR COSTA: That's why – sorry. I'll just say, that's why our supermarkets buy off us rather than buying off some individual growers, because that's what we do. We make their job easy. So - - -

MR O'DONOVAN: Sure. Okay. So it would be – by that I'd take it that there may be consequences for their – for their orders in the future if a grower were to take that attitude.

MR COSTA: Well, yes. If we – if we had a preference, so if we had to make a decision in the future over one product or another, and we have had an experience with a grower that we didn't necessarily agree with, then I think it would be fair to say that our preference would be to work with the other grower.

MR O'DONOVAN: Sure.

MR COSTA: I don't even know if I'm making sense.

MR O'DONOVAN: No, no, no. That – no, no. I think I understand. All right. Now, in relation to – or, sorry. Just one final question on that issue. So would it be fair to say that in the – in the bulk of cases where product gets rejected by supermarkets, it's the grower that ends up suffering the financial consequences of that?

MR COSTA: No. No, but it would be fair to say that in every case – in most cases that the grower wears a percentage of it. That we jointly wear it would be the fairest thing, and this is in the case of us. This – you have got to understand that I'm – I'm trying, and – there are times when I'm – we're actually that grower. So we're actually having that conversation. We sometimes have this conversation with ourselves. So we understand it very clearly from the grower's point of view at the same time, but it would be very, very – it would be – it would be in the absolute minority where the grower would be the sole – would wear the sole responsibility for that.

MR O'DONOVAN: Okay. All right. Now, in relation to specials, where the retailers are specialling a product, in circumstances where a retailer puts out a catalogue and finds that it’s actually specialling a product at a price that’s higher than its competitor, does that have consequences for you, or does that have consequences for the grower, in terms of how the retailers react?

MR COSTA: It would have a consequence for us, and/or the grower, if we and/or the grower agreed to renegotiate.

MR O'DONOVAN: Sure.

MR COSTA: So we have an understanding with the retailer that we will commit at times to promotions, and we will be held accountable to the prices that we commit to. If a further negotiation is to take place, then there is no obligation on our behalf to participate in that. It really comes back to us.

MR O'DONOVAN: Right.

MR COSTA: Our choice.

MR O'DONOVAN: So if a buyer rings you up and says, “Look, we’re 50 cents out on cabbages this week.”

MR COSTA: Yes.

MR O'DONOVAN: “We want you to lower your price,” how often would you say no?

MR COSTA: More often than we would say yes.

MR O'DONOVAN: And is there penalties imposed on you for saying no?

MR COSTA: Well, it’s just a more awkward conversation than you’d have otherwise, but no, there’s no – no.

MR O'DONOVAN: You’re not punished or delisted or have your orders reduced in the future?

MR COSTA: No. Well, it’s never been communicated to me that way, so I’m not really sure. I mean, I think they do business with people that make their job easy, so I’m – and we’ve had times our market share goes up and at times our market share comes back, but I’ve never had a conversation where our market share’s come back and I’ve been told it’s because we didn’t help them out when they had a special go bad on them.

MR O'DONOVAN: Right. Okay. And then if you say yes, do you then have a conversation with your growers and say, “Look, the price we indicated earlier in the week, it’s not going to hold”?

MR COSTA: Well, we wouldn't say yes until we'd had that conversation with the grower. So in the times that we've said yes, we would simply say to the retailer, "Okay, well, give us a period of time and we'll come back to you." Unless it's our product. Now, if we are the grower and it's our products, then obviously we're not going to hang the phone up and have a meeting with ourselves. But if it's an external grower's product, then certainly that conversation will happen prior to us confirming with the retailer.

MR O'DONOVAN: All right. Okay. Now, in terms of monitoring the relationship between the retail price and the wholesale price, do you do that at all? Like, do you see what the stuff you sell – the supermarket sells for at retail?

MR COSTA: Okay. Sorry, the margins that they get, you're talking about?

MR O'DONOVAN: Yes.

MR COSTA: Yes, we'd keep a fairly close eye on it, I suppose. Not religiously, but we've got a pretty good idea.

MR O'DONOVAN: Okay. And in terms of the margins that you've observed in the last – say, five years, have you seen the margins rising where the retailers are getting more and you as a wholesaler or as a grower is getting less?

MR COSTA: No, I don't think it's changed. I think that the retailer has done what we'd all like to do, and they've actively pursued taking costs out of their business, and at the same time I can't say with any level of confidence that I believe that they've reduced their margins. I'm not really – I don't follow it that closely, but I don't think that their margins have changed. And our margins unfortunately are often – you know, we don't have so much control over our margins because of costs that are incurred and the like. I don't think the two are necessarily parallel. I don't think they reflect – I don't think the retailer gets more money when we get less and vice versa.

MR O'DONOVAN: All right. Okay. Now, in terms of the Horticulture Code, presumably Riverside is aware of it?

MR COSTA: Very much so.

MR O'DONOVAN: Okay. All right. And the Code requires written agreements between an emergent and a grower in – you know, subject to some grandfathering clauses. And you've indicated you don't have a written agreement. Can you explain to us how your arrangements are in compliance with the Code?

MR COSTA: We have an agreement with the grower in accordance with the Code. We don't have a contract with the grower. We don't have a written contract with the grower. But no grower supplies us with our – signing-off on our – what do you call it? Our Horticultural Code - - -

MR MARTIN: Terms of trade.

MR COSTA: Terms of trade.

MR MARTIN: We have a terms of trade.

MR O'DONOVAN: Right. Which is the start of – is this a document they sign when they deliver, or is it a general governance relationship, generally?

MR MARTIN: When the Code was initiated, which I think was a year ago, we were required to publish our terms of trade, and the growers at that point in time had an option, I guess, to continue to do business with us if they agreed to our terms of trade, or if not that was a time and place to have a discussion or negotiation. I'm not aware that one grower stopped trading with us.

MR COSTA: No.

MR MARTIN: That's been in place for a year.

MR O'DONOVAN: Okay. That's all I've got.

MR SAMUEL: Thank you. Thank you very much, gentlemen. Appreciate your assistance. Damien, what do you want to do now? Do you want to – Mr Chant?

MR O'DONOVAN: Yes.

MR SAMUEL: Yes, okay. Okay. All right, Mr O'Donovan.

MR O'DONOVAN: Okay. Could you just state for the record your name?

MR CHANT: Doug Chant.

MR O'DONOVAN: Okay. And are you here in a personal capacity, or representing an organisation?

MR CHANT: Well, I've been invited to attend as an individual. I'm not representing an organisation as such.

MR O'DONOVAN: All right. Now, were you summonsed to attend here?

MR CHANT: Yes, I was.

MR O'DONOVAN: Okay. And can you confirm that you understand that it is an offence under the criminal code to give evidence to this enquiry that you know is false or misleading, or omits any matter or thing about which the evidence is misleading? Yes. All right. Now, I understand from a newspaper article in The Age that you were a potato farmer?

MR CHANT: Mm.

MR O'DONOVAN: Okay. Firstly, can you just give us a brief history of your time in farming?

MR CHANT: I'm still farming. I'm currently president of the United Dairy Farmers of Victoria. We grew potatoes for probably 25 years as part of the dairy operation on the farm, because we'd rotate our pastures over, get a crop of potatoes out, and put it back to new pasture. And we did that for probably 25 years. My brother, who is a neighbour of mine, we grew them together and we were probably averaging about 1000 tonne a year, each of us, in supplying the market at that time. Predominantly the fresh market, was which we supplied.

MR O'DONOVAN: All right. And when did you give it up?

MR CHANT: It'd be about nine or 10 years ago now.

MR O'DONOVAN: Right. Okay. So the events that are recounted in the story in The Age - - -

MR CHANT: Sorry. It'd be about probably seven years ago.

MR O'DONOVAN: Yes. Seven years ago. All right.

MR CHANT: Time flies, but not that quick.

MR O'DONOVAN: Okay. Now, firstly, can you explain to us what your root market was for the potatoes that you produced on the farm?

MR CHANT: When we first started growing, I think we probably had about 10 or a dozen packing sheds that we could supply to. So there was a fair bit of competition out there for product.

MR O'DONOVAN: Okay. And – sorry. And these packing sheds, where did they ultimately sell into? Do you know?

MR CHANT: They sold to supermarkets. They also sold to corner shops, to restaurants, and many of those packing sheds had runs through different parts of Victoria, delivering to different towns. So there was a fair range of options available to us.

MR O'DONOVAN: Yes.

MR CHANT: During that time, most of the packing sheds allowed about 10 per cent wastage, and we had a very good working relationship with those sheds over that period. As time went by, they were gradually disappearing. We got to a point where there was about – in our part of the world, which is in Western Victoria, about two main packing sheds to sell to.

MR O'DONOVAN: Right. And in terms of – did that reduction in the number of options have an effect on the prices you were obtaining?

MR CHANT: Well, the prices never went up in all that 25 years. When we first started growing potatoes we were getting $120 a tonne in the paddock, and the last year I grew them we were getting $80 to $100 a tonne in the paddock. So prices hadn’t improved. The other thing we found was dockage out of those potatoes, every tonne we sold, that they went from accepting up to 10 per cent damage – because you can imagine boxes, half-tonne bins stacked on top of each other, and forklifts going – the forks on the forklifts going into those boxes, across the top they were damaging potatoes. So there was a percentage just in the sheer handling of those potatoes damaged, and the packing sheds used to allow 10 per cent. It got to a point where they were automatically docking them 10 per cent.

MR O'DONOVAN: Now, you say it was priced in the paddock?

MR CHANT: Mm.

MR O'DONOVAN: Does that mean that someone else would come and harvest them for you?

MR CHANT: No, we would harvest them, but they would send their trucks in and pick up direct out of the paddock.

MR O'DONOVAN: Right. Okay. And so the $80 a tonne, I think you were saying, is where they literally pick it up at your farm gate and take it off your hands?

MR CHANT: Yes.

MR O'DONOVAN: All right. Now, in that time did you look at alternatives such as the wholesale markets as a way of getting your product to market?

MR CHANT: Yes. Look, I had the opportunity at one stage of buying a packing shed of my own and putting it in and packing for the market. I approached a small Franklins, it was, supermarket in Geelong to see if they were interested in purchasing potatoes. And we could have supplied them all year round, because where we live we’re close to the Otway potato growing area, also Ballarat and up towards Warrnambool. So we had a region where we could supply – get potatoes all year round. I approached them, and they came back to me and said that – the manager of one of their stores came to Melbourne to a meeting and put the proposal forward that they’d buy direct off us. He was told if he purchased off us he’d lose his job. So I didn’t proceed with the packing shed.

MR O'DONOVAN: Right. But in terms of – instead of selling direct to packers, did you – would you ever ring a wholesaler and ask them what the price of potatoes was that week?

MR CHANT: Look, yes, we'd ring – well, the packing sheds were wholesalers in their own right, and we'd ring around to get different prices. But they were all pretty well much of a muchness as far as price was concerned.

MR O'DONOVAN: But did you try wholesalers operating in the Flemington markets?

MR CHANT: No, we didn't, because we'd had experiences with growing onions, having them brought down here, getting a call from the wholesaler to say the market was better in Sydney, we'll send them through to Sydney, then get told that the product sweated under the tarps and the whole – we ended up getting a bill back for the disposal of those onions. And that was probably two months after the event, so it was no good us going to find where they'd gone or whether it happened or not. So we had little faith in – once you've lost sight of them, you've lost control of them.

MR O'DONOVAN: Sure. I mean, the reason why I ask about these alternatives is that looking historically at the price of potatoes, they're well above the prices, say, for the last five years – you know, have never been as low as the 10 cents a kilo that you're quoted in the article. Is - - -

MR CHANT: That's to me.

MR O'DONOVAN: Yes.

MR CHANT: They're about – look, I'm not sure, but I was talking to a grower just recently, and I think they were about 20 cents a kilo, which is $200 a tonne. And in the shops they're retailing – I'm not sure - - -

MR O'DONOVAN: Okay.

MR CHANT: Two to three dollars.

MR O'DONOVAN: At least in terms of the published data, which is available, at least in the last – well, if we just take the last few months, there's been nothing on the wholesale markets less than 60 cents a kilo. Can you give us any explanation as to why there is such a big difference between the prices?

MR CHANT: No, I can't, but being in the industry for the length of time that we were involved, you would get fluctuations. I think we did get up to $500 a tonne for one period. But predominantly, on the average over that period the price hasn't altered all that much.

MR O'DONOVAN: Right. And how much of, say, Victoria's potato supply do you think goes through the packers that you had dealings with?

MR CHANT: Well, the small corner shops are gone. They're the ones that were predominantly buying through the market. And those small shops are not there to the extent that they used to be, so it really is the supermarkets that do control probably – I'm only guessing here, but I'd say 70 to 75 per cent of the retail end of the market at this point. So wherever you sell, it's got to go through there.

MR O'DONOVAN: Right. Okay. But you can't offer us an explanation as to why, for example, potatoes are listed as selling for $1.40 a kilo in December of '06, whereas - - -

MR CHANT: No.

MR O'DONOVAN: - - - the people you know in the market are only getting – growers you know are only getting 20 cents?

MR CHANT: Yes. Look, I've been out of it in recent times, but as I said, we've had 25 years' experience in the market, and saw the changes that were occurring, and that's why – the article in The Age, I delivered potatoes into an agent – a packing – I've got to be careful, I don't want to name names – but into a premise in Geelong which both packaged and retailed potatoes. And I saw my potatoes go from that wall there to that wall there on a trolley – not washed, packed or anything – they were still in my box – and I was getting 10 cents a kilo there and the consumer was paying $1.49 there, which was $1495 a tonne.

MR O'DONOVAN: Sure. But that's not necessarily a representative mark-up at present?

MR CHANT: At present, I can't comment, but at that time, the mark up was there. The mark up was just growing all the time and at the same time, we were getting docked more and more for damaged potatoes. Just an example on that, I sold three truck – I had an opportunity to sell to a small packing shed, a family operation, that was setting up near Geelong. I had approached them about delivering potatoes to them and they said that they were happy to take the potatoes, and I said, well, as soon as we know that they are ready to dig, that the skin was firm and they'd be all right to start digging them, I would give them a call.

When they matured off, I sent three loads to a packing shed in Ballarat. I rang the packing shed in Geelong and said, "Look, those potatoes came out fine, do you want me to bring a sample down?" I was then told that, not to worry, because the three loads that we had already sent had gone to the packing shed in Geelong. They hadn't gone to Ballarat. And that's fine, an agent can on-sell them wherever they want and that's fine. So, I proceeded to then sell – the potatoes I carted them down to this packing shed in Geelong. Three months later I received the cheque for the three loads that went to Ballarat. They were docked 25 per cent.

I rang the company up and spoke to the manager, who I knew, and I said, "You docked me pretty hard on those potatoes," and his response was, "Well, look, they looked really good in the box but when we started to grade them, you know, this was wrong, that was wrong." And they had docked me 25 per cent. He said, "I'd better go, I've got a truck just pulled in, we've got to go and unload it," and I said, "Peter, before you leave," I said, "you never saw those potatoes. They never went to your shed." There was dead silence and then he came back and said, "I will send you a cheque for the difference."

And that's what we were confronting and that's why when I delivered them in to Geelong the last time, and saw the mark up that was going through there, I pulled the pin and my harvester and all my equipment still – is still sitting at home and I don't mind the work, but I don't like being ripped off to the extent that we were. In my district, there was probably – I am only guessing – 20 or 30,000 tonne of potatoes grown in our district. I don't think there is a potato grown there now. They have all pulled out for the same reason.

MR O'DONOVAN: And just so that we can date these – these incidents are all pre-1998?

MR CHANT: Yes. They'd be around 90 – yes, around that period. I can get those dates back to you if you want, but, yes.

MR O'DONOVAN: Sure. And in terms of the extent to which you explored whether there were more remunerative options in terms of selling your potatoes.

MR CHANT: Yes.

MR O'DONOVAN: You didn't explore alternatives? Selling direct to a supermarket or selling through the Flemington markets?

MR CHANT: They would not deal with us. They wouldn't deal with us at all. They would only deal off their agents because that's how they controlled, in my view, the market. Because as I said, originally there was – we had quite a number of sheds we could sell to. But once it was down to one or two, or down to two in our case, they were controlling both ends of the market.

MR O'DONOVAN: Right.

MR CHANT: So, we really had no options.

MR O'DONOVAN: Sure. Now, if we were to go back to 1998, and find the difference between – a substantial difference between what you say your – you were receiving from these packing houses, and the wholesale markets, could you – is there any way you could explain that difference, as to why people would choose to sell to these packing houses rather than deal on the floor of the wholesale markets?

MR CHANT: No, look, I can't. But I – I don't think – the markets themselves, as I said, the outlet for vegetables from those markets is decreasing all the time. It has been predominantly the family owned corner grocery shop that's been buying from those markets and that's decreasing all the time. And it's becoming more and more the agents, the packing sheds and that, that control it.

MR O'DONOVAN: Are there specific packing sheds that are still operating now?

MR CHANT: Yes.

MR O'DONOVAN: So, what would be the names of the key ones in the industry now?

MR CHANT: Look, in an open court, I am not prepared to name names and, you know, one of the problems I think you face is that for many of us – I am not quite as bad because I am not in the industry any more, but a lot of our farmers will not speak openly about it because of they are frightened of the consequences of it. So, I, you know, I am not prepared to do that in an open court. If you want to clear the court, I will.

MR O'DONOVAN: Sure. Well, we might get you to send in the names. But just to be clear, as I understood it, you say that there are only two processors left, so - - -

MR CHANT: Yes, in our – in our area. Yes.

MR O'DONOVAN: Right. So, they won't have too much difficulty working out who you are talking about.

MR CHANT: No. Probably not.

MR O'DONOVAN: Okay.

MR CHANT: But I don't want to be, you know - - -

MR SAMUEL: But there is no secret about who the names are – the names of the processors?

MR CHANT: Not – we are talking about packing sheds here, not the processors.

MR SAMUEL: Yes, okay.

MR CHANT: There's - - -

MR SAMUEL: But there's no secret as to the names of the packing sheds, is there? I mean, that's public knowledge. I am not asking you to say that this one is a culprit or this is the one that did you over in Geelong or Ballarat, or anything. But just to name who owned the packing sheds. That's no secret, is it?

MR CHANT: You would know them.

MR SAMUEL: I am just trying to understand the secrecy in not disclosing there names. That's all.

MR CHANT: Well, I am not prepared to name them in an open court. If you want to clear the court, I am more than happy to.

MR O'DONOVAN: Okay.

MR CHANT: Perhaps I am being a bit pedantic about it, but I just don't want to put myself in a position where I can be held accountable for - - -

MR SAMUEL: Well, it might be just as easy for us to get the Yellow Pages, I think, and just look it up. And I just think it's a bit silly, that's all.

MR CHANT: All right.

MR SAMUEL: But that's fine. Okay.

MR CHANT: All right.

MR O'DONOVAN: Well, we can get the names later. There is no need to clear the room. Look, I think that's all I've got for this witness.

MR SAMUEL: All right. Well, we will talk a bit later about what we can find out of the Yellow Pages, but I just wanted to ask a question. You've said on a couple of occasions that the – what you call the corner store, you know, the greengrocer – is diminishing. That would appear to contradict evidence that's coming from a range of sources, including Choice, AC Nielsen surveys and the like, all of which suggest exactly the contrary.

That, in fact, the corner stores as you call them, are, in fact, growing and that I think you indicated that your guess was that the market share of Coles and Woolworths, the major supermarket chains was, I think you said, something between 70 and 75 per cent. Yet, all the evidence that has been put before us, from a range of different sources, suggests that the market share of Coles and Woolworths in respect of fresh food, that is, greengroceries, is around the 43 per cent to 45 per cent mark. And that the major share is held by the mum and pop stores – the greengrocer stores. Indeed, as I recall, an AC Nielsen survey suggests that their market share is actually growing, rather than diminishing. I am just trying to reconcile what you are putting to us and - - -

MR CHANT: Well, I am – I am putting that – I am saying what is happening in my part of the world in western Victoria, that we have seen a huge decline in the little corner greengrocer that used to supply, and used to purchase, the vegetables that were grown in our region. Now, I mean, the facts are that in our region we had one of the biggest potato growing areas in the state and it does not exist anymore. And that has come about for only one reason, and that was, the fact that farmers were not getting paid a fair price for the product and they've gone out.

MR SAMUEL: I understand what you are saying and we will talk in a few moments about the packers and the like, but I am just trying to pin down the proposition you are putting that this is largely attributable to the control being exercised over the market by the two major supermarkets, which as I am indicating to you, seems to contradict some very authoritative statistical evidence that suggest that, in fact, the market shares of the major supermarket chains are at the highest level around 45 per cent. In fact, I think, Choice surveys suggested it might be as low as 37 per cent, if I recall correctly. Or even lower. And I am just trying to reconcile that with your submission that they have got 70-odd per cent of the market.

MR CHANT: Well, as I said, I can only talk from my region and, you know, about their surveys, as far as on a broader scale, or is it basically metropolitan? Or is that, you know, on a broad scale? I don't know. I am only talking about our particular part of the world where we used to supply most of those markets and they are not here any more. They are gone. And it's predominantly the major supermarkets as where the fruit and vegetables are sold in our region.

That may not be the case in other regions, but I am talking about our particular region. But certainly the mark up between farm gate price, what farmers get paid, and what the consumer is paying, is quite substantial. And in this instance, that the article in The Age was written about, was the fact that there was no processing, there was nothing done to those potatoes whatsoever. They were wheeled in, in my box, with our dirt still on those potatoes and the price went from 10 cents to $1.49.

MR SAMUEL: Now, tell me, you and your fellow growers. Did you engage in any collective bargaining processes, with the packers?

MR CHANT: No. Not in those times. You either accepted what they offered you, or they would move on to the next grower.

MR SAMUEL: But didn't – what about if all the growers had got together and said, "Well, we will act collectively"?

MR CHANT: Well, we should have, yes.

MR SAMUEL: Yes.

MR CHANT: It is certainly what has happened in the dairy industry. We have seen farmers, you know, and we've instigated that, to come together as a collective and to bargain to get a better price, but in the vegetable growing area, that wasn't the case and it didn't happen that way. Perhaps it should have.

MR SAMUEL: All right. Well, we will clear the room and get the information from the Yellow Pages. Yes, it will be back about 2 o'clock, I think, the public session.

CONTINUED IN TRANSCRIPT-IN-CONFIDENCE

CONTINUED FROM TRANSCRIPT-IN-CONFIDENCE

RESUMED **[2.11 pm]**

MR SAMUEL: All right. Look, I think we'll start, Damien, so if you could proceed.

MR O'DONOVAN: Okay. All right. Could you state your name, your position in the company, and the company that you represent?

MR NOBLE: My name is Peter James Noble, and I'm the Chief Executive Officer of Australian United Retailers Limited, trading as FoodWorks.

MR LONGMUIR: And I'm Graeme Longmuir. I'm the National Merchandise Manager for FoodWorks as well.

MR O'DONOVAN: Okay. Now, have you been summonsed here today?

MR NOBLE: No, we haven't.

MR O'DONOVAN: Okay. Do you understand that it's an offence under the Commonwealth Criminal Code to give evidence at this inquiry that you know is false or misleading, or omits any matter or thing without which the evidence is misleading?

MR NOBLE: Yes.

MR LONGMUIR: Yes.

MR O'DONOVAN: Okay. All right. Now, could you state briefly, first, what FoodWorks is at present, what it is, and what it does, and then perhaps give us a history of how it came to be?

MR NOBLE: Thanks, Damien. Firstly, commissioners, I'd like to thank you for the opportunity to be present today.

MR SAMUEL: No, no. We appreciate the fact that you're making yourself available. So appreciation comes from our way. Thank you.

MR NOBLE: Thank you. Yes. FoodWorks is a marketing and retail services company. It's, if you like, providing services for some 700 plus large, medium and small supermarkets across Australia. It's a retail and services marketing and merchandising company, in that we provide all the functionality and infrastructure for those sites, in terms of central supply and procurement agreements, services agreements. We provide them with business planning skills and field support, merchandising and marketing services, brand development, customer valuer proposition, promotional programs, access to pricing system, and understanding of pricing systems, and the way that their businesses develop, and if you like, FoodWorks represents, therefore, 700-odd large, medium and small supermarkets, and let's define who they are.

They're small and medium business people. They're families, and relationships with families right across Australia. So we operate that business in contract, or under contract with those retailers. We call that a unity agreement. It's currently a six year agreement between the retailer and the central services company, and those retailers are our shareholders. Recently we put a prospectus into that retailer closed market, and we consummated that prospectus with a capital raise and a restructuring on 1 July 2007, and I have made available to the commission a copy of that prospectus with all the details that go with that, and we're in the process in the next 12 months of moving the company from a historical focus on being a co-operative, more in terms in the future of being a for profit company.

So, in other words, those shareholders who have subscribed capital in return for equity, the company will in fact restructure on 1 July next year. So that's who FoodWorks is today. In terms of its history, it started in approximately 1997 with a breakaway group of what were then Tuckerbag retailers who broke away from the historical Davids organisation. That group formed a supply contract with the then Woolworths company here in Victoria. There were approximately 30 of those stores at the inception, and Woolworths set up an independent warehouse to service the needs of independent retailers here in Victoria, and in other states, called Australian Independent Wholesalers, AIW, and that was a five year agreement that started in 1997.

As the first year took place Woolworths then went into the marketplace with a large cheque book and bought the largest 10 stores of that group, which virtually decimated it, and required that fledgling group called FoodWorks then to aggregate other independent retailers into the group to have critical mass to exist under the AIW contract. So then in 2002 negotiations took place, because the five year agreement was up with AIW Woolworths, and that was the time that I joined the business. We ran very detailed supply and value chain models using Booz Allen Hamilton Global Consultants to understand the Australia marketplace from a supermarket point of view, and we then engaged in quite aggressive negotiations with both AIW Woolworths and with Metcash, and that resulted in the Metcash supply arrangement starting in the middle of 2002.

The things that were clear in those early days, at the fledgling stage of FoodWorks, were that Woolworths and AIW were using the same warehouse for both independent groceries, and also for the rapid development of packaged liquor for the Woolworths organisation from the same Clayton warehouse, and so unit cost reductions and cross-subsidy of IT initiatives and those sorts of things would appear to be what was going on there. Also the product SKUs that were available to the independents was in the order of 10 to 12,000 SKUs or products out of the warehouse, and I'll talk later probably about Metcash offering us access to 24,000 SKUs from a product point of view.

So we moved the business across to Metcash, and it was quite a difficult rationalisation period for the industry, and that also allowed FoodWorks to spread, because we got access to Metcash warehouses up the eastern seaboard. That wasn't going to be the case if we'd have stayed with AIW. We weren't going to be given access to the interstate warehouses, and so we moved to Metcash and really consolidated the business. We moved to about 136 supermarket stores from a base of 90 in late 2001, and we spent a lot of time in 2003 looking globally, and also looking in depth at the Australian supermarket marketplace, again using the consultants, Booz Allen Hamilton.

We did very compelling supply and value chain work. We discovered the very strong market dominance of the chains here, quite unique in the world in terms of market power, and supermarket positioning, and I guess the call to action for FoodWorks, as still a fledgling business, was to develop a compelling case to continue to change. So with Booz Allen we did that for a period of 12 months, and on the radar screen for us, of course, was to look at a potential merger with the AUR group, the Australian United Retailers group in Queensland, a very large group; in fact, a bigger group than FoodWorks, who are Queensland based, and FoodWorks were predominantly in Victoria, and in November 2004 we merged those two groups, with quite a lot of public attention from the independent supermarket industry.

We spent the next 12 to 18 months, through till 2006, consolidating those merged activities. Classically with mergers, as you know, there's the critical mass buying power that a merger will give you; the unit cost reductions, because both companies were doing similar things, but in different ways; and to stay competitive and continue to fight above our weight in the industry we needed to get those synergy benefits and unit costs reductions, which were all delivered. Then, importantly I think, the cultural part of it was of large interest to me as the CEO of the new group, in that by bringing these two cultures together we had to create a lot more organisational capacity to be more competitive, take the chains on as small as we were, but to really fight for our place in the industry and the marketplace, all of which we started doing.

The other thing we did, and you'll see around the marketplace these days, we launched the new FoodWorks brand, and I'm sure you have all seen that, with the very bright contemporary or modern colour schemes; inviting value proposition for customers; the advent of people like Graeme headhunted into the business from a merchandising point of view to really start driving standards and best practice way beyond what the independents were doing before; scan data recovery; IT investment. Today we're sucking scan data from nearly 400 sites, 24 hours a day, which no other independent group in Australia are doing, and so the commercial decision-making we were able to do in the business post that merger gave us a lot more management ability to lift the standards and drive the business's growth and competition in the marketplace.

So we consolidated the merger for 18 months and then set about again doing more economic studies, supply and value chain work, and of course, it's never good enough in this industry. It's always compelling and competitive out there. Nobody has given us a free ride, and we don't expect one. We have got to stand up, be fit and healthy and compete. So the next stage of the business development was to say, well, we need to restructure. We need to go to the marketplace with a prospectus, raise some capital, because like all companies like ourselves at that stage we had a very poor balance sheet, because running the company as a co-operative all money was coming in and going out again, and we were spending what remained on behalf of our shareholder retailers.

So acquiring some capital in terms of the balance sheet was the basis of the prospectus. Also for balance sheet strength we had to put in place a compelling agreement between our retailers and the company, and thirdly, we needed to restructure the company from a capacity point of view to be for profit in the longer term. All of those things happened in 2007, and between July and November last year we set about doing a closed listing of the company on the national stock exchange based in Newcastle, which was enacted approximately November last year, and I'll just stress to the commission that that is a closed listing, and the definition of our shareholders, or to be a shareholder of FoodWorks you must be a FoodWorks shareholder or a related party of that retailer, and related parties, super funds, family, that sort of thing.

So FoodWorks – that's really a history and where we are today, and I guess in closing that summary I'd say that we fight very much above our weight in the industry. We're very determined. Our retailers are unbelievably entrepreneurial. They're family. They're centred in the values of the local community, and certainly provide a valued proposition to their customers, evidenced by the continuing increase in our customer count and basket sizes and relative sales growth compared to the big majors, that tell me that we're tracking healthily. Thanks, Damien.

MR O'DONOVAN: Okay. All right. Now, you mentioned that you have got up to 700 stores, but you're currently getting scan data from 400 sites.

MR NOBLE: Yes.

MR O'DONOVAN: Does that mean that not all of your stores are branded and integrated into your system?

MR NOBLE: That's correct. We have approximately – I think it's 701 this week, but it does vary each week. Sot he mix is that we have got – I think we had our 401st branded store about four weeks ago, so about 400 stores are branded FoodWorks. Many of the others are unbranded, so they could be Ma and Pa supermarkets somewhere in Australia, unbranded. But we also have supply arrangements through our Metcash contract for the NightOwl group, a convenience store small store format in Queensland, and also we provide some services, including the central supply agreement to the Queensland Government Aboriginal and Torres Strait Island communities who run Aboriginal-run supermarkets. So that there's seven of those. So that's sort of the mix of the unbranded group outside of the branded network of 400 stores.

MR O'DONOVAN: Okay. And the unbranded stores, are they subject to the – have they entered into these unity agreements with FoodWorks?

MR NOBLE: No. Some have of their own volition. Others are on just a standard approved store agreement to get access to our supply arrangements.

MR O'DONOVAN: Right. Okay.

MR NOBLE: So the unbranded stores don't take all the branding and the merchandising and the marketing and all those central activities which are essentially for branded stores.

MR O'DONOVAN: Right. Okay. So in terms of the 300 unbranded stores, is their relationship with you one where they order dry groceries and other products through you or - - -

MR NOBLE: Yes. They still off-take from the central agreements that we have. So, in the main, Metcash, who is our national wholesale supplier for dry groceries, frozen products, packaged liquor, and tobacco. They would take orders through that system, through Metcash. That's correct. And where it's applicable they can also take direct supply, if they want to do that as well.

MR O'DONOVAN: Sure. Okay. So is their relationship with you, and then you arrange for Metcash to supply them? Or do they actually have some relationship with Metcash?

MR NOBLE: No. All of our retailers have a commercial or financial trading relationship with Metcash through IGA Distribution. So the test of that is the invoice that is written. It is between Metcash, therefore IGA Distribution, and the retailer, whether they're a branded FoodWorks store or an unbranded FoodWorks store.

MR O'DONOVAN: Right. Okay. So what does FoodWorks supply in that chain, if they're – if these – they're unbranded stores and they're buying from Metcash - - -

MR NOBLE: Yes.

MR O'DONOVAN: - - - what is it that FoodWorks gives them?

MR NOBLE: Essentially, they get access to our pricing systems, to our costs files if they like it. Some of them – some of them don't take those, and if they require some basic pricing systems or some marketing activities, they can have them, but nowhere near the level of the branded stores, and we offer them, for those very restricted range of services – the main one being the supply agreement – a lesser rebate than the branded stores are paid.

MR O'DONOVAN: Right. So they're not actually charged a fee by FoodWorks?

MR NOBLE: No. No.

MR O'DONOVAN: Okay. But they get lower rebates as a consequence of not taking the whole - - -

MR NOBLE: Lower rebates and a lower service level, commensurate with what they require of us.

MR O'DONOVAN: Right. Okay. From their point of view, why would they choose to supply, effectively, through an arrangement with FoodWorks rather than direct from Metcash?

MR NOBLE: They, like many retailers in Australia, like the choice between an IGA vertically integrated system that Metcash runs, and FoodWorks, a company owned by its retail shareholders. So those unbannered stores have a class A share and are a shareholder of FoodWorks, and in fact, could have bought shares if they wanted to. In fact, some of them did at the time of the prospectus last year. So it's a – it's a choice for them.

MR O'DONOVAN: Right.

MR NOBLE: Okay?

MR O'DONOVAN: And in terms of, if they were just looking at it purely from the point of view of where's cheapest to get my – what's the cheapest system for me to get my dry groceries - - -

MR NOBLE: Nothing compels them to do anything. So if they wanted to go to Campbells Cash and Carry, to a direct supplier, or to source goods from wherever they could, if they think on a better basis, they could.

MR O'DONOVAN: Sure. And in – so – and the offering that you give them, in terms of supplying through your contract with Metcash, does it compare with if they had no relationship with you and just dealt with Metcash? And if this is confidential, then I'm quite happy to take it up in a confidential session.

MR NOBLE: No, I don't think it's confidential. The fact is they don't have – I suppose they could. You'd have to ask Metcash, whether Metcash would take them on as an unbannered, therefore, a non-IGA retailer. So, Damien, you would have to ask them that. But in our case we do welcome them to work through our system as an unbannered shareholder of FoodWorks. Okay?

MR O'DONOVAN: Right. Okay. So one of the points of difference is that they can be fully independent, working with – working through you rather than tying into the full IGA system.

MR NOBLE: Yes. Correct. Correct.

MR O'DONOVAN: Right. Okay. Then in terms of the 400 sites that are branded, again, is there – in a sense there are two separate businesses. There's the store level business, which is fully independent in one sense.

MR NOBLE: Yes.

MR O'DONOVAN: And then there's the FoodWorks business, which is now a company with capital raised, and presumably a need to earn revenue for shareholders.

MR NOBLE: Correct.

MR O'DONOVAN: How is the revenue earned for shareholders from the 400 branded stores?

MR NOBLE: Okay. Yes. Yes. As evidenced in the prospectus, you know, you'll see that our revenues come from rebates, from the Metcash supply contract, and also from direct suppliers, where Graeme and a team of category managers from a merchandising point of view negotiate deals, promotional allowances, those sorts of things, from direct suppliers. So, essentially, two sources; from the warehouse contract, and from direct suppliers. In the case of the warehouse rebates, we're happy to talk about those off line or privately, if you'd like to later. But most of those moneys are passed on a performance basis on volume directly back to the retailers. Okay?

MR O'DONOVAN: Okay. So, now, it's our understanding that at least some of the rebates are normally captured by Metcash at the warehouse level for their revenue purposes. Was FoodWorks able to negotiate a better arrangement than a standard person acquiring from Metcash because of the competitive tension between Australian Independent Wholesalers and Metcash?

MR NOBLE: The Metcash arrangement at the time we negotiated, yes, was a better commercial arrangement, in terms of revenue coming in to FoodWorks. The other benefits of the different arrangements between AIW and Metcash related to the ability for us to expand interstate and develop some critical mass, and also a provision of IT and related services as part of the supply agreement, as opposed to AIW, in renegotiating their agreement, they were planning to pass on all of those IT infrastructure charges to FoodWorks and the retailers. Another additional benefit was that Metcash traditionally, in terms of the product range they have, it's about 22 to 24 SKUs, and of course, AIW had 10 to 12,000 available to FoodWorks. So it was a combination of all of those, Damien, as opposed to just the deal.

MR O'DONOVAN: Right. Okay. Now, what happened to AIW following the decision by FoodWorks to move its business to Metcash?

MR NOBLE: Yes. Quite an acrimonious range of events happened. The company secretary of Woolworths at the time sent me a note, and I guess threatened to sue FoodWorks for, you know, breaching the belief that they were the sole and exclusive negotiator with us for our long-term future. I know our chairman got a note also, threatening to sue us, and at that time Mr Roger Corbett made some pretty aggressive phone calls and things, and as a result of all of that we saw rapid rationalisation in the independent industry.

By the time that FoodWorks went across to Metcash it was in about August 2002, we physically moved across from the AIW warehouse, and very shortly after Woolworths closed the AIW warehouse in Victoria, the warehouse and depot infrastructure in Sydney and Canberra, and then came to arrangements over the further 12 months, if I can remember correctly, with the then ARL group, who had Five Star at that stage and now have SPAR – came to arrangements with them over a period of three, four or five years to pass that warehouse on to that small cell of retailers and their infrastructure in Brisbane. So as a result of all of that, the only post-AIW warehouse that's still operating is that small warehouse based in Brisbane, which has about 10 or 15 SKUs, 1000 SKUs, and has been restructured for the SPAR group.

MR O'DONOVAN: Right.

MR NOBLE: Okay?

MR O'DONOVAN: So that competitive tension between AIW and Metcash, if you came to renegotiate that contract now – that doesn't exist any more? Is that - - -

MR NOBLE: That doesn't exist any more. The FoodWorks arrangements were always for a long term, and I think everybody here knows the time decay that occurs with contracts as one comes up to renewal, and I guess with the time decay in mind, FoodWorks will have to decide in the next couple of years, because we have approximately four years to go on the national supply contract with Metcash, as to whether we'll renew or whether we'll seek arrangements elsewhere with a partner.

MR O'DONOVAN: Right. Okay. Now, if AIW hadn't been there in 2002, if they'd decided to shut up shop and say, "Well, you make your own supply arrangements," what sort of terms would have been available to you from Metcash in that kind of environment?

MR NOBLE: I think very definitely the competitive tension that existed, as you have said, helped us get a good arrangement. Again, I can't remember exactly, but my recollection is that the market capitalisation of Metcash Trading, as it was there, went up several hundred million dollars in the weeks that followed us signing up and moving across from AIW. So the competitive tension, I guess, was good for Metcash. They signed us up for the long term. But, of course, there's no competitive tension at the moment because AIW doesn't exist.

MR O'DONOVAN: Right. So then, in terms of expanding your business at present – so increasing the number of independent FoodWorks stores operating out there – firstly, what sort of business model are you operating on, and what sort of size independent businesses suit the FoodWorks model?

MR NOBLE: Okay. It's a – yes. It's a big question. Let me have a go at it. So we have large, medium and small supermarkets. We have approximately 67 large, greater than 1000 square metre supermarkets, we have a couple of hundred middle sized community supermarkets, and quite a long, long – large range of several hundred small community based supermarkets. So our model is flexible, in your answering your question. If you go into the marketplace, or you read the recent trade press, you'll see that FoodWorks very recently has launched what we call our perfect store concept. So our market position and the business model that we have developed as a retail system for that business model is a modular approach of community based supermarkets between 500 and 1500 square metres. Okay?

So our sweet spot is in that range, and the model that we have got, with all the architectural designs and the building specs that we have developed for FoodWorks, and there's a number of these in the marketplace that have been built in the last nine of 12 months, it's a modular approach to fit in mainly into regional Australia, into communities that aren't serviced well by supermarkets currently. Okay? I can think of Clifton outside of Toowoomba in Queensland as a very good example, where a year ago we had a 150 square metre supermarket, and most of the people in that 1400 population town were driving 80 kilometres to Toowoomba to do a main shop at the big chain stores.

Well, now we have a 780 square metre supermarket in town for FoodWorks, and the innovations of the retailer, supported by us, have built a very, very smart tilt slab brand new supermarket there, which is very competitive, and if it wasn't competitive those consumers or those customers would still be driving into Toowoomba. So it's happened here at Bunyip. It's happened at Kanungra in Queensland as well, and many other locations. So we're, in fact, starting to roll that new model out at the moment, a modular model, 500 to 1500 square metres.

MR O'DONOVAN: Okay. And so what would be the largest supermarket in the FoodWorks chain?

MR NOBLE: In excess of 3000 square metres. We have Bacchus Marsh and Gisborne are two good ones here locally in Victoria, and about 1800 to 2000 squares metres. One of those has just gone through a major refurbishment, Gisborne, and the other one, Bacchus Marsh, is about to have a 500 square metre refurbishment in the next 12 months. Both of those, as large supermarkets, compete on price, service and community exceptionally well against the big chain stores who are in both their community demographics.

MR O'DONOVAN: Okay. Now, in relation to those large supermarkets that are competing, I guess, head to head with the major supermarkets, it's been said publicly in – by the NARGA representative, that you don't earn any margin on dry groceries supplied by Metcash, and that you have to make your money elsewhere in the store. Are you prepared to – or would you able to comment on that publicly, or would you prefer to do that in confidential session, or do you have no comment on that at all?

MR LONGMUIR: Probably confidential.

MR NOBLE: Yes. I think Graeme is better capable of answering that, but can we do that in private, please?

MR O'DONOVAN: Sure. Okay. All right. Now, then in terms of FoodWorks' ability to access sites, it's been indicated to us that there are difficulties for chains looking to expand, and for small stores looking to become big stores in accessing sites. Could you just indicate what FoodWorks' experience has been in terms of access to sites?

MR NOBLE: Yes. Certainly. We're new to the property network development game. It's in the lead up to and since the prospectus period, where we have raised capital. This is an area of heightened interest to us. We no longer can rely on what we call a reactive strategy, in terms of property and network development. So a reactive strategy is one where a retailer comes to FoodWorks and says, "I want to redevelop my store. I want to relocate it," or "I want to build a brand new store," or refurbish it. And also a reactive strategy is where we wait for the phone to ring, or the next developer who wants to develop a supermarket to come in and work with us. Okay?

So whilst we have developed 20 brand new FoodWorks supermarkets approximately in the last 12 or 13 months, and they're all stand out examples of our new model, that isn't good enough. So as part of the capital that we have acquired from our retailers we're investing in the capacity of FoodWorks to work with very smart network predictive models. We have identified 900 suburbs in Australia that could take a new modular FoodWorks, and we're now working out with that intellectual capital proactively to put in place working with developers and retailers, and the possibility of moving into joint ventures and further capital raises to speed up proactively the development of those supermarkets.

Having said that, there are barriers. We know about the legislative requirements of local councils, the two, three, four year process to get one of these approvals through to build one. We know about the market dominance of the chain stores. Certainly in their anchor tenancies with big shopping centres you just can't get a look in, because they'll always be more attractive to a developer with anchor tenancy in terms of rentals and yields and those sorts of things. Also, again, we're new to the game, but subjectively I can say from what we read and what we see, the land banking and being third or fourth on the list compared to the big chains is a structural barrier to the speed with which we need to get new sites and build those sites in the marketplace.

I guess the simple strategy is it's a war out there. Aldi are doing an extremely good job of developing their model and building in Australia, and I'm sure, taking longer than they would like, and the chains are out there, Metcash, IGA are out there, and we need to be too. So there's a real time constraint on backfilling some of these market opportunities, because our customers are screaming for our business model. The industry and our retailers are screaming for our business model.

MR O'DONOVAN: So are there sites that you have earmarked or identified or even progressed that ultimately you have not been able to obtain because the major supermarkets have taken them?

MR NOBLE: Too early, Damien, to give you examples. You know, in private I'd like to tell you more about that strategy, but it's too early to say that there's an actual site at this stage.

MR O'DONOVAN: Sure. Okay. All right. Then in terms of the unit agreements themselves, are there – what do they tie the independent businesses into in terms of the relationship with FoodWorks.

MR NOBLE: It's a six year term commercial agreement with obligations on behalf of FoodWorks and obligations on behalf of the retailers, particularly it references the Metcash supply agreement and off taking from that, as and when the retailers need to, sort of thing. There are marketing statements in there. There is also a first and last right option, should the retailers decide to sell their business, and that's in there because in the industry today, having a first and last right helps our retailers get the maximum price for those businesses when they go to sell. If they go to sell. But also it gives FoodWorks the opportunity to keep that site as a FoodWorks store longer term. So, that's the central unity agreement. It's a pretty simple, straightforward agreement.

The ACCC looked at that agreement with the Queensland branch late last year, and did not see it as a franchise under the Franchise Act, so we've called it a unity agreement and we've got now more than 90 per cent of the volume of the FoodWorks business secure in that unity agreement. We needed to do the unity agreements because from a balance sheet point of view, we could not move forward in a great sense in the Australian market place, without those sites being secure. Historically, it has been too easy for those retailers to move across to IGA or historically into an alternate group. And it's very good news for FoodWorks that there is such commitment to the leadership of our company, that 90 per cent of the volume has signed up to those unity agreements in the first couple of months of 2007.

MR O'DONOVAN: Okay. So, then, in terms of supplying the actual businesses themselves, obviously a fair proportion of that comes through Metcash, but is there a component that doesn't come through Metcash?

MR NOBLE: Yes, there is. Metcash, and we've given you the data on this, Metcash provide approximately 58 per cent of the goods going in to the FoodWorks stores nationally and, as I said earlier, they are a mixture of dry grocery, frozen, tobacco and particularly in Victoria and southern New South Wales, we have got about 170 package liquor licences associated with our supermarkets through the ALM Metcash entity, the supply of packaged liquor. So, yes, and then 42 per cent, or approximately 42 per cent, are supplied by about 400 plus direct suppliers. And those direct suppliers can be, of course, fresh, so produce, deli, bakery, milk products, confectionery, snack foods, deli ranges, produce – an enormous range of different suppliers supply those stores direct. Many of those Graeme has developed for FoodWorks trading relationships with those, and so we also negotiate very smart deals for our retailers as a result of those direct relationships.

MR O'DONOVAN: And when you say "direct relationships", are they direct between the retailer and the supplier?

MR NOBLE: Yes. Yes, again, the point of invoice similar to what it is with Metcash and IGA Distribution, in the case that they invoice the retailer. Similarly, with the direct suppliers it generally is invoiced directly by the suppliers.

MR O'DONOVAN: Right. So, if a – so, I assume – is it mostly in the area of fresh?

MR LONGMUIR: Yes, predominantly, it is through fresh foods.

MR O'DONOVAN: Right.

MR LONGMUIR: Yes. Whether it's produce, as Peter said, produce, meat or deli products, or milk or bread. So, perishable type products which don't really suit going through a warehouse. They actually have to be delivered direct in to stores.

MR O'DONOVAN: Right. Okay. And is the independent retailer responsible for negotiating that arrangement? Or does FoodWorks itself take a role?

MR LONGMUIR: We will take a role in the majority of the supplies that are going direct, but they also have the ability to do deals themselves for specific supplies, if they wish to. But we will aggregate the volume of the 400 stores and work with the suppliers to come up with a deal that is suitable for the stores.

MR O'DONOVAN: Right. Okay. And then from the point of view of the independent retailer, they can either take advantage of the deal that you've negotiated - - -

MR LONGMUIR: That's right.

MR O'DONOVAN: - - - or they can chance their arm on a low volume deal.

MR LONGMUIR: That's right. Correct.

MR O'DONOVAN: With a supplier.

MR LONGMUIR: That's right.

MR O'DONOVAN: Okay. And so, where FoodWorks add value is in that aggregation of - - -

MR LONGMUIR: Correct.

MR O'DONOVAN: Right. Okay. And in terms of the number of direct arrangements with suppliers? Would it be most common for stores of that 42 per cent, would more than half of that be supplied as a result of the work that FoodWorks does?

MR LONGMUIR: Yes. Yes, more than half of that would be through the work that we do.

MR O'DONOVAN: Right.

MR LONGMUIR: Probably the majority of the deals that are done direct with the store would be for smaller supplies. So, we would be working with the direct suppliers of the bread, which is high volume, and the milk, which is high volume, for instance. Whereas, if a store prefers to buy a bread from a local bakery, they can do that themselves.

MR O'DONOVAN: Right. Okay. And on things like fruit and veg, do they just approach the local wholesale markets normally?

MR LONGMUIR: We will have – we have a group of preferred wholesalers that we have arrangements with and we encourage our stores to work with those wholesalers and then it's a matter of whether they choose to use the preferred ones or their own.

MR O'DONOVAN: Right.

MR LONGMUIR: A lot of them have a bit of history of working in the markets and doing the dealing themselves and they prefer to go to the markets themselves and do it.

MR O'DONOVAN: Right. Okay. And so, from FoodWorks point of view, there is revenue to be made at the company level, in terms of rebates, and from the store owners point of view, there's value in it from the better prices that they get from - - -

MR LONGMUIR: That's correct.

MR O'DONOVAN: - - - working together.

MR LONGMUIR: Yes.

MR O'DONOVAN: Okay. All right. In terms of the – we have discussed sites as a barrier to expansion. Are there any other structural barriers within the market in Australia that make expansion difficult for an independent retailer? Or an independent retail network, like yourselves?

MR NOBLE: Look, I would not say so. We are very healthily growing. Our relative growth, as you've seen from the data that we've sent you, is at or above the best in the industry and the best in the market place. We have a long way to go in terms of unit sales performance, so there's a lot more development work we need to do internally. So, aside from building new sites and continuing to grow the business, we've, sort of, always had the view that we've got to stand out there by ourselves and compete and stand up and be counted. So, I don't think there are other major structural issues. Off line, or privately, we might talk about, you know, the transparency of cost in this industry. And some of those issues. But, yes, I will just leave my comments there.

MR O'DONOVAN: Okay. All right. That's it for me for the time.

MR SAMUEL: I just want to burrow a bit deeper, if I can. I won't delve into your private issues which we will do in the confidential session.

MR NOBLE: Right.

MR SAMUEL: But just a couple of preparatory questions. Are you members of NARGA?

MR NOBLE: No, we're not members of NARGA. NARGA – and you will have to check that – but I understand that NARGA is an organisation sponsored by Metcash. It purports to represent the independent supermarkets throughout Australia but FoodWorks pays NARGA no money, does not have a membership, has no links to its board or management or operational activities, although I've met John Cummings a couple of times and I think we've shared emails a few times. So, FoodWorks does not have any structural, financial or service relationship with NARGA.

MR SAMUEL: All right. And the reason I ask that is, because of course, as you have correctly suggested, NARGA purports to represent – I will take you up on the word "purport" in a moment – but purports to represent the customers of Metcash and FoodWorks is a customer of Metcash, and that's why I was wondering why you weren't member of NARGA.

MR NOBLE: Because purports, it is a lot of things, Graeme, in this industry that purports, I think, is a good word.

MR SAMUEL: It was your word, that's why I was going to pick you up on it.

MR NOBLE: Yes. I mean, they purport to, but they don't. So, if they represented FoodWorks, FoodWorks would not have put a stand alone submission into this inquiry. That's how I'd answer the question.

MR SAMUEL: And can I ask you, your points of difference with NARGA in policy and other issues? I mean, I am not trying to create a division. I am just trying to understand, you are a substantial organisation representing 700 stores, 400 of which are branded FoodWorks, 300 - I think that's the proportion – 300 of which are unbranded.

MR NOBLE: Yes.

MR SAMUEL: I am just interested in why you are separate from NARGA – separate from in an entirely different way to the way that Franklins is, because Franklins said it wasn't going to work with Metcash anymore. And I am just interested as to your separate identity.

MR NOBLE: The simple answer to that is, and probably it's a personal view as opposed to a Board view, but my view has always been that I go for the highest levels of professionalism possible and an advocacy group that's trying to manage the public affairs and the state of interests of various stakeholders, like independent retailers, needs to be at the highest level of professionalism and long since has the oil industry had its combined entities that represent the interests of the oil industry, well, this industry has none of that.

We have pocketed, small, vested interest retailer organisations like NARGA, who purport to represent the whole independents. And I think, to get a share of voice with government and legislators, we would have to be seen to have a combined professional approach from the point of view of retail in Australia and then supermarket retail in Australia, so whatever industry form that would be, the interests of supermarkets and retailing would be represented to legislators and governments. And that is not the case. I don't believe it's professional, so, we don't subscribe to it.

MR SAMUEL: Yes. All right. I won't pursue that too much further.

MR NOBLE: I am happy to go a bit more privately, if you want to.

MR SAMUEL: Yes, well, we might take it up a bit more privately.

MR NOBLE: Yes.

MR SAMUEL: Okay. Let's just get down to the FoodWorks business model and I wanted to, sort of, try and draw a distinction between IGA - - -

MR NOBLE: Yes.

MR SAMUEL: - - - other branded, but differently branded customers of Metcash, FoodWorks, that is branded FoodWorks, unbranded customers of FoodWorks, and Franklins. Right, so there is an awful lot to cover there but I think it's - - -

MR NOBLE: A couple of days work.

MR SAMUEL: Yes. No, it's very important to us.

MR NOBLE: Yes.

MR SAMUEL: To understand how this part of the industry operates, because there's a lot of focus on Coles and Woolworths, but the relationship of Metcash to its customers is a very important element of the competition in the grocery market that we want to understand a bit better.

MR NOBLE: Yes.

MR SAMUEL: Now, let's deal with FoodWorks position. Let's just – I just want to put a couple of questions to you on all that. If the FoodWorks branded operators were to deal with Metcash direct, they would deal with IGA Distribution or they'd deal with Campbells Cash and Carry?

MR NOBLE: It's sort of - - -

MR SAMUEL: Let's assume that FoodWorks didn't - - -

MR NOBLE: - - - a question that you would have to you'll have to ask Metcash. But taking the point, the individual – do you mean, FoodWorks? Or do you mean, individually the retailers?

MR SAMUEL: Well, it's the – it's the banner group, if you like, called FoodWorks. Let's assume that the FoodWorks company didn't exist – the co-operative company did not exist.

MR NOBLE: Can I just say that I don't subscribe to the terminology "banner group" anymore. We are a closed listed company.

MR SAMUEL: Yes.

MR NOBLE: And so, it's a company. So, we have a structured commercial relationship with Metcash and our retail shareholders use our procurement or supply agreement with Metcash, etcetera. So, our retailers, should they wish and some probably do, can go to Campbells Cash and Carry and buy products. And I am sure some of them do have a Cash and Carry card and actually do that. Particularly some of the smaller ones.

MR SAMUEL: Now, why – what would be their advantage of buying via FoodWorks? I am trying to understand the FoodWorks business model a bit better.

MR NOBLE: Essentially, buying power, the rebate structures and the fact that we provide the marketing and merchandising systems, the pricing methodologies and all the support activities that we engage with them on. As opposed to going to a Cash and Carry. You literally go there with a pallet lift and pick up products and put it in your ute and drive home. You just cannot do that with the sophistication and size of our mix of supermarkets. These are very complex businesses that need a lot of infrastructure support. The difference in that model and Metcash and IGA – and the IGA model is obviously an excellent model and obviously well run. Ours, though, is an independent company, so our supply agreement with Metcash is one of supply of boxes into our supermarkets as we have described.

All those other services and infrastructure support things, we do that for and with our retailers. Our company is owned, our model is owned, our company is owned by our shareholder retailers. IGA is like a "vertically integrated franchise". So, Metcash enact all those services and support for IGA in the market place. So, they are very different models. One is inextricably linked vertically to a warehouse, and ours, in fact, is completely separate disaggregated entity that just takes boxes from Metcash and some other services.

MR SAMUEL: Would you – I mean, I am sure because there's ..... secrets in this whole trade, so I am sure you would be aware of the terms of trade and the basic cost structures of an IGA store. Would your FoodWorks stores have a competitive cost structure in terms of goods purchased and cost of - - -

MR NOBLE: Can I do that privately, please?

MR SAMUEL: Yes, sure.

MR NOBLE: If that's okay.

MR SAMUEL: Okay.

MR NOBLE: Please, if you can just note that.

MR SAMUEL: Yes. Now, let's take Franklins. Just remind me, someone, how many stores Franklins has got?

MR NOBLE: About 70.

MR SAMUEL: Seventy. Right. So, about 10 per cent of the number of stores you've got. Now, Franklins, in open session indicated that they were very happy to be out of the Metcash process, out of the Metcash supply process. And that they – again, in open session – indicated that they were much more profitable when they were no longer linked to Metcash but were actually buying direct from their suppliers.

MR NOBLE: Yes.

MR SAMUEL: You have got 10 times the number of stores.

MR NOBLE: Yes.

MR SAMUEL: And you – well, to questions, I guess. Have Franklins ever considered joining FoodWorks?

MR NOBLE: The answer is, no. The relationship to that question and more information I'd like to take privately, please.

MR SAMUEL: Yes.

MR NOBLE: But I would like to say publicly that we recognise, and the industry of independents needs to recognise, that Metcash in this last 10 years has done an outstanding job.

MR SAMUEL: Right.

MR NOBLE: And they have bought Davids out of the ashes, that old operation that they bought into. They've helped efficiently rationalise the industry. They operationally support all the independents who are customers of theirs generally very efficiently. Infrastructure – the new warehouses, all of those sorts of things. So, I think Metcash should get a lot of credit for what they have done in this industry and FoodWorks has been a beneficiary of that. In terms of some of the financial relationships and Franklins, I am happy to talk about that privately.

MR SAMUEL: Yes, okay. But if I could just take, then, the general principle that on the public record, Franklins have said they are financially better off buying direct from suppliers, with 70 stores only in New South Wales, than dealing via Metcash and so I am wondering why the 700 stores under the FoodWorks banner, are not better off dealing directly with suppliers rather than dealing via the intermediary wholesaler of Metcash.

MR NOBLE: The answer is, I don't know. We have not an alternative to Metcash and we do have a supply relationship with them. I could not ask Graeme today to go to six or 700 suppliers and try and get them to directly supply the FoodWorks network of 700-odd stores. It would be much higher cost to do that because of the logistical infrastructure. Okay. So, there isn't an alternative nationally to Metcash and Franklins does not present a panacea solution to FoodWorks in that they are a smaller operation, given big volume, but a small operation just in New South Wales.

MR SAMUEL: Yes.

MR NOBLE: Now, we have stores now nationally and it's quite a complex logistical task that Metcash currently does for us to supply all those configurations of stores. Now, Franklins are all big stores. The major chains are all big stores. More or less squares or rectangles. We have 700-odd stores of differing shapes and sizes, in all sorts of logistical areas, all around Australia. So, it's quite a task to do that and there just is not an alternative at this stage in the market place.

MR SAMUEL: Do you operate out of Tasmania?

MR NOBLE: We have 11 stores in Tasmania, and we operate through a Metcash infrastructure there in terms of supplying those stores. Yes.

MR SAMUEL: If we were to look at a model that appears, at least superficially, to be similar to the FoodWorks model, it would be TIW in Tasmania?

MR NOBLE: Yes.

MR SAMUEL: And they seem to have a structure that, again, to them is more profitable than dealing through the Metcash structure. I haven't got anything against Metcash, by the way. I am just trying to test the various models of the various business models.

MR NOBLE: Yes.

MR SAMUEL: Would you care to comment on that?

MR NOBLE: I won't comment publicly. Love to comment privately later.

MR SAMUEL: All right.

MR NOBLE: Okay.

MR SAMUEL: Okay.

COMMISSIONER MARTIN: The only question I was going to ask, going back to that history of the starting with the 30 stores and moving through towards the 90, and did you say that Woolworths bought 10 of the top stores?

MR NOBLE: Yes. In the - - -

COMMISSIONER MARTIN: And then – but they were supplied – well, AIW were - - -

MR NOBLE: Yes, the then CEO of Woolworths did the deal with – and I wasn't involved then – but the records of history tell me that the deal was done and the contract enacted at a certain volume and in the weeks and months after the contract was signed, the Woolworths guys went out there with a cheque book and bought every one of the biggest stores. About 10 or 15 of them. Okay. In the several months after the agreement was signed.

COMMISSIONER MARTIN: And what happened about the suing? Did anybody get sued?

MR NOBLE: A fledgling company with no balance sheet finds it difficult to sue in the Australian environment.

COMMISSIONER MARTIN: No, I thought you were threatened – there was a threat that you would be sued.

MR LONGMUIR: Later on.

COMMISSIONER MARTIN: The - - -

MR NOBLE: The ARW, sorry.

COMMISSIONER MARTIN: In 2002.

MR NOBLE: That vaporised in a day or so following when it was sent. Yes, there was no writ issued. They were veiled, hollow threats.

COMMISSIONER MARTIN: Was your model, give or take a bit, is a bit similar to one of the major set ups in New Zealand?

MR NOBLE: Yes.

COMMISSIONER MARTIN: In the New Zealand - - -

MR NOBLE: Yes.

COMMISSIONER MARTIN: Have you modelled on that - - -

MR NOBLE: Yes, we are deeply interested in that model and we've done some modelling on it. I've had the opportunity to head hunt a very talented business development manager out of that activity. It differs, in that it's pretty much a very strict franchise. It has warehousing structure and a pretty compelling balance sheet to go with it. But it is very strong in that it still commands some 50-odd per cent of the New Zealand market place, set against the power, if you like, of the big chains.

So, it is a very attractive model. Balance sheet capital are the big issues here. When you've got major chains commanding 80 plus per cent of the market place, it is very difficult to incisively move your market share quickly. Now, the Food Stuffs model, as you're probably aware, was a 13 per cent going to 50 per cent and they certainly went very hard at it with a very compelling model. So, yes, have looked at it and we are interested in it.

COMMISSIONER MARTIN: And in terms of the property side of the business, do you lease properties or - - -

MR NOBLE: As part of the new property developments, we have head leased our first two stores and they are being developed and built at the moment. And it is potentially the intention of our Board to support taking head leases on property. That's correct.

COMMISSIONER MARTIN: Thanks.

MR SAMUEL: Just to take that property issue further. I mean, I know Stephen King's got a couple of questions, but take the property issue further. You indicated some difficulty in getting in to shopping centres. Are you able to tell us, in general, without specific reference to specific centres – we might ask you privately about that – what responses you are getting from the shopping centres?

MR NOBLE: I think the thing about shopping centres, and we are fledgling in this property area – but it's certainly very interested. The response normally is that we are either fourth or fifth on the ranking list, after the big chains and Metcash IGA and then ourselves, Aldi are in there these days. And the other issue is the appeal of the anchor tenancy for Coles or Woolworths. It's – it really stops and starts there.

MR SAMUEL: Right. Now, in terms of obtaining free standing sites, other than the shopping centres, experience there?

MR NOBLE: Again, can you ask met that privately, please?

MR SAMUEL: Yes.

MR NOBLE: I am happy to disclose some quite exciting things that are happening for us.

MR SAMUEL: ..... this is all getting very interesting. Stephen?

COMMISSIONER KING: Just one question. Which, again, you may prefer to answer in private. Just if we follow the New Zealand model of Food Stuffs, obviously they have their own distribution centres. Have you looked at what sort of investments you would need to make in terms of having your own distribution centres?

MR NOBLE: I am happy to talk in private in any detail that you would like.

COMMISSIONER KING: I thought that would be your response, which is why I didn't ask it earlier on.

MR SAMUEL: Yes. All right. Well, I think we can move into the private session. All those other than – those connected with the ACCC or FoodWorks.

CONTINUED IN TRANSCRIPT-IN-CONFIDENCE

CONTINUED FROM TRANSCRIPT-IN-CONFIDENCE

RESUMED **[3.54 pm]**

MR O'DONOVAN: Can you just identify yourselves, your name, the company you represent and your position in the company.

MR JAMES: My names is Martin James, I work for Colonial First State Property Management and I am General Manager, Leasing, for the group.

MR GILCHRIST: I am Tony Gilchrist, I am Head of Development for Colonial First State Property Management.

MR O'DONOVAN: Okay. Were you summonsed to attend here today?

MR GILCHRIST: Yes.

MR JAMES: We were.

MR SAMUEL: We might just have the legal advisers.

MR O'DONOVAN: Yes, sorry. Could you introduce yourselves.

MS CAMERON: Joanne Cameron, partner, Malleson Stephen Jaques.

MR MORGAN: I am David Morgan, a senior associate at Malleson Stephen Jaques.

MR SEWARD: David Seward, corporate solicitor at Colonial First State Property Management.

MR O'DONOVAN: I just want to confirm that you understand that it is an offence under the criminal code to give evidence at this inquiry that you know is false or misleading or omits any matter or thing without which the evidence is misleading.

MR GILCHRIST: I do.

MR JAMES: I do.

MR O'DONOVAN: Very good. All right. Now, firstly, could you describe the Colonial First State business in so far as it is involved in setting up suitable sites for retail grocery.

MR GILCHRIST: Colonial First State Property Management manages 36 shopping centres across the country. They are centres that are owned within a stable of funds managed by Colonial First State. So we don't actually own the property ourselves but we manage the properties.

MR O'DONOVAN: Okay. Do you have any role in setting up the development?

MR GILCHRIST: Yes.

MR O'DONOVAN: Okay. How do you go about identifying a site that's suitable for development?

MR GILCHRIST: Well, most of our work is expanding existing shopping centres, so a very small part of our business is looking at new sites. So when we look at expanding an existing centre, it is really driven from what the market will support. So if there is – if we believe there is market opportunity for expanding a centre, and by market I am saying the demographics of the market, current population levels and growth, then we will look to expand a shopping centre.

MR O'DONOVAN: Right. Then when you look to expand do you acquire the centre, like buy the freehold?

MR GILCHRIST: Well, they are typically under management.

MR O'DONOVAN: Yes.

MR GILCHRIST: The development we do is expanding centres that we already own.

MR O'DONOVAN: Right.

MR GILCHRIST: Or that are already managed but us by owned by the funds.

MR O'DONOVAN: Right, okay. All right. So there are obviously some key metrics, some demographic metrics which you find and then decide that's an opportunity to expand the centre that you've got.

MR GILCHRIST: That's right.

MR O'DONOVAN: Okay. I suppose, the first element to that is, do you decide on the tenant mix that you think that that demographic will provide?

MR GILCHRIST: The first step we take is getting some usually independent market research by groups such as Urbis or Di Marzio, two good groups we typically use. They are really to find the opportunity in terms of sales potential. We will take that research and then look at a physical, I suppose a physical solution to capture that sales potential.

MR O'DONOVAN: Is every opportunity you are looking at an opportunity that necessarily includes a supermarket or are there many opportunities that don't?

MR GILCHRIST: No. Many opportunities that don't.

MR O'DONOVAN: Okay. All right. Then in terms of taking that demographic information and then deciding what it is that you are going to building, if the information comes back and says, you know, there's an opportunity for two – will it be as specific as saying, look, there's an opportunity there for two additional supermarkets?

MR GILCHRIST: It can get to that. The initial information will be there's a certain amount of sales potential and that is split up into, you know, there might be apparel spend, food and grocery spend or general merchandise spend. So we tend to then match the development opportunity to that research.

MR O'DONOVAN: Right. So that research will then drive your decisions about tenant mix?

MR GILCHRIST: Yes, yes.

MR O'DONOVAN: Okay. Now, if the research came back with, I suppose, a mid point - - -

DISCUSSION REGARDING MOBILE PHONE INTERFERENCE

MR O'DONOVAN: So if the research came back that there was one, possibly two supermarkets could be sustainable within a development - - -

MR GILCHRIST: Yes.

MR O'DONOVAN: - - - where would you go from there in terms of making your decisions about tenant mix?

MR GILCHRIST: We would obviously look at who – typically in a centre that we have there is already one supermarket or a number of supermarkets. The first choice would be trying to create a point of difference to the retailers we already have. So you would be looking to include someone that's not already in the centre or in the trade area.

MR O'DONOVAN: Okay. Then is it essential for the development to go ahead if, again, the research points to a supermarket development opportunity? Do you have to get anchor tenant to expand the centre?

MR GILCHRIST: Typically, yes.

MR O'DONOVAN: All right. In terms of your – the list of possibilities, who does Colonial First State regard as an appropriate anchor tenant for a supermarket opportunity?

MR GILCHRIST: Well, the anchor tenant is very – or who the anchor tenant is is very important because it's the strength of the anchor tenant that determines the strength of that expansion to the shopping centre because the number of sales and the foot traffic that the anchor tenant generates determines the number of people that are going to walk past the speciality retailers and, therefore, that determines the success of the development. So we would be choosing someone that from our research and from our knowledge of the market who would generate the largest sales for that anchor tenant and, typically, that is Woolworths and Coles.

MR O'DONOVAN: Right. Okay. Is there anyone else who is even on the list to be considered? If you approached Coles – well, presumably, you would approach Coles and Woolworths first almost as a matter of course, would that be fair to say, in supermarkets?

MR GILCHRIST: Not always. I think we have had instances – and Martin will probably be able to talk more directly about it because he is having the individual negotiations – but I think there has been opportunities where we had gone to the market with an opportunity, rather than going directly to Coles or Woolworths. Do you want to talk about it?

MR JAMES: Yes. I mean, we've – the majority of the stores we do hold are Coles and Woolworths, but we have got two sites with Foodlands in South Australia, we've got an IGA in Queensland, and we've got a couple of small independents as well. We recently went to the market with a very prime site, and we've leased that to Woolworths, but we did go to the open market and we did get offers from an independent, which were substantially less than what we were able to get out of Woolworths. And a lot of that came down to the sales expectation of the retailer in that site, which then generates the rent that they can afford to pay. So one is sort of linked to the other at the end of the day.

MR O'DONOVAN: Right. So in terms of those sites where you've ended up with an independent, so let's take the South Australian Foodland example.

MR JAMES: Yes.

MR O'DONOVAN: Are you aware of how that was run and how it came to be that the Foodland site - - -

MR JAMES: Both those centres, we acquired them, and they were tenants that were in the centre. So one centre has a Woolworths and a Foodland, the other one's got a Coles and a Foodland. So we're aware of how they trade relative to the major groups. In both those cases, those two Foodland stores are run by the Drake family, which are one of the best operators of the Foodland chain in South Australia. And they, you know, those stores perform reasonably well, but again not at the level of the major groups.

MR O'DONOVAN: Right. Okay. So even with the well run – even a well run independent doesn't have the same draw power.

MR JAMES: Still fall short of the major groups.

MR O'DONOVAN: Okay. All right. Well then going back to the site where you went to the market and Woolworths ultimately prevailed.

MR JAMES: Yes.

MR O'DONOVAN: Where was that?

MR JAMES: It was Chadstone Shopping Centre.

MR O'DONOVAN: Chadstone.

MR JAMES: Yes.

MR O'DONOVAN: Okay. And in terms of what was an offer, to the extent that you can talk about it in public.

MR JAMES: Yes.

MR O'DONOVAN: Did you think that the price that was offered by the independent for the quality of the site, did you think it was realistic?

MR JAMES: No, it turned out to be about 65 per cent of what we achieved from Woolworths.

MR O'DONOVAN: Right. Okay.

MR JAMES: So it was a substantial differential.

MR O'DONOVAN: Okay. And looking at what the offer was from Woolworths, do you think that the offer from Woolworths was justified by the demographic data in terms of turnover?

MR JAMES: Very much so. Where we felt the sales would be, and I guess with these negotiations it comes down to sales expectations, obviously the landlord has one view, the tenant has another view, and you meet at a point. And that basically is how we come up with a rental figure ultimately.

MR O'DONOVAN: Sure.

MR O'DONOVAN: But in terms of what you know about, I suppose, the expectations of a Coles and a Woolworths in terms of sales.

MR JAMES: Yes.

MR O'DONOVAN: And what you knew about the capability of that site, in terms of driving those sorts of sales.

MR JAMES: Yes.

MR O'DONOVAN: Do you think that Woolworths was paying an amount that was likely to hit the benchmarks that Woolworths expects?

MR JAMES: I think they pay an amount commensurate with the sales that we expect the site to generate.

MR O'DONOVAN: Right. So there's no suggestion that this was just an attempt by Woolworths to block out competition from an independent?

MR JAMES: Not at all. No.

MR O'DONOVAN: No, okay. All right. So would it be fair to say that at present, in the Australian market, if Woolworths or Coles express an interest in a site that you have available, it's most unlikely, all things being equal, that an independent will be able to get in?

MR JAMES: It comes down – if we're able to, I guess, be convinced the sales expectation of an independent would match that of Coles or Woolworths, and conversely we're able to have the same demand from specialty shops outside an independent, then we can seriously consider it. But our experience is that that's not the case.

MR O'DONOVAN: Yes. So based on your current knowledge and experience.

MR JAMES: Yes.

MR O'DONOVAN: And even an equal offer from an independent to anchor a store, anchor a centre, is unattractive? Is less attractive than a - - -

MR JAMES: Yes, I mean, what they pay in rent is one equation, the demand we'll get from specialty shops and what they will pay in rent is the other side of the coin.

MR O'DONOVAN: Yes.

MR JAMES: And I guess, and my experience, I'd be hard to be convinced that they would be on even footing at this stage.

MR O'DONOVAN: Okay. And even if we expand the definition of independent to something like a Franklins, the same principle would apply?

MR JAMES: Yes, it would be the same. We've only got three shopping centres in New South Wales, so we don't have a Franklins in our portfolio.

MR GILCHRIST: Back in the early nineties, when Franklins had an offer they called "Franklins Big Fresh", they were very attractive to a landlord, because they generated very high sales. But the business turned down significantly. So they've become less attractive because of the sales.

MR O'DONOVAN: Yes, okay. All right. Now in the leases that we've seen from you, some of them have restrictive covenants which were presumably placed in at the initiative of the anchor tenant. Can you just give us a description of how they're negotiated. Firstly, is it standard practice for supermarkets to seek a pretty broad restrictive covenant as their starting point?

MR JAMES: Yes. Well a lot of the covenants in the leases, again we've actually purchased those centres with those covenants, but the covenants are really based on each individual situation, depending on, I guess, again it always comes back to sales. So effectively I think you talked about a situation if you had room for, say, one and a half supermarkets. So if you didn't put in the second, you'd be basically relying on sales growing, say the next five or 10 years, to make that a viable operation. So in that case there you would consider a covenant to basically allow them to get a return on their investment, say for 10 years, so that would be a provision of that lease.

So some of the covenants that we've got have a restriction for a period of time, and if you obviously breach that covenant you can put in a competitor. But there is a reduction of rent too, some of them might be half of the base rent, some of them will be one per cent of turnover, so there is some restriction on that basis. Other covenants relate to a competitor based on area, and the deals that we do allow us to get the likes of an Aldi Supermarket in there with a 1500 metre cap, or you could put in a macro store, or a large format fruit and veg store, or a Harris Farm. So that it gives you the ability to put a point of difference into a Coles and a Woolworths, so it gives us some flexibility with product.

MR O'DONOVAN: Right.

MR JAMES: Yes.

MR O'DONOVAN: But in terms of those clauses that reduce the rent to one per cent of turnover, or reduce it by 50 per cent.

MR JAMES: Yes.

MR O'DONOVAN: That's effectively, from your point of view, that effectively rules out putting in another supermarket, unless it's at an astonishing rent.

MR JAMES: It does. But the ability to put in, say, a third supermarket, you know, that's one area. But it's got to be commercially viable, there's got to be the sales there, there's got to be the demand from speciality, and if that's not there, you're not going to put the third one, even if you don't have those covenants. So the whole thing has got to be weighed up.

MR O'DONOVAN: Sure.

MR JAMES: Yes.

MR O'DONOVAN: So if your demographic information said, "Look, the supermarket is going to be $30 million in turnover on this site, and is going to grow very quickly," so within five years it's probably going to be doing 45 million. And Coles or Woolworths sat down and they said, "All right, we want a restrictive covenant that no supermarket for 20 years." Would you give it to them, or would they have a case for you giving it to them?

MR JAMES: Yes. I mean, the Coles deals we do don't have those sort of covenants and, I mean, these historical deals, which aren't deals that we've negotiated. But, you know, we have to look at it case by case, you know, and we do look at them case by case and we look at the ability to expand the centre and the flexibility that we actually do need.

MR GILCHRIST: I think what we do in the case you mentioned, if over a period of 10 years the sales generate – or the sales opportunity in that market got too big, or got to a point where we thought there was an opportunity for a second supermarket, I think the covenant or the restriction, we would agree, would only be to that point in time, so we could then add the supermarket, the second supermarket, when the market got to a point where it would support that business.

MR O'DONOVAN: Sure. But if - - -

MR GILCHRIST: So we wouldn't blankly agree to 20 years, it really depends on the market.

MR JAMES: Yes. I mean, there's a restriction - and a lease I think was provided to the ACCC – where it says that the ability to put a third supermarket occurs when the centre hits $80 million in sales. So effectively you've then got two viable supermarkets to then consider a third. So that's another way it's been done in this lease that we inherited.

MR O'DONOVAN: Right. Now if there was demographic data that suggested that there was scope for possibly two but, you know, it was marginal.

MR JAMES: Yes.

MR O'DONOVAN: Whether you could get two in. Have you ever had circumstances where someone's attempted to – one of the supermarkets has attempted to negotiate – offered to pay you more rent in order to keep someone out?

MR JAMES: To keep their - - -

MR O'DONOVAN: Yes, to keep exclusivity.

MR JAMES: No. No.

MR O'DONOVAN: No, all right. Now, and in terms of where you're, I suppose, expanding in an area where there's obviously a particular pattern of supermarkets already, Coles and Woolworths – perhaps Woolworths might be overrepresented – and you're opening a centre with a supermarket opportunity. Does that affect the willingness or desire of either of the supermarkets to anchor your store, as in does the existing market structure affect their willingness to - - -

MR JAMES: Yes. If you have got a situation where you have got your centre and, say, all the way around it are all Safeway supermarkets, it's not really our preference to put a Safeway here so they protect the market, because, effectively, all you're going to is split the sales.

MR O'DONOVAN: Yes.

MR JAMES: So it's in our interests to get a Coles or another supermarket to, effectively, get some market share off the other Woolworths stores. So, you know, we look at the market holistically. We don't just look at our shopping centre. We need to understand what the competing factors are currently, and also proposed down the track. So we're very aware of that when we make our decisions.

MR O'DONOVAN: Sure.

MR JAMES: Yes.

MR O'DONOVAN: And if Woolworths expressed very strong interest in anchoring in those circumstances, and offered more rent than Coles, would that - - -

MR JAMES: You have got to – the supermarket rent is only, you know, a relatively small component really relative to what may be the overall product. So if you have got a supermarket that's paying a very high rent that's under-performing, well, all the specialty stores around it are going to under-perform as well. The rent is going to drop, and that's going to have a greater detrimental affect on the landlord. So, ultimately, you know, the landlord will lose out of that strategy.

MR O'DONOVAN: Right. Okay. And, to your knowledge, has an offer like that ever been made?

MR JAMES: No. We have not received an offer like that.

MR O'DONOVAN: Right. Okay. Now, in terms of Colonial deciding whether or not to develop a site, is the need to attract an anchor tenant a consideration in that?

MR JAMES: Yes.

MR O'DONOVAN: And can you look at areas and see that Coles or Woolworths would not be interested in entering an area and then, and therefore, shelve your plans to develop the site because of the existing market structure?

MR GILCHRIST: Well, we'd certainly look at who else – at what other players are available. But as Martin said, if we thought there was another operator that could generate sufficient sales to anchor that development we'd certainly look at that other operator.

MR O'DONOVAN: And have you ever had circumstances where you have got an independent – the majors have expressed no interest and then you have got an independent interested, and then the majors have come back in, in terms of their interest in a project?

MR JAMES: I have never been involved in that situation.

MR O'DONOVAN: All right. Okay. Now, in terms of your developments, presumably there are opportunities for existing competitors in the local supermarket market to object. Does that routinely happen, that where there's a new Coles planned that Woolworths will put in an objection to the centre, or where there's a new Safeway planned that Woolworths will object to the council?

MR GILCHRIST: I can't think of an instance - - -

MR JAMES: I can't recall. No.

MR GILCHRIST: - - - where that's happened.

MR JAMES: It's usually other owners that will object to a development of the centre.

MR O'DONOVAN: All right. Okay.

MR JAMES: Rather than the tenant.

MR O'DONOVAN: All right. Now, I have seen in one of your leases, at least, where I think there's an obligation on you to object in – or, effectively, it's a condition of your lease to Woolworths that you object to any adjoining proposal.

MR GILCHRIST: Yes.

MR O'DONOVAN: Any – so, effectively, you're doing Woolworths' objecting for them in relation – in relation to particular projects. Now, firstly, who proposes a clause like that? Presumably it is – it's the major supermarkets.

MR GILCHRIST: Well, we do that as a matter of course anyway to protect our asset. So I think we agree to the – we agree to that clause because we'd do it anyway. It's part of our role in managing the property.

MR O'DONOVAN: Yes. All right. But - - -

MR GILCHRIST: So it's not driven – it's not particularly driven from them. It's driven from ourselves.

MR O'DONOVAN: Right. But, obviously, they ask for it.

MR GILCHRIST: They ask for it, yes.

MR O'DONOVAN: Okay.

MR GILCHRIST: Because, obviously, we can sell the property.

MR O'DONOVAN: Yes.

MR GILCHRIST: So they might get another owner that's not as proactive as we are.

MR O'DONOVAN: All right. But, again, their intention in getting you to do that is with a view to blocking possible supermarket competition outside of your centre.

MR GILCHRIST: I suppose it's – it's – it puts a positive obligation on us to do it. Yes. But, as I said, we'd do that as a matter of course anyway.

MR O'DONOVAN: Sure. But it's possible that the landlords – the other landlords who object to your centres are doing so at the behest of – have similar obligations to Woolworths, or Coles.

MR GILCHRIST: I couldn't comment on what other landlords have. You'd have to ask them.

MR O'DONOVAN: Sure. But you'd concede that it's possible that - - -

MR GILCHRIST: It's possible, yes.

MR O'DONOVAN: - - - that the landlord objections that you're getting in these planning matters might be as a consequence of requirements in their lease that's similar to yours.

MR GILCHRIST: I think if the major – other major landlords, they're probably like us, and they have probably got – they're proactive in looking after the best interests of the property that they either own or manage.

MR O'DONOVAN: All right. Then in terms of the – I suppose the economics of the centre – you have touched on it already, but our understanding is that there's substantial rental differentials between an anchor tenant and specialty stores. Can you just explain the economics behind that set up in centres?

MR GILCHRIST: Probably the best way to start that explanation is to explain that every 18 months we do an exit survey in each shopping centre, and we interview 300-odd people as they leave the centre. Now, when you ask those people what their top five reasons for visiting a centre are it's always the anchor tenants. So, one, the main reason for their trip is to visit the anchor tenants. Typically, the anchor tenants sit at the end of a long mall. Typically, they're big spaces, and our supermarkets, I'd say, typically range from 3500 to 4000 square metres. So they're bigger spaces, so it's a bigger rent in total.

But the rate per square metre, as you suggest, is less. And the strength of the mall really depends on the anchor. If you were asked – if you planned a centre where you had it all specialty tenants and expected customers to walk down the end of that mall, it just wouldn't be viable. And, you know, people visit the centre because of those anchor retailers, not because of the specialty retailers.

MR O'DONOVAN: Right. So the rent differential effectively reflects the economic contribution to the development.

MR GILCHRIST: Yes, and which would be typical in an office building as well. You get the smaller tenants paying higher rent per square metre than the tenants that occupy large spaces.

MR O'DONOVAN: All right. Now, then, in terms of negotiating – sorry – again negotiating restrictive covenants, is the starting position of the major supermarkets that they expect exclusivity for a period, or have they – or including exclusion of Aldi? Is that something that you have to negotiate up from, or – as in push them back from that starting position?

MR JAMES: Yes. I mean, things with Aldi have changed though in recent times. It used to be – again, I know you have got a number of the leases. But the restrictions had caps that were like 600 square metres, and then I think they went up to about 1000. The caps that we have now are 50, 100 square metres, and that's specifically so we have got the option to bring Aldi into our centres, or a specialist organic supermarket, Harris Farm, that type of thing.

So what we're trying to do with our centres, we have the full-line supermarkets, and then we're actually building a lot of fresh food malls now that are complementary to our supermarket, and we're building on those, and that's really been a recent phenomenon over the last three years. So a lot of the new developments now are very much supermarket and fresh food based, which is the exact opposite of 10 years ago when all the butchers and the bakers, etcetera, all – were all pulled out, and that's actually now a growth part of the business, is specialist fresh food.

MR O'DONOVAN: All right. So you'd accept that those 500 – those caps on not allowing a supermarket above 500 square metres would normally keep an Aldi out.

MR JAMES: Traditionally, the old clause - - -

MR O'DONOVAN: Yes.

MR JAMES: - - - which again are the ones we have inherited, but the ones we're doing now, we're actually master planning and trying to incorporate Aldis within our centres, which ..... We have got one trading now. We have just instructed two more deals with Aldi, and we have got another three pending.

MR O'DONOVAN: Sure.

MR JAMES: So this has all really occurred over the last two years. So it's starting to open up now, and – yes.

MR O'DONOVAN: Okay.

MR GILCHRIST: And it's really because Aldi have proven that they can effectively anchor the space and generate the sales that make it attractive for us to bring them into the property.

MR O'DONOVAN: Sure. Okay. So that presents a reason for your negotiating position to change. So, obviously, you now have a strong incentive to keep them.

MR JAMES: Yes, and we see them as being a beneficial part of our mix. They add a point of difference, they have got a strong covenant, they generate the sales, and even the Woolworths and the Safeway – or, sorry – Woolies and Coles group now, would rather them in the centre than down the road.

MR O'DONOVAN: Right. Okay. So does that – by that do you mean do they no longer ask for an exclusion of another supermarket, and put a – I suppose, a square metre cap on it that would exclude an Aldi?

MR JAMES: Well, their issue is the third full-line supermarket. Now, it all – at the end of the day it comes down to sales expectations. I mean, you know, unless there's enough sales there to support three full-line supermarkets, and I – you know, we were talking about it before. I mean, we're struggling to think of a shopping centre in Australia that's actually got three full-line supermarkets which all trade well. I mean, there's a couple around, but there's usually one very poor offer in the centre, and it's obviously not in our interests to have a third supermarket that under-trades.

We’re better off to bring in different product which does trade and adds to the product, rather than just duplicating it. So having three of the same offer, I really don’t think it really does much for us ultimately.

MR O'DONOVAN: All right. But in terms – if we could just focus on what’s currently being asked for. Do either Coles or Woolworths, as a matter of course, when they are asking for a lease, ask for a condition that would have the effect of excluding Aldi? Or do they no longer even ask for that?

MR JAMES: They – no, they – effectively, the cap is set to allow Aldi to come in.

MR O'DONOVAN: All right.

MR JAMES: At 1500 metres.

MR O'DONOVAN: Sure. But in the context of the negotiation, is that because Colonial pushes that and says we are not going to compromise on that, or because Coles and Woolworths do not even ask any more to try to exclude Aldi.

MR JAMES: Probably originally we were driving it, but now it’s just a matter of course. It is not an issue with Woollies and Coles, in our current negotiations.

MR O'DONOVAN: Right. Okay. Now, the – in one of your leases, the lease includes a petrol station first right of refusal. Are you aware of that?

MR JAMES: I am not sure which lease that is.

MR O'DONOVAN: All right. I think that’s – sorry, I can’t give you the exact – okay. Corio Village. Does that ring a bell?

MR JAMES: It does, yes. The Woolworths store there.

MR O'DONOVAN: Yes.

MR JAMES: Yes, that – there’s actually a covenant on the centre from Mobil service station. You cannot put a service station on that site anyway.

MR O'DONOVAN: Right. Okay. So, did you participate in the negotiation?

MR JAMES: I did, yes.

MR O'DONOVAN: Right. And so, presumably, it was Woolworths that asked for the first right of refusal on a site?

MR JAMES: Correct.

MR O'DONOVAN: For a petrol station.

MR JAMES: Yes.

MR O'DONOVAN: All right. And if it was worth anything to you, would you have given it to them?

MR JAMES: Well, effectively, if we are able to get – and it has turned out we can't get a petrol station on that site, but effectively, the sales do improve if you have got a service station on the site. So, it is actually beneficial to us if we are able to accommodate that but we weren't able to because of the Mobil service station covenant.

MR GILCHRIST: Yes, it's a Woolworths branded supermarket. It does help the sales of the Woolworths supermarket.

MR O'DONOVAN: Okay. So, there is a relationship between petrol - - -

MR JAMES: Very much so.

MR GILCHRIST: Very much.

MR JAMES: There is a direct link. Yes.

MR O'DONOVAN: And it's – and the link is not just any petrol station, but a Woolworths branded petrol station?

MR JAMES: Correct.

MR O'DONOVAN: With Woolworths supermarket actually drives traffic?

MR JAMES: It does.

MR GILCHRIST: Yes.

MR O'DONOVAN: Okay. So, you have actually got an economic interest in that?

MR JAMES: We have got an economic interest in achieving it. In this case, we were not able to do that.

MR O'DONOVAN: Right. But if you can – but if the same negotiating pattern came up on a different site, there are economic incentives for you, as a landlord, to accommodate that kind of request?

MR JAMES: Correct. Through additional sales. I mean, we obviously get a rent for the site.

MR O'DONOVAN: Yes.

MR JAMES: But we are about generating sales; more sales is going to help the specialty and there is a flow on effect.

MR O'DONOVAN: Right. Okay. So, all right. So – and was that a new thing for them to ask for that relationship that's the first right of refusal in respect to the petrol station?

MR JAMES: That is the only – the only one that I can recall being in there.

MR GILCHRIST: From memory, it took a while to – for us to see the link, but when it was shown to us that by having either a Woolworths branded petrol station next to a Woolworths supermarket or a Coles branded petrol station next to a Coles supermarket, it took a while to – for them to prove to us that there was a benefit in sales when that petrol station was there.

MR O'DONOVAN: Right.

MR GILCHRIST: And once we saw the evidence of that, we saw the benefit to the centre by having that petrol station there.

MR O'DONOVAN: Right. Okay. Now, just in terms of specific leases, just if you've got information about them just – I want you to comment on them. In relation to Chadstone, in Melbourne, just looking at its set up. It's 420 speciality shops but only one supermarket. Do you know why it has that particular structure?

MR JAMES: Okay. It had two supermarkets. It had a Coles and a Bi-Lo. We have now got the next stage of the development occurring and we have leased a space there to Woolworths. And as part of that, we have now got back the Bi-Lo store, and we have split that, to put in Aldi and a large format fruit and veg store. So, what we have done there is effectively tailored our offer to our demographic, giving us, in our opinion, the best Coles and the best Woollies. Together with supporting specialty and also the Aldi store. So we also have things like Simon Johnson and James the Grocer, going in there. So we will have a full gourmet food offer there to complement the supermarkets.

MR O'DONOVAN: All right. Roxburgh Park in Victoria. Now, there was an exclusivity clause in that agreement which prevented the entry of Aldi.

MR JAMES: Correct. It had a period of 10 years, which expires December next year. We're now redeveloping that centre, which includes an Aldi and a Coles, and a Kmart I think. Yes. And a Kmart. So we'll end up with more competition being in that catchment.

MR O'DONOVAN: Sure. But was that a lease that you inherited, or was that a - - -

MR JAMES: No. That was a lease that was done pre my time. I think that was probably done about – well, it's coming up to 10 years next year, so I have been doing majors for the group for about six years.

MR O'DONOVAN: Sure. If a similar clause was sought now that would have the effect of excluding an Aldi from a centre, would it be agreed to?

MR JAMES: Well, effectively, that – if you think of what that was, that was just a paddock. So, effectively, there was nothing around it. So they have gone there and invested their money and it's really probably the last three years that that supermarket has really kicked along. So, effectively, it was done so they could get a return on their investments I touched on earlier. Now they're at a point where they're doing reasonably well, the 10 years is up, and immediately, as a proactive landlord, we're bringing in competition. So - - -

MR O'DONOVAN: Right.

MR JAMES: Yes.

MR O'DONOVAN: So it is possible that if there was a Greenfield site with poor sales generation and expectations, that you might - - -

MR JAMES: Yes. Well, it's effectively – I mean, the board on both sides needs to feel they are going to get a return on their investment. So - - -

MR O'DONOVAN: All right. And if Woolworths asked to exclude Aldi in those circumstances where there was, you know, a Greenfields site in the outer lying suburbs, but a potentially – potential growth area, it would be considered by Colonial?

MR JAMES: Well, I think – I mean, Aldi wasn't around, obviously, when that was put in place, and the cap on that particular clause was 1000 square metres, and I think it was four years ago we actually put a Turkish supermarket in there, called Fresh Plus. So we did actually put more competition in there, but it was a specialist operator to respond to the Muslim community there. So – but today, if I was doing that deal now, going back 10 years, I would have had the cap at the 1500. So we would have been able to put an Aldi in there.

MR O'DONOVAN: All right. Okay.

MR JAMES: And they're now coming into the development anyway.

MR O'DONOVAN: All right. Now, in Forest Hill you had to negotiate out of one of these clauses in order to get the Aldi in.

MR JAMES: Yes.

MR O'DONOVAN: Again, what was the origin of the clause? Who - - -

MR JAMES: That was with the previous landlord. So I think it's got a restriction that the supermarkets have to turn over $80 million combined with the Coles and the Woolies, and then a third supermarket can actually go in there. So we approached Woolworths to put in an Aldi store, and they have consented that to occur.

MR O'DONOVAN: Right. And what they extracted in exchange was a lease to a Dan Murphy.

MR JAMES: No. There was actually no trade off there. We offered them a Dan Murphy's, and there's one close enough to that particular site, and so they have just allowed it occur anyway.

MR O'DONOVAN: Okay. All right. In relation to Toowoomba, Clifford Gardens, there's a Super IGA?

MR JAMES: There is.

MR O'DONOVAN: I think only a Super IGA?

MR JAMES: There's a Woolworths store and there's a Super IGA. They're both about three and a half thousand square metres in size.

MR O'DONOVAN: Okay. And in terms of the relative performance, has it been good enough to make it attractive to you to consider a Super IGA?

MR JAMES: The Super IGA does 40 per cent of the Woolworths turnover out of exactly the same box.

MR O'DONOVAN: Right. So I take it that that – and if it – in centres where there's a Coles versus a Woolworths, is the differential quite so bad?

MR JAMES: No. There are some state differences. Say, Western Australia, we have got two very strong centres there; Coles outperforms Woolies. So it just depends on the situation, maybe the configuration of the car park. The general amenities may have a bit of a skew, but it's fair to say that probably over recent years Woolworths have been stronger than Coles, but 10 years ago Coles was a lot stronger than Woolworths so I'm sure Wesfarmers will rebuild that brand as well.

MR O'DONOVAN: All right. But in terms of this only doing 40 per cent, is there anything like that where Coles and Woolies compete head to head?

MR JAMES: The differentials? Sorry, I missed the point there. There's – I've got a centre in Victoria where the Woolworths will be doing about 30 per cent. I'm thinking of Altona.

MR GILCHRIST: We shouldn't mention that.

MR JAMES: Sorry. Sorry. Yes, there's a differential where the Woolies would only do about 30 per cent of the Coles.

MR O'DONOVAN: Right. Okay. So the Super IGA, as the second supermarket, is not on its own?

MR JAMES: It's pretty rare, though, to have that differential, to be honest.

MR O'DONOVAN: Okay.

MR SAMUEL: What would your reaction be if all the restrictive covenants contained in your existing leases were declared invalid?

MR GILCHRIST: It wouldn't be a problem to us.

MR SAMUEL: Don't think it would be a problem to you? Might be a problem to the – for the other parties. What would your reaction be if there was a legal ban on any new restrictive covenants of any nature – of the nature of those that we've been talking – sorry, that we've been talking about?

MR GILCHRIST: We wouldn't object. It wouldn't be a problem for us, either.

MR SAMUEL: Would it be a problem to you in that the lessees might take a different view on the rental they're prepared to pay?

MR GILCHRIST: They could do a lot of things. It's a bit of a hypothetical question.

MR SAMUEL: It's entirely hypothetical, yes.

MR GILCHRIST: They could ask for break clauses, they could offer shorter lease terms, they could do a number of things.

MR SAMUEL: If you were to be setting up – well, you're doing an extension of Chadstone, I think, and you've talked about new leases there, but are they likely to – if you were to say to them, look, you want a 3000 square metre supermarket, well the deal is as follows – are they likely to be arguing much?

MR GILCHRIST: Chadstone is a bit of a rare example because everyone wants to get into Chadstone. I don't know; Martin has more direct dealings with them.

MR JAMES: Graeme, with the supermarkets, they do have fairly prescriptive boxes. So if you're doing a deal with Woolies you know the general dimensions and the loadings that should work. If you said, look, there's only 3000 metres there - - -

MR SAMUEL: I was thinking – forget the 3000 metres. I was focusing on making it a restrictive covenant. If you were to say, "Hey, we'll give you the box you want and the frontage you want, the fascia you want, but you can't have a restrictive covenant. And by the way, we're not going to allow you in for less than a" – what's a standard lease? Ten years?

MR JAMES: Twenty years plus options.

MR SAMUEL: Twenty years. "So we're not going to allow you in for a five year lease"?

MR JAMES: But I think with development, at the end of the day you've got restrictions which I guess you're saying you can do or can't do, but the ultimate thing for the landlord is whether it works commercially. So if you took the covenants off, if there's not the sales there, and there's not the special demand, you wouldn't do the development anyway. That's what ultimately it comes down to.

MR SAMUEL: Yes. Would the same answer occur if I was to raise hypothetically the requirement that all new leases or renewals of leases be subject to a competition test?

MR GILCHRIST: If you mean by that that we've got to put that site to the market? Is that what you mean?

MR SAMUEL: Well, no, but that the ACCC might have a look at the proposed lease and say, "Look, if you lease" – take this extension of Chadstone just as the hypothetical, that if you lease it to Coles as distinct from leasing it to a Super IGA, that's going to have a substantial lessening of competition in the market for the retail sale of groceries.

MR GILCHRIST: We may not do the development on that basis. Because as we said before, we wouldn't have – if you now view – as Martin said, the rent offer wasn't sufficient, or they weren't a sufficient sales generator to anchor the precinct we were talking about, the extension we were talking about, we may well not do the development. It is just so important that the anchor tenant is a strong trader.

MR SAMUEL: If restrictive covenants are to be allowed, and to leases, is there an expected or a desirable minimum term, sort of what I'd call a start-up term?

MR GILCHRIST: You'd have to ask the supermarket operators, but I would think – I don't know. It depends what the growth is in that particular market, and when they get a return on their investment.

MR JAMES: I mean, generally the covenants have been 10 years, but the recycle of a major supermarket is seven years, so they must be getting a return after seven, so - - -

MR SAMUEL: Yes, that's right.

MR JAMES: - - - I think it's between seven and 10 would probably be your answer there.

MR SAMUEL: If there was a prohibition on a supermarket containing a positive covenant that you must object to any other competing supermarkets being established close by, would that cause you a problem? You'd do it anyway, wouldn't you?

MR GILCHRIST: We'd do it anyway.

MR SAMUEL: Yes. All right. You indicated that you weren't sure what other landlords were doing. I just want to test whether that's a bit disingenuous. I mean, all their leases are on display, except in Victoria.

MR GILCHRIST: Well, I haven't looked them up recently so I'm only speculating.

MR SAMUEL: So you run your business completely oblivious to what your competition are doing or what?

MR GILCHRIST: No. I've worked for other landlords too and I know – I've had the same approach.

MR SAMUEL: I thought so, yes. Is there much difference?

MR GILCHRIST: No, I think it's of a professional manager you're expected to look after the asset that you're managing, and if that goes to objecting to competition, which is in our view it does, then we'll do it.

MR SAMUEL: Okay.

COMMISSIONER KING: Just one final question, then. You mentioned that the Forest Hill changed the lease, and there was originally a covenant – or there was a covenant on a - - -

MR JAMES: On the Woolworths lease.

COMMISSIONER MARTIN: - - - competing food retailer more than 500 square metres – yes, but in the Woolworths contract – and you said that Woolworths had waived their rights to that without taking the Dan Murphy's licence. Did they require any other quid pro quo on that?

MR JAMES: No.

COMMISSIONER MARTIN: So they were quite happy just to - - -

MR JAMES: They were in this case.

COMMISSIONER MARTIN: Would the Aldi – or was there a threat that the Aldi store would set up in a location close by but outside the centre, like in Mahoneys Road out there?

MR JAMES: Yes. There are opportunities to do that, but it's fair to say that the major groups see the benefit of Aldi actually being in the centre which they can compete against, versus being up the road. And this has been a change that was coming over probably the last 18 months or so, and that's why we're now starting to do deals. We hadn't done any deals with Aldi for a period of time, and now that we've got three and we've got another three pending, I think that's sort of shown that I think things are starting to open up a little bit.

COMMISSIONER MARTIN: Okay.

MR SAMUEL: Thank you very much. Thanks for your assistance and cooperation.

MR JAMES: Thank you.

MATTER ADJOURNED at 4.39 pm INDEFINITELY