

ACCC INQUIRY INTO THE PRICE OF UNLEADED PETROL

Public hearing – Melbourne, 7 September 2007

Time: 10am

Address: CQ Functions
123 Queen Street

Room: Conference room 6 (level 12)

Time	Witness	Submission
10am	Coles Group Mick McMahon, Chief Operating Officer, Coles Group. Mr Peter Short, General Manager, Coles Express.	30
	7 Eleven Mr Warren Wilmot, CEO. Mr John Pettit, National Fuels Manager.	

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TRANSCRIPT OF PROCEEDINGS

AUSTRALIAN COMPETITION

AND CONSUMER COMMISSION

MR GRAEME SAMUEL, Chairman

MR JOHN MARTIN, Commissioner

DR STEPHEN KING, Commissioner

PETROL PRICE INQUIRY HEARING

**CONDUCTED AT: CQ FUNCTIONS
MELBOURNE**

DATE: 10.00 AM, FRIDAY, 7 SEPTEMBER 2007

THE CHAIRPERSON: Good morning, ladies and gentlemen. My name is Graeme Samuel. I'm the Chairman of the Australian Competition and Consumer Commission and Chair of this public inquiry into the price of unleaded petrol. I am joined by Commissioner John Martin, on my right, and Commissioner Stephen King,
5 on my left. As Chair, I welcome you all and declare this hearing open.

The hearing is convened under part VIIA of the Trade Practices Act pursuant to the Federal Treasurer's approval for the ACCC to hold an inquiry into the price of unleaded petrol. The inquiry is well advanced and an immense amount of
10 documentary evidence has been provided to the ACCC. To date, the ACCC has received around 40 submissions. A vast amount of information has also been provided by major participants in the petrol industry in response to notices issued by the ACCC and, of course, information that has been obtained through public
15 hearings.

While all of this information is very useful, it is our view, and the advice of Senior Counsel, that further hearings will be required to enable the ACCC to inquire in more detail on a number of specific issues. This will involve the recall of some witnesses and calling evidence from new witnesses. For these reasons, I wrote to the Federal
20 Treasurer yesterday, 6 September, requesting an extension of time from the original reporting date in order to provide a rigorous and thorough examination of the emerging issues. The ACCC has requested an additional two months to complete the inquiry, with a view to submitting its report to the Treasurer by 15 December 2007.

The terms of reference for this inquiry have been published on the ACCC's website, together with an issues paper, and all public submissions that have been received. The ACCC has also published notes for witnesses at this inquiry which outline the procedures followed by the ACCC at public hearings. The names of the witnesses appearing today have also been published on the ACCC's website. If time permits
30 following the questioning of scheduled witnesses, I may invite others here today to give evidence. But as with scheduled witnesses, anyone planning on giving evidence to this inquiry will need to be sworn in and subject to questioning under oath.

We understand that the price of petrol is of immense concern to all Australian motorists, but the ACCC requests that in the interests of the efficient and effective
35 conduct of hearings, participants concentrate their remarks on the critical issues and not simply providing commentary on petrol prices.

Witnesses appearing today will be questioned by counsel assisting the ACCC. Counsel appearing today are Neil Young and Simon Marks of Senior Counsel, and
40 Fiona Forsyth. Some witnesses will also be represented by their own lawyers.

I would also note that the conduct of the inquiry is within the discretion of the inquiry Chair. Anyone using insulting language or otherwise disrupting the hearing
45 may be excluded. The ACCC may wish to question witnesses about information that has been provided on a confidential basis. The ACCC can take evidence in private if a witness objects to giving evidence of a confidential nature in public and the ACCC considers it appropriate to do so.

If this occurs, it may be necessary for all other persons to leave the room for parts of the hearing. The ACCC intends to hold hearings in public as far as possible but we do want to be able to ask witnesses about matters that are commercially sensitive. This means we may need to close the hearings at certain points. A transcript of this
5 hearing will be taken and made available on the ACCC's website as soon as possible after the hearing. Evidence given in private will be recorded and transcribed but are not be made available on the website.

10 With those matters dealt with, I propose by beginning to ask the witnesses from the Coles Group to, please, come forward to the table. If you could, for the record, state your name and position.

15 MR McMAHON: Good morning, first of all I am Mick McMahon Chief Operating Officer for Coles Retail.

MR SHORT: I'm Peter Short, general manager, Coles Express.

20 THE CHAIRPERSON: I see you have legal representatives with you today. Can they, please, announce their appearance?

MR BAXTER: Bob Baxter from Freehills.

MS PILGRIM: Elizabeth Pilgrim, solicitor, Coles Group.

25 THE CHAIRPERSON: I would like to inform you about some of the rules about giving evidence at this inquiry. Firstly, it is an offence to refuse to answer a question that you are required to answer by the inquiry Chair. Secondly, it is an offence to give evidence that you know is false or misleading or omits any matter or thing without which it is misleading. You may give your evidence under oath, or
30 affirmation if you believe an oath would not be binding or for religious reasons you are prevented from swearing an oath on the Bible.

35 <MICK McMAHON, AFFIRMED [10.09am]

<PETER SHORT, AFFIRMED

40 THE CHAIRPERSON: Mr Young?

MR YOUNG: Gentlemen, I will be asking questions that may at times go into areas that are commercially sensitive. I will try initially to ask questions that can be asked in open session. If you feel that you can't answer the question properly without
45 going into areas which are the subject of commercial confidentiality or sensitivity issues, please say so and we will reserve that line of questions for an in camera session at the end of the public session. But I will endeavour to cover, at least in general terms, many of the issues that this inquiry is concerned with in open session.

MR McMAHON: That's understood.

MR YOUNG: Thank you. I will ask first a few preliminary questions so that my questions and your answers have some context for the public listening.

5

Now, I will direct my questions initially to you, Mr McMahon, but if at any time, Mr Short, you feel that you are perhaps best placed to answer the question, please answer it, or you can pass the ball between yourselves, as you see fit.

10 Mr McMahon, is it correct that Coles Express was formed in 2003, following the development of an alliance between Coles and Shell?

MR McMAHON: Yes, that's correct.

15 MR YOUNG: Coles Express began operations progressively at different times in each of the states of Australia?

MR McMAHON: Yes, correct. From the time that we started up in Victoria, there was then a period of around 15 months from the time we started to the time we were fully operational in the country.

20

MR YOUNG: And Victoria was the first state where you commenced operations?

MR McMAHON: Correct.

25

MR YOUNG: At what date, roughly, was that?

MR SHORT: I can't recall.

30 MR YOUNG: Late 2003, early 2004?

MR SHORT: Middle of 2003.

MR YOUNG: Middle of 2003, and then progressively in other states and territories from then?

35

MR McMAHON: Correct, yes.

MR YOUNG: By what date had you commenced operations in all of the states and territories?

40

MR McMAHON: It was around 15 months later, 12 to 15 months later.

MR SHORT: The exact date I would have to refer to outside the hearing.

45

MR YOUNG: Yes, but progressively rolling out your operations over 12 months to 15 months from the middle of 2003?

MR McMAHON: Correct.

MR YOUNG: You have now 162 fuel and convenience stores and outlets?

5 MR McMAHON: That's correct.

MR YOUNG: Across all states and territories?

10 MR McMAHON: Correct.

MR YOUNG: With the largest numbers being in Victoria and New South Wales?

MR McMAHON: That's correct, yes.

15 MR YOUNG: In respect of the business done by way of selling fuel compared to convenience store sales, what's the relative proportion of sales or revenue between those two aspects of the business?

20 MR McMAHON: In terms of revenue it's around - we're increasing the percentage of C Store sales and revenue.

MR YOUNG: "C Store" is convenience store?

25 MR McMAHON: Convenience store, sorry. So from the start of the alliance, we were - probably around 60 per cent of our revenue came from fuel and around 40 per cent from the convenience store. That balance is changing over time as the convenience store increases in importance, to the point where we are getting closer to 50:50.

30 MR YOUNG: When did you introduce the shopper docket basic 4 cents per litre discount?

35 MR McMAHON: The 4 cents was introduced at the start of the alliance, so consistent with the timings that we outlined earlier.

MR YOUNG: Who was it within Coles who determined the amount of the basic shopper docket discount?

40 MR McMAHON: Specifically, that precedes my time. I have been in Coles only a little over two years. But the whole premise of the alliance - or the alliance was premised upon the 4 cent discount. At the time - if you want a little bit more background than that - at the time, Coles had a shareholder discount scheme which, if you like, was a narrow offer to a narrow segment of our customers, and the intent was to introduce a broad based scheme available to a wider segment of our customer base and offering more value to our customers overall. The 4 cents at the time was
45 simply taking a view of where the competition was and what would represent value to our customers.

MR YOUNG: Yes, but was it a decision of Coles Express or a decision of the board of Coles Limited?

MR McMAHON: A decision of the board of Coles Limited.

5

MR YOUNG: Because that was a decision that affected, in essence, all aspects of the business, supermarkets, liquor and so on as well as fuel?

MR McMAHON: Yes, correct.

10

MR YOUNG: I'm just looking to see whether this was regarded as a matter of confidentiality. The shopper docket program, to what extent is it a loyalty program to generate sales and increase volumes in the supermarket business or Office Works or those other businesses?

15

MR McMAHON: No, it's not confidential. I think we have been clear to the market in the objectives of Coles Express and in essence, we have dual objectives. The first objective is to act as a loyalty mechanism for the brands within the Coles Group, and certainly around supermarkets at the time, as a competitive response to what was happening in the marketplace. Our second objective is to be a profitable and growing business in our own right within Coles Express.

20

MR YOUNG: I will ask you many questions later and about shopper dockets. I'm just asking some general questions at the moment. I want to ask you about the pricing strategy adopted by Coles Express in relation to petrol. Could you explain the basic pricing strategy that Coles Express adopts?

25

MR McMAHON: Yes, in very summary form, our intent is to offer the best value prices to our customers that we can, consistent with what is occurring in the marketplace and making an economic return. In general, our policy consistent with that is to match competitors within a local market area. So rather than, if you like, a national approach, at the end of the day all retail is local and our pricing policy is to match local competitors within, if you like, the local catchment area.

30

MR YOUNG: If we take Victoria as an example, there is a price cycle in relation to petrol in Victoria that seems to be a fairly regular seven-day price cycle, correct?

35

MR McMAHON: There is certainly a weekly pattern to it, yes.

40

MR YOUNG: And by a price cycle, what I mean - and I'll get you to confirm this - is a process by which the price from the beginning of the seven-day period starts at a high and over the course of the seven days it cycles down to a low, which may be 10 cents, 14 cents, 15 cents lower than the initial price?

45

MR McMAHON: Yes, well, I think the price cycle is the outcome of the behaviour in the marketplace. But, yes, that's the observed behaviour.

MR YOUNG: At the end of seven days, the price will shoot back up to the top of the new cycle, correct?

5 MR McMAHON: That's generally the case. It's not always the case, as you would be aware.

MR YOUNG: There are odd exceptions but that seems to be the fairly usual pattern, correct?

10 MR McMAHON: Correct.

MR YOUNG: And in Victoria it appears that the price moves back up, usually, on a Wednesday; correct?

15 MR McMAHON: I think it's fair to say that at the moment the price moves up on a Wednesday. I think if you look back over time, the cycle has moved on different days. In some weeks it doesn't move but in general, yes, it's a Wednesday.

20 MR YOUNG: It's a Wednesday, and the low point of the cycle is generally a Monday or a Tuesday?

MR McMAHON: I would say a Tuesday or a Wednesday morning, but, yes, it's the middle of the week.

25 MR YOUNG: Is it invariably at 11 am on a Wednesday that Coles increases its price?

MR McMAHON: No.

30 MR YOUNG: No? Is it Wednesday morning?

MR McMAHON: No, it's not. Your question was is it invariably - no.

35 MR YOUNG: Well, is it usually a Wednesday morning that Coles raises its price?

MR McMAHON: I don't believe you can say that, no. It's often on a Wednesday. Usually on a Wednesday in Victoria at the moment for the reasons we have just explained.

40 MR YOUNG: Yes. All right. I have taken Victoria as an example. Is there a similar price cycle pattern in New South Wales?

45 MR McMAHON: Not in New South Wales, but in Sydney, yes, so I would differentiate, if you like, between the major metropolitan areas and regional areas.

MR YOUNG: So there is a usual and regular seven-day price cycle of the same description in Sydney; correct?

MR McMAHON: I think that's just a statement of fact.

MR YOUNG: Is it the same in Brisbane?

5 MR McMAHON: It is indeed.

MR YOUNG: Is it the same in Adelaide?

10 MR McMAHON: Pretty much.

MR YOUNG: Is it the same in Perth?

15 MR McMAHON: No, Perth varies. As you would be aware, there is a different regulatory regime in place in Perth.

MR YOUNG: Yes. In Perth the cycle tends to be a cycle of 14 days, correct?

MR McMAHON: Yes, I think you could say that, yes.

20 MR YOUNG: The pattern of price cycles in Perth moved from a regular seven-day cycle to a 14-day cycle after the Western Australian Government introduced regulations requiring petrol prices to be notified on one day and then held constant at that price on the next day?

25 MR McMAHON: Yes - is that a question?

MR YOUNG: Yes.

30 MR McMAHON: It is before my time so I can't comment.

MR YOUNG: Is that what you see happening now, that it's the impact of the 24-hour notification system that has caused a lengthened cycle in Perth?

35 MR McMAHON: I think that's the general view, yes.

MR YOUNG: Is that your view?

40 MR McMAHON: It is certainly our view that the Perth regulation affects the price cycle and our ability to price. More importantly, it restricts our ability to offer discounted prices to customers and, therefore, I think what you are getting is a shallower price cycle over a longer period of time, but probably not a much different outcome for customers.

45 MR YOUNG: Over a longer period of time, if we can be a bit more precise about that - the longer period of time is that it has stretched from, historically, a seven-day cycle to a 14-day cycle?

MR McMAHON: Again, I think that's broadly correct. I think the data would support that, yes.

5 MR YOUNG: And the shallower means that the amplitude, that is, the difference between the highs and lows, has shrunk in Perth?

MR McMAHON: Yes, I think that's just an observation of the facts.

10 MR YOUNG: So that the breadth or the span of the price cycle is less in Perth than it is in the other state capitals?

MR McMAHON: That's what we observe.

15 MR YOUNG: By how much is it less, as a span?

MR McMAHON: I don't have the data here with me in terms of the span.

20 MR YOUNG: Mr Short may be able to answer that. Mr Short, what's the difference in the breadth of the span in WA compared to the other states?

MR SHORT: In terms of amplitude, I would have to refer to data in a specific sense, but suffice to say it does not go quite as far in amplitude as the other states.

25 MR YOUNG: Well, is it in the order of 3 cents or 4 cents per litre difference?

MR McMAHON: I don't know. If you have the data there then - I suggest that's just something that the data will answer. I don't have that available here.

30 MR YOUNG: Mr Short, did you prepare something called a briefing note, presumably to the board of Coles, concerning this inquiry?

MR SHORT: I did.

35 MR YOUNG: It's document 4?

MR SHORT: Yes.

40 MR YOUNG: You can tell me if there is any confidentiality about it, but it doesn't seem to me it is because it is simply an observation of the general patterns in WA.

MR McMAHON: Yes.

MR YOUNG: But at question 4 in the table, there is an observation there.

45 MR SHORT: Yes, dampens price volatility by 2 cents to 3 cents per litre at both ends as competitors - and it goes on from there.

MR YOUNG: Yes. So your observations of the WA price cycle at the present time is that the regulation of intra day prices in WA has dampened price volatility by 2 cents to 3 cents per litre at both the peak of the cycle and the trough of the cycle?

5 MR SHORT: Yes, as I've said there, that's right, yes.

MR McMAHON: So we did have a look at that point in time and it was 2 cents to 3 cents at that point in time.

10 MR YOUNG: That point in time is the middle of this year, I take it?

MR McMAHON: Yes.

15 MR YOUNG: And that hasn't changed, has it, the span of the WA cycle?

MR McMAHON: I don't believe so. Again, I don't have the data in front of me but I don't believe so.

20 MR YOUNG: Coles' public submission observes that most retailers in Australia use what you describe as a high-low pricing strategy. I take it you include Coles in the users of a high-low pricing strategy?

25 MR McMAHON: I think that's just, again, an observed reality of the marketplace. For the reasons you have just been through, there is a price cycle. There are times when the price is higher and there are times when discounted prices are available to customers.

30 MR YOUNG: But this speaks of a high-low pricing strategy. What is the strategy that Coles adopts that involves highs and lows?

MR McMAHON: Our policy, as I said earlier, is to provide the best possible price to customers and, in general, to match the prices in the local area around the site. The outcome of that is the observed price cycle, which at times means that the prices are higher and at other times that discounted prices are available to our customers.

35 MR YOUNG: Doesn't it mean that you achieve your profit and margin objectives by pursuing a strategy of raising prices to a high and otherwise - at other points - pricing low, but the combination of the two you strategically control so that you achieve your overall desired levels of margin?

40 MR McMAHON: If I could just break perhaps that down into three components. First of all, our pricing policy is what I stated. The outcome of that behaviour in the marketplace is the cycle that you described. Secondly, we don't have a policy to drive high-low. We believe that it - while we believe that net net customers benefit from the price cycle, we know that a large percentage of our customers are, at best, confused by the price cycle and, at worst, concerned, because there may be times
45 when they need to fill up when the price is high. The final point though, to break it

into the - to take the third element of your question - is that the economic effect of that is that across a cycle we need to average a reasonable return, yes.

5 MR YOUNG: Surely you have budgets, don't you?

MR McMAHON: Yes, we do, indeed, have budgets.

10 MR YOUNG: You have budgets for the petrol business that require you to achieve - or under which you aim to achieve - a certain stipulated margin, correct?

MR McMAHON: Not so much stipulated but we have budgeted margin targets to achieve and in general - in general - we monitor that on a weekly basis. That's correct.

15 MR YOUNG: And the budgeted margins are monthly margins that you seek to achieve?

20 MR McMAHON: The reporting cycle is that we monitor on a weekly basis, so we have targets at a weekly level. We certainly report internally within the company on a monthly basis through the board level.

MR YOUNG: So you have weekly targets, do you?

25 MR McMAHON: Yes.

MR YOUNG: For margin in the petrol business?

MR McMAHON: Correct.

30 MR YOUNG: Do you have weekly targets for profit in the petrol business?

MR McMAHON: No, we have monthly targets for profit, although at the end of the day it comes down to you can divide by four and you have got the week.

35 MR YOUNG: I take it that the weekly target margin in your budget also translates into a monthly target margin and an annual gross margin?

MR McMAHON: Correct.

40 MR YOUNG: Correct?

MR McMAHON: Yes.

45 MR YOUNG: And from time to time, you review how you are going against budget on a weekly basis, a monthly basis and then year to date effectively?

MR McMAHON: Yes, correct. It is not, of course, the case that each week you will achieve your budget, but across time you will want to achieve your budget.

MR YOUNG: Well, with prices cycling between a high and a low on a weekly basis, isn't it correct that you need to target your pricing in a way that you achieve, by a combination of price and volume, your weekly budgeted margin?

5 MR McMAHON: That is - certainly our preferred outcome is to achieve our targeting income, but ...

MR YOUNG: Yes, go ahead if you want to add something.

10 MR McMAHON: I think perhaps - there is a sense perhaps behind the question that we're in control of the price cycle. We're not in control of the price cycle, so we're responding to competition on a local site basis, and across the course of a week usually, but sometimes longer in terms of price cycles, seeking to balance providing the best possible price to the customers with making an economic return in the way
15 that you have just described.

MR YOUNG: Who is in control of the price cycles?

MR McMAHON: I don't know. I'm not sure that anybody is in control of the price
20 cycles.

MR YOUNG: Let's just take Victoria as an example and the last two weeks' pricing. Are you able to say who has led the price up at the start of each cycle over the last two weeks in Melbourne? It's your job to track this, Mr Short.
25

MR SHORT: Absolutely, so the data is there through Price Watch. Last week Mobil in Melbourne led the price up. They chose a price point of \$1.31.9. Subsequent to that, the market came up and, again, you can see through what has happened in the back part of this week, a number of competitors have been very aggressive and the
30 price has gone down quite considerably as well.

MR YOUNG: And, presumably, the price moved up again yesterday or the day before?

35 MR SHORT: Yes, sorry, I was talking about this week, so this week - - -

MR YOUNG: You were talking about this week since Wednesday?

MR SHORT: Yes, so on Wednesday the price went up, and in this particular case in
40 Melbourne it was Mobil; and since Wednesday, we have been matching competitors as they have moved their prices downwards, which is our normal practice to remain competitive.

MR YOUNG: Yes. The previous week, if we take the previous week, which is the
45 last week of August, effectively, who led the price up that week?

MR SHORT: I think - as in - I would need to refer to some data - I think it was Mobil again last week, but I may be incorrect. I know it wasn't - I know we didn't lead the price up last week.

5 MR YOUNG: I'm looking at a chart for the week preceding that, even. I didn't want to turn this into a memory test for you, Mr Short. But in the week of 18 August to 25 August, the price was moved up by Mobil raising the price first, and then it appears to have been followed a little later by Coles Express.

10 MR SHORT: Yes, so - I believe Mobil, for the last few weeks, has in Melbourne, and certainly the question was who led it, and as I said, it was Mobil.

MR YOUNG: On occasions, Coles Express leads the price up, don't you?

15 MR SHORT: Yes.

MR YOUNG: It appears from the detailed price information that it's usually one of the major oil companies or Coles Express which leads the price up in Melbourne; do you agree with that?

20

MR SHORT: Yes, I would.

MR YOUNG: Sorry, you would?

25 MR SHORT: I would agree with that.

MR YOUNG: And why do you suppose it is that it's the major oil companies or Coles Express which leads the price up? What's their motivation in leading the price up?

30

MR McMAHON: Perhaps to come back to what we said earlier, we're trying to balance the best possible prices to the customers with making an economic return, and I don't think that would be any different for any of the players. While you have nominated some players and not others, I think it's true to say that all players in the marketplace at various points have either - seeking to move prices up, seeking to move them down, and in general we do that on a local competition basis.

35

MR YOUNG: Yes, but Mr Short is right, isn't he, when he says that it's usually the major oil companies or Coles Express which leads the price up at the start of the cycle?

40

MR McMAHON: If that's what he said. He has got the data, absolutely.

MR YOUNG: You agree, Mr Short?

45

MR SHORT: Yes.

MR YOUNG: That's not only the pattern in Melbourne but it's the pattern in the other capital cities as well?

MR SHORT: Yes.

5

MR YOUNG: Let's just take the case where Shell moves the price - sorry, where Coles moves the price up at the start of the weekly cycle. What are the factors that cause Coles to determine to move the price up, if you can try and identify the factors that might bear on that decision, Mr Short?

10

MR SHORT: Our choice to move the price up is a function of reviewing where we are against our targets and, as a result of that, that may cause us to take a decision to balance the overall aspects of our business, it's necessary to take that action.

15 MR YOUNG: So you review where you are against your targets?

MR SHORT: Yes.

MR YOUNG: What are the targets in question? Are they a weekly margin target or something else?

20

MR McMAHON: It's a combination of where we are travelling on a weekly and monthly basis.

25 MR YOUNG: Aside from the weekly and monthly margin targets, what other factors do you take into account in your decision to move the prices up?

30

MR McMAHON: I think maybe to give a little bit of context to this, in general we are driven by local competition and what's happening in the marketplace. I guess - -

MR YOUNG: I would like to pursue my example, Mr McMahon.

MR McMAHON: With Mr Short?

35

MR YOUNG: Yes. Mr Short you are the general manager responsible for pricing, correct?

MR SHORT: Correct.

40

MR YOUNG: You make the decision, in consultation with some subordinates, on a weekly basis to move prices up or, over the course of a week, move prices down, correct?

45 MR SHORT: Correct.

MR YOUNG: So this is your direct area of responsibility, correct?

MR SHORT: Correct.

MR YOUNG: So aside from monthly and weekly margins, targets that you take into
5 account in making a decision to move the prices up, what other factors do you have
regard to?

MR SHORT: We have regard to the current situation in terms of supply. We have
regard to the volume that we are putting through our network on any particular day.
10 We have regard to the relationship between fuel volume, customer traffic and our
shop sales, and we have a view to what has gone on in the marketplace in prior days
and possibly weeks.

MR YOUNG: Can I just take those factors one by one. In what way might the
supply situation, which I take it to mean the availability of fuel, impact on your
15 decision to move the prices up?

MR SHORT: The supply situation wouldn't impact on my decision to move prices
up, but the supply situation - if I was in a situation at a particular service station
where for reasons of supply may mean that that service station was going to be
20 running out of fuel, I may choose to hold my price where it was rather than move a
further cent down and continue to drive customer traffic.

MR YOUNG: But what about moving up, which is what I asked you about? If you
are short of supply at a particular location, would that shortness be any reason for not
25 moving the price up?

MR SHORT: No, we have - actually have a - my policy is that we will not deprive
our customers if we cannot supply a product to them and, therefore, we would
consciously not raise our price if we were in difficulty with supply.
30

MR YOUNG: But if there are no special problems about availability of supply - I
will start again. Is the only circumstance in which supply has a bearing on the
decision to move prices up the situation where there is some difficulty in getting
supplies at a particular location or to a particular group of sites?
35

MR SHORT: If there is a difficulty with supply, I would not compromise my
customer by putting prices up. I would - but if I did perceive at a particular site a
difficulty with supply, I may choose not to continue to compete head to head on it
40 further down.

MR YOUNG: So you basically would hold your price, rather than following prices
down - - -

MR SHORT: Certainly not as a policy - - -
45

MR YOUNG: - - - or moving them up?

MR SHORT: Certainly not as policy, but it would be one of the considerations I would be thinking about.

5 MR YOUNG: The second factor - additional factor - that you said you took into account was volumes through the network. In what way does that impact the decision by Coles to move the price back up to the top of the cycle?

10 MR SHORT: When you choose to move your price up, if you are the party that does so, that clearly impacts your sales volumes on a particular day. Therefore, depending how - how the business is performing across the multiple of things that make up the end result, like customer traffic shop sales, we may choose to either take the risk of losing some volume sales or equally not do so.

15 MR YOUNG: Whether you lose volume may depend on whether your move up is matched by other competitors; is that right?

MR SHORT: Certainly, yes.

20 MR YOUNG: Another factor you said might impact on - just before I go there, on volumes, does the volume you sell affect the price you have to pay Shell for fuel?

MR SHORT: No.

25 MR McMAHON: Sorry, I think can we just be a bit more specific with that response? In general, no, but from time to time our supplier may also be interested in moving volume or may have their own volume arrangement. So from time to time, they may be interested in moving volume and be willing to support a volume push, if I can put it that way. So around the edges then our commercial arrangements with our supplier may be affected by our position in the marketplace.

30 MR YOUNG: You may not be able to answer this in open session, Mr McMahan or Mr Short, but to pick up your last answer, Mr McMahan, are you speaking about a special one-off arrangement with the supplier?

35 MR McMAHON: We are happy to explore that but that would be in camera.

40 MR YOUNG: Yes, all right. If I can go back to you, Mr Short, the third additional factor you mentioned was the combination of fuel volumes and customer traffic through your shop. I wasn't sure whether you were speaking about the convenience stores or petrol. Can you explain what you mean by that factor and why it impacts on the decision to move price up?

45 MR SHORT: I was referring to, when I said "shop", to our convenience store, so our business is intimately linked between fuel, fuel margin, fuel customers who also purchase in the shop. We have an add on program where you could get a extra 2 cents if you purchase in the shop, so there is a strong business correlation in terms of our performance around the numbers of customers we have come through.

MR YOUNG: Are there any other factors that affect Coles' decision to move the price up at the start of the cycle?

5 MR SHORT: I think I have pretty much addressed the ones that I consider ...

MR YOUNG: All right. Of those factors, I suggest to you that the one of overriding importance is the desire to earn your targeted weekly or monthly margin.

10 MR SHORT: Yes, there is - the business is more complicated than just fuel and the fuel margin, and - - -

15 MR McMAHON: Can I answer that? I am the one who sets the parameters by which Peter and the team operate. In general, our strategy, as Peter has just outlined, is fuel - for Coles Express, leaving aside the mechanism across the other business, is that fuel is a traffic driver and our strategy is to convert as many of the customers who come for fuel to shop sales as possible. As we have provided to the Commission, and happy to explore again in camera, we are far more dependent, from an income perspective, on the C Store than we are on fuel, and therefore, the most important factor overall for us to maintain the traffic through the store and keep driving C Store sales.

MR YOUNG: You'd get more people through the store if you kept your price low rather than by raising it by 10 cents to 15 cents at the start of the cycle.

25 MR McMAHON: And that's why our overall strategy and our intent is to prove the lowest possible price to the customer.

30 MR YOUNG: I understand that, but I'm asking a particular question about the factors that lead to Coles on occasions increasing the price at the start of a cycle.

MR McMAHON: And we have covered that.

35 MR YOUNG: If you increase the price at the start of the cycle, that's not going to increase the number of people coming through the convenience store, is it?

MR McMAHON: Which is why we like to do it as infrequently as possible.

MR YOUNG: Once a week?

40 MR McMAHON: Sorry?

MR YOUNG: Once a week you raise the price.

45 MR McMAHON: In terms of - but we certainly don't lead once a week.

MR YOUNG: Once a week, whether you lead or follow, that's going to reduce the number of people coming through the convenience store?

MR McMAHON: That's correct.

MR YOUNG: So - - -

5 MR McMAHON: Sorry, let's just be clear. Our preference is not to lead, because that does reduce traffic. If we follow, in terms of local competition, then that has less of an impact on traffic and, hence, that's our much preferred position.

10 MR YOUNG: At the bottom of the cycle, Coles would be earning very thin margins, correct?

MR McMAHON: Yes, correct.

15 MR YOUNG: Indeed, margins that are so thin as to be well below your targeted margin if you stayed there, correct?

20 MR McMAHON: Yes, I think you are only describing the economic rationale. We need to balance providing the best possible price to customers with making a reasonable economic return. That's what we do.

MR YOUNG: When you move the price back up to the top of the cycle, you achieve much higher margins?

25 MR McMAHON: On much lower volume.

MR YOUNG: Yes, and the much higher margins on much lower volumes offset the higher volumes with the very thin margins at the bottom of the cycle?

30 MR McMAHON: Yes, I think that's just a description of reality, correct.

MR YOUNG: That's a description of why you raise the prices to the top of the cycle, too, isn't it?

35 MR McMAHON: Across a week, in this case, or across the price cycle, we need to balance volume, margin, customer traffic, shop sales - the factors that Peter has just been through.

40 MR YOUNG: Let me ask you about two other cities. Darwin - Mr Short, are you familiar with Darwin?

MR SHORT: Yes.

MR YOUNG: Do you make decisions about prices in Darwin?

45 MR SHORT: Yes.

MR YOUNG: How many competitors are there in Darwin?

MR SHORT: There are three - ourselves - three main ones and ourselves.

MR YOUNG: Three main ones - who are they?

5 MR SHORT: BP, United and Caltex.

MR YOUNG: And Caltex? So two major oil companies and a major independent chain in United?

10 MR SHORT: And Woolworths, sorry.

MR YOUNG: And Woolworths as well?

MR SHORT: Yes.

15

MR YOUNG: So, a supermarket competitor?

MR SHORT: Yes.

20 MR YOUNG: So plenty of hot competition amongst those players in the Darwin market, correct?

MR SHORT: Yes.

25 MR YOUNG: There is no price cycle in Darwin, is there?

MR SHORT: Prices do go up and down, not the same regularity as Melbourne.

30 MR YOUNG: They don't have anything like a cycle that has jumps of 10 or more cents per litre at the start of each week, do they?

MR SHORT: There are cases when the price does jump by 10 cents a litre.

35 MR YOUNG: It's not cyclical on a weekly cycle in the same way as in Melbourne, is it?

MR SHORT: No.

40 MR YOUNG: But you have just as much competition between those players in Darwin as in Melbourne, correct?

MR SHORT: I believe Darwin is a very competitive market.

45 MR YOUNG: So what explains the absence of a price cycle in Darwin?

MR McMAHON: Perhaps I can respond to that?

MR YOUNG: Well, no. Mr Short?

MR SHORT: The - as we were discussing earlier with Perth, Perth has a different characteristic. Darwin, as a different market again, it has a different characteristic as well, but prices do move and prices do go from low points to high points.

5 MR YOUNG: But that's not explaining the presence of the cycle in Melbourne and Sydney and the absence of a cycle in Darwin; is it your answer to me?

MR SHORT: My answer to that is we aim to be competitive. The reason for markets moving is a function of the decisions all the players in those markets take.
10 In Darwin, we aim to be competitive.

MR McMAHON: Would the Commission like me to seek to answer that?

MR YOUNG: In a moment I will give you a chance, Mr McMahon. But, Mr Short,
15 that's not an answer that addresses the question I asked you. You follow these markets closely. What is the difference - what are the different circumstances that explain the absence of a regular price cycle in Darwin compared to the other capital cities? Are there any different circumstances?

20 MR SHORT: No.

MR YOUNG: Well, then, if there are no different circumstances, why isn't Melbourne exactly like Darwin, with prices moving slightly up and down but no severe cyclical jumps week to week?
25

MR McMAHON: Can I - - -

MR YOUNG: Just one more question.

30 MR McMAHON: Well, I'm not - - -

MR YOUNG: Mr Short, just see if you can answer that.

MR SHORT: As I said earlier, each market, whether it's Darwin, whether it's a
35 regional country town, it has its own competitive profile. We have, as we've stated, have an intention to match competition wherever we operate. From there, whether markets go up and down on a daily, weekly, monthly or annual basis is a function of the decision makers in those markets.

40 MR YOUNG: Did you want to add something, Mr McMahon?

MR McMAHON: Thank you. We view Darwin and some other regional cities more
as regional areas, rather than major metropolitan areas. If you look at the market
characteristics of those markets, and I support what Peter has said, which is that our
45 behaviour in that marketplace is no different, in that we seek to match the prices of our competitors and we seek to balance the factors that we have just been through. Those markets, or markets such as Darwin - and I think this is well explored in previous Northern Territory Government inquiries and so on - have less liquid supply

arrangements, if I could put it that way. In general, a number of those regional areas are less reliant on shop sales, so they are less driven to drive customer traffic through the store, and in general, although not necessarily true for every store - in general, the regional areas have lower average throughputs of fuel, so that the competitive
5 dynamic is very different, for those market-driven reasons. Our customer proposition remains the same.

MR YOUNG: What do you mean by less liquid supplies in Darwin?

10 MR McMAHON: If you look at the price cycle and the intensity of it that you have described, you are characterising the behaviour in the major metropolitan - - -

MR YOUNG: Just answer my question. I asked you about what did you mean by less liquid supplies in Darwin.

15 MR McMAHON: That there is no refinery present in Darwin, unlike the capital cities.

MR YOUNG: There is a major import terminal, is it there not, owned by Vopac?
20

MR McMAHON: Yes, I understand that is the case.

MR YOUNG: So there is plenty of fuel coming into Darwin, isn't there? There is no shortage?
25

MR McMAHON: We do not have a shortage of fuel. You were asking for - the question you asked - - -

MR YOUNG: You said less liquid fuel supplies.
30

MR McMAHON: There are no refineries present in the Darwin market.

MR YOUNG: So why should that make a difference to the existence or nonexistence of the price cycle in Darwin?
35

MR McMAHON: I can't answer that question without giving you a little bit of context.

MR YOUNG: Why do you say that that makes a difference to the absence of a price cycle in Darwin?
40

MR McMAHON: Because this industry is characterised by very high fixed costs, not just in the retail end but back through the supply chain. In areas where refineries are local, where volumes are available, if you wish to pursue a volume strategy then
45 there is more incentive for the players to aggressively pursue volume than there is in some of the regional areas where the supply chain is longer, where the volume may be less flexible up and down, because you are waiting for imports on ships and so on. That is why I gave the answer that I gave.

MR YOUNG: Where do you get your supplies of fuel in Darwin? That is, where does Coles Express get them?

5 MR McMAHON: We purchase all our supplies via Shell.

MR YOUNG: Do you have any trouble getting the fuel you want from Shell in Darwin?

10 MR McMAHON: In general, no.

MR YOUNG: Where does Shell get its petrol from in Darwin to supply to you?

MR McMAHON: I think that's a question you'll have to ask Shell.

15 MR YOUNG: That's something you don't know?

MR McMAHON: Not off the top of my head, no.

MR YOUNG: Hobart doesn't have a price cycle, does it?

20

MR McMAHON: Correct.

MR YOUNG: And there are major competitors competing in the Hobart petrol market, aren't there?

25

MR McMAHON: Indeed.

MR YOUNG: The major oil companies are all there?

30 MR McMAHON: Yes.

MR YOUNG: And some major independents as well, correct?

MR McMAHON: Correct, yes.

35

MR YOUNG: And the supermarkets, Woolworths and Coles Express.

MR McMAHON: Correct.

40 MR YOUNG: So, plenty of competition in that market?

MR McMAHON: Yes.

MR YOUNG: And no cycle?

45

MR McMAHON: I wouldn't go so far as to say no cycle, but no cycle with the regularity and rhythm that you've described earlier.

MR YOUNG: Or the large peaks and troughs?

MR McMAHON: Correct.

5 MR YOUNG: There is no refinery in Darwin, is there?

MR McMAHON: No.

10 MR YOUNG: So supplies are obtained by importing petrol from refineries around the country?

MR McMAHON: Did you mean Hobart then?

15 MR YOUNG: In Hobart.

MR McMAHON: In Hobart, yes, correct.

20 MR YOUNG: I am sorry, I said Darwin. Let me go back to Melbourne, to give some concrete framework for this question. In relation to the price cycle in Melbourne, you have said that Coles' basic strategy is to match other prices, correct?

MR McMAHON: Yes.

25 MR YOUNG: Are there occasions when Coles leads the price down, in other words, undercuts everybody else and goes lower in Melbourne?

MR McMAHON: In general, no.

30 MR YOUNG: But on occasions, yes.

MR McMAHON: Well, I guess if we don't follow a cycle up then there will be times when we are pricing lower than our competitors, yes.

35 MR YOUNG: And that's happened, has it not?

MR McMAHON: Yes.

40 MR YOUNG: Mr Short may have more direct familiarity with this but I will ask it generally: There was a period in July 2007 where Coles kept the price down over a period of some three to four weeks; is that correct?

MR SHORT: Without answering the question, but to ask a question for clarification, do you mean Sydney?

45 MR YOUNG: I'm sorry, I mean Sydney, yes.

MR SHORT: So answering the question in Sydney, Coles didn't keep the price down on our own. We were matching competition.

MR YOUNG: Yes. How long was the period where the price by one player or another was maintained - the low ebb of the cycle?

5 MR SHORT: Sorry, I don't quite understand - - -

MR YOUNG: How long did the price stay down in Sydney in this period in July 2007?

10 MR SHORT: I think it missed two cycles and went up on the third week.

MR YOUNG: So we are roughly talking about a period of three weeks?

MR SHORT: Yes.

15 MR YOUNG: So, during that three weeks no player succeeded in moving the price back up, as normally occurs, by a magnitude of 10 or more cents at the start of the cycle; instead, it stayed down towards the bottom of the cycle for roughly three weeks?

20 MR SHORT: Yes.

MR YOUNG: What's your explanation as to the circumstances that led to that situation? In other words, there were no peaks for three weeks, the price didn't go back up in Sydney; it, broadly speaking, stayed down?

25

MR McMAHON: In that particular situation, my strategy was to continue to consistently match competitors and, if they moved, I would have then followed them. But some competitors did not move and therefore the price stayed down until the third week, at which stage it - I took a decision with some of my service stations to move up and, subsequent to that, the market came up. Again, as you would know from the data, the prices over that period were all over the place, depending which company you are looking at.

30

MR YOUNG: Was that situation you have described a Sydney-wide phenomenon?

35

MR SHORT: Yes, broadly across the city, yes.

MR YOUNG: So we are not talking about a few sites, we are talking about broadly across Sydney?

40

MR SHORT: Yes.

MR YOUNG: The data that we have seen seems to suggest that Coles Express, in fact, did not move the price up, although several other places, such as Mobil and Caltex and BP and 7 Eleven, amongst others, attempted to move the price up at each of those first couple of weeks, but Coles didn't move up. Does that accord with your recollection?

45

MR SHORT: Yes, and we were competing with some people that had not moved their prices up.

MR YOUNG: Who was that?

5

MR SHORT: There were a number of Mobil sites and there was a significant number of Woolworths sites.

MR YOUNG: Well - - -

10

MR SHORT: And there was a smattering of independents.

MR YOUNG: Some Mobil sites, some Woolworths sites and a smattering of independents. Mr Short, the data indicates that Mobil tried to move the price up and Coles stayed steady in the week of 7 July to 13 July; does that accord with your recollection?

15

MR SHORT: My recollection is that the sites that we compete with, there were sites that had not gone up, which therefore did not trigger me to take any action.

20

MR McMAHON: It might be the difference - if I can just assist - between an average comment versus individual sites. So there can be, at times, some competitors move some of their stores, whereas we are seeking to be competitive at a local, individual store level.

25

MR YOUNG: Could you tell me which particular sites you were concerned about in the week of 7 July to 13 July, Mr Short?

MR SHORT: Here I couldn't, but I could provide you data that either - data post this that could explain, given our competitive strategy, the stores that we were matching and therefore why we chose to continue matching them.

30

MR McMAHON: We don't apologise for providing competitive prices to our customers, which is what we were doing through that period in time. And as we have explained earlier, from time to time, we may be pursuing volume, market share, or seeking to drive our C Store sales and grow the customer foot traffic through our stores. So there is a sort of a sense to this, that - I'm not sure what the sense is, but we don't - - -

35

MR YOUNG: Don't worry about the sense of it. I'm just trying to get factual information from you gentlemen, all right? Mr Short, you have weekly meetings about setting prices, I take it from what you have said?

40

MR SHORT: Yes.

45

MR YOUNG: When in the week do they take place?

MR SHORT: Generally, on a Tuesday.

MR YOUNG: What decisions are taken in that meeting about the forthcoming seven days from the following day, Wednesday, right through until the following Tuesday?

5 MR SHORT: I believe this starts to move into the strategies that we consider and, therefore, the decision that would come from it, and I believe that would be more appropriately held in camera.

10 MR YOUNG: All right. I will take it up in camera, Mr Short. I will just ask another general question by way of feeler, as it were. Are you able to say anything about the way in which price support operates in the industry, in public session?

15 MR McMAHON: We can say, as we have in our submission, that price support exists. It's a mechanism, as we said earlier, given the high fixed costs, for people to ensure that they keep the volume moving through the system and allows us to match discounting - to provide discounted prices to our customers. I'm happy to go into further discussion on the detailed mechanisms in camera.

20 MR YOUNG: Generally, price support broadly across the industry rather than Coles Express, it seems to be a mechanism whereby the oil company supplier gives the franchisee a rebate, correct?

MR McMAHON: Yes, "price support" is the term, but it is effectively a rebate off the buy price.

25 MR YOUNG: Yes, and the oil company supplies that rebate to a franchisee as a matter of discretion, is the general picture in the industry?

30 MR McMAHON: Again, we aren't a franchisee, and so I can really only comment on our arrangements, but that would be my understanding, yes.

MR YOUNG: The purpose of the rebate, discretionary rebate, is to allow the franchisee to use the rebate to price lower in order to meet competition?

35 MR McMAHON: Correct.

MR YOUNG: I'm just getting the definition so people know what we're speaking about. Does Coles Express get price support?

40 MR McMAHON: Yes. As we have said in our submission, which is on the public record, we have and arrangements with Shell which include price support.

MR YOUNG: And the detail, I assume, you would prefer to address in private?

45 MR McMAHON: Yes, happy to talk the detail about how that works, but in general, the purpose is to allow us to be competitive and to provide discounted prices to customers.

MR YOUNG: Perhaps you can answer this for me, Mr Short, in open session. With so many outlets, more than 600, do you take pricing decisions affecting each of those outlets at your Tuesday meeting?

5 MR SHORT: Yes.

MR YOUNG: How do you communicate your pricing decisions to the various outlets?

10 MR SHORT: We have - I have a person whose full time job is to manage the implementation of the decisions that we take, and there is a number of sophisticated computing tools that enable that to happen.

15 MR YOUNG: And I assume, from what you have described generally about the price cycle, that one of the decisions you take at your Tuesday meeting is if and to what extent Coles Express is going to increase the price on the Wednesday at the start of a new cycle; is that right?

20 MR SHORT: Again, in public we will look at a variety of scenarios that might occur and discuss under those scenarios what our actions may be, and then depending what plays out, we follow whichever plan we have.

25 MR YOUNG: I didn't think I was asking anything confidential, Mr Short. I simply asked you whether at your Tuesday meetings you make decisions as to whether you are going to raise price on a Wednesday and, if so, to what extent. So, just that topic.

30 MR SHORT: So, the black and white answer to that is we would consider whether we would raise prices but that does not necessarily mean that we wouldn't make a decision on Wednesday that would be different to what we have discussed on Tuesday.

MR YOUNG: You might make a decision that in one state you are not going to move your price up, correct?

35 MR SHORT: Yes.

MR YOUNG: And in another state you may decide you are going to move your price up on a Wednesday, correct?

40 MR SHORT: In terms of being first?

MR YOUNG: Yes.

45 MR McMAHON: Yes.

MR YOUNG: If you make that decision, you would also make a decision about how much you were going to move the price up in that particular city, correct?

MR SHORT: Yes.

MR YOUNG: Having made a decision that you are going to move it up by so many cents, your man would then communicate to all those sites in that particular city the
5 instruction; is that right?

MR SHORT: It's done through computers and an interactive voice mechanism.

MR YOUNG: So, computer notification goes to each of your sites in that particular
10 city in my example, instructing each of the relevant sites to move the price up by a stipulated amount?

MR SHORT: It happens that there is no lead time involved in the communication. The way the system works is the site will be informed at the time that we want it to
15 happen and then they are to act on the instruction from that interaction. So there is not a series of phone calls and tomorrow afternoon at 3 o'clock, or anything like that. It's a - from a store manager's point of view or a store team member's point of view, the phone rings, they follow the instructions.

MR YOUNG: You are the senior person involved in these Tuesday meetings; is that
20 correct?

MR SHORT: Yes.

MR YOUNG: And you have the authority to make these decisions as to the raising of prices at the start of the cycle, or not raising prices at the start of the cycle, as the
25 case may be?

MR SHORT: I do.

MR YOUNG: I understand you make, though, a - is it a weekly report or a monthly
30 report to your managing director about what's happened in petrol pricing?

MR SHORT: We have our weekly meeting, yes.

MR YOUNG: A weekly meeting?
35

MR SHORT: Yes, a weekly report and we - the paper that we submitted in the -- to
40 your questions is a talking paper that submit to Mick, my manager, and we use that as the basis around which we have a discussion across the business.

MR YOUNG: But in this case, you are submitting a report directly to Mr Fletcher,
are you?

MR SHORT: No, that report goes to Mr McMahon, who is my manager.
45

MR YOUNG: That is why I asked the question. It is headed - and I think I can give the heading in open session - "Managing Director Weekly Performance Summary". It sounds like it is going to Mr Fletcher.

5 MR SHORT: Mick was the managing director and he has become the chief retail operating officer. Sorry, I haven't changed the heading on the page.

MR YOUNG: So, your title was managing director, Mr McMahon, and you are now the chief operating officer of Coles Express?

10

MR McMAHON: Correct.

MR SHORT: Coles Group.

15 MR YOUNG: Coles Group. What falls under your control, Mr McMahon, in terms of Coles Group? It sounds wider than Coles Express.

MR McMAHON: Yes, I'm responsible for Coles Express, for the Coles liquor group, and for the last six months or so, the Coles supermarkets, and in addition to that I have functions like marketing, property and so on under the chief operating officer role.

20

MR YOUNG: I see. How long have you been with Coles?

25 MR McMAHON: I have been with Coles two and a half years, for the first year with a singular focus on Coles Express, hence the managing director of Coles Express.

MR YOUNG: I'm going to move away from price cycles because other aspects that I wanted to pursue takes me into areas that you will say are confidential. I want to ask you about the shopper docket program, if I can call it that. Earlier you described it - either Mr McMahon or Mr Short, I forget which - as a loyalty program, and you explained the origins of the 4 cent figure as a Coles Limited board decision. Can you explain in open session the objectives that the public company, Coles Limited, seeks to achieve through the offer of the shopper docket discount?

30

35

MR McMAHON: Yes, happy to do so, because it's in the marketplace. Our first objective was to respond to a competitive offer that was already out there.

MR YOUNG: Are you referring to a Woolworths discount offer of 2 cents, I think it was.

40

MR McMAHON: Yes, it was 2 cents at that point in time. If you will just remember that I wasn't here at the time, but this is my understanding of the history, is that when Coles announced the removal of its shareholder discount scheme, our competitor increased - somewhere in that time line - increased from 2 cents to 4 cents.

45

Therefore, the premise of Coles Express - that Coles Express was based around offering a 4 cent discount to customers, because that was both where the market was

at and, secondly, our own research indicated that while you would get a certain effect at 2 cents, you would get a much stronger effect at 4 cents.

5 The effect that was being looked for was to provide greater value to our customers, in particular in supermarkets but across - but available to a number of the Coles Group brands. That's, in essence, how it played out, and the Coles - and the secondary objective was to say that if we were going to provide that then our preference was to participate in the fuel and convenience business so that, if you like, you could manage both ends of that equation.

10 MR YOUNG: What's the objective of offering the shopper docket? Is it to drive supermarket sales volumes?

15 MR McMAHON: Yes, it's to reward our loyal customers and to drive supermarket sales, but also available to our liquor businesses and so on.

MR YOUNG: When you say it's to award your loyal customers, you are referring to the customers of Coles supermarkets, Office Works, K Mart, liquor stores, et cetera?

20 MR McMAHON: Yes, correct.

MR YOUNG: From time to time, you have special promotions in addition to the basic 4 cent a litre shopper docket discount.

25 MR McMAHON: Correct.

MR YOUNG: Who determines to run those?

30 MR McMAHON: The people responsible for those individual brands, so - - -

MR YOUNG: Meaning K Mart, or Office Works or whatever?

35 MR McMAHON: Correct. So the managing director of those individual brands would, in conjunction with their marketing and merchandise people, decide what the promotional program is for the coming period, and whether it contains fuel or whether it's some other form of promotion.

40 MR YOUNG: But the objective of the promotion initiated by that K Mart brand or Office Works brand is to drive additional sales volumes at Office Works or K Mart, et cetera?

MR McMAHON: Correct. Correct.

45 MR YOUNG: That being the objective of these discounts, who bears the cost of it within the Coles Group?

MR McMAHON: We have on the public record the fact that Coles - if I can deal with the base and then differentiate the differential - or the periodic promotions. So

we have publicly stated that Coles Express funds 1 cent of the 4 cent base discount and the initiating brand pays the other 3 cents, so in the main, the supermarkets. And if a brand chooses to run a promotion over and above that then they also fund the incremental cost of that promotion.

5

MR YOUNG: The whole of it?

MR McMAHON: The 1 cent still applies, but anything other than the 1 cent is funded by the initiating brand.

10

MR YOUNG: So let's assume there is the 4 cent basic discount, then there is a special promotion by Office Works with a 10c discount offer. So, all in all, it's 14c combined discount during that promotion period. What portion of the 14c would ordinarily be borne by Coles Express?

15

MR McMAHON: Still 1 cent.

MR YOUNG: Just 1 cent?

20

MR McMAHON: Correct.

MR YOUNG: Not 2 cents? It is not an additional 1 cent out of a special promotion?

MR McMAHON: No.

25

MR YOUNG: I assume Coles treats that as, accounting-wise, as, what, a cost of goods sold or something like that, the 1 cent?

30

MR McMAHON: No, for Coles Express it is treated as a marketing cost, but equally for the initiating brand, the choices made are being made, between do I invest in a fuel promotion, do I invest in a stronger catalogue for that week, do I invest more in TV advertising and so on, so it's treated as a marketing expense.

35

MR YOUNG: And you get a credit effectively across from the other brand - - -

MR McMAHON: For the 1 cent.

MR YOUNG: - - - which you record in your accounts?

40

MR McMAHON: Correct, that's right.

MR YOUNG: And you record it as a credit to your cost of goods sold, so it reduces the cost of the goods that you sell; is that right?

45

MR McMAHON: No, it simply balances out the discount cost.

MR YOUNG: As to the basic discount, let me go back to the basic discount, of 4 cents per litre, that discount means that, leaving aside Woolworths and major oil

companies, you are in a position, because of the financial support from other Coles brands like the supermarkets and Office Works, to offer prices that it's very difficult for independents out there in the marketplace to match; do you agree with that?

5 MR McMAHON: Well, we are obviously primarily concerned with the prices that we can offer.

MR YOUNG: Yes.

10 MR McMAHON: I think it is true that say that it would be difficult for an independent to match but I would also say I think there has been an incredible amount of innovation in this space over the time that we have been offering that discount. So I don't think all competitors have struggled to match. Some have found ways.

15 MR YOUNG: Are you able to say in open session anything about the extent to which people who buy fuel present discount vouchers for credit? In other words, to what extent of your volume are sales in which there is a redemption of a shopper docket voucher?

20 MR McMAHON: I'm happy to give specific percentages in camera, but in general - -

MR YOUNG: Yes, broadly speaking.

25 MR McMAHON: Broadly speaking it's a very, very popular scheme and we have something like 4 million customers a week who present a docket.

MR YOUNG: Can I just go back and clarify one thing. When you said that the 3
30 cents of the 4 cents is funded by the K Mart or Office Works or whoever which is initiating or getting the benefit of that promotion, within the company is there actually a charge that you levy against supermarkets, say, in respect of the 3 cents?

MR McMAHON: Well, there is effectively a charge in that what occurs is that Coles
35 Express redeems the dockets, we accrue that expense, if you like, and then we charge the other brand for the effectively 3 cents.

MR YOUNG: So in your accounts you will see effectively a charge to supermarkets
40 and your accounts will record a credit, a reimbursement of 3 cents?

MR McMAHON: Yes, but it will be at the gross level, obviously, but that's correct.

MR YOUNG: In relation to the basic docket, as distinct from a special promotion
45 when you can track it back to one brand, the 3 cents of the 4 cents that is borne elsewhere than Coles Express, who do you charge with that? Is it Coles Limited or Coles supermarkets or - - -

MR McMAHON: Well, without going into the company structure, it is effectively the brand, such as Coles supermarkets will incur the costs for that 3 cents and Coles supermarkets treat it as a marketing expense, as we do other marketing expenses like Fly Buys loyalty and advertising cost of the catalogues.

5

MR YOUNG: All right. Bear with me, I'm just seeing what I can sensibly ask without requiring access to confidential material. Have you seen a change in the way in which competitors seek to compete with Coles, in that with the basic 4 cent shopper docket discount, combined with the board price, the combined price ends up being very attractive - has that caused a discernible change in the competitive response from, for instance, major independent chains?

10

MR McMAHON: Yes, I think we would say that almost every player has found some way to respond to the 4 cents. As you would be aware, some of the major players have a 4 cent discount if you purchase in the store. Some have a 5 per cent discount if you purchase on a branded credit card. Others have formed alliance with IGA or smaller supermarket chains, and still others of the independents have used, for instance, ethanol-blended fuel as a way to get a cheaper price on the board of the order of 4 cent cheaper than unleaded. In addition to that, Peter just reminds me that there are also some schemes out there, like BEEP, who independently seek to provide a mechanism for independent retailers to provide a fuel discount to customers.

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MR YOUNG: Do you consider that at the moment Coles Express has been financially successful?

25

MR McMAHON: Yes.

MR YOUNG: Is your plan or expectation that the financial success of Coles Express is going to not only continue but improve?

30

MR McMAHON: Absolutely.

MR YOUNG: Do you have plans to expand the network of outlets?

35

MR McMAHON: Yes.

MR YOUNG: I won't ask you for the details, but - - -

MR McMAHON: In general, we do. Again, we report those numbers to the market so I can comment on history, which is that over the life of the alliance, our total network size has stayed reasonably static, but there has been quite a lot of churn within that, so a number of closures under a number of openings.

40

MR YOUNG: Is that a question of trying to find sites that are better located and where the facilities are better than the sites you are closing?

45

MR McMAHON: Yes, correct. They could be as simple as simple roadworks changes, but in the main, the network we inherited was - developed a particular customer proposition in mind and we are seeking, with that network, to better support the Coles brand.

5

MR YOUNG: Is it the case that the price cycle in the major capital cities has been an important contributor to Coles Express' financial success?

MR McMAHON: No, I think that is certainly a factor. It's one that we have to manage every day, and we end up investing in systems and complexity to manage it. But I don't believe that the cycle itself ends up positive or negative in terms of the economics, because of the reasons we have outlined earlier, where you are seeking to achieve a balance between what we can offer our customers and ensuring we get an economic return through the cycle.

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15

MR YOUNG: You are trying to derive a profit by managing a combination of volumes and price - - -

MR McMAHON: Correct.

20

MR YOUNG: - - - at the high end and the low end of the cycle and through the cycle, correct?

MR McMAHON: Correct.

25

MR YOUNG: So, effectively, to the extent you lose margin in the bottom of the cycle you are trying to retrieve it at the top of the cycle?

MR McMAHON: That's the other way to say that we try to get an average through the cycle, yes. I think in terms of have we derived a benefit, certainly it impacts on our business. We have times when our forecourts are very congested, and other times when we have spare capacity. So I would say that - as I say, the economic impact may average out, but certainly the price cycle is a dominant factor in the way we have to manage our business.

30
35

MR YOUNG: It is true, is it not, that in Melbourne and other capitals in recent times, the amplitude of the price cycle, the difference between the peaks and troughs, has grown?

MR McMAHON: I believe that's the fact.

MR YOUNG: That's the case?

MR McMAHON: I believe so.

40
45

MR YOUNG: What, roughly speaking - and Mr Short may have a perspective on this - what is the common differential between the top of the cycle and the bottom of

the cycle? I know it varies from state to state and capital to capital, but what sort of order is it?

5 MR SHORT: Again, I have to speak generally but probably in the 15 cent, 16 cent range.

MR YOUNG: So, the difference between the price on Tuesday, if we assume a price change on the Wednesday is 15 cents to 16 cents from the close of business on Tuesday to close of business on Wednesday?

10 MR SHORT: Yes.

MR McMAHON: That's probably the highest.

15 MR YOUNG: There is one proposition in your public submission I wanted to take up. I don't know if you have it available to you, gentlemen. It's at page 7, third paragraph. It is the statement that Coles Express' experience of fuel sales across the price cycle is that over 50 per cent of fuel is sold below the average cycle price; do you see that?

20 MR McMAHON: I can't find the exact paragraph, but that's correct, yes.

MR YOUNG: Page 7, third paragraph, first sentence.

25 MR McMAHON: We might have a different ...

MR YOUNG: It's under the heading "Price Support and Discount Cycles".

30 MR McMAHON: Anyway, I recognise the statement.

MR YOUNG: You recognise the statement?

MR McMAHON: Yes, that's right.

35 MR YOUNG: I know it's been made publicly.

MR McMAHON: Correct.

40 MR YOUNG: I wanted to ask you about that, because of this: In order to know whether the price cycle benefits consumers or harms them, you really need to know precisely how much volume is sold at each price point between the peak of the cycle and the bottom of the cycle, don't you?

45 MR McMAHON: If you want to know the economic impact on customers, yes.

MR YOUNG: Whether consumers are financially better off or not as a group would require you to know how much volume is sold at each price point between the top of the cycle and the bottom of the cycle?

MR McMAHON: Yes, well, we at least look at that on a daily basis.

MR YOUNG: But simply saying that 50 per cent of fuel is sold below the average cycle price doesn't convey much information, does it?

5

MR McMAHON: I understand that - that's a statement of fact. Perhaps I can say it this way: The cycle, as a minimum, gives customers a choice. There are certainly those who choose to buy at the bottom of the cycle and there are those who prefer to avoid the congestion and buy some other time. I am not advocating a price cycle by any means, because we believe that net net, it's disruptive for customers and for our business. But we nonetheless think, from what we can see, that customers benefit from the price cycle. If we look at where the weight of volume is sold, it is sold at the bottom of the cycle rather than the top of the cycle.

10

MR YOUNG: If your business is going well and your fuel financial profitability is on the increase, that would suggest that the price cycle is not benefiting consumers, wouldn't it?

15

MR McMAHON: No, it would not, because implicit in your statement is that you are focused on fuel rather than the store. Again, we are happy to go into more detail in camera and we have provided a more detailed breakdown to the commission, but our strategy is to grow the C Store, convenience store sales and margins through converting the foot traffic that comes with fuel. It's not necessarily to grow our income from fuel but we don't intend to make a loss, either.

20

25

MR YOUNG: But if we leave aside the profits and the margin you get from the convenience store - and I understand what you say - the fuel business is profitable for Coles, is it not?

MR McMAHON: The fuel business is certainly profitable for Coles. I think on any retail measure - and again, there are not too many fuel retailers in this country who report results publicly to the market; we are one of these very few, and each six months we report our profitability to the market. I think, on any measure, the EBIT margin earned in the fuel retail business is low, both by Australian retail standards and by global standards for fuel retailing.

30

35

MR YOUNG: And for fuel retailing, the return on investments is not low, is it?

MR McMAHON: For fuel retailing, the return on investment - sorry, I'm just trying to understand your question. We again report to the market that we make, at an EBIT level, a return on investment in the low 20 per cents, which we would consider an adequate return on our capital, but that is an average, again, between what you earn on fuel and what you generate from the C Store.

40

MR YOUNG: Yes, but do you calculate your internal rate of return on your fuel retailing assets?

45

MR McMAHON: We have attempted to do - we don't do that in the normal course of business. We have provided that information to the Commission. We are happy to go through it in camera.

5 MR YOUNG: I just want to get at the problem - it is sometimes said that the supermarkets use fuel as, effectively, a loss leader, in other words, they are losing money on fuel retailing per se, in order to generate sales in the supermarkets - - -

MR McMAHON: Yes, well, there are a lot of - - -

10

MR YOUNG: - - - and they are subsidising that by raising grocery prices. But what I am putting that to you is that if you isolate your fuel retailing business, I'm suggesting to you it's not a loss leader; you don't make losses in it, correct?

15 MR McMAHON: I'm happy to agree with that. So let's be absolutely clear - that's why I set out at the start by saying what our commercial objectives are. It's a dual objective to provide a loyalty mechanism to the rest of the Coles Group and to be a profitable and growing business in its own right, which is exactly what it is. If you break down fuel and shop, we make a much lower return on fuel than the investment
20 would warrant, but we are nonetheless okay with our return on fuel and we make more of our income from the C Store. But that's consistent with being a retailer. Can I also take the opportunity, seeing as you have raised it, to just knock on the head the cross-subsidy with grocery. It simply does not occur for the reasons that I outlined earlier. This is treated as a marketing expense. It has nothing to do with the
25 cost of goods sold in either supermarkets or any of the other brands.

MR YOUNG: The point you are making is that although the financial cost of the 3 cents and 4 cents of the standard discount are borne by supermarkets, that's treated by the supermarkets as a marketing expense, one of the overall costs of its business, but
30 it doesn't factor into the pricing of individual groceries?

MR McMAHON: Correct. At no point is there any conversation about the price of groceries.

35 MR YOUNG: Just coming back to my question about the fuel business - I'm trying to separate that in my question from the convenience side of that business.

MR McMAHON: Yes.

40 MR YOUNG: The fuel business is a business, you do track its financial performance, correct?

MR McMAHON: Correct.

45 MR YOUNG: In isolation from the convenience store?

MR McMAHON: We do not - we just need to be clear here. We obviously track gross margin volumes and so on, and track the performance of fuel. It is such a high

fixed cost business that allocating costs between fuel and convenience gets to be an exercise in futility, so we don't do that on any regular basis. We have made an attempt to do that and the Commission has been provided with that.

5 MR YOUNG: But with the limitations that you have just mentioned nonetheless, the financial performance of the fuel business in isolation is, in your words, I think satisfactory?

10 MR McMAHON: We accept the financial performance on fuel. I think -- again I come back on any measure, at an EBIT margin basis, it is very low, but we make an acceptable return on the capital.

15 MR YOUNG: And that return, you said, is in the low - or somewhere in the 20 per cent?

MR McMAHON: Low 20s - for the total business, just to clarify. But I should - just to be crystal clear, we make a positive profit on fuel.

20 MR YOUNG: Yes. The financial performance, the profitability of fuel in isolation is improving; is that right?

MR McMAHON: Again, we will be happy to take the Commission through, but it's been reasonably static over the last couple of years.

25 MR YOUNG: Mr Chairman, I think the other questions I have can only sensibly or conveniently be pursued in private session.

30 THE CHAIRPERSON: Why don't we break for, say, 11 minutes, to have a quick cup of tea or whatever else you want to do, and then go into private session.

MR YOUNG: Thank you.

35 **WHEREUPON THE HEARING MOVED IN CAMERA** [11.35 am]

RESUMED [2.15 pm]

40 THE CHAIRPERSON: Gentlemen, could you, for the record state, your name and position with 7 Eleven?

45 MR WILMOT: I am Warren Wilmot. I am the chief executive officer of 7 Eleven Stores Pty Ltd.

MR PETIT: I am John Petit, national fuel manager, 7 Eleven Stores Pty Ltd.

THE CHAIRPERSON: Do you have legal representation with you?

MR NORTH: Yes, North is my name. I see to appear on behalf of 7 Eleven Stores Pty Ltd. I seek to represent each of the two gentlemen who have been requested to come before the inquiry. There is just one or two preliminary matters which we would seek to bring to your attention.

5

THE CHAIRPERSON: Before we get to that, I will swear in the witnesses.

MS McDONALD: I am Odette McDonald, from Slater & Gordon.

10

<WARREN WILMOT, AFFIRMED

[2.23pm]

<JOHN PETIT, AFFIRMED

15

THE CHAIRPERSON: Mr North?

MR NORTH: There are some matters by way of clarification. In the
20 correspondence which has come from the ACCC to 7 Eleven, it has been
correspondence which has been received and acted upon as if it is 7 Eleven Stores
Pty Ltd. The correspondence identifies 7 Eleven Pty Ltd, two different companies.
The two gentlemen who attend before you work for 7 Eleven Stores Pty Ltd. The
25 notices which had been sent were 7 Eleven Pty Ltd. For the sake of clarity, I thought
I would provide you with copies of the searches. The relevant entity for our
purposes is 7 Eleven Stores Pty Ltd. No point is taken of it, but we want you to
understand that the response which has been made for the provision of documents
and, indeed, to attend before you to answer questions is the company 7 Eleven Stores
Pty Ltd, the relevant entity for the purposes of your inquiry. The other one, 7 Eleven
30 Pty Ltd, is a company which is effectively owned by a US-based company and has
nothing to do with the retail sale of fuel in Australia.

THE CHAIRPERSON: Thank you very much.

MR NORTH: Can I also indicate one other thing. I understand that Mr Wilmot
35 would wish to make a short opening statement, which he has recorded. We thought
we might produce a copy of the opening statement for you, which he would like to
read. It summarises material that has previously been provided. Can I produce it to
you - - -

40

THE CHAIRPERSON: I am happy for you to submit it, but we have taken a
position - a number of witnesses have asked if they can make opening statements to
summarise what is on the public register and I have to adopt a fairly strict policy -
and you understand it is time factors - rather than have those read out, because they
45 tend to summarise what is already on the public record, we would rather get to the
heart of the matters. So I'm going resist, if you don't mind, the reading out of the
statement. Just take it as read and we will put it on the public register so it will be
available there.

MR NORTH: We would seek to produce that opening statement to you and I will hand counsel assisting a copy and we will take it as read. Those are the only two issues we wish to raise.

5 THE CHAIRPERSON: I take it that the contents of the statement are also affirmed under the affirmation that you have given?

MR WILMOT: They are.

10 MR MARKS: Gentlemen, I propose to ask a number of questions which I will endeavour, within a broad compass, to identify in topics. Don't hold me to that. There may be a necessity to move across issues, but I will try and do it in that way. It is the Commission's desire to hear as much if not all of your evidence in public, in line with the requirements imposed upon the Commission by the Act. There will be
15 issues, however, which may require you to give answers about which your organisation has some sensitivity. If I ask you questions to that effect and you make that point, then we will endeavour to cover those issues in a private session which we will hear at the end.

20 Can I start by just making clear what the Commission has from 7 Eleven Stores Pty Ltd in writing at the present time, to the best of our understanding. You have not taken the opportunity of providing an opening submission but have answered, in a set of answers, questions which were posed under section 95ZK of the Act, is that so?

25 MR WILMOT: That's correct.

MR MARKS: As part of that set of answers, you have provided some other documents, but they are of limited number.

30 MR WILMOT: That's right.

MR MARKS: Can I take it, Mr Wilmot, that both you and Mr Petit co-authored the answers?

35 MR WILMOT: That's correct.

MR MARKS: And that appears by your signatures. I wanted to start by asking you some general questions about the structure of 7 Eleven's operations. Some of this may pick up matters that you have put into your introductory statement. 7 Eleven, as
40 you identify it, is an independent retailer; is that so?

MR WILMOT: That's correct.

MR MARKS: When you use that description, what do you mean?

45

MR WILMOT: We are not aligned to an oil refining company.

MR MARKS: Does it also mean that you are not engaged in wholesale in the market?

MR WILMOT: That's correct.

5

MR MARKS: Your site structure, just to ensure that we understand it, you have a number of sites in the three eastern seaboard states; is that so?

MR WILMOT: That's right.

10

MR MARKS: You have 185 sites in total?

MR WILMOT: We have 366 sites in total and 182 in our retail fuel.

15

MR MARKS: 182, not 185?

MR WILMOT: Yes, we have since let three go since the submission was - - -

MR MARKS: Have they been sold or closed down?

20

MR WILMOT: They have been transferred to Coles Express.

MR MARKS: When did that happen?

25

MR WILMOT: Over a period of June/July.

MR PETIT: The actual site hand overs would have all in August.

MR WILMOT: They were all in Queensland.

30

MR MARKS: So until then, you had 57 sites in Queensland and you now have 54?

MR WILMOT: That's right, 54.

35

MR MARKS: You still have 83 sites in Victoria, I take it?

MR WILMOT: That's correct.

MR MARKS: And I think you have at present 45 retail sites located in New South Wales; is that so?

40

MR WILMOT: That's correct.

MR MARKS: The balance of the sites that you have, I think you said there are 366?

45

MR WILMOT: 366.

MR MARKS: Could you tell us about those, please?

MR WILMOT: They are nonfuel sites that are spread across exactly the same eastern seaboard capital cities.

5 MR MARKS: When you say "nonfuel sites", you simply mean 7 Eleven stores or what do you call them?

MR WILMOT: Yes, 7 Eleven stores. They'd be small stores like here in the CBD of Melbourne, or they might be suburban sites without fuel.

10 MR MARKS: Are you able to tell us, in relation to the stores that do not retail petrol, where they are located, so how many you have in each of the eastern seaboard states, or is that something you will have to take on notice?

15 MR WILMOT: Look I could probably guess.

MR MARKS: Just approximately.

20 MR WILMOT: It will probably be 80 in Victoria, probably 50 or so in New South Wales and probably about 45 in Queensland.

MR MARKS: Insofar as the petrol sites are concerned, can I ask you this: Do all of the sites that retail petrol have attached to them, or as part of them, a retail store?

25 MR WILMOT: Yes, every one.

MR MARKS: At those sites, are the following petrol products sold - and I will ask you in turn because not all of them may apply to all sites. Firstly, ULP, is that at all 182 sites?

30 MR PETIT: That is at all 182.

MR MARKS: And premium unleaded petrol?

35 MR PETIT: I think that's at 181 sites.

MR MARKS: Is there some reason why it's not - the critical petrol is not sold at the last site? Has it closed down or what is happening?

40 MR PETIT: Yes, I think it's just a matter of storage capacity.

MR MARKS: So what is sold at that site?

MR PETIT: Unleaded.

45 MR MARKS: Unleaded only. What about diesel and LPG, are they available at all sites?

MR PETIT: LPG we have available at 79 sites, and diesel on about a third of the sites, but I would have to check.

5 MR MARKS: For the sake of completeness, I want to understand what your sites currently do not retail in terms of petrol products. Are we correct in saying that they do not presently retail E10?

MR PETIT: That's correct.

10 MR MARKS: Why is that?

MR PETIT: We haven't been able to source an E10 product. They are becoming available currently.

15 MR MARKS: I will come back to that, if you don't mind. There is premium 98. Is it correct that you don't currently retail that at any site? Your premium unleaded petrol is 95.

20 MR PETIT: We do retail some premium 98 at a number of co-branded BP sites we have in Queensland. Those sites are currently being debadged. That agreement ended in July and BP has taken its branding off. There is in a handful of stores, but that will dissipate in the very near future.

25 MR MARKS: You don't retail, as I understand, any bio fuel at moment?

MR PETIT: No.

30 MR MARKS: I will come back to that. Taking the next step, the mode or manner in which your sites are currently operated, are they all franchisee-operated sites?

MR WILMOT: Except for one. We have one corporate store in Ashford in Victoria for our training purposes.

35 MR MARKS: The rest of them are all franchisee-operated. Just to ensure that we understand that, how does it work in practice? Let's take a site just as an example. Tell us how the franchise works, both in respect to the supply of petrol, the commission payable and then the operation of the store, please?

40 MR WILMOT: Okay. Fuel is totally a commission arrangement. It's not actually a franchise arrangement. So we pay the franchisee essentially 1 cent a litre to maintain the site in clean working order, monitor fuel pricing for us, monitoring stock in the ground, providing customer services of water for radiators and windscreens, et cetera, and for handling the money that comes through the registers for fuel. But we totally own the product in the ground, we own all the equipment on site, both on
45 fuel and merchandise, and we get to set pricing.

MR MARKS: In that, although I gathered that you were really summarising the petrol operation, you included merchandise. Can I ask you to elaborate on that a bit more. In the store operation, can you tell us how that is run and operated, please?

5 MR WILMOT: Yes. The franchise is probably slightly different to most franchises in Australia - much better, of course. What happens is we actually share the gross profit in the merchandise sales rather than just take a royalty on the sales turnover. We actually own all of the equipment in the store, so we fit it out. We cope with all the depreciation. We pay the rent. We pay the utilities. So we have essentially all
10 the fixed costs in the business. We do all of the accounting for the stores, so we process all their invoices. If they choose to, and most do, we do all their payroll, track their superannuation, pay-as-you-go contributions, et cetera. We set up a set of trading terms with bona fide suppliers, the cheapest suppliers that we can find, that the stores can access. They actually buy the products, the merchandise. We give
15 them guidance with plan-a-grams, best sellers, all those sorts of things, and they control the merchandise in the store. They bank all their banking into our account and we pay all of their bills on their behalf and remit the profit back to them.

MR MARKS: You said there was a gross profit share arrangement.

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MR WILMOT: That's right.

MR MARKS: Are you able to tell us what the percentage is? Just bear in mind that if there are some sensitive questions and you want to come back, just tell me and I will come back - - -

25

MR WILMOT: This is totally on the public record. The older sites, it is a 54:46 split. We take 54 per cent of the gross profit. On the current agreements, it's a 57:43 per cent split.

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MR MARKS: What do you mean by the older sites?

MR WILMOT: Older agreements.

35 MR MARKS: And does that cover still a large percentage of your sites?

MR WILMOT: We probably have just over half now on the new agreements.

MR MARKS: So it's about a half-half.

40

MR WILMOT: Yes.

MR MARKS: I take it that as agreements expire, you will go and make new arrangements and that is happening periodically?

45

MR WILMOT: Yes.

MR MARKS: What is the length of the franchise agreements?

MR WILMOT: It is currently 10 years, or the primary term of the lease on the property.

5 MR MARKS: Are all of the properties upon which 7 Eleven sites are based lease properties or does 7 Eleven Stores own any of those - - -

MR WILMOT: 7 Eleven Stores Pty Ltd doesn't own any sites. Our parent company actually owns six of the 366 sites.

10 MR MARKS: Who is your parent company?

MR WILMOT: RG Withers Holdings Pty Ltd.

15 MR MARKS: What percentage of 7 Eleven Stores Pty Ltd does RG Withers Holdings - - -

MR WILMOT: 100 per cent.

20 MR MARKS: Thank you. Can I ask you - to change the topic, unless there is anything you want to add further on the structure questions, I want to move on to the question of your petrol supplies. I really want to ask you a little bit about your current supply arrangements. I want to ask you some questions about your pre-existing supply arrangements and a little bit about the international market. Firstly, can I ask you about the local arrangements that you presently have. If I
25 understand your submission correctly, you have supply arrangements predominantly with Shell, is that so?

MR PETIT: That's correct.

30 MR MARKS: But also with Caltex, is that right?

MR PETIT: In Queensland, yes.

35 MR MARKS: Is the practical reality this, that with your sites on the eastern seaboard metropolitan areas and - just help me there, if you would - do I understand the position correctly that in each state all of your sites are located within the metropolitan boundaries or within a very short radius of them?

40 MR WILMOT: It would be a short radius. We go up as far as Newcastle, down to Wollongong, out to Toowoomba, down to Geelong. But we are about an hour and a half from distribution.

45 MR MARKS: Within those parameters, in the state of Victoria and in the state of New South Wales, do we correctly assume, therefore, that all of your supplies come from Shell?

MR PETIT: In Victoria and New South Wales, yes.

MR MARKS: Correspondingly, when I move to Queensland, do I assume that all your supplies come from Caltex?

5 MR PETIT: No, it's a mixture between Shell and Caltex, and on those BP sites that we mentioned, naturally they are BP-supplied.

MR MARKS: Perhaps I will ask you about BP in the context of preexisting arrangements. Under your present arrangements, though, can I ask you about Shell - when was your existing agreement with Shell struck? That is, when was the first agreement - whatever reviews and extensions there may have been?

10

MR WILMOT: We are on the first round of this - they were struck two years ago, so it was valid from 1 January 05 to the end - - -

15 MR PETIT: 1 January 05 to 1 January 06.

MR WILMOT: No, because it expires at the end of this year, so it would be 06 to the end of 07.

20 MR MARKS: But a two-year agreement?

MR WILMOT: That's right.

MR MARKS: Do you have any opportunity under this current agreement to either extend it or to renegotiate it?

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MR WILMOT: It's being renegotiated at the moment.

MR MARKS: Does the agreement come up again for renewal on 31 December?

30

MR WILMOT: That's correct.

MR MARKS: I will come back to this shortly, but just picking up what you said, is that agreement in a state of negotiation at the moment?

35

MR WILMOT: Yes.

MR MARKS: Prior to Shell in both Victoria and New South Wales, who was your petrol supplier?

40

MR PETIT: A combination of Caltex and Trafagura.

MR MARKS: So that's a major and an importer?

45 MR PETIT: That's correct.

MR MARKS: Was there any science to that arrangement? Why didn't you renew those arrangements at the end of 2005?

MR WILMOT: We never had a formal arrangement with Caltex, it was always a handshake agreement.

5 MR MARKS: I see. So did you just buy spot from - - -

MR WILMOT: No, I think we had a fairly prearranged method of buying the product but we didn't actually have a contracted volume.

10 MR MARKS: I see. What arrangement did you have with Trafagura?

MR PETIT: The Trafagura was - it would have been based on a volume. I'm just trying to remember.

15 MR MARKS: Was there a contract with Trafagura, or did you similarly - - -

MR PETIT: There would have been a contract with Trafagura, yes.

20 MR MARKS: You ceased taking supplies from Trafagura. Was there a reason for that?

MR PETIT: It was around that time of the change to the national fuel standards, and there was - - -

25 MR MARKS: What consequence did that have?

MR PETIT: There was concern on obviously the ban of MTBE and the ability of Trafagura to import product at a cost-effective price.

30 MR MARKS: You might need to elaborate. One of the issues obviously the Commission is very interested in understanding is what the availability of import product on to the market is and what change has recently come about in that market, so tell us about Trafagura. The arrangement came to an end. You say the fuel standards had an impact. How and what was the concern?

35 MR PETIT: The fuel standard impact was - I think the major factor for Trafagura was the MTBE component.

MR MARKS: When was the MTBE - January 2006?

40 MR PETIT: 2004.

MR MARKS: Yes, okay. And the concern was, you were saying, availability of supply?

45 MR PETIT: I guess with the amount of volume that we put through our stores - we are a small player in the market, but it is still a considerable volume that, you know, we need to have security of supply.

MR MARKS: No doubt that issue arose. Was there any endeavour to renegotiate that contract with Trafagura?

MR PETIT: No.

5

MR MARKS: Was Trafagura given an opportunity to respond to the proposition that security of supply would be a problem or, alternatively, that the extra cost would not be competitive?

10 MR PETIT: We would have had those conversations.

MR MARKS: When you say "would have", did you play any part in those negotiations?

15 MR PETIT: I was involved with Trafagura and other independents on discussions on the fuel standards. Looking back, Woolworths were in the same situation as us with Trafagura supply. Subsequently, they did their deal with Caltex. We were in the same position where we felt it was necessary for us to go and source alternate supply which we knew would be secure, and from that point, we made a decision to align
20 with a refinery in each state.

MR MARKS: Just let me make sure we do understand that correctly. Was the issue one or other or both of the following: There was a security supply issue, and that is can we actually get fuel with the MTBE requirement? Secondly, can we get fuel at
25 an available price? By that, I mean at a price which is competitive in the market with what we could get from an alternative source. Were they both issues for 7 Eleven?

MR PETIT: They would both be issues, yes.

30 MR MARKS: Is the answer that despite the contractual negotiation, Trafagura were unable to satisfy either requirement, or was it simply the 1.5 cent a litre price differential that caused the problem?

MR PETIT: I think it was just the actual uncertainty of the situation.

35

MR MARKS: Does that mean it was both or only the uncertainty?

MR WILMOT: I think it would have been both.

40 MR MARKS: That's Trafagura. I just want to then ask you this before I leave Shell: Under the present arrangement, you said Shell does not supply you with E10. That's the one I'm predominantly interested in. Is that an important deficit or an important issue for 7 Eleven, either now or in the immediate future?

45 MR PETIT: I think in the immediate future it is an important factor for us and they have certainly included it in their current negotiation with 7 Eleven.

MR MARKS: Does that mean that Shell will be providing 7 Eleven in any future contract from 1 January 2008 onwards with an E10 deal?

MR PETIT: That's correct, yes.

5

MR MARKS: Is that the understanding? At the moment E10 represents, by volume, a total 1.5 per cent of the total market; is that correct?

MR PETIT: I know that - I would have to check the numbers - but in Queensland, it's 4 per cent of the gasoline market.

10

MR MARKS: It varies from market to market. In Queensland it is higher, in other states it is lower; overall, it is about 1 per cent, would you agree?

MR PETIT: That sounds about right.

15

MR MARKS: If that is so, has the unavailability of E10 caused you any difficulties in your existing marketing of petrol and your existing ability to compete on the market, do you think?

20

MR WILMOT: I would say it's very limited, the impact that it has had. We missed that opportunity of having a much lower price on the price board at different times.

MR MARKS: That's really what I was coming to. I was wondering what the impact of that was.

25

MR WILMOT: I guess we can't guess what that is because we have never had the opportunity to see it.

MR MARKS: Can I ask you about Caltex. You said Caltex is in Brisbane. That's where the Caltex terminal is, or the Caltex refinery is as well. Tell us about that arrangement, what is its duration and when was it struck?

30

MR PETIT: With Caltex, we have been on a handshake deal for I don't know how long, long before I started with 7 Eleven.

35

MR WILMOT: Probably about 15 years.

MR MARKS: So there is not a contract?

40

MR WILMOT: We're all friends.

MR MARKS: Is your Caltex deal one that you were - I don't want to be pejorative in my question - one that you were pushed into as a consequence of discontinuing your arrangements with BP?

45

MR WILMOT: Sorry, no, BP has almost been a side issue. We managed to acquire I think it was 13 BP-branded sites in Queensland. One of their multi-site franchisees sold us the sites.

5 MR MARKS: They became co-branded?

MR WILMOT: They became co-branded, and the fuel supply arrangement was assigned, and that expires - it's been going for about three years, and effectively it expired on 1 July, but they are very slowly with debranding them.

10

MR MARKS: I see. So Caltex has been around for a long time now.

MR WILMOT: A long time.

15 MR MARKS: When you say a long time, what do you mean? Does that mean a year, two, three, five?

MR WILMOT: 15.

20 MR MARKS: 15. I think you said that. Under that arrangement, you get all your fuel supplies for your stores in Queensland?

MR WILMOT: About half the fuel supplies, excluding those BP sites. But we still buy some from Shell.

25

MR MARKS: Are your arrangements with Shell competitive with those of Caltex in Queensland?

MR PETIT: Yes, they are. The current arrangements are, yes.

30

MR MARKS: Why do you need two suppliers?

MR PETIT: Again, as Shell don't have a refinery in Queensland, so we took the decision back on - the Shell agreement together that we would choose to align with a refinery in each state to give us some security of supply.

35

MR WILMOT: I think the other thing is there is really only the four refiners that we could really align with. BP have shown no interest in trying to supply us at any stage and we just didn't feel that we wanted to have all our eggs in one basket at any point.

40

MR MARKS: Just before I leave the current agreements, do either or both of the current agreements - it's a little hard to talk about Caltex because it's a handshake arrangement - but certainly in the case of Shell, does the agreement or indeed your proposed agreement allow for any periodic reviews of the price at which 7 Eleven buys?

45

MR PETIT: The current agreement has been fixed for a two-year period.

MR MARKS: Did that have within the two-year period a price review provision?

MR PETIT: No.

5 MR MARKS: No six-monthly review or 12-monthly review?

MR WILMOT: It is actually a formula-based price, so as the Singapore Mops, the US dollar conversion, freight rates, and there was a provision for extra quality premiums if they came into the market as well.

10

MR MARKS: I see. All right. Can I then move just beyond your existing arrangements to the position vis-a-vis any imports of fuel. Trafagura was one supplier which gave you an exposure to the import market. You discontinued. Has 7 Eleven ever had any other exposure to or any other requirement to look to the import market for petrol suppliers in the last 15 years?

15

MR WILMOT: Not that I can remember.

MR MARKS: The import market and the price at which fuel is obtainable in that market, is that of any relevance to 7 Eleven in its dealings with its Australian suppliers?

20

MR WILMOT: Not that I can think of.

MR MARKS: Let me give you an example of what I'm thinking of. You say at the end of this year you are about to, or you are proposing to strike a new deal with Shell. Does the availability of alternative supplies and, as part of that, the availability of supplies from any overseas source, have any bearing on the price that you may ultimately be able to strike with Shell?

25

30

MR WILMOT: I think it might be the lack of availability of a commercial deal on imports that will have an effect on the eventual commercial deal we will have to do with one of the local refiners.

MR MARKS: When you say the lack of a deal, what endeavours are you or might you between now and the end of December make to ascertain whether there is truly a lack of alternative source of supply from the international market?

35

MR WILMOT: Look, we have probably had regular discussions with people like Trafagura. We still do talk to them. It's a bigger deal than that, though. One of the things we would like to do is actually obtain a little bit of branding on our sites, so we would like a Shell branding or a Shell card, or if it's Caltex, Star Card and some Caltex branding, just to let customers know that it is a quality local product. So it is not just around the actual cost of the product that we are trying to encompass in the deal that we are doing.

40

45

MR MARKS: Just while I'm asking you these general questions about the market and its impact internationally - are you aware, Mr Wilmot, whether there are

available sources for independent operators, in your case, 7 Eleven as a retailer, from the international market and, if so, where?

MR WILMOT: No.

5

MR MARKS: For example, if you were to decide that it was a proposition and to enlist Trafagura or Vopac or another independent terminaliser, if there was one, or any other major, do you know anything about what is available on the international market?

10

MR WILMOT: No, I don't.

MR MARKS: Can I, then, just ask you some general questions, a couple of general questions about the wholesale market in Australia and your view about it. You are an interesting case, really, because you have had exposure to independent suppliers. You are now aligned to two majors. You are proposing to realign, all going well, again. Do you believe that the wholesale market is a competitive market at the present time in Australia?

20 MR WILMOT: Not that I'm aware of.

MR PETIT: It would be speculating but I would assume across the market that there would be barely any differential in the price that people will pay.

25 MR MARKS: I picked up on that only because I think you said earlier that BP had nothing offer. What did you mean when you said that?

MR WILMOT: They have never expressed an interest when we've spoken to them about the potential of supply. They have said that they don't have a mechanism for it. They weren't interested doing it. They were very happy doing their own BP stores.

30

MR MARKS: In the position of Caltex, you say it's a handshake arrangement, it's been a very comfortable and reliable one. But is there reason why there isn't a contract or a formal arrangement with Caltex?

35

MR WILMOT: I don't think we've ever felt we needed one. It was always a very good arrangement.

40 MR MARKS: Not a reluctance on the part of Caltex to enter into such an arrangement?

MR WILMOT: I don't think so.

45 MR MARKS: For example, because they may need flexibility to other players in the market, such as Woolworths?

MR WILMOT: I think when we had to move was when Woolworths came into the market. They certainly picked up a lot of volume there that they had to deal with and they seemed less interested in it.

5 MR MARKS: But did they say to you then, we are less interested in you, we will continue to supply you in Queensland but it will be on a handshake arrangement only and we're not going to commit ourselves?

10 MR WILMOT: Look, I think they were happy just to continue. There were other factors that affected it at the time. We were taking Star Card for - certainly I have been around for 15 years and - - -

MR MARKS: Can you describe Star Card?

15 MR WILMOT: Star Card is a fleet card, similar to Shell card, BP card. So a lot of corporates provide fuel cards to their corporate drivers and you have got to go and use it at the sites that actually accept those cards. Because Caltex didn't have a very big network in Victoria and they were supplying us, we actually had a lot of co-branded sites up until about 1996. We were taking Star Card. We actually run on
20 their EFT network as well, so we had other elements of the relationship to the background. So we were are tied together reasonably nicely, but when the Woolworths deal came along, they removed Star Card from us and showed a little less interest in supplying us.

25 MR MARKS: Let me ask you this question, please: In Queensland at the present time, there is, is there not, an alternative supply channel to you, to Caltex, and that is Shell?

30 MR WILMOT: And we take half of it.

MR MARKS: Is the position that there would be flexibility under that arrangement - those co-arrangements were you require them in Queensland?

35 MR WILMOT: Yes.

MR MARKS: Take the position in Victoria and New South Wales. Is there now, at this point in time, any other realistic supplier for 7 Eleven, apart from Shell?

40 MR WILMOT: Yes. Yes, I think both Mobil and Caltex are expressing interest in providing us.

MR MARKS: In your ongoing negotiations with Shell, is that alternative a very significant reality that is bearing upon the negotiations?

45 MR WILMOT: I hope so.

MR MARKS: Can I then ask you just some questions about your wholesale buy price at the present time. I think you said before that it was - I think this was you, Mr Petit, it was a price based on formula.

5 MR PETIT: Yes, it is.

MR MARKS: We understand the formulaic nature of wholesale pricing arrangements. We understand the IPP basis for those arrangements and any additional factors that, in different cases, can weigh into the equation. Can I ask
10 you - and if this is something you want to deal with on a confidential basis, we understand, but can you explain to us what your price formula is at the present time?

MR PETIT: I think we would have to do that under confidentiality.

15 MR MARKS: We can come back to that. I will return to that subject in a separate context. Can I turn, then, to your retail operations, which are your predominant operations. Before I get into too much detail about that, we understand your structure and so on. I just want to ask you a question about documents. At the
20 present time, we have very few documents from others who are in a similar position to you. We have a great deal of documents. What day-to-day operating documents do you have that we would be helped by seeing? There are obvious ones that come to mind. There may be many more. We have not seen any of your management reports. We have not seen any of your pricing strategy documents and so on. What
25 is available, Mr Wilmot, and how do we get hold - - -

MR WILMOT: We would not have a pricing strategy document on fuel anywhere in our business, otherwise it would have been obviously disclosed.

MR MARKS: What about management meetings and discussions about pricing?

30 MR WILMOT: Certainly there would be management documents but not on pricing. All it would be was gross profit for the month, how many price cycles there were by state, and that would be it. There would be nothing about pricing strategy in any of those and that's why they weren't tendered.

35 MR MARKS: Where would that information be? If it's not in writing, where is it?

MR WILMOT: Probably be discussed in the agreement that we have or what our pricing strategy is.

40 MR MARKS: Firstly, who is responsible for pricing by 7 Eleven within management and how is it implemented? Why isn't there any documentary records of even its implementation?

45 MR WILMOT: I think by the very nature of what we have been saying all along, we are a market follower. How much pricing strategy can you have except we are going follow our competitors.

MR MARKS: Perhaps I will come back to that in the context discussing how you do actually price in a practical way, but you say you have no documents?

5 MR WILMOT: No documents on pricing strategy.

MR MARKS: Are there any other documents that you do have that you haven't provided to the Commission and that would assist in our understanding of the way 7 Eleven's operations work?

10 MR WILMOT: The only thing we would have would be management reports on what the profits was for the prior month and how many cycles there were.

MR MARKS: Are there any other board reports, other than the one - - -

15 MR WILMOT: That's the only one we have put to the board and I'm not sure if it's totally relevant to that.

MR MARKS: All right. Let's talk about retail in a little more detail. What is 7 Eleven's current market share of total volume in sales by retail at the moment?

20 MR PETIT: Nationally or in - - -

MR MARKS: Nationally first, and then we can deal with the three states.

25 MR WILMOT: And you are talking about fuel?

MR MARKS: Just talking about fuel, just gasoline generally.

30 MR PETIT: Gasoline and diesel?

MR MARKS: When you talk about gasoline, which you do in your materials, do you include diesel?

35 MR PETIT: Yes.

MR MARKS: You do. Okay, tell us, first of all, the general figure and then we can break it down.

40 MR PETIT: It's difficult to actually figure out this information. Of retail, we submit our volumes monthly to the Department of Industry and Tourism. So we try to provide our volumes back into the data we receive back from the department, and actually figuring out what is retail and what is wholesale and total volume. We believe that at retail last financial year, we were 2.9 per cent nationally, and of total volumes sold in Australia, we are 1.55 per cent.

45 MR MARKS: Are you able to break that down into ULP or deal with ULP; is that possible? I didn't see that figure.

MR PETIT: It is possible. It may have been provided in the report.

MR MARKS: I didn't see it, but in any event - maybe that's something you can take on notice - you don't have that available to you off the top of your head?

5

MR PETIT: No. But they are numbers that we do submit to the government every month so - - -

MR MARKS: So you could easily get your hands on - - -

10

MR PETIT: Or vice versa. The Commission could look at those numbers through the Department of Industry, for all market participants.

MR MARKS: Why don't you take on the mantle of that responsibility? We have lots of other documents to look at and we would be helped by you doing that. Can I ask you, then, to just tell us - your figures look like they show a slight growth over the past three years. I don't necessarily want to delve into this in too much detail, that's pretty obvious, but is there anything you can tell us at the moment about the future direction of sales, your expectations in regard thereto so that we can get a feeling for where 7 Eleven sees itself positioned in the market at the present time and going forward?

20

MR WILMOT: We certainly will probably stay around the three eastern seaboard capital cities that we are currently in. We will probably grow by about 10 to 15 stores in total per year, but only half of those will be fuel sites, so we will be growing about six fuel sites a year. I think our general expectation is that like stores for fuel will probably only grow at about 1 per cent to 1.5 per cent; 3 per cent might be an extremely good result, coming from sort of reinvestment in new pumps and some of the infrastructure that we need to update.

25

30

MR MARKS: I wanted to ask you a couple of questions about your sales volumes, just to make sure I understand them. Again, these answers are provided to us on the back of a request for confidentiality. Are these matters of sensitivity for you? Can I ask about them in this context?

35

MR WILMOT: Sorry?

MR MARKS: If I ask you about volumes and so on - - -

40

MR WILMOT: That's fine. Everyone could guess what they are.

MR MARKS: Yes, I would have thought so. Can I quickly make sure that we understand the pattern of your volumes. Looking at information you have provided to us nationally, it would appear that over the period from 2003 to 2007, that is, the last five years, there has been a growth in petrol volumes sold. Is that attributable to a growth in your business or is it more attributable to a growth in volumes overall in the market?

45

MR WILMOT: I think most of it would be attributable to growth in stores.

MR MARKS: So that your market position has actually improved in terms of sale volumes?

5

MR WILMOT: Slightly, yes.

MR MARKS: Taking it state by state, first of all, not necessarily the most important but as we are here, Victoria, your figures in Victoria would like look like there has been a downward movement over time in that five-year period. Is there any reason for that downward trend in volume in Victoria?

10

MR WILMOT: I think there would be various. We have done very few new stores here. Most of our new stores have actually been in Queensland. We have very small sites here in Victoria. We are probably quite different to the oil majors with their big canopies and multiple pumps. We have a majority of our stores in Victoria that have a very tiny canopy with two pumps only, so they are somewhat limited in what they can dispense, and increasingly with the move on shopper docket, et cetera, the market shift has been away from those very small store.

15

20

MR MARKS: That's what I wanted to ask you about, whether any of that reduction in volume had been attributable to the players - or to other layers in the retail market. I'm thinking, naturally, of the supermarkets. It might not be only them.

MR WILMOT: Two major factors, and again I don't think we have hidden any of this. We have lost about 7 per cent of our volume when we lost Star Card, because we knew what the Star Card volume was, and we think we lost about another 8 per cent of our volume when Coles really ramped up their roll out in Victoria and all three states.

25

30

MR MARKS: In that 8 per cent, over what period of time? Was it an immediate loss and it reached a stable position or was it a gradual loss?

MR WILMOT: There was a sort of a gradual loss, because Woolworths was generating some of it before Coles actually did the roll out and, unfortunately, we lost Star Card exactly the same time that Coles actually - - -

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MR MARKS: That was about October 2003, or November, or maybe the beginning of 2004?

40

MR PETIT: The actual cut off for Star Card would have been 1 January marriage 2004.

MR MARKS: That's where your 7 per cent impact occurred?

45

MR PETIT: Yes.

MR MARKS: You then refer to the 8 per cent, what I call Coles impact.

MR PETIT: Yep.

MR MARKS: Over what time period did that manifest itself?

5 MR PETIT: I think Coles entered Victoria in July 2003 and rolled out into New South Wales in late 2003 and Queensland early 2004. So, over that period.

MR MARKS: You have seen an impact over that period?

10 MR PETIT: Yes.

MR MARKS: The New South Wales position, despite what you say about Coles' roll out, looks like it was steady, even through the roll out period in 2003-2004, and then it seems to have modestly increased and then steadied. Is the New South Wales market - was it insured against the Coles roll out or immunised against it by its structure? Can you explain why New South Wales was not impacted the same?

15

MR WILMOT: I'm not sure that Shell and Coles have got the same network in New South Wales, so it didn't affect us quite as much. We are a bit concentrated in particular parts of Sydney as well; I think we own some of those market a little bit more than the diverse nature of what we have in Victoria.

20

MR MARKS: So the structure is perhaps a little different.

25 MR WILMOT: Yes.

MR MARKS: In Queensland, the situation looks altogether different. There has been a substantial volume increase over the period despite roll-outs, supermarket schemes and so on.

30

MR WILMOT: We have continued to grow some very good new stores in Queensland that we have been first to market in a lot of areas. We probably now have, I would claim, the best retail network in the south-east corner of Queensland of any of the players up there.

35

MR MARKS: Is it the increased volume derived from your new stores that has immunised you against the impact of the shopper docket rollout, or is it the performance of your entire operation?

40 MR WILMOT: I think it's probably a bit of both. I think we have finally got brand presence up there as well. Our first fuel store in Queensland only occurred in 1993, so we built the network in 15 years. So it took us quite a few years to get even a bit of brand presence. In the year 2000 we brought 53 stores from Burma, which is where the association with Trafagura originated.

45

MR MARKS: Where were the Burma stores?

MR WILMOT: Again, across those three markets but that gave us a huge leap in Queensland. There are some really prime sites.

MR MARKS: When did that happen?

5

MR WILMOT: In 2000.

MR MARKS: So it was a little bit before - - -

10 MR WILMOT: Yea, it took a little while, again, to rebrand them and get all those volumes.

MR MARKS: Tell me, then, very quickly, the trends we are talking about here, do you anticipate that they will continue or will these trends that we are seeing depicted
15 over this five-year period change in any way?

MR WILMOT: I think, in general, they will continue.

MR MARKS: So, Queensland, you think will continue to be a - - -

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MR WILMOT: I think Queensland will continue to grow. Victoria may just slow up a little bit. It is very hard to find new to industry type sites.

MR MARKS: Are you changing your marketing or sales strategy in Victoria to
25 accommodate the decreases in volume?

MR PETIT: What we are doing at the moment is we are about to embark on a major pump upgrade program. Through that pump upgrade program, we will be putting diesel on to a lot more sites and try to grow some sales through additional products.
30

MR MARKS: I wanted to ask you some questions about the determination of your retail prices. Obviously, those questions will overlap or be overlaid upon questions of the price cycle and so on. Who is it within management that ultimately decides the price at which 7 Eleven will retail its fuel?
35

MR PETIT: It is me.

MR MARKS: Do we take it that the final price that is charged by 7 Eleven at particular sites will vary by locality?
40

MR PETIT: Yes.

MR MARKS: Does 7 Eleven model its sites by geographical boundaries of some form or another delineated by competitors or otherwise?
45

MR PETIT: We do. Any stores that are in close geographical proximity, we will cluster those together and just the cycle, I guess, gets down to a point of cost or

below, well, we will break those sites up obviously to try to minimise the financial impact.

5 MR MARKS: So, for all practical purposes, when you are talking about price to the Commission, you are talking about a conglomeration of a whole lot of little locations which are identified, it might even be by number, by your organisation and in respect of which pricing decisions are made?

10 MR PETIT: Yes. That's correct.

MR MARKS: Are the pricing decisions made in respect of every one of those locations, whether it's the 185 sites or - are they all done by you?

15 MR PETIT: No, people who work for me, but I will set the parameters by which those prices can be changed.

MR MARKS: What are the parameters, can you tell us in public session?

20 MR PETIT: Well, they will vary a little bit, depending on the situation at hand, what is happening with our wholesaler price, what is happening with our stock and brand, what our competitors are doing, at what stage in the weekly cycle we are at.

25 MR MARKS: You have raised a number of matters which obviously impact on the price. I imagine, if I were to ask you, you would say competition within areas is a significant factor also. When you say "competition", and you have said it in your submission, do you mean just within the locality or do you mean more generally?

30 MR PETIT: I think if you look at a market like Melbourne and the price competition spreads across the metropolitan area fairly quickly so ...

MR MARKS: So what's the answer?

35 MR PETIT: I guess we're looking at a couple of things. We're looking at a greater - a greater metropolitan area and we're also looking at site specific or cluster specific - -

MR MARKS: Factors?

40 MR PETIT: Yes.

45 MR MARKS: All right. Can I ask you about price cycles then in this context, because we want to understand how 7 Eleven moves and how it operates within the cycles that we know exist. In the three capital cities in which 7 Eleven operates, that's Melbourne, Sydney and Brisbane, there are distinctive patterns in the price cycles; would you agree?

MR PETIT: I would agree that the price cycle has been fairly regular with the odd inconsistency on the Wednesday for probably the last 12 months.

MR MARKS: Does that comment or observation apply across all three markets?

MR PETIT: Yes.

5 MR MARKS: So your evidence essentially to the Commission is, yes, there is a price cycle in each of the markets. By pattern, it is generally weekly; is that so? When you said it varies from time to time on a Wednesday, what did you mean?

10 MR PETIT: We just recently in July we went through a period where I don't think we had a market cycle for three or four weeks.

MR MARKS: In what capital city?

15 MR PETIT: In New South Wales, Sydney.

MR MARKS: Did you experience a similar pattern in Melbourne?

MR PETIT: Not over the same period.

20 MR MARKS: Can I ask you some questions about the cycle. Perhaps I will try and split my questions into a couple of categories or subtopics. I want to ask you some questions about the cycle generally and I also want to ask you a little bit about the role of the supermarkets and what impact that has had. I want to then ask you about your pricing strategy in the context of the operation of the cycle and then I want to
25 ask you about its impact on 7 Eleven's operations and perhaps even upon consumers. Generally, if I were to take Melbourne as an example, can you tell me what, in your view, in Melbourne drives the cycle?

30 MR PETIT: The cycle, I guess, works where the market will, through competition, move down to a point where it is generally at or close to or sometimes below the cost of product. It will reach a point where someone will finally move the price up and the market will generally follow.

35 MR MARKS: When you say by competition it will reach a point, are you saying that at a given point in time or from a given price, there will be a trend of market activity away from and down from that price point driven by different players in the market?

MR PETIT: That's correct.

40 MR MARKS: Who are the players in the market that you are talking about in a typical Melbourne price cycle?

MR PETIT: Typically, the independent sector of the market is usually ...

45 MR MARKS: If I were to ask you who you meant by the independent sector, who would you be pointing to?

MR PETIT: Competitors such as United.

MR MARKS: You see United - I'm just getting some general observations here - but as a downward leader or a downward player, if I can more generally use that, in the Melbourne price cycle on a general basis?

5 MR PETIT: Generally, United would price fairly competitively in the market.

MR MARKS: When you say competitively, do you mean that United will actively lead the price down in Melbourne in a general cycle or in a general pattern?

10 MR PETIT: At a general point in time it may be United, at another point it may be Woolworths.

MR MARKS: That's why I use the expression "player" because it does not mean necessarily every single week. We know that there isn't that sort of rigour to the pattern. I am just trying to get a feeling for where you see the independent United playing a role. Does United's role extend right to the bottom of the typical Melbourne cycle pattern?

MR PETIT: I would generally say, yes, but we don't have the same sort of visibility to United's data as we would of the major oil companies, because they are not a subscriber to Informed Forces.

MR MARKS: You are not?

25 MR PETIT: No, United are not.

MR MARKS: No, but United's movement are plotted in Informed Sources data for the benefit of those who are subscribers to Informed Sources, of which you are one.

30 MR WILMOT: Only daily, though.

MR MARKS: So you get a sort of one-off?

MR PETIT: No, we don't. We subscribe to the electronic service.

MR MARKS: Just tell me this: The electronic service - again, if there is some difficulty tell me - but the electronic service that you subscribe to, that gives you information about the movements of other players in the market but not necessarily all players; is that correct?

40 MR PETIT: No, it's only the ones that subscribe to the electronic data. The other data service, subscription service, is a manual drive-around collection.

MR MARKS: Let me make just sure I understand that. Let's take United as an example. United doesn't subscribe to Informed Sources, but I have seen a lot of Informed Sources data, which I think, picking up Mr Wilmot's point, plots United's activity in the market albeit it may only be once a day.

MR PETIT: Yes.

MR MARKS: That information, is it information which you enjoy the benefit of?

5 MR PETIT: No.

MR MARKS: So that your subscription does not extend to the provision of that information?

10 MR PETIT: That's correct.

MR MARKS: Does it extend to the provision of pricing movement information about all the major oil companies?

15 MR PETIT: Yes, it does.

MR MARKS: Does it extend to information about any other independents in the market at all apart from the two supermarkets?

20 MR PETIT: No, maybe independent brands such as FuelZone, which Mobil operated, but not actual independent operators.

MR MARKS: So you know what I mean, just to identify some other independent, you know, it might be Liberty. It might be - it doesn't give you that information?

25

MR PETIT: No.

MR MARKS: Now, that means, does it not, that when you talk about the activity of United in the market you are talking about the activity you have or your team has discerned from visual observation?

30

MR PETIT: That's correct.

MR MARKS: What visual observations do you make on a daily basis from 7 Eleven; you make a number a day, do you?

35

MR PETIT: We have a lot of eyes out there in our franchisees and they are all obviously very keen to see a competitive fuel price. So they will report in to us, if they have a United down the road, they will monitor the price for us.

40

MR MARKS: And they will keep you abreast of movements from United and other independent players?

MR PETIT: That's correct.

45

MR MARKS: Do you require the franchisees to do that as part of their arrangement with you so that you are fully informed?

MR PETIT: Historically we did. But since we have had the Informed sources subscription it hasn't been an onerous requirement we have put on the franchisees. We have given them the option to provide that data.

5 MR MARKS: Is that because at the end of the day you are not overly concerned about the movements of other Independents?

MR PETIT: I think some of our major competitors are. You know, as long as we know that major - say, if you look at someone like Woolworths, for example, we
10 know that they are competing with that level of the market.

MR MARKS: Yes, but taking that as read, is the position nevertheless, though, that from your perspective 7 Eleven is not overly concerned about the role that the independents are playing in lowering the price in the weekly cycle?
15

MR WILMOT: No, I don't think that would be a fair statement at all. One of the main reasons, almost a marketing one, everyone knows or everyone assumes in the public that convenience stores are dearer in terms of merchandise - the biggest price that we have visible to the customer is the price board. If we are not competitive
20 with what is going on in the local area, forget fuel profitability, it has actually has a perception issue across our merchandise store. So we have an absolute interest to be either spot on in the market or as competitive as we possibly can be.

MR MARKS: The Melbourne market, again, I'm asking questions by reference to that market. It may or may not be typical of other markets, but if you could help us. Does the price in general cyclical activity go below cost price frequently. And by cost price I'm referring to the price at which 7 Eleven can obtain fuel from its supplier?
25

30 MR PETIT: I wouldn't say frequently. Spasmodically.

MR MARKS: It does happen?

MR PETIT: It did happen last week.
35

MR MARKS: That certainly seems to us to be the case. We are trying to get an idea of how often it happens and what impact it has.

MR WILMOT: And that is ignoring any effect of shopper dockets, where you would be buying at well below cost price.
40

MR MARKS: I want to put those to one side, if you wouldn't mind.

MR WILMOT: I wish I could.
45

MR MARKS: At least for the purposes of this discussion if you could bear me out. How often in the cycle has it happened - say, in the first six months of the year - just,

without going to all the data, as best you can discern? I just want to get your feeling of what is typical in the Melbourne market.

5 MR PETIT: We would have to go back through records to check.

MR MARKS: Do you have a feeling for it? You do this every day. Do you have a feeling for how often you are looking at the deep point in the cycle, which I imagine is late Tuesday or early Wednesday morning; it is a Wednesday cycle, is it not?

10 MR PETIT: Yes.

MR MARKS: How often in the Wednesday cycle you are looking, as you discern the movements in prices and saying this is below what we are buying for; how often does that happen?

15 MR PETIT: Again, I'd have to check records, but we would be at or near cost on every Wednesday.

MR MARKS: Is that right?

20 MR PETIT: Yes.

MR MARKS: Can I ask you: Is that typical of the three cycles that are the subject of our questions here? What about New South Wales and Queensland? Is it a typical similar - - -

25

MR PETIT: I would say Queensland is probably the strongest of the three markets we operate in.

30 MR MARKS: When you say "strongest" what do you mean?

MR PETIT: It's the highest margin state that we would operate in.

MR MARKS: Does that mean that the cycle doesn't go down below cost often?

35 MR PETIT: The cycle may not be as aggressive as it is in Melbourne or Sydney.

MR MARKS: When you say it may not be, that's not that helpful a description. Do you mean it isn't or your observations would suggest it is not, what do you mean?

40 MR PETIT: Our observation over a long period of time would be that it's not.

MR MARKS: Can I quickly ask you about the other manifestation of the cycle, that is, the movement up. Do we understand it correctly that this happens usually - at the present state of the market it is happening in all of the markets on a Wednesday.

45

MR PETIT: Yes.

MR MARKS: At some time from the early hours of Wednesday morning through to perhaps lunchtime?

5 MR WILMOT: No, it does go much later than that. It's been getting much later.

MR MARKS: Quickly taking the Melbourne market, does that comment apply to the Melbourne market?

10 MR WILMOT: Yes.

MR MARKS: Typically the others as well?

MR PETIT: In all states it is getting later and later into the day. Whether what happened last week was a correction in it getting too late in the day or not.

15 MR MARKS: The movement up that we see happened - and the consumer sees so frequently - again from your observations, please, who are the key drivers in the upward part of the market? Who is leading the Melbourne market up? Can you tell us? Just your observations.

20 MR PETIT: My observations or Informed Sources observations?

MR MARKS: Hopefully they will coincide?

25 MR PETIT: Typically over the month of August it was mainly our observation and information we have obtained from Informed sources would that be its Mobil, BP, Coles, Caltex, Woolworths, 7 Eleven in that order.

30 MR MARKS: Let me come to Mobil. How frequently is Mobil leading in Melbourne?

MR PETIT: Looking over the month of August it was every week.

35 MR MARKS: Every week for August? Is that pattern a little more active on Mobil's part than at other times this year or is Mobil always a very active player in Melbourne. I want to put my question differently. I want to understand who in each of the three markets you think is the dominant player leading the cycle up. Is it an oil major, if so, whom? Is a supermarket if so whom?

40 MR PETIT: It would depend on the time throughout the year. It may be different. At the moment I would say it's Mobil in Melbourne. It might be BP or Caltex in Queensland. And New South Wales at the moment has been a bit tempamental of late with no cycles all through July.

45 MR MARKS: If I'm trying to pick any pattern here I'm thinking to myself, look, Mobil have a refinery in Melbourne, or Caltex has a refinery, BP has got a refinery in Queensland; is there a pattern here? Is it the majors with refinery capability in the

particular state or market concerned that tend to be the influential players in the upward movement of the market?

5 MR PETIT: Like I said, it's different people at different sometimes.

MR MARKS: Accepting that's so, and unarguably so looking at the data, my question nevertheless remains: Is it the key majors who have refinery capability and access in a market that tend to as a matter of general purport the drivers of the upward movement in the cycle?

10 MR WILMOT: I'm not sure that we could say that. It might be fact, but I'm not sure that we could say that.

MR MARKS: It's just that it's not your observation.

15 MR WILMOT: Not to hand. There are two elements, though. One is who is driving the market up, and the other one is who needs to be up for the cycle to be perpetuated. Essentially the four majors would have to be up for the cycle to actually hold at the top of the market. In other words, if someone doesn't go up, the market will crash down.

MR MARKS: When you say "all four", let's accept that if one or other of the four went up, there is a fair chance that on a Wednesday at least there would be a legitimate expectation on their part that the market would follow?

25 MR WILMOT: There might be a hope. I am not sure a legitimate expectation.

MR MARKS: A hope that seems to be borne out every week.

30 MR WILMOT: Not necessarily. Last week in Melbourne Mobil hung out there for a while and then crashed the market.

MR MARKS: It is true what you say, but you are talking about a rule by aberration. I am talking about a rule by a rule. Is it the reality that the rule, although it may be honoured in the breach on occasion, that the Wednesday movement will be a movement made by one of the majors in the expectation that - - -

MR WILMOT: I don't think you can call it a rule.

40 MR MARKS: What do you want to call it?

MR WILMOT: I don't know, a general observation, it's an entrenched part of the market that there is a cycle most weeks.

45 MR MARKS: The major, to pick up what you were saying a moment ago, tends to be the mover. Done, I suggest to you, that in the expectation with its power in the market others will follow on that day of the week; is that not a fair comment?

MR WILMOT: Probably.

MR MARKS: What about the supermarkets, what activity do they play? You have mentioned the majors. What about the supermarkets?

5

MR WILMOT: We probably refer to them as part of the majors.

MR MARKS: Let me take those. Take the Melbourne market. How predominant is Coles' activity on the upward part of the curve? How often does it lead the movement of the market up? Is it frequent?

10

MR PETIT: I wouldn't say it's frequent. It might depend on the time of the year, or they might be more proactive over the festive seasons when there are higher discount offers on.

15

MR MARKS: I ask you that question because you say in your answers - and I just want to - I don't know that there is any particular sensitivity about this - the difficulty I have with these answers is that they are all formulated under an umbrella of confidentiality; much of the material in them is in no way confidential. If I'm trespassing into confidential ground please tell me. You say in your responses that supermarket dockets have increasingly transformed consumer behaviour to the point where there is little volume impact to be achieved by independents through discounting.

20

MR PETIT: That's correct.

25

MR MARKS: That's an observation that we have an acute interest in. You say in this regard that the independents have essentially changed behaviour from discounters to market followers. Can I ask you firstly to explain the observation and then tell us what it means in the context of 7 Eleven's operations, please.

30

MR PETIT: I guess it's our experience and our observation that we found by undercutting the market or undercutting the major retailer they will now match you very quickly, so there is no competitive advantage there. And also I guess the customer perception of the saving they are making through the shopper docket is that - again, the supermarket seems to have won their loyalty regardless of the amount of discounting that the independent does.

35

MR MARKS: Let's now understand in the context of 7 Eleven's behaviour. What does that mean? You say, well, independents generally have essentially changed behaviour from discounters to market followers. Do you include yourself in that description?

40

MR WILMOT: I think we have always been a market follower.

45

MR MARKS: What do you mean by market follower?

MR WILMOT: We will follow the board price in general.

MR MARKS: Does it mean you never lead the market down or up?

MR WILMOT: Not that I can think of - we never lead it up. We just can't get away with it. It comes back to that price perception across our merchandise volume. But,
5 again, the other side of that is if we have less than a cent net profit in our fuel how much have we got to discount against the 4c discount docket. There is just no margin there to discount.

MR MARKS: Let me ask you about that. Assuming for one moment that what you
10 say about the upward movement in the market holds good, what about the downward movement? You say, no, we're really a market follower. Do you ever lead the market down or do you in any event find yourself at the bottom of the market frequently?

MR PETIT: There will be occasions where we are priced fairly competitively in the market. It may depend on a store-by-store basis or a state-by-state basis. We may have lost considerable volume and we may be trying to recoup some of that volume. And there may be just a point in time where the market is on \$1.20.5 we might choose to move to \$1.19.9 because it's perceived as a barrier you are breaking through
20 and it's more attractive to the consumer.

MR MARKS: So are you saying you might go just a little bit below the bottom even to secure volume?

MR WILMOT: It will depend on what our current margin is, how much we have got to play with within that month. What the individual impact is at stores. If we are trying to promote a new store or whatever we might price it very competitively to attract people to have a look at it.

MR MARKS: Just to understand your position generally, gentlemen, and I may ask you some more questions about this in a confidential environment, would you say that 7 Eleven are at the low point of the lowest point in the cycle - by that I mean below other players frequently in the Melbourne market?

MR PETIT: At the low end of the cycle?

MR MARKS: Yes, so if you take the curve in its full amplitude from top to bottom, I'm talking about the trough of the low point, call it what you like, and asking you really this question: Does 7 Eleven position itself at lowest point frequently?
40

MR PETIT: If it's not below our cost price, yes, we do.

MR MARKS: What about if it is below your cost price?

MR PETIT: Generally we will try not to. Like last week, if you are you will be caught out if the market fails to cycle.

MR MARKS: But does that mean that below cost you do not go?

MR PETIT: No, it doesn't. In specific areas we may choose to.

MR MARKS: This is all very general. I'm just trying to understand your position.
Do you have a budget?

5

MR PETIT: Yes.

MR MARKS: Why don't we talk about this, then, because this is a central aspect of
your pricing, isn't it? You have perhaps an annual budget. What is the issue here?
10 Are we trying to work out what you need to obtain by volume to get a certain
revenue stream?

MR WILMOT: Normally by gross profit.

15 MR MARKS: Do you have an annual budget?

MR WILMOT: Yes. And by store.

MR MARKS: I was going to ask you. Do you have a monthly budget and a budget
20 by store?

MR WILMOT: Yes.

MR MARKS: You say yes. Do have you have a weekly budget?
25

MR WILMOT: No.

MR MARKS: Within the monthly budget, I presume you have a set of performance
30 targets of some description, do you?

MR PETIT: That's right.

MR MARKS: That will in the end involve a balancing between volume and price to
get return and so on that you are looking to get you a reasonable margin and
35 eventually a reasonable profit, is that so?

MR WILMOT: That's right.

MR MARKS: Is the position, then, that those realities overlay your decisions on
40 price at the various outlets?

MR WILMOT: Not probably on a day-to-day basis. We will expect wild
fluctuations in fuel profitability from month to month.

45 MR MARKS: Forget the day-to-day and look at the beginning of or the upward
movement of the cycle on a Wednesday. Whether you are reacting or leading, do the
realities of your budget bear upon the decision you make as to what price you will
move up to on that day?

MR WILMOT: No.

MR MARKS: None whatsoever?

5 MR WILMOT: No.

MR MARKS: So you might have been trading on a long cycle at very low, close to cost or below cost prices. You will be starting to get a stitch and hurt at the seams. You have to go up. What impacts upon the decision you make as to price you go?

10

MR WILMOT: What the competitors do.

MR MARKS: So you don't have revenue or margin issues in your mind?

15 MR WILMOT: We probably do and we will hope that the overall cycle over 12 months would even that all out?

MR MARKS: So how would you explain it, then, if we were to find Informed Sources data that finds you above the position of other players in the cycle at the top of the peak, how would you explain that?

20

MR PETIT: I'm not quite sure. We would aim to certainly be in line with the market at the top of the peak. Are you looking over a geographical area?

25 MR MARKS: Just looking at figures generally. You would say, if your argument holds good, that we would never find you at a high point in the cycle alone?

MR WILMOT: Unless the market has crashed and somehow we have been caught out and have not responded to the market coming down in a timely fashion.

30

MR MARKS: So you say 7 Eleven's pricing policy generally is to be a follower, to watch others and then to pitch yourself where, a little below the top prices? What's the strategy?

35 MR PETIT: Look, we certainly aim to follow the market. There will be times when, if there is margin available, we can afford to be more competitive than the market. But, again, it will totally depend on the situation at hand.

MR MARKS: Do you have a target margin that you aim to attain on average on a monthly basis?

40

MR PETIT: Yes.

MR MARKS: Do you have achieve that more often than not?

45

MR PETIT: Haven't so far this financial year.

MR MARKS: Is that because of some differing market conditions or just because of poor targets? Has something happened in the market in the last six months that has made those targets unattainable?

5 MR PETIT: Certainly the market failing to cycle for the whole of July in New South Wales.

MR MARKS: Were you on track until the beginning of July?

10 MR WILMOT: That was the start of the financial year.

MR MARKS: What about the last financial year?

15 MR PETIT: The last financial year we made budget.

MR MARKS: Can I ask you - and I will take up some further questions if I may about your pricing position shortly, but I just wanted to ask you a couple of further questions. If the proposition you make is that - and I'm just bringing together a couple of threads here. As I understand your point in your submission it is this:
20 Look, a combination of factors. The people in the market or consumers in the market becoming less price sensitive. Supermarket shopper docket arrangements bringing this impact and so on. The result has been that, broadly speaking, independents have become followers, that in any event 7 Eleven is a follower and its strategy really now is just monitor and respond; am I right thus far?

25 MR WILMOT: Yes. I'm not sure about the first. You said that there was less price sensitivity. I'm not sure where that has come from?

30 MR MARKS: I gleaned what you were saying in your submission effectively that the dockets had increasingly transformed consumer behaviour to the point where there was little volume impact to be achieved through discounting. I have assumed that by that you mean there is a dampening - the impact of the discount - - -

35 MR WILMOT: Sorry, I think we meant our discounting. We can't discount to counteract any volume loss? There is not enough margin there.

MR MARKS: Is there any point in you discounting right down to the bottom of the cycle?

40 MR WILMOT: Again, it goes to the argument we have made on merchandise. If we don't, we are perceived to be dearer across our whole network.

45 MR MARKS: But is there another side to that argument, that there is quite a positive aspect to it, because the more you discount it might affect your petrol returns but it might have significant contra benefits in your convenience store operation by bringing foot traffic in through the door?

MR WILMOT: Not necessarily. Quite a few of our sites, because of the very small nature of them, even in terms of the canopies, et cetera, we actually have sites where you put fuel volume up by being fairly price competitive; our merchandise sales go down. So in fact it isn't necessarily a good traffic generator. The other indicator to
5 us is that, often as you increase volume on sites for whatever local reasons at times, you don't actually necessarily get a huge conversion to merchandise purchase as well.

MR MARKS: Let me ask you a couple of questions just built upon that. Firstly, is
10 one of your strategies to use petrol as a means by which to get foot traffic in the door to your convenience store operations?

MR WILMOT: I think - probably the answer is yes. Out in the outer suburban areas if you haven't got fuel I'm not sure a convenience store can really work.

15 MR MARKS: Let me ask you this, then: In terms of the overall profits of your site operations, can you tell us what proportion generally is made up from profits within the convenience store and what proportion is made up from petrol sales?

MR WILMOT: At a gross level, sorry, even at a net level, the way we analyse it,
20 three years ago in fact we lost money pumping petrol. Last year we have probably made about a quarter of our net profit from fuel.

MR MARKS: When you say last year you mean the last financial year just gone?

25 MR WILMOT: Yes, last financial year.

MR MARKS: So about 25 per cent, 75 per cent - - -

MR WILMOT: Yes.
30

MR MARKS: Is that really underpinning the reality that part of your marketing strategy is really to use the petrol and the availability of discounted petrol as a basis upon which to secure foot traffic through into your convenience store profit areas?

35 MR WILMOT: No, because it's too sensitive. You probably need fuel as a reason to have your convenience store there. But with the high capital intense nature of being in fuel, it is one of the three top categories in your store that has the highest per capital intensity, we just haven't got that amount of flexibility to be able to use it as a loss leader. It is certainly never a loss leader for us to be able to sell more
40 merchandise.

MR MARKS: And yet you say, look, we're a price taker. I'm trying to understand then if I was to see aggressive discounting by, say, 7 Eleven in my observations of the market in Melbourne, how I would align that with your 7 Eleven notion that it's a
45 price taker.

MR PETIT: I think you have to look at what period you are looking at that information over.

5 MR MARKS: Let me give you an indication. From our observations it would appear as if in the last financial year 7 Eleven has been at the bottom - the very bottom and below others - on over 30 per cent of the occasions; that is, one third of the entire annual cycle has seen 7 Eleven at the very bottom and below any other player. Is that the activity of a price taker and, if so, how, please?

10 MR PETIT: Well, again, coming back to our annual volume - sorry, our annual budgeted gross profit that we're heading towards - as I said, we made that budget so we can probably afford to be more competitive in the market. We still had negative - in fuel volume over that period. So we were losing sales to competitors.

15 MR MARKS: Of course that maybe so. And I have no doubt that there are others in the market who when they go below cost are also losing revenue and so on. My question is not that. It is a different question. How is it consistent, on the one hand, to say you are a price taker and yet have to concede - I'm just looking at the figures again - in fact, I was wrong, it appears it is closer to 40 per cent than 30 per cent - 7
20 Eleven are at the lowest proportion of the market a very large proportion of the time; how do you explain that?

MR PETIT: Again, coming back to the earlier statements we made, if we are making margin and we do think there is the opportunity to try to recoup some volume, we
25 will price more aggressively in the market.

MR MARKS: I'm not sure that that really answers my question, but I will put to you a different one. If the data were - and I want you to assume for one moment that it is - sufficient to show that 7 Eleven were at highest point or what I would describe as
30 the peak of the market, 12 per cent of the time last financial year, how would you align that reality with your statement that you are a price taker?

MR PETIT: I would have to see that data.

35 MR MARKS: Assume - bear with me, if you will - that it does bear out that reality, and that 12 per cent of the time 7 Eleven finds itself at the peak, at least on just averaging calculations, what would you say about that? How does that lie with an assertion that you are in truth a price taker?

40 MR PETIT: Again, I don't believe that is the situation. I would be interested in seeing that data. But certainly it's not our intention to be leading the market in any way.

MR WILMOT: It can happen, though, that if we are looking at Informed Sources
45 data and see one or two sites go to \$1.24.9, we take all out sites to \$1.24.9 but the rest of the market doesn't actually make it there, it will look like we are above the market, but we would always try and price ourselves in parity with what we think the market is doing.

MR MARKS: Let me move on quickly to ask you a couple of more questions about the cycle and then I will ask you a couple of other questions in private session. In terms of the impact on consumers - I know that's not necessary in line with 7 Eleven's own position although no doubt it would be interested in its own
5 shareholders' position. From the perspective of consumers do you think that from what you have observed of price cycles there is a benefit to consumers and, if so, what is that benefit?

MR WILMOT: They can choose at what part of the price cycle they want to buy.
10 They have got the option to be buying essentially at cost price if they want to do that on a Monday or a Tuesday, and obviously the majority of them take that option.

MR MARKS: That's to, I suppose, highlight the stark reality of choice available to individual consumers. If I was to put the question more broadly and ask you about
15 consumers generally, do you think the cycle is beneficial to consumers generally? Is the reality that for every guy who gets a good deal there are five who do not?

MR WILMOT: No, because the reality is that more people buy at the bottom of the market. So if anything it is five get a good deal and one does not.
20

MR MARKS: Yes, but is the reality not this also: Although information would tend to suggest that on a median scale more below than above will buy, isn't that a weak argument in a sense that unless you know where below the median and above the median the respective purchases are made?
25

MR WILMOT: I think you can only just make the observation who is buying when and where. I would say - if there is an alternative that might actually be in the consumers' better interest, it seems to me it has got to be a commercial return on investment for the people who are playing in the market. If we are making less than
30 a cent at the moment, whatever you structure with our cycle has to make us at least a cent no matter which way you go. So I'm not sure that it has an overt benefit. I think it gives them a choice of when they actually buy, but I'm not sure there is anything else that necessarily means we can give up some margin somehow to support some other scheme.
35

MR MARKS: That's really what I was getting to. Trying to understand where at the end of the day consumers generally are. From 7 Eleven's perspective, though, you would prefer there was no cycle?

MR WILMOT: So long as there was a good commercial return in the market.
40

MR MARKS: Accepting that is so, do you think that the elimination of a cycle might achieve that end?

MR WILMOT: So long as it stayed at the top of the cycle, yes, it probably would.
45

MR MARKS: That's not going to happen, is it? In reality there will be an averaging. What I'm asking as matter of logic is, assuming that was so, do you think that the

absence of a cycle and the return to a more median price or a median around which price much more closely attends would be preferable from 7 Eleven's perspective?

5 MR WILMOT: Probably, but I have never seen a price cycle stop at a price that still gives you a sensible commercial return.

10 MR MARKS: They are two different points. I'm trying to get to the bottom of whether at the end of the day were a cycle to be eliminated from the market you would see 7 Eleven in a better position, in the same position or in an adverse position to the one it is presently in.

MR WILMOT: I'm not sure.

15 MR MARKS: Have you never thought about it?

20 MR WILMOT: Of course we have thought about it. But we do not have the market power to drive it to that. The trouble is where does that the absence of the cycle actually set your margin? If it's going set it at a gross margin of 3c we are going to be adversely affected. If it's going to set the gross margin at 7c, we are probably going to benefit.

25 MR MARKS: Thinking about that a little further, where do you think you might be with the reality of the supermarket shopper dockets? Assuming that shopper dockets were to continue but in a market without a cycle, what impact might that have for 7 Eleven? Might it mean that the supermarkets were always able to trade 4c below the lowest price? Would that be bad for you? Have you thought about that?

MR WILMOT: Essentially I think that's what's happening at the moment.

30 MR MARKS: Why do you say that?

MR WILMOT: Generally we are matching board price, and they are giving another 4c off that, any way. Whether it's a cycle or whether it's not - - -

35 MR MARKS: But that's not an ongoing thing. The market is cyclical and you have an opportunity to pick back up margin at the high point in the cycle. It's not the same at all, is it?

40 MR PETIT: But in the consumer's - they can still go to the competition and get a 4c a litre discount.

MR MARKS: I accept that. I'm asking you questions about how 7 Eleven sees itself and what 7 Eleven feels would be the consequence to it of the abolition of a cycle.

45 MR WILMOT: I don't think we can tell you unless you can tell us at what margin that cycle - - -

MR MARKS: I just wanted to give you the opportunity. Let me move on quickly to - can I pick up a few more points about the shopper docket, please. In your submission you say - again, I don't see that there is any secret about this, that 7 Eleven cannot compete with supermarket discount offers particularly when they extend up to 10c a litre for prolonged periods of time. Can I just ask you in that context this: How frequently does that happen in reality?

MR WILMOT: I would be - from my observation I would think probably three and a half months a year, four months a year. It was on for nearly two months over Christmas in January.

MR MARKS: Perhaps I better take this by market. Take the Melbourne cycle. How frequently do you say the supermarket docket discount extends 10c a litre for prolonged periods.

MR WILMOT: I think it was nationwide, the Christmas discount that went in in December and was extended into January.

MR MARKS: Obviously, that's the time when that might happen, because people are away and there is less fluctuation in the market. Less attractiveness perhaps to the players in the market to cycle the market. Was the position, though, that 7 Eleven found itself below cost for a significant portion of that time?

MR PETIT: No, we found probably the exact opposite. Our margins were higher.

MR MARKS: But your volume was at the lowest?

MR PETIT: We had negative store growth over those periods. So we were losing fuel sales, but our margin was higher.

MR MARKS: Is that holiday break reality typical in the three markets?

MR WILMOT: I think it was national this year.

MR MARKS: I understand what you say about that. Can I just take that out of the picture because it is something particularly associated with the holiday break. Is it right to say, though, that for the rest of the period the cycle in a sense insures against a prolonged impact of that kind? In other words, there might be a time within a cycle or within one or two cycles when there is a 10c per litre differential, but the occurrence of the cycle and the movement back up to the peak in a sense insures against any long-term impact created by that?

MR WILMOT: There is still a shift in volume even at the top of the cycle, if there is a 10c discount for the consumer going to a Woolworths or Coles co-branded site, we are still going to lose volume from our stores. It will depend on where the market settles in. I think Coles and Woolworths would both say that they are not funding the shopper dockets through the stores, that it has actually been from the supermarkets.

I'm not sure that it actually has an impact on the cycle. It just has an impact on consumers' behaviour.

5 MR MARKS: You say in the submission that the price of petrol and the level of discounting is now effectively being driven by the supermarkets' desire to sell more groceries. Where does that comment come from?

10 MR WILMOT: I think it comes from them, doesn't it? They are saying that the whole idea of doing a discount scheme is to build market share in their grocery business.

MR MARKS: What do you mean by the price of petrol and the level of discounting is now being driven by that reality? What are you trying to say?

15 MR WILMOT: If they are having to run 10c deals every so often, and they do different deals with Liquor Land and OfficeWorks and those sorts of things, they are obviously using it as a loss leader for their other businesses.

20 MR MARKS: Accepting that that is so - I'm looking at your volume figures that we asked you about earlier. It doesn't seem that there has been a significant ongoing adverse impact to your business. You say 7 Eleven has no competitive response to the supermarket dockets; is that an overstatement?

25 MR WILMOT: No commercial competitive response that we can find.

MR MARKS: You seem to have attained a commercially sound position in the market. Do you want to undermine that by this comment, "7 Eleven has no competitive response".

30 MR WILMOT: In other words, we are not going out to discount. We are not going to do a Mobil deal, which is a 4c discount against a \$5 purchase. Our like store volumes are still down. We have only built market volume because we have built more stores.

35 MR MARKS: But that's been a competitive response. You have only lost 8 per cent by volume and you have recovered it and intend to do better than recover it over time. Is this not a bit of an overstatement really?

40 MR WILMOT: But we have had to significantly invest in infrastructure and capital to even just get that extra volume.

45 MR MARKS: But no doubt you have done that with careful application to the critical questions as to whether you will achieve a return and presume that you have or you will and you are?

MR WILMOT: Yes.

MR MARKS: I just want to make sure the Commission understands the seriousness of your comment. You say that "we have no competitive response". Do you mean by that that other than what you have done thus far in the market, which it does appear has been a successful competitive response, you do not intend to take any
5 further steps specifically responsive to the shopper docket scheme?

MR WILMOT: I think that's right. We don't intend to go down a discount route.

MR MARKS: Can I then just go quickly to a few more comments before I ask the
10 Commission if we can go into private session. Firstly, can I ask you about the last part of your submission, where you have - again, I hope there is no difficulty with me - and, gentlemen, I'm going to move to question 16 - asking you about this in open session. Because you have raised some points which are potentially important. You said this, just for the record. I just think I said, and perhaps I didn't make it clear
15 enough, I'm going to question 16. Is it all right if I ask you questions about that?

MR WILMOT: That's all right. The only thing I would see sensitive there might be the international freight marker. But in general terms I'm happy to talk about it.

MR MARKS: Can I ask you, then, can you describe to us just with a little more
20 elaboration, please, you said impediments in the wholesale market are - and the first you have identified is the buy/sell arrangements. We are familiar with the buy/sell arrangements. Why do you say that the buy/sell arrangements at wholesale between refiners are an impediment? We would be interested to know your answer, please.
25

MR PETIT: I think what we were looking at - the question we were asked to answer there, just in relation to how the buy/sell works. Obviously we are making our own interpretation of how it works. I guess with the trading and supply between the majors, they are effectively showing each other what their pricing is, would be I
30 guess our interpretation of that first statement.

MR MARKS: What do you mean by that? Secondly, what are the consequences?

MR PETIT: Just with quality premiums, different formula increases coming into the
35 market - imposing those cost on another one, do they then become part of that major's cost base? And is it passed around like that? Is that how we manage to change international freight markets? Those sorts of issues.

MR MARKS: That's an important consideration. Are you suggesting that built into
40 the buy/sell arrangement there are - and between the major oil companies - there are either costs or margins which do not accurately reflect the real position in the market vis-à-vis the particular entities?

MR WILMOT: I don't think we know.
45

MR MARKS: It is just an area where there is room; is that what you are saying?

MR WILMOT: I think so.

MR MARKS: Okay. Then you talk about the quality premiums. Is the point really a similar one there?

MR PETIT: It is, yes.

5

MR MARKS: I won't ask you about the third point in open session, if there is an issue about that.

10 Thank you, Mr Chairman. That concludes the questions we wanted to ask in public session. There are some matters I would like the opportunity to follow up in closed session.

15 THE CHAIRPERSON: Just before we do that, I have a couple of questions I want to pursue on the issue of the shopper dockets. I'm very sensitive to some material you have put in here which is confidential. We have noted the issue of volumes and volume information you have given us in the answer to question 5. And the movement in margins that you have answered in question 6. I won't mention those in open session, but they are set out in the confidential material.

20 Noting that the shopper dockets came into place in about 2002-2003 and have been continuing ever since, you are not Robinson Crusoe amongst various groups that have asked us to consider the possible banning of shopper dockets if we were able to do so. You are not alone in that. I wanted to ask you this: In the event that we determined the shopper dockets should not be banned, that we should not revoke the notification or the authorisation with respect to shopper dockets, would you pursue your own discount scheme along the lines of that that you have in a couple of your outlets which I think is the Maxifood supermarkets?

25 MR WILMOT: No, we would be more than happy to see those go.

30

THE CHAIRPERSON: Most retailers would be very happy to see any discount scheme go to increase their margins. Does that mean you would take a view that the volume trend shown in your answer to question 5 and the margin trend shown in answer to question 6 would continue unabated and you wouldn't need to pursue a shopper docket scheme to compete with the supermarkets?

35

MR WILMOT: There are two parts to the answer. One, I don't think we would come up with a commercial arrangement that would make sense for us to have discount shopper docket scheme. I don't think we can do something like that. I don't think there is anyone for us to align to and I don't think there is anything we can do commercially ourselves. I think the margin trends would probably tend to continue, whether there was a shopper docket scheme or not. While it appears that there has been some increase in margin, I think we have made it very clear on several occasions that in fact our margin percentage has gone down over the last seven years.

40
45

THE CHAIRPERSON: I'm just looking at the margin percentage. Again, I wouldn't mention these in open session. But I'm looking at the margin percentages outlined in question 6, Victoria, New South Wales and Queensland, and the national margin

over the period from the commencement of the shopper docket schemes through to current time. That doesn't suggest a downward trend, does it?

5 MR WILMOT: No, I think I was looking at a period over seven years. When we plotted it out over seven years, there has been a slight downward trend.

10 THE CHAIRPERSON: I was perhaps just trying to focus your attention on the period since the inception of the shopper dockets have been. Although it seems to have been a positive impact rather than a negative one.

MR WILMOT: It does appear so.

15 THE CHAIRPERSON: If that's the case, you want to see shopper dockets banned? If you've had a positive impact on volumes and a positive impact on margins?

MR WILMOT: I think we would get a huge improvement in volumes again if shopper dockets were banned.

20 THE CHAIRPERSON: I'm sure you would. What impact do you think that might have on consumers?

MR WILMOT: I think it would depend on where it settled out in the market. I think it would depend on how supermarkets reflected back in their pricing in their grocery stores.

25 THE CHAIRPERSON: Thank you.

30 MR MARKS: Just one follow-up matter from that. Assuming that something short of banning shopper dockets were on - perhaps I will put the question differently. Is there something short of an absolute ban on shopper dockets that you think could be put into the marketplace and which would impact beneficially on both consumers and 7 Eleven?

35 MR WILMOT: I can't think of anything. The one that would probably benefit 7 Eleven is if there was stricter enforcement of not selling under cost. I think that would be an extremely good one for 7 Eleven. Whether it was in the consumers' interest I'm not sure.

40 MR MARKS: Would it be in consumers' and 7 Eleven's interests perhaps to somehow narrow the impact of the shopper docket so that it was only redeemable within a geographical vicinity or within a distance from the store that it was obtained from? Is there some scheme like that which might work well for both the consumer and 7 Eleven?

45 MR WILMOT: I haven't really thought that one through. I think the information is that most dockets are actually redeemed within a fairly short geographic area, anyway.

50 MR MARKS: That may be so, which is why I was asking the question.

MR WILMOT: It might not change anything.

MR MARKS: All right. Mr Chairman, thank you.

- 5 THE CHAIRPERSON: We will ask those not associated with 7 Eleven or the ACCC to perhaps vacate the room.

WHEREUPON THE HEARING MOVED IN CAMERA

[4.10pm]

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