Public hearing – Sydney, 4 September 2007

Time: 9am
Address: Novatel Brighton
Cnr Grand Parade and Princess Street
Brighton-le-Sands
Room: La Perouse

Time	Witness	Submission
9am	Caltex Australia Petroleum Pty Ltd Mr Des King, Managing Director. Alex Strang General Manager, Supply and Distribution.	37
	Woolworths Limited Mr Rumnik Narsey, General Manager Petrol.	34

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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: **NOVOTEL BRIGHTON BEACH, BRIGHTON-LE-SANDS (SYDNEY)**

DATE: **9.00 AM, TUESDAY, 4 SEPTEMBER 2007**

THE CHAIRPERSON: We will recommence. 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, on my left. As Chair, I welcome you all and declare this hearing open.

This 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. Results of the ACCC's inquiry will be reported to the Treasurer by 15 October 2007. Unless directed otherwise, the ACCC must make its report public after 28 days. 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 of 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 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 do understand that the price of petrol is of immense concern to all Australian motorists but it will greatly assist us in the efficient and effective conduct of hearings if participants confine their remarks to the critical issues and not simply provide commentary on the price of petrol. Witnesses appearing today will be questioned by counsel assisting the ACCC. Counsel appearing today are Neil Young and Simon Marks, both of Senior Counsel, and Fiona Forsyth. Some witnesses will also be represented by their own lawyers.

I would also note that the conduct of this inquiry is within the discretion of the inquiry Chair. Anyone using insulting language or otherwise disrupting the hearing may be excluded.

The ACCC may wish to questions 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 maybe 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. 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 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 will not be made available on the website.

With those matters dealt with, I propose to begin by asking the witnesses from Caltex to, please, for the record, state your name and position.

MR DES KING: Des King, CEO and MD of Caltex.

MR STRANG: Alex Strang, general manager, supply and distribution.

THE CHAIRPERSON: If you have legal representatives with you here today, could they please announce their appearance?

MR HUGHES: Paul Hughes of Freehills.

MS CONWAY: Helen Conway, general counsel, Caltex.

MR OCHS: Greg Ochs, senior corporate counsel, Caltex.

THE CHAIRPERSON: Thank you very much. I would like to inform you about some of the rules regarding giving of 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 under affirmation. If you believe an oath would not be binding or for religious reasons you are prevented from swearing on oath on the Bible then you may give your evidence under affirmation.

<DES KING, SWORN **[9.04am]**

<ALEX STRANG, SWORN

MR YOUNG: Mr King, do you wish to make a preliminary statement on behalf of the company?

MR DES KING: I would be very happy to do that, if I may.

MR YOUNG: Only if you wish.

MR DES KING: May I take the opportunity? I would appreciate it, thank you very much. I appreciate the opportunity of coming to the inquiry today and to give evidence, and we look forward to hearing the results of the inquiry. I think it's a very good step forward to look at petrol prices and to get to the facts because a lot of people come out with assertions rather than facts.

Australia will remain dependent on imports of petroleum products for the foreseeable future. Petrol imports to Australian quality standards are readily available to Australian refiners and independent importers. About 100,000 barrels per day of

Australian grade petrol are accessible to Caltex and any importer, well in excess of current import requirements, and that is in addition to structural supply to Shell and Mobil from their parents' refineries in Asia. The reality of import competition places a strong constraint on wholesale prices in Australia and reinforces import parity pricing as the essential basis of petrol pricing in this country.

The Singapore refined petrol price is the pricing benchmark, as Singapore is the closest major refining centre to Australia and is the major source of imported petrol. Wholesale prices follow movements in Singapore refined petrol prices rather than Singapore crude oil prices because local refineries have to compete with the refiners in the region supplying fuel suitable for import into Australia. Australian pump prices in response to Singapore petrol prices are symmetrical and follow the wholesale price with some delay. Historical data shows retail prices do not respond exactly to Singapore petrol prices. In particular there is no precise arithmetic relationship between retail prices and the Singapore prices or Mops 95.

Turning to market structure, assertions have been made that structural changes have reduced competition. In fact, the retail petroleum industry is not highly concentrated. The structure of independent retailers and resellers has changed in the past 10 years, but competition has, if anything, increased.

The change in marketing structure has not resulted in an increase in Caltex margins at the wholesale level. This supports Caltex's view that the wholesale petrol market remains highly competitive. On the issue of price cycles, they are a product of Australia having one of the most transparent and competitive retail markets in the world. Our information about competitor prices is prominently displayed on roadside price boards and otherwise available in just about realtime to persons who subscribe to fuel price monitoring services.

I understand the angst that price cycles cause consumers, but overall the cycles operate to their benefit. Our information indicates that 60 per cent or more of motorists take price into account when buying petrol, and most can benefit directly by timing their purchases to match price cycles. About 55 per cent of Caltex petrol is sold on low price days of the week. According to the latest available government statistics, for the December quarter 2006, the retail price of petrol in Australia at 63.3 cents per litre before tax ranked it as the third lowest petrol price of the developed countries before tax. Lower, for example, than the UK and the USA. We certainly don't have the economies of scale that places like the United States do have, yet we are still cheaper before tax.

High volumes and high efficiency are required to be profitable in the downstream petroleum fuel business. In the first half of 2007, Caltex profit on a replacement cost of sales basis was only 2.6 cents per litre on average for all petroleum products sold. This number is the sum total of profit over Caltex's entire value chain, including both refining and marketing. More detail on these points is set out in the balance of my witness statement and in Caltex's submissions.

I would also like to comment, too, on statements by the NRMA. We did not comment in the media yesterday because we believe that this petrol price inquiry is the appropriate place to bring up comments on petrol prices, not to use the media as a proxy for this petrol price inquiry. So we saved our remarks on that issue about Tapis crude and petrol prices until this inquiry today, but we would like to comment on those NRMA statements.

Australian petrol prices are based on the price of petrol from Singapore refineries, the source of most of Australia's petrol imports. In the 65-day period recently referred to by the NRMA after the ACCC inquiry was announced, pump prices for petrol in Sydney were an average 4 cents per litre lower than the same period prior to the announcement of the inquiry. Over the same periods, the Singapore refinery price of petrol was also, on average, 4 cents per litre lower. The fall in pump prices was the same as the fall in Singapore refinery prices. Over the same periods, the change in Tapis crude oil prices was about zero. The fall in pump prices was not related to crude oil prices.

MR YOUNG: Thank you, Mr King. The NRMA's evidence given in the hearing yesterday, I think, if you examine, you will find the issues you raise are already issues that have been taken up by the ACCC. Mr King, can I start with the question of imports to which you referred briefly. Your view, as I understand it, is that imports are readily available to anyone wishing to import petrol into Australia?

MR DES KING: Yes, we scan the market on a regular basis, because we also import petrol, and our analysis indicates that in addition to petrol being imported by Shell and Mobil into their facilities, there is 100,000 barrels a day of Australian grade petrol on the market for import, far in excess of Australia's needs, and that data is in our submission.

MR YOUNG: Are there any constraints on the ability of independents to import petrol into Australia?

MR DES KING: There are a number of independent terminals. If independents wish to import, then they need to access those terminals. There a major one in Sydney, for example, Vopac, which is an independent terminal.

MR YOUNG: Yes, which is fully contracted to the major oil companies at the moment, is it not?

MR DES KING: I am not aware of those details, but there is certainly another import terminal in Darwin and there are other import terminals around Australia.

MR YOUNG: You would agree, would you not, that the lack of terminal and storage facilities in Australia is posing an increasing restraint on the ability of people to import? Do you agree with that?

MR DES KING: We can't comment on third parties because we can only comment on what we do as an importer. We have, in the details of our submission, all the details of our terminals and the fact that our own terminals are running very much at capacity. Australia imports almost 20 per cent of all its petrol needs. So those terminals are very important to bring that petrol into the market. Our own terminals are running at full capacity for our own use.

MR YOUNG: Mr King, Caltex's terminals are fully utilised by Caltex; correct?

MR DES KING: That is correct.

MR YOUNG: So you have no surplus storage capacity available to importers?

MR DES KING: No, we are running at very high turn ratio, in terms - in some terminals it's up to 50 or 60 times that tank volume has moved through every year, because we not only import petrol. A third of all diesel that comes into Australia is imported, too, so those importer terminals are required to import a number of petroleum products.

MR YOUNG: The other major oil companies are in a similar position, are they not? No surplus terminal capacity?

MR DES KING: We can't really comment on their exact capacity because we don't know that in detail, but we can certainly comment that our own capacity is fully utilised.

MR YOUNG: If we take Brisbane, the only available terminal for importers is the small terminal operated by Neumanns; is that right?

MR DES KING: I will refer to Mr Strang, who is a supply expert, but I believe that is correct.

MR YOUNG: Correct, Mr Strang?

MR STRANG: I believe that is correct.

MR YOUNG: That is also limited by wharfage restrictions?

MR STRANG: Yes, there are limitations in the size of cargo that can be taken to the terminal.

MR YOUNG: Yes, there are draught restrictions on the wharf so only relatively small vessels can access that terminal?

MR STRANG: At the present time, correct.

MR YOUNG: There is no independent terminal facility in Adelaide; is that right?

MR STRANG: At the present time, although there was a recent announcement of an intention to build a terminal at Port Bonython.

MR YOUNG: By who?

MR STRANG: It was a joint venture. Scotts was one of the parties. I'm just struggling to remember who the other one was.

MR YOUNG: Has it gone anywhere, the proposal?

MR STRANG: All I know is what I've read in the press of an intention. As to whether that will transpire, of course it takes some time between an announcement and the intention to having a terminal in place.

MR YOUNG: Yes. There was a Mobil facility at Port Stanvac in or close to Adelaide, but that's been mothballed, has it not?

MR STRANG: That's correct.

MR YOUNG: You see - no signs that it's going to reopen, do you?

MR STRANG: No, there are no definite intentions to reopen that.

MR YOUNG: The way in which refining is heading in the region would suggest that it's not going to be reopened; is that your view?

MR STRANG: That would be my personal view.

MR YOUNG: There are no independent import facilities in Hobart or elsewhere in Tasmania?

MR STRANG: No, that's not correct. Mastelle has a small terminal at Bell Bay.

MR YOUNG: There was a facility at Hastings in Victoria owned by Trafagura. That's up for sale, is it not?

MR STRANG: There is a facility at Hastings owned by Trafagura. It is still being used by Trafagura. There was an expression of interest process conducted late last year. We understand that there was not a sale forthcoming. I do not know Trafagura's present intentions.

MR YOUNG: Is it correct, to your knowledge, Mr Strang, that all of the available terminal capacity in Sydney, including Vopac's terminal at Botany Bay, is fully contracted to the majors?

MR STRANG: I believe that's the case, although I cannot say definitively what the arrangements are at the Vopac terminal. If I can add, there are proposals/plans to extend the capacity of the Vopac terminal, and I'm not aware of any limitation on who may enter into arrangements in utilising that additional capacity.

MR YOUNG: Your submission - and either Mr King or Mr Strang can answer this - suggests that in 2006, 18 per cent of Australia's requirements for petrol were imported; correct?

MR DES KING: That is correct.

MR YOUNG: Do you know how that was broken down, who did the importing?

MR DES KING: We certainly know how much importing we did, and that's in our submission.

MR YOUNG: In 2006?

MR DES KING: That's correct.

MR YOUNG: How much did you do?

MR DES KING: We imported of the order of 4 per cent of our needs. That's in our submission.

MR YOUNG: And of the 18 per cent?

MR DES KING: If we can refer to the chart that's in the document, that will give the exact details. I would refer you to that chart.

MR YOUNG: Do you have the page?

MR DES KING: That will be at page 26 of the confidential submission. If we look at that, you can see that that's where we state that Caltex imported as a per cent of sales 4.3 per cent in 2006 - per cent of our own sales. It talks that the industry imported as a per cent of sales 18.1 per cent. We show the break down of the types of petrol that we imported. You can see that of the total - there were a total number of imports of 3,429,800. That was the total, and of that total amount of imports, ours was of the order of 10 per cent.

MR YOUNG: Yes.

MR DES KING: So, roughly 3 million litres imported and we were 10 per cent.

MR YOUNG: So you roughly represent 2 per cent of the 18 per cent - 10 per cent.

MR DES KING: Correct. That's 2 per cent of the total imported into Australia, that's correct.

MR YOUNG: You say in your submission that you estimate that the level of imports in 2007 had gone up to 25 per cent, or is that all petroleum products?

MR DES KING: That 25 per cent is of all petroleum product.

MR YOUNG: Do you know what the figure then is in 2005 for unleaded petrol - in 2007?

MR DES KING: Oh, 2007, I do not have the up-to-date data for 2007. However the market for petrol for the first half of 2007 expanded by about 2 per cent in Australia. So one can imagine that the imports, if there are 18 per cent of our total needs in 2006, would be of a similar order for the first half 2007, somewhere in the 18 per cent to 20 per cent range.

MR YOUNG: Are you able to estimate the extent to which the other major oil companies import petrol in 2006 and 2007?

MR DES KING: We don't have exact details on what they do because obviously that is commercially sensitive to them. We just see the total numbers from government statistics.

MR YOUNG: Of the 18 per cent, how much is represented by the majors in 2006?

MR DES KING: I do not have that information. Do you have that, Alex?

MR STRANG: I don't have a precise figure. It would be the greater majority. I'm sorry, the great majority.

MR YOUNG: And the same in 2007, you would expect?

MR STRANG: That's my understanding.

MR YOUNG: Your submission says at page 35 that, in general, industry terminal capacity has become increasingly constrained as a result of factors that you mention. That's a reference, is it not, to the fact that terminal capacity is very largely fully utilised.

MR DES KING: That is correct. Australia, because of the shut down of the refinery by Mobil at Port Stanvac and the fact that the Australian market has expanded so much, particularly for diesel, means that Australia is such a net importer now the existing infrastructure is very much constrained.

MR YOUNG: That is likely to have an adverse impact on the ability of independent oil companies to import; would you agree with that?

MR DES KING: We are not party to negotiations that independent companies may have with their terminals, but from a Caltex standpoint, because our terminals are running so much at capacity, we wouldn't have the capability of taking additional import.

MR YOUNG: The fuel you import, that's basically used to meet your needs for the supply of petrol in those states where you don't have a refinery? Is that a fair conclusion?

MR STRANG: Not exactly.

MR YOUNG: Could you explain it to me?

MR STRANG: In the states where we don't a refinery, it is normal for us to enter into a supply contract - a purchase contract - to meet our needs. It's fairly rare for us to import into those locations. Our imports are, for gasoline, petrol, would be into Queensland/New South Wales.

MR YOUNG: Yes. So you are able to get supplies of petrol in other states where you don't have refineries by virtue of the buy/sell arrangements which you have with the major oil companies; correct?

MR STRANG: Correct.

MR YOUNG: And those buy/sell arrangements are essentially standing six-month contractual arrangements?

MR STRANG: I'm not sure about standing, but they are six-month contractual arrangements.

MR YOUNG: Rolling six-month contractual arrangements?

MR STRANG: Generally, the standard terms and conditions have remained pretty much the same since 2002-03. What happens each six months is that there is a negotiation around quantities and price for the ensuring six months.

MR YOUNG: The nature of the buy/sell arrangement is that - let's take one between - hypothesising between Caltex and Mobil. The nature of the arrangement is that you agree to sell Mobil - to Mobil - its stipulated requirements for petrol within certain maximum and minimum limits at a particular price you have negotiated and, under the same contract, the converse happens, Mobil agrees to sell to you petrol that you may require at that same price and within specified quantity limits; is that the basic nature of the agreement?

MR STRANG: One correction. There are two separate contracts.

MR YOUNG: Two separate contracts but do the same terms apply to the purchase or sale transaction?

MR STRANG: The contracts, for example, the purchase contract, will apply to a set of locations, and that's a different set of locations to the contract for the buy arrangement. There are specific negotiated pricing outcomes in relation to each location. They are not identical in every location.

MR YOUNG: But is the same pricing formula used for the purchase and sale?

MR STRANG: The same structure for the pricing formula is used.

MR YOUNG: And the same basic financial elements of the pricing formula?

MR STRANG: Yes, the same structure, the same elements are used.

MR YOUNG: The basic notion is that you agree to buy and the other party agrees to sell at a price that is essentially the same, with the same structure and the same elements, although there may be minor location adjustments, depending on where the fuel is picked up and used?

MR STRANG: In respect of a given party, that's basically correct.

MR YOUNG: And it's a contractual arrangement under which an average price applies to all purchases in a given month?

MR STRANG: Yes, it's the arithmetic average in that month of the various indicators.

MR YOUNG: And the purchaser pays in the following month for the previous month's usage?

MR STRANG: Correct.

MR DES KING: I should add that all of the details of the buy/sell agreements, all those detailed contracts have been submitted to the ACCC.

MR YOUNG: I'm aware of the detail, Mr King. I'm just trying to get the structure as much as we could in open session. Just in terms of the volumes you have imported, say, since 2006, why is it that imported - imports are particularly necessary for Caltex to meet requirements in Queensland and New South Wales?

MR STRANG: Our sales requirements are in excess of what we can produce.

MR YOUNG: Does that take account of what you have to supply to other oil companies in those two states under buy/sell arrangements?

MR STRANG: Yes, it does.

MR YOUNG: So your refining facilities aren't sufficient in those two states to produce all of the petrol you need for your own requirements and to meet your buy/sell commitments to other oil companies?

MR STRANG: That's correct. They are reasonably close. If I can perhaps offer one technical detail?

MR YOUNG: Yes.

MR STRANG: The producibility of petrol is not ratable across the year. So we do not make the same amount of petrol every day through the year. Most of our importing is in fact to cover scheduled shutdown periods.

MR YOUNG: Scheduled periods for maintenance and upkeep of the terminal facilities?

MR STRANG: That's correct, and part of a refinery shutdown.

MR YOUNG: Aside from these periods of scheduled shutdown or perhaps the occasional unscheduled breakdown, are your refining capacities sufficient to meet your needs?

MR STRANG: They are reasonably close and they are sufficient in winter, probably a little bit on the short side in summer. Again, getting a little technical - the producibility is a little different between seasons.

MR YOUNG: Would you agree with the proposition that terminal infrastructure in Australia at the moment is scarce?

MR DES KING: We could certainly talk about our terminal infrastructure. It is constrained. The market has grown so rapidly and because refining capacity has actually shrunk in Australia rather than grown, because of the economics of running small refineries, more and more imports are coming in, which is constraining the terminal infrastructure.

MR YOUNG: Would it also be correct to say that 90 per cent of terminal infrastructure in Australia is controlled by the four major oil companies?

MR DES KING: We have details in our submission about our terminal capacity. In terms of the rest of the industry, Alex, maybe you can make a comment.

MR STRANG: I haven't done the maths, but that number wouldn't surprise me.

MR YOUNG: Do you have any idea of what it would cost to develop terminal infrastructure capable of handling large shipments of petrol, a full ship load, for instance?

MR DES KING: We have data from the latest industry terminal which was built up in Darwin and that, I believe, cost $60 million.

MR STRANG: That's a 100 megalitre terminal, so it's a large terminal.

MR DES KING: As an independent terminal, the most recent one built.

MR YOUNG: That's Vopac, is it not?

MR DES KING: That is correct.

MR YOUNG: Has the availability of imports into Australia in the last few years been difficult to obtain because relatively few Asian refiners make petrol that complies with Australian fuel standards?

MR DES KING: The Australian fuel standards have been changing steadily over the last few years. There was a major change in 2006 where we went to 1 per cent benzene or less. But despite that, we still estimate today that 100,000 barrels a day of petrol is available on a market base of our analysis that could be imported into Australia, far more than our import needs.

MR YOUNG: From what countries is that obtainable?

MR DES KING: We have a chart that's included on page 27, if we look at that.

MR STRANG: Pages 27 and 28.

MR DES KING: This gives a break down of the cargoes that we believe are available. For example, 2007. So one to two cargoes from Taiwan, one cargo from China, one cargo from GS Caltex in Korea, one cargo from Japan, six from Singapore, a total of 11 cargoes we believe are readily available per month, which equates to 100,000 barrels a day. This is in addition to the imports that are coming we believe directly from Mobil's Singapore refinery into Mobil and Shell's regional refineries into Shell.

MR YOUNG: Mr King, just looking down that list, a number of those cargoes have quality limitations that make them noncompliant with Australian Standards.

MR STRANG: I think that's a misunderstanding. The limitations are a brief explanation as to why they can't make more, or in cases like Formosa, where they are saying none. But the reason they can't make Australian grade is they have difficulty in meeting the Oliphant - but where we have said in the column Australian grade cargoes available per month, there are no limitations in general around that column. The other columns are an explanation of why not more.

MR YOUNG: Yes, but if we look at Taiwan, where Mr King referred to one to two cargoes, the limitation stated is user's MTBE.

MR DES KING: And that is a limitation for more than the one to two cargoes being available. Refineries can slipstream and make small amounts of a given quality. But the impediment in this refinery to making more than those one to two cargoes per month is that MTB limitation. The one to two are available; the additional are not.

MR YOUNG: The other constraint on these cargoes would be to ensure that, from an importer's perspective, they could be obtained at a price which would make the fuel competitive when it gets to Australia; correct?

MR DES KING: That is correct. But our refineries in Australia compete against import parity pricing. So one would imagine that an import of these larger cargoes would be directly competitive with the import parity of other cargoes, because that's what our refineries have to compete against and that in fact sets the wholesale price.

MR YOUNG: It all depends on what refineries in Taiwan and China and Korea would charge and what freight prices might apply to transport in those countries; correct?

MR DES KING: That's correct. But it's a very transparent market. With Singapore being the hub of refining in Asia, a lot of the prices may well be set to assuming Singapore as a benchmark hub.

MR YOUNG: If we have evidence from major independents to the effect that importation is not a credible proposition in the near term, would you disagree with it?

MR DES KING: We can't speak to what their potential commercial arrangements are, but with some of these refineries that could supply them, certainly we could speak to our arrangements are when we import cargoes, and we certainly can import those cargoes and access them on a price based on import parity pricing.

MR STRANG: If I may, could I just elaborate?

MR YOUNG: Yes, go ahead.

MR STRANG: In my view, it turns on what we mean by "near term". If the near term means the next six months, the answer is the only opportunity is via traders into the existing independent terminals.

MR YOUNG: Yes, which are capacity constrained at the moment; correct?

MR STRANG: Correct. If one took a longer term view, though, one can come a different answer.

MR YOUNG: So in the longer term, imports may become a more viable proposition; is that your position?

MR STRANG: Yes.

MR YOUNG: You will have to speak for it to be recorded rather than nod.

MR STRANG: Yes.

MR YOUNG: Let me take those 12 Caltex cargoes that you have referred to, three from Korea, five from Singapore and four from Taiwan, in the 18 months since January 2006 - looking at that page you took me to. What in fact was the fuel imported? What grade was it? Was it Mops 95, was it Mops 91, 92?

MR STRANG: I don't have the details of those cargoes with me but they would normally be mixed cargoes, so there would be unleaded petrol and premium unleaded petrol.

MR DES KING: They would be Australian grade petrol, they would not be Singapore grade Mops 95 and Mops 92. That is the Singapore grade, which does not meet Australian quality standards.

MR YOUNG: If we speak of 91RON or 95 or 98RON, what would be the mix of those cargoes?

MR STRANG: Primarily 91 and 95 research octane.

MR YOUNG: To what extent would it be 95RON that goes into premium unleaded petrol, compared to the 91RON which goes into the unleaded petrol?

MR STRANG: I believe these were finished cargoes, finished product, so - the exact ratios I don't remember. I think if I were - we can get you the data. For the purposes of the discussion now, I would say about 75:25.

MR YOUNG: 75 per cent for 91RON.

MR STRANG: That would be a rough indication.

MR YOUNG: If that is in fact what is imported, is it correct that for those imports, the pricing is based on the Singapore standard Mops 95, which presumably relates to 95RON?

MR STRANG: The unleaded petrol, with a research octane specification of 91 would have been priced off Singapore Platts 95; and the premium unleaded, with a RON specification of 95, would have been priced off Singapore Platts 97.

MR YOUNG: Why is it that when what in fact is imported is unleaded petrol at 91RON, it's priced off a benchmark Mops 95, which is for a higher grade of petrol?

MR DES KING: If we turn to page 31 in our submission, we talk to what the Singapore quality is versus Australian requirements, and octane is only one requirement. Unfortunately, there is no benchmark Australian grade petrol so we have to take an industry benchmark of one of the Singapore Mops, Mops 95 is what we use, and then adjust it. If one looks at page 31, for example, one can see that there are a number of qualities in the Singapore gasoline which are different qualities, worse qualities, to what Australia requires. Running down the list here, for example, more lead is allowed in Singapore grade. It's de minimus nothing here. Higher vapour pressure potentially, a very different boiling range, which is very different from Australian grade. Has a very different benzene content; is allowed to have up to 5 per cent benzene, whereas in Australia we are only allowed to have 1 per cent benzene.

Going to some of the other factors, different MTB content is allowed to be added into the Singapore grade, up to 10 per cent MTB. There are a number of quality factors built into that Singapore benchmark which are very different from Australia. So, whichever benchmark one picks for Singapore, octane is only one of the elements. It has to be adjusted for quality. One has to get Australian grade quality, which is actually higher quality than the Singapore grade. Octane is just one measure.

MR YOUNG: Is it right to assume that the price under the Singapore benchmarks of Mops 95 is higher than the price of Mops 92?

MR STRANG: It's correct to assume that Mops 95 is higher than Mops 92, yes.

MR YOUNG: Mr King has referred to these quality differentials between the Singapore grade petrol and what is imported to Australia as RON91. But isn't it true that quite aside from the pricing benchmark of Mops 95, a quality premium is applied to account for those differences in quality?

MR STRANG: It's both things together.

MR YOUNG: You will need to expand on that answer, Mr Strang. Just for the sake of clarity. I think I understand you, but if you can expand.

MR STRANG: Sure. When you are buying the gasoline, the FOB price, the price at the refinery, is - that you are buying from - is so many dollars. That dollar is expressed in a marker and a premium or discount in relation to that marker. That marker then is used to adjust the price as to what the marker is at the pricing out period on that cargo. So the marker is simply a means of allowing for a variation. As you would be well aware, Singapore prices can fluctuate quite dramatically.

MR YOUNG: I come back to my question: If a separate adjustment is made for the quality differentials between Australian grade petrol and Singapore grade petrol, why is the pricing then based on a benchmark of Mops 95 for unleaded petrol rather than Mops 92?

MR STRANG: It could be based on 92. Some trades are done on 92.

MR YOUNG: Yes.

MR STRANG: However, the final price will be the same, as long as the 92 and 95 move together. For example, you may purchase unleaded petrol for - priced off 95 plus $2.75, I think is the example that we used in our submission. If we were to price off 92, it would be 92 plus $3.75. So it's simply a matter of convention. Why do we prefer the 95? Why is that? Because it's closer in quality, the underlying blend components that would get us to Australian grade 91 petrol, particularly with the low MTBE and the low benzene contents, such that it's a price above 95. The second reason is - it has become the standard. That has led to that being the standard in our selling prices as well. So by buying off 95, we are removing a basis for risk relative to our selling price.

MR DES KING: Overall, since the standards in Australia have been getting to a higher and higher quality since 2003, our estimate is that the quality premium, the higher cost of this petrol is, on average, 2 cents to 3 cents per litre. That's the impact on petrol prices.

MR YOUNG: It seems from the information you have given the ACCC that although on those rare occasions when Caltex exports petrol, the pricing tends to be on the basis of Mops 92 rather than Mops 95. Is there some reason for that?

MR STRANG: I haven't got the full detail here. Not all of the petrol that we are exporting - in fact, the great majority of it - does not meet Australian grade standards. So, for example, if I go through the exports in 2006, when we are selling blend stock which didn't meet Australian specifications on Oliphants. We sold another one, it was a sale where we weren't meeting octane level, so in those cases, as it's not Australian grade quality, it would be quite normal in Singapore to trade on 92. There is a lot of trade in Singapore on both 92 and 95.

MR YOUNG: It's been suggested by others to the Commission that it be more appropriate for pricing benchmarks in this country to use Mops 92 rather than 95. I take it for the reasons you have explained, Mr Strang, you would disagree with that change?

MR STRANG: Yes, our preference would be at this juncture to stay with 95, for the reasons stated. It's a commercial discussion. As you will know from the material we have provided, there is some buy/sell activity based on 92. So whether it's 95 or 92 is not a matter that is of great moment, because the volatility of the differential between 95 and 92 is not particularly high. So, for example, this year it has ranged between 80 cents and $1.30 to $1.40 is the differential. It works itself out generally over time.

MR YOUNG: When you say some buy/sells are based on Mops 92, you are referring to buy/sell agreements in Australia between the major oil companies, are you?

MR STRANG: We are referring to current buy/sell arrangements between ourselves and another company.

MR YOUNG: Is that exceptional? In other words, it's only that buy/sell arrangement with that company which is based on Mops 92? The others are based on Mops 95?

MR STRANG: Correct.

MR DES KING: As a general statement, we would be happy using either benchmark, but since both benchmarks are openly traded and one can use those as a basis, then all of the adjustments for quality are from different bases. So either is acceptable. In fact, as you see, we do use both, depending on the negotiation.

MR STRANG: Can I just add one thing? One of the reasons that 95 prevailed at the time when we moved from refinery exchange to buy/sell, was at that particular juncture, the 92 price was heavily pushed down, in 2002, and it wasn't really - people weren't happy to do deals on 92 for Australian grade petrol. I think folks are a lot more relaxed about it now. It's always a commercial decision.

MR YOUNG: But your position is that it doesn't matter, at the end of the day, because appropriate adjustments will be required from whichever benchmark is used, and that perhaps for historical reasons, people have been happier to use Mops 95? Does that sum it up?

MR STRANG: It's historical and also, in our view it's a closer proxy to the quality of Australian grade unleaded petrol.

MR YOUNG: Can I move away from imports and import prices and ask you about another topic. I want to ask you about refining in this country, and its future. Firstly, how do the Australian refineries compare to those presently existing and perhaps under development in Asia in terms of efficiency and scale?

MR DES KING: When we look at the landscape for refineries across the region, the average size of the refineries is about the same size in Australia, of the order of 100,000 barrels per day. But it's far more expensive to do business in Australia than it is in most of the other parts of the region, so the refineries in Australia, by benchmarking, are some of the most expensive refineries to operate in the region. There are a number of new refineries being planned for the region, large export refineries, particularly India, but also there are certain expansions potentially in Singapore. Those new larger refineries will have much bigger scale, typically 300,000, 400,000 or 500,000 barrels per day and they will be able to make product much more cheaply than the average refinery in the region.

The Australian refineries have been able to do well in the current environment because the whole region is short petroleum products. The difference in shipping crude oil to Australia to refine versus bringing products to refine into Australia is different. It is much more expensive to bring imports into Australia than it is to bring crude - of the order of $2.50 to $2.75US per barrel more expensive to bring products in than crude. So we have a location advantage because it is expensive to ship products compared to bringing crude oil. But that location advantage, that freight differential, is being eroded because of the higher cost of refining in Australia compared to the rest of the region.

So the refineries in Australia either have to get more efficient over time to compete against this growing number of large, highly efficient refineries in the region, or we may well see significant restructuring. We have seen one refinery close already in Australia. That was the Mobil one at Port Stanvac. Certainly, if this trend continues there is the potential for other refineries in Australia to close.

MR YOUNG: Presumably, that would mean that the major oil companies would shift their focus from refining in Australia and selling the product to importing the product from their related companies in Asia and then selling it?

MR DES KING: That potential certainly exists for Shell and Mobil, who are regional refiners. They could refine product and import it. In fact, we believe that is what Mobil is probably doing after their refineries shut down. There are two other refiners in Australia, though, that don't have the capability to go offshore and refine offshore. That's Caltex. Caltex is entirely an Australian company. Our refining marketing is all in Australia, so we have no offshore refining, and BP also does not have any major regional refiners. So the option does not exist for Caltex and BP, but the trend could well be that they will move their refining to large regional efficient hubs and then import more.

MR YOUNG: I suppose this location advantage of the Australian refineries that you have spoken of has been added to in recent years because of our Australian fuel standards being different and higher, if you want to call it that, than those applying in Asia, or at least in many countries in Asia; is that fair to say?

MR DES KING: Actually, since there are a lot of imports available that meet Australian grade, there is not really a local advantage. What our refineries have to do is compete against the price of landed product of Australian grade. The only advantage really is that freight differential between product and crude.

MR YOUNG: If we look back over the past few years, though, there have been difficulties in obtaining imports of Australian grade petrol, have there not?

MR DES KING: Certainly looking at the data we present in our submission, with 100,000 barrels a day available, then one would say today certainly that there is Australian grade petrol available. As these new refineries come on in the region, these new big refineries - there is one in India, for example, starting up the end of 08 which is 580,000 barrels a day - it's part of a 1.2 million barrel complex. That is one and a half times Australia's total refining capacity on one site. These new larger refineries will be more complex refineries and will be able to make Australian grade petrol. So more should be becoming available in time rather than less.

MR YOUNG: I was trying to make this distinction, Mr King, that Australian grade petrol is perhaps, as you say, becoming increasingly available to be imported, but that wasn't the case if we go back more than 18 months; would you agree with that?

MR STRANG: I think not a lot additional has been added in the last 18 months, probably some capability, but there has been reasonable capability. I think the question is are the - because there are a relatively small number of refineries that can make surplus Australian grade gasoline, is there in the margins differential an element of margin that's needed for inducing investment, as against simply covering marginal costs? I think that would be fair to say.

MR YOUNG: The other thing about basing a business on imports is that the Australian company basing a business on importing fuel would need to secure a long term supply agreement, would it not?

MR STRANG: I guess that's a question for strategy. I think most importers would look to a reasonably secure arrangement for a period. Most of the term arrangements on petrol in the region are probably only one year duration, something like that, at the current time.

MR YOUNG: Let me give you an hypothesis. If an Australian oil company were to make a very large investment in new terminal facilities, because that's necessary, the existing ones being unavailable or fully committed, it would only make that investment if it could be assured that it had a suitable supply on a long term secure basis of a source of imports; would you generally agree with that hypothesis?

MR STRANG: Yes.

MR YOUNG: Is it correct that because of the location advantage you have described, Mr King, that refining margins at the moment are at historic highs?

MR DES KING: Yes, refining margins are at historic highs around the world, not just in Australia. The world's demand for petroleum products has gone up tremendously over the past few years, mostly fuelled by Chinese demand increases and Indian demand increases. The refining capacity has not grown sufficiently to keep peace, so worldwide refiner margins are at record highs.

MR YOUNG: That is the case in Australia, is it?

MR DES KING: Australia is linked to the world market, and so that is true for Australia, too. It's a very big change from four or five years ago, when refiner margins were so thin that Caltex almost went bankrupt.

MR YOUNG: I assume that the historic high refining margins at the moment in Australia are also added to by the location advantage that currently exists that you have described?

MR DES KING: That is correct. The location advantage is what helps Caltex have a higher margin than, say, Singapore. But out of that margin must come our operating costs. The margin is not profit. The operating costs of a refinery in Australia is much higher than the operating costs of a large refinery in the region, particularly Singapore.

MR YOUNG: I had better get you to define the term "refining margins" that we have both been using, Mr King. Can you define what you mean by it?

DR KING: Yes, certainly. In Singapore, the refiner margin is defined as the value of the basket of products minus the cost of a benchmark crude. In other words, that's the uplift of the crude that is refined. But out of that must come all the operating costs included to run that refinery, the wages, the chemicals, the shipping of the crude. So it is the available margin before operating costs.

MR YOUNG: So your true refining margin is the available margin after taking account of the cost of crude plus the costs of refining and subtracting that from the sale price you get?

MR DES KING: But the margin is quoted not on that basis. The margin is quoted in the press and then the industry standards are purely basket. The value of the products minus the costs of the crude. So all costs, including running the refinery, have to be deducted from that margin before a profit is determined.

MR YOUNG: Yes. All right. But would it also be true that the true refining margin, that is, the margin after taking account of all costs of refining, is also at the moment at record highs?

MR DES KING: Yes, the refining business is in part of the cycle where it has higher profitability. In fact, Caltex, we often look on a cents per litre basis - for the first half of this year, Caltex's profit was 2.6 cents a litre, averaged across all of our petroleum products, and slightly over half of that came from our refining arm and just under half from our marketing arm. That 2.6 cents a litre profit is much higher than it was a few years ago, when it was very close to zero.

MR YOUNG: So if we separate your business into the arms of refining on the one hand and distribution and marketing on the other, just to clarify what you have said, 50 per cent of your profit is located in the refining area?

MR DES KING: On average. I think for the first half this year, it was 61 per cent. It's typically in that 50, 55 per cent to 60 per cent depending on refiner margins, and the marketing profit is much more ratable.

MR YOUNG: So the cream of the profit, as it were, is found in the refining side of the business?

MR DES KING: Slightly over half. So 61 per cent for the first half of this year. Before 2006, it was a little bit less but it was still in that 50, 55 per cent range.

MR YOUNG: Is that position true if we look at it in terms of return on investment as distinct from profit? In other words, do you get a much better return on your investment in refining than you do on your investment in distribution and marketing?

MR DES KING: Actually, the costs of running the refinery and the investment required is very substantial these days.

MR YOUNG: That's why I have asked the question.

MR DES KING: And increasingly so. We talked about the quality premium for fuels being in the 2 cent to 3 cent per litre range. But, for example, in 2005-06 we spent $500 million to put in the equipment to make that new Australian grade fuel. When we look at our capital program investment, just to keep our facilities/refineries running, our refineries running, that is a large part of our capital. It is much more expensive to run a refinery than a marketing business. If you look at our return on capital employed, they are currently about equal over refining and marketing.

MR YOUNG: It is implicit in some of the explanations you have given that you see these rosy times for refining as perhaps something that is going to change with the dynamics of the refining business changing, with much larger refineries in Asia; do you agree with that?

MR DES KING: I do. If we look now over the next few years, the middle of the next decade, there will be demand increases for petroleum products, but there are more refineries coming on to meet those demands. So we anticipate that robust refiner margins will continue for the next several years. But all of us who have been in this business long enough know that the business goes in cycles. It is likely that eventually, if there is a drop off in demand growth, that refiner margins will come off their current highs. The business tends to go in cycles. It has done for the last fifty years and it is likely to continue.

MR YOUNG: I will move to - as I head downstream - to another segment of your business, Mr King. I want to ask you about the wholesale market. Some years ago, Caltex was a major supplier of independent chains, meeting their fuel needs, correct?

MR DES KING: That is correct.

MR YOUNG: That has changed, has it not, with your alliance with Woolworths?

MR DES KING: We certainly supply less independents than we used to but we do supply a lot of volume to Woolworths. It is interesting to characterise what really is Caltex. If you look at Caltex, we are basically a wholesaler. Of the 2000 retail sites that we supply to, only 170 are ours. The other 1800, or more, are basically wholesale arrangements, whether it be franchisees or with Woolworths. So we are basically a wholesaler.

MR YOUNG: There were some major independents that sought to continue their long term supply agreements with Caltex. Neumann is one, which Caltex declined that invitation and said that they could no longer supply Neumann. Was that attributable to the new alliance with Woolworths which sucked up a lot of your volumes?

MR STRANG: I don't believe we had a long term arrangement with Neumanns but we had been in supply to them. At the particular juncture that they wanted to term up arrangements, which is really at the turning point as to the market in Australia going short and specifications being introduced, we were also in negotiations with Woolworths and with a major independent; and at that juncture we were not in a position to commit to long term supply arrangments, as had been requested by Neumanns.

MR YOUNG: Is Neumann the only example of an independent who tried to get a long term supply agreement with Caltex and failed? Are there others?

MR STRANG: For supply into terminal, such as the Neumanns case, that is the only one that I'm aware of.

MR YOUNG: What about long term supply directly to their outlets? Are there others?

MR STRANG: We may have to take that on notice. I'm not aware of any, but I was not working in that part of the business at that particular time.

MR YOUNG: But generally it's correct that the proportion of petrol that you sell to independents has declined in the last few years; is that correct?

MR STRANG: That's correct.

MR YOUNG: Are you able to give some indication in open session of the extent to which Woolworths has affected your volumes? In other words, how much of the volume of petrol that you supply and sell is directed to Woolworths and how has that increased in recent years?

MR DES KING: We give the details which you talk about in camera on page 45 of the report. But if one looks at the market share that Caltex has and Caltex Woolworths has, about half of the total petrol that Caltex supplies is to the Woolies/Caltex venture.

MR YOUNG: Do you include in the Woolies/Caltex venture the stations which are run by joint venture and the service stations which are owned and controlled by Woolworths?

MR DES KING: Yes, it's a venture rather than a joint venture. There are just over 500 sites in that venture, of which Caltex contributed 134, and Woolworths controls the board price at all 500.

MR YOUNG: What impact has your alliance with Woolworths had on your overall volumes? In other words, half your volumes are directed towards the Woolworths venture, but has the venture with Woolworths meant that you are selling and supplying a much greater volume of petrol than was previously the case?

MR DES KING: That's correct. Woolworths is a wholesale agreement. It's a high volume wholesale agreement. We sell roughly 6 billion litres of petrol in Australia, or we supply 6 billion litres to various entities. Of that about half is supplied to Woolworths. Certainly, going back to before 2003, almost none was supplied to Woolworths.

MR YOUNG: Is it fair to say that that represents largely new volume for Caltex?

MR DES KING: That is correct, to Woolworths.

MR YOUNG: What is the total effect on Caltex's volumes of the Woolworths alliance? You have said you are supplying 6 billion litres to Woolworths annually but what's the total impact on your volumes?

MR DES KING: Overall, Caltex's volumes of total petrol supplied to Australia has gone up from about 4 billion litres at the beginning of this decade to about 6 billion litres today. That's a combination of supply to Woolworths and the natural growth of the market.

MR YOUNG: The period where you are speaking of, Mr King, is that, what, 2003 or 2002 to 2007?

MR DES KING: If we look at the detailed submission, which is on page 45, we have a chart and we can talk about that in more detail in camera. But in broad brush terms, our total volume in 2000 was about 4 billion litres. By 2003, it was just under 5 billion litres - that's when the Woolworths agreement began - and by 2006 our total petrol sales, mostly wholesale, was 6 billion litres.

MR STRANG: I don't know whether it's helpful but if I can add that the chart on page 45 deals with sales ex-terminal. The Woolworths volume, if you want to talk about total volumes, you would have to go to sales under the buy/sell arrangements as well to look at the total impact as far as petrol sales. I just wanted to make sure that that distinction was understood.

MR DES KING: The chart on page 45, the numbers that I was referring to are total retail and reseller volumes in absence of buy/sell.

MR YOUNG: If we allow for buy/sell, does that mean your total volumes in 2006 would have been in the order of 7 billion litres?

MR STRANG: Of that order.

MR YOUNG: Of which something like 1.7 to 2 billion litres is attributable to your alliance with Woolworths; is that ...

MR DES KING: We are happy to talk about those exact details in camera.

MR YOUNG: Thank you. Would it be fair to say that the alliance with Woolworths has been the key driver of Caltex's volume growth since 2001?

MR DES KING: Yes.

MR YOUNG: Now, presumably that's also had a very beneficial effect on your costs in the distribution and marketing arm of your business? In other words, greater volume, greater scale, your costs per litre in marketing and distribution would presumably have fallen significantly?

MR DES KING: We look typically at the overall costs across Caltex but that is correct. The costs per litre certainly have gone down, however the margins have not gone up. We submitted a chart, which we will be happy to talk about in camera, on page 46 which talks about our margins, which is our - the retail margin, basically, the price available to Caltex at the wholesale level minus our buy/sell. So the margin available to marketing from which those costs need to be deducted. As one can see from that chart, in general the margins have been flat over the 2000 to 2006 period.

MR YOUNG: I'm having difficulty understanding that and we might have to go to private session to do this, Mr King, but if your volumes have increased greatly and your costs per litre have fallen significantly, how is it that your true margins have not also grown in the wholesale business?

MR DES KING: These margins are basically the sale price, in other words, the price that we supply to Woolworths. There are different lines for Woolworths brand of reselling - as you can see on this chart the different margins for the different parts of the business, minus the buy/sell price. So this is the margin available, from which we need to deduct the costs.

MR YOUNG: You are speaking about gross margins?

MR DES KING: That's correct, gross margins.

MR YOUNG: But when I introduced costs per litre and scale and so on, I'm really speaking about true economic margin.

MR DES KING: Talking about cost per litre, that's the expense of running the business, which needs to be deducted from the available margin.

MR YOUNG: Yes. If your costs have gone down, it would suggest that your true margin has increased?

MR DES KING: That has to be volume weighted. Because if one looks at the chart - I think we can talk about this in a lot of detail in camera, but certainly somebody that buys a lot of volume from us like Woolworths gets a volume discount, which is not unusual in business. I think, when we talk in camera about those details, certainly the supply price is adjusted for the fact that extraordinarily large amounts of volume are purchased.

MR YOUNG: We will have to reserve that for the in-camera session. Your pricing to Woolworths is basically on a formula that is unique to Woolworths; is that correct?

MR STRANG: It's not unique to Woolworths.

MR YOUNG: The formula is not unique but the size of the discount is?

MR STRANG: The different elements are subject to negotiation, yes, and the negotiation with Woolworths has led to some different outcomes than some negotiations with others.

MR YOUNG: I'm going to move to questions about the retail market. Mr Samuel, were you intending to have a mid morning break?

THE CHAIRPERSON: I was. It is probably not quite mid morning but it is up to you.

MR YOUNG: I wanted some indication of perhaps when you might do so.

THE CHAIRPERSON: You are going to move to the retail market.

MR YOUNG: I will.

THE CHAIRPERSON: What do you have planned after that, Mr Young?

MR YOUNG: Basically dealing with the price cycles.

THE CHAIRPERSON: You tell me when you would prefer to take a break. I don't want to cut across your line of questioning. If you would prefer to break now, I'm happy to do it, otherwise leave it until after.

MR YOUNG: Perhaps I will change what I was going to do rather than risk breaking during an issue. Perhaps I will deal with the impact of the Woolworths arrangements and shopper dockets and so forth.

THE CHAIRPERSON: And then we will take a break.

MR YOUNG: Mr King, I will ask you more generally about the impact on the market itself of your alliance with Woolworths. I think you have said in your paper that your estimation is that the two supermarkets, Coles and Woolworths, have a market share in retail petroleum of roughly 43 per cent?

MR DES KING: That is correct.

MR YOUNG: Could you explain how you make that estimate? What is it based on?

MR DES KING: Certainly. It is based on statistics we have acquired from the government or outside of the Caltex and Caltex Woolworths. But we know how much we wholesale to Woolworths or the Woolworths venture and we know how much petrol is consumed in Australia and that's how we can get that number for Woolworths, which is about 19 per cent of all petrol sold in Australia and, by analysis, come up with the 24 per cent of all petrol sold in Australia for Coles.

MR YOUNG: That's a figure as at July 2006.

MR DES KING: That's correct.

MR YOUNG: Have you been able to make a more recent estimate than that?

MR DES KING: We haven't, because the available information on third parties is not readily available.

MR YOUNG: I think numerous parties have told the ACCC that the share of volume enjoyed by Woolworths and Coles is something in the order of 60 per cent, or slightly greater than 60 per cent.

MR DES KING: Yes, we certainly currently don't have that data, but that would be a very large change in overall market that is only growing in the order of 1 per cent to 2 per cent a year. So it would seem unlikely that they could grow by that extent that quickly.

MR YOUNG: Would your estimate be that the market share, in terms of volumes of Coles and Woolworths, has increased since July 2006?

MR DES KING: We know how much we supply to Woolworths - we know through that arrangement - and the 60 per cent you referred to earlier would imply that Coles is now 40 per cent market share, which seems an extraordinarily large increase in such a short period of time. As we said, Woolworths is about half the total petrol we sell. So we estimate it is still in the 19 per cent to 20 per cent range.

MR STRANG: The other thing we know is the number of sites. So we broadly know the number of sites. We don't believe that Coles/Shell has added sites in that time frame, so it is unlikely that their sales would have increased anywhere like that.

MR DES KING: So looking back at the data which we can talk about in camera on our supply to Woolworths, certainly over the last 18 months out of the total petrol market it has been in that 19 per cent to 20 per cent range, not very far away from the data we submitted in July 2006. Again that would mean that if somebody is claiming that Coles and Woolies have 60 per cent market share, since we know the Woolies number that must imply that Coles has 40 per cent market share, which would be extraordinary.

MR YOUNG: In your figure for Woolworths of 19 per cent you include the Woolworths-owned outlets and the outlets which are jointly conducted by Caltex and Woolworths?

MR DES KING: It includes the venture sites as well. Woolies does set the Board price and controls the petrol in those venture sites, though Caltex still - - -

MR YOUNG: Operates the shops.

MR DES KING: Operates the shops, that's correct.

MR YOUNG: So you would suspect that the higher figures have been based on some kind of blurring of the distinction between Caltex solely operated sites, either directly or through franchisees, compared to those which are in the Woolworths alliance, if I can put it like that?

MR DES KING: We obviously can't comment on others' analysis but we find it very difficult to believe that the total number was so high.

MR YOUNG: What advantages does Caltex itself derive from the alliance with Woolworths? You may need to go into a private in camera session to address some of this, but if you can in open session identify at least the heads of advantage?

MR DES KING: In summary, as we said, we supply petrol to about 2,000 service stations in Australia. Of those, we only really retail at 170, those that we have leases on or own. So, basically, we are a petrol wholesaler. So having a large wholesale agreement with somebody like Woolworths is attractive to us because although large agreements tend to be thinner margins, they are large volumes. The attraction to Caltex of the Caltex Woolworths arrangement is to increase our wholesaling business and to sell more volume, albeit at thinner margin.

MR YOUNG: From your perspective as the supplier, the wholesale supplier, I imagine you regard the shopper docket discount as something which makes Woolworths attractive to you because it drives greater volumes of sales by Woolworths?

MR DES KING: In terms of our wholesale agreement, obviously that's their business model, but it certainly is driving significant volumes. There is another side to that, though, that a number of Caltex stations that aren't in the venture have to compete against those prices. But overall, the driving a large wholesale supply for us is an advantage.

MR YOUNG: What do you regard or assess to be the impact on the market generally of the shopper docket discounts that are offered by Woolworths and subsequently by Coles?

MR DES KING: I think when we talk about price cycles we can see that the supermarkets are the most aggressive discounters, so they have made what was a very competitive market even more competitive.

MR YOUNG: Yes, but has that radically I think changed the retail market? For instance, has it diminished the role played by independent oil companies in driving competition?

MR DES KING: What it has done, I believe, is that the supermarkets have now taken on the mantle of being the low price leaders, and that has driven the market to be extraordinarily competitive from a very competitive market.

MR YOUNG: When you are referring to the low price leaders, you are referring to their board prices before the application of any shopper docket discount?

MR DES KING: That's correct.

MR YOUNG: So you are just saying, just looking at their advertised board prices before they apply that 4c or whatever discount, the major supermarkets tend to be the most aggressive price competitors in the market?

MR DES KING: That is correct. As part of the price cycle - and we can talk about that data when we get to the cycles - but they certainly are the group that most often leads prices down to the low part of the cycle.

MR YOUNG: Was that a role previously filled by independent oil companies?

MR STRANG: I think probably generally that would be the case.

MR YOUNG: So one impact on the market is that the most aggressive price discounters now tend to be the two supermarkets rather than, as previously, the independent oil companies?

MR STRANG: Yes.

MR YOUNG: I know this is asking you a question about somebody else's business, but in your view, has the advent of the supermarkets made it very difficult for the independent oil companies to compete in the retail market?

MR DES KING: It is difficult to talk about other people's business models, but in a very thin margin business like petrol marketing, one needs high volume, high efficiency sites to be competitive. We certainly, as Caltex, have reduced the number of sites over the years because only those that are high volume, high efficiency can be competitive and can make a profit in this market.

MR YOUNG: Given the changes you have just mentioned, low margin, you need to be high volume and highly efficient, what consequences has that had for the number of retail outlets and also the make-up of the retail outlets? In other words, we tend to be seeing more in the nature of large convenience stores associated with retail petrol. Perhaps you can expand on those aspects, Mr King?

MR DES KING: Certainly. We stand at about 6,000 sites today across all of Australia, down considerably from what it was a few years ago. Part of the mix of the offering has changed. We talk about having to be high volume to have high efficiency, but in fact if one operates a service station, the offering in the convenience store is very important, and having a good convenience store - because for a service station operator, 70 per cent of their gross margin comes from what they sell in the shop, not from the petrol. So the whole offering is now more important than just having the petrol available. That's how the dynamics of the market have changed. So those that don't have a good convenience store operation, for example, may find it difficult to be competitive with their overall offering.

MR YOUNG: Is that the direction in which Caltex itself is moving?

MR DES KING: Yes, indeed.

MR YOUNG: Does that mean you are consolidating sites and looking for fewer, larger, better equipped, high volume sites?

MR DES KING: We have continued this trend for some time now, that the low volume sites are ones that we are steadily getting out of with a view to investing in the sites that have the potential to be high volume, high efficiency with good shop sales.

MR YOUNG: My questions have tended to, I guess, focus on the major cities implicitly. What impact has resulted in regional areas from the advent of the entry of the supermarkets and in particular your alliance with Woolworths, which, in some ways, started in regional areas?

MR DES KING: I think in general certainly with the regional Woolworths sites like the other ones that we have in the venture, we have the petrol supply, but our belief is that they certainly are taking the role of the low price leader wherever they operate.

MR YOUNG: From your own observations, have you seen smaller independent outlets, closing, going out of business in this new environment created by the supermarkets?

MR DES KING: I would be happy to supply you with the exact data, but that is the general movement of the market.

MR YOUNG: Was that a movement that was under way before the advent of the supermarkets in any event, consolidation of sites, larger, more efficient sites?

MR DES KING: That has been the general trend for some time, yes.

MR YOUNG: So you wouldn't attribute that change solely to the advent of the supermarkets; you would rather say that that has hastened the development that might have occurred in any event?

MR DES KING: Yes, I believe that's the case.

MR YOUNG: Do you find the same picture that you have just described reflected in each of the major Australian capital cities, or do you find regional or state differences?

MR DES KING: In terms of the impact of the supermarkets?

MR YOUNG: Yes.

MR DES KING: We find that their business model seems to be very similar in most places, being the most aggressive in leading the cycle down, and taking on the mantle of the low price leaders. That seems to be - we observe that's a consistent business model across the country. But when we talk about price cycles, we have our analysis on page 58 about the most aggressive discounters state by state.

MR YOUNG: Yes. I think, Mr Samuel, I will need to move into the price cycle and we can simply break.

THE CHAIRPERSON: Do you want to break now? Your call.

MR YOUNG: I think I will just proceed, because we will probably need to break and then have a private session, anyway, so perhaps I will press on until 11 or 11.15 and we will see how we are going - if that's right with Mr King and Mr Strang.

Let me come to the price cycle, which seems to be such a central part of the operation of the retail market. From your observations, Mr King, who is it that, in general terms, tends to lead the price cycle downwards?

MR DES KING: Our analysis is shown on pages 57 and 58 of the submission. As you can see, the most aggressive discounter in our analysis in 2006 and 2007 was Woolworths, followed by Coles.

MR YOUNG: The noticeable feature of that analysis is not so much that the supermarkets are at the top but that the next two positions are occupied by BP and Mobil ahead of any independents.

MR DES KING: Yes, that's a very interesting statistic.

MR STRANG: I think that's kind of blurring the regional differences and market differences, so when you get to national averages you can get that sort of outcome.

MR YOUNG: Yes. The price cycle, I think it is difficult to speak about nationally; would you agree with that?

MR DES KING: That is correct. It is very different, city by city, depending on local competitive forces.

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

MR DES KING: I don't believe so. We didn't have that data in our submission.

MR YOUNG: And there is no price cycle in Hobart, I don't think?

MR DES KING: The price cycles tend to exist in the major cities, where there is the most competition. Price cycles seem to be a result of intense competitive behaviour.

MR YOUNG: There is intense competitive behaviour in Hobart, is there not?

MR DES KING: I think you will find that the - it's competitive everywhere but it's even more competitive where there is a concentration of a large number of sites, where you have got a large number of players aggressively to hold on or gain market share. That intense competition, even more intense competition, leads to the price cycles.

MR YOUNG: It's true, is it not, that the price cycle in Sydney, if we take Sydney as a relevant example, is pretty much regular as clockwork, is it not? It's a seven-day cycle?

MR DES KING: For many weeks of the year, but we just recently went through a period where one of the market participants wanted to get market share and their prices didn't come above the bottom of the cycle for an extended period.

MR YOUNG: Are you referring to July 2007 or thereabouts?

MR DES KING: Yes, that's correct. So the cycles do a regular pattern but one can't always predict that that will continue. It depends on local competitive forces and the drivers of one particular player or another.

MR YOUNG: Let me make this clear for the purposes of the transcript, the period you are referring to was a period of roughly three to four weeks in July 2007 in Sydney, correct?

MR DES KING: That's correct. In fact, in our supplemental submission, the 95ZK, we include that information on page 52.

MR YOUNG: It must be 51.

MR DES KING: On my print-out it is 52. Sydney TGP and Sydney pump price versus Singapore petrol price, the 95ZK.

MR YOUNG: Which question is it answering, Mr King?

MR DES KING: Question 20.

MR YOUNG: It's page 50 in my print-out. It looks as if we couldn't print the chart.

MR DES KING: Maybe we can give you a copy.

MR YOUNG: I'm familiar with the general pattern in those weeks. Perhaps if you can pass it over, Mr Strang. But just by way of introduction to my question, in that period of July, instead of having the normal pattern of four peaks and troughs of roughly 10 cents to 14 cents' span - cents per litre span - in that period it was relatively flat, trending downwards, with a few small rises and falls in the order of a couple of cents per litre. That was therefore a departure from the normal seven-day peak and trough cycle. Your explanation is that in that period, there was particular competition for market share; is a that right?

MR STRANG: Yes.

MR DES KING: And a similar failure of the cycle existed, if you look at this chart, back in May; there is also a similar event back in January of this year. So deviations from the standard cycle aren't unusual. They may be for different reasons.

MR YOUNG: Do you have independent reasons for saying that the cause of the July departure from the cycle was a particular period of competition?

MR DES KING: It was a particular period of competition where one of the grocery stores decided not to increase their price as others tried as part of the cycle, and because of that - because it's such a competitive market, nobody can afford not to match prices. One of the reasons we talked about, if you don't match prices, you don't get people driving into the service station and then they don't buy goods at the store. Since 70 per cent of the gross margin from running a service station is what you sell in the store versus the petrol, one can understand why people feel they have to match the price, otherwise their foot traffic goes down.

MR YOUNG: Were there attempts during that three or four-week period by one or other of the major oil companies to lift the price back up?

MR DES KING: Yes, and those attempts to lift it failed and so the prices came back down again.

MR YOUNG: And they failed because one particular supermarket chain didn't follow; is that right?

MR DES KING: That's correct.

MR YOUNG: Can you say in open session who the players were?

MR DES KING: We should probably keep that in camera. It is based on confidential Informed Sources data. But the ACCC actually gets the same data.

MR YOUNG: But these are simply your observations of what was happening in the marketplace, aren't they?

MR DES KING: That's correct.

MR YOUNG: Your observations about the conduct of others.

MR DES KING: Yes. We can say that it was Coles were the ones that didn't want to go back to the higher part of the cycle. They were content in keeping the price over that extended period of time down, in fact below the terminal gate price in many cases.

MR YOUNG: You have mentioned the terminal gate point as a pole of reference there, but in fact you don't price your wholesale supply against the terminal gate price, do you?

MR DES KING: We use a formula that has the same elements, but the terminal gate price is the price for somebody who shows up at a terminal with a tank truck with cash.

MR YOUNG: That simply doesn't happen.

MR DES KING: That doesn't happen very often at all.

MR YOUNG: So the terminal gate price is a notified price which in practice is not used in the industry.

MR DES KING: Not used by many but posted. It is the available price. But the break down of the various contract price have the same elements, but different margins and different elements. I would be happy to go through those in detail.

MR YOUNG: Yes, but the fact that the low point of this period of competition we are speaking about was at the level of the TGP is not very meaningful if the competitors are not - out there are not getting the supplies at TGP, is it?

MR DES KING: But it's a reference mark that we look at. We certainly don't know what the supply price to Coles Express is from Shell.

MR YOUNG: TGP may be closer to cost for some players in the marketplace but for others it may still be significantly above the cost of their suppliers?

MR DES KING: Yes, depending upon the individual contract that they have. It can also be below for others. We can talk about the Caltex reference price that we supply to our franchisees, that is actually above TGP.

MR YOUNG: But by saying that Coles for that period in July 2007 was pricing close to the TGP price is not necessarily to suggest that Coles was pricing at or below cost, is it?

MR DES KING: That is correct, because we do not know the supply agreement between Shell and Coles.

MR YOUNG: Although you might infer that for some of the smaller players in the market, when Coles went close to TGP, it was getting very close to cost for those other smaller independent outlets?

MR DES KING: We obviously don't know their supply agreements, but that is quite possible.

MR YOUNG: In that four-week period in July 2007, did Caltex try and lift the price back up?

MR DES KING: Yes, we did.

MR YOUNG: Apparently that failed.

MR DES KING: Yes, it did.

MR YOUNG: Was this a Sydney-wide phenomenon or confined to particular local sites?

MR DES KING: I believe it was a Sydney-wide phenomenon. Our data here is averaged across the Sydney metropolitan area.

MR YOUNG: So that seems to suggest that Coles at all of its outlets in Sydney had dropped its prices and held them down quite low during this period in July?

MR DES KING: We certainly through Informed Sources can give you that detailed information if you request it.

MR YOUNG: Do you regard that as an attempt by Coles to win market share?

MR DES KING: We don't know what the business driver was for Coles, but that certainly seemed to be a likely intent.

MR YOUNG: Was their pricing aimed particularly at one or other competitor, such as Woolworths?

MR DES KING: We don't know. I mean, it's difficult to say from whom they were trying to grab market share, because they post the prices they felt they needed to for their business model and that would presumably - their driver was to take market share from the market.

MR YOUNG: Was the consequence of this period of low prices that when it came to an end, prices were lifted back to by a margin of at least 10 cents or so?

MR DES KING: We don't actually have that to date in our submission but we are happy to provide it.

MR YOUNG: When Coles was pricing low in this fashion in July 2007, what was Caltex's response at its site?

MR DES KING: We only set the price at 170 places across the country.

MR YOUNG: Let's take the ones where you set it directly.

MR DES KING: Set directly? Those in Sydney is we tried to raise the price and that failed.

MR YOUNG: That having failed, were you otherwise matching Coles at the bottom, at the lowest price, or were you staying above that?

MR DES KING: I can't give you the exact details but we were certainly at a low price down there with Coles, whether it was exactly the same price, but it would certainly be a very low price in line with the kinds of prices Coles were offering.

MR YOUNG: During this period, if we move away from your directly-owned and controlled sites to the Caltex franchisees, was Caltex giving price support to its franchisees during this period?

MR DES KING: At times when the price goes low like this, for our franchisees who care to price at this low price or lower, we would give price support, according to a formula that is agreed in the franchise agreement, which is included in our submission.

MR YOUNG: Did Caltex withdraw price support from its franchisees during that period in July?

MR DES KING: We can give you the exact details but normally we may withdraw price support and suggest a higher retail recommended price to bring the price cycle back up. But obviously if that fails then we would offer price support again.

MR YOUNG: I asked you the question because you said that Caltex had tried to move the price back up. Presumably, you did that both directly by instructing your own sites and indirectly by withdrawing price support from your franchise sites.

MR DES KING: That's correct.

MR YOUNG: And the withdrawal of the price support was aimed to achieve the same end, that is to bring the price back up to a price that you recommended?

MR DES KING: The franchisee can choose which price they go to. But because we have the market analysis, we have a recommended price that they can choose to go to, and many do.

MR YOUNG: But if you withdraw price support, the franchisee, as a matter of economic necessity, is going to have to raise the price?

MR DES KING: Yes, and most do.

MR YOUNG: And will have to raise the price at least by the amount of price support that you withdraw?

MR DES KING: It is their final decision at which price they go to but that's their typical response.

MR YOUNG: An understandable response, isn't it?

MR DES KING: Yes, absolutely.

MR YOUNG: Can you recall the amount of price support, the highest figure of price support rebate that you were providing during this period in July 2007?

MR DES KING: I think we can give you those details in camera, because it refers to our agreement with the franchisees, and that table is included in our confidential submission.

MR YOUNG: All right. Let me just ask you more generally: Was that a period during which you provided price support at the high or maximum end of your range of price support?

MR DES KING: It would be price support which was commensurate with the table that is in the franchise agreement in our submission.

MR YOUNG: I was asking you about cities in which there is a price cycle. The price cycle in most of the capital cities is approximately seven days, correct?

MR DES KING: Yes.

MR YOUNG: In Perth it is not seven days, it's 14 days. Are you familiar with the Perth market, Mr King?

MR DES KING: We certainly are in the Perth market, that's correct.

MR YOUNG: But you are familiar with it?

MR DES KING: Somewhat familiar.

MR YOUNG: The price cycle in Perth changed after the introduction of the regulatory regime by the Western Australian government. That included a requirement that prices be notified at 2 pm on day 1 and then that price be held fixed throughout day 2, and so on, a rolling 24-hour notice system. That seems to have brought about the consequence that the price cycle has moderated. It lengthened to 14 days and the span of the price cycle diminished. Now, is that your analysis of what has happened in Perth?

MR DES KING: Yes, our analysis is it is now a two-week cycle and that the span of the cycle is dampened, and that the peaks are actually wider.

MR YOUNG: The peaks are wider? Do you mean further apart in number of days?

MR DES KING: If we refer to page 54 in our 95ZK submission, we actually have on the same page, which is page 54 in my document, the Perth cycle against, for example, Adelaide, which happens to be on the same page.

MR YOUNG: Yes.

MR DES KING: We concur with your remarks that the cycle is now a two-week cycle as opposed to a one-week cycle. And the amplitude is less, although looking at those peaks, they are now - as opposed to very sharp peaks, for example, in Adelaide or Sydney, they are now very broad peaks.

MR YOUNG: In other words, the price rises not so immediately and then falls more slowly, over more days?

MR DES KING: That's correct. It is difficult to assess from this whether there is an advantage to consumers from the Perth cycle. We would actually argue that because people can't actively discount in realtime, they have to wait 24 hours, that can impact the depth of the discounts. Certainly, compared to the Adelaide chart above, we see there are less instances in Perth where the price at the bottom of the cycle goes below the reference TGP. We believe that consumers do not benefit from the 24-hour rule in Western Australia because it does take away from petrol vendors the ability to discount in short time.

MR YOUNG: Intra day?

MR DES KING: That's correct.

MR YOUNG: On the other hand, Mr King, it seems to have produced less sudden rises in petrol price, rises of lesser amounts, more predictability in the market, more transparency in the market, because people know what prices are being charged and where; and moreover, it seems to have produced petrol prices in Perth which are several cents below, on average, petrol prices in other states.

MR DES KING: We did some analysis for the Senate inquiry, and we looked at 04-06 period. On average Perth was 1.3 cents per litre lower price than Sydney. It happened to correspond, though, that the transport from Singapore for petrol, transport costs to Perth was also 1.3 cents per litre lower than the transport to Sydney. So it is difficult to say whether that impact was due to market forces at the retail level or the fact that when one looks at the build up of the wholesale prices, which include a transport component, the transport to Perth is lower than the transport to Sydney.

MR YOUNG: If that was the explanation, you would expect to see the same differential before the WA regulations compared to after, wouldn't you?

MR DES KING: And I think if the market was steady, that would be the case.

MR YOUNG: What evidence is there, Mr King, that the absence of intra day competition in Perth has had any detrimental effect on competition?

MR DES KING: We only have the statements made by the ACCC in 2001 that raised concerns about that. We don't have any detailed information on that, apart from the analysis we do on the average price. But certainly, looking at the curves by inspection, there aren't as many occasions it appears where in Perth the price at the bottom of the cycle goes as deep and goes below TGP, and certainly consumers in cities like Melbourne and Sydney, who know the cycles well, benefit from that. We believe that 55 per cent of the petrol is actually bought by consumers below the average price. They take advantage of the cycles, and they are not able to do that in places like Perth to the same extent.

MR YOUNG: I have asked you generally who leads prices down on an overview, and I appreciate you may need to look at market by market or even local site by local site to give a better answer. Let me ask you who leads prices up. If we take Sydney, is it not invariably the major oil companies which are the entities which escalate the price by a significant amount at the end of each cycle and move it back to the top of the cycle?

MR DES KING: Yes, it is.

MR YOUNG: And on occasions it is Caltex that does that?

MR DES KING: Yes, it is.

MR YOUNG: And on occasions it is one or other major oil company.

MR DES KING: That's correct.

MR YOUNG: In Perth it always seems to be BP. Always. Is there some reason why it is Perth that always moves - why it is BP that always moves prices back to the top of the cycle in Perth?

MR DES KING: No, I can't comment on BP's behaviour.

MR YOUNG: You follow that market.

MR DES KING: We don't know why they do it. But certainly the data indicates that they do.

MR YOUNG: Is it perhaps because they have the biggest network of outlets in Perth?

MR STRANG: Yes, I was just about to make that point. Having a large market share and a large network, they are more highly incentivised to lead the market up in that particular market.

MR YOUNG: In other words, if they want to make what they think is an appropriate or desired return on their investment, they need to achieve margins that can only be achieved by moving the price back up?

MR STRANG: Yes, correct. If they stayed at the bottom, they would not achieve an acceptable return, I don't think.

MR YOUNG: Let's take occasions in Sydney, say, where Caltex is the first mover that moves the price back up by a moving one day of, say, 12c a litre. What are the factors that cause Caltex to initiate that move?

MR DES KING: Basically, we need to, over the average of the cycle, achieve a reasonable margin to be able to get reasonable returns. So if the price stayed at the bottom of the cycle long term, then our returns would not be acceptable.

MR YOUNG: So you move the price back up by a significant amount? You always seem to do it in Sydney on a Wednesday or Thursday, correct?

MR DES KING: Yes. It just almost seems to be the psyche of the market that one party or another is expecting somebody to move on that day, and it's built into the mentality of the market. It is not always the same day. As you said it is Wednesday or Thursday. But there is a pattern there that the market seems to expect.

MR YOUNG: Now, if this move was simply the product of competitive tension, you wouldn't expect to find that the competitive tension reaches the point where there is some shift in the market always on a Wednesday or a Thursday, would you?

MR DES KING: This market is one of the most transparent anywhere in the world because of Informed Sources, where all of the people that subscribe to Informed Sources, including the ACCC, are able to get almost realtime data about where the prices of competitors are versus themselves. That means that when one person does move, others have the information and then can decide to move or not very quickly. But why it's Wednesday or Thursday, it's almost if the cycle hasn't moved by then, somebody will say - and it's often us - it's about time the cycle moved up. So then we make the decision to move it up.

MR YOUNG: The people who regularly subscribe to Informed Sources tend be to the other major oil companies as well as Caltex.

MR DES KING: That is correct.

MR YOUNG: Presumably, Caltex does its own market research about what days it might be best to have the price at its highest?

MR DES KING: Actually, I don't know that we have done that research. I have not been aware of it. It's almost the market that has developed these patterns, and the patterns reproduce themselves. It's not really as much marketing science as marketing art.

MR YOUNG: Your intention, is it not, is to make the highest level of profit you can from the retailing of petrol?

MR DES KING: That is correct.

MR YOUNG: Wouldn't you maximise your profit by raising the price to the highest level coincident with a period of heavy purchasing?

MR DES KING: What seems to happen is that - if one took that logic, then we should have high prices Monday through Friday, when there is a lot of traffic, a lot of business traffic. But in fact what we see, and it's in our submission, is in fact the highest volume days in Sydney and Melbourne are Monday, Tuesday, when the prices are lowest. So it seems that consumers are educated about when the price cycle is low and more volume is purchased on those days.

MR YOUNG: But you make your money out of matching price and volume, don't you?

MR DES KING: That's correct.

MR YOUNG: And you make more money out of each litre you sell when the prices are at the high part of the cycle?

MR DES KING: Yes, for those sites where we have some part of the retail margin, which is a small number of sites.

MR YOUNG: When I asked you about moving prices up, and you accepted that usually it's the majors and on occasions it's Caltex - Caltex achieves an upward movement by two means, does it not, direct instruction to its own outlets on the one hand and withdrawal of price support to its franchisees on the other?

MR DES KING: That is correct. If we look at the 2,000 service stations that we splay across Australia, 170 come into the category of we directly control the price, and then our franchisees are another 330, roughly. So the sum of those two that you just talked about are 500 out of the 2,000 that we supply.

MR YOUNG: It seems that the decisions to increase the price back to the top of the cycle are taken by the national fuels marketing manager?

MR DES KING: That's correct, in concert with discussions with the local marketing manager.

MR YOUNG: It is also the national fuels marketing manager who takes decisions to withdraw price support?

MR DES KING: That's correct.

MR YOUNG: Those decisions are not level to the regional manager or the local manager?

MR DES KING: There are discussions with them but the ultimate responsibility is with the national manager.

MR YOUNG: Whereas the movement of prices otherwise on a day-to-day basis to meet competition, the prices are taken independently by the local or regional manager?

MR DES KING: In terms of the franchisees, for those 330 stores, it will be the franchisee, although we will issue a recommended retail price that they may wish to set or not, based on the analysis that we do. But you are correct.

MR YOUNG: That would seem to indicate that these two decisions about taking the price back to the top of the cycle are regarded as important decisions by Caltex?

MR DES KING: They are very important decisions, because if you look at where we can make money in sort of retail marketing, if we didn't have the tops of the cycle it would be a very poor business.

MR YOUNG: If you didn't have these sudden moves back to the top of the cycle, the price might find an equilibrium, a competitive equilibrium by small movements somewhere lower than the peak and somewhere higher than the bottom?

MR DES KING: That's correct. If we remove the peaks and remove the troughs and came in a perfectly efficient market to the same average then, by definition, our profits would be the same.

MR YOUNG: What factors are taken into account by the national fuels marketing manager when he resets the price to the top of the cycle?

MR DES KING: If it's in the case where we are following somebody up, which is certainly the majority of cases, we would look then at how high the competitor has moved up and then we decide if we want to move up this high or not. If it is an unusual movement on the upside, we actually have a management discussion about it. We don't just leave it to the national pricing manager on his or her own.

MR YOUNG: Do you mean by that that you become involved in that?

MR DES KING: That's correct. We have put in place over the last several months a discussion that if there is an unusual movement up by a competitor, we will have a management discussion, including myself, to decide if we wish to go that high or not. Certainly, since we put that in place, we have not had to have that discussion.

MR YOUNG: There have been on occasions, have there, where you haven't gone as high as another party, you haven't gone right back to the top of the cycle but stayed a little bit below it?

MR DES KING: That's correct.

MR YOUNG: Have there been occasions when you have declined to move?

MR DES KING: I'm not aware of those, but we could certainly get some documentation and provide you some details.

MR YOUNG: Why, then, do you always seem to move back to the top or almost the top of the market when one of your competitors initiates one of these sudden price increases?

MR DES KING: Because we need the peaks to get the higher margins to offset the low margin troughs. So if somebody moves up, we will follow in order to try and get a reasonable average margin.

MR YOUNG: The height of the peaks is determined by what the major oil companies think a reasonable average margin is?

MR DES KING: I don't think it's quite that scientific, but it's certainly trying to move up to a typical peak that, based on marketing art and experience, says that that should enable us to achieve reasonable margins.

MR YOUNG: Do you have forecasts of sales volume anticipated for the balance of the week when you make the decision to move the prices back up?

MR DES KING: We actually do forecasts for the month as part of our business planning process for the year, and so we do regular forecasts.

MR YOUNG: And does that mean that the size of the movements at the start of each cycle, week by week, are to some extent determined by your budget, what you planned for? So they are set in advance?

MR DES KING: The national pricing manager makes those decisions based on his assessment of the various markets. We certainly have an earnings targets for all our marketing for all of the year, and local market responses will be determined based on what we think is the best way to achieve the best profit possible in each of those markets.

MR YOUNG: When prices moved by Caltex, take one example, in Sydney at the start of the cycle, is it a uniform move right throughout the city of Sydney?

MR DES KING: We will send out a note at the same time through our electronic point of sales system to the franchisee saying the price support is removed and there is a recommended retail price if they wish, and at the same time send a message to our wholly-operated facilities. So it happens very quickly, but at the same time.

MR YOUNG: This is an electronic message that is sent?

MR DES KING: That's correct. Not through SMS but through our point of sale system.

MR MARKS: The days of phone calls and SMS have been left behind - it is sent electronically.

MR YOUNG: At the start of the cycle, what I was trying to get at, either by your direct instruction or your withdrawal of price support and recommendation, is it a uniform target figure that is set right across Sydney for all franchisees and direct outlets as to the price to which Caltex is to move?

MR DES KING: I believe we send out a similar recommended retail price but we can give you some more detail. It does vary from time to time to different parts of the city.

MR YOUNG: But my point, Mr King, is that when you move the price back up, it's not a response to localised conditions at a particular site, in the sense that the instruction or recommendation is not a recommendation or instruction that's peculiar to that particular site, attributable to competition factors at that site, but it's a more general, Sydney-wide instruction or recommendation?

MR DES KING: That's correct. It's actually to specific market groups, which is a group of sites.

MR YOUNG: What you have been describing I think you call tactical pricing; is that right?

MR DES KING: Yes.

MR YOUNG: And the tactic is to raise prices so that you achieve your desired financial return from the sale of the petrol at the site?

MR DES KING: Yes, we over the cycle, or over the year, achieve what is our target margin.

MR YOUNG: Why do you think it is that the oil - the major oil companies invariably follow each other up at start of each cycle?

MR DES KING: Because that is our only business and if we don't succeed in this part of that business, for example, we can't offset that with other elements of the business, so we need to achieve a reasonable margin. I think all the majors are keen to get a reasonable margin. So I think everybody is looking at everybody else to see who will raise the price. If one goes up, others normally follow.

MR YOUNG: Now, if the main driver for the increase in price is the objective of achieving a reasonable return, why is it that it's always on a fixed day, Wednesday or Thursday, that the price is raised in this fashion? What difference does that make? Why the day?

MR DES KING: And it could be different days. It does move around from time to time in different markets from one day to another, but in general it's on the same day, if the cycle holds. It is just the psyche of the market. The market is conditioned in Sydney to expect somebody to go up in price on a Wednesday, and everybody is looking at everybody else to see who is going to do that. Because the data is so readily available in realtime from Informed Sources, when one moves, others follow very quickly.

MR YOUNG: Does the choice of day, Wednesday or Thursday, depend on some target that you have as to how much volume you want to sell while the prices are high?

MR DES KING: No, we have an average target volume over the year and over the month, and an average margin we look for. That's the overall strategy. It actually gets down to the tactics, then, versus strategy of how those cycles can be achieved to get the net average goal.

MR YOUNG: Let me just ask a slightly different question. On occasions you adopt a strategic pricing approach, in that you might determine that some particular site is so well located or the demographics of the area are such that that site can maintain a price which is several cents higher than competitive sites run by others; is that right?

MR DES KING: We could decide that or the individual franchisee could decide that they want to price above a recommended retail price because they felt that the market conditions locally would warrant that and could support that.

MR YOUNG: Let's just assume that - I will withdraw that. Are there company-owned sites that meet that description, so well located and of such quality that they can justify a higher price than otherwise applies in the system?

MR DES KING: And there may be some sites like that. Actually, we would be happy to give you the details in a separate submission.

MR YOUNG: Let's assume there is a site like that in Sydney. At the start of the cycle, when there is a general direction or move or recommendation to move up to a much higher price, how is that particular strategic site treated? Is it treated in the same way?

MR DES KING: I believe we treat our sites as market groups, but the national pricing manager would have discussions with the local manager. But I am not familiar with a particular site that meets that category. That's why I think we need to look at our information and supply that to you separately.

MR YOUNG: Well, your submission - I think your section 95ZK response at page 37 - suggests there are such sites. But perhaps we will come to that later.

THE CHAIRPERSON: Mr Young, I am wondering whether we - - -

MR YOUNG: It is probably sensible to break now, otherwise the advantage of the break might be lost.

THE CHAIRPERSON: We will call a break.

ADJOURNED **[11.21 am]**

RESUMED **[11.42 am]**

MR YOUNG: Mr King, I was asking you about the price cycle. You have said on occasions Caltex will lead the price back up and on other occasions it will be other major oil companies, speaking generally. Now, what is it that leads Caltex on a particular occasion to decide that it is going to be the one this time that leads the price back up, what causes Caltex to do that?

MR DES KING: If you look across the whole cycle, in general across the whole cycle, we are a price taker rather than a price maker, because others lead it down and we follow. In most markets most of the time others lead it up and we follow. But there are some rare occasions where we may lead the market up. That may happen because we feel that we do have the market presence that is appropriate for us to lead that up. We don't have daily or weekly price targets or margin targets. We have annual targets but the market gives what the market gives and we are indeed the price taker. On those few occasions where we may decide to lead it up is because we may feel that it is appropriate because of our market presence - Queensland, Brisbane is an example where we have a very strong presence - that we should lead it up. But that's a tactical decision made by the national pricing manager.

MR YOUNG: Does it mean, then, because of your prominence in Brisbane, Caltex is the one that regularly leads the price up in Brisbane?

MR DES KING: We have done that recently because of our prominence there, and we believed that that was a reasonable thing to do to improve our average performance over the cycle.

MR YOUNG: I'm looking at some graphs from late 2006, September, October, November, which seem to indicate that it was Caltex which leads the price up in Brisbane in that time period.

MR DES KING: Yes.

MR YOUNG: Is it wider than that? Is Caltex the normal entity which leads the price up at the start of the cycle in Brisbane?

MR DES KING: That is certainly true on a number of occasions. I will be happy to give you all of those details in a separate submission. That's a level of detail that goes beyond my normal knowledge of market mechanics.

MR YOUNG: You qualified your answer by saying a number of occasions. I was trying to get the usual or common picture - in Brisbane in 2006 and 2007, has it been Caltex which usually leads the price up at the start of the cycle?

MR DES KING: Yes, that's my understanding. We can give you all those details in a separate submission.

MR YOUNG: Yes, thank you. Is Caltex - is it only Brisbane where Caltex plays that role or does it take on that role in other places as well?

MR DES KING: I believe it's Brisbane where predominantly Caltex leads up more often. I'm not familiar with us taking that lead role on a regular or frequent basis in other cities. I would be happy to give you a detailed submission on that detail.

MR YOUNG: Where are the 170 company-owned sites predominantly located?

MR DES KING: We don't have that level of detail in our submission, but we would be happy to give that to you.

MR YOUNG: It struck me - I asked the question because the thought occurred to me, is it Brisbane where they are mostly located, which gives you the prominence to play the lead role in taking prices up?

MR DES KING: I don't know that fact, to be honest, but we would be happy to provide it to you separately.

MR YOUNG: What are the factors which constitute the prominence that causes you to act that way in Brisbane?

MR DES KING: We have a refinery in Brisbane, so we have a large supply in Brisbane.

MR YOUNG: Yes, anything else?

MR STRANG: No, I don't have the detail.

MR YOUNG: You have got a refinery in Sydney.

MR DES KING: Yes.

MR YOUNG: But do you play the lead role in Sydney?

MR DES KING: To my knowledge, we do not play the lead role frequently in Sydney, and we can give you all of those details.

MR YOUNG: Who does in Sydney?

MR DES KING: To be honest, we don't know. We can give you that data.

MR YOUNG: But it is one of the other oil companies? Major oil companies?

MR DES KING: To my understanding, it is one of the major oil companies.

MR YOUNG: On those occasions in Sydney where Caltex decides to lead the market up, why does it take that decision?

MR DES KING: It's a tactical decision that we decide that it's about time that the price cycle went up. Nobody else has led up, looking at Informed Sources, and so we say, well, maybe it should be us. It is not always the major oil companies. I mean, sometimes in Sydney Coles has led the price up. It is not always the major oils.

MR YOUNG: Is that a rare occurrence, that one of the supermarkets, Coles, for instance, leads the cycle up?

MR DES KING: It has happened recently. I'm not aware of the frequency in the past. I'm happy to give you that submission. I don't believe it's that frequent.

MR YOUNG: Why don't you simply wait in Sydney for one of the other majors to lead the price up?

MR DES KING: I think on many occasions we do.

MR YOUNG: You know it's always going to happen on a Wednesday or a Thursday so there is not long to wait, is there?

MR DES KING: It didn't always happen. We talked earlier in the submission about July, where the cycles didn't happen. So it isn't hardwired into the market. In fact, when we talked about Sydney in 2007 we talked about three occasions where the cycles actually didn't follow their normal pattern.

MR YOUNG: That was something of an aberration, was it not, July 2007 in Sydney, from the normal pattern of the market?

MR DES KING: It wasn't the normal pattern but certainly there were three occasions over 2007 where the cycles weren't normal, and so there's certainly local market forces can cause a cycle to be different.

MR YOUNG: The two other occasions were occasions, were they not, where retail petrol prices were moving in the opposite direction compared to the lagged Singapore benchmark?

MR DES KING: But normally, even though the petrol prices may change compared to the benchmark, there is normally a cycle. But the cycle just did not exist for those three periods over that year.

MR YOUNG: On each of those three occasions in 2007 - I have asked you predominantly about one - on the other two occasions, was the absence of the cycle due to the fact that one or other of the supermarkets refused to go up when the major oil companies wanted to go up?

MR DES KING: I don't have that level of detail, unfortunately, but we would be happy to provide it to you.

MR YOUNG: You said a moment ago that Caltex was predominantly a price follower?

MR DES KING: Yes.

MR YOUNG: When the price is going down, does Caltex ever lead it down?

MR DES KING: If we look at our chart where we talk about the aggressors that lead the price down, which is pages 57 and 58 of our submission - - -

MR YOUNG: You - - -

MR DES KING: There are some occasions where we may lead it down.

MR YOUNG: I think your statistics suggest that something like 15 sites, you were the most aggressive price discounter; am I reading that correctly?

MR DES KING: We were ranking at number seven with eight. So we were seventh out of nine for leading the price down.

MR YOUNG: Yes, but in terms of the actual number of local market areas where you were the most aggressive discounter, in 2006 it was 15 local market areas?

MR DES KING: That's right, in 2007 it was eight year to date, yes.

MR YOUNG: So in 15 local market areas, you were the most aggressive discounter?

MR DES KING: In that data set, that's correct - or we were the most aggressive in terms of we were the first to move in the state.

MR YOUNG: Does that mean go the lowest as well? Were you the most aggressive in pushing the price lowest?

MR DES KING: How we defined the most aggressive here is the first one to move to the bottom of the cycle. I don't have the detail whether it's actually the tenth or 1 cent, the actual lowest point, but certainly the aggressor we have defined here I believe is the first mover to aggressively discount, rather than defining the depth of it.

MR YOUNG: As I understand what you say, that situation will be the product of conditions in that particular local market area because your general policy is to be a price follower on the prices going down?

MR DES KING: That is correct, and in general, a price follower when the price is going up. We do not have a policy to lead the prices up, but there are certain markets where there is the right opportunity that we do that - in Brisbane has been that one recently.

MR YOUNG: In Brisbane, you do have the policy of leading the price up.

MR DES KING: It's not a stated policy, but we certainly have a pattern of doing that.

MR YOUNG: Aside from what you call the prominence of Caltex in Brisbane, are there any other factors that explain why Caltex tends to lead the price up in Brisbane and you say it does not normally do that in Sydney?

MR DES KING: No, I'm not aware of any particular factors.

MR YOUNG: Does it simply come down to the fact that there are other major oil companies eager and willing to lead the price up in Sydney?

MR DES KING: I think what happens is when Informed Sources data is so readily available, everybody is watching everybody else and somebody is the first mover - you mentioned in Perth it was BP.

MR YOUNG: Just staying with Perth for a moment, is Caltex reluctant to be the first mover in Perth?

MR DES KING: We certainly don't have a history of it.

MR YOUNG: No, but since the introduction of the WA regulations, the notification system means that it quickly becomes public knowledge which oil company is leading the price up in Perth, doesn't it?

MR DES KING: Yes.

MR YOUNG: Has that impacted on Caltex's approach to price leadership in Perth?

MR DES KING: I think we certainly don't have the scale of reach in Perth to make a significant difference like BP. They are a much bigger player than we are. But I don't know if that's really entered into our psyche of whether we should lead it up or not. But BP certainly leads. I can't comment what drives them.

MR YOUNG: There has been some suggestion from evidence we have heard that oil companies are reluctant to lead the price up in Perth because of the adverse publicity it attracts and that has been left to BP.

MR DES KING: I can't comment on and that. I think petrol companies get enough adverse publicity around the country. I don't think adverse publicity in Perth would add to any more of the adverse publicity that we receive. The cycles everywhere unfortunately cause a lot of angst amongst the public, and one can understand that, and prices do move so rapidly. But overall, as I said earlier, over 55 per cent of the petrol is bought by customers below the average price in the cycle.

MR YOUNG: Can I take up your last point about the day or days on which petrol is purchased. Just before I do, let me ask you this: If one of the drivers for the cycle is the desire of the oil companies to derive a reasonable return and they need to raise the price to do so, why doesn't Caltex simply raise the price in Sydney on a Tuesday?

MR DES KING: In theory, we could.

MR YOUNG: Why don't you?

MR DES KING: I think that's interesting, it goes into the marketing art. I don't know if we have done that. We will have to provide you with information to see if we have done that in the past. The market psyche could be the fear that because it was Tuesday, the others wouldn't follow and it wouldn't hold.

MR YOUNG: If you raised your price on Tuesday, you could raise it by a lesser factor than raising the price on Thursday because you get greater volumes?

MR DES KING: That's on the assumption that the price cycle held and didn't because it was adverse so it collapsed.

MR YOUNG: Why wouldn't it be natural for all of the oil companies to think the same way, that is, they will raise the price on the high volume day, which is Tuesday? Why doesn't that make more sense to them, profit-wise, than raising it on a Thursday?

MR DES KING: It is hard to speculate what the market would do, but if the price was higher on a Tuesday, one could construct that maybe less volume would be sold.

MR YOUNG: Hasn't Caltex made a calculation that the best time to raise prices in terms of maximising profit is a Wednesday or a Thursday?

MR DES KING: No, I do not believe we have made that calculation. The market has developed this pattern over time and it's almost built into the market that somebody is waiting for somebody else to move, and through Informed Sources, they see that transparency and then they follow.

MR YOUNG: Why did it change in Perth from a weekly cycle to a two-weekly cycle where prices move on I think it's a Monday in Perth?

MR DES KING: I don't know why it changed specifically in Perth. I'm sure through a separate submission we could give you our opinion. But certainly the 24-hour price rule has caused people in Perth to be more cautious about how they move their prices, because if you get it wrong, move it too high, for example, you can't recover the volumes you have lost for that day, because it's fixed for that day.

MR YOUNG: Is that your explanation or your understanding as to why the amplitude of the price cycle has been lessened or dampened in Perth?

MR DES KING: Yes, that's my understanding. If one makes an error, the ability to recover is lessened considerably.

MR YOUNG: Are Caltex's wholesale margins any different in Perth than elsewhere?

MR DES KING: We would be happy in camera to give you our wholesale plus retail margins. We have those details in the 95ZK.

MR YOUNG: We will take that up with you in camera. Can I go to your statement that 55 per cent of petrol is sold on low price days?

MR DES KING: Yes.

MR YOUNG: I think you made that at the outset in your statement. What do you define as "low price days"?

MR DES KING: It does vary from city to city but we define it as the three days before transition day.

MR YOUNG: The transition day in Sydney is a Wednesday, is it?

MR DES KING: That's correct.

MR YOUNG: So that's Sunday, Monday, Tuesday?

MR DES KING: Yes - and we give that data on page 89 of our submission.

MR YOUNG: Yes, that's what I was looking for, thank you.

MR DES KING: It has the Melbourne data as well.

MR YOUNG: The passages that appear at 89 to 91 seem to suggest that the figure of 55 per cent is in fact based on the three days preceding the Thursday, not preceding the transition day?

MR DES KING: Yes. It moves around in our analysis, depending on if the transition is Wednesday or Thursday. There is the table on page 91 that one can see.

MR YOUNG: I'm looking at page 90 and the passages below the pie chart, which speak of Melbourne and the three days preceding Thursday, and Sydney, the volume in the three days preceding Thursday, these are the lowest price days of the week, it's 55 per cent, and so on.

MR DES KING: Yes.

MR YOUNG: So the 55 per cent figure includes in those three days what you have called the transition day, the Wednesday. You would give a fairer picture, would you not, if you in fact took the three days before the transition day, wouldn't you?

MR DES KING: It's a complicated analysis, that's why it's difficult. Because it depends on what time during the transition day the actual increase takes place. To really do it accurately you always have to go hour by hour, and that's not an analysis that we have done.

MR YOUNG: No, but the transition day would catch, to some extent at least, rising prices on that day, won't it?

MR DES KING: Yes.

MR YOUNG: If you take the three days - or in fact if you take the Wednesday, Thursday, Friday and Saturday in your table at page 91 - on my reckoning, those days, that's the transition day and then the high days that follow, they represent about 55 per cent of the volume.

MR DES KING: That is on the assumption that the transition day is entirely a high price day. And that is - - -

MR YOUNG: I'm not saying anything about price. I'm just saying if you take the volumes on the four days, Wednesday, Thursday, Friday and Saturday, thereby excluding the low days, that's 55 per cent of the volume.

MR DES KING: The one concern with that analysis is you are comparing four days to three days. That also blurs the analysis.

MR YOUNG: But what I'm suggesting to you is that it's a bit of a game of statistics to suggest that 55 per cent of petrol is sold on low price days, isn't it?

MR DES KING: We believe also - I think the ACCC has indicated a similar kind of analysis - that the majority of petrol is sold on the lower priced part of the cycle.

MR YOUNG: One could equally say, as I just said to you, that 55 per cent of the petrol is sold on the four highest priced days, Wednesday through Saturday?

MR DES KING: That analysis assumes, though, that Wednesday is entirely a high priced day. I think what we need to do is provide to you the analysis that goes in more detail hour by hour. Because that Wednesday is a very important day, because it is a day, depending what time of the day the price goes up, it very often is later in the day when that price goes up.

MR YOUNG: We know in Brisbane, for instance, where you lead it up, that it's usually about 11 am in the morning.

MR DES KING: I believe that the time the prices go up in different cities may well be different and we need to supply you with that information.

MR YOUNG: I can tell you in Melbourne the figures also suggest that it's in the morning. That means that the Wednesday is a questionable day to include in the lowest price group of days, isn't it?

MR DES KING: It is a function of when the price goes up, so I think that's the detailed analysis that we need to provide you.

MR YOUNG: The real picture depends on the more minute analysis of what volumes are sold at what particular prices, doesn't it?

MR DES KING: That is correct.

MR YOUNG: And one can't really tell whether this increased price at the start of the cycle is good or bad for consumers without doing that analysis of what volumes are sold at what particular prices in the cycle, can you?

MR DES KING: That is - a detailed analysis is required.

MR YOUNG: So the claim that the cycle benefits consumers is not really demonstrated by the general kind of analysis that you have advanced, is it?

MR DES KING: If we go to the details of what happens on that high price day, and I think our analysis makes the assumptions as dictated in the document, and I think we would be happy to provide those in more detail on an hour by hour analysis.

MR YOUNG: We will take you up on that.

MR DES KING: We would be happy to do that.

MR YOUNG: It's also - I know you don't say this but let me put it to you - it's also not very meaningful to say that the greater percentage of volume is sold at prices below the average price, is it?

MR DES KING: Well, it again goes almost to the calculation we said previously about looking hour by hour. We would be happy to provide that to you.

MR YOUNG: You need to a volume weighted average, don't you.

MR DES KING: That's correct. It's a pretty complex calculation, but we would be happy to provide it to you.

MR YOUNG: What is your explanation, Mr King, for the fact that in recent years the span, the amplitude, of the price cycle seems to be increasing? In other words, we are getting higher peaks and the move from trough to peak is increasing? It's now in the order of 10 cents to 15 cents per litre. What's the explanation of that?

MR DES KING: I don't have a specific explanation for that, but certainly there are more people - the supermarkets particularly are willing to drive the discount down at the bottom of the cycle. They dictate the bottom of the cycle. Certainly that's having an impact.

MR YOUNG: In other words, you are saying that if the price is discounted low by the supermarkets, the major oil companies and perhaps even the supermarkets are quite happy to see the price move back at the start of the cycle by a large amount, 10 cents to 14 cents, in order to recoup at the top of the cycle the margin they lose at the bottom?

MR DES KING: Yes, we don't know that that's their mentality. All we see is the data and certainly that indicates that the cycle is getting wider as a net result.

MR YOUNG: The effect of the data is what I just put to you, is it not?

MR DES KING: The effect of the data at that is that we are getting a wider cycle, yes.

MR YOUNG: Is that the way you approach it at Caltex? You need bigger price increases, a wider span in the cycle, in order to retrieve an appropriate return?

MR DES KING: We are only a small part of the market. For most of the cycle in most places, we are a price taker, so we follow down and we follow up. We don't - aren't able and nor could we actually determine what the market does.

MR YOUNG: But you have a choice about whether you follow it up to the top, don't you?

MR DES KING: We have that choice to follow, yes.

MR YOUNG: You invariably make that choice to follow it up to the top.

MR DES KING: In most conditions we do, because it makes sense to do so.

MR YOUNG: And in Brisbane you lead it to the top.

MR DES KING: In Brisbane we lead it, that's correct.

MR YOUNG: And you do that in order to derive the profits you have targeted for yourself.

MR DES KING: We aren't driven by the targets. The targets are an outcome. We have an overall target for the year but that does not impact the day-to-day, week to week, month to month setting of prices and how we follow the cycle. It is an outcome.

MR YOUNG: But then how do you determine what price you move to in Brisbane? You must go through some rational process in Brisbane of saying we will now on a Wednesday move the price from 140 cents per litre to 135 cents per litre. What's the process that determines that decision?

MR DES KING: I do not believe that's set by any plan. It is set by the pricing manager speaking with local managers, making a determination of what the market will be able to accept.

MR YOUNG: What the market will bear?

MR DES KING: Yes.

MR YOUNG: If you have some confidence that everyone in the market will follow you back up for that price, that's what the market is going to have to bear, is it not?

MR DES KING: But if we get it wrong, the cycle could fail.

MR YOUNG: Yes. It appears that the major oil companies and the supermarkets have been prepared to tolerate movements at the start of the cycle to higher prices than had previously obtained, in other words, the jump, the span is increasing. Is there a reason for that?

MR DES KING: I don't know of any particular reason. That tends to be what we observe as the market dynamics. But the overall span could be dictated by the fact that the discounting part of the cycle is apparently getting deeper in some areas.

MR YOUNG: I think I should correct something, Mr King. I think earlier you said a figure of 55 per cent on low price days was also a figure advanced by the ACCC. I think you will find that's not correct. It's been advanced by various oil companies in submissions to the ACCC. In your written submission to the ACCC, you have said that the price cycle has many negatives for Caltex. Can you identify what they are?

MR DES KING: Yes, certainly. In most markets in the world, particularly which aren't as transparent as what we have in Australia, the market is much more steady. There are much more minor movements of the retail price compared to wholesale. Certainly, when we incur a large cost in the price support mechanism for our franchisees - and in camera we can talk about this, in the tens of millions, we can give you that number - the way we have to observe the market and follow the market, the amount of effort we have to put in because of the rapid movements of the market in Australia do mean that it incurs a cost for us.

MR YOUNG: Surely, Mr King, the price cycle exists and is controlled by the major oil companies because it suits their plans for deriving a return on investment; isn't that right?

MR DES KING: You indicated that the price cycle was controlled by the major oil companies.

MR YOUNG: Yes.

MR DES KING: As we talked earlier, they are, in most markets, a price taker. The consumer markets lead it down typically, as we talked earlier, and then they follow, and then it is typically a major oil company that tries to move it back up again. We don't know what the targets are for our competitors for their returns, but it is evident that if they don't get reasonable returns they will probably exit the market, like any other market individual. But the price cycles, for us the big concern is our price - public reputation. It is very difficult for consumers to understand this cycle. We have more deliveries on site in high volume days. If it was spread over a long period of time with a similar price and so if the volumes were more even throughout the week then we would have more ratable deliveries. On the high volume days we have a lot of congestion at those sites. It would be nice if those could be smoothed over a period of time. At the bottom of the cycle, the intense competition overall probably reduces our margins. We talked about the franchisee price supports. It's a very complicated system to administer and very expensive for us, and significant costs in obtaining this realtime data across the country. That is - one pays for that privilege.

MR YOUNG: But isn't one view of the cycle this: Prices go as low as they do with discounting by the supermarkets because they know that in a week, in seven days, or within a week, the prices are going to move back to a new high and profits can be made and margins retrieved at the new high? So isn't it right that the oil companies would have the ability to stop the price cycle if it wasn't to their overall benefit?

MR DES KING: We don't know the price cycles will return. We certainly hope it would from a recovery of margin standpoint. But we actually tried in Adelaide to - with a test to try and see if we could dampen the cycle, what impact we could have. We did a trial from 2000 to 2004. It was a four-year trial where we adjusted arrangements with our franchisees to try and see if we could dampen the price cycle, what impact that may have as a test. Unfortunately - and we have given details of that in our 95 submission - unfortunately, that didn't dampen the cycle. The market still wanted to have the cycles.

MR YOUNG: You have mentioned price support and its cost. Presumably, the cost of price support is also a cost that you seek to retrieve when the price goes back to the top of the cycle?

MR DES KING: How we recover the price support is in the Caltex reference price, which is the price that we charge our franchisees, and because of the price support that wholesale price is above TGP.

MR YOUNG: So you have a reference price above TGP and you allow rebates off that reference price by way of price support to the franchisees?

MR DES KING: In addition to that, price CRP is built into the cost of us providing them support with the business manager, helping with merchandising, those kinds of things. Brand support, all the kind of elements that one gets in a franchisee package. And actually price support can be important to franchisees, because these are small businesspeople and to smooth out their cash flow can be important to a small businessperson.

MR YOUNG: Why don't you simply give the franchisees a better fixed reference price not as high as the CRP and avoid the need for discretionary rebates off it?

MR DES KING: That was the basis of our Adelaide trial which we would be happy to talk about but unfortunately that didn't eliminate price cycling.

MR YOUNG: The rebates you allow off CRP have presumably been allowed for by Caltex when it fixes the CRP in the first place?

MR DES KING: The CRP calculations is the basis of the franchise agreement. The details of those rebates are given in the document. I'm not familiar with the exact negotiations with the franchise counsel. They ended up at that point.

MR YOUNG: All I mean, Mr King, is that you negotiate the CRP price, which is the standard price, higher than it would otherwise be because you know that you need to allow for the prospect that from time to time you will have to give price support to the franchisee.

MR DES KING: Included in the CRP is that ability or the likelihood of giving price support, plus the other elements of the franchisee package, which includes the brand support, business manager support, help with the retailing merchandising - those kinds of elements in the overall franchise package - Star Card assistance.

MR YOUNG: The grant and withdrawal of price support is discretionary, is it not, for Caltex?

MR DES KING: Yes, I think - when the prices go down, we will send out an electronic message through the point of sale system to say that the franchisee, if you wish to lower your price to this level to match the competition or lower, we will offer you price support as per the agreed schedule.

MR YOUNG: Yes, but it's at your discretion to offer that price support?

MR DES KING: I will have to get you the details of the contract. I'm happy to supply those details to you, but certainly that's - - -

MR YOUNG: But let me go to the other end: You have the discretion to withdraw price support by notification.

MR DES KING: That is correct.

MR YOUNG: When you do withdraw the price support, that allows you indirectly to influence or control the end price that the franchisee can charge?

MR DES KING: When we withdraw price support, we have a recommended retail price based on market analysis that the franchisee is free to go to or some other price. If we put this in context, the franchisees are just over 330 sites of the total of 2,000 that we supply across the country. 170 additional are the sites where we control the price. So the franchisees plus where we control the price directly are 500 of the 2,000 of the sites that we supply.

MR YOUNG: But these franchisees, when they are told you are withdrawing the, pick a figure, 10 cent rebate by way of price support, is put in a position where that franchisee, for economic reasons, is practically compelled to raise its price by the missing 10 cents?

MR DES KING: The franchisees will raise the price. The exact level they will increase it to is to be determined by them on their own market conditions, and they may not go, on your example, the full 10 cents. They could go higher, they could go lower.

MR YOUNG: You recommend a figure and your expectation is they will go to your figure?

MR DES KING: Our expectation is that they will use that figure as a guide, as indicative of the market conditions.

MR YOUNG: Your experience is that when you withdraw price support and recommend a figure, they usually go to that figure?

MR DES KING: Our experience is that many of them choose to use the recommended retail price as their guide.

MR YOUNG: That indicates this, Mr King, doesn't it, that you use discretionary withdrawal of price support as an indirect means of influencing the end price charged by franchisees?

MR DES KING: Yes.

MR YOUNG: And you use the withdrawal of price support to move the price back up at the start of the cycle?

MR DES KING: We withdraw price support and our expectation is, because of the economic conditions, that the franchisee will move the price up, yes.

MR YOUNG: If you move to a lower fixed reference price for the franchisee without the discretionary price support rebates, that would remove your ability to influence the price cycle in the case of franchisees, would it not?

MR DES KING: In terms of - that is correct, in terms of price support. Our experience in Adelaide, though, is what we did is gave them a lower supply price, a lower wholesale price, but what we found in that case was many of the franchisees still followed the price cycles that were in the marketplace set by others. And, overall, the net impact to us is when we changed the dynamics in Adelaide of how we support franchisees, overall they and Caltex lost volume.

MR YOUNG: Lost volume or lost revenue?

MR DES KING: Lost volume. And we can give you some more details of that Adelaide trial in camera in a separate submission.

MR YOUNG: Why would they lose volume? Because they would have a right to go lower than they otherwise would under your higher CRP price with rebate?

MR DES KING: They would have the right to do that but many of them chose not to do that and they lost volume. Each is an independent business looking at their own independent economic conditions.

MR YOUNG: So they made their own decisions - and competitive decisions - and the trial didn't work because they made bad competitive decisions; is that right?

MR DES KING: They made their own decisions based on their own situations, but in terms of the impact on the overall price cycles in Adelaide for all players, there was no major impact.

MR YOUNG: Did they lose volume because they got a better price and they were happy to price less aggressively both upwards and downwards and make their profit out of the margin you gave them?

MR DES KING: I can't comment on what drove their business decisions as independent businesses, but we would be happy to give you all of the details of that Adelaide trial in a separate submission.

MR YOUNG: You chose Adelaide for the trial. How many outlets, direct outlets, does Caltex have in Adelaide?

MR DES KING: We touch upon that in the 95ZK.

MR YOUNG: I think it's question 18.

MR DES KING: We don't actually list there what the number of sites are, but it was 42 franchisees and six Caltex Cal stores, a total of 48, and we had about 27 per cent of the market.

MR YOUNG: How does that compare to the other majors in Adelaide?

MR DES KING: I actually don't have that information but we would be happy to provide it.

MR YOUNG: Is Adelaide one of the places where you have a relatively small representation?

MR DES KING: 20 per cent - 27 per cent is a reasonable representation. I don't have the details of the other cities, but certainly it's a reasonable representation, it may not be the largest, but certainly 27 per cent of the market is reasonable. You saw across - from the overall across the nation, when we take the total petrol supplies, we have 38 per cent, you add Caltex plus Caltex Woolworths.

MR YOUNG: Just to give me an idea of scale, Adelaide with 42 franchisees and six direct outlets, how does that compare to Brisbane?

MR DES KING: I don't have those details.

MR YOUNG: Is Brisbane many more by a factor of two, or three or four?

MR STRANG: Again, I don't have the detail but I would be guessing it's closer to 100.

MR YOUNG: 100 all up, franchisees and direct outlets?

MR STRANG: Close. I don't think it's quite that many.

MR DES KING: The Adelaide trial points to the fact that is a different business model a better one? And I think companies always from time to time are doing experiments with different business models, whether it's at a given site or a given market, just to see if there is a more attractive business model, both for franchisees and for companies.

MR YOUNG: But the conclusion of the Adelaide trial seems to be that from Caltex's perspective, it generates higher volumes and better margins with the price cycle than without?

MR DES KING: The price cycle did not change in Adelaide.

MR YOUNG: It did for Caltex.

MR DES KING: But Caltex had a different arrangement where we sold at a fixed wholesale price - lower wholesale price to the franchisees, who then decided how they wished individually to follow the price cycles.

MR YOUNG: I thought the effect of the Adelaide trial was that price fluctuations did moderate within the Caltex network, in the sense that your franchisees didn't raise the prices much, they didn't discount as much, their prices were less volatile, so from a Caltex perspective, the trial did moderate the volatility of the price cycle, but from Caltex's perspective it delivered less volume and less profit than full participation in the price cycle. Isn't that right?

MR DES KING: Yes. That probably goes to the point that the price cycles benefit consumers.

MR YOUNG: Just one other question about price support. I have asked you about withdrawal, but as prices are being discounted downwards and price support is being granted progressively by notification to particular franchisees, how does Caltex determine how much price support will be granted progressively as prices are falling?

MR DES KING: We have a predetermined table based on where the competition is going for a price. We tell franchisees if you go to that price or lower, your support will be based on that pre-determined table, which is included in the submission, which is on page 87.

MR YOUNG: Is the table confidential, Mr King?

MR DES KING: Yes.

MR YOUNG: I will take that up in private session. Likewise I will ask you about margins only in private session. You have got some details in your submission. There are a couple of questions I want to come back to on disparate topics which I can do in open session, so I am moving away from the price cycle --

THE CHAIRPERSON: Can I ask one question, I don't want to interrupt your train of thought but I did have one question. You have indicated on several occasions, Mr King, and your submission suggests that price cycles benefit consumers. On the assumption it benefits consumers, it is probably less to the advantage of the suppliers; would that be correct?

MR DES KING: That would be correct. That goes part to the point that you look at the price of petrol, before tax in Australia it is even lower - 4 cents even lower than the United States, which is an extraordinarily competitive market, which indicates it is even more competitive here, even though we have a longer supply chain and don't have the economies of scale.

THE CHAIRPERSON: If it benefits consumers and if it is thus, as I think you have just commented, to the adverse position of suppliers, why did companies try and get rid of it in Adelaide?

MR DES KING: It was a trial to see if a different business model might be better. In any business, one's always trying different avenues to see what the outcome might be. Until one has done the test, it is difficult to determine.

THE CHAIRPERSON: But if you have concluded that it's to the benefit of consumers and that it's to the disadvantage of suppliers, then why try a different model that might potentially, on your own analysis, be to the disadvantage of suppliers and - - -

MR DES KING: This trial started in 2000, so it started a long time ago when the market dynamics were very different, and it was a market where we thought we should try it to see what happened, and whether we should adjust our franchise model. We came to the conclusion that it certainly didn't work for us.

THE CHAIRPERSON: Thank you.

MR YOUNG: Mr King, I asked you a few questions about exports but focusing on pricing I want to ask you a few more general questions. Given what you have said about your refinery capacity being stretched and being able essentially to sell as much as you can make, what are the circumstances that lead to petrol being exported from Australia?

MR DES KING: One that Mr Strang mentioned earlier is if our refineries are going through a maintenance period where key pieces of equipment were shut down, and then we are not making - small volumes of the product we make is not Australian grade so we have to export that offshore, because it's not compatible with the requirements here. Alex may have some - any others?

MR STRANG: Typically, it is for balancing, as Des has said. Also, there are times where you get a little imbalance in expected sales and production. So you are planning ahead on your supply chain for three months and if, for example, market demand or sales are less than were anticipated and you can no longer contain your production, then you need to either slow down your refinery, which you won't do, because we need - we will generally need a diesel injection as well. The next alternative is to try to place some of that additional production. Typically, if it's initiated by a reduction in demand, we're not the only ones who are a little bit long. Generally, most other parties are. But we will look for local sales. In fact, if you look at our export or gasoline sales in 2006 and 2005, a large proportion we place locally. If we can't place it locally then we will export it.

MR YOUNG: And what you export, is it confined to petrol that doesn't comply with Australian Standards?

MR STRANG: It's not confined to that. The next best choice, if you like, is New Zealand. So the net back on an export to New Zealand is relatively attractive, and New Zealand standards, I believe, now they are identical to Australian Standards.

MR YOUNG: What I'm not following in the conditions that prevailed in the market in recent years is why you can't sell that product locally, assuming it's compliant with Australian Standards?

MR STRANG: We seek to sell it, right? I just - maybe I shouldn't presume - I'm not quite sure where your question is leading.

MR YOUNG: You said you seek to sell it, but my understanding really was that there were plenty of buyers and the product was relatively scarce. Is there some particular reason to explain the fact that you were not able to find a local buyer?

MR STRANG: Yes. Again, to be clear, here we are talking about a sale into terminal.

MR YOUNG: Yes.

MR STRANG: The point I was making is, yes, we do try to find a local buyer. Quite often, the reduction in local sales is due to a common factor, a common cause. Generally, we find, when we are a little bit long, if it was in Sydney, for example, Shell will also be long. Whilst the market may still be importing, because import arrangements have been made two or three months in advance, you have a need to quit that product promptly.

MR YOUNG: All right. I understand.

MR DES KING: I think on page 21 of our submission it gives the volumes that were exported in 2006, and you can see of a total supply demand of 7.9 billion litres, exports were very small indeed, only 32 million litres. So it's a very small volume.

MR YOUNG: Yes. The other question or area I wanted to ask you about concerned Caltex's competition with Woolworths and Coles, because of course you have your own outlets that compete with Woolworths' outlets and you are competing with Coles Express. To what extent has the shopper docket, the 4 cent discount and sometimes it's increased beyond that - to what extent has that made it difficult for Caltex to compete on price in the marketplace and what strategies have you used to try and respond to that?

MR DES KING: We have a pretty vigorous retail offering and we can talk in camera about how the margins may or may not have changed in the different sectors of our bins. But in an increasingly competitive business, the overall strategy is to attract customers with the full offering, and what we have done, too, is move steadily towards more efficient, more high volume sites and improve our convenience stores, because our opportunity is to attract customers to the overall package, which includes convenience store shops as well as the petrol sales.

MR YOUNG: Do you attempt to compete with Shell and Woolworths in terms of their price after the 4 cent discount, or do you simply compete with their board price pre-discount?

MR DES KING: When they lead the prices down we tend to compete with the board price.

MR YOUNG: Presumably, from your observations of the market, that's what others do as well? They compete with the board price, they don't try and compete directly on price with the further 4 cent discount?

MR DES KING: That's our understanding, yes.

MR YOUNG: Is that because the major oil companies and the independents really don't have the flexibility to compete with that 4c shopper docket discount as such?

MR DES KING: Coles and Woolworths have a different business model. They tie petrol sales to sales in other elements of their business, and we don't have that capability because we only have the one element of our business.

MR YOUNG: I guess it goes in spades for the independent oil companies, that they don't have that ability, either, correct?

MR DES KING: They'll have to speak for themselves, but certainly they don't have the breadth of the business that the supermarkets do.

MR YOUNG: Does that mean that your view is that the 4 cent discount is cross subsidised from the grocery side of the business operated by Woolworths and Coles?

MR DES KING: We don't have the details of their business model. So I - something I think that obviously the ACCC may well explore in your questioning, but we don't know how their business model operates.

MR YOUNG: In Woolworths' case, you supply their fuel and you know the price at which you supply, don't you?

MR DES KING: Yes, we do, and we can talk confidentially about that in the in camera session.

MR YOUNG: Mr Chairman, I don't have anything further that I can pursue in open session with Mr King or Mr Strang.

THE CHAIRPERSON: I think Commissioner King has one follow-up question he wants to put.

DR KING: If I can return to exports for a minute, Mr King. Whilst I realise in 2006 the export volumes were low, they were a bit higher in 2005. I'm just looking at page 26 of your submission. But again I take your point, that they are low compared to the volume of total sales by Caltex or, indeed, the total volume of sales in Australia over, say, an annual period. I must confess that it surprises me that you export those volumes, because if I understand your submissions to us today, that a not insubstantial amount of it is able to be sold in Australia. It is an Australian Standard. Shipping it overseas must be ghastly expensive, in the sense that you are paying for the transport cost and yet you can't seem to shift the petrol in Australia even though you could offer a significant discount to the import parity price. I must confess I just don't understand that. If you could expand - - -

MR DES KING: We would rather place it in Australia. That would be our first choice. But if it doesn't meet Australian specifications because our refinery is going through maintenance, we have no choice but to export it to somewhere where they have lower quality standards or they can blend it off. So then we get down to the small part of the small volume that was Australian grade that we couldn't move locally. Alex has more details on the supply statement.

MR STRANG: Yes. Particularly in 2005, if you went to the detail you would see nearly all of it occurred in the last quarter, which was in the lead up to the specifications change. So we exported quite a deal of gasoline that was noncompliant, to be ready for the specifications change. In the case where we do export to New Zealand, some Australian grade quality petrol, again small quantities, as we indicated earlier, in a prompt case it is not possible to place it in most cases locally, and typically structural arrangements are made on six months, 12 months' time frames. At the end we have to place it and it just doesn't make sense for a small quantity of gasoline, to try to force it into the local market and marginalise that whole market.

DR KING: Sorry, can you expand on your last statement? Presumably, you are saying that you will sell it locally if you offered a big enough price discount, but what do you mean by marginalise the local market?

MR STRANG: As I think you are aware, the overall elasticity of demand is extremely low. The market wants 100 of petrol. That's all it's going to - it doesn't matter whether the price is this high or this high, it still wants 100. And if you are simply trying to force that gasoline in, I'm saying I'm going to change my pricing position, you will gain a fraction but the market will come and match and you will in fact sell very little of that additional product, and all you will have done is succeeded in reducing your own profit.

DR KING: Can I take it from that that what you are saying is you prefer to export the fuel because if you try to sell it domestically, you would lead to a reduction in domestic prices and you don't want to face a reduction in domestic prices?

MR STRANG: We are talking in special circumstances. Normally, we can place all production structurally in Australia. Here we are talking about in short-term circumstances, where you are long product, the market is long product.

DR KING: I understand, but I'm just trying to understand also what you said just a few minutes ago, which, if I can put it in simple language, it sounded to me like you were saying we prefer to export the product rather than sell it domestically because if we sold it domestically we would push down the price in the domestic market and we don't want to - - -

MR STRANG: And we will not have sold the quantity that we want to sell.

DR KING: Has Caltex recently exported any unleaded petrol?

MR STRANG: I'm not 100 per cent over this year. I know, for example, that we just entered into a sale contract for gasoline to - or actually selling to Trafagura for delivery in Melbourne. So, yes, we have had local sales.

DR KING: But with regards to export sales?

MR STRANG: I guess in this category we are sort of putting those in the same category. They are ex-refinery sales, so we are not directly selling to the market. We are not delivering to our terminal for sale.

DR KING: You don't know, off the top of your head - - -

MR STRANG: Not off the top of my head - - -

DR KING: - - - whether it is sold over to New Zealand or elsewhere - - -

MR STRANG: I think we might have had one cargo to New Zealand early in the year, in April.

MR MARTIN: Just to ask - one of the other witnesses giving evidence talked about the competitive response on ethanol blends. What is Caltex's position in terms of where they see that in their marketing strategy?

MR DES KING: We offer bio fuels now to our network. Over 300 of the sites that we support now are selling bio fuels. Of that total I think we are up to just 180 are selling ethanol blends across the country. We are well on track to meet the Federal Government's standard of having 350 million litres of bio fuels blended into the petrol and diesel mix by 2010. Basically, our market share size is roughly a third of that target, so increasingly rolling out E10. It's in the early days as yet. We are turning up the ethanol contracts contract by contract, and we are passing along a 3 cent a litre discount for E10 to consumers, which is part and parcel of the lower tax on ethanol. There are some higher infrastructure costs required for ethanol. How that margin on E10 compares to the regular fuel is very much a function of the local ethanol contract that we have. Alex may have some comments.

THE CHAIRPERSON: All right. We will move into private session.

MR YOUNG: Mr Chairman I can give an indication I think the questions I have in private session will probably occupy 45 minutes to one hour. That raises the question of whether we should break for lunch now or part way through.

THE CHAIRPERSON: I'm just conscious that we have another witness - we have a witness from Woolworths who is scheduled for I think 1.30. It is clearly going to be later than that, but I wonder whether we don't continue now, given we only just had a break for tea and I take it that your headache is somewhat relieved.

MR YOUNG: Receding.

THE CHAIRPERSON: If you are happy, why don't we continue now and then we can conclude with the witnesses from Caltex, break for lunch for five minutes, and those that are exiting the room in order to enable us to have this private hearing can probably clear the lunch plates while they are waiting.

MR DES KING: Would it be possible to take a short 10-minute break while the room clears?

THE CHAIRPERSON: Yes, sure.

WHEREUPON THE PROCEEDINGS MOVED IN CAMERA [12.51pm]

RESUMED [2.40 pm]

THE CHAIRPERSON: I reconvene the hearing. My apologies to the representatives of Woolworths. We went a bit over time this morning. So apologies for having delayed you beyond the scheduled starting time for your giving of evidence. I wonder if you could just, for the record, please, state your names and role or position with Woolworths?

MR NARSEY: My name is Rumnik Narsey. I am the general manager of the petrol division of Woolworths. And my colleague is Mr Rohan Jeffs. And he is the general manager, group compliance, for our company.

THE CHAIRMAN: Thank you. Witnesses, your evidence will be given under oath or affirmation.

<RUMNICK NARSEY, AFFIRMED

<ROHAN JEFFS, SWORN

THE CHAIRMAN: Also, just for the record, I see we have some legal representation here, if you could identify yourselves.

MR SMITH: Mr Chairman, my name is Smith. I'm a barrister instructed by Mr Corrigan of Clayton Utz to appear on behalf of Woolworths, its related companies and Mr Narsey today.

MR CORRIGAN: Michael Corrigan, Clayton Utz.

MS PALMER: Ellie Palmer, Clayton Utz.

MR YOUNG: If in the course of my questions you think there are matters of commercial sensitivity that you would have to go to answer me properly, please say so and the course we can take is to have a separate, private in camera hearing after we have concluded the public session.

MR SMITH: If it's convenient, Mr Narsey would like to read a statement as an opening.

THE CHAIRPERSON: We are happy to do that. but can I emphasise that your submission has been read and so if it's just a short opening statement that is fine.

MR NARSEY: I would like to inform you that I have had a 30-year background in the oil industry. Prior to joining Woolworths five years ago in my current capacity I worked for a major oil company in Australia for around 25 years. Prior to joining Woolworths some 20 years ago, Mr Jeffs also worked for a major Australian oil company for around 10 years, and Mr Jeffs has had an involvement with Woolworths' petrol business since its inception in 1996 and is familiar with much of its history. We welcome the opportunity to respond to the Commission's questions about the petrol business, particularly its role within the Woolworths company, our way of doing business, the position we take in the market and what we have achieved in the last few years. By way of background I thought a brief history or our petrol business would be useful to the Commission. In the mid-1990s - - -

THE CHAIRPERSON: Just to - I am a bit conscious of the time. Does this repeat what is already in your submission, because the submission should be taken as read. It will help us to get to the issues a bit more quickly if rather than having an oral presentation of the history and the like. I don't want to cut you off entirely but it would make it a bit easier I think if Mr Young can get to some of the critical issues we need to address.

MR NARSEY: Perhaps there is one part of the presentation that is not articulated in the submissions that might be worth going through.

THE CHAIRPERSON: If you could confine it to that that would be very helpful.

MR NARSEY: I would like to address one particular issue that has come up in matters that were raised by folk in previous appearances at the commission. In fact some allegations were made by some of those who said that Woolworths' petrol discount scheme was a sham, the implication being that we merely increase the price of groceries to pay for the discount. This is entirely incorrect and represents a misunderstanding of the way Woolworths operates its business. Woolworths does not price the over 25,000 product lines it sells on a cross-subsidy or cost recovery basis. For instance, the net cost of the fuel discount program is only a fraction of a cent of the average selling price of the 25,000 lines we sell in our supermarkets. It's difficult to see how one can comprehend this relatively small cost of one particular product when setting the selling price of another. The fact is retailers throughout the world have many and varied loyalty and reward schemes and promotion schemes. Like all other customer attracting activities, loyalties programs seek to maintain and increase customers by short and long-term strategies, all of which have various costs attached. These are part of the total cost of operating a retail business and simply represent the cost of incentivating customers to keep coming back, buying more and to switch brands. It's no different in Australia. The majority of our customers today also cross-shop at other competitor stores. So the opportunity exists for all retailers to attract greater loyalty. Some do it through heavy promotions, through their weekly catalogues, Friday specials and the like, and we have seen them all. Some offer shareholder discounts. Others offer loyalty cards and some use petrol. The successful retailers use a combination of some or all of these and balance them in a way that minimises the overall cost while maximising the effectiveness in terms of the exercise. After all if you didn't manage your overall cost of your programs effectively and didn't get the extra sales, how would you compete against those retailers out there who do not have such programs and who could therefore undercut our supermarket prices? The Australian customer differentiates between competitors on the best offer available to them in both petrol and the food market and we have to be on the pace in both. We believe we are on both counts. The growth in our sales in supermarkets and our petrol outlets is clear evidence of this.

THE CHAIRPERSON: Thank you.

MR YOUNG: Can I take up the issue of the shopper docket and the 4c discount that you have just addressed while it is current. In what you have just said you have described it as in effect a customer loyalty program, correct?

MR NARSEY: Correct.

MR YOUNG: If I understood you correctly, you also indicated that the costs of the customer loyalty program, that is to say the 4c discount, is borne by the overall Woolworths business both petrol and grocery and other aspects of its retail business; is that right?

MR NARSEY: It is correct to say that it is borne by the overall business. In terms of financially how it is handled in an accounting sense, I would address that in closed session. But the answer is, yes, it is borne by Woolworths overall.

MR YOUNG: From time to time, in addition to the standard 4c discount on the shopper docket, that discount is extended by special programs, correct?

MR NARSEY: That's correct.

MR YOUNG: At times you may offer a 10c shopper docket discount if special conditions are satisfied?

MR NARSEY: We haven't done a 10c except in response to competitors, but the answer is, yes.

MR YOUNG: I take it that extensions of the shopper docket discount to special programs like that where there is an additional discount is likewise regarded as part of the customer loyalty program?

MR NARSEY: Absolutely. It's a program run by the supermarket to drive sales.

MR YOUNG: When you speak about customer loyalty you are speaking about the loyalty of customers who shop at Woolworths supermarkets?

MR NARSEY: Yes, indeed. Perhaps I might clarify this slightly. We can talk about loyalty programs, absolutely we want to protect the business we have, but the program also drives those same customers to increase their basket size. So we want them to keep buying from us, we want them to buy more from us, and we also hope to convince others customers who don't buy from us to also buy from us. It is about keeping the foot traffic and more foot traffic and that foot traffic you already have to get them to buy from is. That is the purpose.

MR YOUNG: So effectively the 4c discount is an incentive to your supermarket customers to buy more or, if they are not already your customers, to shop at Woolworths rather than somewhere else?

MR NARSEY: That's right.

MR YOUNG: Do you keep track of what percentage of discount dockets are actually redeemed at service stations?

MR NARSEY: You mean in terms of the dockets which are issued at supermarkets and redeemed or is this - my question is: We have an accurate idea of what percentage of people come to our service stations have a docket. What we don't have an accurate account of is how many qualifying dockets are actually issued by supermarkets and what percentage of those actually get redeemed.

MR YOUNG: Separate that and see if you can give the figures or some figures in open session. In relation to petrol sales at Woolworths petrol outlets, what percentage by volume of petrol sales are sales that involve the presentation of a discount docket?

MR NARSEY: It's about 60 per cent.

MR YOUNG: Is it increasing or decreasing?

MR NARSEY: I can't answer that question. I have to look at the numbers.

MR YOUNG: Dealing with a separate matter, of all of the dockets actually issued, that is to say, the qualifying dockets what percentage of them actually are presented and redeemed at a petrol station?

MR NARSEY: I don't have that analysis. I don't have that data.

MR YOUNG: Presumably the business keeps track of that data?

MR NARSEY: Not in a form that I can extract to analyse. I mean, in a closed session I am happy to express a view of some analysis that we had done on a limited number of supermarkets for a limited period of time. I'm happy to share that information with you in closed session.

MR YOUNG: We will reserve that for a private session. In relation to the costs of the shopper docket program. I take it from what you said earlier that Woolworths does not expect the fuel retailing business to support the costs of the 4c discount by itself?

MR NARSEY: Without being precise about how it is handled in an accounting sense, the answer is, yes.

MR YOUNG: Again, leaving aside the question of allocation, is the extent of the 4c per litre discount such that the cost of that could not be borne by the petrol retailing business in isolation from the balance of the business?

MR NARSEY: Again, I would like to address that in a closed session.

MR YOUNG: Let me ask you this, because it might cut short my questions. Can you address in the private session as well the way in which the costs of the shopper docket program are in fact allocated across the different business divisions?

MR NARSEY: Yes.

MR YOUNG: Just to get this clear, your opening statement indicated, I think, that the costs of the shopper docket system are not something that is taken into account in setting individual prices for grocery items?

MR NARSEY: That's correct.

MR YOUNG: Generally in determining prices that will be offered by the Woolworths petrol outlets, does Woolworths attempt to compete with rival outlets on price without regard to the impact of the shopper docket?

MR NARSEY: That's correct.

MR YOUNG: In other words, you try and match the board prices of your competitors quite apart from any consideration of the further 4c per litre discount?

MR NARSEY: That's correct.

MR YOUNG: If we put to one side Coles Express, which has a similar offer, why do you adopt that competitive strategy in relation to other petrol outlets who don't offer this additional 4.4c per litre discount?

MR NARSEY: When we introduced our offer we introduced our offer as a discount which was a real discount, a meaningful discount. If we were not on the pace with board prices, our customers would say to us, "That's not a real discount." Indeed we get phone calls from people and letters from people saying, "You were 1c a litre or 2c a litre more expensive than the site next door. Your 4c a litre discount is really only 2c a litre." We like to be true to our brand. We like to say to people you will get the best price in the market as well as the discount. It is to ensure that the discount we offer is meaningful.

MR YOUNG: In setting prices, does Woolworths pay particular attention to the prices offered by Coles Express?

MR NARSEY: No, no more than other competitors.

MR YOUNG: In setting prices, does Woolworths do it on a location by location basis or does to do it across a city?

MR NARSEY: Yes, on a location by location.

MR YOUNG: Does Woolworths take the view that certain locations are so well situated and so convenient that that particular site can justify a price that might be higher than competing locations?

MR NARSEY: No.

MR YOUNG: So you would endeavour to match rivals on their board prices without regard to any special attractions that your site might have?

MR NARSEY: Yes.

MR YOUNG: Does the price that you set on a location by location basis vary depending on whether your particular petrol outlet is adjacent to or close by a supermarket?

MR NARSEY: No.

MR YOUNG: Do you have a policy of trying to locate your petrol stations as close as possible to a supermarket?

MR NARSEY: Yes.

MR YOUNG: What is the thinking behind that?

MR NARSEY: I think it goes back to the original concept of the loyalty offer. People go to supermarkets several times a week. They usually do their big shops once a week. What could be more convenient than having your service station next to the supermarket to do your shopping, fill up with petrol. It's a convenience issue.

MR YOUNG: Have you seen a noticeable impact on independent service stations of your entry and the offer of shopper dockets?

MR NARSEY: No.

MR YOUNG: You haven't seen independents ceasing to adopt a strategy of being the price discounters and effectively leaving that to the supermarkets?

MR NARSEY: No. I think they are as aggressive as ever.

MR YOUNG: Of the competitors in the market, and I know it is hard to speak generally rather than location by location, who do you find is the most aggressive competitor for Woolworths?

MR NARSEY: You said putting aside location by location. I really think that makes a difference. In different cities there are different competitors. It is not uniform every week. We find sometimes our major supermarket competitor is very, very aggressive. More recently we have noticed my last employer being very aggressive. Some of the independents are super aggressive. We have a convenience operator who adopts a very aggressive stance. I am not being evasive, but it really does change - it's not the same person in every city. It is not even the same person in every locale. It really does vary. I could not point you to one particular offer.

MR YOUNG: Others have described the two supermarkets as the most aggressive discounters in the market city by city region by region at the present time. Do you disagree with that?

MR NARSEY: Absolutely.

MR YOUNG: Do you think it varies from location to location and city to city?

MR NARSEY: Yes, it does. Our policy is to match to the lowest price in our local area. So I would vehemently argue that we are not the cheapest in the market. We match, we follow. So others are more aggressive than us.

MR YOUNG: Is that always the case or are there particular circumstances in particular locations where for one reason or another Woolworths is leading the price down?

MR NARSEY: We don't lead the price down.

MR YOUNG: Never?

MR NARSEY: No.

MR YOUNG: Do you have a limit below which you won't cut the price?

MR NARSEY: No.

MR YOUNG: No? Does that indicate that at times if competition requires you would be prepared to price below cost?

MR NARSEY: Yes.

MR YOUNG: Are there occasions when you have in fact priced below cost?

MR NARSEY: Yes.

MR YOUNG: Your evidence is that whenever you have done that you have done that in order to meet a lower price that was first set by a competitor?

MR NARSEY: Exactly.

MR YOUNG: Where you have gone below cost, is it always a particular competitor who takes you down that far?

MR NARSEY: No. Not just one. Again, it could be different ones in different markets.

MR YOUNG: Is that something that Coles has done by setting prices low and you will follow? In other words, set them so low as to take you below cost?

MR NARSEY: Yes. Coles have adopted a position which at certain sites is below cost and we have had to match, yes.

MR YOUNG: It has been suggested that in Sydney there was a particularly aggressive period of pricing in about July of 2007. Do you agree with that?

MR NARSEY: Absolutely.

MR YOUNG: Tell me about it. What was the cause of it and who was driving it?

MR NARSEY: To the best of my ability in terms of observing what is happening in the market, it appears as if our major supermarket competitor was pricing to drive sales. And the market was fiercely competitive. There were sites where we were selling below cost for days on end.

MR YOUNG: Was that Sydney wide or particular locations?

MR NARSEY: The low prices were Sydney wide. I can't exactly tell you how many sites we had below cost, but there were a few.

MR YOUNG: When you say a few sites were below costs, does that mean they went lower than other sites?

MR NARSEY: Yes, the market was not using one price across the city. There was variations in the market at those different sites.

MR YOUNG: That was roughly a period of about four weeks in July of 2007?

MR NARSEY: I think that's right. It was most of July.

MR YOUNG: What course of action was taken by the other competitors in the market leaving aside Coles Express and Woolworths?

MR NARSEY: I seem to recall that the other oil companies tried to lead the market up with the normal Wednesday weekly cycle, and our major competitor did not respond. The majors basically led the market up. I can't recall if that was the case every one of those four weeks, but certainly I think it was.

MR YOUNG: So in each of those four weeks you think one of the major oil companies tried to lead the market back up?

MR NARSEY: Yes.

MR YOUNG: And the attempt failed, did it?

MR NARSEY: Yes.

MR YOUNG: Basically the reason was that Coles Express did not follow it back up?

MR NARSEY: That was my observation, yes.

MR YOUNG: What course of action did Woolworths take?

MR NARSEY: We didn't have a lot of choice. We had to match our competitor.

MR YOUNG: Did you attempt to move up along with the majors?

MR NARSEY: Not in an across-the-board sense. Because we price sites individually, if we had sites where Coles were not within our trading area, we would have gone up when the rest of our competitors would have gone up. So you would have seen a few sites up. But it was pretty clear certainly by the second week that our competitor had market share in mind and there was no point in leading the market up until we had a clear indication that they had had enough of picking up market share.

MR YOUNG: Over this four-week period, these circumstances meant that there was effectively no weekly price cycle, a peak and a trough?

MR NARSEY: That's correct.

MR YOUNG: What brought the period to an end?

MR NARSEY: I seem to recall that the company in question led the market up.

MR YOUNG: Coles Express.

MR NARSEY: If not that, then certainly when somebody else led it up, they responded quite quickly is my recollection.

MR YOUNG: And what course did Woolworths take?

MR NARSEY: We followed our pricing policy. We matched when the market went up. When our competitors went up we matched that.

MR YOUNG: When you went up at the end of that period, did you go up to the same price as the others led the market back to?

MR NARSEY: I'm sorry, I can't recall that precisely now. I think we might have but I would have to check.

MR YOUNG: As a general policy when the market moves back up to the top of the cycle, does Woolworths move back up to a matching price right at the top of the cycle?

MR NARSEY: Generally speaking, what happens is - this does vary by market. Is that not everybody, all of the majors, go to the same point. So we would normally take a guess at where the market is going to settle. For instance, one particular feature of one particular market is that one branded major has got their own sites and a lot of independently owned sites but of the major's brand. They traditionally price below where the major is at. So we don't usually go up to that point. We go up to where the independently owned but the majors branded site have gone. We don't necessarily go right to the top. We go to where we think the market is going to settle within a few hours. It just saves us the trouble of going back down again.

MR YOUNG: Which is the company you just referred to?

MR NARSEY: It has similar colours and logos. Beyond Petroleum.

MR YOUNG: What is its name?

MR NARSEY: BP.

MR YOUNG: What are the policy reasons why Woolworths will adopt that approach, that is, if someone else moves the market back up by a significant jump at the start of the cycle, A, why do you follow and, B, why do you go to the point where you think the market will settle?

MR NARSEY: Why do we follow? Because it's our policy to follow the rest of the market. The economics dictates that when we have been pricing down at the bottom of the cycle and the margin is very thin, you do have to try and recover or you get to a point where the average margin through the week is about where you are going to sell. And so it actually makes a lot of sense to follow the market up. In terms of - as an example, in Melbourne where there is a major independently owned BP chain, they usually price, they are pretty good sites, they usually price a cent or two below where BP's company owned sites price at the top of the cycle. And as soon as the other majors see where these independent guys have priced, the market usually comes back there anyway. So there is no point going up only to come back down again. So we are probably being - we are anticipating - - -

MR YOUNG: In terms of your first ground you referred to for going back up, that's essentially to recover margin that has just been lost by pricing low as others have led the market down, correct?

MR NARSEY: Yes.

MR YOUNG: Why do you consider that the market cycles as it does in say, take, Sydney, on a regular 7-day cycle?

MR NARSEY: I can't answer the question accurately about why it is seven days. It seems to have happened historically for a long time. In terms of why the market cycles, I have a particular view, which is that in the marketplace we have a lot of players. We probably have two categories of players. We have players - most of these are the majors who have good quality sites, are in a good location, have got a great brand reputation. And we have other players, who usually comprise independents, who usually have poor locations, poor offers and on a level price playing field they would find it difficult to survive. And the customer, if they had a choice of driving into a poor offer versus a good offer, they would go to the good offer if the price was the same. I have always believed that independents in particular need the price break to survive in the marketplace. The consumer considers petrol as pretty homogenous - considers petrol to be a fairly homogenous product. They will switch brands on price. They are very price sensitive. I don't think the people with good size, which usually are the majors, can afford to just stand there and lose business to a guy who has got 0.2 or 0.3c a litre price break. In order not to lose volume they match the market and match those guys. The independent usually - this has historically been the case, they price below the majors again and so the price keeps toggling to a point where usually the majors say, "Hell, we can't afford this anymore. We need to jack the price up again." Without being oversimplistic I think that's the way it works.

MR YOUNG: In Woolworths' case, what is the business motivation for following the price back up towards the top of the cycle?

MR NARSEY: To restore margin.

MR YOUNG: Do you have a pre-determined level of margin or return that you are aiming to achieve over the course of the cycle?

MR NARSEY: No. Our policy is to match the market. To some extent the margin is an outcome. Having said that, we do have a budget that we have to achieve.

MR YOUNG: You have a budget for sales in terms of volume presumably?

MR NARSEY: Indeed.

MR YOUNG: And also a budget in terms of revenues generated by those sales?

MR NARSEY: And indeed that ugly P word "profit".

MR YOUNG: Do you break down your budget by volume and profit, revenues on a monthly basis?

MR NARSEY: Yes, we do.

MR YOUNG: Do you do it on a weekly basis?

MR NARSEY: No.

MR YOUNG: When a manager within Woolworths - - -

MR NARSEY: I have given you an inaccurate answer. We have a weekly volume budget but not a profit budget, margin budget.

MR YOUNG: Does the weekly volume budget impact on your pricing decisions?

MR NARSEY: No.

MR YOUNG: Your return really depends upon a combination of volume and price, correct?

MR NARSEY: That's right.

MR YOUNG: What you are aiming to achieve is that volume weighted price that is going to deliver you a return you are seeking?

MR NARSEY: That's correct.

MR YOUNG: Is that set in advance for each week of operations?

MR NARSEY: No.

MR YOUNG: Presumably the managers who are in control of the price decisions will know on a monthly basis what combination of volume and prices they are seeking to achieve?

MR NARSEY: Yes, they do.

MR YOUNG: When you move the price up and down, is it done with a view to achieving those targets?

MR NARSEY: No.

MR YOUNG: It's overborne by the desire to match competitors, is it?

MR NARSEY: Correct.

MR YOUNG: Since the advent of Woolworths and Coles Express, isn't it correct that the independents have ceased to be the real drivers of the cycle and the petrol discounts?

MR NARSEY: I think the independents are just as aggressive as ever for almost the entire length of the price cycle. I think I have noticed right at the bottom of the cycle, particularly when the margins are starting to get very thin, they are probably less aggressive. But that's not the case for everyone. Some of them are still fairly aggressive.

MR YOUNG: But your expectation would be that on a cost basis the independents can't compete with either Woolworths or Coles Express. In other words, their costs of petrol are going to be higher than yours?

MR NARSEY: I don't know about - I don't know their cost of petrol. So I'm not sure I can answer that.

MR YOUNG: I know you don't know it, but you have an expectation given the volumes you buy and given the volumes that Coles Express buy that the prices you can achieve from the major oil company suppliers would be better than the independents, wouldn't you?

MR NARSEY: Yes.

MR YOUNG: And significantly better?

MR NARSEY: What is "significantly"?

MR YOUNG: Significantly better would be at least several cents per litre?

MR NARSEY: In my view, that's not the case.

MR YOUNG: It is true, is it not, tell me if you can't answer this in open session, that you do in effect get significant volume discounts from Caltex in respect of your purchase price of petrol?

MR NARSEY: I'm not trying to be clever. I'm not sure what you mean by "discounts". We have a contract price.

MR YOUNG: You get a price that reflects the volumes that you purchase?

MR NARSEY: It's the same contract price throughout the year for the entire period of the contract. It reflects the volumes we buy. What I meant was our price doesn't go up and down.

MR YOUNG: I think you have told me that in terms of the price cycle who leads it down varies from location to location. It's sometimes the independents, correct?

MR NARSEY: Yes.

MR YOUNG: It's sometimes your competitor Coles Express?

MR NARSEY: Yes.

MR YOUNG: And is it sometimes the major oil companies?

MR NARSEY: Yes.

MR YOUNG: But it's not usually Woolworths?

MR NARSEY: No.

MR YOUNG: When the prices go back up, which party generally leads the prices back up or which category of market participant?

MR NARSEY: Usually oil companies. And our major supermarket competitor.

MR YOUNG: You say there are occasions when it is Coles Express that leads the price back up to the top of the cycle?

MR NARSEY: Yes.

MR YOUNG: But leaving aside those occasions it otherwise tends to be one of the major oil companies which leads the price back up.

MR NARSEY: Yes. Can I just clarify a little bit. I'm not certain if our major competitor leading up has been more prevalent in the last few months. Certainly they were a regular leader of the market when they first entered the market. I would have to think about whether they have been as active in leading the market up in recent months.

MR YOUNG: If I understand what you have just said, in the past Coles Express did on occasions lead the market back up to the peak, correct?

MR NARSEY: Yes.

MR YOUNG: But you are not sure that that position has been prevailing in recent months?

MR NARSEY: That's correct.

MR YOUNG: Do you have any explanation as to why the cycle is a fairly regular seven-day cycle in, for instance, Sydney?

MR NARSEY: Other than its been historically that's exactly what happened, I don't have any other explanation.

MR YOUNG: And it always seems to be Wednesday or Thursday when the prices are led back up to the peak in Sydney?

MR NARSEY: In recent times, yes, but it wasn't that long ago that it used to be Mondays.

MR YOUNG: What determines the day on which the prices go back to the peak of the cycle?

MR NARSEY: You would have to ask those that lead the prices up.

MR YOUNG: Can you see any rational explanation for it always happening on a particular day?

MR NARSEY: No. I don't think I could give you a clear answer on that one.

MR YOUNG: If it was simply competitive tension, you would expect the pattern to be quite variable, wouldn't you?

MR NARSEY: I'm not sure.

MR YOUNG: Are you familiar with the markets in Perth and Darwin?

MR NARSEY: Yes, I am. More so Perth than Darwin.

MR YOUNG: What about Hobart?

MR NARSEY: Less so Hobart.

MR YOUNG: Do you know that in Hobart there is no price cycle at all?

MR NARSEY: That's true. Hobart doesn't cycle like the capital cities.

MR YOUNG: How many major participants are represented in the Hobart market? Woolworths, firstly?

MR NARSEY: I think all the major oil companies are. Supermarket companies are. There is a very large independent there. Small independents. There is quite a mixture.

MR YOUNG: So there are many market players in Hobart?

MR NARSEY: I think in more recent times Mobil is not there, from memory, but there are quite a few.

MR YOUNG: Representatives from each category, major oil companies, the two supermarkets and some independents, correct?

MR NARSEY: Yes, I believe so.

MR YOUNG: Including a major independent?

MR NARSEY: Yes, indeed.

MR YOUNG: That's not very dissimilar from the picture in Sydney, Brisbane or Perth, is it?

MR NARSEY: That's probably accurate, yes.

MR YOUNG: From your observations, the Hobart market has competition between those various players?

MR NARSEY: Yes.

MR YOUNG: But there is no price cycle?

MR NARSEY: Not in the manner in which you see them in capital cities, no.

MR YOUNG: Are you able to venture an explanation as to why not?

MR NARSEY: Other than saying that I think it would be true to say that there are less independents in Hobart, but I would have to check the data on that.

MR YOUNG: But there is still price discounting in Hobart, isn't there?

MR NARSEY: Discounting from what? I'm sorry?

MR YOUNG: There is still price competition in which competitors try and match each other's prices?

MR NARSEY: Absolutely.

MR YOUNG: If somebody sets a lower price in Hobart Woolworths would match it?

MR NARSEY: We do.

MR YOUNG: Can I just ask you about Perth. In Perth the cycle has moved from seven days to 14 days. Are you familiar with that?

MR NARSEY: That's correct.

MR YOUNG: That followed the introduction of regulations by the Western Australian government including the 24-hour notification rule.

MR NARSEY: I don't think that's correct.

MR YOUNG: What do you say the position is?

MR NARSEY: I think the 14-day cycle did not happen immediately after.

MR YOUNG: Some time after?

MR NARSEY: I think so. I have not studied it in detail.

MR YOUNG: Perhaps it happened as people became familiar with the notification system and began to use it as a source of information?

MR NARSEY: That could be correct.

MR YOUNG: Can you point to any reason as to why the cycle is 14 days in Perth compared to seven days in other capitals?

MR NARSEY: The only explanation that I have is that because you can't change the prices through the day it tends to mean the prices are less volatile, so this constant problem, if you like, doesn't happen, No. 1. No. 2, to a large extent you are guessing prices, what your competitors are going to post the next day. So you can get two extremes. You can get overcompetitive thinking your competitors will be at a particular point, or you can be conservative in pricing. The only thing I can put it down to is that it does not have the same degree of competition as the eastern states, the intraday competition.

MR YOUNG: What you are saying, if I understand you correctly, is the 24-hour notification rule means that players have to be more cautious about the prices they notify because they will have to hold them for 24 hours?

MR NARSEY: I think that's probably true.

MR YOUNG: And the other difference is that, because of the notification system, it immediately becomes public knowledge as to who is discounting significantly or alternatively who is leading price increases? Is that a factor?

MR NARSEY: Yes, the information is publicly available.

MR YOUNG: In Perth, when we take Woolworths, what has been the impact of the regulation system on Woolworths and its pricing decisions?

MR NARSEY: It's been extremely difficult, because it's entirely guesswork in terms of what the competitors are going to be posting.

MR YOUNG: Does it mean that Woolworths has been more cautious in posting prices?

MR NARSEY: Not necessarily more cautious. I think it's what I said before. We have had to use guesswork to work out what our competitors are going to post. Sometimes we get caught out being far too competitive, sometimes we get caught out not being competitive enough. I don't know what the balance point is and whether net net we are more competitive or less competitive.

MR YOUNG: That would tend to lead you in Woolworths' case to price on a basis that is more reflective of a stable price that gives you the return on investment that you are seeking?

MR NARSEY: Not at all.

MR YOUNG: No? Do you still try and price competitively?

MR NARSEY: We try and guess where the competition is going to be, yes.

MR YOUNG: But you pay more attention to the consequences of making an error, do you?

MR NARSEY: I think we probably do, yes - guessing.

MR YOUNG: The consequences of making an error is that it would adversely affect your profitability?

MR NARSEY: Which way?

MR YOUNG: One way or the other?

MR NARSEY: You are probably right. If I have a guess I think that's the consequence.

MR YOUNG: You might get a pleasant surprise when you notify a price or you might get a nasty shock.

MR NARSEY: I'm in favour of pleasant surprises.

MR YOUNG: What would be the impact if such a system was introduced in Sydney?

MR NARSEY: I think the consumer would miss out.

MR YOUNG: Why would the consumer miss out? If the cheapest price in Sydney for the western suburbs was in Narellan and you lived in Mennai, you would have to travel 25 kilometres to get it.

MR YOUNG: But the system would allow you to locate the cheapest price across Sydney that was relatively proximate to where you are. That's how the Perth system works, isn't it?

MR NARSEY: In most cities prices are - the ripple effect of prices is that the variants between most regions isn't great. You can have quite large differences in Perth. I think the consumer is looking for best price without having to drive long distances. I am absolutely certain - that's what is going to happen in Sydney. People will miss out on the great prices.

MR YOUNG: At the moment the only way they know about prices is if they happen to drive past a board or alternatively if they trust in the shopper docket 4.1 or 4c per litre discount that the supermarkets offer, isn't it?

MR NARSEY: They do.

MR YOUNG: Yes. But they don't have much information about where the cheapest price is unless they drive around the suburbs looking at boards, do they?

MR NARSEY: Except that I think the customers are now pretty used to the price cycles. So the price conscious customer is out there looking for a deal, and that's why our sales are large - are much higher on the cheaper days of the week and customers who are looking for great deals take advantage of that. In terms of being able to observe it, I think the competition drives most markets to reasonably within a cent or two virtually across the city. And I think that's the advantage of the - having visibility of your competitor prices; customers don't have to drive further.

MR YOUNG: Is it the case in Sydney, to take the Sydney market as an example, that the amplitude of the price cycle, that is, the difference between the bottom and the top, has been growing in recent years?

MR NARSEY: I think that's true.

MR YOUNG: When you have a price hike at the start of the cycle it is now a larger price hike in terms of cents per litre than it was some years ago?

MR NARSEY: I feel that's correct.

MR YOUNG: That is also the pattern in other capital cities other than Perth, is it not?

MR NARSEY: That's probably also true.

MR YOUNG: But in Perth the magnitude of the price cycle span has diminished since the introduction of the regulations, correct?

MR NARSEY: That's true.

MR YOUNG: Just go back to your about proposition about customers shopping around and buying petrol on a certain day of the week to take advantage of low prices. Why do you suppose that it is that the major oil companies don't seek to raise their prices, in other words, to start the cycle on that day?

MR NARSEY: Sorry, I don't understand?

MR YOUNG: What are the low days of the week in Sydney, the peak-volume days?

MR NARSEY: Monday/Tuesday.

MR YOUNG: Monday/Tuesday? All right. So Monday/Tuesdays have the highest volumes sold?

MR NARSEY: Yes, usually.

MR YOUNG: Usually. And that tends to be towards the end of the price cycle, Monday/Tuesday?

MR NARSEY: Usually.

MR YOUNG: The prices generally move upwards on Wednesday or Thursday?

MR NARSEY: Wednesday usually, yes.

MR YOUNG: If those prices were to move up on Tuesday and purchasing patterns remain the same, a greater volume would be sold at a higher price?

MR NARSEY: I think if the price were higher you wouldn't sell the same volume.

MR YOUNG: Do you think volumes move around in response to prices?

MR NARSEY: Yes.

MR YOUNG: But there is a large percentage of people who simply buy petrol as a matter of convenience whenever they need it; isn't that right?

MR NARSEY: Yes.

MR YOUNG: A lot of people buy petrol when it suits them or when it's convenient in reliance, for instance, on your 4c shopper docket discount.

MR NARSEY: I'm not sure I understand the question?

MR YOUNG: If they get the 4c discount, they are getting pretty cheap petrol, are they not, whenever they buy it?

MR NARSEY: Yes.

MR YOUNG: They may not necessarily tailor their purchase for a particular day of the week if they are getting that discount, correct?

MR NARSEY: There would be a percentage of them who wouldn't, the less price sensitive customer.

MR YOUNG: Why do you suppose it is that the price cycle then jumps up on a Wednesday if greater volumes are traded on a Monday or Tuesday?

MR NARSEY: I think the greater volumes are because of the lower prices. There is a certain percentage of consumers would be less price sensitive, but I would say a large portion of the big kick in sales on Monday or Tuesday are price sensitive customers who would merely shift to the new day of the week - or the new - who would merely shift it to a couple of days before the new day of the week that the market moved up. If it moved up on Friday, for example, they would buy on Wednesday, Thursday.

MR YOUNG: There is one statement that I wanted to take up from your submission. It's at page 16. In answer to question 33.

MR NARSEY: Yes.

MR YOUNG: There Woolworths says that it's more recent experience is that the majority of "our volume is sold below the average price across the price cycle, with the greatest volumes being recorded in the days leading into the upwards cycle". If we take the Sydney example, that's Monday and Tuesday, just before a price increase on the Wednesday. What I wanted to put to you is this: That figure that a majority of volume is sold below the average price across the price cycle, is not very meaningful, do you agree with that?

MR NARSEY:

MR SMITH: In what sense? Perhaps I could ask the Commissioner and my learned friend ...

MR YOUNG: I will be more helpful. What I mean is this: Your revenues depend on the mix of price and volume, correct?

MR NARSEY: That's correct.

MR YOUNG: So it's not just prices and it's not just volumes. It's a combination of the two that deliver your profits. The converse is true, is it not, too, that for consumers whether they are better off or worse off depends on the combination of price and volumes? In other words, looking at all consumers, whether they are paying more or less depends on how much is sold at what particular price?

MR NARSEY: I don't follow.

MR YOUNG: Just look at this statement about the average price. The majority of volume is sold below the average price. Well, if 45 of the 51 per cent majority was sold just a fraction below the average price, that would be a very different situation than if the large percentage of the volume was sold at 10 cents below the average price.

MR NARSEY: That's correct.

MR YOUNG: Correct? On the other side of the fence, if of the 49 per cent minority volume, if a large amount of that was sold at 5c or 6cor 7c above the average price, you might infer that despite that statement consumers are worse off?

MR NARSEY: That's true.

MR YOUNG: It depends in which band plus or minus 5 per cent, 10 per cent and so on above or below the average.

MR NARSEY: Again, we don't sell a lot at the top of the market, so consumers are not losing out.

MR YOUNG: How much of your volumes are sold in the top third of the price range?

MR NARSEY: I would have to do that analysis.

MR YOUNG: How much is sold in the bottom third of the price range?

MR NARSEY: More than the bottom third of the volume.

MR YOUNG: My point when I asked you about whether it's meaningful is that you need more precise information of the kind I have just been putting to you to work out whether the price cycle is operating to the benefit of consumers or not; would you agree with that?

MR NARSEY: Yes. We have provided the data on the daily sales commission.

MR YOUNG: Can you provide the data that breaks down your sales according to how much is sold, tranche by tranche?

MR NARSEY: We can have a go at that, yes.

MR YOUNG: That is to say, how much is sold in the top 10 per cent price bracket, how much is sold in the next 10 per cent price bracket and so on.

MR NARSEY: We would be happy to have a shot.

MR YOUNG: We would be grateful if you could provide it. This passage does suggest that when you look at profitability you look at average volume weighted price.

MR NARSEY: Indeed.

MR YOUNG: Average volume weighted price is really a way to analyse whether the price cycle is providing greater revenue to the sellers than it is providing benefits to consumers?

MR NARSEY: That's correct.

MR YOUNG: Your submission refers in a few places to data from Informed Sources.

MR NARSEY: Yes.

MR YOUNG: You are a subscriber to Informed Sources?

MR NARSEY: Yes.

MR YOUNG: I imagine you work on the basis that your major rivals, the major oil companies and Coles Express also subscribe?

MR NARSEY: They also subscribe, yes.

MR YOUNG: So that means the major competitors at least have up-to-date and accurate information about prices?

MR NARSEY: On a historical basis, yes.

MR YOUNG: Do you think the availability of that data has affected prices in the marketplace?

MR NARSEY: I think competition is sharper to the extent that competitors can react quicker. You get better quality data and more timely data on what our competitors are doing, so it allows you to respond. I would contend that that makes a market more competitive.

MR YOUNG: Do you agree with this proposition: The price cycle would not exist in the way it does at the moment in say, take Sydney, with the severe price hikes at the start of a week and gradually eroded over the course of the week before it jumps up again, unless that system was operating to the benefit of the major oil companies?

MR NARSEY: I think I disagree with that statement.

MR YOUNG: Why?

MR NARSEY: I think the price cycles from a logistics standpoint is - is a problem in that when you sell high volumes on particular days and you are quiet on other days it makes logistics in terms of deliveries to the site, organising sales just in time in terms of inventory, queuing on forecourts - look, perhaps I shouldn't talk for the other oil companies. But certainly from our point of view, you know, we follow the market, but what we call high-lows, for example, high-low pricing. I think it's quite inconvenient for retailers, but consumers like it.

MR YOUNG: Well, can you think of any other market outside petrol where you have large weekly jumps in price as you have in petrol in, say, Sydney?

MR NARSEY: I can't.

MR YOUNG: In the absence of the desire of the major oil companies to lead the price back up by a substantial amount at the start of each week, you would simply expect that the price would settle down and then move in a moderate equilibrium range, would you not?

MR NARSEY: Yes, reflecting changes in cost, yes.

MR YOUNG: With some price changes and some discounting in a small margin, but not with the savage changes that you see in the price cycle? Do you agree with that?

MR NARSEY: Can I go back to your previous statement. I think you said that if the oil companies didn't cycle, the prices would - I'm not sure it's all the oil companies in terms of the cycle. I think I said previously that I think historically and even now independents are the instigators of price movement downwards. So just major oil companies not doing it I'm not sure would stop the price cycles.

MR YOUNG: I wasn't speaking about downwards or at least downwards only. I was speaking about the major oil companies moving it back upwards. They are the ones who initiate that upward movement, aren't they?

MR NARSEY: But if the movement downwards is outside their control, I can't see that they would have any choice but to take it back up again because their margin would be too low.

MR YOUNG: But if the margin is too low for participants in the market to make a return, then absent these weekly price hikes, the price would just tend to fluctuate upwards to a point where the decent margin can be earned in a gradual way?

MR NARSEY: That is true absent the price cycles.

MR YOUNG: And Woolworths' attitude would not cause any other outcome because, as you have said, you simply have a policy of competing and matching the market wherever it is?

MR NARSEY: That is true.

MR YOUNG: In the absence of a price cycle Woolworths would be better off, wouldn't it?

MR NARSEY: I think there would be pluses and minuses. I'm not sure exactly where I would come out of it. I might have to think about it.

MR YOUNG: You wouldn't have the logistical difficulties you spoke about.

MR NARSEY: That's true.

MR YOUNG: You wouldn't have supply problems or problems with crowded aprons and so on.

MR NARSEY: But the majority of customers will take advantage of the less than average price and they might miss out and they - - -

MR YOUNG: But in the absence of the price cycle with your shopper docket discounts you would maintain the position of being the most competitively priced offer in the market?

MR NARSEY: I think on balance we would probably be happen' about it, yes.

MR YOUNG: In all events, it is not Woolworths that is perpetuating the price cycle, correct?

MR NARSEY: No. Correct.

MR YOUNG: And these days I suggest to you it is not the independents which are perpetuating the price cycle?

MR NARSEY: I disagree with that.

MR YOUNG: It is certainly not the independents who hike the price back up, is it?

MR NARSEY: No, they don't.

MR YOUNG: Indeed when the price goes back up they don't follow it right from the top, do they?

MR NARSEY: No, they don't.

MR YOUNG: They tend to stay at the absolute peak of the cycle. At the bottom end the independents tend to stay a bit above the bottom point of the market, too; isn't that correct?

MR NARSEY: Some independents do, yes.

MR YOUNG: That's because they can't compete with the prices that Woolworths and Coles are able to charge at the bottom of the cycle?

MR NARSEY: That's probably true.

MR YOUNG: That would tend to suggest that it is not independents that are driving the continuation of the price cycle?

MR NARSEY: As I said previously, the independents are still as active as ever, except right probably at the bottom of the cycle. That's not true for all independents.

MR YOUNG: They are not responsible for the phenomenon that you have said exists, which is that the troughs are getting lower and the peaks are getting higher, are they?

MR NARSEY: I'm not sure I agree with that.

MR YOUNG: How could they be if as a general matter they don't go right at the bottom and they don't go right to the top?

MR NARSEY: Let me clarify that. I suspect where they stop is where they go into negative margins. Because margins wouldn't go to negative all the time, so they have the capacity therefore to drive the market down to the bottom. And they do.

MR YOUNG: I just wanted to ask you a few questions about another topic, away from price cycles for the moment.

In your submission you have said to the Commission that Woolworths does not regard imports as a credible proposition in the near term. That's at page 8. Now, can I ask you firstly what you mean by the "near term"? Were you talking about a six-month horizon or 12 months?

MR NARSEY: No, I think our best guess is on the other side of 2010.

MR YOUNG: Why is it that you think imports are not a credible proposition as a source of competitive supply this side of 2010?

MR NARSEY: From a supply standpoint there are two issues. One is terminalling, but I will put that aside for a minute. The other issue is just availability from refineries. The Asian refineries are not producing as a matter of course Australian-quality gasoline. Most refineries do it in special batches when they import into Australia. But in terms of independent refineries, not oil company linked refineries but independent refineries, our view is that the volumes we require are not available meeting Australian-quality specifications on a regular basis over a decent contract period for a decent price.

MR YOUNG: Is that view based on recent inquiries or investigations or is it based on earlier explanations?

MR NARSEY: I think one of the people who works for me who looks after this particular area was in Singapore last September. That was the view he had formed then. We have not inquired since. We have a long-term contract with Caltex, so there is no ongoing requirement to monitor this. But I don't think the situation has changed.

MR YOUNG: Do you keep track of the costs and availability of imports as a matter of necessity because of price issues and so on? You are negotiating with Caltex from time to time?

MR NARSEY: We try to keep tabs because the contract with Caltex is a finite one.

MR YOUNG: You mentioned that there was another problem associated with imports as a competitive source of supply, which was terminalling.

MR NARSEY: Yes, storage facilities.

MR YOUNG: Can you expand on that.

MR NARSEY: There is no imports and there is no independent storage facility available in Sydney. There is a facility available in Melbourne. The facilities in the other ports are essentially not available. So even if we did decide to start importing, we would face difficulties in virtually all markets perhaps bar Melbourne.

MR YOUNG: The Melbourne facility that is potentially available is the one at Hastings controlled by Trafagura?

MR NARSEY: That's correct.

MR YOUNG: Trafagura recently tried to sell that, did they not?

MR NARSEY: I can't confirm that, but I understand that to be true.

MR YOUNG: It is implicit in what you have said that you don't see any possibility of an importer such as Woolworths or any other independent gaining access to terminal facilities owned by the majors?

MR NARSEY: Sorry I should not have laughed. No. My apologies.

MR YOUNG: I take it that's a no. I think you have also said your information is that there are negligible volumes of independent importing of petrol at the moment?

MR NARSEY: Petrol, yes.

MR YOUNG: What importing takes place is largely by the majors, is it?

MR NARSEY: Yes. I think Trafagura still imports some.

MR YOUNG: I want to ask you some questions about your contractual arrangements with Caltex and about your margins, but I think it's best if I do that in private session. Mr Chairman, the topics I have left would require, I think, a private session in camera.

THE CHAIRPERSON: Before we go do that, I have two or three questions from the table here.

DR KING: I have a very short one.

MR NARSEY: Can you tell me, do you know off the top of your head Woolworths' retail margins in Perth? I'm not going to ask you for a specific figure.

THE CHAIRPERSON: I think that's something that is going to be asked in private session.

DR KING: Getting to margins?

MR YOUNG: Yes.

DR KING: Okay. We will hold that off.

THE CHAIRPERSON: Just three or four questions, if I can. You have done an estimate of Woolworths' market share of petrol sales.

MR NARSEY: Just over 19 per cent.

THE CHAIRPERSON: How did you reach that estimate?

MR NARSEY: We added the volumes of petrol that we sell at our 507 sites and divided it by the volume supplied by the department of - the Australian Bureau of Statistics - in terms of total sales in Australia. So total market volume, total sales volume in the Australian market is the divider and the nominator is what we sell.

THE CHAIRPERSON: It has been suggested to us in evidence from a number of parties that the combined market share of Coles and Woolworths in petrol sales is upwards of 65 per cent. That would suggest that Coles on your analysis would have a market share of around 45 per cent. Is that your assessment?

MR NARSEY: No, sir. I think our common market share would be more like 42 to 43 per cent between the two companies.

THE CHAIRPERSON: It was put to us in evidence yesterday - let me go back. Earlier on in your evidence you suggested that, if you priced above the market by, for example, 2c, those holding your discount vouchers would take the view that your discount was truly only 2c and you have indicated you get some reaction to that. It was put to us yesterday that a 12c differential would tend to be ignored for up to three to four days, because of the primary focus on the discount vouchers. Can you shed some light on that?

MR NARSEY: I would never, ever take the customers for granted like that - never. We do not believe for a minute that you could sit on a price that was 12c above the market for three or four days and still have people coming in and buying just because they have 4c a litre. Perhaps a small minority would. Most of them would be probably on fleet cards of some sort. But - - -

THE CHAIRPERSON: Have you ever tried a differential of that order or any significant order?

MR NARSEY: We have never tried that. We wouldn't - - -

THE CHAIRPERSON: Not even for a day?

MR NARSEY: Not even for a day, not even for a few hours.

THE CHAIRPERSON: In your submission in the heading relating to current impediments to efficient petrol pricing, and this goes back to the price cycles - you say this in answer to the question are there any impediments to pricing in general, and you say that the pricing legislation for fuel pricing in WA is an impediment to efficient competitive pricing, and that free market principles should be allowed to exist. You say that government intervention impedes the free market and efficient operators in the industry, resulting in increasing operating costs and requires retail operators to seek to achieve higher fuel margins over the longer term to remain available. I take it that that particular sentence applies to the pricing legislation for fuel pricing in WA; is that right?

MR NARSEY: Yes.

THE CHAIRPERSON: Can you indicate to me what increased operating costs would apply relative to the pricing cycle that occurs in the seaboard states of eastern Australia, what increased operating costs would apply in the context of the application of Fuelwatch, which requires setting of a price once a day only?

MR NARSEY: I'm sorry, I think I understand your question now. The statement on government intervention was a more general one and not specifically - there was a philosophical belief that wherever government intervenes, eventually it involves a cost of some sort or the other. So it was not directly related to the Western Australian example.

THE CHAIRPERSON: Can we assume that there would not be increased operating costs requiring retail operators to seek to achieve higher fuel margins over the longer term if the Fuelwatch concept was introduced into the eastern states as was I think suggested by Mr Young in one of his questions?

MR NARSEY: I think that's correct.

THE CHAIRPERSON: Do you consider that the Fuelwatch concept benefits consumers?

MR NARSEY: No, I don't.

THE CHAIRPERSON: In fact, I think you indicated that - I think your words were that the consumer misses out in the Perth market.

MR NARSEY: Yes.

THE CHAIRPERSON: If the consumer is missing out, then the supplier is obviously benefiting; is that not right?

MR NARSEY: I guess that's true. I would have to think about that, though.

THE CHAIRPERSON: Why wouldn't, then, the suppliers be seeking the introduction of a Fuelwatch across the country?

MR NARSEY: That's a question good. Can I answer like this. From a Woolworths' standpoint, with our policy of matching price and making sure that our fuel discount offer is real, the Western Australian legislation constantly catches us out. We are either way too competitive or too far below the rest of the market or out of the market, which creates problems in terms of customers finding out - so to the extent that we cannot deliver our customer promise, which we are determined to do in any market that it will last, we can't do it in Perth. We don't like the system.

THE CHAIRPERSON: Because it catches you out, which would therefore require you to be more cautious, perhaps more conservative in your pricing, discounting?

MR NARSEY: It can be the other way. You know, if you get a half a dozen phone calls, you say, "I don't want to get any more phone calls, people complaining." You might get too competitive and that can bring the rest of the market down as well. I would contend that anything that does not give you the ability to match your competitors at any time of the day is uncompetitive. It doesn't give me the ability to provide my customers with the best price because I'm not allowed to on the day.

THE CHAIRPERSON: Except I think you have been indicating, haven't you, that the concern you have with the Fuelwatch concept is that you might miss out by overpricing, that is, underdiscounting? Wouldn't that therefore create the incentive for you to discount to a point at which you beat your competitors otherwise you miss out for 24 hours?

MR NARSEY: Yes, we do. We will have sites where we will be clearly cheapest in the local area. As I said, to deliver the promise sometimes, you know, we have to go overboard.

THE CHAIRPERSON: And that works to the benefit of consumers?

MR NARSEY: Yes, it does.

THE CHAIRPERSON: So where do the consumers miss out?

MR NARSEY: But it also goes the other way as well. I mean, how long can we keep going like that in terms of always being cheaper across - I don't know, I can't remember how many, 80-odd sites across the network. I mean, we like to deliver the best price in the marketplace. We are not about leading the prices down. And the regulations in Perth doesn't allow us to do that. I think if we are allowed to compete on an interday basis, my firm belief is that our customers will be better off, because they can be sure that in their local area they can rely on us having the best price.

THE CHAIRPERSON: Just two final questions. You mentioned your previous employer. I don't think you actually identified who that was.

MR NARSEY: That's Mobil.

THE CHAIRPERSON: When did you join Woolworths?

MR NARSEY: Five years ago.

THE CHAIRPERSON: Were you with Mobil at the time that Caltex sought to beat the price cycle or dampen the price cycle in Adelaide in 2000?

MR NARSEY: Yes, I was. In 2000 I think I was in the lubricants division. I wasn't in retail.

THE CHAIRPERSON: So you wouldn't be in a position to tell us or give any guidance as to why Mobil amongst the others resisted the attempt by Caltex to dampen the price cycle in Adelaide?

MR NARSEY: I could offer a view.

THE CHAIRPERSON: I would be interested in your view.

MR NARSEY: I think that - and I don't know precisely what Caltex did. If the attempt was to, as it were, have a band in terms of price, so here is the bottom of the cycle, here is the top and we are not going to vary within it. Because the price is so visible it is easy for people to undercut that price. I don't know how anyone can hold a particular position in a market where the price is displayed in numerals two feet high. I think Mobil had worked out previously that trying to hold a market in a particular place is impossible.

THE CHAIRPERSON: Thank you. Are we going to go into private session? All non-Woolworths, non-ACCC, please, if you can vacate the room.

PUBLIC HEARING ADJOURNED **[4.07pm]**

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