Public hearing – Melbourne

19 May 2008

ACCC Counsel assisting – Mr Damien O'Donovan & Ms Catherine Freeman

ACCC Inquiry Members: Graeme Samuel; Stephen King; John Martin

Time: 10.00am – 5.00pm

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

Time (indicative only)	**Witness**	**Legal representation**	**Submission**
10.00am	**<u>Woolworths Limited</u>** **Mr Michael Luscombe** Chief Executive Officer **Mr Naum Onikul** **Mr Stephen Bate** **Mr James Aylen** **Mr Ralph Kemmler** **Mr Ian Dunn** **Mr Peter Horton**	**Ms Gina Cass-Gottlieb** Gilbert & Tobin	No. 134 on website
Approx 1.00pm – 2.00pm	*Lunch*		
2.00pm	Woolworths (continued)		

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TRANSCRIPT OF PROCEEDINGS

O/N 80618

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: 10.00 AM, MONDAY, 19 MAY, 2008

MR SAMUEL: All right. Thank you, everyone. Sorry we're running a little bit late but my name is Graeme Samuel, I'm 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'm joined by Commissioner John Martin and Commissioner Stephen King who are the other two presiding members for this inquiry.

The inquiry is convened under part 7A of the Trade Practices Act 1974. It's held pursuant to a request from the assistant treasurer and Minister for Competition Policy and Consumer Affairs, Minister Chris Bowen, received by the ACCC on 22 January 2008. Details regarding all matters to be taken into consideration by the inquiry are available on ACCCs website. I note that we have so far received over 190 public submissions to the inquiry as well as a number of 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 to us.

The purpose of these hearings is to give the ACCC an opportunity to investigate in detail the key issues that have been raised. We've held hearings throughout Australia during April and May with the remaining hearings being held in Melbourne which meant the size of the many witnesses that have attended hearings over the last two months did not attend voluntarily and were summons to appear pursuant to our powers under section 95S of the Trade Practices Act. In particular, we summonsed all supply companies therefore no conclusions can be drawn regarding a company's willingness to participate in the inquiry from the fact that a company appeared at the hearings.

Some of the material covered in today's hearing with Woolworths will be confidential and commercially sensitive and therefore parts of the hearing will not be open to the public. This is because the ACCC must be able to investigate issues without damaging the witness' competitive position or commercial relationships. We'll also be questioning Woolworths about confidential documents the ACCC has obtained using our information gathering powers. Now obviously that can't occur in public. Transcripts of the public parts of the hearings are available on the ACCCs website. We may disclose some aspects of the confidential components in the transcript some time after the hearing if we consider that some of the material should be in the public domain but we will consult with Woolworths before doing this.

In terms of procedural issues, all Woolworths representatives 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 are not taking evidence under oath at this hearing, it is a serious offence to give false or misleading evidence to the ACCC. In relation to confidentiality if Woolworths believes that a particular question or a series of questions are likely to result in the disclosure of confidential information then Woolworths should indicate an objection to answering the question on that basis. I'll then consider whether the inquiry should take that evidence in private.

I note that although the ACCC is not utilising external counsel at this hearing, Woolworths will be questioned by the ACCCs internal lawyers, Mr Damien O'Donovan and Ms Catherine Freeman.

Now that concludes my preliminary remarks. I thank all of the Woolworths representatives for attending the hearing and for travelling to Melbourne. We realise you are busy people and attending is a significant imposition on Woolworths. I'll now hand over to Mr Damien O'Donovan.

MR O'DONOVAN: Just before I begin this, just a couple of additional documents that I'd like the commissioners and the witnesses to have. All right, well, we might begin. Perhaps if each witness can identify themselves, the company they represent and their role in the organisation. So starting with - - -

MR DUNN: Ian Dunn, senior business manager, Trade Relations for Woolworths.

MR AYLEN: James Aylen, the general manager of Long Life, the supermarket division.

MR HORTON: Peter Horton, general counsel and company secretary.

MR LUSCOMBE: Michael Luscombe, CEO – chief executive officer, Woolworths.

MR O'DONOVAN: If the legal representatives could also identify themselves?

MS CASS-GOTTLEIB: Well, I'm Gina Cass-Gottleib; I'm legal representative of Woolworths.

MR KEMMLER: Ralph Kemmler, I'm director of property for Woolworths.

MR BATE: Stephen Bate, general manager of Fresh Foods for Woolworths supermarkets.

MR ONIKUL: Naum Onikul, director of supermarkets.

MR O'DONOVAN: Okay. All right, now I'll need each of you to confirm that you understand that it is a breach of Commonwealth Criminal Code to give evidence which you know is false or misleading or omits material without which the evidence is misleading. Just each say "I understand".

MR DUNN: I understand.

MR AYLEN: I understand.

MR HORTON: I understand.

MR LUSCOMBE: I understand.

MS CASS-GOTTLEIB: I understand.

MR KEMMLER: I understand.

MR BATE: I understand.

MR ONIKUL: Yes, I understand.

MR O'DONOVAN: Okay. Well, good. All right. Now, I'll leave it to your discretion as to which witness is the appropriate witness to answer the question and I just want to reiterate that if there are matters which you believe are confidential but that arise from a question, you will notify us of that fact so that we consider whether the evidence ought to be taken in private.

All right. Now just again, Woolworths operates supermarkets in both - - -

MR SAMUEL: Did you want to make any opening statement at all before - - -

MR O'DONOVAN: Yes, my apologies. Yes.

MR SAMUEL: Thank you. Yes, Mr Chairman - - -

MR LUSCOMBE: Mr Chairman, I wish to thank the commission for the invitation to appear voluntarily here today. Let me say from the outset that Woolworths welcomes this inquiry as an opportunity to contribute to a better understanding of food prices in Australia and of competitive trends in the retail grocery industry. We recognise that Australians have faced the period of rising living costs from health care, education, petrol, insurance and, in particular, food inflation. It's timely that these issues are examined in a rigorous and rational way. We've sought to meet all the requests for information that have been put to us by the ACCC. We want this inquiry grounded in facts and in hard evidence. I personally welcome the opportunity to speak on behalf of Woolworths today. I speak on behalf of more than 155,000 Australians and a company which is one of Australia's largest private sector employers.

The supermarket business is very complex. The core focus of our business, however, is very simple; is to provide Woolworths' customers with quality, competitive prices, convenience, product range and we endeavour to do that in a market where we compete with others. Because we do this well, our business is strong; it's growing and it's profitable. We make no apologies for that. In fact, as a company we are very proud of it. Our customers, the Australian public, are smart, value conscious and very discerning. They wouldn't shop at Woolworths consistently if we didn't consistently meet their demands and expectations.

Woolworths operates in a highly competitive market place, a point that has been made consistently in many inquiries and studies over recent years. While there are many reasons why Woolworths is a strong and successful business, I'm going to highlight three in particular. First and foremost, our people – more than 155

Australians working hard to ensure the customer is king. Secondly, our supplier relationships – we work with more than 3000 suppliers to deliver qualify product at competitive prices to all parts of Australia, week in/week out, and have done so now for over 80 years. Our investments – Woolworths has continued to invest and take risks in order to increase efficiency, contain costs and improve our product offering including a $1 billion investment in the supply chain. These investments are a sign both of our long-term commitment to Australian consumers and of the highly competitive environment in which we operate, not simply vis-à-vis a competitor like Coles but also in the face of growth and expansion of the likes of Metcash IGA and ALDI as well as many smaller specialist retailers.

Mr Chairman, a key focus of this inquiry is food price inflation in Australia. It's important to remember that as a part of its business, Woolworths has had to deal with many of the same cost and price pressures operating on other parts of the food supply chain, indeed, other parts of the Australian economy. We do not operate in a vacuum. We've had to manage the challenges from rising fuel and energy costs, supply problems caused by drought and other climate-related shocks, infrastructure challenges, skills shortages and wage pressures. Woolworths has continued to work hard to contain price pressures on working Australians.

Indeed, we believe that Woolworths has been a force in moderating price pressure in the grocery business. Work done for us by independent consultants has confirmed that when you compare the Woolworths inflation rate on food items to the consumer price index for food our figures track well below the CPI rate. To cite just one comparison, between June 2002 and December 2007 the trend of Woolworths food price index rose at an average annual rate of 2.1 per cent compared with the annual growth rate of 3.7 in the trend of the Australian food CPI.

Part of the reason for this marked difference is that the Woolworths food index is a real expenditure based figure where the Australian Bureau of Statistics figure relates to a basket of goods generally updated every five years or so. Mr Chairman, a number of issues have arisen in the context of this inquiry concerning the food supply in Australia, particularly the food supply chain. Woolworths proudly sources the bulk of its products in Australia including around 95 per cent of fresh food, fruit and vegetables and 100 per cent of fresh meat. This is part of our broader commitment to meeting the demands and expectations of Australian consumers.

The food chain supply in Australia is undergoing continuous change with the rise of more consumer driver value change. The traditional picture of food pushed off farms into the marketing chain has evolved into a much more complex set of channels with both forward and backward linkages. Consumers are very much the driving change, driving force of these changes with demands for greater product diversification, the growth of niche products and increasing public concern about food quality and safety. At the same time international trade and globalisation are sources of both challenge and opportunity along the food supply chain. Any analysis of market power issues in the food supply chain need to take these factors into account.

Strong and sustainable supply relationships are fundamental to Woolworths' business. We invest heavily in cooperating with suppliers to meet changing consumer demands including product development. Looking forward, Mr Chairman, the food supply industry in Australia faces many challenges, domestic and international. Many of these have been identified by the federal government. It is important that this inquiry not be divorced from the discussion of the larger economic challenges that Australia confronts such as infrastructure, skill shortages, improving productivity and environmental challenges like climate change and water security.

We are encouraged that government is to tackle these long term economic challenges because we believe that this is where further progress can be made in fighting inflation and building Australia's competitiveness. Conversely we don't believe that burdensome regulations or other populous policy reactions will help in meeting this challenge. Indeed we believe that they will have the opposite effect leading only to higher prices for consumers and a less competitive economy. The fact that have entered what appears to be a prolonged phase of higher world food prices only underlines the need for sensible policy responses going forward.

Woolworths looks forward to a useful exchange today on how we tackle real challenges and ensure that all Australians are well served by a competitive dynamic grocery industry today and into the future. Thank you, Chairman.

MR SAMUEL: Thank you, Mr Luscombe? Mr O'Donovan? By the way, if it's going to make you more comfortable take your coats off because this room will get a bit warm not necessarily through hot air but you might just want to do that please feel free to do so.

MR O'DONOVAN: All right. I might just take you to the first document in that folder set that you've been given. Now I just want to confirm before I begin that the document there is a public document?

MR LUSCOMBE: That's correct.

MR O'DONOVAN: All right. Now can you just tell me what it was and what the purpose of its creation was?

MR LUSCOMBE: This document is the slides that are used to back up the announcement of our half-yearly profit results to the market.

MR O'DONOVAN: Okay. So what is the audience for this document?

MR LUSCOMBE: There are two sessions, one for journalists and one for financial analysts.

MR O'DONOVAN: Right, okay. All right. Now Woolworths operates supermarkets in both Australia and New Zealand?

MR LUSCOMBE: That's correct.

MR O'DONOVAN: Okay. Would you describe the environment, the competitive environment in New Zealand for a retail supermarket as more competitive or less competitive?

MR LUSCOMBE: About the same.

MR O'DONOVAN: About the same, all right. If we look at this reporting in relation to the performance of both the Australian supermarkets and the New Zealand supermarket, let's start with the Australian supermarkets and just compare the published data. Now in terms of growth margin for the Australian supermarket business and the growth margin is really effectively the gap between what you pay for goods and then what you are able to sell them for. Would you agree that that is broadly what gross margin means?

MR LUSCOMBE: Broadly. There are other elements to it but broadly that's the case.

MR O'DONOVAN: Yes, okay. Broadly it is true, isn't it, that the gross margin in Australia is higher than the New Zealand supermarkets?

MR LUSCOMBE: That's correct.

MR O'DONOVAN: Okay. Then the EBIT margin which is your earnings, which is effectively once you strip out all of the costs of operating the supermarket from the gross margin you end up with an EBIT margin.

MR LUSCOMBE: Correct.

MR O'DONOVAN: Does that accurately describe the concept there?

MR LUSCOMBE: Correct.

MR O'DONOVAN: Yes, all right. When you strip out all of the costs when you're left with an EBIT margin, the EBIT margins in Australia are higher than in New Zealand as well, aren't they?

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay. If we can just go to one of the other slides there, in relation to the New Zealand market, I think it's one of the ones that I just gave you. It states that:

> *The price investment has significantly reduced price differential versus the main competitor.*

MR LUSCOMBE: That's correct.

MR O'DONOVAN: So it's true to say that on your assessment that seems to suggest that you're not the price leader in the New Zealand market?

MR LUSCOMBE: Up until now we haven't been.

MR O'DONOVAN: Right, okay. So in that environment you're unable to earn as good a margin in the New Zealand market as you are able to earn in the Australian market. Is that right?

MR LUSCOMBE: That's correct.

MR O'DONOVAN: Okay. It would appear that you're going to be required to reduce your margins or at least reduce your prices not necessarily your margins but you may have to reduce your prices further in the New Zealand market to be price competitive?

MR LUSCOMBE: Yes, we may have to.

MR O'DONOVAN: Okay. You're not subject to that same price pressure here in Australia?

MR LUSCOMBE: It depends on which market we're talking about.

MR O'DONOVAN: All right. But if we just, but focussing then on in terms of the earnings that you can make, the EBIT margin, you're actually able to earn a larger – your earnings are larger and the gap between your wholesale price and your retail price can be larger in the Australian market?

MR LUSCOMBE: You're comparing two businesses that are vastly different. One has been around for 80 years and has made substantial investment in being a lot more efficient. The business that we've purchased in New Zealand is not in that same position so it will be some time before that EBIT margin approximates the Australian one because there are significant investments still required to be made in New Zealand.

MR O'DONOVAN: Sure, okay. Well, if that were the case you would see the cost of doing business would be higher in New Zealand if there was, I suppose, scope to make, improve margins by reducing costs. Would that be right?

MR LUSCOMBE: The structure of costs in New Zealand is very different to the structure of costs in Australia. We would see that there is an ability to take that cost down a little bit further in New Zealand in investment in the supply chain.

MR O'DONOVAN: Sure. But they are already lower?

MR LUSCOMBE: Yes, structurally they are lower. Yes.

MR O'DONOVAN: Okay. So it would be true to say that in the New Zealand market that you're not able to charge as big a gap between what you buy goods for and what you sell goods for?

MR LUSCOMBE: We choose not to.

MR O'DONOVAN: Yes. But presumably in response to market conditions?

MR LUSCOMBE: Yes, that would be correct.

MR O'DONOVAN: All right. Those same market conditions aren't operating in Australia pushing the margins down to the levels that they are in New Zealand?

MR LUSCOMBE: That would be correct.

MR O'DONOVAN: Okay. Which does seem to suggest that at least at present that the New Zealand market is more competitive than the Australian market? Would you agree with that?

MR LUSCOMBE: In New Zealand there are two competitors, ourselves and Foodstuffs.

MR O'DONOVAN: Sure, yes. I'm aware of the structure of the market. The question is, I'm talking about the competitiveness of the market. Would you agree that the competitiveness of the market in New Zealand that it is more competitive in terms of the pricing of retail groceries is more competitive than it is in Australia?

MR LUSCOMBE: I don't think that's a conclusion that we could reach. The issue in New Zealand is that we've had a very strong competitor that has been very stable, invested for a long period of time. We've bought a company that is an amalgamation of a number of companies that hasn't been able to do that and so their ability to actually compete on price for many years has been somewhat missing and we're trying to address that problem in New Zealand.

MR O'DONOVAN: Sure. But if we just look at the basic statistics at the moment without stepping behind the reasons for why it might be so, as a matter of objective fact that it is more competitive in New Zealand in retail grocery than it is in Australia?

MR LUSCOMBE: Yes. We're doing the catching up in New Zealand. That's correct.

MR O'DONOVAN: Okay, and it would be fair to say that the New Zealand consumers are benefiting from narrower margins for the retailers?

MR LUSCOMBE: Certainly in our case, that's the case, I can't speak for the others because they don' publish numbers.

MR O'DONOVAN: Sure, all right. Okay, now in relation to the relation to the way you've engaged – one of the consequences of engaging with the New Zealand market is that suppliers to the Australian market have – there's been harmonisation of terms between the Australian, I suppose, supply into the Australian market and supply into the New Zealand market? Is that right?

MR LUSCOMBE: Yes, we've asked suppliers that supply the same products into Australia and New Zealand to supply them on the same trading terms.

MR O'DONOVAN: Okay and that's public information, I found it in a published decision - - -

MR LUSCOMBE: That's correct, yes.

MR O'DONOVAN: - - - so there's no confidentiality about that.

MR LUSCOMBE: That's correct.

MR O'DONOVAN: Okay and so is the net affect of that that the terms on which the New Zealand supermarkets obtain things like packet groceries from suppliers, they are the same as they would be for the Australian supermarket?

MR LUSCOMBE: No the trading terms would be pretty similar if not identical in most cases.

MR O'DONOVAN: Right, okay and so a good way of testing I suppose the relative competitiveness of the Australian market and the New Zealand market would be to look at where a supplier has harmonised the supply terms for the New Zealand market and the Australian market comparing the retail prices that things go for in New Zealand and the retail prices things are sold for in Australia. Would that be right?

MR LUSCOMBE: No, the base price may actually be different.

MR O'DONOVAN: Now, when you say base price what do you mean by that?

MR LUSCOMBE: The list price.

MR O'DONOVAN: Notwithstanding the harmonisation of the terms?

MR LUSCOMBE: Correct, yes.

MR O'DONOVAN: So in what sense then are prices harmonised?

MR LUSCOMBE: Trading terms; the level of rebates, etcetera.

MR O'DONOVAN: Right, so are you saying that the rebates are the same but the wholesale prices might be different?

MR LUSCOMBE: They might be different, yes.

MR O'DONOVAN: All right, are they normally different or are they normally the same?

MR LUSCOMBE: Look, I can't – I couldn't answer that directly, we could test that and come back.

MR O'DONOVAN: Right, okay, but if we wanted to explore that way of comparing I suppose the relative level of competition in the New Zealand and the Australian market - - -

MR LUSCOMBE: Well, there isn't - - -

MR O'DONOVAN: - - - we could do it that way?

MR LUSCOMBE: We could do it, the issue is that many products are not quite the same, so in the coffee category, for instance, where we sell the – the majority of our products are sold in jars, Nescafe, etcetera, in New Zealand most – or a lot of coffee is actually sold in packets. So it's not strictly speaking the same product.

MR O'DONOVAN: Right, okay. But there may be others that where it is exactly the same product and we would be able to do a comparison?

MR LUSCOMBE: I think we could do that, yes, given time.

MR O'DONOVAN: Okay, all right. Now, then in terms of the performance of the Australian supermarkets, just looking again at the published data, the EBIT margins over time in say the last five or six years they've stretched out somewhat?

MR LUSCOMBE: They have.

MR O'DONOVAN: They're now larger than they were five years ago.

MR LUSCOMBE: They were, correct.

MR O'DONOVAN: Okay, now – and again the EBIT margin is a good proxy for the difference you can sell – the difference between the wholesale price and the retail price, minus all the costs - minus the cost of doing business?

MR LUSCOMBE: Well, it's a combination of that and your changes in your cost base.

MR O'DONOVAN: Yes, okay, so just looking at it conceptually, there might be a number of reasons – a number of ways in which you can improve your EBIT margin?

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay and one of them is that you're just paying less for the goods that you buy, so that the wholesale – your wholesale cost is lower?

MR LUSCOMBE: That could be one, yes.

MR O'DONOVAN: Yes, all right and alternatively you could be buying them for the same price but selling them for more, that's another way of stretching your margin?

MR LUSCOMBE: That is one, yes.

MR O'DONOVAN: Yes, all right. The other way is that you might be buying a mix of different things, so that rather than stocking things that didn't give you a good margin you can stop stocking them and start stocking other things where the gap is bigger between what you've paid for it and what you can sell it for.

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay and then you can also stretch it by, I suppose, losing and breaking and having stuff stolen less in the shop?

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay and I think that's called shrinkage?

MR LUSCOMBE: That's the general term for it, yes.

MR O'DONOVAN: Yes, okay and the result of improving – having less shrinkage is you get a better margin?

MR LUSCOMBE: Correct.

MR O'DONOVAN: All right. Are there any other ways that margin can be improved in a retail grocery context?

MR LUSCOMBE: Well, over time there are a number of things that didn't happen. One of the major changes had been that we had a lot of product that would go direct to store and we were - obviously embedded in that cost was the cost of delivering to 700-odd supermarkets with an individual invoice, with the investment that we made in infrastructure we were able to redirect those through our centralised distribution. As a result of that we added a cost, because we pick up the cost of distribution and freight, but we also negotiated a reduction in the cost price of the product. But the sell price obviously stayed the same, so Arnotts Tim Tams for instance used to go direct to store, maybe once or twice, maybe three times a week, now the store has the ability to deliver it or have it delivered essentially seven times a week.

Private label is another area where because private label doesn't carry the cost of marketing that branded products doesn't have, we can clearly make a better margin on that and yet deliver it to the customer at a lower price and then generally speaking over time consumers have moved in their preference to products that have generally carried a higher margin, so the interest in olive oil, for instance, as opposed to just using plain old cooking oil, the incidents of sauces that are pre-made, rather than making them up your own sauce, the incidents of pre-packed salads, that are obviously – have some further additional manufacturing done before it reaches the consumer.

Then just generally people have moved upwards in their aspirations, so we're finding that generally the products that are selling better, doesn't matter whether it's a dishwashing detergent, you know, there are now seven ways of making your dishes cleaner in your dishwashing machine, whether it's to do with laundry detergents that include a softener as well as a water conditioner, all of those are products where people have moved away from the basic Surf and Omo and Surf and Omo have actually added things and generally consumers have moved up the chain and all of that has meant that they've moved into products that typically have carried a higher margin.

MR O'DONOVAN: Okay, all right, so that would fall into the category of just change of product mix?

MR LUSCOMBE: Yes, just generally, yes.

MR O'DONOVAN: Okay, all right, now in the half-yearly results you made some statements about how in particular Woolworths' gross margin increased.

MR LUSCOMBE: Yes, I did.

MR O'DONOVAN: Okay, now firstly you said reductions in shrinkage, so again that's that loss through other means.

MR LUSCOMBE: Yes.

MR O'DONOVAN: Now, that's put first. Now, is that because it's the most important contributor?

MR LUSCOMBE: No, none of those are in any particular order of importance.

MR O'DONOVAN: Right, okay, now, it says changing mix from – sales mix from write about campaigns. What does that mean?

MR LUSCOMBE: Yes, in any category you typically have got three levels of products. You've got private label, you've got typically your market leaders and you'll have the rest of the products that are not the market leaders. The market leaders that have been around for a long time, so you know, the Coca Colas, the Cadbury chocolate, etcetera, of the world, typically carry a lower gross margin, because they're highly competitive, highly promoted and they – typically because they're the market leaders have a larger share of the category. If you take products that actually have a higher margin to begin with and you take the price back, in other words roll the price back, take a lesser margin, but that margin happens to be still higher than the one that you get on the market leader, any product choice a consumer makes that moves from the market leader into one of those secondary products actually means that the consumer gets a better deal, but our average margin goes up.

MR O'DONOVAN: Right, okay. All right. Now then, the success of Private Label, how does that impact on margin?

MR LUSCOMBE: Clearly, as I mentioned before, we are able to, not in every case but in may cases, able because we don't carry the marketing cost that the branded products have with TV campaigns, etcetera, we're able to ascertain a better starting margin. Of course, we also work very hard right back along the chain to ensure that we optimise the cost of the product vis-à-vis the quality that we're seeking to obtain with the products. So that just means that we're able to have a very keenly priced product without necessarily having a margin that is down where the margin leaders are.

MR O'DONOVAN: Okay. Then reduction of direct store deliveries.

MR LUSCOMBE: Yes.

MR O'DONOVAN: You discussed that earlier.

MR LUSCOMBE: Yes, I did.

MR O'DONOVAN: Now, is the effect of that that the costs effectively are shifted from – that you earn a bigger margin on the product, but there are some losses in increased costs of doing business?

MR LUSCOMBE: There's a commensurate cost in our CODB line. Where we pick up, quite frankly, is we find that one, our sales increase when we go direct store delivery to centralised distribution because we have the ability to actually have that product available fresh each night and secondly, our experience has been that we typically have less shrink because if it's sitting out in the backroom, the chances are it can get damaged, it can get purloined, it can go out of date because it gets mixed up with other products and also one of the reasons, of course, that perhaps sales are not as good is it doesn't tend to be worked as regularly as the grocery load that comes in each night. So our experience when we moved to, say, our major biscuit supplier in Western Australia, in Arnott's, where we moved in we, from memory, our sales increase for those products in Perth, which was one of the first markets we moved in, were in the region of 10 to 15 per cent increase in sales is because we just did a better of keeping them on the shelf.

MR O'DONOVAN: Okay. All right. So then, I suppose, honing in on what you said about Private Label, you say that because there aren't marketing costs involved you can earn a better margin - - -

MR LUSCOMBE: Yes.

MR O'DONOVAN: - - - on Private Label?

MR LUSCOMBE: Mm.

MR O'DONOVAN: All right. Now, it's true that Coles also runs a private label strategy?

MR LUSCOMBE: They do.

MR O'DONOVAN: All right. Well, firstly, I'll discuss Woolworths' positioning. It has obviously the Select label which is the premium - - -

MR LUSCOMBE: That's correct.

MR O'DONOVAN: - - - Private Label? Okay, and then it has Home Brand.

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay, which is, I suppose, would it be described as a fighting brand?

MR LUSCOMBE: It's what's typically known as a generic brand.

MR O'DONOVAN: Generic brand.

MR LUSCOMBE: Yeah.

MR O'DONOVAN: All right. I'll leave aside Fresh for the time being. Now Coles, on the other hand, offers You'll Love Coles?

MR LUSCOMBE: Yes.

MR O'DONOVAN: And Coles Smart Buy?

MR LUSCOMBE: Correct.

MR O'DONOVAN: Would it be true to say that Coles Smart Buy is directed at the same sort of market as Home Brand?

MR LUSCOMBE: I would presume so.

MR O'DONOVAN: All right, and You'll Love Coles is directed at a similar market to Select?

MR LUSCOMBE: I would not think that's the case, no.

MR O'DONOVAN: Right, okay. What's the differences there?

MR LUSCOMBE: I think that that's an intermediate brand. They actually have another brand that they're targeting for the Select area. George, Coles is it? Finest, sorry. Coles Finest.

MR O'DONOVAN: Coles Finest, okay. So they're operating in that same generic space, offering house brands at tiers similar to Woolworths.

MR LUSCOMBE: Private Label of which generic is the bottom, yes.

MR O'DONOVAN: Right, okay. Private Label. All right. Now, if they were competing strongly in those categories, you would expect that margins would erode over time. Would you accept that?

MR LUSCOMBE: In some cases. I did mention earlier that it is not a general rule that we make really good margins on all products. In some products, we actually don't make a great margin.

MR O'DONOVAN: Sure, but one of the factors that you've noted as a cause of Woolworths' ability to improve its margins - - -

MR LUSCOMBE: Correct.

MR O'DONOVAN: - - - is the fact that you've been able to shift customers to the higher margin Private Label goods?

MR LUSCOMBE: Yes, that's correct.

MR O'DONOVAN: Okay, and Private Label goods, notwithstanding that Coles offers private labels that compete directly with those products, we haven't seen that reduction in margins. Can we infer that from your public statements?

MR LUSCOMBE: In Home Brand, we've had some reduction in margins.

MR O'DONOVAN: All right, but in terms of the competitive approach that Coles have taken, it hasn't forced the reduction in margins?

MR LUSCOMBE: No, it's been more ALDI.

MR O'DONOVAN: Sure, okay. So again, does that suggest that there's weak competition in those premium house brands?

MR LUSCOMBE: In terms of Select versus Finest, we've got far more products in – I think we've got over a thousand Select. I don't think there's anywhere near that in Finest at this stage.

MR O'DONOVAN: In relation to the generic brands, has there been a reduction in margins at the generic level?

MR LUSCOMBE: In particular products, particularly where we've been matching against ALDI, that's correct.

MR O'DONOVAN: All right. So that we can expect that in the future, there won't be a positive contribution to your EBIT margins coming from people switching to home brand products?

MR LUSCOMBE: More from Select and other private labels.

MR O'DONOVAN: So you expect that you'll continue to get a positive contribution to EBIT from customers switching to Select?

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay, which suggests that at least that category of the market remains only weakly competitive, from Woolworths' point of view?

MR LUSCOMBE: No, it's more to do with the fact that we will continue to roll that range out. So we haven't finished rolling that range out.

MR O'DONOVAN: All right, but – okay.

MR LUSCOMBE: Yeah.

MR O'DONOVAN: But in terms of the products that exist there and for which there is a competitive Coles' product, are you able to maintain the target margins that you had?

MR LUSCOMBE: At this stage, we have, yes.

MR O'DONOVAN: All right. So would you agree that that suggests that there's weak competition, at least at that sector of the market?

MR LUSCOMBE: I think it's actually more to do with the fact that there are very few Finest products. I might just defer to James Aylen. James, can you recall how many products there are in Finest?

MR AYLEN: To the best of my knowledge, Michael, there's only about 30 - - -

MR LUSCOMBE: Thirty versus - - -

MR AYLEN: That's just across a couple of categories.

MR LUSCOMBE: So against over a thousand Select. So it's actually more to do with the fact that there isn't a product to compare to.

MR O'DONOVAN: Sure, okay. Now, the statement in the public accounts was:

> *Gross margin increase demonstrates better management of costs, not higher prices.*

Now, are you suggesting there that higher prices didn't make any contribution to the improved margins?

MR LUSCOMBE: There would be a small amount, but the words that went around this was to really indicate that the real driver of gross margin improvement was actually those one, two, three, four, five items that I went through in detail with both the media and the analysts.

MR O'DONOVAN: Right. So it wasn't an increasing gap between the wholesale and the retail price that was driving the margins?

MR LUSCOMBE: Well, the gap – are you talking about - - -?

MR O'DONOVAN: I'm sorry, yeah, in gross margin terms. That's what I'm talking about.

MR LUSCOMBE: There may have been a little bit, but not much.

MR O'DONOVAN: Right. Not caused by increases in retail prices.

MR LUSCOMBE: No.

MR O'DONOVAN: Okay. All right. We might return to that, I think, in the confidential section. Now, another metric I suppose I want to discuss with you is return on funds employed. Now, is that a metric that Woolworths uses or it takes an interest in or calculates?

MR LUSCOMBE: Yes, it does.

MR O'DONOVAN: Okay, all right. Now, just to make sure that I understand it, if I had a million dollars and I put it in a term deposit at seven per cent, my return on funds employed would be the seven per cent that I earn in the term deposit. Is that oversimplifying it?

MR LUSCOMBE: In simple terms, that would be correct, yes.

MR O'DONOVAN: Yeah, okay, all right. Now, looking at the published data for 06/07, I think the return on funds employed for Woolworths was 75 per cent. Is that consistent with what you understand the position to be?

MR LUSCOMBE: For Woolworths Limited or - - -

MR O'DONOVAN: Yes, Woolworths Limited.

MR LUSCOMBE: Limited. I've got the annual report for 2007 and the return on funds employed was 27.1 per cent and it increased from the previous year from 24.2.

MR O'DONOVAN: All right. Sorry, I think the figure I'm referring to would be the breakdown for the supermarket division.

MR LUSCOMBE: Yes. The supermarkets would be higher because it actually has a number of assets that, because of the age of the business, that basically have been written down, so the return, obviously, is always going to be higher.

MR O'DONOVAN: Right.

MR LUSCOMBE: The lowest will always be on a business that you've just acquired or one where you've put substantial investment in, or one where you carry a much higher working capital.

MR O'DONOVAN: Right, okay. So the 75 per cent return, you don't think – I suppose the comparison with the term deposit of earning a 75 per cent return - - -

MR LUSCOMBE: No, well, you're getting a return on no deposit because the deposit has actually – they've given you back the money but they're still paying you the interest, basically, because you've able to write down the assets over time.

MR O'DONOVAN: Right. So in terms of the asset representation in Woolworths' reports it actually doesn't represent the total asset value within Woolworths?

MR LUSCOMBE: It certainly wouldn't represent the market value of those assets, no.

MR O'DONOVAN: Right. So how is it represented? Is it a tax value - - -

MR LUSCOMBE: It's actually an accounting standard that we have to follow under EFERIS.

MR O'DONOVAN: Sure. Right, okay. So there are more assets employed in the business than are represented on that figure?

MR LUSCOMBE: Yes, that won't have any monetary value attached to them at this stage.

MR O'DONOVAN: All right.

MR LUSCOMBE: Yes.

MR O'DONOVAN: So - - -

MR LUSCOMBE: Or very little.

MR O'DONOVAN: Right. So you say the 75 per cent figure is not really representative
of - - -

MR LUSCOMBE: Of Woolworths Ltd.

MR O'DONOVAN: Sorry. I was just saying – no, let me finish the question. Yes, or I suppose the quality of the supermarkets' business, it's – which, you would agree, it is an astounding return on – if one's employed, if you could get a term deposit at 75 per cent you would be delighted.

MR LUSCOMBE: Yes, I guess you would be, I was certainly unable to get it.

MR O'DONOVAN: Yes. So - - -

MR SAMUEL: Well, particularly if your money has been repaid, as Mr Luscombe has suggested, yes.

MR O'DONOVAN: So then the question then is do you say that that is not a fair comparison and that is not representative of the performance of Woolworths supermarket division, relative to other investments?

MR LUSCOMBE: I think the important thing is to see what happens over time. You know, the important thing with ROFE is to actually see how it actually moves over time.

MR O'DONOVAN: Sure, and - - -

MR LUSCOMBE: Rather than the absolute number.

MR O'DONOVAN: Do you think the absolute number is indicative of a valuable and well-performing investment?

MR LUSCOMBE: I think it represents the fact that the company has been around for 80 years and, you know, the treatment of assets over time has changed under various accounting standards so some assets were able to be written off that are no longer able to be written off, etcetera, etcetera, etcetera. So to take a business that has been in business as long as Woolworths and to say that that absolute number in comparison to other absolute numbers out in the marketplace for companies of a different standing in time, it is not a true comparison. It is actually more important to actually look at what's happening to the return over time.

MR O'DONOVAN: Okay. Well, if we look at, say, Woolworths New Zealand - - -

MR LUSCOMBE: Mm.

MR O'DONOVAN: - - - and the return on funds employed is less than 10 per cent.

MR LUSCOMBE: Correct, yes, and - - -

MR O'DONOVAN: Yes, and the reason for that?

MR LUSCOMBE: As I've just described, you know, we've just purchased it so we've paid full price for all the assets and we've paid obviously goodwill for the business, etcetera, etcetera.

MR O'DONOVAN: Okay. So if you think 75 per cent doesn't represent, you know, a realistic return on funds employed, what sort of number do you think would more fairly represent the performance of Woolworths as an investment?

MR LUSCOMBE: I'm afraid, Mr Chairman, I will have to take that number on advice. Probably the one that is of more interest is the one for Woolworths Ltd because, you know, we're actually an accumulation of companies and over time the company has been in the 20s, although I note that over the last three years we had a bit of a dip and then we've come back again because of the acquisitions of the various liquor businesses that we bought, plus New Zealand, and plus FAL, etcetera.

MR O'DONOVAN: Okay.

MR SAMUEL: But can we just take that a step further? I mean, look, it is obviously much more attractive in terms of the public audience to suggest that the return on funds employed of 20-odd per cent is a more realistic figure to look at, that it relates to the company as a whole.

MR LUSCOMBE: Mm.

MR SAMUEL: But clearly in terms of you, as the chief executive, your financial operations and your board of directors, you will look at each division. If, for example, you showed across the board 27 per cent return on funds employed, that your return on funds employed in the supermarket division was 3 per cent, you would be asking yourself a very serious question as to whether it was a business that was operating properly.

MR LUSCOMBE: We probably would not be in business, generally.

MR SAMUEL: Well, that is exactly the point. I wasn't going to go and sort of make that business judgment decision for you. Clearly, yes, while return on funds employed will reflect both the profit that you're making, the margins that you're making - - -

MR LUSCOMBE: Yes.

MR SAMUEL: - - - but also reflect the level of investment or the lack of investment in the business itself over a period of time.

MR LUSCOMBE: Correct.

MR SAMUEL: You would take the supermarket division as a separate issue so you will know your EBIT margins, you will know your gross margins, and you will know your return on funds employed in respect of the supermarket operations, you're going to make a decision as to whether it is worth continuing to run. Would you agree that the return on funds employed and that your gross margins and your EBIT margins for the supermarket business are, on any analysis, very attractive?

MR LUSCOMBE: They're as good as any in the world, correct.

MR SAMUEL: Yes, yes.

MR O'DONOVAN: So you do, do international comparisons in terms of return on funds employed?

MR LUSCOMBE: From – well, not on return on funds employed but certainly in terms of EBIT margins we do, yes.

MR O'DONOVAN: Right, okay. All right, all right. Now, I think you will find in that folder in front of you an article, the title of which appears on about the fifth page, unfortunately, which is: Stock take. It comes - - -

MR SAMUEL: Sorry, just before we go off that, Mr O'Donovan, I just want to take that sort of discussion that we were having before with Mr Luscombe just that step further. If you're achieving a return on funds employed in the supermarkets of 75 per cent, I think is the figure, if we go back over time, that's increased from the – well, it's increased from 2001/'02 from about 53 per cent to 2006/7 to 76 per cent.

MR LUSCOMBE: Yes.

MR SAMUEL: Let's just take that as a bit of a guide.

MR LUSCOMBE: Yes.

MR SAMUEL: You would normally be able to do that in circumstances where there was no pressure to either reduce your revenue, reduce your margins - - -

MR LUSCOMBE: Mm.

MR SAMUEL: - - - or there was equally no pressure to invest further in assets.

MR LUSCOMBE: Mm.

MR SAMUEL: I mean, they will be the two factors that will influence.

MR LUSCOMBE: One other.

MR SAMUEL: Go on.

MR LUSCOMBE: Working capital.

MR SAMUEL: Working capital, okay. Can you give us perhaps a more detailed explanation of how the return on funds employed and the increasing gross margins that we've talked about, which are in your published accounts, the increasing EBIT markets, which we've talked that are in your published accounts, how they're able to occur in the context of the two factors that normally influence that? One is competition, or lack of it; and two is better management. I would just be interested in a further discussion from you on that.

MR LUSCOMBE: Well, my answer would obviously be that we believe it's a better management of our business over that period of time, vis-a-vis our competition. We've obviously invested a lot of money in infrastructure and in particular one of the key investments was some 300 million dollars in computer systems to manage the flow of product far more carefully than we have in the past and to reduce our working capital. So there is no doubt, as we started off with Project Refresh and we had one billion dollars of investment in mind, that we saw that there were going to be a number of opportunities for us to actually improve the financial performance of our business.

The first one was to reduce our cost of doing business, whilst taking on more work that has traditionally been done by the vendor community, that's the conversion of the direct store delivery, that we also believed that we could, with the likes of private label and global sourcing, etcetera, improve our gross margin. We had also saw that by managing our stock a lot better, that we could reduce our shrinkage number, which also would help with our margin. So we had three elements of our financial performance that we believed this investment in both systems and infrastructure would enable us to: one, reduce our costs; two, improve our margin, but not just by changing the difference between the sell price and the cost price but by other means; and then thirdly, one of the key elements of a retailer in terms of funds employed, of course, is the stock that we actually carry.

So we believed that we could actually take at least one or two days' worth of stock per year out of the system. That, on top of it, actually has, as I mentioned before, a shrinkage benefit but it also has a cost benefit. As we take stock out, it means that the number of times that we handle product, both at the distribution centre and at the store before it finally gets into the customer's hands, is reduced. Every time we touch a product, obviously we incur a cost. So our plan was to actually manage the flow of product from the vendor to the customer in a much smarter way than we had in the decades up until then. We didn't do it because we'd suddenly thought about it in our own mind, we studied other international retailers such as Tesco in the UK; Best Buys; Wal-Mart; Ahold, Albert Heijn; Carter Four; anybody that would allow us to understand how they were able to move a 3 per cent margin to a circa 5 to 6 per cent EBIT margin.

We set about in the late-90s and in 2000 onwards, we put into practice the benefits of the investment as they matured, and it came online, and we always knew and we actually tracked where we believed we were going to get cost improvements. We also knew that as things changed in the way that we went from vendor to customer, how we'd be able to get margin improvements with shrinkage, with roll-back, with private label, with global sourcing, etcetera, etcetera, etcetera.

MR SAMUEL: I'm sure if I was a director sitting around your board table I would say, "Congratulations" and all that, Mr Luscombe, but, look, don't come to us, as a board, with any new proposals for investment because why would we?

MR LUSCOMBE: Mm.

MR SAMUEL: I mean, it is, as you said, 76 per cent return on funds employed is about the best in the world. The EBIT margins, I think you called just then, of nearly 6 per cent are super EBIT margins. You know, we're increasing our gross margins and our EBIT margins, we don't have to invest any more in capital because you couldn't do better than have the best returns on funds employed that can be produced in the world. So frankly, Mr Luscombe, let's just sort of sit back a bit and be a bit lazy, if you like, and I'm just trying to understand what argument you would put up against a director that put that proposition to you?

MR LUSCOMBE: I'd be very surprised that that argument was ever put to me, chairman, but we're a public company, we're charged by owners, we've got 300-odd thousand Australian shareholders, mainly mums and dad directly, many more through managed funds and superannuation who are owners of the company, to grow the company and we invest in all of our businesses, including the supermarkets and we invest on the basis that we can return ahead of our cost of borrowing, so we have a weighted average costed capital and any investment, whether it's a new store, a refurbishment, a new piece of equipment, a new business, over time we need to show that we can return a higher rate than the weighted average costed capital and by doing that we may dilute that number over time, but as a company – as a public company, our valuation obviously is based on a couple of things.

The first one is our ability to actually make profit EBIT divided by the number of shares that we have or the net profit after tax divided by the number of shares that we have, which is our earnings per share and of course if we don't issue any more shares we want to increase the profit if we've issued more shares, we've got a bit of an issue with dilution and then the market takes a view of our future prospects and applies a multiple to that, based on what they believe we're going to do and our growth prospects and hence the share price that you see in the marketplace. So our shareholders are looking for us to improve their capital valuation that they have in the ownership of the shares, but they're also looking for a dividend stream, which is typically about 70 per cent of the earnings per share that we give back to our shareholders each year.

MR SAMUEL: I'm sure they'd be pleased that over the past five years the return of funds employed in supermarkets has increased by 50 per cent from 52 per cent to 76 per cent and so that's good, but is that the result of a capital strike or is it the result of lack of competition and thus lack of pressure on margins?

MR LUSCOMBE: No, I would say it was the result of investment.

MR SAMUEL: Well, actually if they're investment though you'd tend to see your – you certainly wouldn't see it go up by 50 per cent, your return on funds employed, would you? In fact you'd go the opposite way.

MR LUSCOMBE: Mr Chairman, it depends on the return that you make on each of those investments and we obviously didn't go into the investment of these distribution centres or everything else that we invested money in without doing business cases that determine that we would get a substantial return on those investments.

MR SAMUEL: Well, okay, if I can take that a step further just to analyse that – I'm sorry, maybe I'm misunderstanding it, but if you've increased from 52 or 53 per cent to be accurate in 2001/2 to 76 per cent in 2006/7, let's take that five year period and you've made investment decisions that have involved significant capital investment, but you've also managed to increase your return on funds employed to 76 per cent, my rough guess would be, without having the detailed numbers, is that your return on funds employed in respect of those new investments must have been upwards of the order of 100 per cent. It's the only way you could get to those numbers, isn't it?

MR LUSCOMBE: No, well, you've got a number of other things that are happening at the same time, chairman, you've got the working capital reduction coming down, so there is obviously significant money in that and of course there are other assets that were there at the beginning that may have been retired, but still actually being used. Mr Chairman, if it helps the commission I'd be more than willing for us to provide the base data so you can actually see the drivers at that changeover time.

MR SAMUEL: No, that would be very helpful, yes.

MR LUSCOMBE: I'm more than willing to do that.

MR SAMUEL: Thank you, yes.

MR O'DONOVAN: All right, would you agree at least on that analysis that – no perhaps on any analysis that the returns in the Australian supermarket sector for Woolworths have been very attractive?

MR LUSCOMBE: Based on the historical costs of the assets, yes. If someone had to go out and buy Woolworths' assets now and pay for them they certainly wouldn't be getting 75 per cent return.

MR O'DONOVAN: Right, okay and so that suggests then that barriers to entry are high for anyone wanting to enter this market?

MR LUSCOMBE: Well, Ald have shown that that's not the case.

MR O'DONOVAN: Sure.

MR LUSCOMBE: FoodWorks are out there saying that they believe that they've got many hundred new store sites signed in. I think Metcash have also signalled that they see great growth opportunities, so I would think that – and Cosco has announced that they're coming into the Australian marketplace. So I don't believe that there are barriers to entry. Does it take time to build up the business the size of Woolworths? Absolutely, we are now the 25th biggest retailer in the world, so it's taken us 80 years to get here.

MR O'DONOVAN: Sure, but it's true to say that Ald – Ald is certainly not running a large format supermarket business - - -

MR LUSCOMBE: No, they're not.

MR O'DONOVAN: - - - directly competing with Woolworths?

MR LUSCOMBE: They compete with us for food. Our customers shop at Ald and Ald customers shop with us, absolutely.

MR O'DONOVAN: Sure, so in terms of establishing a business that competes head to head with Woolworths in the same way that Coles competes – you'd accept that Coles is a head to head competitor with Woolworths?

MR LUSCOMBE: Coles is, yes.

MR O'DONOVAN: Yes and in that same – and Ald is not a head to head competitor in that same sense, you'd accept that?

MR LUSCOMBE: Well, we would say that they sell food, they sell groceries, they sell fresh food, they sell liquor, they sell general merchandise. They don't sell anything we don't sell. We don't sell anything that they don't sell of – so we'd say that they are a full – we actually treat them as a direct competitor, absolutely.

MR O'DONOVAN: Sure, but not across every line and - - -

MR LUSCOMBE: Well, of course they only have about 700 food lines.

MR O'DONOVAN: Okay.

MR LUSCOMBE: And we've got 15-odd thousand plus.

MR O'DONOVAN: Okay and which makes it quite a different consumer offering, you'd agree with that?

MR LUSCOMBE: It very much depends on – I would presume in the eyes of the consumer, many consumers would see it to be another supermarket, others may not.

MR O'DONOVAN: All right, but if a market entrant wished to come in and operate a large format supermarket business like Woolworths, your earlier answer suggested that would be a very expensive and difficult proposition, you'd agree with that?

MR LUSCOMBE: Correct, as it was in New Zealand, the only way for us to get in was to purchase an existing business, yes.

MR O'DONOVAN: Yes, okay, which you'd agree suggests that in terms of replicating your model the barriers to entry are high?

MR LUSCOMBE: Considering the investment that we've made over 80 years it would be very hard to replicate it very quickly.

MR O'DONOVAN: Okay, so does that mean you agree that it – the barriers to entry into that market are high?

MR LUSCOMBE: Well, I think what I'm saying, Mr O'Donovan, is that to replicate Woolworths' business would be very difficult. To enter into the marketplace Ald have shown that it's not difficult.

MR O'DONOVAN: Sure, to enter into the food market, but to enter into the large format one stop supermarket, I'm not necessarily suggesting that it's a market, but to enter that category of the market the barriers are very high, would you be prepared to concede that?

MR LUSCOMBE: We've got 770-odd supermarkets, you know, we typically increase by about 25 a year, so the maths are pretty much evident that it would take a number of years to get the same mass that we have.

MR O'DONOVAN: All right, look, then moving on I think to the document that's behind tab 2.

MR LUSCOMBE: I've got two here, Mr O'Donovan. I've got this one and this one.

MR O'DONOVAN: Yes, I think it ignored the last page, I think the relevant page is - - -

MR LUSCOMBE: I should say, Mr O'Donovan and Mr Chairman, I haven't had the chance to read this document, I was just given a copy - - -

MR O'DONOVAN: Okay, yes.

MR LUSCOMBE: - - - as people wandered in, so bear that in mind, please.

MR O'DONOVAN: Yes. No, no, my apologise for the late provision, but if you can – it's an article from CFO magazine.

MR LUSCOMBE: Right.

MR O'DONOVAN: All right, are you familiar with that magazine?

MR LUSCOMBE: I don't think I've ever read it.

MR O'DONOVAN: But you know of its existence?

MR LUSCOMBE: I think I may have seen it in the airport lounge from time to time.

MR O'DONOVAN: Sure, all right. Now if I can just take you to page 27?

MR LUSCOMBE: Page 27, yes. I have that.

MR O'DONOVAN: Now there's a table on page 27.

MR LUSCOMBE: Yes.

MR O'DONOVAN: About one-third of the way down there's a line there for Woolworths?

MR LUSCOMBE: Yes, I've got that.

MR O'DONOVAN: Okay. Now I mean, there are four columns there and I just want to take you through each of them and these appear to be metrics that are used to assess the working capital of an organisation.

MR LUSCOMBE: Yes.

MR O'DONOVAN: In one column it's:

> *Days sales outstanding, days inventory held, days payable outstanding.*

MR LUSCOMBE: Yes.

MR O'DONOVAN: Then the cash to cash cycle.

MR LUSCOMBE: Right.

MR O'DONOVAN: Okay. Now firstly, are those metrics that Woolworths uses internally to monitor the efficiency of its use of working capital?

MR LUSCOMBE: The only one that we do is "days' stock on hand". That's the one that we typically refer to in our business.

MR O'DONOVAN: Right, okay. Now – well, perhaps I'll ask you some questions anyway and I'll take it as far as we go. It may be that you're not able to comment.

But in relation to the first metric, "day sales outstanding", as I understand it that just measures the difference between when you make a sale and when you get paid for that amount which in a supermarket business is basically the same day so that when customers go to the check-out they get paid – Woolworths gets paid immediately upon the sale being made?

MR LUSCOMBE: Except for credit card and other – a large proportion of our sales now are not cash, they're actually either debit cards or credit cards and, of course, there's the settlement timeframe but point 8 looks a reasonable – it's not something I've ever measured before but it looks reasonable.

MR O'DONOVAN: Sure, okay. So broadly speaking it indicates that it's not necessarily instantaneous but it's close to on the majority of transactions?

MR LUSCOMBE: That would be correct, yes.

MR O'DONOVAN: Yes, okay. That's consistent with your understanding of the business?

MR LUSCOMBE: Mm.

MR O'DONOVAN: All right. Now the next one is "days' inventory held" and it's at 23.5 which is basically as I understand it how long it takes goods once they're delivered and I suppose owned by Woolworths to ultimately get moved through the supply chain and then sold?

MR LUSCOMBE: Yes. That would be - - -

MR O'DONOVAN: Okay. Now does that figure look right? The 23.5?

MR LUSCOMBE: What year is it? 2006 to 2007? I've only got the half year here and it was 32.5.

MR O'DONOVAN: Okay. Now is that measured - - -

MR LUSCOMBE: That's average inventory.

MR O'DONOVAN: All right. Do you know how that is measured?

MR LUSCOMBE: Average inventory? Yes, it's the average amount that we have on hand over a period of time rather than the point in time so it's a rolling average.

MR O'DONOVAN: Right. But in terms of what it means, that stock broadly takes 32 days, 32 and a half days from the time it gets into Woolworths system to the time that it's sold. Is that - - -

MR LUSCOMBE: Correct.

MR O'DONOVAN: Do I understand that correctly?

MR LUSCOMBE: Yes.

MR O'DONOVAN: Yes, all right. So that's higher than what has been calculated there in the article?

MR LUSCOMBE: Yes, for some reason.

MR O'DONOVAN: Yes, okay. Then the third is "days' payable outstanding" which I s - - -

MR LUSCOMBE: Sorry. The only thing I could infer, it might have been a transposition error.

MR O'DONOVAN: Okay.

MR LUSCOMBE: Of 32.5 to 23.5.

MR O'DONOVAN: Right.

MR LUSCOMBE: Anyway that – I can't answer that.

MR O'DONOVAN: Yes, okay. So then in relation to "days' payable outstanding" that is effectively the delay between the time you get the goods and the time you actually have to pay for them?

MR LUSCOMBE: On average, yes.

MR O'DONOVAN: Yes, on average. Okay. Then it says 28.1. Is there an internal Woolworths source that might suggest a different figure?

MR LUSCOMBE: There is. Can I take that, rather than hold this up I'll take that on later?

MR O'DONOVAN: Sure. Okay. Then looking at that fourth figure of 3.8 taking Woolworths figures I accept that not correct but what it attempts to measure as I understand it is the number of days between you having to pay for stock and you being paid for stock and it's a negative number which in this case which suggests that Woolworths gets paid for stock before it has to pay so it gets paid by the customer for stock before it has to pay any of its suppliers for that stock – on average?

MR LUSCOMBE: On average.

MR O'DONOVAN: Yes.

MR LUSCOMBE: That's correct. Whilst these numbers are not, they're not numbers that I can readily track back to our accounts, we do have negative working capital - - -

MR O'DONOVAN: Sure.

MR LUSCOMBE: - - - which is typically what you would find with retailers around the world.

MR O'DONOVAN: Right, okay. So the result is effectively that the stock in your shops hasn't been yet paid for to the suppliers?

MR LUSCOMBE: On average.

MR O'DONOVAN: On average.

MR LUSCOMBE: Correct.

MR O'DONOVAN: That at the checkout you're actually receiving money which you then don't have to use to pay for goods for a few days?

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay. So that provides you with, I suppose, an opportunity to invest the spare cash and earn a return on that gap?

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay. All right. Now, I suppose, to get to negative working capital you have to first, it's dependent on two things, isn't it? Firstly, the efficiency with which you can pass the goods through your supply chain?

MR LUSCOMBE: Correct.

MR O'DONOVAN: To the checkout, so obviously that's – if you can improve that number that's a reflection of the efficiency of the organisation?

MR LUSCOMBE: Mm.

MR O'DONOVAN: That's right? Now the other is the willingness of suppliers to delay being paid?

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay. Now it would be fair to say that all things being equal that a supplier would prefer cash on delivery terms to waiting a month or two months to be paid?

MR LUSCOMBE: Correct.

MR O'DONOVAN: You would agree to that. Yes, all right. So the fact that your suppliers are – give up, I suppose cash on delivery and accept delayed payment is a reflection to some degree of the bargaining power that Woolworths has in respect of those suppliers. Would you agree with that?

MR LUSCOMBE: That would be a fair assumption, yes.

MR O'DONOVAN: All right. So it would be fair to say that because of Woolworths' size and your importance in the market to suppliers that it's able to negotiate terms that are very favourable to Woolworths and suppliers are forced to give up conditions which they would if the bargaining power were more equal would insist upon?

MR LUSCOMBE: I'm not – are you talking viz a viz other retailers?

MR O'DONOVAN: No. Only if they had a choice in terms of how they dealt with Woolworths if they felt that they had market power, more market power than they do have would you agree that they would choose to give less generous payment terms to Woolworths?

MR LUSCOMBE: I think that's a natural conclusion that one could reach.

MR O'DONOVAN: Yes, all right. Okay. Now then if I can take you to document number 3 - - -

DR KING: Sorry, just on that last question. Do you agree that your suppliers are getting, in a sense, slower payment for their goods than they might otherwise? That adds a real cost to those producers or suppliers presumably.

MR LUSCOMBE: Yes. That's something that hasn't changed over time. That's been in place for – so it's not something that has increased dramatically, or in fact it hasn't changed. What are known in the trade as settlement terms have been pretty fixed for as long as I've been in the business.

DR KING: But presumably that can cause cash flow issues for your suppliers?

MR LUSCOMBE: From time to time, if a vendor has an issue with cash flow, we actually make arrangements to bring forward payments. That's not an unusual event that happens.

DR KING: In periods of relatively high interest rates, as we seem to be enduring at the moment, presumably that cost goes up to your suppliers?

MR LUSCOMBE: If they're borrowing to run their business, yes.

DR KING: Well, most of your suppliers presumably would be in that position? You just don’t know?

MR LUSCOMBE: I couldn’t answer that, commissioner.

DR KING: Okay.

MR SAMUEL: Would you have the, I’m sure you would, to take these columns again on page 27, the DPO figures, for example, the 2000 to 2001 year to compare it with the 2006 and 2007 year?

MR LUSCOMBE: We would have those somewhere, I assume. We’re happy to provide them later.

MR SAMUEL: Could you do that? Yes. It would be helpful.

MR LUSCOMBE: Certainly.

MR SAMUEL: All right. Any idea what they are for year to date for 2007/8?

MR LUSCOMBE: For?

MR SAMUEL: 2007/8, year to date. For DPO.

MR LUSCOMBE: No. I don’t have that.

MR SAMUEL: Okay. Well, if we could get those, that would be helpful. Yes.

MR O’DONOVAN: Okay. Now if you could just turn to document 3.

MR LUSCOMBE: Yes.

MR O’DONOVAN: Now that’s the submission that was put in by Choice Magazine as part of the inquiry and effectively it represents a survey of 1000, no, 5000 Choice subscribers and it asked them to - - -

MR LUSCOMBE: 1000, I think, Mr O’Donovan. 1000 replied.

MR O’DONOVAN: Yes. That’s right. And it asked some questions about where customers mainly do their grocery shop.

MR LUSCOMBE: Yes.

MR O’DONOVAN: Then, I suppose, it broke up the responses into various product categories like grocery products or fruit and veg, those kinds of things.

MR LUSCOMBE: Yes.

MR O'DONOVAN: Now, just looking at the raw figures, 78 per cent of those surveyed shop at either Coles or Woolworths. ALDI only has 6 per cent market share of mains supermarkets shopped at. This may not be a question you want to answer publicly but in terms of what you understand to be Woolworths market share, is that 42 per cent figure, if we were to take that as roughly representing the share of the supermarket market?

MR LUSCOMBE: Firstly I would say that what the respondents here are saying is they mainly shop at these stores. They don't, not exclusively, so put that on record to begin with. In terms of; does this represent what we believe our market share to be, no and I'm happy to answer that in camera unless the commission wants it on public record but I'll leave it to - - -

MR SAMUEL: If you're happy to answer on public record, we'd be delighted to have it on public record. Given that it's of intense public interest.

MR LUSCOMBE: Okay. Annually we have a study done for us by MapInfo, which basically looks at the Australian Bureau of Statistic numbers for food and grocery and it takes into account all retailers, so it excludes restaurants and fast food etcetera but it takes into account places that sell meat, groceries, frozen foods, deli, seafood and bakery. Our estimate, based on the numbers that we get annually, is that Woolworths would represent, in the year to June 2007 - unfortunately we can only do this annually – 30.77 per cent and for interest's sake, Chairman, I will take you through the various categories. The calculation for meat would be 30.11 per cent. For produce 26.16 per cent.

MR SAMUEL: Just so as we understand what produce is, that is?

DR KING: Fresh.

MR LUSCOMBE: Fresh fruit and vegetables, Chairman, yes.

MR SAMUEL: That's right, yes.

MR LUSCOMBE: Groceries, which includes the dairy case and the freezer. 32.8 per cent.

MR SAMUEL: Does that include dry packaged goods?

MR LUSCOMBE: Yes it does, Chairman.

MR SAMUEL: Okay, right.

MR LUSCOMBE: Delicatessen. 30.58 per cent. Seafood 25.77 per cent and bakery, 23.03 per cent. So to once again, at a high level, describe how this number is prepared for us on an annual basis, the Australian Bureau of Statistics numbers are taken. Then exclusions are made for, in this case, we've taken tobacco and liquor out of it so it's not food, liquor and groceries. It's actually food and groceries.

We've taken general merchandise out. It actually comes from the household expenditure survey. Then we match our published numbers for each of those departments and express them as a percentage of the total.

MR SAMUEL: That leads to an obvious question. Let's leave aside meat, fresh fruit and vegetables, seafood and bakery and delicatessen, which is what I call fresh produce, from the moment and let's just go to groceries, which you've said includes all dry packaged goods.

MR LUSCOMBE: Yes. And chilled and frozen foods.

MR SAMUEL: And chilled and frozen. All right. Where you say the Woolworths market share there is 32.8 per cent.

MR LUSCOMBE: Correct.

MR SAMUEL: If we then take the claimed market share of Coles and Woollies for dry packaged goods alone. I'm leaving dry packaged because I want to separate out the rest. At 80 per cent that suggests that you're copping a real whopping from Coles, doesn't it?

MR LUSCOMBE: No, that's not correct. You know, the number that is quoted, which is the Aztec Nielsen number, is a calculation of scan data from 133 categories for Aztec for us and somewhat less than that for AC Nielsen for others. So they take our scan data for a subset of our products. In the case of AC Nielsen, there is a mixture of some scan data, some warehouse withdrawals from the likes of Metcash for some of their customers and also a household survey where people report what they buy and an approximation is made. So it is a subset of one part of our business. Whole categories, big categories that are dominated by direct store delivery like carbonated beverages, Coca Cola etcetera. They typically are not in there. Biscuits may not be there. Milk etcetera are not there so it's not - - -

MR SAMUEL: When you say not there, that is not in this 32.8 per cent figure or not in
the - - -

MR LUSCOMBE: No. It's actually in this.

MR SAMUEL: It's in this?

MR LUSCOMBE: It's in this. Everything - - -

MR SAMUEL: So just explain to me because this is important. How do we get this market share? We had NARGA in and we talk about market shares and their analysis was that between Coles and Woolworths there was 80 per cent market share. They then assessed ALDI at something like, I think they said, correct me from the record somewhere but I think it was something in the order of 2 to 3 per cent or quite small and Metcash, in terms of dry packaged goods, that's IGA and the like, you know, making up the balance. 17 to 18. But I'm just trying to understand what we're dealing with in terms of these statistics.

MR LUSCOMBE: Okay. So if you take Woolworths supermarkets, then you take off produce. You take off meat, you take off general merchandise etcetera, etcetera and you get back to the groceries and the dairy and the freezer.

MR SAMUEL: Yes.

MR LUSCOMBE: Then in that we have 300 categories. We only give scan data where there's someone that wants, a vendor that wants to buy the data. Of those 300 categories, we provide 300 – sorry, 130-odd, so only a third of the categories. In the case of Aztec, sorry, in the cause of Nielsen for everybody else, it's a little less than that. I think it's circa 100. 88, so it's even less than 100. 88. Then for our data it's all scanned. For the AC Nielsen data there's actually a number of iterations that get to the number. In fact, AC Nielsen actually sat in terms of determining market share, these numbers should not be used. There's a disclaimer in their publication because you know, to use an analogy, it would be saying – I think we've got two radio stations that are government-controlled here in Victoria. 774 and Radio National. Would that be right?

It would be like saying that Radio 774, ABC, has got a 70 per cent share of the air waves here in Victoria. Well, that is correct if you measure only radio controlled – sorry, government controlled radio stations as opposed to all the AM and all the FM. So, it is a matter of what you start with will determine what that number is. So, that the number is accurate in terms of what it actually describes but it in no way actually describes what the market is for products that we compete in.

MR SAMUEL: Now, that is why I am having difficulty. Let me just try and sort of – I will ask you to speculate a little bit here because you won't be expected to know the numbers of Coles or Metcash or others but if – I am just taking dry groceries because we believe that – I think it has been accepted there are different figures in respect of meat and product and the like in the sense that it is suggested that the market share of Coles and Woolworths in respect of those fresh produce products is probably around the 50 per cent or that sort of order. Maybe a little bit less, because there is substantial presence in those areas by some of the smaller outlets. That is, the - - -

MR LUSCOMBE: Correct.

MR SAMUEL: - - - bakeries and the specialist retailers. That is why I am just focussing on groceries. Groceries is – you have described as being dry groceries. That is packaged goods plus what on the supermarket freezer shelves. Right? So, it is all packaged goods.

MR LUSCOMBE: Yes but what is measured, Mr Chairman, is only a sub-set of that. So, it doesn't measure everything that is on the grocery shelves and everything that is on the diary and freeze chambers.

MR SAMUEL: So, I have just got to make it clear. When you say what is measured, measured in this - - -

MR LUSCOMBE: In Aztec or A.C. Neilsen and the numbers that are quoted.

MR SAMUEL: Right. As distinct from this analysis that you are providing us here?

MR LUSCOMBE: Correct. This is actually the market for everything that we sell.

MR SAMUEL: Okay, right. Now, can I take that then a step forward. Just to make sure that we have got it clear. That in dry packaged grocers plus what is on the freezer shelf - - -

MR LUSCOMBE: Yes.

MR SAMUEL: - - - you would say you have got 32.8 per cent of the market?

MR LUSCOMBE: Correct.

MR SAMUEL: Do you want to hazard some speculative assessment as to who has got the rest? Rough will do.

MR LUSCOMBE: The only one that I would like to make a guess on would be probably Coles. I think they are probably in the mid 20s.

MR SAMUEL: Right. So, we have got Coles. Say – let's just roughly use the figure 25 per cent?

MR LUSCOMBE: Yes.

MR SAMUEL: I don't want to hold you to it. We will find from Coles.

MR LUSCOMBE: Chairman, the reason I say that is because this is – we can't just take the published Coles numbers because it also includes liquor and tobacco and alcohol and general merchandise, etcetera, which has been excluded from this.

MR SAMUEL: All right. Let's just assume for the moment that you are right on Coles and that we end up then with something like around 58 per cent is held between Coles and Woolworths in terms of dry packaged groceries and supermarket shelf frozen goods. All right? Who has got the rest? Because – sorry, just to take that a step further.

MR LUSCOMBE: Yes.

MR SAMUEL: Metcash would claim in its public statements, that is, made to the Stock Exchange, that it has around 18 or 19 per cent of the market. So, if I have got – I will round all this up just to make it a bit easier but if we have got 60 per cent between Coles and Woolies - - -

MR LUSCOMBE: Yes.

MR SAMUEL: - - - and we have got 19 per cent from Metcash, well, that takes us up to just below 80 per cent - - -

MR LUSCOMBE: Yes.

MR SAMUEL: - - - between Metcash – and Metcash covers all the IGAs and the FoodWorks and the like.

MR LUSCOMBE: Correct.

MR SAMUEL: Any idea what you reckon ALDI has got?

MR LUSCOMBE: In terms of a national share, it would be in the single digits.

MR SAMUEL: Yes. What, two or three or eight?

MR LUSCOMBE: Less than five, I would say.

MR SAMUEL: Okay. So, let's – I am rounding up on all these just to make – all right. So, we have got ALDI at say less than five.

MR LUSCOMBE: That decision out there will be wincing with this, Chairman.

MR SAMUEL: That is all right. Well, this is all very rough and it has got all those caveats. So, we have got 85. Now, I am missing 15.

MR LUSCOMBE: There are so many places that sell groceries. There are milk bars, there are convenience stores, there are petrol stations, pharmacies that sell groceries. You have got fruit shops that sell groceries. You have got delicatessens that sell groceries. You have got butchers from time to time sell groceries. All we need to do is to go to a local mall and walk around and things that would be designated groceries are actually sold in a multitude of outlets. Discount department stores sell groceries. So, Big W sells groceries, K Mart sells groceries, Target sells groceries, Myer, DJs sell groceries as well.

MR SAMUEL: These numbers to your percentage share include what Big W sells?

MR LUSCOMBE: Correct.

MR SAMUEL: Yes. Includes what you sell through – you know, those attached to service stations and the like, the convenience stores?

MR LUSCOMBE: Sorry. For this 32.8?

MR SAMUEL: Yes.

MR LUSCOMBE: No, it is all the supermarkets.

MR SAMUEL: It is all the supermarkets. So, it doesn't include Big W?

MR LUSCOMBE: No, it doesn't.

MR SAMUEL: Right, okay. If you were to add Big W and those others to it, your other outlets, overall groceries?

MR LUSCOMBE: Well, I haven't got that, Chairman.

MR SAMUEL: Okay. All right. Now, what I want to do, give all of us a bit of a ten minute coffee break. Would you like to – would it be convenient to break for that now?

MR LUSCOMBE: I think, Chairman, it would be welcome.

MR SAMUEL: All right. Let's break for – let's make it, say, ten minutes if we can and that will stretch out to 15, I am sure.

ADJOURNED **[11.36 am]**

RESUMED **[11.54 am]**

MR O'DONOVAN: Actually, one way we might be able to begin, you indicated in the break that you wanted to add some additional comments in relation to the pricing of Select.

MR LUSCOMBE: Yes, and also to settlement discount, that question from the chairman. In regards to Select, I just want to make it clear that we don't actually price Select, chairman, off any other private label. We actually compete against the branded market leader and we price accordingly against that, on average a certain percentage below that. In regard to settlement discount, because those settlement discounts have been around and unchanged and published on our website at the moment, but pretty much unchanged for at least 20 years that I can recall, my view would be – I don't have evidence – that over time the cost of goods has the cost of money priced into it. Thank you, chairman.

MR SAMUEL: Do you want to wait for Catherine now? We'll wait a couple of minutes, if you're happy with that, just to make it easier for us. I note, Mr Luscombe, that there's been a run on dry groceries outside, tea, coffee and - - -

MR LUSCOMBE: Mr Chairman, I've just noticed that other people have biscuits.

MR SAMUEL: Yes. Well, I have to say that the run on those dry groceries is directly attributed to your presence, so we may place an order for some more.

MR LUSCOMBE: Well, can I recommend, Mr Chairman, that Select ..... are by far the most delicious on the market.

MR SAMUEL: I was going to make a plea that our payment terms be on exactly the same terms as those that you pay your suppliers just ..... our own cash flow.

MR LUSCOMBE: I'm sure we can make arrangements.

MR SAMUEL: We're just photocopying a document that we got during the break, so I think it would be preferable to wait.

MR LUSCOMBE: Mr Chairman, I did recall during the break that at an earlier meeting with yourself and the commissioners prior to this, that we did prefer an estimation prepared by MapInfo on market shares. Your questioning earlier was around groceries. This actually is around food - - -

MR SAMUEL: Right.

MR LUSCOMBE: - - - liquor, so food and grocery turnover and to go to the relevant market shares that includes meat and produce, etcetera, we would say that in 2006/07, that 30.77 that I mentioned before for the total, the Coles Bi-Lo was 22.76 and that's based on their published numbers less what we estimate the categories like liquor and tobacco, for instance, that were taken out, general merchandise. Metcash at 16.64, FAL is obviously now included to a degree in the Metcash numbers and also in the Woolworths and Coles numbers. ALDI at 2.84, Franklins at 1.09. So total supermarkets in the independent stores, 74 per cent. Mass mergence which include discount department stores such as Target, Big W, K-Mart, etcetera, etcetera, and department stores, 1.64, and other retailers selling food and this is not takeaway food, not restaurants, which includes butchers and bakers and convenience stores, delicatessens, etcetera, etcetera, etcetera, 24.25 per cent.

MR SAMUEL: Okay, and the reason I focussed particular on groceries was because – that is, dry groceries is that there is, I think, acknowledged that the market share in respect of fresh produce is significantly influenced by the presence of all other retailers selling food, that bottom line, where they tend to have, according to ......I think AC Nielsen, I haven't seen Aztec figures, but according to AC Nielsen, they have not only a strong presence, but an increasing presence, but in terms of dry groceries, the other retailers would not appear to be as significant. That's why I wanted to focus on the dry groceries figures alone because that's the one where most often the 80 per cent market share is quoted and - - -

MR LUSCOMBE: Yeah.

MR SAMUEL: - - - we're having a great deal of difficulty in reconciling some of those claimed numbers and, you know, actually what's occurring in the market place.

MR LUSCOMBE: Chairman, if I could help, we're talking about groceries and perishables which is about half of our business and we're talking about half of that half.

MR SAMUEL: Yes.

MR LUSCOMBE: For AC Nielsen, they've got two different statistical measures: ScanTrack and Homescan. ScanTrack is packaged barcode grocery sales from supermarkets and grocery stores only, so it misses all the other people that sell groceries. For dry grocery, frozen, bakery, drinks, snacks, dairy case, pet items, tobacco, household, health and beauty, and health and beauty is another area where supermarkets, as part of their grocery offer, the whole health and beauty – we've typically got a very low share because you've got the likes of all the department stores, all the pharmacies, Priceline and other discounters that actually sell a lot of those health and shampoos and soaps, etcetera. It covers a Woolworths POS scan which they get from Aztec, so the 88-odd common categories, Coles scan, Franklin scan. ALDI is based on Homescan which is there's a panel of customers that sit at home and when they buy things, if they remember, they actually record to say, "I've bought it" and scanned it. If it doesn't have a barcode or they don't do it or they've consumed it before they get home, then it obviously doesn't make it. Also some independents, like Richies and Drakes and FoodWorks, also have POS scan, so they're more organised. For other independents, it covers warehouse withdrawals for Metcash, for Statewide and for ARL and, of course, there's some issues there from time to time. You know, Andrew had a disaster happen prior to Christmas where his roof was destroyed by hail, so that obviously distorted the figures for quite a while and, of course, there's always a distortion between what gets sent out and what gets sold. Also, it doesn't include direct delivery products. You know, biscuits and fresh cakes and snack foods and bread and milk and cream and eggs and smallgoods and magazines that go direct to store and AC Nielsen actually make a guess or a projection on that. It also excludes fresh fruit and vegetables, meat, deli, flowers, most general merchandise, apparel, stationery, photograph, other services, lotteries, phone cards, utensils, appliances, prepared foods, music, DVDs, etcetera. So you can see that it's not a robust number and hence why both Aztec and AC Nielsen say, "Do not use this as a market share". We use it just to give us a view on how our relative performance, particularly against Coles, is going from time to time, so in our monthly board reports and in our quarterly reviews, we would review to the Aztec numbers as showing that in that small subset that we're either making some ground, vis-à-vis Coles, or not and others that are obviously part of that, but we recognise and the board understands and our management understands that we are not saying that this is our actual market shares. We only have that available to us once a year when this calculation is actually done and we can see over time that in some years we've actually made some ground and in a couple of years, we actually lost some ground because of the relative strength of particularly the specialties. You know, produce and meat and others that have made a bit of a comeback and others, such as ALDI, that obviously have come into the marketplace and gone from nothing to, you know, nearly three per cent market share in a very short period of time.

MR SAMUEL: Well, now, just help us through these numbers a bit further if you can because if we look at the market share of Woolworths, it's gone from – I'm sorry, I'm taking the numbers you've given us on the sheet here which is the 02/03 year through to the 06/07 year.

MR LUSCOMBE: Correct.

MR SAMUEL: What we see is there's been a gain of .16 per cent by Woolworths - - -

MR LUSCOMBE: Correct.

MR SAMUEL: - - - a loss of .33 per cent by Coles.

MR LUSCOMBE: Correct.

MR SAMUEL: Overall, across the two major supermarket chains, a loss of .18 per cent.

MR LUSCOMBE: Correct.

MR SAMUEL: Now, we look at where that's been picked up and how it's all arisen and the big, sort of, reduction, of course, is the Foodland Action Stores operation which was sold out in November 2005, and just remind us all, but I think you bought the bulk of - - -

MR LUSCOMBE: No.

MR SAMUEL: Sorry, you bought the bulk of it in Western Australia, I think - - -

MR LUSCOMBE: No.

MR SAMUEL: - - - or not, no?

MR LUSCOMBE: No, that's not quite right, chairman.   We bought approximately 20 stores only - - -

MR SAMUEL: Yes.

MR LUSCOMBE: - - - and three development sites and they were - the majority of them were in Western Australia, but there were a handful in the Queensland market place.

MR SAMUEL: Queensland, yes.

MR LUSCOMBE: Yes. Coles also bought some stores and around 60 of them went to Metcash.

MR SAMUEL: Okay, which then explains why, on these figures, Metcash, for a range of reasons, has gone up by 3.57 per cent.

MR LUSCOMBE: Correct.

MR SAMUEL: ALDIs picked up 1.89 per cent - - -

MR LUSCOMBE: Correct.

MR SAMUEL: - - - and the mass merchants have remained about the same, but all other retailers, that is the smaller independent retailers, have gone up by 1.78 per cent.

MR LUSCOMBE: Correct.

MR SAMUEL: So if you were to iron out all of those figures, the aberration of FAL and its sale in November 2005, there doesn't appear to have been a significant change in market shares between 2003 and 2007. Is that the way you see it?

MR LUSCOMBE: That's correct, chairman, except obviously that there is no doubt, and in my own opinion and I imagine the opinion of my colleagues in walking around, there is no doubt that the specialty retailers have had a resurgence in this last half of the decade.

MR SAMUEL: That's specialty retailers in what, your fresh produce as distinct from dry goods?

MR LUSCOMBE: Fresh, but also, you know, there are other specialty grocery stores and there are coffee stores. There are a whole host of - - -

MR SAMUEL: Like the organic food stores and - - -

MR LUSCOMBE: - - - confectionary stores, etcetera - - -

MR SAMUEL: Yes.

MR LUSCOMBE: - - - and Priceline and others that have all come into the market that supermarkets both large and small compete in.

MR SAMUEL: Yes. If we take the combination of ALDI and those other specialty stores, their growth over that four year period has gone up 3.5 per cent.

MR LUSCOMBE: That would be correct.

MR SAMUEL: Yes, and then Metcash, of course, has gone up by its own 3.57 per cent which is partly attributable to the fact that it bought 60 of the FAL stores.

MR LUSCOMBE: Around 60, I believe.

MR SAMUEL: Around 60, yes. Okay. All right. Thanks, Mr O'Donovan.

MR O'DONOVAN: Okay. Look, just a couple of final questions on this matter. Did I understand correctly that some of this data is based on the Homescan data which reflects what consumers actually buy?

MR LUSCOMBE: No, this is not - - -

MR O'DONOVAN: This is not based on that?

MR LUSCOMBE: These numbers are not, no.

MR O'DONOVAN: No, all right.

MR LUSCOMBE: These numbers are based on the Australian Bureau of Statistics government published numbers and where available, publicly available numbers, such as Woolworths. In the case of Woolworths, we've been able obviously to take out the things that are not part of what we're measuring. In the case of others, the demographer has had to make an assumption about what that may be. So in the case of Coles, I would presume that what he has done is approximate Woolworths share of its total sales in general merchandise, etcetera, etcetera, etcetera.

MR O'DONOVAN: Right, and in terms of the percentage we're talking about, are we talking about percentage in – just in revenue terms, is that - - -

MR LUSCOMBE: Correct.

MR O'DONOVAN: All right and when you say the demographer that's math info?

MR LUSCOMBE: Math info, yes, Tony De Marci is the principle that has worked on this report now for a number of years for our company.

MR O'DONOVAN: Right, okay.

MR SAMUEL: And would you make him available to us to provide us with detailed information as to the means by which he does his calculations?

MR LUSCOMBE: Absolutely, chairman, absolutely, chairman.

MR SAMUEL: Thank you.

MR O'DONOVAN: All right, well, I think if we can ask – so long as we can ask questions about its calculation, I think we can leave that matter there.

MR LUSCOMBE: Right.

MR O'DONOVAN: All right, now the next matter I wanted to take you to was – there was a Choice article published comparing prices in the supermarkets in 2007 and that's still behind tab 3.

MR LUSCOMBE: This one, yes.

MR O'DONOVAN: Yes, all right, now are you familiar with the survey prior to looking at it now?

MR LUSCOMBE: Broadly I am, yes.

MR O'DONOVAN: Yes, all right, now it's fair to say that it was not a good result for Woolworths. Would you agree with that in terms of the conclusions?

MR LUSCOMBE: As published it was not flattering, no.

MR O'DONOVAN: No, all right and it suggested that Coles came in cheaper by more than 8 per cent, including specials and 3 per cent without.

MR LUSCOMBE: Yes.

MR O'DONOVAN: Did you think that's a fair reflection of pricing relativities between Woolworths and Coles?

MR LUSCOMBE: We made a public statement at the time that there were three items that caused us some concern. The first one was the bacon, where there are different grades of bacon and we only carry choice grade, A-grade bacon and the product that was compared was actually lower grade bacon so obviously it would have a lower cost and a lower sell price. We also – in the case of the cheapest oil at 750 ml, the generic brand for Coles is a 750 ml, ours is a 1 litre, so the cheapest one was actually a branded one in our case, so, you know, a pro rata of our generic one would have closed that gap again and then, thirdly, we believe the cheapest bread available, based on the data that we were given access to, wasn't actually identified in each store that they went to, because we know by our scan data what the cheapest was for sale in the timeframe that the survey was taken.

Now, I don't do this by way of criticism of Choice, because what we do know, because we do it ourselves every week, doing price surveys is a very, very exacting thing and it's very, very easy to, you know, pick the wrong product, it gets really hard to judge when you've got specials in one and odd specials in the other. You've got a whole host of things in terms of particularly when it gets into generics, whether they're actually the same product, you know, the specifications for the product could be very different, the sizes could be different. So they're always fraught with danger. They've done it for their subscribers and the subscribers can take it and act upon it as they see fit, but in terms of a really scientific measure, you know, there are a couple of gaps there that we would say, you know, in time perhaps it could be a little bit better.

I think more importantly for us is that we go out on a regular basis and check literally thousands of lines on a rotational basis every month and that gives us a much better idea of where we sit in the marketplace. We are not the cheapest on every product. What we hope to be is the cheapest over all basket for everything that we sell, across the year, which includes things like specials and private label and roll back and of course our fresh food and our general merchandise and phone cards, etcetera, etcetera, all of that goes in, so we don't aim to be the cheapest on every single product every day of the week. No retailer in the world can do that.

MR O'DONOVAN: Sure. So in terms of the relativity of Coles being cheaper by 3 per cent of the - - -

MR LUSCOMBE: That would not be our experience.

MR O'DONOVAN: All right. So what would be your experience of the relativities between Coles and Woolworths?

MR LUSCOMBE: I'm happy to answer that in camera later.

MR O'DONOVAN: Okay. All right, now, the article also indicated that Ald, not so much in – I don't want to discuss absolute price terms, but in terms of the trend in the price of Alvi's goods was a negative one, that Coles and Woolworths prices both went up, Alvi's prices went down, okay and the public statement from Ald was that they were able to share efficiencies with consumers was their explanation. All right, now, it's true in that period that Woolworths, as you've explained, obtained a lot of efficiencies through the supply chain, yet the trend in prices remained up. You'd agree with that?

MR LUSCOMBE: These are products that are mainly branded products and what Ald is talking about is the private label. I would suggest that we would be able to point to private labels that have also gone down because of efficiencies within the works, I'd be happy to do that if required.

MR O'DONOVAN: Okay, all right, but in terms of the efficiencies in the supply chain, that there were efficiencies in the supply chain that were spread across – that could have been spread across into the pricing of branded goods. Would you agree with that?

MR LUSCOMBE: Could have, we don't necessarily choose to do that. Sometimes we choose to put it into things like private label.

MR O'DONOVAN: Sure, but you've indicated in your public statements that your buying term's improved with a lot of – in relation to some products?

MR LUSCOMBE: Yes.

MR O'DONOVAN: All right and your efficiencies through the supply chain improved?

MR LUSCOMBE: Yes.

MR O'DONOVAN: Yet, the trend in prices – in retail prices, unlike Ald was up, you'd agree with that?

MR LUSCOMBE: Yes and we would say it follows the trend across prices, yes.

MR O'DONOVAN: Sure. But does that also reflect a greater willingness on the part of Ald to share the benefits and efficiencies in the supply chain with its customers?

MR LUSCOMBE: Well, we would say the same thing and we would say that it probably is more evidence in private label.

MR O'DONOVAN: All right.

MR LUSCOMBE: And Ald has obviously done it all in private label.

MR O'DONOVAN: Sure, but would it be true to say that your shareholders generally have obtained the benefit of – the majority of the benefit you've obtained in improved buying terms and in improved costs and customers have not had a similar proportion?

MR LUSCOMBE: No, in fact over time and it's in our annual reports, a round about 70 to 80 per cent of the benefit that's been generated has been put back – hasn't flowed onto the shareholders.

MR O'DONOVAN: To the shareholders?

MR LUSCOMBE: Has not flowed back to the shareholders.

MR O'DONOVAN: Has not.

MR LUSCOMBE: So it's obviously stayed within the business for reinvestment.

MR O'DONOVAN: Right, but so does that suggest that your margin improvements, your EBIT margins have improved in the last five years?

MR LUSCOMBE: Yes.

MR O'DONOVAN: By three or four - - -

MR LUSCOMBE: They've improved each year, yes.

MR O'DONOVAN: Yes, each year substantially. So are you suggesting that there was even more margin improvement which has then been passed back to customers?

MR LUSCOMBE: Correct.

MR O'DONOVAN: All right. All right, now, in relation to moving on then to category management, now you indicated that you select pricing, that's the select range - - -

MR LUSCOMBE: Yes.

MR O'DONOVAN: - - - you price that against the leading brand?

MR LUSCOMBE: Yes, we do.

MR O'DONOVAN: Okay, so the idea is that select will sit below the leading brand?

MR LUSCOMBE: Correct.

MR O'DONOVAN: But will attempt to compete with – or will compete with it on quality?

MR LUSCOMBE: It actually will compete, yes. We specify the product to be equal to or better than in fact in 99 per cent of cases better than the market leader in terms of quality of the ingredients or in terms of innovation of packaging, etcetera.

MR O'DONOVAN: Okay, so then in terms of how the category structure works you've got the leading brand at a higher price, then you have select of similar quality, but at a lower price?

MR LUSCOMBE: At least – or I would say – my personal belief is that most of them are actually better quality.

MR O'DONOVAN: Sure, okay. So – and you've indicated that the private label delivers you a better margin than the branded product?

MR LUSCOMBE: Correct, correct.

MR O'DONOVAN: Okay, which then has the consequence for the category that Woolworths will have a preference, at least in terms of return, for consumers to choose the select label over the leading brand, you'd agree with that?

MR LUSCOMBE: There's a better outcome for us when they do that, a better outcome for the consumer as well.

MR O'DONOVAN: Sure, but in terms of your financial outcome it's a better – it is a better outcome for you.

MR LUSCOMBE: Yes, it's a win-win situation, absolutely.

MR O'DONOVAN: Yes, sure, all right, now ordinarily within a category the reaction of a competitor to a lower priced better quality product would be to reduce their price to compete with the product. You'd agree with that?

MR LUSCOMBE: Could be or increase the promotion.

MR O'DONOVAN: Sure, okay, but one of the competitive responses can be a price reaction to make themselves price competitive.

MR LUSCOMBE: Could be, yes.

MR O'DONOVAN: Sure. Okay. One of the competitive responses can be a price reaction to make themselves price competitive?

MR LUSCOMBE: Could be, yes.

MR O'DONOVAN: Okay. In this circumstance the branded product doesn't have control over the retail price? Woolworths has control over it?

MR LUSCOMBE: No, but they do have an opportunity to promote their product more frequently.

MR O'DONOVAN: Sure. All right. They have this opportunity but you'd agree that Woolworths is effectively the gatekeeper of that opportunity, if Woolworths says, "No, we're not going to alter the retail price no matter what you pay us".

MR LUSCOMBE: Well it would very much depend on – if they came back with a, you know, a reduction in cost, we may do that.

MR O'DONOVAN: Sure, but in terms of their ability to compete by lowering the price, Woolworths can control that decision by either not passing on the benefit of a reduced wholesale price or not permitting them to promote that product.

MR LUSCOMBE: Yes, well, you know, law specifies that retailers must set the prices without influence from suppliers, so that's how it works, absolutely.

MR O'DONOVAN: Okay. So in terms of management of a category, by the introduction of Select, Woolworths now has a positive disincentive for allowing the leading brand to reduce price. Would you agree with that?

MR LUSCOMBE: No, because one of the things that typically has happened is the market leaders come back with an improved promotional program so that actually means we have those leading products on special more often or maybe they give us money to have a sharper price. So that actually increases our overall attractiveness to our customers because not only do they get a wonderful offer product label but other products that they might consider to be alternatives, such as the branded market leader are more frequently on special.

MR O'DONOVAN: Sure, but if they came back to you with an offer of reducing – actually reducing the wholesale price to flow into the retail price, that would be unattractive to you in terms of - - -

MR LUSCOMBE: No, not necessarily. No, not at all.

MR O'DONOVAN: All right. Well, let's look at that. If they lower their price, that - - -

MR LUSCOMBE: Yes.

MR O'DONOVAN: For select to maintain that same position in the market as offering a lower price but the same quality, it would push down - - -

MR LUSCOMBE: We might – we might - - -

MR O'DONOVAN: - - - push down margins in Select.

MR LUSCOMBE: We might take the Select price down again, yes.

MR O'DONOVAN: Right. That's a possibility.

MR LUSCOMBE: That's possible.

MR O'DONOVAN: An unattractive one, from your point of view?

MR LUSCOMBE: Yes, of course.

MR O'DONOVAN: Yes. Of course. That's right. So that at least makes it unattractive to them from Woolworths' point of view in terms of passing on that benefit.

MR LUSCOMBE: Sorry. I just - - -

MR O'DONOVAN: So if it's - because of necessary reaction within the Select category whenever a branded product's price is reduced, it makes it less attractive for Woolworths to pass onto consumers, the lower wholesale price.

MR LUSCOMBE: Yes. Well, I might just defer here to James Aylen because he would be in a position – has that happened?

MR AYLEN: No.

MR O'DONOVAN: All right. In relation to - - -

MR LUSCOMBE: So it's not a question we've had to ask ourselves.

MR O'DONOVAN: All right. Well, let me pursue that further then. So, in circumstances where a promotion is offered, so a supplier comes forward and says, "Look, the Select is attacking our market share. We want to promote it down below a price – down to a certain price point and we're willing to give you extra promotional funds to do it" to fund that lower price point. The effect of that would be to shift customers to a lower margined product for Woolworths. Has Woolworths ever declined a promotion on a leading brand product in circumstances where it would put the price below Select?

MR AYLEN: Not to my knowledge.

MR O'DONOVAN: Have you ever made inquiries about whether or not that's occurred?

MR AYLEN: No, I haven't.

MR O'DONOVAN: Okay. All right. Will you make inquiries as to whether that's occurred following this hearing?

MR AYLEN: Yes.

MR O'DONOVAN: Okay All right. Now if I can take you then to the – behind tab 7. Now essentially what's there is just an economics article which suggests there are variations in local pricing and the only reason for drawing it to your attention was to consider whether you're happy to discuss local pricing in a public context given that this material is on the public record.

MR LUSCOMBE: In generally terms I will. There might be a point where we might take it in-camera, but some history. Going back when Woolworths was a number of state companies, obviously we had – in the turn of the century, when we brought them together, our accumulated number of price scripts was around about 55; our long-term goal has been to work towards one national price and it's been a journey over a number of years where we've been reducing the number of price scripts and when we do that, our typical method is to actually reduce the higher price scripts not raise up the lower one. So it was actually bringing the whole lot down.

The latest situation happened earlier this calendar year where we moved to a point where we have got - except for two exceptions – one state price for groceries, dairy, freezer, general merchandise and we've got about 13 stores, I think, that are the likes of Nhulumbuy, Derby etcetera where the costs of getting product there logistically is exorbitant and so we obviously pass some of that cost on, not all of it. So that means that the price of the standard price of cornflakes, even if I take here in Melbourne, will be the same price as the price in, say, Echuca.

The states don't actually follow the state boundaries; they actually follow basically where the catchment areas for our regional distribution centres. So, for instance, Broken Hill actually comes out Adelaide, so it has the Adelaide prices. The only exception is that a part of the range, South Australia also looks after the Northern

Territory. A portion of the range in the Northern Territory is actually a little bit higher than Adelaide and, in fact, when I look nationally across the products – and correct me if I'm wrong here, guys – I think from memory there are some 6000 products that would be the same price nationally, except for those 13 stores, and there is another 3000 products that would be the same except for those nine Darwin stores.

That has been a considerable investment of Woolworths over a number of years where we have gone from that 55, then we went to the 40 and the 30 etcetera and we've been gradually working our way down. Of course, our long-term goal would be to try as much as possible to get to one price script. It's not possible in fresh food because of the varying source of supply. So a packet of cornflakes is a packet of cornflakes. Obviously, a banana in Western Australia comes from Carnarvon, obviously comes from either Coffs Harbour or far north in terms of the eastern states and, you know, there are various growing regions that come into play through the year. So fresh food is always problematic but in terms of dry groceries and general merchandise, our goal eventually is to get to one national price script.

Over and above that, which I can handle in-camera, we have our local competition policy which says "for known value items". In a prescribed little market area, the store manager for those items has the ability for – not when they're on special but for standard shelf price, to actually go down to meet it if they need to. Not to go up, never to go up but to go down.

MR O'DONOVAN: All right. So just on the last point, it's – so the structure of the local market will effect or may affect local pricing?

MR LUSCOMBE: Less so now because we basically have taken our lowest price script in each state and, in general terms, moved to that lower price script. So in the case of the eastern states, you know, we had a price script that was competing against ALDI stores when they were in that area. All stores in the eastern states that have ALDIs somewhere in it, now have that same price script except for, as I said, you know, Mt Isa and stores like that that are way off the beaten track. You know, a combination of plane, train and ship to get there.

MR O'DONOVAN: Sure. Putting those aside, there is facility for a local Woolworths store to respond to the local competition around it?

MR LUSCOMBE: If need be, yes. For known value items, yes.

MR O'DONOVAN: Yes. Okay. Are you happy to explain in broad terms the concept of the known value item?

MR LUSCOMBE: They would be items that we would think a customer probably has a good awareness of what the price might be generally in the market place against – for all the opportunities because, you know, if you take a bottle of milk or a carton of milk, clearly there's the supermarkets, there's the service stations, you know, the butcher and sometimes the fruit shop usually sells milk, etcetera, etcetera, there’s a whole host of different opportunities to buy a particular product. So they would probably be fairly aware. They may not know to the exact cent what the price of that is. Certainly customers have got no – probably unless they buy a product regularly, wouldn’t know the relative price of thousands of items so – not possible for a human being to do that. I certainly can’t. There’s a small list of items, say, for instance, in produce – you know, bananas would be another good example that most people would probably know generally what the price of bananas are from time to time.

MR O’DONOVAN: All right. But it would be fair to say from that that the structure of the local market so what the other stores around the Woolworths stores are doing can affect the pricing of that Woolworths’ store?

MR LUSCOMBE: In those items, correct.

MR O’DONOVAN: Yes, okay. So from - - -

MR LUSCOMBE: Just to reiterate, Mr O’Donovan. They have an ability to go down to but not under.

MR O’DONOVAN: Yes.

MR LUSCOMBE: They under no circumstances can go up, under no circumstances. That’s an end of career choice.

MR O’DONOVAN: Okay. But it is true to say that the structure of a local market can put downward pressure on the pricing of the Woolworths’ store?

MR LUSCOMBE: Yes. We’re finding it less so these days now that we’re, particularly in the last couple of months as we have brought the general price down.

MR O’DONOVAN: Yes.

MR LUSCOMBE: Less so.

MR O’DONOVAN: Okay. If we were to look backwards and in the past there was probably more effect, more ability of local market conditions to influence - - -

MR LUSCOMBE: That would be a fair deduction, yes.

MR O’DONOVAN: Yes, all right. So anything that affects, anything that diminishes local competition can be good for Woolworths. Would you agree with that proposition?

MR LUSCOMBE: No. Because what we do is we start off with price group 1 nationally and basically what we do is we go and survey all of our, you know, our major competitors, ALDI – we look at price line, we look at even our own business in Big W and then we make a competitive stance on that price so, you know, we look at the likes of Ritchies and Drakes and everybody, Franklyns.

MR O'DONOVAN: Sure. But if a store opens locally that discounts key value items - - -

MR LUSCOMBE: Yes?

MR O'DONOVAN: - - - the expectation is that the local Woolworths shop will have to meet them?

MR LUSCOMBE: Yes. They're charged with safeguarding the business and the jobs of the people that work for Yes. They're charged with safeguarding the business and the jobs of the people that work for Woolworths in that store, absolutely they must, yes.

MR O'DONOVAN: Sure. So local entry by a competitive retailer can have adverse consequences for that Woolworths store?

MR LUSCOMBE: If they choose to sell. Yes, absolutely.

MR O'DONOVAN: Right. So local market structure is important from Woolworths' point of view?

MR LUSCOMBE: Yes.

MR O'DONOVAN: That can affect, it definitely affects pricing?

MR LUSCOMBE: Yes. Our whole premise is being that, you know, our customer has these days a vast choice of alternatives for buying food and groceries and it's just a little bit of pressure on the left foot or the right foot as to whether they go through our front door or Coles or Metcash or the fruit shop or the baker or the butcher or – it says, you know, it's not all that convenient, I'll pick it up from the convenience store on the way home or I'll as I'm buying my petrol I'll pick up a loaf of bread and two litres of milk. Hence, absolutely, you know, we are presuming and we do believe that the Australian consumer is a very savvy person and for those known value items if you are consistently across the basket dearer than everybody else quite rightly they should go shop somewhere else if price is their main consideration.

MR O'DONOVAN: Sure, okay. Now as part of an information request which the commission gave you we sought details about where Woolworths had undertaken planning objections to the establishment of supermarkets - - -

MR SAMUEL: Sorry, just before we get off this part can I just take it a step further forward?

MR O'DONOVAN: Sure.

MR SAMUEL: I think the proposition you're putting is that Woolworths is heading towards a single national pricing with the exception of what you would call the very high cost delivery areas.

MR LUSCOMBE: Yes.

MR SAMUEL: Okay and except for known value items, the KPIs that the pricing will tend to be the same if not very similar across a broad area. So if I was to take the metropolitan area of Melbourne that I could go to a store in Doncaster and a store in, to take a potential alternative store in Toorak and find that the pricing for other than known value items will be about the same? No?

MR LUSCOMBE: In the absence of human error that should be the case.

MR SAMUEL: Okay. We might take that a bit further with you in private session.

MR LUSCOMBE: Sure.

MR SAMUEL: Because we've got information and you've given us some of that. Now the other thing you've said in respect of known value items that what your store managers are specifically instructed to do is three things. One is not to go higher than the competitor.

MR LUSCOMBE: Correct.

MR SAMUEL: Two, not to go lower than the competitor.

MR LUSCOMBE: Correct.

MR SAMUEL: But, three, to match the competitor?

MR LUSCOMBE: Correct.

MR SAMUEL: Okay. Let's assume that there's one competitor in an area and assume it's Coles, let's assume that Coles instruction to its managers is exactly the same as Woolworths. We've got a pretty cosy arrangement at that stage, haven't we?

MR LUSCOMBE: Well, Coles is not the only person that we're matching, of course - - -

MR SAMUEL: No, I just made an assumption just for the moment, right? Okay? I'm going to deal with the others.

MR LUSCOMBE: Right.

MR SAMUEL: Just for the present because this is what, yes, we're getting to sort of what we call sort of "tacit co-ordination" and the like. But this is what happens if you’ve got one party that says, “I’ll match” and the other one that says “We’ll match” they’re both matching but they’re actually neither of them are going any lower, so - - -

MR LUSCOMBE: I have no knowledge, chairman, of what Coles’ competition policy is so - - -

MR SAMUEL: No, no. I understand that. We’ll find that out in due course when we - - -

MR LUSCOMBE: Sure.

MR SAMUEL: - - - have our discussion with Coles. Now let’s just take it a step further because we got evidence from the National Association of Retail Grocers which is representative of the IGA Group but what they do is they price to match the lowest competitor of Coles and Woolworths so that’s very interesting. We’ve now got three of you – I think that’s the words used, wasn’t it, Mr O’Donovan, that they said that they priced up to the lowest level of their major competitor which would be Coles or Woolworths and so now we’ve got three people – I’m sorry, I’m making an assumption about Coles at the moment but potentially three that are saying, “Well, we’ll all price to above that matching level but we won’t price below”. I’m trying to actually figure out who is doing the discounting to start pulling the price down but we’ll get to that. ALDI says, “Well, we’ll price at our price” but they’re pricing in a market that many would observe is a different market to that of Coles and Woolworths and IGA other than in respect of Black and Gold or the Coles – what is it, Coles, the various home brands. But they would probably argue that they’re in a slightly different market and indeed in evidence that we’ve had over the past few days the major landlords in the shopping centres are indicating that the attitude of Coles and Woolworths to an ALDI store being present in the shopping centre is that it is something that is a complimentary to the major supermarket chains rather than being of immediate, vigorous competition, that it’s something that, you knew, restrictive covenants are no longer being required to exclude the ALDIs. So I’m just trying to paint a picture and just to get your response to it.

MR LUSCOMBE: Sure.

MR SAMUEL: So the picture that I’m just starting to get a bit of sense of at the moment is that without having got yet the Coles’ evidence that we’ve got Woolworths and IGA saying, “We’ll match but we won’t go below in respect of known value items”. We’ve got a tendency towards national pricing except in the high cost delivery areas by Woolworths. We’ve got ALDI that’s a complimentary outlet as succinct from a competitive outlet except in respect of home brands, tell me where is the competition?

MR LUSCOMBE: Okay. Chairman, to describe exactly what we do, we go and check a whole host of retailers, Coles, various Metcash brands, ALDI, et cetera and we price off the lowest. So we don’t price off Coles. We price off the lowest.

MR SAMUEL: Right.

MR LUSCOMBE: In regards to - - -

MR SAMUEL: Just keeping in mind – sorry, that IGA says, well it prices up to the lowest - - -

MR LUSCOMBE: Well, I was going to - - -

MR SAMUEL: I'm sorry, I shouldn't interrupt you.

MR LUSCOMBE: I was going to, Mr Chairman, say that our surveys of prices of independents would suggest that that might be the intention but not the outcome.

MR SAMUEL: Right, okay. So I won't interrupt.

MR LUSCOMBE: Because typically they would be higher across a big basket of goods, a big group of prices. I think the other thing that is in public domain now is the report that's just been commissioned and published by the Bureau of Infrastructure, Transport Infrastructure Research.

MR SAMUEL: Yes.

MR LUSCOMBE: It basically said that independents choose to price particularly in country areas according to where a major supermarket may be. So to say that the independent group actually price off the cheapest of the price survey is not backed up by our own information and certainly this report suggests the exact opposite. So I would say that ALDI for the small range of products that it has we price off those for the, you know, for your somewhat equivalent product, they're very hard to get an equivalent product. In some cases we price off couples, in some cases we might price off in some markets off, yo know, if there's an independent that has a particular product that they have always sold cheaply well, then, that becomes our price but for the whole state.

MR SAMUEL: Well, actually, what you've just done is to weaken even further the competitive structure they were trying to paint because what we've got is, you're saying, that the BITRE survey indicates - - -

MR LUSCOMBE: Yes.

MR SAMUEL: - - - and I acknowledge that survey, that that indicates that the independents are tending to price not at the lowest of Coles and Woolworths, but are pricing above.

MR LUSCOMBE: We're not there, their evidence would say absolutely.

MR SAMUEL: Yes.

MR LUSCOMBE: Our surveys would show that even when we go head-to-head, that across the big basket of goods, that generally speaking, they're dearer.

MR SAMUEL: Okay. So that removes them from the competitive dynamic.

MR LUSCOMBE: Yes, but not on every item so - - -

MR SAMUEL: No, no. No, but I understand that.

MR LUSCOMBE: - - - and that's where, Chairman, I say that we look item-by-item.

MR SAMUEL: Yes.

MR LUSCOMBE: So we actually go out and look at thousands of items and the business manager has to sit down and look at the evidence for each of the items from each of the surveyed areas and make the decision, item-by-item.

MR SAMUEL: Okay. So what we've got, just to paint a scenario, sorry, and I'm not trying to verbal you or put words in your mouth.

MR LUSCOMBE: No, no.

MR SAMUEL: No, I'm sure you will check me or correct me if I got it wrong, but what we've now got is Woolworths pricing to match; independents pricing, well, at best to match but probably above; ALDI being complementary in respect, and potentially offering, in some few select areas – I think their total number of items are less than 800 of that sort of order compared to your tens of thousands – but in respect to those areas, offering some competitive pricing but mainly in respect to the generics or the home brands. Now, we've got to find out from Coles, they'd better be pricing below or else we've got some really interesting tests in coordination, haven't we?

MR LUSCOMBE: I wouldn't – no, I wouldn't – you know, the other thing, chairman, is that shelf pricing is but one element of the basket for the customer. So you have roll-backs.

MR SAMUEL: Yes.

MR LUSCOMBE: You have promotions, in any one week we would have normally about 4000, 4000 individual items on special in a Woolworths/Safeway's supermarket, a typical one. You have got other price positions that we might take, for instance with private labels. So recently we've taken the price of our private label bread down across the nation. So it is not purely and simply just have a look at what the shelf price is. Yes, we're very competitive with that and, yes, we check against everybody, but there's a much bigger parcel that goes to what the consumer finally pays.

MR SAMUEL: Do they have a lower bounds, your managers, for pricing?

MR LUSCOMBE: Sorry?

MR SAMUEL: A lower boundary below which they can't go?

MR LUSCOMBE: Look, of recent times, if it goes – what – to a point where they presume costs might be, they're encouraged, before they do anything, to make contact with the buying office to make sure that we don't tread into areas that we don't want to tread into.

MR SAMUEL: Right. Can they price below cost to match a competitor on known value items? You might want to consult with Ms Cass-Gottleib before you give a response to that.

MR LUSCOMBE: We will answer that in camera, please.

MR SAMUEL: Okay, okay. Thank you. Sorry, Mr O'Donovan.

MR O'DONOVAN: Right. So sorry, just to confirm again, the upshot of the local pricing policy can be that the structure of the local market can affect the pricing, at the least, of key value – of known value items?

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay. Now, the commission issued a notice earlier in the course of this inquiry and asked questions about the planning appeals which Woolworths lodged in response to attempts by competitors to enter a local market.

MR LUSCOMBE: Yes.

MR O'DONOVAN: Okay. Are you happy to discuss the response to those?

MR LUSCOMBE: In camera.

MR O'DONOVAN: In camera?

MR LUSCOMBE: Absolutely, in camera, yes.

MR O'DONOVAN: Okay.

MR SAMUEL: The actual planning appeals though would be on the public record, would they not?

MR LUSCOMBE: Yes, if the questions go to why we may have done it.

MR SAMUEL: Right. Let’s perhaps just pursue it in public arena for the moment in terms of what would be on the public record, and then we can go into reasons in private.

MR O’DONOVAN: Sure, okay. Now, on that list of places where Woolworths lodged an objection was Appin in New South Wales?

MR LUSCOMBE: Yes.

MR O’DONOVAN: Okay. Now, just from looking it up on Google maps, Appin is a small town on what looks to be the outskirts of Campbelltown, but several kilometres from that area.

MR LUSCOMBE: I think that’s where it is, yes.

MR O’DONOVAN: Yes, all right. Now, so Woolworths lodged an objection in relation to an upgrade of a supermarket in Appin. Okay. Now, can you tell us, does Woolworths have a store in Appin?

MR LUSCOMBE: I don’t believe so, no.

MR O’DONOVAN: No, all right. Is it true to say that Woolworths does not have a store within 12 kilometres of Appin?

MR LUSCOMBE: I can’t ask that, can you?

MR KEMMLER: We have a store at Tamore.

MR O’DONOVAN: Okay, and how far away is that?

MR KEMMLER: Off the top of my head, I don’t know.

MR O’DONOVAN: All right. Would it be more than 10 kilometres?

MR KEMMLER: I don’t know the geographic distance.

MR O’DONOVAN: All right.

MR SAMUEL: You’ve got your Google map there, I think, on you, which is – but - - -

MR KEMMLER: All right, well, we can find it.

MR O’DONOVAN: All right. Yes, look, actually, can I take you to the map at tab 5? Okay, have you got that?

MR KEMMLER: Yes.

MR O'DONOVAN: Okay. Now, I don't think the store in Tamore is listed but that seems to be at least as far away as the stores in Campbelltown, which, on our assessment, is about 12 kilometres away, okay. Now, I won't disclose the – well, firstly, can I clarify it, does Woolworths have any other property interests in Appin that would - - -

MR KEMMLER: At that particular point in time we were considering pursuing a supermarket interest at Wilton.

MR O'DONOVAN: Right, okay. Which is still 10 kilometres from Appin?

MR KEMMLER: I think this is going to head into some areas of confidential information.

MR O'DONOVAN: Sure, but you can at least - - -

MR SAMUEL: Well, it is probably not too confidential as to how far one town is from another so I think we can - - -

MR KEMMLER: Yes, I'm assuming there's a distance of about 5 to 10 kilometres.

MR O'DONOVAN: Yes, okay. So Woolworths lodged an objection to the improvement of the supermarket in Appin?

MR KEMMLER: It was a – I understand it was a new supermarket in Appin.

MR O'DONOVAN: A new supermarket, okay, all right. It is fair to say that – well, are you prepared to say publicly what the basis of the objection Woolworths had was?

MR KEMMLER: I think that should be in camera because it relates to some other issues.

MR O'DONOVAN: Right.

MR SAMUEL: Would that not be on the public record? I would have thought that the nature of the objection would have to be, wouldn't it, so that the submitting parties can respond. Or maybe I don't understand the process.

MR O'DONOVAN: Yes. Well, that would be my understanding but I haven't checked it. But can I press on that?

MR SAMUEL: Wouldn't that be on the public record, the nature of your objection? That is, the reasons for your objection as set out?

MR KEMMLER: The nature of the objection was on planning grounds.

MR LUSCOMBE: The reason, chairman, was a broader commercial consideration.

MR O'DONOVAN: Okay.

MR SAMUEL: Which was not disclosed to the planning authority or was disclosed?

MR LUSCOMBE: No, look, we obviously would have appealed on the grounds that are allowable under the Act.

MR SAMUEL: Right. The appeal itself is public or it is not?

MR LUSCOMBE: Yes, it is, yes.

MR SAMUEL: You would have explained the reasons in public?

MR LUSCOMBE: For the objection, yes.

MR SAMUEL: Yes.

MR LUSCOMBE: But not for the broader reason why we may have considered objecting in the first place.

MR SAMUEL: Okay. Well, let's just deal for current purposes with what would have been explained in public.

MR O'DONOVAN: Right.

MR SAMUEL: Just for the record.

MR O'DONOVAN: Okay. So can I just confirm that you had a private commercial objective which you don't want to discuss here but then you had public objections which were based on the planning process.

MR KEMMLER: That's correct.

MR O'DONOVAN: Okay, and in terms of those objections they included things like traffic and access?

MR KEMMLER: Correct.

MR O'DONOVAN: Heritage?

MR KEMMLER: Correct.

MR O'DONOVAN: Noise impacts?

MR KEMMLER: Correct.

MR O'DONOVAN: Overshadowing?

MR KEMMLER: Correct.

MR O'DONOVAN: Okay. Now, it would be fair to say, wouldn't it, that there was absolutely no impact on Woolworths in relation to traffic and access if there was a new supermarket in Appin?

MR KEMMLER: Correct.

MR O'DONOVAN: Okay. There was absolutely no noise impact on Woolworths in relation to a development in Appin?

MR KEMMLER: Correct.

MR O'DONOVAN: Okay. Would it be fair to say that Woolworths does not make a habit of objecting to reduction in heritage values, except where it has a specific commercial interest that it wants to object?

MR KEMMLER: Correct.

MR LUSCOMBE: Generally correct, yes.

MR O'DONOVAN: Okay, so all of these objections were done for the purpose of pursuing the commercial opportunity which we don't need to discuss, but you took advantage of the planning laws in order to do it.

MR LUSCOMBE: Correct.

MR O'DONOVAN: Okay, and is it Woolworths' policy to, in a sense, interfere with the establishment with competitive entry of alternative supermarkets by use of the planning laws?

MR LUSCOMBE: Our position is very clear. We're a public company that is in retailing and the way that we grow our company is by growing our sales and one of the ways we grow our sales is to both have our opportunity for new stores protected and secondly, to try and protect existing businesses. Likewise, whenever we try to change a store or whenever we put in an application for a new store, it would be a rare occasion where we don't actually have similar objections from multiple parties on various grounds and typically, they would also use exactly the same allowable objections under the relevant Act in the relevant jurisdiction to object to the development by ourselves. So we make no apology for the fact that we're a retailer. We grow our business by growing our sales and we grow our sales by improving our sales in our existing businesses, but also over time, get new businesses. In camera, we can talk about why that may have been the case in that, but - - -

MR O'DONOVAN: Sure, but you don't – from your point of view, it is a company policy which you're happy to defend that you will use planning laws which are put in place to preserve, you know, public amenity and all those other goals as a way of interfering with competition - - -

MR LUSCOMBE: No, no.

MR O'DONOVAN: - - - with your stores.

MR LUSCOMBE: No, it's to do – to make sure that, you know, it's a level playing field, you know, because every time that we put one in or most times when we put one in, we have to satisfy the same requirements. So if we believe that there's a business that may be entering into a marketplace that seeks not to follow the same, then quite rightly we have the legal right under the Act to object and that's exactly what we have done.

MR O'DONOVAN: Sure. So it's standard industry practice to lodge these objections?

MR LUSCOMBE: I'm not sure what you'd call standard industry, but it is - - -

MR O'DONOVAN: Well, you've suggested that all the other retailers do it.

MR LUSCOMBE: - - - it's a fairly regular occurrence, yes.

MR O'DONOVAN: All right, and it's standard practice for Woolworths.

MR LUSCOMBE: Where we believe we've got a commercial interest to protect, either one that exists or one that we plan for the future, absolutely.

MR O'DONOVAN: Sure, and there can't be any doubt that the effect of these objections is to add to the retailer's costs in establishing a new or expanding an existing supermarket.

MR LUSCOMBE: Well, that's not part of our thought processes about growing our business.

MR O'DONOVAN: Sure, so the key factor is that it delays entry or may stop entry of the competitor.

MR LUSCOMBE: It's actually about protecting and putting opportunities for our growth in place.

MR O'DONOVAN: Sure, but you weren't proposing to enter in Appin.

MR LUSCOMBE: Well, we could answer that a little bit later.

MR O'DONOVAN: All right. Okay, but – now, and you'd agree that it's no part of the planning law to protect existing players from competitors.

MR LUSCOMBE: Well, I'm not an expert in planning law. I might defer that question to Mr Kemmler.

MR KEMMLER: Well, I'd probably just – in answer to your question, we've only objected or made 22 appeals since 2005. It's fair to say every single site that we enter we achieve objections against us, so it's actually fairly uncommon for us to object to other developments, where it's very common for objectors to object to our developments.

MR O'DONOVAN: Right. So would you agree with the proposition that it's standard industry practice to try and keep competitors out using planning appeals?

MR KEMMLER: It appears to be standard industry practice for a number of players.

MR O'DONOVAN: Right, and Woolworths certainly is not averse to using that process.

MR KEMMLER: From time to time.

MR O'DONOVAN: Okay. All right, now the same is true in relation to when other grocery stores want to establish liquor stores? That you also have a – generally speaking, you would object using the liquor licensing process?

MR LUSCOMBE: The same answer as before, yes.

MR O'DONOVAN: Yes, okay. So you would agree that the purpose of liquor licensing laws is not to improve Woolworths competitive position?

MR LUSCOMBE: No, it gives you an ability to actually retail alcohol.

MR O'DONOVAN: Yes, okay. The purpose for which Woolworths uses the objection is to delay or prevent entry into their markets by competitors.

MR LUSCOMBE: It's to protect our existing business.

MR O'DONOVAN: Yes, by excluding competitors from the local area.

MR LUSCOMBE: If they don't satisfy the requirements of the law, then they shouldn't get it.

MR O'DONOVAN: Sure, but you make sure that – in fact, you invest a substantial amount of money ensuring that if there's any doubt about whether or not they do that the authorities will know that they don't.

MR LUSCOMBE: I would suggest that's good – well, I wouldn't say it's substantial, but it's good commercial practice.

MR O'DONOVAN: Good commercial practice, all right.

MR LUSCOMBE: Yes.

MR O'DONOVAN: Do you think it's good corporate citizenship to do that?

MR LUSCOMBE: Absolutely, because the grounds typically will be based on social impact.

MR O'DONOVAN: Okay, and do you ever obtain these social impact statements to determine whether Woolworths, for example, should stop retailing in the area?

MR LUSCOMBE: From time to time we do, yes, of course. It's part of the process.

MR O'DONOVAN: Right, and have you stopped retailing in the area because of social impact?

MR LUSCOMBE: Some people have been unsuccessful in their application because they haven't satisfied the requirements of obtaining a licence, yes.

MR O'DONOVAN: No, no. You misunderstand my question. Has Woolworths Liquor, as a result of the discoveries it's made about social impact in an area, decided that it simply would be wrong for them to continue to operate a liquor store in that area because of the social impact? Have you ever closed a store?

MR LUSCOMBE: Us?

MR O'DONOVAN: Yes, has Woolworths Liquor ever closed a store?

MR LUSCOMBE: Yes.

MR ONIKUL: In a number of areas, we reduce the trading hours in liquor also in a number of areas. We reduce certain lines, remove from shelves certain lines, so we have reacted to that.

MR O'DONOVAN: So let me just be clear. You've never closed a store in response to one of these social impact – the things that you've discovered about the social impact of running a liquor store in an area?

MR ONIKUL: Not to my knowledge.

MR O'DONOVAN: No, all right.

MR HORTON: Can I just actually clarify that? As I understand it, the process is that you actually lodge the social impact assessment statement with your application for a liquor licence, so it's not actually being done to review existing licences. It's in relation to an application for a licence.

MR O'DONOVAN: Sure, but it's true to say, isn't it, that Woolworths obtains, for example, crime information about the level of assaults in an area and suggests that introduction of a competitor might increase the level of violence in an area? That's the practise that you engage in in terms of objecting to a liquor licence?

MR LUSCOMBE: I don't think that we're in a position here today to talk about the particulars of evidence that we may have preferred.

MR O'DONOVAN: Sure, okay. All right. Now, if I can take you to the next tab, tab 6. Now, you see there we've received a submission in relation to a site at Doncaster east. Now, if I can just take you through that submission and just see – primarily to confirm whether or not the facts that are available to us are correct. Now, the first allegation there is that on the Doncaster east site, Woolworths has opened up a number of other supermarkets nearby. I think there's one within - - -

MR LUSCOMBE: We bought the Franklins business at Doncaster Shoppingtown.

MR O'DONOVAN: Now, is that in relation to the site? Is that the site in respect of which this - - -?

MR LUSCOMBE: No, no, no, no. No, that's one nearby though.

MR O'DONOVAN: Right.

MR LUSCOMBE: It's the one that – Shoppingtown's just been rehashed and there's a replacement store there now, a brand new Woolworths store, Safeways store.

MR O'DONOVAN: Yes, okay, but there are, on our estimates, there's something like five Safeways stores within a three kilometre radius in that area.

MR LUSCOMBE: Yeah, that's about right.

MR O'DONOVAN: Does that sound right to you? All right. Now, the allegation is that Woolworths retained the lease on the Jackson Court site just to stop any other supermarket providing an alternative.

MR LUSCOMBE: That's not correct.

MR O'DONOVAN: That's not correct. So is it true that the supermarket has not been upgraded or maintained?

MR LUSCOMBE: That's correct.

MR O'DONOVAN: That is correct? So that's in the last 12 years.

MR LUSCOMBE: I'm not sure in the last 12 years.

MR KEMMLER: No, we've – I'm not sure exactly what we've spent on the store in the last 12 years, but we would have done some minor refurbishment works in that period.

MR LUSCOMBE: Yeah, it would be hard to run a supermarket for 12 years without spending money on it.

MR O'DONOVAN: Sure, but it is true to say that you would normally upgrade all of your stores within a 12 year timetable?

MR LUSCOMBE: Yes, perhaps between seven and 10 years for supermarkets normally.

MR O'DONOVAN: So it's unusual in this case not to have upgraded the store in a period of 12 years.

MR LUSCOMBE: Well, we're not sure whether that's the case or not. My presumption is that we may have done something.

MR KEMMLER: There is a – we purchased, as Michael said, the Franklin store at Doncaster. Doncaster is undergoing a major redevelopment in which the size of our store – and was – our store was to be shut and relocated and the size of the other supermarkets in that particular centre were to be upgraded as well. That particular redevelopment work was delayed. As a result of that delay, there was no refurbishment works carried out on the Doncaster East site.

MR DONOVAN: I am sorry, I am not sure that I understand why a delay in other stores expansion would delay refurbishment.

MR KEMMLER: Well, the primary reason is that the lease expired in 2008.

MR DONOVAN: Yes.

MR KEMMLER: We anticipated that at the end of the lease we would try to negotiate for a new lease for a Dan Murphy store in that particular location.

MR DONOVAN: Okay. When did you anticipate that?

MR KEMMLER: I think we are heading into some confidential timing issues here.

MR DONOVAN: Okay.

MR LUSCOMBE: It would be fair to say that Naum Onikul and Tony Leon who was the General Manager of Dan Murphy identified that particular store site as a prime site for a Dan Murphy wing.

MR KEMMLER: It is roughly when we purchased the Dan Murphy stores around – in 2.10.00.

MR LUSCOMBE: Yes. So, it has been a long term view that that particular site would make an ideal Dan Murphy site.

MR DONOVAN: Okay. So, when does that put the date of identification? So, it would have been identified as the site for Dan Murphy in 2000 and?

MR LUSCOMBE: 2001/2002.

MR DONOVAN: Okay, all right. Now, that is contrary to the allegation in the paper which suggests - - -

MR LUSCOMBE: It is.

MR DONOVAN: - - - that the decision to replace the Dan Murphy there was a recent decision in order to occupy the site?

MR LUSCOMBE: Naum, did you ever travel to Doncaster East with Tony?

MR ONIKUL: I never did. I had a number of debates with Tony Leon about that particular site and the suitability of that site for Dan Murphy stores, yes.

MR DONOVAN: All right. Now, why would the manager at Dan Murphy, the Dan Murphy development manager, tell Mr Bishop, who has provided a submission, that Jackson Court had not been planned as a development until recently?

MR LUSCOMBE: We have no - - -

MR ONIKUL: I go. Because we got no knowledge why the discussion took place.

MR LUSCOMBE: No. The person that may have said that, who is the development manager, actually asserts that he made no such statement.

MR DONOVAN: All right. So, you did undertake inquiries as to the accuracy of these submissions?

MR LUSCOMBE: We did. We were unable to find anyone that made a statement of that manner because it – the process within Woolworths is that it goes through a planning stage and then it gets to the property committee. The property committee is the formal decision making body but there may be a long term process in terms of planning and strategy about, you know, what is the best use of that particular location. That may go back a number of years in the case of this one. In fact, 2001/2002 where it was determined that it would make – because of its location and its size, it would make an ideal site for a Dan Murphy.

MR DONOVAN: Okay. If we were to make a document request on Woolworths seeking documents relevant to this site - - -

MR LUSCOMBE: Absolutely.

MR DONOVAN: - - - we would be able to confirm that?

MR LUSCOMBE: Absolutely.

MR DONOVAN: Okay. Now, in relation to – the commission also asked you questions in relation to whether or not Woolworths negotiated leases with restrictive covenants in them?

MR LUSCOMBE: Correct.

MR DONOVAN: Okay. Now, I think – I am not sure that all of them have been reviewed but at least 306 that we have looked at have some form of restrictive covenant in Woolworths leases?

MR LUSCOMBE: Correct.

MR DONOVAN: Okay. So, would it be fair – sorry. Just to identify the types that clauses that routinely appear in those leases, there are clauses which prevent the establishment of a second or a third supermarket within a particular centre. That clauses of that kind are often present?

MR LUSCOMBE: They are the rarity. The more prevalent one is reduction in our occupancy cost.

MR DONOVAN: Right, okay. Would it be fair to say that the reduction in your occupancy cost is so penal that a landlord economically is most unlikely to allow a competitive supermarket into its area if it has one of those clauses?

MR LUSCOMBE: I think we can – in camera we can actually answer that it actually isn't as penal because I think it goes to understanding exactly how the rent structure works.

MR DONOVAN: Sure.

MR LUSCOMBE: It is not – you know, on the face of it, it looks as though it goes to halve it. That is not the case at all. So, it actually is a very different mathematical outcome than the one – than just reading the clauses would lead you to believe. So, it doesn't, for instance – you know, reducing by one per cent doesn't actually mean exactly that. So, in camera we can actually – Ralph can take the commission through exactly how that mathematics works.

MR DONOVAN: Right. So, when it says that - - -

MR LUSCOMBE: So, in other words – you know, if we are paying two and a half per cent, it doesn't mean that it automatically goes to one and a half per cent of sales.

MR DONOVAN: Right. Even though that is what it says?

MR LUSCOMBE: Even though that is what it says, yes.

MR DONOVAN: Right.

MR LUSCOMBE: Because there are ratchet structures within the lease that actually preserve historic bases for the landlord going forward.

MR DONOVAN: All right.

MR LUSCOMBE: We can cover that off in camera.

MR SAMUEL: Given that they are in the lease document which is generally, with the exception of Victoria, on a public register, is there any difficulty explaining that in the public environment, how they work? I mean, they are there in – you know, it is an invitation to you but it might actually help people understand how these clauses work in their structure.

MR LUSCOMBE: Yes. Well, we will do that, Chairman.

MR SAMUEL: All right. Now, do you want to start that now or would you like to take a break for lunch and sort of take up on that perhaps straight after lunch? Would that be helpful? Your call.

MR DONOVAN: Yes. No, take it up after lunch.

MR SAMUEL: All right. So, we will start it straight after lunch with a review of how these clauses work.

MR LUSCOMBE: Sure.

MR SAMUEL: All right? For those that – yes, back at 2 o'clock, yes. For those who want to help the independent sector, there is a number of good coffee houses downstairs that you can - - -

MR LUSCOMBE: Otherwise, Queen Victoria Building.

ADJOURNED **[1.04 pm]**

RESUMED **[2.07 pm]**

MR SAMUEL: We'll resume and I think we've got a particular area to deal with which is leases and we should give .....

MR LUSCOMBE: Mr Chairman, just before we start.

MR SAMUEL: Yes?

MR LUSCOMBE: I need to correct something that I said earlier and that was in regard to the rent review clauses within our leases that I said that the mathematical outcome or the maths of it led to an outcome that didn't show that. In fact, it's not the maths it's actually to do with the renegotiation of leases subsequently. So the outcome has never gone to what the lease would say.

MR SAMUEL: Right.

MR LUSCOMBE: But I was in error in saying that it was actually the mathematical calculation. That's not the case.

MR SAMUEL: I was looking forward with some enthusiasm to your explaining how the mathematics could work out the way it was, Mr Luscombe.

MR LUSCOMBE: I misunderstood.

MR SAMUEL: You've left me disappointed.

MR LUSCOMBE: I misunderstood some – a briefing that I got late last week.

MR SAMUEL: Right, okay.

MR LUSCOMBE: So I apologise for that.

MR SAMUEL: That's all right. Well, thanks for correcting that. Let's resume on that basis which takes us a quantum leap forward potentially. Can we then sort of work through that and we'll see how far we can go because then we'll get into material that's not on the public record, it will be dealing with material outside the public record in terms of negotiations.

MR LUSCOMBE: I've asked, I think it's in the interests of getting a full understanding. Mr Kemmler spent his career in property. He's best to have the correct - questions directed to him in this particular area.

MR SAMUEL: Okay and, look, without wanting to pressure you into public material that would, that you might otherwise prefer to be confidential can I just perhaps emphasise that the more public the evidence you can give the more it assists in the public understanding the way that Woolworths operates and understanding some of the issues we're going to have to address. So if you get - - -

MR LUSCOMBE: We have erred on that level already today. There were several answers that we had determined probably we wouldn't wish to answer publicly but we, in fact, have so we have anticipated your advice.

MR SAMUEL: Thank you, right. All right. Okay. Mr O'Donovan?

MR O'DONOVAN: All right. So as I understand the position is that you do include in leases that you negotiate clauses which if they operate on their face create a financial penalty to the landlord and in some cases a financial penalty so great that it effectively operates to prevent them granting a lease to a competitor? Is that right? I'm just saying on its face so just on it's face.

MR KEMMLER: I think it's important just to understand the context of the leasing - - -

MR O'DONOVAN: Look, I'll let you to that in a minute but can you just confirm at least on the face of the leases the clauses that are there will if enforced by Woolworths would have the effect of making it economically foolish for the landlord - - -

MR KEMMLER: That's not necessarily the case.

MR O'DONOVAN: Okay.

MR KEMMLER: Just to give the commission an understanding of the lease environment with which Woolworths operates in. Woolworths is predominantly a tenant in buildings and Woolworths undertakes an arrangement with the landlord who owns the property and that arrangement is then generally for a period of about 20 years with options. So what Woolworths does when it investigates going into a particular area it looks for landowners who own some land in that particular area or owns a potential shopping centre and then over a period of time we negotiate with the landlord the whole gambit of issues which create the environment with which Woolworths can operate in that particular area.

So a landlord will come to us with a particular plan and from that plan we make an assessment of how easy is it for the customer to get from their home into that particular shopping centre, what sort of car parking is available, what sort of shopping centre environment is there? What's the tenancy mix of that particular shopping centre? So the landlord makes a number of representations to Woolworths as to the make up of a particular shopping centre and from that particular make up we have an assessment as to what our sales might be. So if a landlord comes to us and shows us a plan, you have two supermarkets in a particular shopping centre, we make an assessment on potential sales that we can derive from one of those particular sites.

If the landlord comes up to us with a shopping centre with one supermarket in a particular shopping centre we'll make a different potential assessment of the sales. The leases and the base rent that we then negotiate with the landlord are factored around the potential sales. So what you have with a landlord is a long term relationship and a sharing of development risk between the two. So we invest fairly heavily in the shopping centre, the developer invests fairly heavily in the shopping centre and the rent that's determined is based on the environment that the particular landlord has promised us.

So once we've agreed on the plans we make an assessment on the potential sales. We then determine a rent that's agreed between the parties and then we enter a lease arrangement and that lease arrangement reflects the commerciality of what has been agreed. So if the landlord has promised us that this particular shopping centre will have one supermarket and no other supermarket then that is the arrangement that is reflected in the lease. If we're a small tenant and we're under 1000 square metres we come under the Retail Leases Act and the landlord has to disclose to the tenant what other competing elements there will be for a particular specialty shop.

In the case of anything over 1000 square metres the only document that actually provides us or provides the landlord any need to maintain what he has promised us is the lease. So the lease effectively is the arrangement and the environment that the landlord has promised us and on that basis we're able to pay the rent that's been agreed.

MR O'DONOVAN: All right. But in some circumstances when you're negotiating with the landlord there is scope down the track some time within the period of the lease for that lease – for that centre to be expanded or for further things to be added as part of the centre. You agree with that?

MR KEMMLER: That's correct.

MR O'DONOVAN: Okay. In those circumstances you can't be sure whether in five years' time there's going to be space for an additional supermarket in that area?

MR KEMMLER: The leases we enter into are for a period of 20 years and in excess of 20 years so the landlord makes us a commitment as to what that particular environment will be like for the duration of the lease. The leases and the lease structures that we have are percentage rent based so as our sales increase we pay a higher rent. Every five years there's a rent review and that percentage rent is converted into base rent so effectively what happens is that the rent keeps ratchet-ing up. If the environment changes after 10 years and then we're paying at a level of rent that is much higher than if the environment hadn't changed.

MR O'DONOVAN: Sure. Just to - - -

MR LUSCOMBE: The only other thing – sorry, I might just add is that during a 20 year lease plus options frequently the ownership of the centre may change and the lease has the protection of the representations of the original owner for our investment that – the new owner may actually have a different view and may actually go out and buy, you know, adjacent blocks to actually further develop the centre. So it's our protection.

MR O'DONOVAN: Sure. So what you effectively do at the point in time in which you negotiate the lease is make an assessment of what you know but there might be things in terms of prospective development in that area which you don't know. You would agree with that?

MR KEMMLER: Well, when you mean "in the area" do you mean with - - -

MR O'DONOVAN: In the centre.

MR KEMMLER: Within the shopping centre.

MR O'DONOVAN: So the centre may be extended to include another supermarket?

MR KEMMLER: It could be but we rely on what representations the landlord has made to us at the commencement of the lease and the rent is factored around that particular representation.

MR O'DONOVAN: All right. Rent is reflected in your turnover, isn't it? Part of your rent is determined by the – on the basis of your turnover in a lot of cases?

MR KEMMLER: That's correct.

MR O'DONOVAN: Okay. So even if there is another supermarket added you are protected to a degree in that if your turnover falls then your rental so falls?

MR KEMMLER: That's not correct. If there's - - -

MR O'DONOVAN: Sorry. Let me stop you there. So are you saying that your rent doesn't fall if your turnover falls?

MR KEMMLER: It depends on the particular arrangement and it depends on the particular calculation and the extent of sales falling. As I mentioned before, that there are rent reviews on a fairly regular basis and that ratchets the rent up. So then you - - -

MR O'DONOVAN: So that's the base rental.

MR KEMMLER: It's – there's a combination of base rent, percentage rent and outgoings and all of those particular factors affect the rent and in rent reviews percentage rent gets – the base rent gets recalculated.

MR O'DONOVAN: Sure. But so your approach to negotiating a lease is that if the landlord tells you at the start of a lease that there's not going to be another supermarket, there's no space in the centre for another supermarket, you will ask for 20 years of protection, for trading protection for Woolworths? Is that right?

MR KEMMLER: We reach a commercial arrangement with the landlord and the landlord reflects that arrangement in the lease?

MR O'DONOVAN: Sure. Your starting point is that you will ask for 20 years' protection if at the start of that lease the landlord hasn't indicated that he's going to put another supermarket in?

MR KEMMLER: We enter a 20-year lease. Yes.

MR O'DONOVAN: Yes. The effect of that is to – and the effect of the arrangement is that if the landlord were to grant a lease, five years down the track or 10 years down the track, to another supermarket after the population of the area has grown and the turnover of your supermarket has doubled, you could prevent that supermarket coming in because of the clause that you negotiated 10 years before. That's right, isn't it?

MR AYLEN: The clause could have that effect.

MR O'DONOVAN: Yes, and in that sense this clause goes much further than is necessary to protect the legitimate interests of Woolworths at the start of an investment, doesn't it?

MR KEMMLER: The clause – what it does, it actually reflects what the agreement is between the landlord and as a result of the rent and the commercial arrangement that's been agreed between the parties, it does not stop any competitor from coming into that particular trade area or that catchment.

MR O'DONOVAN: Well, that depends, doesn't it, on whether there's another suitable site that can be used as a supermarket?

MR KEMMLER: Each area has its own specific characteristics.

MR O'DONOVAN: Sure, and there are some areas where there might be no other suitable site other than in an extension of that shopping centre. That's right, isn't it?

MR KEMMLER: That may well be the case but in - - -

MR O'DONOVAN: And so that agreement that you have struck, that rewards the landlord with higher rent and Woolworths with exclusivity, affects the competition in that local area for the next 20 years. That's the case, isn't it?

MR KEMMLER: I think you have to look at each area on its particular merits because each shopping centre doesn't have exclusivity in the particular catchment.

MR O'DONOVAN: No, that's right, but it's fair to say that when you do ask for these 20-year exclusivity arrangements, they do go beyond legitimate protection of that initial investment by Woolworths in the centre.

MR KEMMLER: No, I don't agree that. I think they legitimately protect the business arrangement that's been agreed with the landlord. They are fairly common arrangements that exist with all supermarket operators. They've been in existence for around 40 years and they have not prevented or restricted the amount of supermarkets that have been established over the last period of time.

MR O'DONOVAN: What do you mean by that last comment? Are you saying that you've never relied on one of these clauses?

MR KEMMLER: Your inference is that those clauses are preventing additional supermarkets. What we're finding since 2002, ALDI have opened up 167 supermarkets. The independents have opened quite a number of supermarkets. All of our competitors have opened a lot of supermarkets in that last 10-year period. Those clauses do not prevent supermarkets coming into a particular catchment. What they do is protect the particular trading environment that has been agreed with the landlord on a particular site.

MR LUSCOMBE: And in fact there are quite a number where existing operators in a centre other than us have got similar clauses but we're in there. What happens as a result of that would be the existing operator, one can never know, but in the – it hasn't prevented us from going in.

MR O'DONOVAN: As in the clause hasn't been enforced?

MR LUSCOMBE: I don't know whether the clause has been enforced or not with the other operator. What I'm saying is we're aware with certain shopping centres that there were restrictions of some sort or rental reviews, more appropriately termed, and we've been able to get in.

MR O'DONOVAN: Sure.

MR LUSCOMBE: So it hasn't prevented us from getting in.

MR O'DONOVAN: All right, but you'd agree that in terms of your power with landlords Woolworths is in a fortunate position compared to, say, independent supermarkets?

MR LUSCOMBE: Look, we've actually missed out on a number of sites that have gone to independents over the years. SO, you know, there was a wonderful site in Canberra Civic where the Conduras Group got that. We would have loved to have got in there but they beat us and they've – Conduras himself has beaten us on a number of occasions.

MR O'DONOVAN: Sure, but it's fair to say that is the exception and not the rule.

MR KEMMLER: I'd say that the retail property market is a highly competitive market and it's difficult to achieve sites and I'm not sure that we've got a particular advantage over anybody else. We have to work very hard to make sure that we win particular sites and we make certain – the comment I'd made is that of the 309 leases that we've issued to yourselves that have the particular competitor clauses that you're talking about, in less – it's only in 12 of those locations there is not significant competition in a three to five-kilometre radius.

MR O'DONOVAN: But in those 12 locations it is having an impact on competition.

MR KEMMLER: They're predominantly in country areas.

MR O'DONOVAN: Now, just in relation to your earlier comment that you don't think you've got a special advantage over anyone else, we've had evidence from developers, Colonial First State, yesterday and Westfield and they were both stating publicly that in terms of looking for anchor tenants Woolworths and Coles are effectively the only parties that they approach to anchor their sites. Do you disagree with that assessment and do you genuinely think that you can say that you don't have a significant advantage over every other tenant and prospective tenant in the grocery retail sector apart from Coles?

MR LUSCOMBE: That is their assessment. The likes of Westfield only make up – they're only our landlord in about four per cent of locations.

MR O'DONOVAN: Sure, that's a non-important proportion. The point they're making is that you enjoy a very substantial advantage in obtaining sites. From the landlords' perspective. You're a much more attractive tenant than an independent and the only other company that can match you is Coles. Do you accept that you have that advantage?

MR LUSCOMBE: I might just answer that. There is no doubt that – customers make their choice of stores for a whole host of reasons and I think even the Choice article and our own internal research and research I've read elsewhere basically says there are a whole host of reasons and price being one of the reasons why people choose to shop in a supermarket. The Woolworths package of convenience and fresh foods and prices and service and ambience and everything else that makes us successful has meant that our sales per square metre – in other words, the number of customers that come for a given square metre – are significantly higher than our competitors, generally speaking.

If I was putting a shopping centre together, what I want is as many people coming to this shopping centre as possible because that actually gives me the opportunity to actually successfully rent out the reset of the centre, particularly to specialties, to fashion, etcetera, because they rely on passing foot traffic in the large to be successful. So insofar as Woolworths has got a proven track record of being able to run a store that has more people visited in comparison to others, then I'd absolutely accept the fact that we are a preferred tenant on the basis that we actually bring value to the centre and bring value to the other retailers in the centre.

In regard to is that always the case, I'm sure that we can look back and we can find where in South Australia a couple of the Foodland guys have been preferred tenants, that in Western Australia people like Neville Garth with Advantage was a preferred tenant, that FAL with their Action stores – I query whether they're independent or part of a group – they were certainly preferred to us in Western Australia because of their local attraction. So it's not always the case that we just win hands – I mean, there's ample evidence that we miss out on a lot of property opportunities that we'd really love to get. You know, Canberra Civic Centre is a classic example where the Supabarn group won on merit.

MR O'DONOVAN: Just to take you back, and perhaps we can deal with this in short, you said earlier that you didn't think Woolworths had any special advantage in obtaining sites and I put it to you that that isn't the case and indeed your last answer explains that that is not the case.

MR LUSCOMBE: Exactly.

MR O'DONOVAN: Yes. So it is true that Woolworths does enjoy advantages, certainly over independent supermarkets, in terms of its ability to obtain sites.

MR LUSCOMBE: To generate traffic but not necessarily - - -

MR O'DONOVAN: I'm not saying it's not a legitimate or hard-won and it may be all of those things.

MR LUSCOMBE: I'd agree with you.

MR O'DONOVAN: Yes, but as a basic proposition and in terms of how easy it is for others to break into the market, it's safe to say that Woolworths does have an advantage over other people seeking to obtain access to sites.

MR LUSCOMBE: I would say from time to time various large centre owners, large centre groups had a view that they'd rather have one group rather than another, so, you know, I mean, for quite a while there was one particular group that preferred to have Coles because they could put a Coles in and get a Target and a K-Mart and a Myer at the same time, so it doesn't necessarily mean just because we're the best supermarket operator that we're necessarily going to win a supermarket site in a centre.

MR O'DONOVAN: Right. So in addition to these clauses which, I suppose, substantially reduce the rent for the landlord, or if a second alternative supermarket is added, you also have clauses which require landlords to object, make planning objections to the introduction of any competitor to an area, and presumably again, that is for the purpose of delaying or preventing the competitive entry on adjoining or nearby sites within your competitive area, that's why you've included them.

MR LUSCOMBE: It's to protect our investment, once again, and they'll only be successful if the application doesn't conform with the law.

MR O'DONOVAN: But the purpose is not to ensure that the planning goals are achieved, the purpose is to ensure that competitors of Woolworths don't enter that area.

MR LUSCOMBE: It's – the purpose is to protect our existing investment in that business.

MR O'DONOVAN: Sure, okay. Now, you also include first and last rights clauses, so that if another – if the landlord is going to offer a site to a supermarket, that he has to offer it to Woolworths first, he can shop the site around and then offer it back, then offers Woolworths the last right to come back, which again gives Woolworth's an opportunity to, I suppose, the last opportunity to ensure that it ties up – proves to be a valuable site.

MR KEMMLER: There are obviously some clauses like that in our leases that they are standard clauses within this search – in the industry for supermarket leases.

MR O'DONOVAN: Sure, all right. But the effect of it, again, is to allow Woolworths an opportunity to prevent competitive entry in that centre.

MR KEMMLER: You'll generally find that in a supermarket lease, there are first rights refusals for other businesses.

MR O'DONOVAN: For?

MR KEMMLER: Other businesses, such as if there was a petrol site to be vacated on that site, that we had a first right of refusal for the petrol site, generally not for another supermarket.

MR O'DONOVAN: Right, but going back a step, there are cases where there are first rights of refusal in relation to supermarket sites?

MR KEMMLER: There may be the odd one, yes.

MR O'DONOVAN: Yes, all right, and the purpose there is to block competitive entry into that centre?

MR LUSCOMBE: Not necessarily. If a new – if a new – I mean, once again, it's a site by site, if there's a new supermarket that's going to come in, and it actually ends up that the existing one is disadvantaged because of the reconfiguration of a car park, etcetera – your ability, because you've been in - investing in that centre for a period of time to get the – I guess, the pick of the sites, if it's going to be redeveloped is protected by that, but it doesn't actually – I think we've only got the two that I recall where we've got two in the same centre, and they were, you know, because we had Woolworths and Safeway here in Victoria at Karingal, I guess, is the centre, but already there's another supermarket in that particular centre, anyway, so it's now got three.

MR O'DONOVAN: Right, two of which are both - - -

MR LUSCOMBE: Yes, both Safeway, one at either end, yes. One was Woolworths, one was Safeway when we bought Safeway.

MR O'DONOVAN: Yes, but you agreed, from a competition point of view, that's an undesirable outcome, to have a supermarket – a suitable supermarket site in a centre that can sustain three supermarkets, where two of them are owned by a single operator?

MR LUSCOMBE: No, we think it's good competition, our company.

MR O'DONOVAN: So that Woolworths has two thirds and some other - - -

MR LUSCOMBE: No, the third one came in.

MR O'DONOVAN: Right, well, obviously it's better that the third one came in, but clearly it would be better if you ended up with three different supermarkets competition in the one centre, would you agree with that? Not from your point of view, but from a consumers - - -

MR LUSCOMBE: From a commercial point of view, I'd have to say – well, I honestly don't believe that, you know, once again, it gets back to why consumers shop in a particular shop. It's to do with convenience, so the location is not likely to change, it's do with the ambience, the car parking, a whole host of other things that may not change for that site, depending on who's tag is across the top of the door.

MR O'DONOVAN: Right, so you don't think the third offering a large format supermarket run by someone other than Woolworths would be good for competition?

MR LUSCOMBE: Well, only if they can deliver all of that and lower prices than Woolworths, other than that, they might go in and offer half of what Woolworths offers and higher prices, that can't be a better thing for the consumer.

MR O'DONOVAN: Sure, but if we take, say, Superbarn, which has taken the Canberra site - - -

MR LUSCOMBE: Well, I'd have no evidence to say that they're actually delivering better overall value and lower prices than Woolworths across the basket.

MR O'DONOVAN: Sure, okay, but it's - - -

MR LUSCOMBE: So in that case, maybe the consumer is worse off that we're not there .....

MR O'DONOVAN: Right, but – so generally you wouldn't accept the proposition that three supermarkets of different brands competing in the one centre is a better outcome than two Woolies and one Coles?

MR LUSCOMBE: Only if that one had a prudent track record of doing much better than we are, and there isn't one out there.

MR O'DONOVAN: All right. Now, then, moving back to petrol sites, you've indicated that sometimes you leverage – sometimes when you take out a lease, it's a condition of the lease that if there is a petrol site that's put on offer, that Woolworths gets first right of refusal on petrol sites, did I understand - - -

MR KEMMLER: There are – yes, in some leases, that is the case.

MR O'DONOVAN: Yes, all right. Now, my understanding is that Woolworths has done research in relation to this which they've provided to landlords to persuade landlords that you actually drive more traffic if you have a Woolworths supermarket and a Woolworths petrol station, and the same would be true if you had a Coles supermarket and a Coles petrol station, is that – have you seen research of that kind, or supplied research of that kind to landlords?

MR KEMMLER: I have seen research to that effect.

MR O'DONOVAN: Okay. So – have you supplied it to landlords in an effort to persuade them to give you these first and last rights of refusal in your leases?

MR KEMMLER: We have, I don't know if that's the persuasion, but we have advised landlords that the inclusion of the petrol business does, we think, have a positive impact on the supermarket sales.

MR O'DONOVAN: Sure, okay. So in terms of the way in which you're now negotiating your anchor tenancy in shopping malls, you're now able to leverage your – whatever influence or advantage that you have over landlords in that sector into obtaining petrol sites, would you agree with that?

MR KEMMLER: If there are some locations where the landlord has potential land for a petrol site, we offer to the landlord the opportunity to put our petrol site there, the landlord has a choice of whether he wants to put a Woolworths petrol site there, or another competing petrol site, that's the landlord's choice.

MR O'DONOVAN: Well, it may not be the landlord's choice if he's got a first right of refusal to Woolworths in respect of that site already containing the lease.

MR KEMMLER: At the time of doing the lease it is his choice whether he agrees to that clause.

MR O'DONOVAN: Sure. But then that – if he were to subsequently sell the property, the obligation to offer it to Woolworths would then go with the copy.

MR LUSCOMBE: Correct, that's protection of the lease, that's allowed under the law, yes.

MR O'DONOVAN: Okay. So we're now in a position where Woolworths, which we already understand has substantial advantages in obtaining sites in the first place, can now use that advantage to obtain sites in the grocery market, to also obtain sites in the petrol market. Is that correct?

MR KEMMLER: When we negotiate for a supermarket site, it generally happens over a long period of time, and the landlord makes a lot of representations to us about the training, and if he has a petrol site on his particular block of dirt, and he says, well, I'll give you that petrol site but not now, I'll get it to you at some point in the future, and we can't agree on the commercial terms then and there, we include a first right of refusal in the lease. So if he happens to sell that property to someone else, the commitments that he's made to us at the time of entering the lease, the only way that they're recorded is actually in the lease itself. Otherwise there's no way that that – those commitments and promises can be maintained in the future.

MR O'DONOVAN: Yes, I understand that, but that was not the question that I asked you. The question that I asked you is, is Woolworths, which you've said enjoys a substantial advantage in obtaining sites with landlords, now using the power that it has in that market to obtain additional sites in the petrol market. Is that – I suppose the question is, is it Woolworths policy, where it can, to use its power as an anchor tenant to obtain petrol sites?

MR KEMMLER: If there is an opportunity in a particular shopping centre, and we're the tenant in a shopping centre, we would much prefer to have our petrol station than say, a Coles aligned petrol station.

MR O'DONOVAN: All right, so it's fair to say that in leases where this opportunity exists, Woolworths pursues that opportunity.

MR KEMMLER: Yes, in those particular circumstances where those opportunities do exist.

MR LUSCOMBE: Of course, of course we do. So once again, we're in the business of growing our business and if we can get an opportunity to support our supermarket with a petrol offer, then we'll always attempt to do that.

MR O'DONOVAN: Right, okay. Now, in relation to – occasionally you do purchase sites or purchase supermarkets rather than develop them - - -

MR LUSCOMBE: I'm sorry, I was distracted for a moment, my apologies.

MR O'DONOVAN: That is all right. Occasionally you do buy either an existing supermarket that is there, an independent supermarket, or a particular site. The question I asked is whether it is any part of your considerations that by buying that site you can block competitive entry into an area you already have a Woolworths' supermarket?

MR LUSCOMBE: No, our primary consideration always is: is this a growth opportunity.

MR O'DONOVAN: No, I didn't ask you your primary consideration, I asked whether it was any consideration.

MR LUSCOMBE: Obviously, if you're trying to grow your sales, if you're there and someone else is not, it's going to be a positive outcome for your company.

MR O'DONOVAN: Yes. So it is a consideration in assessing whether or not you will buy a site?

MR LUSCOMBE: Yes, we'd rather be there - - -

MR O'DONOVAN: That it has the effect of blocking competitive entry.

MR LUSCOMBE: We'd rather be there than someone else, absolutely.

MR O'DONOVAN: Sure. So is it true to say that it can change a site which would be otherwise be unattractive, from a business point of view, in terms of what revenue can be made from it, into a site that you're willing to buy because it blocks competitive entry?

MR LUSCOMBE: In the long term we want to have a viable business there. So if we don't believe we can have a viable business over the 20 plus years that we're going to be there then it wouldn't get past the property committee.

MR O'DONOVAN: Are you saying that they wouldn't buy a site that didn't meet your, I suppose, performance benchmarks?

MR LUSCOMBE: Well, it depends on – you know, we do an initial assessment that might – that covers the first couple of years of the 20 years but we quite often have a long term view of a particular market area that goes past that first one so there might be the odd proposal that on face value, when you look at our hurdle rates, may not quite get to the hurdle rates. But we're there for the long run and if we believe that it's going to be a long term profitable business, that it will have more growth in the longer term, then we'll make the decision to invest in that particular property. But if we believe it's going to be a dead duck forever, well, we won't.

MR O'DONOVAN: Sure. But if it's marginal, so somewhere between those two, and it has the effect of blocking competitive entry - - -

MR LUSCOMBE: Well - - -

MR O'DONOVAN: - - - would you agree that you take it into account, the fact that it does block competitive entry, in deciding whether or not to proceed with the acquisition?

MR LUSCOMBE: Well, we'd always seek – we'd always take the view we'd rather be there. You know, whoever goes there – if it's marginal, it's marginal, whoever goes there is going to be marginal. We'd rather us be there than someone else because in the end, part of a large retailing business is economies of scale. So whilst, yes, you take into account the profitability and the investment in a particular store but you also need to take into account the economics of scale.

MR O'DONOVAN: Right. So and have you personally ever been persuaded that it was appropriate to proceed with an acquisition that was otherwise uncompetitive – sorry, otherwise didn't meet the financial benchmarks - - -

MR LUSCOMBE: In the long term, no, that I'm aware of.

MR O'DONOVAN: All right, but in the short term? So in the short term it did not meet the competitive – your performance benchmarks for a business but it had the additional benefit of blocking competitive entry?

MR LUSCOMBE: Yes. I think we can actually go into a lot more detail in camera but what I will say is the documents that you've got have got several layers of conservatism built into them that we're aware of, in terms of sales projections, fevered projections, etcetera, etcetera, etcetera. So even when something on paper appears to be on the borderline or even slightly negative, we can actually make a reasoned judgment that in 10 to 15 years we're going to have a good business there. That's – are we right every time? We're right most of the time. Can we guarantee that we're going to be right every time? Probably not but we make reasoned judgment on the basis that we understand the enate conservatism that's been put into those particular papers but in camera we can actually take you through how that conservatism manifests itself and why.

You know, the paper that you see, you'd probably look at it and go, "Well, you know, it's a seven-year assessment that has no terminal value in it", etcetera. So there's a whole host of things in there that we understand when we make the decision, the economics of it as opposed at the bit of paper that's there.

MR O'DONOVAN: Sure. But in answer to my question which was whether you had ever opted to acquire a site or a supermarket or a business - - -

MR LUSCOMBE: Yes.

MR O'DONOVAN: - - - that was not a dead duck but was marginal or below marginal for the purpose of blocking competitor entry?

MR LUSCOMBE: Not that I can recall.

MR O'DONOVAN: Okay. All right. Well, I think we will have a few more questions in the confidential session.

MR LUSCOMBE: Sure.

MR O'DONOVAN: All right. Now, the next issue I want to discuss is in relation to a – there's a Stocklands' development in Burleigh Heads. Now, who would be best to answer questions about that?

MR LUSCOMBE: Probably Ralph.

MR O'DONOVAN: All right. Now, that development – now, were you personally involved in the negotiations with Stocklands in relation to that development?

MR KEMMLER: I don't know exactly which particular negotiation you're talking about.

MR O'DONOVAN: All right.

MR KEMMLER: I'm not sure what documents you're referring to.

MR O'DONOVAN: Okay. Well, look, our understanding is that there's presently now a Stocklands in Burleigh Heads.

MR KEMMLER: That's correct.

MR O'DONOVAN: You know the development I'm talking about?

MR KEMMLER: Yes, I think that's the development Stocklands bought from the Shorts group.

MR O'DONOVAN: Right, okay, I don't think that's the – the evidence that we have indicates that Stocklands wish to develop a site in Burleigh Heads which currently contains a Woolworths.

MR KEMMLER: It currently contains – there was an existing Woolworths many, many years ago with some speciality shops. It was then expanded to include a Big W. At some point in time there was an ownership transfer to Stockland. Stockland, I understand, redeveloped the centre and relocated the Big W because they bought the adjoining hardware house, I think, from recollection, and relocated the Big W, expanded the mall, it was quite a long mall, and renegotiated the supermarket lease, and that's as much as I know about that particular development.

MR O'DONOVAN: Okay. So you weren't involved in the discussions renegotiating the lease that would allow the developments to proceed?

MR KEMMLER: I'm aware of those discussions, yes.

MR O'DONOVAN: All right. Who was involved in those discussions?

MR KEMMLER: The relevant property manager from the supermarkets at the time.

MR O'DONOVAN: Okay. You were not involved at the relevant time?

MR KEMMLER: At various points in time I'm aware of it, but I'm not sure exactly which discussions you're referring to.

MR O'DONOVAN: Well, I just want to find out whether you were involved in any discussions?

MR KEMMLER: Yes, I have been.

MR O'DONOVAN: All right. So you were personally involved in some of the discussions which occurred?

MR KEMMLER: Yes.

MR O'DONOVAN: Okay. Now, presumably Stocklands, in order to proceed with the redevelopment, had to obtain some concessions for Woolworths?

MR KEMMLER: They wanted to relocate the Big W.

MR O'DONOVAN: Yes, okay, which would have required Big Ws consent?

MR KEMMLER: Yes.

MR LUSCOMBE: Absolutely.

MR O'DONOVAN: Okay. Now, were you involved in those discussions?

MR KEMMLER: The Big W property manager looked after it but I'm aware of them.

MR O'DONOVAN: You're aware of those discussions?

MR KEMMLER: Yes.

MR O'DONOVAN: Okay, all right. Now, it has been indicated to us that ALDI was showing an interest in taking a lease in the redeveloped Stocklands' centre?

MR KEMMLER: I can't recall – I can't remember whether – I think there was – there might be a Franklins already in the centre as well, I can't recall.

MR O'DONOVAN: Sure. So either you're saying that you were never alerted to the possibility that there may be an ALDI in that centre?

MR KEMMLER: There may well be, I just – I can't recall that – those discussions.

MR O'DONOVAN: So what are you saying, you may have been told that there were talks going on with ALDI?

MR KEMMLER: No, no, my understanding is that you're talking about something that happened back in 2000 or 2001.

MR O'DONOVAN: No, this is much more recent than that, this is May 2005.

MR KEMMLER: The difficulty is I don't know exactly what you're referring to so I can't – I don't recall those conversations.

MR O'DONOVAN: No, let's not get ahead of – or ahead on what we don't recall. Just focus for a minute on whether you were ever told or whether you ever understood around about April '05 that ALDI were expressing an interest in going into that centre?

MR KEMMLER: I can't recall.

MR O'DONOVAN: You can't recall.

MR KEMMLER: My apologies, there are 777 supermarket sites around the country, I don't remember the intimate detail on exactly what's been discussed with various property managers around the country. I'm not trying to be illusive, I just don't recall a particular conversation about that particular centre. I don't get – I get involved at a fairly high level on some of the negotiations around the centre. I do recall a supermarket lease being renegotiated at the time of the Big W and the centre being redeveloped. I can't recall exactly when that was so the conversations you're talking about, I don't know whether they're part of the redevelopment of the centre or they're something close to the redevelopment of the centre. You're asking me something I can't put in context.

MR O'DONOVAN: Okay. Well, let's see if we can just follow through as what standard practice would require. If Woolworths is approached to give up its right to quiet enjoyment of a lease in order to facilitate an extension of that development and it is told that an ALDI is going into that extension, if Woolworths will allow it, who would normally have to deal with an issue of that kind? So giving up rights under a lease, that would have the effect of allowing a competitor into a centre. Who would normally deal with that?

MR KEMMLER: If there were changes to the commercial terms that are agreed on an existing lease, the property manager would negotiate that and it would need our property committee approval.

MR O'DONOVAN: To consent to that lease, that change?

MR KEMMLER: To consent to any changes to an existing lease.

MR O'DONOVAN: Okay. Are you on the property committee?

MR KEMMLER: Yes, I am.

MR O'DONOVAN: Okay. So if such a proposal were to be put to Woolworths, it would have gone to your committee?

MR KEMMLER: If there was a proposal agreed to that extent, yes.

MR O'DONOVAN: Okay. So we might be able to find documents which confirm whether or not you were on the committee at the time and whether such a proposal did go to that committee?

MR KEMMLER: Once again I'm not – you've got me at a disadvantage here because I don't know the context of what you're talking about. As I said before, I don't know whether the discussions about ALDI potentially coming into the centre or not were part of the renegotiation of the lease or it's something subsequent to the lease. At the time we were renegotiating the lease, there was certain plans and representations made by Stocklands in relation to how the centre would look. There was an assessment on what the implications of what the changes to the centre would be on the sales and there was a renegotiation of the lease that occurred at that particular time.

MR O'DONOVAN: Okay. You have a recollection of all of those details?

MR KEMMLER: I don't have a recollection of the details but I recall there being a new lease negotiated at that particular point in time.

MR O'DONOVAN: Okay. So did the landlord, as part of showing you the site plan, show you a site plan that had ALDI on it?

MR KEMMLER: I can't recall the detailed plan.

MR O'DONOVAN: Right. Okay. Now the documents that went to the committee, would they still be in existence?

MR KEMMLER: Yes, they would.

MR O'DONOVAN: Okay. All right.   So we can pursue this issue - - -

MR KEMMLER: Yes, we can.

MR O'DONOVAN: - - - through looking at documents. All right.   But we've completely exhausted your memory of the issue?

MR KEMMLER: Yes.

MR O'DONOVAN: Was there a touch of hesitation there?

MR KEMMLER: Once again, I don't know exactly what you're saying. I know that there's been a renegotiation of the lease and I know there was a relocation of the Big W but I don't know the context of what – what you're talking about, whether it was as part of that negotiation.

MR O'DONOVAN: Sure. As part of that, was there any discussion between you and the landlord about the presence of ALDI in the new centre?

MR KEMMLER: I can't recall.

MR O'DONOVAN: All right.   Now the next issue I want to discuss was the national vendor trading terms, which I think.

MR SAMUEL: Before we get off, sorry, are we off property?

MR O'DONOVAN: Yes, sorry.

MR SAMUEL: Right. I just want to test you with a few propositions because we've talked at length about restrictive covenants and leases. We've talked about objecting to new supermarkets or competitive retailers opening up in, you know, in certain areas and that would be lodging objections with planning authorities and the like. What would you say to the following propositions? I will take each in turn. The first is that there should be a prohibition – let me go back. The first is that any restrictive covenants contained in any of the leases you've got would no longer be enforceable after a certain date.

MR KEMMLER: The difficulty with that is that the commercial arrangements and the rents that we're paying and other supermarket operators pay do reflect the environment that's been agreed between the parties and the investment made by both the landlord and ourselves revolves around the deal that's actually been struck. So when a supermarket is developed, for instance, a landlord may pay somewhere between 5 and $10 million for the land. They may pay another 10 or $15 million to develop it. We'll put a significant amount of capital in as well. So you're talking about tens of millions of dollars that are invested around a particular set of circumstances that have been agreed between the parties.

MR SAMUEL: You'd agree, would you not, that there is a period of years during which that investment, if I can put it in these terms, I don't want to say is fully recouped but whereby the investment and a return on the investment is sufficiently rewarded by a restrictive covenant beyond which the restricted covenant ceases to be relevant to rewarding or providing adequate return on investment but starts to become an anti-competitive process.

MR LUSCOMBE: Chairman, we would go back and refurbish the store and typically the cost of refurbishing is actually the same as or in most cases more expensive than fitting out a new store. So if a new store costs us $3 and a half million to put the equipment in, when we go back and refurbish because we've got to do a lot of background work, it potentially can cost us 4 and a half to $5 million to refurbish a store and that gets done regularly during that 20 years.

MR SAMUEL: How regularly?

MR LUSCOMBE: Well, it depends on the store but if it's one that's a key store to us that's very busy and has a lot of customers, we might go back and do it every four years. In some cases even a little bit more frequently. We would go back and give it what we call a paint and paper but as a minimum, on average we would do it every seven years. There would be the odd store that's, you know, very well cared for in a country location where it might stretch to nine. There's been the odd ten but very rarely a ten because by then the refrigeration certainly needs to be updated. So along with that, during the course of the lease, we may invest in a liquor license. We may actually do further work to extend the store. There are a whole host of reasons why we would reinvest in that particular store over a period of 20 years.

MR SAMUEL: If I can take the four to seven-year time frame that you expressed in terms of the more usual practice, wouldn't you then concede that a requirement at law that a restrictive covenant should no longer be enforceable after, say, the expiration of five years, would be an appropriate means of giving you the ability to get a fair return on your investment, to make up your mind at the end of that five-year period whether you wanted to refurbish or not for whatever commercial reason might be the case, but not to have the advantage or the market power, if you like, associated with a continuous restrictive covenant running through a 20-year lease?

MR LUSCOMBE: We have to refurbish for a number of reasons. One, you know, for food safety. We also need to keep it up with the latest look and feel that is reflected in our advertising and I guess from our point of view, it’s a bit like when you buy a home. You know, you’d like to think that the zoning, you know, if you buy a house in Camberwell, that five years down the track that suddenly you don’t have a factory next door to your house, because you would say that the value of your house is going to continue to increase. We would say the value of our investment and our business should continue to increase, because we build up custom. We build up trust in that particular location. So our belief is, as you know, a home owner has the protection of zoning laws to say that you’re not going to end up with a sewerage farm next door, we should be able to protect our investment in that business over time and we’re going to continue to invest for the reasons that I’ve mentioned earlier.

MR SAMUEL: While you’re obviously committed towards protecting the investment, you understand that the ACCC is committed to protecting competition in the interests of consumers. So we may have a slightly conflicting objective but we can work that through.

MR LUSCOMBE: What we would say is that – and I think in camera we’ll be able to describe that we don’t actually believe that these rent review clauses have actually had the material effect of stopping people coming into centres where we are and in fact, as I’ve mentioned earlier, it hasn’t stopped us from time to time getting over.

MR SAMUEL: No, we’re well aware from evidence been given by Westfield and Colonial that, you know, certainly there’s been a relaxation to allow ALDI in but then I think we talked before about ALDI being a complementary rather than a competitive offering.

MR LUSCOMBE: I think there’s been an relaxation to allow us into some as well to be honest.

MR SAMUEL: Yes. We’ll talk a bit about that later on and what - - -

MR LUSCOMBE: In-camera if we can.

MR SAMUEL: Okay. Let me ask you, in terms of restricting your ability to object to the development of new sites, new fresh sites, that might provide a competitive retail offering. You know, that’s probably a different kettle of fish because you’re – it’s – well, you might be protecting your investment in an existing site. It’s not something that you’ve entered into or not an investment you’ve entered into on the basis that you've got some contractual arrangement with the local council to preventing this site being developed. I hope not anyway.

MR LUSCOMBE: I think, Chairman – correct me on the number, but I think over the last 5, actually, longer years we've only actually done it on 25 occasions – 23 occasion was it?

MS CASS-GOTTLEIB: Twenty-two.

MR LUSCOMBE: Twenty-two. In consideration of the number of competing retailers that would have opened over that period of time, it's a rare occurrence and it will only be successful if the application actually does conform to the law. If they conform to the law, they'll get the tick and they'll open.

MR SAMUEL: Okay. So - - -

MR LUSCOMBE: And we would only appeal if we believe they're trying to build something that doesn't conform to the laws – the same laws that we've had to conform to because if we ever tried to do something like that, we'd get plenty of appeals. On four occasions in Victoria of late, we've lost it and we haven't been able to develop the store.

MR SAMUEL: Yes, but lodging an objection then an appeal can often have a significant delaying impact though, can't it?

MR KEMMLER: The town planning process actually allows a period where particular developments are put on exhibition and calls for objections and you'll find that objections come from all sorts of parties, come from neighbours and as Michael has said, we objected on very, very few occasions. The three sites that Michael is referring to in Victoria are actually zoned sites for a particular use and the objections came in from the community and other - - -

MR LUSCOMBE: Other retailers.

MR KEMMLER: Other retailers and on zone sites, when it went through the court process, we actually were not able to develop on those particular sites.

MR LUSCOMBE: Churchill being one.

MR SAMUEL: Okay. Then the finally one, I just want to test with you hypothetically, is a requirement that any new lease and/or any new development that you are involved in in terms of opening up a new supermarket outlet would be subject to a competition test.

MR LUSCOMBE: Could you describe what the competition test would be - - -

MR SAMUEL: Yes. A similar competition test that we say would apply to the acquisition of an existing supermarket, which you are well aware are subject to competition tests under section 50. Just giving you a lot more work, Ms Cass-Gottleib, so - - -

MR LUSCOMBE: That's exactly the point that - - -

MS CASS-GOTTLEIB: That's the problem.

MR LUSCOMBE: My learned friend was saying. He said, we'd – it would add dramatically to the cost of everybody's application and eventually find its way into food. So it would not be something that we would – I hope that's not mine. Another learned friend. We think the present process that is there in principle clearly could do with some updating and some national uniformity but in terms of do we need to have a whole host of other tests that would need to be tested in court and subject to appeal, it would just add to the length of development and would actually add to the cost of that development which naturally is going to be recouped over time by whoever in this end of business, whether it's Woolworths or someone else.

MR SAMUEL: All right. Thank you.

MR O'DONOVAN: Okay. If you could just turn to document 10 in the set? Now that's the national vendor trading terms. Just ignore the - - -

MR LUSCOMBE: I'm having a little mechanical trouble here. I'm getting there. Right.

MR O'DONOVAN: Okay.

MR LUSCOMBE: Thank you.

MR O'DONOVAN: Now, just ignoring – ignoring the specific vendor but that – is that document the standard national vendor trading terms that Woolworths offers to people supply it?

MR LUSCOMBE: It looks to me to be the most recent one. Mr Dunn, is that correct?

MR DUNN: Yes. Yes, it is. I'm just looking to see if it's the complete document. Yes.

MR O'DONOVAN: All right. This is used in relation to the supply of fresh fruit and veg as well as any other products that Woolworths stocks?

MR LUSCOMBE: It's basically the basis of a trade – well, to do business with Woolworths, yes.

MR O'DONOVAN: Yes. So, sorry, just let's be clear, including growers – fresh fruit and veg growers and - - -

MR LUSCOMBE: Can I just double-check that? Is that the case, Stephen?

MR BATE: Yes, that is the case.

MR O'DONOVAN: Okay. All right. Now, if we go to clause 3 which is on the second page which is in relation to rejected goods and it says:

> *If at any time, whether after delivery of or payment for the goods and not withstanding our acceptance of the goods, we find that the goods do not meet the standards and requirements set out in these terms we may notify you that we have rejected the goods, return the rejected goods to you at your own cost and require you to replace or repair the rejected goods immediately at your own cost –*

and a few other consequences. The net effect is that that pretty much permits rejection of goods at any time and well after delivery of the goods and even after it's been through some kind of acceptance process by Woolworths. You'd agree with that?

MR LUSCOMBE: The practice is that it's typically on receipt.

MR O'DONOVAN: Sure. I know it's typically on receipt but in terms of what that provides, that does provide an opportunity for rejection significantly after receipt of the goods?

MR LUSCOMBE: Not being aware, but I would presume that that's provided – counsel? It does?

MS CASS-GOTTLEIB: Yes.

MR LUSCOMBE: It does.

MR O'DONOVAN: All right. So obviously in relation to fresh fruit and veg, which it can deteriorate dramatically in a relatively short period of time depending on how handled, this – at least in legal terms – provides an opportunity for Woolworths to return goods which had, in fact, deteriorated while in their possession and putting the loss effectively back on the grower.

MR LUSCOMBE: That would not be our practice.

MR O'DONOVAN: Let's not get ahead of ourselves.

MR LUSCOMBE: Sure.

MR O'DONOVAN: So the answer to my question is?

MR LUSCOMBE: Legally, as the words are there, that's correct. Yes.

MR O'DONOVAN: Yes. Okay. So that opportunity is there. Now you indicate that that's not your practice. Okay. Can you say that that's not ever occurred?

MR LUSCOMBE: Not to my knowledge.

MR O'DONOVAN: Right.

MR LUSCOMBE: Mr Bate would be - - -

MR BATE: In my five years in the job, I could not recall of one instance where that would have occurred.

MR O'DONOVAN: Okay. Now can you just explain your role and when – are you actually responsible for directing links with growers?

MR BATE: My role is the general manager of fresh foods so I have the overseeing role of that particular function.

MR O'DONOVAN: Okay. Now if a particular buyer in a particular DC behaved in this way, would it come to your attention – the sending goods back to a grower later than – having accepted them on arrival and held them in the DC for a few days and then sent them back. If he was doing it, would it come to your attention?

MR BATE: I would imagine so, yes.

MR O'DONOVAN: Right. Is there anything you specifically do to make sure this doesn't happen?

MR BATE: It's actually the job of quality control, so that's a separate function to the buyer. Those products are received and within hours of receipt they are measured against the specification. If there's a variance, they're photographed. That variance is emailed and also a telephone call to the grower or the supplier.

MR O'DONOVAN: Okay. So that's the standard practice?

MR BATE: Yes.

MR O'DONOVAN: Okay. What do you do to monitor whether there are deviations from that standard practice?

MR BATE: There's never been a complaint or any instance brought to our attention where that would have occurred, so - - -

MR O'DONOVAN: Sure. Okay. Now, in – are you aware of the existence of the Horticulture Code?

MR BATE: Yes.

MR O'DONOVAN: Okay. At present it doesn't apply to Woolworths as a retailer.

MR BATE: No.

MR O'DONOVAN: Now, if it actually requires that the trader specify the period in which the trader must notify the grower of rejection of the goods.

MR BATE: Yes.

MR O'DONOVAN: Okay? Now at present, looking at the terms that you have, there isn't that requirement.

MR BATE: No.

MR O'DONOVAN: It's only a matter of practice, as far as Woolworths is concerned. But if that requirement were to apply to you, that you did have to specify the time for rejection, what would be the time which Woolworths could comply with, if it were legally obliged to tell a grower the period in which it was going to reject its goods?

MR BATE: Well, in practice, currently, it's on the same receipt day, so, you know, we would be – I think the code, if I recollect is within 48 hours, 24 to 48 hours.

MR O'DONOVAN: Okay.

MR BATE: So we would be better than that practice.

MR O'DONOVAN: Right, okay. So from Woolworths point of view, if the Horticulture Code were to apply to it in relation to rejection of goods, while it may have to change its standard form, it would not have to change its actual practice in terms of its standards with growers?

MR BATE: In terms of rejection, no.

MR O'DONOVAN: No. Are there any other change – are there any other practices that would have to change if it were to apply?

MR BATE: If I understand the code correctly, there's also a dispute process that involves an industry export and so on, so – which is marginally different to the produce and grocery code of conduct which we've been a signatory to for, I think, eight or nine years.

MR O'DONOVAN: Right, so in practical terms, would you anticipate that would make much difference in practical terms, in your experience, under the Produce and Grocery Code?

MR BATE: I think the biggest issue is that it's the complexity of having to deal with two codes, and also the onerous task of administration and so on that goes with that when, I guess, in my experience, we've had only one dispute in my five years, go through to the ombudsman, and that wasn't a Woolworths supplier, so to us, you know, industry tells us, and our suppliers and industry bodies that I meet with regularly, which say that we're a best practice already, so it would effectively then two codes that we've got to comply with.

MR O'DONOVAN: All right. Now, the vendor trading terms also have a best buy requirement that Woolworths will always buy at the best possible price for quality, okay, I'm not sure who I should direct this question to, but in terms of – what are the consequences for a grower if it's discovered that they have not supplied Woolworths at the best possible price? Or firstly, are there examples of where that's happened?

MR BATE: I can't think of any, no.

MR O'DONOVAN: Right, okay, so in practice, that clause hasn't been brought to bear against a grower?

MR BATE: No, not that I'm aware of.

MR LUSCOMBE: Can I suggest that too is to do with products that are generic, so Corn Flakes, etcetera, from that particular vendor. In regards to fresh food, produce in particular, the buyer and the seller negotiate the price before it gets on the vehicle, to come to us, you know, before we receive it, and doesn't get changed, so we would consider that to be the best price for that particular load of product, because we've negotiated for that product at that time having regard for all the knowledge we have of the market and the quality at the time, etcetera. In regards to Kellogg's Corn Flakes, you know, basically what we're saying there is, we buy more Kellogg's Corn Flakes than anybody else, we would presume. We would hope that we'd buy at least at the best price that's available in the market place, that's the intent of that term, and it really doesn't have any effect in produce, because there's a separate negotiation on a regular basis for that sort of product.

MR O'DONOVAN: Sure, okay. So then, well, in the context of packaged groceries then, what is the consequence for a vendor if it's discovered that they have not supplied at the best price?

MR LUSCOMBE: Well, it hasn't happened, not that I can recall.

MR AYLEN: I can't recall an instance where we've been able to find that on a standard pricing, that a vendor has charged us a higher price than our competitors.

MR LUSCOMBE: Once again, because the price actually includes trading terms, we're not privy to anybody else's trading terms, so - and the list price typically in the marketplace is the same for everybody, it's actually the trading terms that may determine our best buy on it, so it's – because we're not in the offices of Tooronga or at Andrews Place at Metcash, you know, we don't actually have a view, but that particular phrase has been in Woolworths trading terms since, I don't know, before I started. Can you recall any particular time?

MR DUNN: Mid seventies, perhaps?

MR LUSCOMBE: Mid seventies, yes.

MR DUNN: It relates to buying at the best rack rate, at the best volume price. It doesn’t refer to buying at the best net price, the supply may well offer deals in the market place, or trading terms that are better to someone else, but generally, as Mr Luscombe says, suppliers have the same list price in the market anyway, and therefore it tends not to apply. When they choose to put their variations into the area of discount and into the trading of trading terms.

MR O’DONOVAN: So if a buyer was offering you the same wholesale price, but was in fact offering Coles or Metcash a larger percentage rebate, you wouldn’t regard that as a breach of this term?

MR DUNN: We wouldn’t know, and we certainly wouldn’t regard it as a breach of this term.

MR O’DONOVAN: Sure. Okay, now, the next issue is the one of – I think is what’s loosely described as predatory prices.

MR SAMUEL: Sorry, before you get off this one. If these terms are not relied upon, why don’t you just revise it?

MR LUSCOMBE: There may be occasion where we do have to rely on them, but to date we haven’t.

MR SAMUEL: Well, given that you’d accept that over the past five years, I think you indicated, you’ve never relied upon them, and that if you did rely upon them, and if you were subject to the horticulture code, you’d be in breach of the horticulture code, and given that there are some requests that you be subjected to the horticulture code, why don’t you just revise the contract to bring it into line with what would be regarded, at least under the horticulture code, as fair and reasonable?

MR LUSCOMBE: We’d take that under advisement, presumably.

MR O’DONOVAN: All right, now, an incident’s been brought to the inquiry’s attention by – I think it’s NARGA, is the organisation, and it related to some cataloguing done by Woolworths in the town of Cootamundra. Now, we indicated we were going to ask some questions about it, so - - -

MR LUSCOMBE: Can I suggest that I can give you – Mr O’Donovan, a brief overview of local marketing, but in terms of the individual elements of that, we can certainly go into great detail in camera.

MR O’DONOVAN: Sure.

MR LUSCOMBE: So basically what generally happens in the marketplace, not just Woolworths, but others, when a new store opens, or a store is relaunched as a refurbishment, typically it is relaunched with a catalogue by Woolworths or whoever else as, you know, built the new store, or refurbished the store, and they will typically offer for an extended period of time, usually about anywhere between four and eight weeks, depends on – sometimes a little bit longer, a range of products that are specials, that are probably, in fact, most cases cheaper than you'd typically see in the marketplace at that time for a certain number of products.

Likewise, when we open one, we would anticipate that the local competitors would also have some sort of special promotions in their – to protect their customer base, as we open – we relaunch a refurbishment, and they would typically have products that also would be sharper than the normal marketplace. In the case of this particular opening, it was to do with that same practice, and that is, you know, change of ownership, new phase, anticipate that there will be a marketing program, need to make sure that we match that as well, and we would do it a number of stores that we consider to be in the catchment area of that store or likely to attract customers because of the price into that new store. So it's a practice that is about maintaining your customer base, and it's a practice that has been going on for the 30 years that I've been in the business, by all players that I can recall.

MR O'DONOVAN: Sure.

MR LUSCOMBE: So it's not something that's peculiar, but in regards to the individual items and the question that you posed, we're more than happy to cover that off the camera.

MR O'DONOVAN: Okay, all right, but if I can just confirm the details specifically in relation to Cootamundra.

MR LUSCOMBE: Yes.

MR O'DONOVAN: The store, the IGA store, was refurbished, and in response to that, when it reopened after refurbishment, Woolies released a Cootamundra specific catalogue, is that right?

MR LUSCOMBE: Look, I haven't got the exact details.

MR AYLEN: That is correct.

MR O'DONOVAN: Okay. The Cootamundra specific catalogue contains specials which were, I suppose, more special than were available in the national catalogues or the state-based catalogues?

MR AYLEN: Yes.

MR O'DONOVAN: Okay. This special catalogue persisted for a period of six to eight weeks? Do we know how many weeks it went for?

MR AYLEN: Our records show that we ran a special activity for a four-week period.

MR O'DONOVAN: For a four-week period, okay, all right. That is standard practice to do special activity for a limited period?

MR AYLEN: Can we please discuss that on camera?

MR O'DONOVAN: Yes, sure, sure.

MR LUSCOMBE: One of the other things that is always difficult is to actually anticipate when something will open. Because these arrangements need to be made, because of printing and a whole list of other things, several weeks out so you have a best guess as to when someone might launch but quite often that moves a week or two. So sometimes you can be a week late, which is embarrassing, and sometimes you can be one or two weeks early, because for whatever reason the store opening or the relaunch has been put back because of building difficulties or whatever it may be. So there's not always a perfect timing between the two.

MR O'DONOVAN: Okay. Then that may explain a longer period of catalogue, is that what you're suggesting?

MR LUSCOMBE: It could be. You know, if you believe they're going to open on 1 June and you start – planned to have your catalogue start around about that time and they don't open to the third week of June, you actually have to extend the time so that you've got a sufficient period of time where you're giving the customer an alternative to what you anticipate will be the opening set of brochure promotions over an extended period of time before the new store.

MR O'DONOVAN: All right. The next area I wanted to cover was unit pricing.

MR LUSCOMBE: Yes.

MR O'DONOVAN: This may not be a question you want to answer publicly.

MR LUSCOMBE: No.

MR O'DONOVAN: But does Woolworths intend to implement unit pricing?

MR LUSCOMBE: Yes, we do, yes, we do.

MR O'DONOVAN: Okay. Does it support proposals to make it mandatory? So - - -

MR LUSCOMBE: We do. The only thing that we'd say, Mr Donovan and chairman, is that we anticipate the cost of doing it at about 4 million dollars. If however, we're given a 12-month period during which we would change our normal – our shelf labels as a result of planogram changes and price changes, etcetera, it won't be an additional cost. If however, we have to do it – a very short period of time, it will be an additional cost. The only other thing I'd say is that if there's some mandate on the size of the font and we have to change our shelf stripping, the capital cost alone of that will be some 7 million dollars – 6 to 7 million dollars plus the labour to actually change it all. So that would be something we wouldn't like to see flow through to the price of food.

So we support it. We've had it in the past, quite frankly, we had it in Safeway in Victoria until their legacy systems were closed down. We had a few, but not many, queries from customers when that actually happened. We've had it in New Zealand. I can't say that it's been seen as a positive thing for us versus the others but there is certainly a certain section of the community that have asked for it and as a result of that we started investment in changing our systems about nearly 12 months ago, to put a pilot store in place, and we now have that pilot store going through all the wrinkles. It'll be – so long as we keep it to the per hundred mil and the per hundred grams, if we get to, you know, per centimetre of rope or, you know, per metre or liquorice stick, something like that, then it'll be a nonsense.

The only other one that we're having a little difficult is with is on a – you know, if someone says it should be a per roll of toilet paper, then you've got different thickness and different number of sheets per roll, etcetera. So that will become an algorithmic nightmare. So if we just stick to, you know, per 100 mills, per 100 grams, then we think it'll be of benefit for those customers that really want it and we'd support it.

MR SAMUEL: Out of deference to the more maturing members of the community, have you got any idea what sort of minimum font you'll be looking at?

MR LUSCOMBE: Well, if - - -

MR SAMUEL: Given that I do remember the Safeway fonts and they were fairly small.

MR AYLEN: In fairness, Michael, with the test, I believe we're currently at nine.

MR SAMUEL: Yes.

MR AYLEN: Now, it could be 8, it could be 10, a bit like my eyesight, but I think we're bout 9 mill with the test at the moment.

MR LUSCOMBE: I'll be applying my own test, chairman.

MR SAMUEL: Well, if I could also be consulted in that, that would be helpful, thank you. All right.

MR O'DONOVAN: All right. That's it for the public session, I think.

MR SAMUEL: All right.

MR LUSCOMBE: Thank you, Mr Donovan.

MR SAMUEL: He might have finished but I don't think we have. Have you got anything?

MR MARTIN: I just wanted to follow up a bit on the horticulture side. We talked a bit about specifications. Sorry.

MR LUSCOMBE: Yes, sorry, chairman, could I just - - -

MR SAMUEL: Yes.

MR LUSCOMBE: Just to, if need, the additional information for Mr O'Donovan. On the Kooringal stores, within 3 to 5 kilometres of that particular centre there are 11 non-Woolworth supermarkets already in existence. So there is plenty of opportunity and competition in that area existing. Sorry.

MR MARTIN: Yes. Just looking at the horticulture produce and your arrangements with the suppliers or the growers, whatever format that is, in terms of setting price I think you said that you set the price before it is shipped or just to help us understand how price is set would be helpful, and how it relates to the wholesale market.

MR BATE: Sure. Each week, typically on Wednesday, we would receive quotes from all of our suppliers of that particular product to each of our buying officers, and we've got seven of those around the country. We'd have a look at those quotes. We'd either accept them or not or renegotiate, and that's based upon the buyer's experience, what's happening in the market, etcetera. Once we've agreed to that, we would then place what we call a programmed order, which is from Sunday through to the following Saturday, for deliveries at the agreed price on the quote and for the approximate quantities we want each day.

MR MARTIN: But can that price be renegotiated?

MR BATE: It can. Once Monday comes, we have a look at the market. If the market's moved substantially up or down, we would go back into a renegotiation but we can only renegotiate on product that hasn't left the particular site, so whether that's the market or the grower's premises.

MR MARTIN: So in terms of the code therefore, strictly in terms of the letter, of the way the horticulture code works - - -

MR BATE: Yes.

MR MARTIN: - - - which is reasonably inflexible on setting a price and sticking to it, you don't quite follow that process?

MR BATE: Sorry, I don't understand the question.

MR MARTIN: Well, under the horticulture code, upon delivery a price has got to be agreed and that's it.

MR BATE: The price is agreed prior to delivery.

MR MARTIN: Yes.

MR BATE: So it's agreed prior to it leaving the supplier.

MR MARTIN: But you said it can be renegotiated.

MR BATE: No.

MR LUSCOMBE: Only for future deliveries.

MR BATE: Only for future deliveries, not for what we've already received.

MR MARTIN: Okay. So which wouldn't have left the grower.

MR BATE: That's right.

MR MARTIN: Okay.

MR BATE: Yes, and we provide an electronic purchase order with price.

MR LUSCOMBE: So, commissioner, we would say that we're actually ahead of the code.

MR MARTIN: Yes. No, that was the impression we'd had, I just wanted to clarify that.

MR LUSCOMBE: The other - - -

MR MARTIN: So there's two ways then of looking at that, there's claims by some of the growing community everyone should be covered by the code. So you could say, "Well, because you do so well, it wouldn't matter if you were subject to the code." But on the other hand, why would you need to regulate someone who is doing well?

MR BATE: Yes, that's right.

MR LUSCOMBE: Commissioner, we're already a signatory to the other codes.

MR MARTIN: To the - - -

MR LUSCOMBE: So we just think having two would be - - -

MR MARTIN: Yes. Just one other question, you've mentioned, Mr Luscombe, the weighted average cost of capital targets.

MR LUSCOMBE: Yes.

MR MARTIN: Are they moved over time for Woolworths?

MR LUSCOMBE: Of recent months they've moved a little bit, yes.

MR MARTIN: Well, I meant over the years.

MR LUSCOMBE: The number that you see in the – this goes back to the inherent conservatism that we talked about, the number that you see noted in the document we provided as the WAK is not our WAK. Our actual WAK is substantially less than that.

MR MARTIN: Right.

MR LUSCOMBE: So that's where I was indicating that, you know, on the face of it, and that is to make sure that we – we have got so many opportunities to buy – invest right across the country, not just in supermarkets. We apply a very strict and high hurdle rate for the initial sorting out because there's only so many things we can physically do and it's a good sorting out to do. But that number that you see in the document is now our weighted – it's substantially lower than that, to be quite frank, and that's part of the conservatism that I referred to, to Mr O'Donovan, in saying, "Don't presume that what you see on a property document that says it's, you know, a non-goer." It's just part of that sorting out process.

MR MARTIN: Yes, it is the threshold.

MR LUSCOMBE: It's a very, very tough artificial hurdle, you might say, for investment. But that's just to make sure that we don't drown ourselves with more things than we can do in here.

MR SAMUEL: Go on?

MR MARTIN: Thanks.

MR SAMUEL: Okay. We will adjourn now, we will go into private session. We might just take 10 minutes break for a cup of coffee and then we can take the private session, it will take it through to the conclusion.

MR O'DONOVAN: Thank you, chairman.

MR SAMUEL: All right. Thank you. Thank you for members of the public and others that have attended but that will be the end of the public hearings for today, we're moving to a confidential session now.

ADJOURNED **[3.27 pm]**

RESUMED **[3.39 pm]**

CONTINUED IN TRANSCRIPT-IN-CONFIDENCE