



Australian
Competition &
Consumer
Commission

Determination

Application for authorisation

lodged by

British American Tobacco Australia Limited,
Imperial Tobacco Australia Limited and
Philip Morris Limited

in respect of

a proposed agreement to cease supply of
tobacco products to retailers and wholesalers
that supply illicit tobacco products

Date: 23 June 2017

Authorisation number: A91550

Commissioners: Sims
Rickard
Cifuentes
Court
Featherston
Keogh

Summary

The ACCC has decided to deny authorisation to British American Tobacco Australia Limited, Imperial Tobacco Australia Limited, and Philip Morris Limited (the Applicants) to engage in joint and coordinated action against retailers and wholesalers in circumstances where the Applicants determine a retailer or wholesaler is supplying illicit tobacco. This includes the Applicants agreeing to jointly cease supply to those retailers and wholesalers for an agreed period.

The Applicants are each already able to, and do, conduct covert surveillance on retailers and give effect to terms in their contracts with retailers and wholesalers to suspend or cease supply of their products if a particular retailer or wholesaler is found to be selling illicit tobacco. However, since they are each other's competitors, in order for the Applicants to share information about the findings of this covert surveillance, and to agree to jointly boycott retailers and wholesalers without facing the risk of action under Australia's competition laws, the Applicants have sought authorisation.¹

The proposed arrangements are intended to result in a change in the *composition* of tobacco sales in Australia by reducing sales of illicit tobacco and increasing sales of licit tobacco. Accordingly the benefits sought to be achieved by the proposed arrangements do not include an overall reduction in smoking or tobacco sales, but are limited to benefits associated with a change in the composition of tobacco sales, including greater collection of relevant taxes and excise, greater compliance with health warnings requirements, and a reduction in the distorting effect of illicit tobacco sales on competition for the sale of licit tobacco.

The ACCC recognises that illicit tobacco is a problem which undermines public health policies and diverts revenue from legitimate retailers and government. The ACCC also recognises that reducing the supply of illicit tobacco would constitute a public benefit, and that boycotts of individual retailers and wholesalers in the manner proposed may have some effect in reducing the supply of illicit tobacco.

However, the ACCC considers there to be considerable uncertainty as to the extent to which the proposed arrangements would reduce the overall supply of illicit tobacco – including because the proposed arrangements only target certain types of illicit tobacco sold through one channel, namely retailers who sell both licit and illicit tobacco.

Further, to the extent that the threat of ceasing supply is effective in deterring retailers from selling illicit tobacco, the Applicants are currently able to achieve a significant part of this effect by taking *unilateral* action to cease supply to retailers detected selling illicit tobacco. This has been done before with a degree of success and could be expanded without authorisation since it does not involve an agreement between competitors in breach of competition laws.

Together, the Applicants comprise the vast majority of retail sales of licit tobacco products in Australia. The Applicants seek authorisation for an arrangement which would involve repeated interactions to share commercially sensitive information about retailers, and to reach agreements with each other to boycott

¹ Authorisation provides statutory protection against legal action under certain of the competition provisions of the *Competition and Consumer Act 2010*. Parties that wish to engage in conduct which is at risk of breaching certain competition provisions of the Act but nonetheless consider there is an offsetting public benefit can lodge an application for authorisation with the ACCC.

particular retailers. Any such arrangement between three dominant market participants, particularly in a market where the threat of new entry appears low, raises significant competition concerns. In addition, the ACCC is concerned that the arrangements are also likely to result in detriment by undermining public health outcomes and enforcement agencies' efforts to enforce tobacco control laws and their underlying policies. The arrangements give the Applicants a quasi-regulatory role in circumstances where their commercial incentives do not entirely align with those of government. This may be inconsistent with World Health Organization guidelines for the implementation of Australia's obligations under international agreements about tobacco control, and could create community perception of a partnership between the Australian government (and government agencies) and the tobacco industry.

In these circumstances, having considered all of the evidence and submissions received from the Applicants and interested parties, the ACCC is not satisfied that the proposed arrangements are likely to result in a net public benefit and therefore has decided not to grant authorisation to the arrangements.

Abbreviations

ACCC	Australian Competition and Consumer Commission
AFP	Australian Federal Police
AIHW	Australian Institute of Health and Welfare
ATO	Australian Tax Office
BATA	British American Tobacco Australia Limited
CCA	<i>Competition and Consumer Act 2010 (Cth)</i>
DOH	Federal Department of Health
DIBP	Department of Immigration and Border Protection
FCTC	Framework Convention on Tobacco Control
WHO	World Health Organization

The application for authorisation

1. On 25 August 2016 British American Tobacco Australia Limited (**BATA**), Imperial Tobacco Australia Limited and Philip Morris Limited (the **Applicants**) lodged an application for authorisation² (A91550) with the ACCC. The Applicants initially sought authorisation for a period of five years in relation to a proposed agreement to cease supply of tobacco products to retailers and wholesalers that supply illicit tobacco products.
2. On 15 December 2016 the ACCC issued a draft determination proposing to deny authorisation to the arrangements.
3. A conference was requested by the Applicants and was held on 13 February 2017. In two further submissions, the Applicants proposed changes to the arrangements, aimed at addressing the ACCC's concerns. Most of these proposals were discussed at the conference and interested parties were invited to provide further written submissions in relation to the Applicants' proposed amendments. These amendments are described in the section that follows.
4. In order to provide time to consider and consult on the proposed amendments, the ACCC (with the agreement of the Applicants) extended the statutory deadline by which it is required to make its final determination by three months, until 29 June 2017.

The proposed conduct

5. The Applicants propose to engage in joint and coordinated actions against retailers and wholesalers where the Applicants form the view that a retailer or wholesaler is supplying illicit tobacco, including agreeing to jointly cease supplying those retailers and wholesalers with tobacco products for an agreed period.
6. The Applicants intend to take actions against such retailers and wholesalers, based on information gathered using two different approaches, which they describe as the '*Covert purchase model*' and the '*Agency cooperation model*'.
7. The ACCC understands that the Applicants currently already covertly gather information on illicit sales, and, at times, unilaterally suspend or withhold supply of their tobacco products to wholesalers and retailers found to be selling illicit products. The Applicants seek authorisation to allow them to share this information and reach agreement to jointly cease supplying these retailers.

Covert purchase model

8. At the time of lodging the application for authorisation, the Applicants proposed to continue to individually engage their own private investigators to make covert "mystery shopper" purchases of tobacco products from retailers and wholesalers throughout Australia. Private investigators were to make assessments of whether

² Authorisation is a transparent process where the ACCC may grant protection from legal action for conduct that might otherwise breach the Competition and Consumer Act 2010 (the CCA). Applicants seek authorisation where they wish to engage in conduct which is at risk of breaching the CCA but nonetheless consider there is an offsetting public benefit from the conduct. Detailed information about the authorisation process is available in the ACCC's Authorisation Guidelines at www.accc.gov.au/publications/authorisation-guidelines-2013

a particular tobacco product purchased by them may be illicit tobacco based on a set of criteria. If a private investigator purchased what they suspect to be illicit tobacco, they would provide a written report to the Applicant/s identifying the details of the purchase and supplier, the basis for their suspicion that the product is illicit, and attach physical evidence in support of their belief. The Applicants would then be able to examine and test the covertly acquired products to determine whether they were illicit tobacco.

9. In the draft determination and at the pre decision conference, concerns were raised that the evidence collection method proposed may involve conduct in contravention of the *Plain Packaging Act*. In response to these concerns, the Applicants propose to amend the methodology such that no sale or purchase of any suspected illicit tobacco product would occur, but instead:
 - evidence would be collected by means of photographic, video and audio evidence, or, where this is not lawful,
 - evidence would be collected by means of sworn affidavits or statements by trained operatives detailing their interaction with the sales assistant that made an offer to sell the product to the operative.
10. If the Applicants agree that the product is illicit tobacco, they would cause a letter to be served upon the retailer advising of the offer for sale of suspected illicit tobacco, identifying the reasons the offered tobacco is considered illicit, and seeking a written undertaking from the supplier that they will cease and desist from selling the suspected illicit tobacco from a specified date. The supplier would also be advised that, should they fail to provide or comply with the undertaking, the Applicants will all cease to supply their products to that supplier until further notice.
11. The Applicants propose to jointly decide not to make further sales of their legal tobacco products to a supplier for an agreed period, where the supplier fails to provide such an undertaking, or breaches the undertaking as evidenced by a further offer (to a trained operative) of suspected illicit tobacco from that supplier.
12. In response to concerns raised in the draft determination about the uncertainty of the length of the boycott initially proposed by the Applicants, the Applicants later proposed that boycotts of retailers found to be selling illicit tobacco would be of limited duration (6 months for a first offence after a warning, 12 months for a second offence and permanent cessation of supply for a third).

Agency cooperation approach

13. The Applicants propose that, upon being advised of a successful prosecution of a supplier for the sale of illicit tobacco product by a regulatory authority, they may jointly decide not to make further sales of their tobacco products to that supplier for an agreed period, and to advise the supplier of the reasons for that decision in writing.

Later amendments to the proposed arrangements

14. In addition to the revised methodology for evidence collection and specific periods for boycotts, the Applicants have proposed a number of other changes or additions to the proposed arrangements since the ACCC issued its draft determination.

15. In summary, the Applicants proposed the following clarifications and changes to the operation of the proposed arrangements:
- a) retailers will have recourse to independent review of any decision by the Applicants that they have supplied illicit tobacco, and no action will be taken against the retailer until the review is completed
 - b) to reduce the risk of inadvertent interference with law enforcement activities the Applicants will notify relevant law enforcement agencies before taking any action against a retailer and will not proceed if the law enforcement agency asks them not to
 - c) with respect to concerns that the conduct could be used to selectively target retailers that stock competing brands, the Applicants propose to:
 - o allow other suppliers of lawful tobacco products (including competing brands) to participate in the arrangements
 - o boycott only retailers or wholesalers that supply certain types of illicit tobacco products which do not comply – or attempt to comply – with plain packaging requirements – specifically, ‘picture packs’ (i.e. packs which feature branding), chop chop tobacco, or shisha
 - d) with respect to the ACCC’s concerns about how effective the proposed arrangements will be, the Applicants propose to:
 - o report to the ACCC every six months on actions taken and
 - o reduce the period for which authorisation is sought from five years to three (at which time the ACCC would be able to take into account the evidence of the effectiveness of the conduct in deciding whether to re-authorise).

Rationale

16. The Applicants submit that the proposed agreement is necessary because the efforts of law enforcement agencies in Australia to counter the importation and supply of illicit tobacco are focussed primarily on interrupting and preventing organised criminals involved in the importation and distribution of illicit tobacco, rather than focussing on individual retailers or wholesalers who may be supplying illicit tobacco. The Applicants further submit that, where action is taken against retailers by law enforcement agencies, it is not uncommon for a retailer of illicit tobacco to recommence supply of illicit tobacco soon after being prosecuted. The Applicants consider current enforcement measures at the retail and wholesale levels of the market have failed to have any material impact on the supply of illicit tobacco products.
17. In the view of the Applicants, the majority of illicit tobacco is sourced by consumers from retailers that also supply licit tobacco products. Such retailers use the supply of licit tobacco as a front for their trade in illicit tobacco, reducing the risk involved in the supply of illicit tobacco. The Applicants submit such retailers also have the advantage of two potential customers – one seeking licit and one illicit tobacco products – and that there is the potential for them to switch a consumer of licit tobacco products to illicit products. The Applicants express the view that, if the ability of a supplier to acquire and supply the Applicants’ legal tobacco products is removed, so too is one of the key factors that permits the supplier to conduct a trade in illicit tobacco.

18. The Applicants submit that they are in a unique position to disrupt the supply of illicit tobacco by retailers and wholesalers of licit tobacco products, by ceasing supply of licit tobacco products. They submit that an agreement between them for joint and coordinated action is essential to their disruption because, if only one of the Applicants were to cease supply, the retailer or wholesaler would be able to continue to acquire and supply legal tobacco products from the other Applicants. The Applicants submit their coordinated action would complement law enforcement efforts by discouraging the supply of illicit tobacco at the retail and wholesale level of the market.

Background

Tobacco supply in Australia

19. The Applicants are the three major suppliers of tobacco products in Australia, including manufactured cigarettes and loose tobacco. They (or their parent companies) are also major suppliers of tobacco products globally. None of the Applicants manufacture cigarettes in Australia any longer.
20. BATA has previously reported that the global parent companies of the Applicants hold a 99% share of the licit tobacco products sold in Australia.³ Imperial Tobacco has publicly reported that the Applicants together hold a 90 – 95% share of the Australian licit tobacco market, depending on the measure used.⁴ BATA has the largest market share of the Applicants (at close to 50%), with Philip Morris holding close to 25% and Imperial Tobacco around 15%.⁵
21. The Applicants act as wholesalers and importers of their parent companies' tobacco brands and hold a combined market share of around 85% of the wholesale market, with the remaining 15% of licit tobacco sold comprising much smaller independent wholesalers operating within smaller geographic areas.⁶ The ACCC understands that many of these independent wholesalers are buying groups for franchises, and that independent wholesalers still largely supply the products of the Applicants' parent companies.
22. As noted, a large majority of licit tobacco products are supplied to retailers directly by the Applicants. Supermarkets and grocers are the largest retailers of tobacco products, with convenience stores also a key supplier. Smaller retailers include specialist tobacconists, cigarette machines, clubs, restaurants, hotels and duty-free shops.⁷
23. The supply of tobacco in Australia is subject to a high level of government regulation. This is outlined further in the following section.

³ Official Committee Hansard, Parliamentary Joint Committee on Law Enforcement, *Illicit Tobacco*, 4 March 2016, p 10.

⁴ Official Committee Hansard, Parliamentary Joint Committee on Law Enforcement, *Illicit Tobacco*, 22 March 2017, p 3.

⁵ IBISWorld, *Tobacco Product Wholesaling: Australian Industry Report*, August 2016.

⁶ IBISWorld, *Tobacco Product Wholesaling: Australian Industry Report*, August 2016.

⁷ IBISWorld, *Tobacco Product Wholesaling: Australian Industry Report*, August 2016.

Tobacco regulation in Australia

24. The National Tobacco Strategy 2012-2018 (**National Tobacco Strategy**) sets out a national framework for government aiming to reduce tobacco-related harm in Australia, and provides a framework for building the evidence base for tobacco control and monitoring progress. The goal of the National Tobacco Strategy is to “improve the health of all Australians by reducing the prevalence of smoking and its associated health, social and economic costs, and the inequalities it causes.” In November 2012, the National Tobacco Strategy was endorsed by all Australian Commonwealth, state and territory health ministers.
25. Tobacco products are subject to a range of Commonwealth, state and territory laws. Tobacco products which are imported into Australia are subject to customs duty under the *Customs Act 1901* (Cth) and the *Customs Tariff Act 1995* (Cth), collected by the Department of Immigration and Border Protection (**DIBP**). DIBP is also responsible for detecting, deterring and disrupting the trade in illicit tobacco at the border.
26. The Australian Tax Office (**ATO**) is responsible for detecting, investigating and prosecuting illicit domestically grown or manufactured tobacco products, as these fall under the *Excise Act 1901* (Cth), administered by the ATO. All legal tobacco products are currently imported into Australia as there are no current licences to grow or manufacture tobacco in Australia.⁸ Illicit tobacco in Australia is almost entirely overseas-sourced product,⁹ although there have been some recent seizures of local illicit tobacco crops.¹⁰
27. About 70% of the retail value of licit tobacco products sold in Australia is comprised of excise or customs duty and goods and services tax (**GST**).¹¹
28. In addition to the applicable customs duties and excise, tobacco products sold in Australia are required to comply with a range of legislative requirements including under the *Plain Packaging Act* and associated regulations (also termed the plain packaging legislation), which prohibit the use of logos, brand imagery, and promotional text on tobacco products and packaging, and set out the colours, size and font permitted for retail tobacco packaging. The plain packaging requirements are administered by the Department of Health (**DOH**).
29. Health warnings are required on tobacco product packaging under the *Competition and Consumer (Tobacco) Information Standard 2011* (the **Standard**). DOH has policy responsibility for the health warnings, while the Standard is enforced by the ACCC, in collaboration with the state and territory fair trading agencies. The ACCC also has responsibility to ensure compliance with safety requirements to reduce fire risk from cigarettes.
30. In addition, state and territory laws regulate the retailing of tobacco, including the licensing of tobacco retailers which is required in most states and territories¹² of

⁸ ATO, *Submission to the Inquiry into illicit tobacco*, 2016, page 3.

⁹ Australian Crime Commission (ACC), *Organised Crime in Australia 2015*, p145.

¹⁰ Eg. ATO, *ATO rolls illegal tobacco*, media release, 4 May 2014.

¹¹ Scollo, Michelle, “Trends in tobacco consumption”, in *Tobacco in Australia: Facts and Issues*, Cancer Council Victoria, 2012.

¹² At the time of writing, retailers of tobacco in Victoria and Queensland were not required to hold a licence.

Australia. State and territory authorities are responsible for illicit tobacco sold at retail outlets in their jurisdictions.

Illicit tobacco in Australia

31. The World Health Organization Framework Convention on Tobacco Control (**WHO FCTC**) defines the illicit trade in tobacco products as being “any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale or purchase [of tobacco products] including any practice or conduct intended to facilitate such activity.”¹³
32. DOH has previously stated that “illicit tobacco” is primarily tobacco on which legally-required duties and taxes have not been paid.¹⁴
33. The Applicants’ submission of 23 November 2016 indicates that for the purposes of the proposed arrangements, any product that is counterfeit or does not meet the requirements of any Australian laws and regulations, including the provisions under the plain packaging legislation, will be considered illicit.
34. The Australian Criminal Intelligence Commission (formerly Australian Crime Commission) has identified three different forms of illicit tobacco supplied to the Australian market. These are:
 - unbranded tobacco (known as ‘chop chop’). This is roughly-processed tobacco sold either as loose leaf, or packed into cigarette tubes
 - contraband – manufactured cigarettes or tobacco imported illegally and sold without the payment of applicable duties. The ‘contraband’ category can include the genuine products of tobacco manufacturers, which may be smuggled from a different (lower-taxed) jurisdiction without the payment of customs duty at importation, or have evaded customs duty as a result of being diverted from legitimate supply¹⁵
 - counterfeit – generally a copy of a particular product and carrying a trademark without the permission of the trademark owner.¹⁶ If duty is not paid on counterfeit cigarettes, they can also be considered ‘contraband’.¹⁷
35. Internationally, it is recognised as highly challenging to accurately estimate the size of any illicit tobacco market, due to the nature of tax avoidance and evasion.¹⁸ There is no current official estimate of the size of the illicit tobacco

¹³ World Health Organization (WHO), *Framework Convention on Tobacco Control* (FCTC), Article 1.

¹⁴ Department of Health, *Submission to the Inquiry into Illicit Tobacco*, February 2016, p6.

¹⁵ For example, where customs duty is paid on imported tobacco products that are subsequently exported, parties can claim a “drawback” of the customs duty. Such products may be diverted prior to being exported and find their way back into the illicit market within Australia. See: <https://www.ato.gov.au/Business/Excise-and-excise-equivalent-goods/Tobacco-excise/Claiming-excise-refunds,-drawbacks-and-remissions/#Drawbacks>.

¹⁶ ACC, *Organised Crime in Australia 2015*, p68.

¹⁷ Scollo, Dr Michelle, “The pricing and taxation of tobacco products in Australia”, in *Tobacco in Australia: Facts and Issues*, Cancer Council Victoria, 2012.

¹⁸ International Agency for Research on Cancer (WHO), *Handbooks of cancer prevention: Tobacco Control (Vol 14) – Effectiveness of tax and price policies for tobacco control*, 2011, p299.

market in Australia,¹⁹ and the Department of Health has previously noted that there are inherent difficulties and challenges in reliably measuring the size of the illicit market.²⁰

36. Estimates which do exist vary considerably in both their market size and means of measurement. The most recent bi-annual report by KPMG²¹ commissioned by the Applicants provided an estimate that illicit tobacco constituted around 14% of total tobacco consumption, by weight, in Australia in 2016 (a small decrease on 2015 estimates).
37. The World Health Organisation (**WHO**) has expressed the view that the tobacco industry has often exaggerated the proportion of the tobacco market related to illicit trade,²² and a number of interested parties (including DOH, DIBP, Cancer Council Victoria, and Cancer Council Western Australia), in submissions on this matter, consider the industry estimates to be unreliable due to methodological shortcomings including unrepresentative sample sizes and groups, restrictive survey measures, and drawing upon unreliable secondary sources to validate results. DOH submits that there is no evidence to suggest that illicit tobacco in Australia is a large and growing problem. Other studies have also criticized the methodology employed.²³
38. The results of an Australian Institute of Health and Welfare (**AIHW**) survey have indicated a considerably lower rate of illicit tobacco consumption than the KPMG report. The AIHW found that 3.8% of respondents to their survey reported currently smoking unbranded tobacco, and 5.5% reported having purchased branded tobacco which did not comply with plain packaging requirements (presumed to be contraband), the majority of these only occasionally. Less than 1% of survey respondents reported use of illicit tobacco “half the time or more”.²⁴ An independent study’s findings were consistent with those reported in the AIHW’s survey.²⁵ While the AIHW survey used different measures to the KPMG report (measuring prevalence of unbranded or contraband tobacco smoking among smokers vs the proportion, by weight, of tobacco consumption which was illicit), they appear to provide very different estimates of the prevalence of illicit tobacco in Australia.
39. The Applicants consider that there has been an increase in the importation, availability, supply of, and demand for, illicit tobacco products in Australia from 11.5% of total tobacco consumption in 2012 to 14% in 2015, contributed to by

¹⁹ Department of Health, *Submission to the Inquiry into Illicit Tobacco*, 2016, p3.

²⁰ Joint Committee on Law Enforcement, *Inquiry into Illicit Tobacco, Answers to Questions on Notice: Health Portfolio*, 22 March 2017.

²¹ KPMG, *Illicit tobacco in Australia: 2016 Full Year Report*, 20 March 2017.

²² WHO FCTC Secretariat report, *The Tobacco Industry and the Illicit Trade in Tobacco Products*, 2016.

²³ See Scollo, Zacher, Durkin, Wakefield, *Early evidence about the predicted unintended consequences of standardised packaging of tobacco products in Australia: a cross-sectional study of the place of purchase, regular brands and use of illicit tobacco*, *British Medical Journal*, 2014:4; and Quit Victoria and Cancer Council Victoria, *Illicit trade of tobacco in Australia: a critique of a report prepared by Deloitte for British American Tobacco Australia Limited, Philip Morris Limited and Imperial Tobacco Australia Limited*, 2011.

²⁴ Australian Institute of Health and Welfare, *National Drug Strategy Household Survey Key Findings Report*, 2016.

²⁵ Scollo, Dr Michelle, Zacher, Meghan, Coomber, Kerri, and Wakefield, Melanie, “Use of illicit tobacco following introduction of standardised packaging of tobacco products in Australia: results from a national cross-sectional survey”, *Tobacco Control*, 2015: 24.

regulatory changes such as plain packaging laws and excise increases on legal tobacco products.

40. The Australian Border Force (within DIBP) reports having seen no discernible growth in the illicit tobacco trade as a result of the introduction of plain packaging,²⁶ and a government-commissioned post-implementation review of the plain packaging measures likewise found no substantive impact on the illicit tobacco market, if any at all.²⁷ An independent study found no evidence in Australia of increased use of contraband or 'chop chop' tobacco between 2011 and 2013.²⁸
41. The WHO and some Australian government agencies have stated a view that there is no clear or direct correlation between high taxes and the size of the illicit tobacco market.²⁹ However, the DIBP notes that excise increases may impact on the size of the illicit trade in tobacco.³⁰ DOH also accepts that it is recognised, in some circumstances, that increasing excise (leading to increases in price) may influence both the demand for cheaper tobacco and the profitability of illicit tobacco imports.³¹
42. Government agencies have identified that organised crime has a high level of involvement in illicit tobacco in Australia, and understand that it is perceived by participants as a low risk, high profit enterprise.³²
43. The Applicants advise their research indicates that 70% of the trade in illicit tobacco to consumers is conducted through existing retailers of licit tobacco. DIBP has previously reported that its investigations suggest that sales of illicit tobacco follow similar distribution and sales patterns as licit tobacco, and that illicit tobacco is available from a number of tobacconists and tobacco retailers,³³ but notes in its submission that it is unable to comment on the proportion of the illicit trade that is conducted through existing retailers.
44. DIBP reports that, in its experience, illicit tobacco is usually concealed under the counter or in a paper bag, indicating that retailers make a conscious choice to purchase and then sell illicit tobacco, and that illicit tobacco smokers also make a conscious choice to purchase illicit tobacco.³⁴

²⁶ DIBP, *Submission to the Inquiry into Illicit Tobacco*, 2016, p5.

²⁷ Siggins Miller Consultants Pty Ltd, *Consultancy services to inform the development of a Post Implementation Review of the tobacco plain packaging measure: Regulatory Burden Measurement & Analysis of Costs and Benefits*, January 2016.

²⁸ Scollo, Dr Michelle, Zacher, Meghan, Coomber, Kerri, and Wakefield, Melanie, "Use of illicit tobacco following introduction of standardised packaging of tobacco products in Australia: results from a national cross-sectional survey", *Tobacco Control*, 2015: 24.

²⁹ World Health Organization, *Illegal Trade of Tobacco Products: What you should know to stop it*, 2015, p7; Department of Health, *Supplementary Submission to the Inquiry into Illicit Tobacco*, 2016, p5.

³⁰ DIBP, *Submission to the Inquiry into Illicit Tobacco* 2016.

³¹ Department of Health, *Submission to the ACCC interested party consultation on the British American Tobacco & ors Application for Authorisation A91550*, November 2016, pp4-5.

³² ACC, *Organised Crime in Australia 2015*, p145; Australian Federal Police (AFP), *Submission to the Inquiry into Illicit Tobacco*, February 2016; ATO, *Submission to the Inquiry into Illicit Tobacco*, 2016; Department of Immigration and Border Protection, *Submission to the Inquiry into Illicit Tobacco*, 2016.

³³ DIBP, *Submission to the Inquiry Into Illicit Tobacco*, 2016, p4.

³⁴ DIBP, *Submission to the Inquiry into Illicit Tobacco*, 2016, p4.

Enforcement of illicit tobacco laws

45. DOH has identified that enforcement and compliance aimed at combating illicit trade in tobacco products is a critical element of Australia's approach to tobacco control, as it ensures that continuing smokers remain in the legal tobacco market where they are exposed to the full range of Australia's tobacco control measures.³⁵ DIBP has also said that combatting the importation of illicit tobacco is one of its key operational priorities.³⁶
46. A number of government law enforcement agencies are involved in a collaborative whole-of-Government approach to combatting illicit tobacco. These include the DOH, DIBP, the ATO, the Australian Federal Police (**AFP**), the Australian Criminal Intelligence Commission, the ACCC, and state and territory police.³⁷ These agencies are involved in a range of measures to work on matters relating to illicit tobacco in a whole of government setting, including a Tobacco Control Inter-Departmental Committee and an Industry Advisory Group.³⁸ Government enforcement agencies have previously identified a range of limitations on their ability to investigate and prosecute illicit tobacco offences.³⁹ These include:
- different law enforcement powers available between law enforcement agencies
 - differing priorities between agencies
 - inconsistencies between border regulations and domestic requirements (i.e. that tobacco must comply with requirements including plain packaging, health warnings, and safety requirements at the point of sale but not at the border)
 - inconsistencies between legislative regimes. Specifically, that for successful prosecutions the place of origin of the illicit tobacco (i.e. either imported or domestically grown and/or manufactured) is required to be established in order to determine whether the offenders should be prosecuted for evasion of excise (under the *Excise Act 1901*) or customs duty (under the *Customs Act 1901* and the *Customs Tariff Act 1995*). This is not always easy to determine when the tobacco is seized somewhere other than at the border
 - the requirement that, in order to obtain a conviction under the relevant sections of the *Customs Act 1901*, it must be established that the offender either intended to defraud the revenue, or knew the tobacco was imported with the intention to defraud the revenue.
47. These difficulties manifest particularly in enforcement actions which occur at the level of the retailer or wholesaler.

³⁵ Department of Health, *Supplementary Submission to the Inquiry into Illicit Tobacco*, April 2016, p2.

³⁶ DIBP, *Submission to the Inquiry into Illicit Tobacco*, 2016, p3.

³⁷ Department of Health, *Supplementary Submission to the Inquiry into Illicit Tobacco*, April 2016, p2.

³⁸ Department of Health, *Answers to Questions on Notice: Inquiry into Illicit Tobacco*, 22 March 2017.

³⁹ DIBP, *Submission to the Inquiry into Illicit Tobacco*, 2016; AFP, *Submission to the Inquiry into Illicit Tobacco*, February 2016; ATO, *Submission to the Inquiry into Illicit Tobacco*, 2016.

48. The ACCC understands that the Australian Government is developing a number of reforms to address the issues identified,⁴⁰ including as part of the *Tobacco excise measure to improve health outcomes and combat illicit tobacco* announced in the 2016-17 Budget.⁴¹ The Government has provided an additional \$7.7 million in funding for the DIBP's Tobacco Strike Team and there are legislative reforms underway.⁴²
49. DIBP advises the reforms will increase the range of enforcement options available for illicit tobacco offences, and include legislative changes that aim to resolve the proof of origin issue, to include new offences relating to tobacco smuggling based on recklessness, and to increase the penalties for tobacco offences in the *Excise Act 1901*.⁴³ DIBP is also looking to develop a regional illicit tobacco strategy, working collaboratively with nations in South-East Asia, New Zealand and the United Kingdom.⁴⁴

World Health Organization Framework Convention on Tobacco Control

50. At a global level, countries have taken steps to regulate tobacco products due to concern about the health, social, economic and environmental consequences of tobacco consumption and exposure to tobacco smoke. The WHO FCTC was developed in response to these concerns.
51. Australia's National Tobacco Strategy is consistent with Australia's obligations as a party to the WHO FCTC, which entered into force on 27 February 2005.⁴⁵ Australia was an original signatory to the WHO FCTC. Parties to the WHO FCTC have committed to implement a range of tobacco control measures focussed on reducing the demand and addressing the supply of tobacco products, including action to combat illicit trade in tobacco products.
52. Article 5.3 of the WHO FCTC sets out a general obligation on each party:

[i]n setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law.

⁴⁰ See for example Department of Health, *Submission to the ACCC interested party consultation on the British American Tobacco & ors Application for Authorisation A91550*, November 2016; DIBP *Submission to the Inquiry into Illicit Tobacco*, 2016, p7.

⁴¹ See: http://www.budget.gov.au/2016-17/content/bp2/html/bp2_revenue-08.htm.

⁴² Parliamentary Joint Committee on Law Enforcement Inquiry into Illicit Tobacco, *Proof Committee Hansard*, 23 November 2016.

⁴³ DIBP, *Submission to the ACCC interested party consultation on the British American Tobacco & ors Application for Authorisation A91550*, April 2017.

⁴⁴ Parliamentary Joint Committee on Law Enforcement Inquiry into Illicit Tobacco, *Proof Committee Hansard*, 23 November 2016, p17.

⁴⁵ Department of Health, *Submission to the Inquiry into Illicit Tobacco*, February 2016, p2.

53. Guidelines for implementation of Article 5.3 (the **Guidelines**) have been developed and adopted by the Conference of the Parties (the governing body of the FCTC). The Guidelines are in themselves non-binding on the parties to the FCTC but make a range of recommendations for parties to consider. One of these is a recommendation that:

*parties should not accept, support or endorse any voluntary code of conduct or instrument drafted by the tobacco industry that is offered as a substitute for legally enforceable tobacco control measures.*⁴⁶

54. The purpose of the Guidelines for implementation of Article 5.3 is to ensure that efforts to protect tobacco control from commercial and other vested interests of the tobacco industry are comprehensive and effective, recognising that there is a fundamental and irreconcilable conflict between the tobacco industry's interests and public health policy interests.
55. Consistent with these Guidelines, the Australian Government has previously declared its interpretation of the obligations of parties to the FCTC under Article 5.3, that parties to the FCTC "should interact with the tobacco industry only when and to the extent strictly necessary to enable them to effectively regulate the tobacco industry and tobacco products, and should ensure that any such interactions are conducted transparently."⁴⁷

Consultation

56. The ACCC tests the claims made by an applicant in support of its application for authorisation through an open and transparent public consultation process.
57. The ACCC has invited submissions from a range of potentially interested parties including tobacco retailers, industry associations, state and federal government departments, anti-smoking non-government organisations and research institutions.⁴⁸
58. Prior to the draft determination, the ACCC received 21 submissions from interested parties. Submissions from retailers and their industry associations and academics⁴⁹ were generally supportive of the application, although some raised

⁴⁶ WHO FCYC Conference of the Parties, *Guidelines for Implementation of Article 5.3 of the WHO Framework Convention on Tobacco Control: on the protection of public health policies with respect to tobacco control from commercial and other vested interests of the tobacco industry*, November 2008.

⁴⁷ Declaration by the Australian Minister for Foreign Affairs to the Secretary General of the United Nations, 5 January 2015. See:

https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IX-4&chapter=9&clang=_en.

⁴⁸ A list of the parties consulted and the public submissions received is available from the ACCC's public register www.accc.gov.au/authorisationsregister.

⁴⁹ Dr Adam Masters (Transnational Research Institute on Corruption, Australian National University), and Prof. Sinclair Davidson (School of Economics, Finance and Marketing, RMIT University. Professor Davidson is also a Senior Research Fellow at the Institute of Public Affairs, which has received funding from tobacco companies).

issues.⁵⁰ A number of concerns were raised in submissions from government and non-government anti-smoking organisations.

59. On 23 November 2016 the Applicants provided a submission in response to these issues raised by interested parties.
60. In response to the draft determination, the ACCC received a further seven submissions from interested parties. Four retailers and retail industry associations reaffirmed their support for the proposed arrangements.⁵¹ One government submission and two non-government anti-smoking organisations expressed support for the ACCC's draft determination proposing to deny authorisation.⁵²
61. On 19 January 2017 the Applicants lodged a submission in response to the draft determination which provided further clarifying information about the proposed arrangements, proposed some alterations to address the ACCC's concerns, and requested the ACCC hold a pre-decision conference to discuss the draft determination. The Applicants proposed revisions to the conduct are outlined where relevant in the ACCC assessment section of this determination.
62. The pre-decision conference was held on 13 February 2017 and was attended by representatives of the Applicants, a retailer, three retail industry associations, DOH and DIBP. A summary of the issues discussed at the conference may be obtained from the [Authorisations Public Register](#) on the ACCC's website.
63. The ACCC issued a further invitation for submissions in response to the Applicants' submission and the matters discussed at the conference. Two submissions were received in response, from the Cancer Council Western Australia (opposing authorisation, and submitting that the Applicants' proposals do not address the ACCC's concerns), and from the Master Grocers' Association (reaffirming support for the application).
64. The Applicants provided a further submission on 15 March 2017. Submissions responding to the proposals outlined in this submission were received from the Cancer Council Western Australia and DIBP.
65. The ACCC wrote to the Applicants on 3 May 2017 providing an opportunity to respond to the latest submissions and requesting some further information. The Applicants' response was received on 24 May 2017.
66. Three submissions were received from interested parties following this submission, from DOH, the Western Australia Department of Health, and the Cancer Council of Victoria, raising concerns with the Applicants' revised proposal and responding to their submission of 24 May 2017.
67. A submission from the Applicants was received in response on 13 June 2017.

⁵⁰ Submissions by the Australian Lottery and Newsagents' Association and the Black Cat Consultancy are available on the ACCC's public register.

⁵¹ Namely, the Australasian Association of Convenience Stores (an industry association which has retailer members and supplier members, including each of the Applicants), the Master Grocers' Association (an industry association which represents independent supermarkets, and lists each of the Applicants as Diamond or Gold level 'corporate partners'), the Australian Lottery and Newsagents Association (an industry association representing retailers in this category), and Cignall (a tobacconist franchisor).

⁵² The Cancer Council Western Australia, Victorian Cancer Council, and the Northern Territory Police, Fire and Emergency Services.

68. A submission from Professor Mike Daube, Professor of Health Policy at Curtin University, was received on 15 June 2017, expressing opposition to the proposed arrangements and submitting that the Applicants' proposal runs counter to the spirit, intent and aims of Article 5.3.
69. Submissions from the Applicants and interested parties (including verbal submissions made at the pre decision conference) are considered as part of the ACCC's assessment of the application for authorisation and are discussed below.
70. Copies of all public submissions may be obtained from the [Authorisations Public Register](#).

ACCC assessment

71. The ACCC's assessment of the proposed arrangement is carried out in accordance with the relevant net public benefit tests⁵³ contained in the *Competition and Consumer Act 2010* (Cth) (the **CCA**). In broad terms, the ACCC may grant authorisation if it is satisfied that the likely benefit to the public from the proposed arrangement would outweigh the likely detriment to the public, including from any lessening of competition.

Relevant areas of competition

72. The Applicants consider the relevant area of competition to be that for the supply of tobacco products (both legal and illicit) to consumers in Australia.
73. The ACCC considers the relevant areas of competition are likely to be those for the importation, distribution and retail supply of licit tobacco in Australia, recognising that the importation, distribution and retail supply of illicit tobacco is a substitute for some consumers, retailers and distributors.

Future without the conduct

74. To assist in its assessment of the proposed conduct against the authorisation test, the ACCC compares the benefits and detriments likely to arise in the future with the conduct for which authorisation is sought against those in the future without the conduct the subject of the authorisation.
75. The Applicants submit that, absent the proposed agreement, the availability and supply of illicit tobacco by retailers and wholesalers will increase due to pressure on consumers from excise increases and the further emboldening of current and potential retailers and wholesalers of illicit tobacco.
76. The ACCC considers that, should the conduct for which authorisation is sought not occur, Commonwealth, state and territory government agencies will continue to be responsible for the investigation and enforcement of breaches of the relevant legislation. The Applicants have also stated that they consider this is the likely outcome should authorisation not be granted.⁵⁴

⁵³ Subsections 90(5A), 90(5B) and 90(8).

⁵⁴ Official Committee Hansard, Parliamentary Joint Committee on Law Enforcement, *Illicit Tobacco*, 22 March 2017, p 9.

77. The ACCC notes that one or more of the Applicants currently individually covertly collect intelligence on the retail of potentially illicit tobacco,⁵⁵ and that it is likely they will choose to continue to do so in the absence of authorisation.
78. As noted in their submission of 23 November 2016, the Applicants currently also have the ability to, on an individual basis, give effect to terms in their contracts with retailers and wholesalers to cease supply of their products if a retailer or wholesaler is discovered to be selling tobacco considered to be illicit.
79. It appears all three Applicants, at times, give effect to these terms in their contracts. Philip Morris has publicly noted that these terms are “fairly rigorously enforced. If we can find out that someone has been involved [in the breaking of any law such as illicit trade], we will cease doing business with them completely, and we have done so repeatedly for people convicted or even where we are comfortable that there is a good case that they have been involved in illicit trade.”⁵⁶ Similarly, Imperial Tobacco has said that “if a [tobacco] manufacturer is aware of a retailer that is engaging in the sort of conduct the agreement proposes, it would be my opinion that they would cease supply. I am aware that manufacturers individually have ceased supply to individual retailers who have been engaged in the illicit tobacco trade.”⁵⁷ At the pre decision conference, BATA advised that it has unilaterally ceased supply of its products to retailers it has discovered (through covert purchases) to be selling illicit tobacco and estimated that its unilateral boycotts were often effective (i.e. the retailer subsequently ceased selling illicit tobacco products), perhaps about half the time.
80. Based on the information available to it, the ACCC considers that, in the absence of the arrangements for which authorisation is sought, it is likely the Applicants will continue, on an individual basis, to:
- covertly collect intelligence on the retail of potentially illicit tobacco
 - issue warning letters to retailers or wholesalers they consider to be selling illicit tobacco
 - give effect to terms in their contracts with retailers and wholesalers to cease supply of their products if a retailer or wholesaler is discovered to be selling tobacco considered to be illicit.
81. The implications of this are discussed in paragraphs 93 - 102 below.

⁵⁵ KPMG, *Illicit tobacco in Australia: 2015 Full Year Report*, 15 April 2016, p26.

⁵⁶ Parliamentary Joint Committee on Law Enforcement, *Inquiry into Illicit Tobacco, Official Committee Hansard*, 4 March 2016, p5.

⁵⁷ Senate Select Committee on Red Tape hearing into the effect of red tape on tobacco retail, *Proof Committee Hansard*, 16 May 2017, p5.

Public benefit

82. The CCA does not define what constitutes a public benefit and the ACCC adopts a broad approach. This is consistent with the Australian Competition Tribunal which has stated that the term should be given its widest possible meaning, and includes:

...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements ... the achievement of the economic goals of efficiency and progress.⁵⁸

83. The Applicants submit that the proposed conduct will reduce the availability and supply of illicit tobacco in Australia at the retail level, which is likely to result in a number of public benefits including:

- reduction in the loss of revenue by retailers and wholesalers who only sell legal tobacco products, to those retailers and wholesalers who sell illicit tobacco
- reduction in lost excise duties
- reduction in the burden on law enforcement agencies
- ensuring the effectiveness of regulatory measures around the sale of tobacco including health warnings, fire risk, and pest control measures
- reduction in the health dangers of 'chop chop' tobacco, including the inhalation of fungal spores.

84. The ACCC received a number of submissions by retailers and retail industry associations which emphasised the impact of illicit tobacco on legitimate small retailers of tobacco. A number of industry associations and retailers sent representatives to attend the pre decision conference to voice these concerns in person. Retailers of licit tobacco products are subject to a range of actively-enforced regulatory measures (such as minimum age requirements), and retailers must bear the costs of ensuring compliance with these measures. Interested parties noted that retailers of licit products are losing business to retailers and wholesalers of illicit tobacco products, who sell a cheaper product and do not bear the costs of complying with any regulations. Retailers and retail industry associations saw the proposed arrangements as a response to the problem of illicit tobacco at the retail level, in the absence of sufficient or effective enforcement action by the relevant government agencies.

85. The ACCC acknowledges the harm to legitimate businesses that lose revenue to retailers who sell illicit tobacco. The ACCC accepts that there is a public benefit in reducing the loss of this revenue by reducing the availability and supply of illicit tobacco, and also in reducing the distortion in competition in the legal tobacco market caused by sales of illicit tobacco.

⁵⁸ *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,242; cited with approval in *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,677.

86. The ACCC also accepts that reducing the availability and supply of illicit tobacco in Australia would be likely to result in benefits including:

- reducing the loss of excise duties (because a proportion of consumers who would have purchased illicit tobacco would presumably, if this was unavailable, instead purchase licit tobacco on which excise had been paid)
- improving the effectiveness of regulatory measures around the sale of tobacco including health warnings, plain packaging, price measures, fire risk, and pest control measures (because illicit tobacco often does not comply with these measures, with the result that consumers and society do not benefit from their deterrent and other effects)
- reducing the enforcement and compliance burden on government regulatory agencies.

87. While estimates of the size of the illicit tobacco market vary and are contested (see discussion at paragraphs 35 - 38), all parties consider the issue of illicit tobacco is an important problem.

88. The ACCC considers that even though there is a wide range of views about the scale of the illicit tobacco problem, any reduction in illicit tobacco sales would constitute a public benefit. It is also clear that there is the potential for coordinated action to cease supply to retailers who sell illicit tobacco to result in some reduction in illicit tobacco sales. In particular, the ACCC accepts that a boycott of a retailer or wholesaler by all three Applicants would likely be effective in preventing future supply by that particular retailer or wholesaler of the types of illicit tobacco products targeted by the conduct. The key question for the ACCC's consideration of the extent of benefits from this conduct, therefore, is how effective the proposed arrangements are likely to be in reducing total sales of illicit tobacco compared to the likely reductions that could be achieved without the need for authorisation of coordinated action.⁵⁹ The ACCC considers that a range of factors are likely to considerably reduce the benefits resulting from the proposed arrangements, which are discussed in the following sections.

Effectiveness of the arrangements

89. In its draft determination, the ACCC expressed the view that there was considerable uncertainty as to the extent to which the proposed arrangements are likely to reduce the supply of illicit tobacco (and therefore to result in public benefits).

90. The ACCC notes that a range of factors have potential to affect the extent to which the proposed arrangements reduce the availability and supply of illicit tobacco, and the likelihood this will occur. These specific factors are addressed in the sections that follow.

⁵⁹ The ACCC must also consider any detrimental outcomes that are likely to arise from the proposed conduct. See the assessment in the 'Detriments' section below.

91. In their submission of 19 January 2017 the Applicants proposed measures intended to address the Commission's concerns regarding the effectiveness of the arrangements, specifically to:
- report to the ACCC on a six monthly basis providing information such as the number of covert purchases conducted, the number of illicit tobacco purchases, any requests for mediation or arbitration, any action taken against a retailer or wholesaler, and the Applicants' assessment of the impact of the conduct, and
 - reduce the period for which authorisation was sought from five, to three years, to allow the ACCC to consider the impact of the conduct.
92. The ACCC considers that, while these proposals may provide a higher level of transparency (in circumstances where the ACCC had decided to grant authorisation), neither of these proposals increase the possibility that public benefit will result from the arrangements.

Unilateral action by the Applicants without the need for authorisation

93. A key question for the ACCC's assessment of the likely public benefits from the proposed arrangements is the extent that unilateral cessation of supply by each Applicant would impact on illicit sales, and hence what the additional reduction might be from acting jointly.
94. As noted in paragraphs 77 - 80 above, one or more of the Applicants currently covertly obtain intelligence of potentially illicit tobacco sales and, apparently, withhold supply if a retailer is found to be selling illicit tobacco products. The Applicants do not require ACCC authorisation to, on an individual basis, give effect to terms in their contracts with retailers and wholesalers to cease supply of their products if a retailer or wholesaler is discovered to be selling tobacco considered to be illicit.
95. The Applicants' rationale for the proposed arrangements is that an agreement between them for joint and coordinated action is essential to their disruption because, if only one of the Applicants ceases supply, the retailer or wholesaler would be able to continue to acquire and supply legal tobacco products from the other Applicants. In other words, they submit that unilateral boycotts of retailers or wholesalers by each Applicant individually are not an effective deterrent to retailers or wholesalers to stocking illicit tobacco products.
96. However, at the pre decision conference, BATA advised that it currently unilaterally ceases supply of its products to retailers it has discovered (through covert purchases) to be selling illicit tobacco, and estimated that its unilateral boycotts were often effective (i.e. the retailer subsequently ceased selling illicit tobacco products), perhaps about half the time.
97. The ACCC requested further information from the Applicants as to the extent to which each of the Applicants had unilaterally withheld supply from retailers they believed to be selling illicit tobacco, and the effectiveness of this. In response, the Applicants:
- advised that each of the Applicants has, on several occasions, made decisions *not* to cease supply, due to concerns that one or both of the other Applicants would 'fill the gap'

- provided an example of an occasion in 2014 where one of the Applicants ceased supply to a retailer that was subject to a dawn raid by police, and, in response, one of the other Applicants increased the supply of its products to that retailer
 - advised that they do not, at this point in time, have data to comment on the extent to which a consumer would be likely to switch between retailers and/or brands in circumstances where none of a consumer's regular brands are available in an outlet.
98. While the Applicants submit that unilateral cessation of supply would not be effective due to the other Applicants stepping in to 'fill the gap', they have not provided any detailed information which demonstrates that they have found unilateral cessation of supply (or the threat thereof) to be ineffective. It is unclear, therefore, the extent to which other Applicants would seek to 'fill the gap' or whether a retailer would consider the products of one of the Applicants to be a substitute for the products of another of the Applicants. In any event, in circumstances where one or more of the Applicants observes one of the others has ceased supply to a retailer, it is open to the other Applicants to, on an individual basis, undertake their own investigations regarding whether that retailer is involved in illicit trade, and to make their own decisions as to whether to cease supply. To do so would not require authorisation.
99. It is likely that in some cases where one of the Applicants unilaterally ceased to supply a retailer, the retailer would seek and find an alternative source of this Applicant's products (in order to satisfy the brand preferences of its customers), even though this would likely cost the retailer more than products supplied directly by the Applicants. At the pre-decision conference, comments by retailers and the Applicants indicated that they were aware of situations in which retailers which had been cut off by one of the Applicants sourced alternative supply of the Applicant's products, either from a different wholesaler or from another retailer, even where this was at a higher cost. This suggests that retailers consider it important to stock preferred brands and do not see other brands as strong substitutes.⁶⁰
100. Given this, it appears that the cessation of supply of only one of the Applicants' product ranges can be a significant disincentive to retailers to stock illicit tobacco products. This is a very concentrated market, with each of the Applicants having strong brands and high market shares. A retailer who is unable to supply the products of any one of the Applicants, particularly BATA given its dominant market share, or who could obtain supply of those products only at a price premium, would be significantly disadvantaged.
101. Given the degree of brand loyalty and the importance to retailers of stocking popular brands, unilateral cessation of supply is likely to still be an effective sanction against retailers who breach their contracts by selling illicit tobacco, and in many cases would not be rendered ineffective through other Applicants' 'filling the gap' by increasing supply of their competing products.

⁶⁰ See the Pre-Decision Conference Minutes at:

<http://registers.acc.gov.au/content/index.phtml/itemId/1198125/fromItemId/278039/display/preDecisionConference>.

102. The ACCC considers that the benefits that can be attributed to coordinated action are limited to any reduction in sales of illicit tobacco that it achieves *above and beyond* the impact of unilateral action. Therefore the likely benefit that can be attributed to coordinated action is substantially reduced by the ability of each of the Applicants to engage in the unilateral cessation of supply without the need for authorisation.

Impact of the proposed arrangements on the illicit tobacco market

103. The ACCC notes that the proposed arrangements can only address illicit tobacco that is sold by retailers who also stock the licit tobacco products supplied to them by the Applicants. The arrangements would not, for example, be able to target illicit tobacco sold through markets, from the back of a taxi, or “by a guy on a milk run”.⁶¹ Philip Morris has commented that “there is a large section of the illicit tobacco market that actually does not sell any legal product at all. These stores are devoted exclusively to selling illicit tobacco. They do not have retail licences and they do not buy products from legal tobacco companies.... There are many of them, and they would not be impacted at all by [a joint boycott by the three major tobacco companies]”.⁶²
104. There are no official estimates available as to the proportion of illicit tobacco sold through stockists of licit tobacco products. On the estimates supplied by the Applicants, 70% of the current illicit tobacco market has the potential to be targeted by the proposed arrangements; however DIBP states it is unable to comment on the proportion of illicit trade that is conducted through existing retailers.
105. DIBP notes that it is possible that a proportion of the sellers who were targeted by the Applicants in their implementation of the proposed arrangements would switch to selling entirely illicit tobacco products (thus reducing the proportion of illicit tobacco supplied by retailers of licit tobacco products and able to be targeted by the proposed arrangements).
106. At the pre decision conference, the Applicants advised that they did not consider it likely that retailers currently selling both licit and illicit tobacco products would shift to selling only illicit tobacco products in response to the implementation of the proposed arrangements. This is because retailers had invested a lot to establish their businesses, and often relied on the cover of legitimacy to operate their illicit business.
107. Even if very few of the retailers targeted by the proposed arrangements would switch to selling only illicit products in response to a boycott, it seems likely that a proportion of the consumers who currently purchase illicit tobacco through such retailers would switch to purchasing illicit tobacco products from other suppliers should their regular retailer be shut down, including some switching to retailers and wholesalers who only stock illicit products.
108. In this way, the ACCC considers that it is likely that the distribution of illicit tobacco would change (to an unknown extent) in response to the proposed arrangements such that it is likely that a greater proportion of illicit tobacco would

⁶¹ Examples provided by Cignall and the AACS to the Senate Select Committee on Red Tape hearing into the effect of red tape on tobacco retail, 16 May 2017.

⁶² Parliamentary Joint Committee on Law Enforcement, Inquiry into Illicit Tobacco, *Official Committee Hansard*, 4 March 2016, p10.

be sold through retailers who do not stock licit tobacco products. The ACCC considers that this is likely to reduce the effectiveness of the proposed arrangements in decreasing the supply of illicit tobacco, and therefore reduce the public benefits which are likely to result from the proposed arrangements.

Defining and identifying “illicit” tobacco

Concerns at draft determination

109. In its draft determination, the ACCC noted that the proposed arrangements could only effectively identify (and therefore target) some types of illicit tobacco – specifically, only tobacco products which did not comply with plain packaging or health warning legislation, or those which are counterfeit, could be identified, because customs records would not be available to the Applicants in order to determine if appropriate duties or taxes had been paid on a given product.
110. This may, in turn, lead to an increased supply of some contraband tobacco which is compliant with plain packaging requirements (but on which the appropriate duties have not been paid). This would reduce the public benefits which are likely to result from the proposed arrangements, because the arrangements would only target some types of illicit products, and because it may encourage an increase in the supply of the types of illicit products it does not target.

Applicants’ proposals in response

111. Since the draft determination, in order to address other concerns of the ACCC, the Applicants have revised the methodology by which they proposed to collect evidence (specifically, to use evidence obtained by photography or affidavit rather than collect physical evidence through mystery shopper purchase), and have also limited the range of products which they propose to apply the proposed arrangements (to those which do not comply, or attempt to comply, with plain packaging requirements).
112. In response to the ACCC’s request of 5 May 2017 for further information on the Applicants’ revised methodology, the Applicants advised that:
- the methods of evidence collection proposed in the Applicants’ revised proposal have been used to collect evidence that has been allowed into evidence by courts in Australia
 - the quality of concealed recording devices has dramatically improved and would be used by professionals trained in their use
 - poor quality photographic, video or audio evidence would not be used to take action against the retailer involved
 - independent sworn statements from private investigators can create a strong body of evidence against a retailer that can be tested in mediation, arbitration and court proceedings.
113. The DOH submits that the Applicants have not clearly articulated how they intend to accurately and consistently identify illicit tobacco, and the arrangements should not be authorised until the process by which they base their allegation against a retailer is robust, with there being no question on whether or not a particular product is illicit or not in terms of duties or excises being paid.

114. Cancer Council Victoria submits that the evidence relied on by the Applicants under the revised proposal may not be unambiguous in every case, and it is possible that an innocent retailer who is wrongly accused of selling illicit tobacco on the basis of ambiguous (or poor quality) evidence may be forced to incur significant costs by participating in the mediation and/or arbitration process in order to protect their business interests.

ACCC assessment

115. While products which do not comply (or attempt to comply) with plain packaging requirements may be easily distinguished from those that do by sight, in the absence of physical evidence the ACCC is concerned that the Applicants may more frequently be unable to obtain evidence “to a standard necessary for such evidence to be admitted in court”.⁶³ The evidence obtained via the revised process is also more open to challenge in the mediation and arbitration process proposed by the Applicants in their submission of 19 January 2017.
116. As with the Applicants’ original proposal, the revised proposed arrangements would only target some types of illicit tobacco – specifically, tobacco products which do not comply (or attempt to comply) with plain packaging or health warning legislation, or those which are counterfeit. This may, in turn, lead to an increased supply of some illicit tobacco which is compliant, or attempts to be compliant, with plain packaging requirements, since those products will not be affected by the proposed arrangements.
117. The degree to which this is likely to reduce the benefits arising from the proposed arrangements depends upon the proportion of the illicit market comprised of tobacco products which comply, or attempt to comply, with plain packaging requirements. The most recent KPMG report on illicit tobacco in Australia (commissioned by the Applicants) estimates that plain packaging compliant illicit tobacco constitutes a small but growing proportion of all manufactured cigarette consumption.⁶⁴ Cignall, in response to the draft determination, submitted that “the biggest growth in illicit product is in the tobacco products that come into the country in plain packaging.”⁶⁵ The ACCC is not aware of any other estimates of the proportion of the illicit market comprised by plain packaging compliant tobacco.
118. The ACCC notes that, while currently small, the indications are that the proportion of illicit tobacco constituted by plain packaging compliant illicit tobacco is increasing rapidly. Further, the proposed arrangements are likely to encourage even greater growth in these illicit tobacco products, because suppliers of illicit tobacco will have incentive to switch to products not targeted by the arrangements. This will reduce the public benefits which are likely to result from the proposed arrangements. The ACCC also considers that the revised methodology proposed by the Applicants may lack robustness in relation to the

⁶³ Applicants’ submission to the ACCC re A91550, 23 November 2016, p11.

⁶⁴ KPMG reported its analysis showed an increase from 0.11% of all manufactured cigarettes consumed in 2015 to 0.56% of manufactured cigarette consumption in 2016. The ACCC notes that this is a proportion of all manufactured cigarettes (not a proportion of illicit tobacco) and the estimate does not include, for example, cigarettes which have been legitimately manufactured for the Australian market but which have leaked into the market without appropriate duties or taxes having been paid. Source: KPMG, *Illicit tobacco in Australia: 2016 Full Year Report*, 20 March 2017, p46.

⁶⁵ Cignall, Submission to the ACCC re A91550, 19 January 2017.

standard of evidence collected, and therefore may be ineffective at identifying illicit tobacco, and be open to successful challenge.

Incentives in relation to illicit tobacco

119. The Applicants submit that, in the specific case of combating illicit tobacco, the interests of industry and government are aligned, and that they share the same objective of reducing the availability and supply of illicit tobacco to consumers.
120. The ACCC accepts that the interests of industry and government may in part be aligned in this regard, because illicit products will to some extent be considered substitutes for licit products, and therefore some sales of these products will reduce the revenue and profits earned by the Applicants on licit tobacco sales. However, the ACCC considers that the Applicants also have other interests, such as maximising the sales of licit tobacco generally and of their own products in particular, which may not align with government interests.
121. It has also been suggested that the illicit tobacco market may benefit tobacco companies by providing a source of cheaper tobacco to the population, and thereby increasing overall tobacco sales through increased uptake and consumption.⁶⁶
122. Additionally, in relation to contraband cigarettes or tobacco (which are legitimately manufactured overseas but have evaded customs duty through being diverted from legitimate supply or smuggled in from a different (lower-taxed) jurisdiction), global tobacco companies make profit on the sale of these products before they enter the illicit market. This may give the Applicants an incentive not to target such contraband tobacco products, even where they are identifiable through a failure to comply with plain packaging or health warning legislation, in their implementation of the proposed arrangements.
123. DOH notes in its submission that tobacco companies overseas have played a role in illicit tobacco trade, including aiding persons to sell or be in possession of illicit products.
124. While the ACCC considers that these conflicting incentives may reduce the potential benefits of the proposed arrangements, it is unable to give significant weight to these concerns given the limited evidence before it on this point.

Legislative responses

125. Part of the rationale put forward by the Applicants for the proposed arrangements is that law enforcement agencies have been focussing on interrupting and preventing organised criminals involved in the importation and distribution of illicit tobacco, rather than focussing on individual retailers or wholesalers who may be supplying illicit tobacco, and that current government enforcement measures at the retail and wholesale level of the market are not working and have failed to have any material impact on the supply of illicit tobacco products.

⁶⁶ See LeGresley, E., and E. Lindblom, *Illegal Pathways to Illegal Profits: The Big Cigarette Companies and International Smuggling*, Campaign for Tobacco-Free Kids, December 2002, pp 1-2, and Winstanley, M.H. & B. Freeman, "The tobacco industry in Australian society", In Michelle Scollo and M.H. Winstanley (Eds.), *Tobacco in Australia: Facts and issues* 4th ed, Cancer Council Victoria, 2012.

126. DOH advises that “work continues at a whole of government level – through various fora... - on a legislative reform program aimed at strengthening the ability of Commonwealth, state, and territory law enforcement agencies to tackle illicit tobacco at all levels of the supply chain.” As discussed in paragraphs 46 - 49 above, government enforcement agencies have previously identified a range of limitations on their ability to investigate and prosecute illicit tobacco offences at the retail and wholesale levels.
127. DIBP’s submission of 28 April 2017 sets out some further detail on the proposed legislative changes aiming to resolve these issues, including:
- aiming to resolve the proof of origin issue (which requires the prosecution to establish whether tobacco was imported or domestically produced)
 - amendments to the *Customs Act 1901* to include a new tobacco smuggling offence based on recklessness, and
 - increase the penalties available for the tobacco offences in the *Excise Act 1901*.
128. In response, the Applicants submit that changes to the law are still under development and may take some time and, once implemented, may not be effective or may be affected by the level of resources available to relevant government agencies to implement and enforce those laws. The Applicants submit that the proposed changes would be unlikely (based on the limited information available) to operate at the retail level of the supply chain.
129. The ACCC notes that, while there have been some seizures of locally grown illicit tobacco, it appears the large majority of illicit tobacco is imported into Australia, and therefore effective enforcement at the border will reduce the supply of illicit tobacco including at the retail and wholesale levels.
130. The ACCC considers that any legislative reforms (once implemented) are likely to strengthen the ability of the Commonwealth, state and territory law enforcement agencies to tackle illicit tobacco at all levels of the supply chain, including the retail level.⁶⁷ As such, the ACCC considers that the legislative reforms would reduce the benefits which are likely to result from the proposed arrangements.
131. However, an indication of the likely timeframes for the implementation of any legislative reforms in this regard is not publicly available at the current time. The ACCC considers that any legislative reform program is unlikely to be implemented immediately.

Health dangers of illicit tobacco

132. The Applicants submit that the public health benefit of reducing the use of ‘chop chop’ tobacco should be given significant weight, because of the particular health dangers associated with smoking chop chop including from the inhalation of fungal spores.

⁶⁷ The ACCC notes comments of the ATO and DIBP to the Parliamentary Joint Committee on Law Enforcement Inquiry into Illicit Tobacco on 23 November 2016, which indicate the proposed legislative changes will make prosecution of offences at the retail level easier for law enforcement agencies.

133. The DOH has previously expressed the view that “at present, the only reliable epidemiological evidence of reduced risk associated with smoking tobacco products is to avoid exposure to tobacco smoke by not smoking.”⁶⁸ The DOH submission of 6 June 2017 submits that “no one tobacco product is safer than any other, whether licit or illicit.”
134. On the basis of the information available from the DOH, the ACCC does not recognise that there is a significant public benefit in public health terms from reducing the exposure to ‘chop chop’ tobacco when compared to licit tobacco products.

ACCC conclusion on public benefits

135. The ACCC accepts that if the proposed arrangements were to result in a reduction in the availability and supply of illicit tobacco, this would likely result in public benefits by:
- reducing the loss of excise duties
 - improving the effectiveness of regulatory measures around the sale of tobacco including health warnings, plain packaging, price measures, fire risk, and pest control measures
 - reducing the loss of revenue by retailers and wholesalers who only sell legal tobacco products, to those retailers and wholesalers who sell illicit tobacco, and
 - reducing the enforcement and compliance burden on government regulatory agencies.
136. However, the ACCC considers that there is considerable uncertainty as to the extent to which the proposed arrangements are likely to significantly reduce the supply of illicit tobacco, beyond that which would be achieved through unilateral and government actions.
137. The ACCC considers that a significant portion of the claimed public benefits can be achieved by the Applicants acting on a unilateral basis without an agreement to jointly boycott.
138. The ACCC also notes that the proposed arrangements would target only a portion of the supply of illicit tobacco (i.e. that which is sold by a retailer who also sells legal tobacco products, and does not comply with plain packaging or health warning legislation).
139. Because the proposed arrangements would target only a portion of the supply of illicit tobacco, it is likely that in response to implementation of the proposed arrangements, the patterns of importation and distribution of illicit tobacco may simply change, for example, certain categories of contraband tobacco supply may increase. It is also possible that some consumers may switch to purchasing illicit tobacco from other sellers including those who exclusively stock illicit tobacco, and importers of illicit tobacco may switch to importing tobacco which complies

⁶⁸ Joint Committee on Law Enforcement, Inquiry into Illicit Tobacco, *Answers to Questions on Notice: Health Portfolio*, 22 March 2017.

with plain packaging requirements. Given the benefits claimed by the Applicants will materialise only to the extent the overall supply of illicit tobacco is reduced when compared to the future without the proposed arrangements, this would therefore reduce the benefit likely to result from the proposed arrangements (to the extent joint boycotts by the Applicants are more effective than unilateral cessation of supply).

140. Further, the proposed legislative and regulatory responses to the current enforcement problems will reduce any public benefit likely to result from the proposed arrangements, since it could achieve a reduction in illicit tobacco sales without the need for an agreement between competitors; however the ACCC notes that the timing of implementation of any legislative responses is unknown.
141. In relation to the Applicants' proposals to report to the ACCC on the operation of the arrangements and to limit the length of authorisation, the ACCC considers that, while these would increase the level of transparency of the arrangements and make it easier to assess (retrospectively) the extent of any benefits and detriments from the authorised conduct, they would not of themselves alter the possibility or extent of public benefits arising.

Public detriment

142. The CCA does not define what constitutes a public detriment and the ACCC adopts a broad approach. This is consistent with the Australian Competition Tribunal which has defined it as:

...any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.⁶⁹

143. The Applicants submit that the proposed arrangements are unlikely to result in any detrimental impact on competition other than in relation to competition between legal tobacco retailers and wholesalers and those that sell illicit tobacco products. The Applicants have identified safeguards within the arrangements which they submit ensure only retailers and wholesalers of illicit tobacco products would be targeted, including the issuing of warning/cease and desist letters to retailers and wholesalers, advising government enforcement agencies of any intended boycott, and a mediation and arbitration process to deal with complaints from affected retailers.
144. Interested parties submit that the proposed arrangements are likely to result in detriments including:
- there may be issues with consistency, transparency and accountability in the arrangements because there is no provision to seek review and no independent oversight of decisions
 - the inappropriateness for tobacco companies to be involved in regulating tobacco, because there is a fundamental and irreconcilable conflict between the tobacco industry's interests and public health policy interests, and

⁶⁹ *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,683.

- action by the Applicants at a retail level has the potential to interfere with larger government investigations which may be underway either at the border or at retail level.

145. The submissions of the Applicants and interested parties on key issues are discussed in the sections that follow, along with the ACCC's assessment of the likely public detriments from the proposed arrangements.

Lessening of competition between tobacco manufacturers

General competition concern

146. Together, the Applicants comprise the vast majority of the retail sales of licit tobacco products in Australia (see paragraph 19 - 22) and therefore would have considerable market power if acting cooperatively. The Applicants seek authorisation for an arrangement which would involve repeated interactions to share commercially sensitive information about retailers and to reach agreement to boycott particular retailers. Any such arrangement between three dominant market participants, particularly in a market where the threat of new entry appears low, raises significant competition concerns.

Concern at draft determination about targeting competitors

147. Prior to the draft determination, interested parties raised concerns that it is also possible that the Applicants may implement the proposed arrangements in such a way as to further their own commercial interests and/or reduce competition between tobacco manufacturers.

148. In particular, DOH submitted that there is a conflict of interest regarding the business interests of the Applicants and other competing tobacco brands. The Cancer Council Victoria submitted the proposed arrangements have the potential to be misused to further commercial (or personal) interests. Tobacco wholesaler Black Cat Consultancy raised concerns that the arrangements are open to possible abuse of power by the Applicants, by targeting newcomers, traders they feel threaten their market share, or traders that reject their trading terms. Black Cat Consultancy advised that it is constantly defending its legal tobacco products (not the Applicants' brands) to retailers who have been told by representatives of the Applicants that the products are illegal.

149. In its draft determination the ACCC expressed concern that there was scope under the proposed arrangements for the Applicants to selectively target retailers in order to pursue unrelated commercial objectives, such as by boycotting retailers who stocked tobacco products not manufactured by the Applicants. This would result in detriment from a lessening of competition between tobacco manufacturers (by limiting the access of smaller manufacturers to retail outlets). Alternatively, the Applicants may use the proposed conduct to limit price competition by targeting retailers who are discounting the Applicants' products.

150. In the draft determination, the ACCC noted in particular that, under the arrangements as they were then proposed, and given the Applicants' proposed definition of "illicit" tobacco for the purposes of the arrangements, it was possible that tobacco products on which duty has in fact been paid would be subject to action by the Applicants, on the basis that they did not comply with plain packaging legislation.

151. DOH has previously stated that its activities in relation to non-compliance with plain packaging legislation are most often undertaken in a conciliatory manner (including educative responses and issue of warning letters) aimed primarily at quickly rectifying non-compliance. Enforcement action is proportionate to the breach identified and strategic decisions are made on a case by case basis.⁷⁰
152. This means that the Applicants may, under the arrangements as originally proposed, have been able to make joint decisions not to supply a retailer who stocks a competing tobacco brand on the basis of non-compliance with plain packaging legislation, in circumstances where DOH had considered, or would have considered, a conciliatory, educative response to be appropriate. This may discourage retailers from stocking competing brands of licit tobacco products, and may also cause commercial and competitive harm to these competing brands.

Applicants' proposals in response

153. In response, the Applicants proposed a number of changes to the arrangements to address the ACCC's concerns. In their submission of 19 January 2017, the Applicants proposed they would allow other suppliers of lawful tobacco products (including competing brands) to become parties to the Cooperation Deed between them. Further, at the pre decision conference and subsequently more formally in their submission of 15 March 2017, the Applicants advised they would (if necessary) agree to limit the authorisation application to include only some types of illicit tobacco products – specifically, 'chop chop' and 'picture packs' (i.e. products which did not comply – or attempt to comply – with plain packaging requirements).
154. Cancer Council Victoria submits that there does not appear to be anything in the proposed arrangements that would prevent the Applicants from selectively focusing evidence collection on particular retailers or wholesalers to further commercial interests other than the disruption of illicit trade.
155. The Applicants submit in response that, if these concerns had any legitimacy, they would also have been expressed by retailers and their associations, but in fact the submissions of retailers and their associations have strongly supported or not opposed the proposed arrangements.

ACCC assessment

156. The ACCC considers that the first proposal of the inclusion of competing suppliers in the arrangements would not address its concerns that the arrangements may be used in such a way as to discourage retailers and wholesalers from stocking competing brands. Under the proposed arrangements, the Applicants individually exercise discretion in deciding which retailers or wholesalers to target with covert purchases, and which of the breaches they discover to bring to the group to consider for joint boycott. The Applicants would still have a commercial incentive and ability to target retailers and wholesalers who stock the products of competing brands, and to ignore retailers who do not (even if they are suspected of trading in illicit tobacco); Black Cat Consultancy has raised concerns about this type of behaviour already occurring.
157. The Applicants' second proposal to exclude certain products from the arrangements may, in part, address the ACCC's concerns that the arrangements

⁷⁰ Department of Health, *Supplementary Submission to the Inquiry into Illicit Tobacco*, April 2016, p4.

could be used to target suppliers of competing products. The exclusion of products which comply – or attempt to comply – with plain packaging requirements from the arrangements ensures that retailers and wholesalers cannot be boycotted on the basis of stocking the products of competitors of the Applicants (because suppliers of licit tobacco products can be assumed to comply – or attempt to comply – with plain packaging requirements).

158. However, the ACCC considers that the amended proposed arrangements may still be implemented in such a way as to discourage retailers and wholesalers from stocking competing products, or from discounting the Applicants' products. The ACCC is concerned that the Applicants would have a commercial incentive to turn a blind eye to illicit sales by preferred retailers, but take action against other retailers that stock competing products or who otherwise do not comply with the Applicants' preferred trading terms. The proposed arrangements would provide the Applicants with the ability to use the process against a retailer to try to force an outcome in a commercial negotiation, in circumstances where a small business is likely to have significantly less resources available to it.
159. The ACCC considers that any appeals process is not able to address concerns that the implementation of the arrangements may occur selectively in order to further unrelated commercial aims of the Applicants, or that the threat of collective boycott may be used in commercial negotiations (as discussed above).
160. Further, the ACCC considers that limiting the authorisation to particular kinds of illicit products would be likely to lead to an increase in supply of those products not targeted by the arrangements, (see discussion at paragraphs 116 - 118).

Inappropriateness of industry involvement in law enforcement

161. A number of interested parties have raised concerns about the appropriateness of industry being involved in a monitoring and law enforcement role.
162. Cancer Council Western Australia submits that the enforcement of laws to reduce the supply of illicit tobacco is a matter for the Australian Government, and industry interference is therefore unnecessary.
163. The Minister for Health, Culture and the Arts (Western Australia) submits that there are significant inherent conflicts of interest associated with the tobacco industry becoming involved in monitoring and enforcement activity related to tobacco control.
164. The Northern Territory Police, Fire and Emergency Services submit that the enforcement of tobacco control laws should be left to the relevant Government enforcement agencies, and that it is not appropriate for tobacco companies to undertake private investigations and impose sanctions.
165. The Applicants submit that the proposed arrangement consists of actions performed in a private capacity against private parties, and does not require, contemplate or rely upon any government agency involvement. The Applicants submit that the proposed conduct does not amount to a form of regulatory enforcement action and that authorisation is sought to exercise individual contractual remedies in a coordinated manner.

166. The ACCC notes that, while it is open to the Applicants to exercise their private contractual rights of ceasing supply on an individual basis, they cannot do so on a joint basis without authorisation, because to do so is prohibited under the CCA.
167. Further, the ACCC notes that the proposed arrangements do effectively involve the Applicants monitoring the compliance of retailers and/or wholesalers with the laws prohibiting the sale of illicit tobacco, and taking joint action against any retailers or wholesalers that the Applicants consider are contravening relevant laws. Any such joint action is likely to have a significant impact on a retailer or wholesaler; in fact, this is essential if the conduct is to have the desired effect of discouraging retailers from contravening the law by selling illicit tobacco. The relevant laws are those which enshrine the government's tobacco control policies.
168. The Applicants have indicated that the proposed arrangement is required because of inadequate law enforcement at the retail level, submitted that the arrangement may have the effect of reducing the enforcement burden on law enforcement agencies, and acknowledged that the ACCC could withdraw authorisation should legislative reform allow increased enforcement by government at the retail level. The ACCC considers that this indicates that the proposed arrangements can be considered a substitute for the activities of law enforcement.
169. This view is supported by the Department of Health, which describes the proposed arrangements as 'quasi law-enforcement'.
170. In this way, while the proposed arrangements do not generally rely on government agency involvement, they may be said to be 'quasi-regulatory', and may also give the impression to retailers and wholesalers and to the public that the Applicants are engaging in some form of law enforcement.
171. The proposed arrangements constitute a blunt instrument (of boycotting retailers) by the three dominant market players, in contrast to the range of options available to law enforcement agencies (see for example paragraphs 150 - 152 above in relation to the enforcement of the plain packaging legislation).
172. The Applicants submit that in the specific case of combating illicit tobacco, the interests of industry and government are aligned.
173. However the ACCC considers that the industry has incentives which do not entirely align with government objectives in relation to illicit tobacco. As discussed above (see paragraphs 119 - 124), the Applicants have commercial incentive to maximise sales of licit tobacco generally and of their own products in particular, to increase overall tobacco sales through increased uptake and consumption, and to avoid targeting sales of contraband products of their own branding (because they make a profit on these products in the jurisdiction in which they are originally sold).
174. The ACCC considers that it is detrimental for the Applicants to be involved in the enforcement of laws which apply to the products they import and wholesale, because they have commercial incentives which do not entirely align with those of the government.
175. The ACCC notes that the Applicants suggested at a recent hearing of the Parliamentary Joint Committee on Law Enforcement inquiry into illicit tobacco, that one of the key things they believe needs to happen to address illicit tobacco sales is to have a national illicit tobacco strategy, preferably with one law

enforcement agency that is appropriately resourced.⁷¹ The ACCC considers this is likely to be a more appropriate and effective approach to address illicit tobacco sales.

Undermining public health outcomes

176. As a signatory to the WHO FCTC, the Australian Government has obligations under Article 5.3 to protect its tobacco-related public health policies from the interests of the tobacco industry (see paragraphs 50 - 55 above). The obligation in relation to Article 5.3 falls on the Australian Government. The Australian Government has previously declared its interpretation of the obligations of parties to the FCTC under Article 5.3, that parties “should interact with the tobacco industry only when and to the extent strictly necessary to enable them to effectively regulate the tobacco industry and tobacco products, and should ensure that any such interactions are conducted transparently.”⁷²
177. The Guidelines report that “the broad array of strategies and tactics used by the tobacco industry to interfere with the setting and implementing of tobacco control measures... is documented by a vast body of evidence.”⁷³ As set out in paragraph 53 above, the WHO Guidelines for implementation of Article 5.3 recommend that parties should not accept, support or endorse any voluntary code of conduct or instrument drafted by the tobacco industry that is offered as a substitute for legally enforceable tobacco control measures.
178. A number of submissions from interested parties refer to concerns related to Article 5.3, including that the proposed arrangements may be inconsistent with Article 5.3 as they may create a perception of government being in partnership with industry.
179. The Department of Health submits that “effective tobacco control is, by its nature, antithetical to the economic interests of the tobacco industry”, and notes that “the tobacco industry has a long, proven history of trying to delay, dilute and defeat the World Health Organization’s and governments’ attempts to reduce tobacco use.”
180. Cancer Council Western Australia submits that authorisation of the proposed arrangements by the ACCC could create a perception of cooperation or partnership with government, which has potential to undermine or subvert tobacco control efforts, and may be promoted as a public relations exercise and to foster a perception of social responsibility by the tobacco industry.
181. The Applicants submit that, aside from matters of transparency (and that this requirement is clearly satisfied by the authorisation process), Article 5.3 of the WHO FCTC has no bearing on their application, because it does not require, contemplate or rely upon any government agency involvement. The Applicants further submit that the proposed arrangements consist of actions performed in a

⁷¹ Parliamentary Joint Committee on Law Enforcement Inquiry into Illicit Tobacco, *Official Committee Hansard*, 22 March 2017.

⁷² Declaration by the Australian Minister for Foreign Affairs to the Secretary General of the United Nations, 5 January 2015. See: https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IX-4&chapter=9&clang=_en.

⁷³ WHO FCTC Conference of the Parties, *Guidelines for implementation of Article 5.3 of the WHO Framework Convention on Tobacco Control*, November 2008.

private capacity against private parties, and should not be miscategorised as an attempt to influence public health policy.

182. The Department of Health responded:

To comply with Article 5.3 of the FCTC, Australia must be able to demonstrate that it has taken concrete steps towards protecting public health policies with respect to tobacco control from the interests of the tobacco industry. The Applicants have submitted that tackling illicit trade in tobacco is not a public health policy, which, with respect, is incorrect. There is no doubt that the subject matter covered by the applications for authorisation clearly falls within the ambit of Article 5.3.

183. The Department of Health expressed strong concerns that the proposed arrangements are inconsistent with Australia's obligations under the WHO Framework Convention on Tobacco Control:

The Guidelines also importantly recommend that 'Parties should not accept, support or endorse any voluntary code of conduct or instrument drafted by the tobacco industry that is offered as a substitute for legally enforceable tobacco control measures.' The department considers the Application could reasonably be categorised as an *instrument drafted by the tobacco industry*; and the quasi law-enforcement offered by the Applicants, *a substitute for legally enforceable tobacco control measures*.

184. In response, the Applicants submit that a finding by the ACCC that the arrangements would contravene Article 5.3 would undermine and call into question important and established intelligence relationships, and would signal to organised crime that Australia's competition laws are there to protect them from attempts at cooperative industry-led efforts against illicit tobacco.

185. In assessing an application for authorisation, the ACCC assesses the likely benefits and detriments arising from the proposed conduct pursuant to the relevant statutory tests. While the Applicants have proposed amendments to the arrangements which rely on the involvement of government agencies (see discussion below), the core of the proposed arrangements for which authorisation is sought does not require significant involvement with government agencies. It involves the Applicants seeking to make and give effect to provisions in an agreement to, amongst other things, jointly cease supplying their products to retailers who they consider to be supplying illicit tobacco.

186. The ACCC has considered the policy underlying Article 5.3, and the history and context which led to the development of the WHO FCTC. The ACCC considers the arrangements would give the Applicants a quasi-regulatory role (see paragraphs 166 - 175). This may be inconsistent with the WHO Guidelines for implementation of Article 5.3, because it constitutes an instrument drafted by the tobacco industry, offered as a substitute for legally enforceable tobacco control measures, and could create a community perception of a partnership between the Australian government (and government agencies) and the tobacco industry.

187. As a result, the ACCC considers the proposed conduct is likely to result in public detriment by undermining government health policies and enforcement agency efforts to enforce tobacco control laws and their underlying policies. The ACCC considers that the regulation of illicit tobacco in this way is a role appropriate for government, rather than the tobacco industry.

Disrupting government investigations

Concerns at draft determination

188. Prior to the draft determination, DOH raised an issue that proposed conduct of the Applicants may interfere with investigations being conducted by law enforcement agencies. However, DOH notes that this area does not fall within the policy remit of the department.
189. DIBP noted that the application does not impact directly on border controls, legislation or activities.
190. The Applicants, in response, noted that DOH did not provide any examples of how the proposed arrangements would interfere with investigations being conducted by law enforcement.
191. As the Applicants are unaware of government investigations that may be underway, the ACCC considers that their actions may unintentionally disrupt government investigations by DIBP, police or the ATO at any point in the supply chain. For example, investigations or a decision to cease supply by the Applicants at the retail level may result in a change of behaviour by a retailer or importer, who may be under investigation by a government agency. The Applicants' actions may more directly impact on investigations occurring at a retail level.
192. In its draft determination, the ACCC expressed concern that, in the process of potentially preventing the supply of illicit tobacco by an individual retailer, the Applicants may unintentionally disrupt a much larger enforcement action, undermining enforcement and deterrent outcomes. The ACCC noted that it did not have sufficient information at that time to assess the likelihood of any detriment in this regard.

Applicants' proposal in response

193. In their submission of 19 January 2017, the Applicants proposed certain changes to how the arrangements could operate. In particular, prior to them taking steps against any retailer or wholesaler they would:
 - notify and disclose evidence to the relevant law enforcement agencies and departments, and
 - provide those agencies with the opportunity, in response, to request the Applicants not to take any action against the retailer or wholesaler.

Concerns with proposal

194. On 3 May 2017 the ACCC asked the Applicants for further information as to the possible application of Article 5.3 of the WHO FCTC to their proposal that law enforcement agencies could request the Applicants to not take action with respect to a particular retailer or wholesaler.

195. In response, the Applicants submit that they do not consider that the terms of Article 5.3 would restrict in any way the ability of law enforcement agencies or departments to request that the Applicants not take action with respect to a particular retailer or wholesaler. They note that:
- no concerns or objections to the revised approach had been raised by any of the State, Territory or local government agencies responsible for targeting the supply of illicit tobacco at the retail level of the supply chain
 - Article 5.3 expressly permits agencies or departments to interact with the tobacco industry to enable the effective regulation of the tobacco industry and tobacco products
 - Article 8.13 of the WHO FCTC *Protocol to Eliminate Illicit Trade in Tobacco Products* (FCTC Protocol) expressly acknowledges the need for interaction between relevant government agencies and the tobacco industry for the purposes of combatting illicit trade.
196. The Applicants submit there is a well-established history of meetings and communication between the industry and law enforcement agencies and departments. The Applicants submit that this shows they already communicate in a regular, transparent and appropriate manner, and that those departments and agencies consider these interactions necessary for them to effectively regulate illicit tobacco products.
197. Article 8.13 of the FCTC Protocol requires that: “Each Party shall ensure that its competent authorities, in participating in the tracking and tracing regime, interact with the tobacco industry and those representing the interests of the tobacco industry only to the extent strictly necessary in the implementation of this Article.”
198. The DOH submits that for decades there has been a clear and critical delineation between the role and interests of Australian governments and the tobacco industry. The Department submits that it holds significant concerns that the perception of a partnership between government agencies (including law enforcement agencies) and the tobacco industry that would arise should the authorisation be granted would significantly blur this delineation and undermine public confidence and support in Australian governments’ legitimate role in protecting the health of Australians through reducing smoking prevalence.
199. The DOH submits that in making various references to several pre-existing cooperative initiatives with government agencies, the Applicants have overstated the relationship between industry and the Government. DOH acknowledges that government agencies will accept intelligence information and referrals of non-compliance from all sources, including the tobacco industry, but this interaction is of a different character than that proposed in the Application.
200. The DOH also sought to clarify that Article 8.13 of the FCTC Protocol, referred to by the Applicants, relates specifically to interaction between authorities participating in the ‘tracking and tracing regime’ and the tobacco industry. The Department notes that Article 8.13 provides that such interaction should be ‘only to the extent strictly necessary’ and that a tracking and tracing regime does not currently operate in Australia. Importantly, Article 8.13 does not expressly refer to or otherwise recognise a general need for interaction between the tobacco industry and regulation agencies in the context of illicit trade.

ACCC assessment

201. The ACCC remains concerned that the proposed arrangements have potential to result in detriment through unintentionally interfering with government investigations into illicit tobacco. And, while the ACCC acknowledges that the proposed amendments suggested by the Applicants could reduce the likelihood of the proposed arrangements interfering with government investigations, such interaction by enforcement agencies with tobacco companies appears to be inconsistent with government obligations under Article 5.3 of the FCTC.

Purchasing non-compliant tobacco

202. Under the *Plain Packaging Act* it is an offence for a person to purchase tobacco products in retail packaging that does not comply with the requirements of that Act (i.e. prohibition of logos, brand imagery and promotional text, and restrictions on colour, size, format and materials of packaging), unless it is purchased for their own personal use.⁷⁴
203. In its draft determination, the ACCC expressed concerns that some purchases made under the 'covert purchase' component of the proposed arrangements may not comply with the requirements of the *Plain Packaging Act*, as the purchases would not be for personal use, and that this conduct may therefore constitute a contravention of that Act.
204. Under the revised proposed methodology, the Applicants propose to gather the necessary evidence without a sale or purchase of illicit product occurring (but instead rely on evidence gathered by means of photographic, video and audio evidence, or (in jurisdictions where this is not lawful) by means of sworn affidavits of statements by trained operatives offered illicit tobacco).
205. The ACCC considers the updated methodology addresses this potential detriment by no longer involving conduct that may be illegal.

Lack of appeals or independent review

Concerns in draft determination

206. Under the arrangements originally proposed by the Applicants, there were no appeal or independent review mechanisms available for businesses to which the Applicants decide jointly to cease supplying tobacco products.
207. Prior to the draft determination, a number of interested parties raised concerns about transparency, consistency and accountability of the arrangements because there was no appeal mechanism or review body to oversee decisions.
208. In its draft determination, the ACCC expressed concerns that small businesses may be may be wrongly or mistakenly subject to an inappropriate joint decision of the applicants to cease supply, without any opportunity for independent review of that decision, in circumstances where such a boycott is likely to have significantly detrimental impacts on the small businesses concerned. In addition, some businesses may be penalised disproportionately to their involvement in the sale of illicit tobacco. The length of a boycott and how it may be brought to an end by a

⁷⁴ s32(1) & s3(2). There is also another exception to subsection (1) in section 49 (non-compliant tobacco products for export).

retailer were unclear. The ACCC considered these aspects of the proposed conduct constituted a public detriment.

Applicants' proposal in response

209. In its submission of 19 January 2017, the Applicants proposed a mechanism for independent review of a determination by the Applicants that a retailer or wholesaler has supplied illicit tobacco. Under the proposal, the retailer or wholesaler could request independent mediation and (if the mediation is not successful) arbitration through the Australian Disputes Centre. Each party would be liable to bear its own costs of the mediation and arbitration. The Applicants would not boycott any retailer or wholesaler until this process was resolved.
210. The Applicants also specified fixed periods to apply to cessation of supply: six months for the first breach, 12 months for the second, and permanent for the third.
211. Industry associations and retailers who attended the pre-decision conference expressed satisfaction with the proposed appeals and review process, and reported that they believed it would not be unduly burdensome for their members.

ACCC assessment

212. The ACCC considers that the Applicants' proposal adequately addresses the ACCC's concerns about the likely impact on individual small businesses as a result of a joint decision by the Applicants to cease supply of their tobacco products. However, the ACCC considers that any appeals process is not able to address concerns that the implementation of the arrangements may occur selectively in order to further unrelated commercial aims of the Applicants, or that the threat of collective boycott may be used in commercial negotiations (as discussed above).

ACCC conclusion on public detriments

213. The ACCC considers that the proposed revised methodology for evidence collection addresses the ACCC's concern regarding the arrangements relying upon conduct which may be in breach of the *Plain Packaging Act*.
214. The ACCC notes the Applicants' proposals in response to the ACCC's concern that the proposed arrangements may result in a lessening of competition between tobacco manufacturers. The ACCC considers that the proposal to include competitors in the arrangements will not address its concern that the proposed arrangements may be detrimental to competition, and that the proposal to limit the arrangements to certain kinds of tobacco products could be only partially effective in addressing these concerns. The ACCC remains concerned that the Applicants have commercial incentive to use the significant additional power conferred by the proposed arrangements for commercial gain, including by imposing preferred terms of trade on retailers.
215. Given the incentives of the Applicants in implementing the proposed arrangements, the ACCC considers that it is likely that public detriment will arise from the proposed arrangements in the form of:
- lessening of competition between tobacco manufacturers including by potentially limiting access of smaller manufacturers to retail outlets, and

- undermining public health outcomes and enforcement agencies' efforts to enforce tobacco control laws and their underlying policies.

Balance of public benefit and detriment

216. In general, the ACCC may grant authorisation if it is satisfied that, in all the circumstances, the proposed arrangements are likely to result in a public benefit, and that public benefit will outweigh any likely public detriment, including any lessening of competition.
217. The ACCC considers that, to the extent the proposed arrangements reduce the supply of illicit tobacco, they may result in public benefits in the form of reducing the loss of revenue by some retailers and wholesalers of licit tobacco products, reducing lost customs duties, increasing the level of compliance with regulatory requirements, and ensuring the effectiveness of regulatory measures around the sale of tobacco.
218. However, the ACCC is not satisfied that the proposed arrangements are likely to result in substantial reductions in the supply of illicit tobacco over and above the reductions that would be achieved through unilateral action without authorisation. The ACCC considers that the benefits likely to result from the proposed arrangements are reduced because the proposed arrangements can only target a portion of illicit tobacco sales. This may result in changes to, rather than reductions in, the supply of illicit tobacco. Further, the potential for these benefits to be achieved is reduced by the likelihood of legislative and regulatory responses to the enforcement problems the proposed arrangements are seeking to address, once these are implemented (noting that the timing of implementation is currently unknown).
219. The ACCC notes that the proposed arrangements involve agreement, and ongoing communication, between the three dominant participants in a concentrated market. The ACCC considers the proposed arrangements are likely to result in public detriment through reducing competition between manufacturers of tobacco and undermining public health outcomes and enforcement agencies' efforts to enforce tobacco control laws and their underlying policies. The Applicants have not satisfied the ACCC that the proposed arrangements are likely to result in public benefits that would outweigh these detriments.
220. For the reasons outlined in this determination, the ACCC is **not satisfied** that the proposed arrangements are likely to result in a public benefit that would outweigh the likely public detriment, including the detriment constituted by any lessening of competition that would be likely to result.

Determination

The application

221. Application A91550 was made using a Form A, under subsections 88(1) and 88(1A) of the CCA. Authorisation is sought to make and give effect to an arrangement between the Applicants to engage in joint and coordinated actions against retailers and wholesalers where the Applicants form the view that a retailer or wholesaler is supplying illicit tobacco, which may include agreeing to jointly cease supplying those retailers and wholesalers with tobacco products for an agreed period. Authorisation is sought as the proposed arrangement may

contain a cartel provision and/or be an exclusionary provision within the meaning of section 45 of the CCA.

The net public benefit test

222. For the reasons outlined in this determination, the ACCC is **not** satisfied, pursuant to sections 90(5A) and 90(5B) of the CCA, that in all the circumstances the arrangement for which authorisation is sought is likely to result in a public benefit that would outweigh any likely detriment to the public constituted by any lessening of competition arising from the proposed arrangement.
223. The ACCC is also **not** satisfied, pursuant to section 90(8) that the arrangement for which authorisation is sought is likely to result in such a benefit to the public that the proposed arrangement should be allowed to take place.
224. The ACCC therefore **denies** authorisation to application A91550.
225. This determination is made on 23 June 2017.
226. Any application to the Australian Competition Tribunal for review of the determination must be made on or before 14 July 2017.