

Estimating Cost in Excessive Pricing Cases

UNPACKING THE COSTING CHALLENGES UNDER AUSTRALIA'S NEW GROCERY PRICING PROHIBITION

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The introduction of Australia’s new excessive pricing prohibition marks a significant development in the regulation of grocery retail pricing. Starting 1 July 2026, the amendments to the Competition and Consumer (Industry Codes—Food and Grocery) Regulations 2024 (the Food and Grocery Code) will prohibit excessive pricing by large grocery retailers. The prohibition applies to retailers with annual revenue exceeding A\$30 billion and defines excessive pricing as pricing that is significantly excessive when compared to the cost of supply, plus a reasonable margin.^{1, 2}

While debates regarding excessive pricing often focus on prices and profitability, the practical application of the prohibition may depend just as heavily on which costs are identified as relevant and how those costs are estimated. At first glance, the concept of the “cost of supply” may appear straightforward. In practice, however, identifying and estimating the relevant costs of supplying a product can involve a series of complex judgements with respect to how the product is defined, where it is situated in the supermarket’s value chain, and over what time period the product is supplied.

This article draws on insights from cost accounting to examine how the cost of supply may be identified and estimated when assessing excessive pricing under the new prohibition. We address the core elements of costing as they relate to the cost of supply standard, and set out the implications of alternative interpretations of the cost of supply on grocery retailers’ accounting and information systems.

KEY TAKEAWAYS

- The new excessive pricing prohibition provides for a wide interpretation of a product and the cost of supply.
- How these terms are defined can influence the identification of relevant costs, the reliance on – and robustness of – cost allocation methodologies, and the resulting product cost estimates.
- Supermarket retailers can prepare for the new regulations by ensuring that their accounting and information systems can (i) respond to specific queries for retrieving targeted cost information, (ii) trace a wide variety of costs to different cost objects, and (iii) provide a basis for constructing defensible cost allocation methodologies.

¹ Competition and Consumer (Industry Codes—Food and Grocery) Amendment (Supermarkets Excessive Pricing Prohibition) Regulations 2025.

² Excessive Pricing Prohibition Regulations 2025, Section 8.



The Excessive Pricing Prohibition

The Competition and Consumer (Industry Codes—Food and Grocery) Amendment (Supermarkets Excessive Pricing Prohibition) Regulations 2024 introduce a new prohibition on excessive pricing by very large grocery retailers. The legislation states:

“A very large retailer must not engage in excessive pricing in supplying, or offering to supply, a kind of grocery product to consumers by way of retail sale.”³

Excessive pricing is defined as “supplying, or offering to supply, a kind of grocery product if, in all the circumstances, the pricing for the supply is significantly excessive when compared to the cost to the very large retailer of the supply, plus a reasonable margin.”⁴ This applies to products defined narrowly and broadly. For example:⁵

- rice of a particular brand, packaging, and quantity;
- white long-grain rice of all types;
- all rice.

The new prohibition highlights three core elements: the cost of supply, the reasonable margin, and whether the resulting price is excessive. A price is excessive if it exceeds the cost of supply plus a reasonable margin to such an extent that it can be defined as excessive. While each of these elements may be subject to judgement, this article focuses on the first of these elements – the cost of supply – and examines how different interpretations can affect the identification and estimation of relevant costs.

Why “Cost of Supply” Is Not Self-Evident

Costing is not a one-size-fits-all mechanical accounting exercise. Rather, it is a highly contextual analysis aimed at deriving economically relevant information on resource use or consumption for a specific purpose and under a set of circumstances.

³ Excessive Pricing Prohibition Regulations 2025, Division 4A, section 45B.

⁴ Excessive Pricing Prohibition Regulations 2025.

⁵ Excessive Pricing Prohibition Regulations 2025. See, Schedule 1 (Amendments).

A practical way to identify relevant costs is to use a framework that starts by clarifying why the costing exercise is being undertaken, what exactly is being costed, and the conditions under which it is produced.

A key component of costing design is identifying what is referred to in the cost accounting literature as the 'cost object.' Cost objects can include goods and services, customers, business units, or any other clearly defined area of interest. Defining the cost object is important because it establishes a clear boundary around the subject of interest, ensuring that relevant resources, processes, and associated costs are identifiable and attributable. When the cost boundary is vague or discretionary, it can have significant impacts on which costs are considered relevant, and by extension, can influence the conclusions drawn from the costing analysis.

In the context of the new excessive pricing prohibition, identifying the cost object (i.e., the relevant product under review) may be one of the most consequential steps in the costing analysis. The legislation contemplates that products may be defined at different levels of aggregation, raising important questions regarding the appropriate scope of the costing exercise.

Once the costing question has been framed in a way that engages meaningfully with the problem, costing requires an understanding of the operations that generate the cost object's costs. In the context of the new excessive pricing prohibition, this step is important because the relevant costs depend not only on *how* a product is supplied, but also on *where* or to *whom* it is supplied. For example, supply could be interpreted as ending when a retailer acquires a product, when the product is made available to consumers on a store shelf, or when a consumer takes possession of the product.

Each interpretation of supply may imply a different set of relevant resources and associated costs. Identifying those costs is rarely straightforward in a large and complex organisation. They are not always apparent from accounting records alone and can change over time. Relevant costs are also influenced by an organisation's operating conditions. Entirely new sources of cost can arise under particular operating conditions or over particular timeframes.

For example, supplying additional volumes may impose little additional cost where spare store and distribution capacity exists, but may require significant investment in labour, warehousing, or logistics where capacity constraints are binding. Understanding which resources are consumed, and how they are consumed under different circumstances, therefore requires an understanding of both the cost object under consideration and the organisation's operations.



On a practical level, extracting relevant cost information from accounting systems can present a range of challenges. Costs are generated by operational activities, not by the accounting system itself, meaning that the available data may not necessarily align with the costs that are meaningful from an operational perspective. Moreover, accounting systems are typically designed with financial reporting and managerial control purposes in mind, which can influence how costs are classified, assigned, allocated, and reported. As a result, accounting data may reflect conventions or constraints that are not appropriate for the costing purpose at hand. Carefully assessing whether the available accounting information is fit for purpose is therefore essential to producing robust and defensible cost estimates.

Defining the Cost Object (i.e., the Relevant Product)

The new excessive pricing prohibition applies to grocery products offered by large retailers. Those products may be defined at different levels of aggregation, ranging from an individual stock keeping unit (SKU) to an aggregate product category.

Consequently, a threshold issue in any excessive pricing assessment may be determining the relevant product against which costs are measured. Different definitions of the relevant product can influence both the costs attributed to it and the resulting assessment of profit margins.

To see how, consider first a narrowly defined cost object, such as a specific perishable product (e.g., a yogurt). When a yogurt is delivered to a supermarket via refrigerated transport, that refrigerated transport may be shared across other refrigerated products. As a result, including the cost of transport requires defensible allocation methodologies based on appropriate cost drivers. The reliance on shared resources is important in the context of excessive price allegations because, if shared support costs are not properly assigned or allocated, the cost of supply may be understated and margins correspondingly overstated.

A further implication of interpreting the cost object in a narrow sense is the risk of treating products as if they are priced in isolation. In practice, pricing and costs are often determined within a broader commercial context. Suppliers and retailers may negotiate across product portfolios, and retailers optimise pricing across categories rather than at the level of individual items. Where cross-subsidisation occurs, some products could carry higher margins to support others. Consequently, the level at which products are defined may itself influence whether pricing appears excessive. A product-level assessment may yield different conclusions than a category-level assessment, even where the underlying economics are unchanged.

By contrast, defining the cost object more broadly – such as at the level of an entire perishable product category – may reduce the need for some cost allocations while limiting the extent to which excessive pricing claims can be assessed. At higher levels of cost aggregation, many shared costs become directly traceable to the cost object, reducing the need for cost allocations. For example, refrigerated transport costs could be directly attributed to an entire perishables category, thus eliminating the need to allocate them across individual products.

However, broader cost objects can also potentially mask cost of supply variation across individual products. Prices or margins that appear reasonable at the category level may conceal specific products associated with relatively low costs and high prices.

What Does It Mean to Supply a Product?

Not only does the definition of the cost object matter for costing, but the context in which it is supplied also matters. In the case of a supermarket retailer, the cost object may encompass a product as well as one or more services. This is because the way in which products are supplied to consumers can imply different levels of accompanying service. The cost of supply could refer to the costs associated with product acquisition and logistics, making products readily available on store shelves, and/or ensuring that consumers can check out and pay for them. Accordingly, the relevant costs depend on how the product and associated services are defined.

A narrow “cost of supply” interpretation would focus on the costs required for a supermarket to acquire a product. This would limit the consideration of costs to those that are required to bring the product into the supermarket’s inventory. A broader interpretation would recognise that consumers do not simply purchase a product; they purchase a product under particular conditions of supply – such as reliability, availability, freshness, safety, and convenience. For example, a consumer purchasing a loaf of bread is not simply acquiring the bread itself. That consumer is also purchasing product longevity, convenience, and the ability to make a transaction.

These conditions attached to the product require that the supermarket retailer have in place a range of potentially costly, and often out-of-sight, supporting resources, such as inventory, IT and cybersecurity, and other back-office systems. The issue becomes even more pronounced in online grocery channels, where consumers may expect order fulfillment, picking, packing, delivery coordination, and customer support. Whether these activities form part of the cost of supply will depend on how that term is interpreted.



Defining the Relevant Timeframe

Even where there is agreement regarding the relevant product and the meaning of supply, excessive pricing assessments may remain sensitive to the period over which costs are measured. Different timeframes can produce materially different estimates of cost and, therefore, different assessments of profit margins. For example, the relevant time horizon can influence which costs are considered incremental to supply and which costs are attributed to the product. Short-term measures may emphasise costs that vary with production volumes, whereas longer-term measures may allocate a broader range of capacity, overhead, and capital-related costs that are necessary to sustain supply over time.

The choice of time period can also impact the stability of cost estimates. For instance, a short-term cost analysis may place greater weight on cost fluctuations – such as promotions, supply disruptions, and demand spikes – whereas a long-term analysis may smooth those fluctuations and better reflect underlying normal conditions and associated costs.

Implications for Retailers

The breadth of the concepts of product and cost of supply suggests that retailers should review whether their accounting and information systems can support multiple costing analyses. In particular, retailers may wish to determine whether they can:

- retrieve cost information at both SKU and product-category levels;
- trace costs across operational and accounting systems;
- construct and justify cost-allocation methodologies;
- reproduce historical cost estimates over extended periods; and
- explain changes in costing methodologies over time.

Retailers that can clearly demonstrate how costs arise and how they are recorded are likely to be better positioned to respond to excessive pricing inquiries.

As noted above, although costs are generated by operating systems, cost information is accumulated and assigned in accounting systems. This means that even if a “relevant cost” is correctly identified from an operating standpoint, that specific cost still needs to be

accurately located within an organisation's accounting system. Extracting the right accounting information is not always straightforward and depends on the functionality inherent in the organisation's accounting system. For example, the cost of maintaining product availability may arise from inventory buffers and logistics coordination within the operating system, but in the accounting system, the costs may be dispersed across warehousing, transport, and overhead line items rather than recorded as a single, identifiable cost.

This often-overlooked interplay between accounting systems and operating systems can lead to common costing errors, such as not including the correct cost information or being influenced by the accounting system's cost hierarchy and standardised management reports when designing the costing analysis in the first instance. Recognising that accounting information is itself generated by a system designed for specific purposes draws attention to how that information is prepared and encourages a more cautious approach to relying on readily available accounting information and accounting labels.

Where costing data over many periods is analysed to address excessive pricing allegations, additional inquiries into an organisation's accounting data may need to be performed. This is because accounting systems, like operating systems, can evolve over time. For example, changes in cost aggregation, cost classification, or cost-allocation methods can create the appearance of cost increases or decreases even when the underlying resources and processes remain unchanged. Alternatively, cost trends shown in routine management accounting reports might appear relatively constant when, in fact, those reports do not include allocations from certain support costs, which may have been increasing over time.

Conclusion

The introduction of a "cost of supply" standard may appear straightforward, but its practical application raises a series of complex costing questions. The breadth of the concepts of product and cost of supply, together with the choice of timeframe over which costs are evaluated, means that different, but reasonable, costing approaches may produce materially different estimates of cost.

Ultimately, the most difficult question under the excessive pricing prohibition may not be identifying a reasonable margin, but determining the appropriate measure of cost against which that margin should be assessed. On a practical level, supermarket retailers with flexible, well-integrated accounting and information systems will be better prepared to extract the type of costing information required to respond to excessive pricing allegations.

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Hans Weemaes is a Principal and the Director of Brattle's Sydney office. He is an experienced economist and cost accountant with 25 years of experience in Australia and the United States as an advising CFO, consultant, and testifying expert on matters involving business operations, cost analytics, and profitability. He has expertise in cost allocations and cost drivers, cost estimation, cost-recovery pricing, counterfactual cost analysis, time-in-motion studies, systems thinking, and causal inference.

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