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To:

Professor Alan Fels AO
Price Gouging Inquiry
365 Queen St
MELBOURNE VIC 3000

23 August 2023

Dear Professor Fels,

Thank you for the opportunity to make a submission to the inquiry into price gouging and unfair pricing practices.

This submission makes three high-level recommendations and provides a brief explanation for each as well as a case study relating to . It draws upon our work supporting companies and their investors maximise long term returns by ensuring alignment with the interests of their customers and workforce, in particular research into 'covert' price gouging practices and understanding the implications for investors as part of an ESG framework.

Recommendation 1: The inquiry should examine 'covert' forms of price gouging as a distinct category of unfair pricing practices.

Covert price gouging can be understood as circumstances where consumers are subject to an effective price increases (as opposed to a nominal price increase) caused by deliberate reductions in quality or quantity of a good or service and typically implemented in a manner that minimises the perceptibility of the change.

Perhaps the most widely understood form is what's been called 'shrinkflation', whereby common grocery items have their package size shrunk without a compensating drop in prices. Shrinkflation cases receives regular media attention which partially mitigates its concealment, but not the inflationary impact on households which can be substantial. For instance, a recent SBS News report highlighted weight reductions of 50 grams to 45 grams and 300 grams to 227 grams, amounting to effective price hikes of between 11% and 32%[1].

Unfortunately, other covert practices are not as easy to detect as shrinkflation, particularly for individual consumers. For example:

i. Recipe reformulations that dilute the nutritional value of a product by increasing the amount of lower costs ingredients[2], would only be detectable by consumers that hang on to empty jars or packets so they can look for miniscule changes to ingredients
ii. Telecommunication companies accepting payment for NBN plans with speeds that could not be delivered[3], would only be detectable by households that regularly tested their available speeds

[1] See *Feel like you're paying more for less? These are the latest items to be hit by 'shrinkflation'* from SBS News, 14 May 2023
[2] See *Nutella: Weniger Kakao – mehr Milchpulver* from Verbraucherzentrale Hamburg, 9 November 2017

iii. Travellers that have had their flights unilaterally cancelled by airline consolidating passenger loads on to fewer flights (without no recourse to recover the value of any unused accommodation) would need a data science degree to figure out if this has become more prevalent.

iv. Reduced headcount in company call centres would not be observable by individual callers, making it difficult for them to contest a claim that delays in answering their call is due to a larger call loads than normal.

Recommendation 2: The inquiry should consider non-regulatory mechanisms for tackling covert price gouging, including raising awareness amongst investors of the risk in their portfolios and encouraging them to include 'covert price gouging' as part of the ESG engagement and stewardship programs.

It's not just consumers that are at negatively impacted. While not to encourage overt price gouging, at least from an investor's perspective their relative transparency means a judgement can be formed in 'real time' about management's time and the possible impacts on the company's reputation and future sales. In contrast, covert practices by their very nature tend to only come to light over time. So, if financial projections are partially underpinned by an undisclosed degradation in the product or service, the risk to reputation and sales is also concealed and investors are at risk of pricing the stock higher than they would if there had been full disclosure.

Within an ESG framework, this is a classic example of pursuing higher short-term profits to the detriment of long-term returns. For investors that prioritise sustainable long-term returns, including superannuation funds, the choice is clear: either limit exposure to companies that deploy covert practices or incorporate the issue as part of your engagement and stewardship by communicating your expectations to companies and monitoring for a positive and negative response. For clarity, this wouldn't preclude companies from ever reducing quality or quantity, but when they do so for legitimate purposes (e.g., filling a perceived gap in the market) there should be no reason to conceal it from investors or even the target customer base.

For consumers, the benefit of having long term investors in their corner can be understood by looking at the manner in which investors have 'led' the domestic action on climate change over the last decade.

Aviation case study

In certain industries, covert price gouging practices can contribute to higher nominal prices as well. For example, the primary short run operational lever used by profit maximising airlines is the passenger seat factor, with levers such as service frequency, aircraft type and fleet size traditionally viewed as medium/long run levers[4]. However, when an airline can cancel flights up to the last minute without financial penalty, they are able to convert service frequency into an additional short run lever. The net result is a reshaped marginal cost curve that means an airline can set higher airfares in the comfort they can scale back capacity and operating costs. Australian consumers were repeatedly told that the increase in flight cancellations is a result of disruptions caused by the pandemic and were a global phenomenon[5]. While to some extent this will be true, it does necessarily account for all cancellations (just as higher jet fuel prices may not always be the sole driver of increasing airfares). It certainly doesn't explain why Australian carriers account for a disproportionate share of cancelled international

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[3] See Telstra, Optus and TPG allegedly misled consumers over NBN maximum speeds from ACCC, 9 August 2021 and Telcos to pay a total of $33.5 million for misleading statements about NBN maximum speeds from ACCC, 11 November 2022

[4] See Chapter 7 in *Airline Microeconomics* by Tony Weber published 2022

[5] See *Australia's Qantas apologises to customers for operational problems* from Reuters, 22 August 2022 or *Australia (and the world) is still grappling with travel chaos. But it could have been worse* from Sydney Morning Herald, 21 July 2022

flights departing from Denpasar Airport in Bali: since late January, Australian carriers operated less than a quarter of outbound flights but were responsible for more than three quarters of cancellations (see appendix).

If Australia had something similar to the EU's compensation scheme for delayed or cancelled flights (as the ACCC is calling for[6]), then Australian travellers could have confidence that these disruption to their vacations were not caused by commercial decisions to maximise profits. By offsetting the avoidable operating costs for a cancelled a flight, financial penalties would incentivise airlines to maximise profits by adhering to their promised services and selling more seats (possibly even lowering airfares to do so).

Recommendation 3: The inquiry should also consider the role monopoly or quasi-monopoly assets could play in mitigating covert practices by other actors within their supply chains (e.g. airports in aviation, NBN in broadband services)

While the inquiry should lend support to the ACCC's proposal for a statutory scheme, there are intermediary options that are also worthy of consideration. For instance, the central position that major airports hold could allow them to impose compensation schemes through their contractual arrangements with airlines.

One of the drawbacks of the EU's process is that the claims process is either administered by airlines themselves (who are able to impost administrative barriers that could undermine the scheme's effectiveness) or by independent claims processors who charge commissions of around 30% of the compensation value. In contrast, a scheme administered by airports:

- would be uniform for all carriers servicing that catchment
- could be built into the cost of providing the infrastructure and therefore more cost effective
- could benefit from the alignment between an airport's commercial incentives to maximise short run utilisation and an effective compensation scheme for passengers
- could potentially tailor the penalties to best suit local market dynamics

Finally, it's conceivable that a commercial scheme could be deployed quicker than a statutory scheme and thereby generate relief for households sooner. Particularly if there was a strong signal to industry that legislation would follow if they failed to act within a defined timeframe. Therefore the inquiry should think about how government could stage or sequence reforms for sectors where commercial interventions ought to be viable so as to prompt accelerated action by relevant parties. Particularly for sectors that have a concentrated ownership of long-term investors.

Thank you once more for the opportunity to contribute to this important inquiry. I'd pleased to expand on any of the information provided in this submission or respond to any additional questions you may have.

Yours faithfully,

James Pawluk
Managing Director

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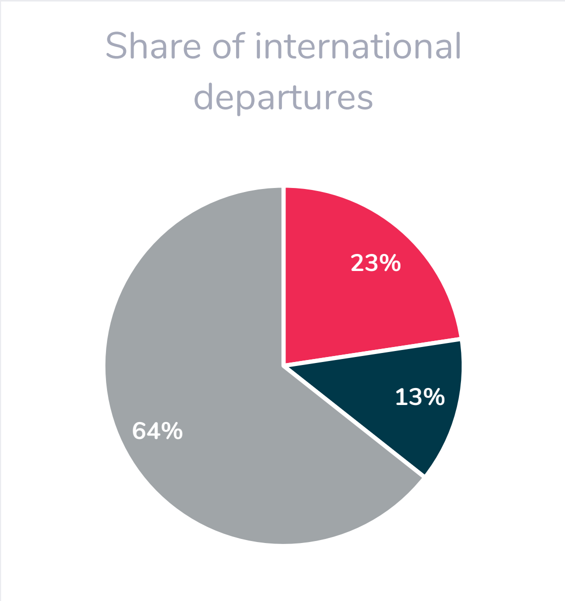
[6] See *Airlines should be fined for cancelling flights, says ACCC* from AFR, 5 June 2023

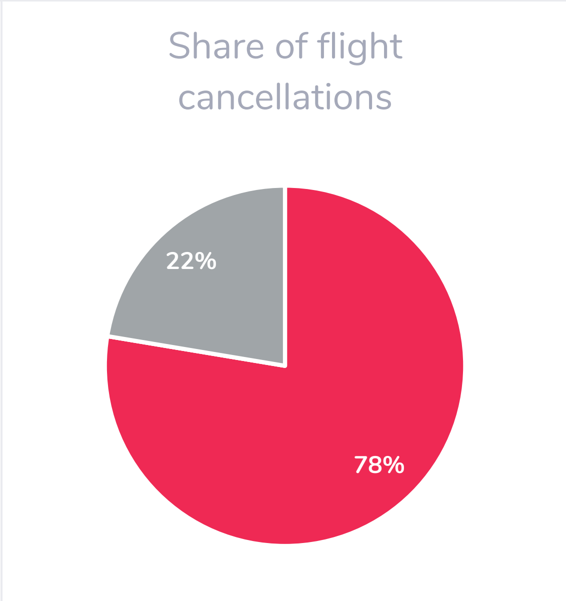
Appendix: Analysis of cancelled international flights departing Denpasar Airport

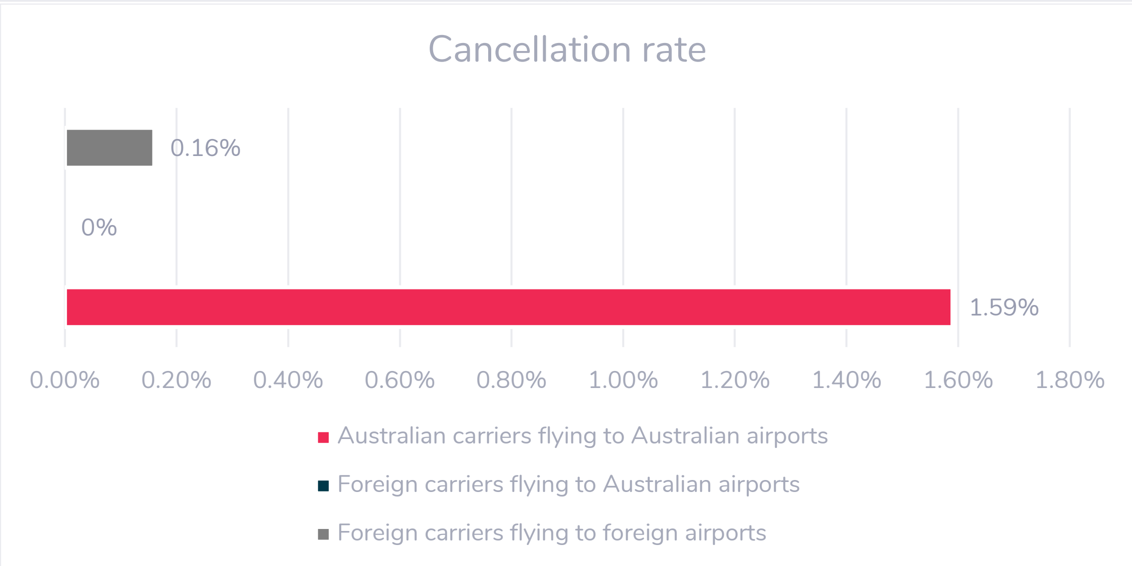
The following table provides a summary of international flights departing from Bali's I Gusti Ngurah Rai International Airport in Denpasar between 23 January and 26 August 2023, as record on the airport's website.

The traffic for 22 March 2023 has been isolated in order to exclude erroneous data points caused by the closure of the airport in observance of the public holiday of Nyepi, the Balinese 'Day of Silence'.

It shows that while Australian carriers accounted for just 22.6% of departing flights for the period, they were responsible for 77.6% of flight cancellations. Travellers flying with an Australian carrier were almost 10 times more likely to have their flight cancelled than those travelling on a flight nearing another country's flag.







		Scheduled Departures		No of cancellations			Cancellation rate		Share of cancellations	
Destination	**Carrier**	**Count**	**Share**	**Total**	**on Nyepi**	**ex. Nyepi**	**inc. Nyepi**	**ex. Nyepi**	**inc Nyepi**	**ex. Nyepi**
Australian	Australian	3,707	22.61%	62	3	59	1.67%	1.59%	45.59%	77.63%
	Foreign	2,136	13.03%	10	10	0	0.47%	0.00%	7.35%	0.00%
	Combined	5,843	35.64%	*72*	*13*	*59*	*1.23%*	*1.01%*	*52.94%*	*77.63%*
Foreign	Foreign	10,552	64.36%	64	47	17	0.61%	0.16%	47.06%	22.37%
	Total	16,395	100.00%	**136**	**60**	**76**	**0.83%**	**0.46%**	**100.00%**	**22.37%**