



Australian  
Competition &  
Consumer  
Commission

# Determination

Application for authorisation

lodged by

**The Tobacco Co-operative of Victoria (TCV)  
for itself and on behalf of its members**

*in relation to*

- *Agreements between individual growers and the TCV to supply all tobacco grown to the TCV*
- *Arrangements whereby the TCV negotiates common terms conditions with cigarette manufacturers on behalf of member growers*
- *Provisions of growing agreements entered into by each grower with the TCV which, in effect, regulate the quantity of tobacco grown by each grower.*

**Date: 3 August 2005**

**Commissioners:**

Samuel  
Sylvan  
McNeill  
Smith  
King  
Willett

## **Executive summary**

The ACCC has decided to grant authorisation to applications A90941 – A90943 for five years.

On 29 November 2004 the Tobacco Co-operative of Victoria (TCV) lodged applications for authorisation A90941, A90942 and A90943 with the Australian Competition and Consumer Commission (ACCC).

The TCV has sought authorisation for itself and on behalf of its members for:

- exclusive dealing arrangements as between individual growers and the TCV for the supply of growers' tobacco through the TCV
- the negotiation by the TCV on behalf of Victorian tobacco growers for the adoption of common terms and conditions for the sale of Victorian growers' tobacco to each Australian cigarette manufacturer and
- implicit control over the quantity of tobacco able to be supplied by each grower to the TCV, which is currently governed by the growing entitlement attaching to the number of TCV shares held by each grower.

The ACCC granted interim authorisation to the proposed arrangements on 15 December 2004. This interim authorisation will remain in place until the date the ACCC's final determination comes into effect.

On 6 July 2005 the ACCC issued its draft determination proposing to grant authorisation to the proposed arrangements for five years.

### **Assessment of public detriment**

The ACCC considers there is likely to be minimal anti-competitive detriment as a result of the proposed collective bargaining arrangements, particularly given the competitive pressures from imported tobacco and within the industry. The ACCC is also satisfied that the arrangements do not inhibit competition between growers to improve the quality of tobacco supplied to manufacturers.

Given current excise legislation, the ACCC is also satisfied that preventing growers from supplying tobacco to anyone other than the TCV (and through the TCV, the only legal purchasers of tobacco) under the proposed arrangements will result in negligible public detriment.

In addition, the ACCC considers any detriment generated by restrictions on the quantity of tobacco each grower can supply is also likely to be minimal as the proposed arrangements do no more than match the aggregate quantity of tobacco grown to the legal domestic demand. Furthermore, growers will still compete on the quality of crops grown with higher quality crops attracting a premium price from manufacturers.

Whilst such arrangements could, in some industries, generate significant anti-competitive detriment, the ACCC considers that, given the highly regulated environment within which tobacco growers operate, in this instance the arrangements generate minimal anti-competitive detriment.

### **Assessment of public benefit**

The ACCC is satisfied that the proposed arrangements are likely to result in a benefit to the public, particularly by assisting to minimise the:

- incidence of excise tax avoidance through the illegal sale of tobacco
- health risks associated with the illegal sale of tobacco and
- incidence of criminal activity associated with the illicit trade in tobacco.

The ACCC is also satisfied that the proposed arrangements are likely to result in some cost savings through the central coordination of growing terms and conditions.

Finally, the ACCC considers that improving the bargaining power of growers, thereby providing growers with the opportunity for more effective input into contract terms and conditions will result in some, limited, public benefit.

### **Balance of public benefits and anti-competitive detriment**

Overall, on balance, the ACCC considers that in all the circumstances, the public benefit is likely to outweigh the public detriment.

## List of abbreviations

BATA	British American Tobacco Australia Limited
chop chop	Leaf tobacco sold illegally to avoid the government excise.
Excise Act	<i>Excise Act 1901</i>
PM	Philip Morris Limited
TCV	Tobacco Co-operative of Victoria
manufacturers	British American Tobacco Australia Limited and Philip Morris Limited.

# Contents

<b>1. INTRODUCTION .....</b>	<b>1</b>
THE APPLICATIONS FOR AUTHORISATION .....	1
DRAFT DETERMINATION .....	2
INTERIM AUTHORISATION .....	3
<b>2. BACKGROUND TO THE APPLICATION .....</b>	<b>4</b>
TOBACCO CO-OPERATIVE OF VICTORIA .....	4
CIGARETTE MANUFACTURERS .....	5
THE AUSTRALIAN TOBACCO LEAF INDUSTRY .....	5
HISTORY OF TOBACCO REGULATION IN AUSTRALIA .....	6
AUSTRALIAN TAXATION OFFICE LICENSING REQUIREMENTS .....	8
TOBACCO EXCISE .....	8
<b>3. THE APPLICATIONS FOR AUTHORISATION .....</b>	<b>10</b>
THE PROPOSED ARRANGEMENTS .....	10
<i>The Grower's Agreements</i> .....	11
<i>Purchasing Agreements</i> .....	11
<i>Threshing Agreements</i> .....	12
<b>4. SUBMISSIONS RECEIVED BY THE ACCC .....</b>	<b>14</b>
PRIOR TO THE DRAFT DETERMINATION .....	14
FOLLOWING THE DRAFT DETERMINATION .....	14
<b>5. THE PUBLIC BENEFIT TEST .....</b>	<b>15</b>
<b>6. ACCC EVALUATION .....</b>	<b>19</b>
THE RELEVANT MARKET .....	19
THE COUNTERFACTUAL .....	20
PUBLIC DETRIMENT .....	22
<i>Collective negotiations</i> .....	23
<i>Exclusive dealing</i> .....	25
<i>Restrictions on the quantity of tobacco supplied by growers</i> .....	26
PUBLIC BENEFITS .....	27
<i>Protection, preservation and maximisation of public excise and taxation revenue</i> ..	27
<i>Effective and efficient contract negotiations</i> .....	30
<i>Minimising the monopolistic or duopolistic tendencies of tobacco manufacturers</i> ..	32
BALANCE OF PUBLIC BENEFIT AND DETRIMENT .....	34
DURATION OF AUTHORISATION .....	35
<b>7. DETERMINATION .....</b>	<b>36</b>
THE APPLICATIONS .....	36
THE PUBLIC BENEFIT TEST .....	37
CONDUCT FOR WHICH THE ACCC PROPOSES TO GRANT AUTHORISATION .....	37
INTERIM AUTHORISATION .....	38
DATE AUTHORISATION COMES INTO EFFECT .....	38

# 1. INTRODUCTION

- 1.1. The Australian Competition and Consumer Commission (the ACCC) is the Australian Government agency responsible for administering the *Trade Practices Act 1974* (the TPA). A key objective of the TPA is to prevent anti-competitive arrangements or conduct, thereby encouraging competition and efficiency in business, resulting in greater choice for consumers in price, quality and service.
- 1.2. The TPA, however, allows the ACCC to grant immunity from legal action for anti-competitive conduct in certain circumstances. One way in which parties may obtain immunity is to apply to the ACCC for what is known as an 'authorisation'. Broadly, the ACCC may 'authorise' businesses to engage in anti-competitive arrangements or conduct where it is satisfied that the public benefit from the arrangements or conduct outweighs any public detriment.
- 1.3. The ACCC conducts a comprehensive public consultation process before making a decision to grant or deny authorisation. Upon receiving an application for authorisation, the ACCC invites interested parties to lodge submissions outlining whether they support the application or not, and their reasons for this.
- 1.4. The TPA requires that the ACCC then issue a draft determination in writing proposing either to grant the application (in whole, in part or subject to conditions) or deny the application. In preparing a draft determination, the ACCC will take into account any submissions received from interested parties.
- 1.5. Once a draft determination is released, the applicant or any interested party may request that the ACCC hold a conference. A conference is generally called by a party dissatisfied with the ACCC's decision and provides interested parties with the opportunity to put oral submissions to the ACCC in response to a draft determination. The ACCC will also invite interested parties to lodge written submissions on the draft.
- 1.6. The ACCC then reconsiders the application taking into account the comments made at the conference (if one is requested) and any further submissions received and issues a written final determination. Should the public benefit outweigh the public detriment the ACCC may grant authorisation. If not, the authorisation may be denied.
- 1.7. The ACCC also has the power to grant interim authorisation, at the time the application is lodged or at a later stage. Interim authorisation protects the arrangements for which authorisation is sought from legal action under the TPA while the ACCC considers and evaluates the merits of the application.

## **The applications for authorisation**

- 1.8. On 29 November 2004 the TCV lodged applications for authorisation A90941, A90942 and A90943 with the ACCC.

- 1.9. Authorisation is sought under application A90941 for the TCV to make and give effect to a contract, arrangement or understanding, a provision of which would be, or might be, an exclusionary provision within the meaning of section 45 of the TPA.
- 1.10. Application A90942 seeks authorisation for the TCV to make and give effect to a provision of a contract, arrangement or understanding, a provision of which would have the purpose, or would have or might have the effect of substantially lessening competition within the meaning of section 45 of the TPA.
- 1.11. Application A90943 seeks authorisation for the TCV to engage in conduct that constitute or may constitute the practice of exclusive dealing.
- 1.12. Broadly, the TCV seeks authorisation for itself and on behalf of its members for:
- exclusive dealing arrangements as between individual growers and the TCV for the supply of growers' tobacco through the TCV
  - the negotiation by the TCV on behalf of Victorian tobacco growers for the adoption of common terms and conditions for the sale of Victorian growers' tobacco to each Australian cigarette manufacturer and
  - implicit control over the quantity of tobacco able to be supplied by each grower to the TCV, which is currently governed by the growing entitlement attaching to the number of TCV shares held by each grower.
- 1.13. The TCV seeks authorisation for a period of approximately ten years until 1 January 2015.

#### **Draft determination**

- 1.14. On 6 July 2005 the ACCC issued a draft determination proposing to grant authorisation to the TCV for the proposed arrangements for five years.

### **Interim authorisation**

- 1.15. At the time of lodging the application, the TCV requested interim authorisation for the proposed arrangements.
- 1.16. On 15 December 2004 the ACCC granted interim authorisation to the TCV for:
- Exclusive dealing arrangements between the TCV and its grower members. Broadly, these arrangements require TCV members to supply all the member's tobacco grown in Victoria to the TCV and not to sell it to any other person without the agreement of the TCV.
  - Negotiation by the TCV on behalf of Victorian tobacco growers for, and the adoption of common terms and conditions in respect of, the sale of Victorian growers' tobacco to each Australian cigarette manufacturer.
  - Potential exclusionary provisions in growing agreements entered into between the TCV and growers which allow the TCV to control the quantity of tobacco able to be supplied by each grower.



## 2. BACKGROUND TO THE APPLICATION

### Tobacco Co-operative of Victoria

- 2.1 In the early 1990's the Australian tobacco leaf industry was deregulated. Prior to deregulation import tariffs protected local growers. A statutory marketing body, the Tobacco Leaf Marketing Board of Victoria (TLMBV), controlled tobacco production through a quota system and was responsible for marketing all tobacco grown by Victorian growers.
- 2.2 The Tobacco Co-operative of Victoria (TCV) was formed on 30 September 1994, following the abolition of the TLMBV. The TCV was instructed by the Victorian government to coordinate and streamline tobacco farming sales in Victoria. Since this date, the TCV has marketed all of Victoria's legally grown tobacco leaf.
- 2.3 The TCV is the representative body for Victoria's 135 tobacco growers.<sup>1</sup> It is a constituted company established both under the *Corporations Act 2001* and the *Co-operatives Act 1996 (Vic)* with all shares held by its member growers. Initially, shares were distributed free of charge to all growers electing to remain in the industry post deregulation. The amount of shares received by growers was based on their previous growing quota.
- 2.4 TCV growers are able to sell their shares to other members or new entrants to the industry, subject to the TCV's minimum and maximum shareholding limits, Australian Taxation Office (ATO) licensing requirements, approval by the TCV Board of Directors and the TCV's Rules. A minimum of 8000 shares must be held by a member.
- 2.5 The TCV's Rules (Appendix 2) set out the requirements to maintain active membership of the TCV, including:<sup>2</sup>
- the member must comply with each provision of the Growers Agreement entered into with the TCV (discussed in further detail at paragraph 3.10)
  - the member must comply with standards, specifications and directions which may be prescribed from time to time by the Board of the TCV concerning the quality, method of growing and packaging of tobacco leaf, infrastructure requirements and transportation processing treatment for tobacco bales supplied to the TCV and
  - the TCV may from time to time prescribe a quantity of tobacco for each growing year which the member is required to supply through the TCV.

---

<sup>1</sup> TCV supporting submission, 29 November 2004, p26.

<sup>2</sup> Ibid, p8.

## **Cigarette manufacturers**

- 2.6 The TCV sells tobacco on behalf of growers to two cigarette manufacturers – British American Tobacco Australia Limited (BATA) and Philip Morris Limited (PM). The TCV advises that for all practical purposes, it has no other customers.<sup>3</sup>

### *British American Tobacco Australia Limited*

- 2.7 BATA is a wholly owned subsidiary of British American Tobacco. British American Tobacco has 87 cigarette factories in 66 countries worldwide. In 2003, it processed 660 million kilos of tobacco leaf and produced 792 billion cigarettes globally.<sup>4</sup>
- 2.8 BATA has 43.5 percent share of the Australian cigarette market and produces a wide range of tobacco products including cigarette brands such as Winfield, Dunhill and Benson and Hedges.<sup>5</sup>
- 2.9 Since 2003 BATA has sourced all of its domestic tobacco requirements from Victoria.<sup>6</sup>

### *Philip Morris Limited*

- 2.10 PM is a subsidiary of Philip Morris International. Philip Morris International has 50 cigarette factories around the world.<sup>7</sup> In 2004, Philip Morris International's operating income was \$6.6 billion.
- 2.11 PM processes tobacco leaf and manufacturers tobacco products at its premises in Moorabbin, Victoria. Cigarette brands manufactured locally include Alpine, Longbeach and Peter Jackson.

## **The Australian tobacco leaf industry**

- 2.12 The TCV submits that the market for Australian domestic tobacco leaf has declined significantly in recent years. For example, in 1993, the tobacco growing industry supported around 600 growers across Queensland, Victoria and New South Wales. Approximately 60 per cent of the crop was produced in Queensland, 36 per cent in Victoria and 4 per cent in New South Wales. In 1993, sales of Australian grown leaf tobacco amounted to 12.7 million kilograms, with a total value of \$78.2 million.<sup>8</sup>

---

<sup>3</sup> TCV supporting submission, 29 November 2004, p10.

<sup>4</sup> Ibid, p27.

<sup>5</sup> British American Tobacco Australia website: [www.bata.com.au](http://www.bata.com.au), viewed 4 May 2005.

<sup>6</sup> Ibid.

<sup>7</sup> Philip Morris International website: [www.philipmorrisinternational.com](http://www.philipmorrisinternational.com), viewed 4 May 2005.

<sup>8</sup> TCV supporting submission, 29 November 2004, p25.

- 2.13 Today, the vast majority of Australian-grown tobacco is grown on approximately 1400 hectares near Myrtleford in northeast Victoria. In particular, tobacco is grown within a 110 kilometre radius of Myrtleford, near the valleys of the Ovens, King, Buffalo and Kiewa Rivers and surrounding districts. Approximately 4 million kilograms of tobacco are produced in Victoria each growing season, with an approximate value of \$27 million (including excise tax).<sup>9</sup>
- 2.14 The average grower produces 30 000 kilograms of tobacco each year on an average farm size of 40 hectares. Growers earn an average gross revenue of \$200 000 per annum and average net profits are \$20 000 per annum.<sup>10</sup>
- 2.15 The ACCC is advised that there are only six tobacco growers remaining in southern Queensland. They produce approximately 120 000 kilograms of tobacco per year under contract to manufacturers.<sup>11</sup> The ACCC understands that there are no remaining tobacco growers in New South Wales.
- 2.16 Australian tobacco manufacturers import approximately 16 million kilograms of tobacco each year, in addition to domestic tobacco purchased through the TCV. Imports are valued at approximately \$75.5 million (wholesale) per annum. The main sources of imported tobacco are the United States of America, Brazil, India, Africa and South East Asia.<sup>12</sup>
- 2.17 Australia growers produce a very small proportion of the world's tobacco. China is the largest producer, with a 59 per cent market share, followed by Brazil (with 11 per cent) and the USA (with 6 per cent). By comparison, in 1994 Australia accounted for 0.2 per cent of the world's tobacco production.<sup>13</sup>

#### **History of tobacco regulation in Australia<sup>14</sup>**

- 2.18 From the 1960's to 1990's the Australian tobacco industry was regulated by complimentary Commonwealth and State Government legislation and a series of tobacco industry stabilisation plans (TISP's).
- 2.19 By way of support for the domestic tobacco industry, the Commonwealth government introduced the Local Leaf Content Scheme in 1936. This scheme required cigarette manufacturers to use a prescribed proportion of Australian grown tobacco – initially 7.5 per cent and then later increased to 50 per cent in 1965 under the TISP.

---

<sup>9</sup> TCV supporting submission, 29 November 2004, p25.

<sup>10</sup> Ibid, p26.

<sup>11</sup> Ibid.

<sup>12</sup> Ibid.

<sup>13</sup> Ibid.

<sup>14</sup> The information under this heading is taken from the TCV's supporting submission, pp 2 to 4.

- 2.20 Under the *Tobacco Marketing Act 1965*, all Australian tobacco growers and manufacturers agreed, through the Australian Tobacco Marketing Authority (previously known as the Australian Tobacco Board), on annual aggregate marketing quota levels, grades of tobacco leaf to be marketed and the price of each grade. An import tariff was also introduced.
- 2.21 In Victoria, the *Marketing of Primary Products Act 1958* established the Tobacco Leaf Marketing Board of Victoria (TLMBV) as the statutory marketing authority. All tobacco grown in Victoria was vested by law in the TLMBV. The *Tobacco Leaf Stabilisation Act 1966* (Vic) was introduced to compliment the *Tobacco Marketing Act 1965*.
- 2.22 In practice, this meant that all Victorian tobacco growers were issued with a growing entitlement to grow tobacco by the TLMBV. The growers were then issued a selling entitlement (which was an entitlement to sell quota tobacco up to a fixed limit) from the Victorian Tobacco Quota Committee. Provided that the crop reached a minimum quality grade, all tobacco grown within the limits of the growers' selling entitlements was marketed directly to the manufacturers on behalf of the growers by the TLMBV.
- 2.23 In 1993, the Victorian government announced a tobacco industry restructure package, which incorporated the introduction of the *Tobacco Leaf Industry (Deregulation) Act 1994*, repealing previous Victorian tobacco legislation. At this time, the Victorian government provided approximately \$3 million to tobacco growers to assist the restructure of the industry. The Rural Finance Corporation used these funds to purchase growing entitlements (at \$2 per kilogram) from growers who elected to leave the industry. At this time, 68 growers left the industry.
- 2.24 Further, in 1995-96 quotas imposed on individual growers were abolished, the statutory requirement on manufacturers to acquire local tobacco leaf was also abolished and import tariffs were reduced to zero. As previously mentioned, the TLMBV was also wound up around this time and its assets vested in the TCV. Therefore, the previous quota system was replaced with shares in the TCV, which allow growers to supply tobacco in direct proportion to the TCV's aggregate annual contracts with manufacturers.

## **Australian Taxation Office licensing requirements**

2.25 Today, the growing of tobacco is strictly regulated by the Australian Taxation Office (ATO) under the *Excise Act 1901* (Excise Act). Under the Excise Act, a potential grower must obtain a producer licence from the ATO. ATO licensing requirements prescribe the TCV's involvement in storing, controlling and monitoring the movement of all Victorian grown tobacco. In particular, the Excise Act provides that a licence granted to a Victorian grower is conditional upon the grower:<sup>15</sup>

- baling all tobacco within seven days of curing and then moving all tobacco grown to the TCV's storage facility within 7 days of baling
- applying the grower's individual ATO licence identification number (issued by the TCV) to each bale immediately after baling
- acquiring within three months of the conditional licence and maintaining thereafter an 'approved shareholding' in the TCV
- providing documentary evidence of the shareholding in the TCV to the ATO within seven days of acquiring such evidence
- acquiring and maintaining a TCV approved alarm system for the licence holder's storage sheds and kilns
- not producing tobacco seed, leaf or product of any sort without an approved licence and TCV shareholding and
- leaving all tobacco which is deemed 'out of quota' (that is, it does not comply with the current grade and price schedule) with the TCV for destruction.

## **Tobacco excise**

2.26 The Australian government imposes an excise tax on tobacco products sold in Australia. It receives considerable taxation revenue from these charges. More than 60 per cent of the retail price of a packet of cigarettes is accounted for by excise.<sup>16</sup> For the 2003/2004 financial year, the total value of excise collected from tobacco sales was approximately \$5.2 billion.<sup>17</sup>

---

<sup>15</sup> TCV supporting submission, 29 November 2004, p16.

<sup>16</sup> Ibid, p15.

<sup>17</sup> TCV supporting submission, 29 November 2004, Annexure D, p1.

- 2.27 Until 1 November 1999, excise duty was levied according to the weight of the tobacco manufactured product – in the case of cigarettes, on the total weight of the cigarette (that is including paper and filter but not packaging) and for loose tobacco, on the weight of the tobacco alone.<sup>18</sup>
- 2.28 In August 1998, the government announced its decision to introduce a ‘per stick’ tobacco excise system to replace the existing weight based system. The weight-based system enabled manufacturers to minimise costs by reducing the weight of each cigarette and packaging more cigarettes in larger packs. These cigarettes were much cheaper per cigarette and attractive to price sensitive smokers. The price of high volume, low weight cigarettes rose as a result of the introduction of the ‘per stick’ excise duty.<sup>19</sup>
- 2.29 As at 1 February 2005, the excise paid per stick on a cigarette containing 0.8 milligrams of tobacco is 22.621 cents per stick. Tobacco products containing more than 0.8 milligrams of tobacco are charged excise at a weight based rate of \$282.76 per kilogram.<sup>20</sup>

---

<sup>18</sup> Department of Health and Ageing website:  
<http://www.health.gov.au/internet/wcms/publishing.nsf/Content/health-publth-strateg-drugs-tobacco-taxation.htm-copy7> viewed 5 May 2005.

<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

### **3. THE APPLICATIONS FOR AUTHORISATION**

- 3.1 On 29 November 2004 the TCV lodged applications for authorisation A90941, A90942 and A90943 with the ACCC.
- 3.2 Application A90941 was lodged under section 88(1) of the TPA for the TCV to make and give effect to a contract, arrangement or understanding, a provision of which would be, or might be, an exclusionary provision within the meaning of section 45 of the TPA.
- 3.3 Broadly, an exclusionary provision exists where the proposed contract, arrangement or understanding is made by businesses (at least two of whom are competitors) for the purpose of preventing, restricting or limiting the supply of services to particular persons or classes of persons by all or any of the parties to the contract, arrangement or understanding.<sup>21</sup>
- 3.4 Application A90942 was lodged under section 88(1) of the TPA for the TCV to make and give effect to a provision of a contract, arrangement or understanding, a provision of which would have the purpose, or would have or might have the effect of substantially lessening competition within the meaning of section 45 of the TPA.
- 3.5 Application A90943 was lodged under section 88(8) of the TPA for the TCV to engage in conduct that constitutes or may constitute the practice of exclusive dealing.
- 3.6 Broadly exclusive dealing involves one person who trades with another, imposing restrictions on the other's freedom to choose with whom, or in what, it deals.

#### **The proposed arrangements**

- 3.7 The TCV seeks authorisation on its own behalf and on behalf of its members for:
- exclusive dealing arrangements as between individual growers (who are members of the TCV) and the TCV for the supply of growers' tobacco through the TCV
  - the negotiation by the TCV on behalf of its members for the adoption of common terms and conditions in respect of the sale of Victorian growers' tobacco to cigarette manufacturers and
  - implicit control over the quantity of tobacco able to be supplied by each grower to the TCV, which is currently governed by the growing entitlement attaching to the number of TCV shares held by each grower.

---

<sup>21</sup> Section 4D, *Trade Practices Act 1974*.

- 3.8 The collective negotiations between the TCV and tobacco manufacturers are in relation to:
- the amount of tobacco to be grown each year under the Purchasing Agreements
  - the grade and price schedules for tobacco applicable to each season and
  - the arrangements and fee scales applicable under the Threshing Agreements.
- 3.9 The TCV advises that it negotiates as agent for each member grower pursuant to the Grower's Agreements and the growers are bound by the arrangements and agreements entered into annually between the TCV and the manufacturers.

#### *The Grower's Agreements*

- 3.10 Under the Grower's Agreement, a member of the TCV:
- appoints the TCV as the member's exclusive agent for the sale, marketing and invoicing of tobacco leaf grown in Victoria at the best price obtainable by the TCV for the grade of leaf supplied<sup>22</sup> and
  - must supply and deliver to the TCV all the member's tobacco grown in Victoria and may not sell it to any other person, unless otherwise agreed with the TCV.<sup>23</sup>
- 3.11 Individual growers are not able to opt out of the Grower's Agreement.
- 3.12 Practically therefore, all tobacco grown by member growers is stored under high security at the TCV's premises and sold on a collective basis. The TCV does not take ownership of tobacco leaf at any stage. Sales to the manufacturers are held between March and September each year, with each sale session taking three or four days.

#### *Purchasing Agreements*

- 3.13 The TCV collectively negotiates on behalf of its members a price and grade schedule for tobacco and the volume of tobacco able to be grown for each season.
- 3.14 In particular, representatives from the TCV negotiate separate Purchasing Agreements with the two cigarette manufacturers –BATA and PM. These agreements provide for the purchase by each manufacturer of an agreed base amount of tobacco on a 'run of crop basis' in the first season of those agreements.

---

<sup>22</sup> Clause 2.1 of the Grower's Agreement.

<sup>23</sup> Clause 5(a) of the Grower's Agreement.



- 3.15 Based on the manufacturers anticipated tobacco requirements, the TCV advises its members of the total amount of tobacco able to be grown and delivered for sale during the next season. The TCV then polls all grower members to determine how much (if any) they intend to grow in that season.<sup>24</sup>
- 3.16 Shares in the TCV grant a grower the entitlement to supply a certain amount of tobacco in direct proportion to the TCV's aggregate annual contracts with the manufacturers. For example, assuming the manufacturers require 3.8 million kilograms of tobacco, each TCV share would entitle a grower to supply 1.204 kilograms of tobacco – that is, 3.8 million kilograms divided by 3 155 224 shares.<sup>25</sup>
- 3.17 To the extent that a grower member does not fully utilise their grower entitlement, that entitlement is again apportioned pro rata across all other members who wish to grow more than their existing grower entitlement.<sup>26</sup>
- 3.18 In subsequent seasons, the TCV is required to provide for sale a minimum amount of tobacco as prescribed by each Purchasing Agreement – these minimum amounts form the basis for determining the total amount of tobacco to be grown in the relevant season. This minimum amount may be exceeded by an amount (if any) negotiated at the beginning of each season by the relevant manufacturer and the TCV.
- 3.19 For each season, the TCV also negotiates the grade and price schedule for tobacco with each manufacturer individually. Each grade of tobacco is defined according to the plant composition, colour and quantity.
- 3.20 For example, in 2004 the grade and price schedule contained thirty different prices and approximately 84 grades of tobacco, ranging from a high of \$8.30 to \$1.50 per kilogram of tobacco.
- 3.21 The TCV submits that it aims to negotiate a grade and price schedule which is, as near as possible, the same for each manufacturer, the practical result being that one grade and price schedule emerges from negotiations in each season.
- 3.22 The Purchasing Agreements are subject to periodic reviews and renegotiation between the TCV and each manufacturer separately.

### *Threshing Agreements*

- 3.23 Threshing is the first stage of tobacco processing prior to cigarette manufacture, which is aimed at ensuring optimum conditions during storage. The TCV undertakes threshing on behalf of manufacturers to their individual specifications at its sales plant in Myrtleford, Victoria.

---

<sup>24</sup> TCV supporting submission, 29 November 2004, p10.

<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

- 3.24 The TCV enters into separate agreements for the threshing of each manufacturer's tobacco. These agreements are negotiated separately (both from the Purchasing Agreements and with each manufacturer). The TCV advises that it charges each manufacturer for threshing services essentially at cost.

## **4. SUBMISSIONS RECEIVED BY THE ACCC**

### **Prior to the draft determination**

- 4.1 The TCV provided a supporting submission with its applications for authorisation.
- 4.2 The ACCC also sought submissions from interested parties, including cigarette manufacturers, government departments of agriculture and the ATO. The ACCC received public submissions in response from BATA and PM. Both BATA and PM support the applications for authorisation.

### **Following the draft determination**

- 4.3 On 6 July 2005 the ACCC issued its draft determination in relation to the applications for authorisation. The draft determination proposed to grant authorisation.
- 4.4 A conference was not requested in relation to the draft determination.
- 4.5 The ACCC received no submissions in response to the draft determination.
- 4.6 The views of the TCV and interested parties are outlined in the ACCC's evaluation of the arrangements in Chapter 6 of this determination. Copies of public submissions are available on the ACCC's website ([www.accc.gov.au](http://www.accc.gov.au)) by following the 'Public Registers' and 'Authorisations Public Registers' links.

## **5. THE PUBLIC BENEFIT TEST**

- 5.1 The ACCC may only grant authorisation if the relevant public benefit test in section 90 of the TPA is satisfied.

### **Application A90941**

- 5.2 The TCV lodged application A90941 under section 88(1) of the TPA to make and give effect to a contract, arrangement or understanding, a provision of which would be, or might be, an exclusionary provision within the meaning of section 45 of the TPA.
- 5.3 The relevant public benefit test for this application is found in sub-sections 90(8)(a) and 90(8)(b) of the TPA.
- 5.4 In respect of the making of the arrangements, section 90(8)(a) provides that the ACCC shall not make a determination authorising a proposed exclusionary provision of a contract, arrangement or understanding, unless it is satisfied in all the circumstances that the proposed provision would result or be likely to result in such a benefit to the public that the proposed contract, arrangement or understanding ought be authorised.
- 5.5 In respect of the giving effect to the arrangements, section 90(8)(b) provides that the ACCC shall not make a determination authorising a provision of a contract, arrangement or understanding that is, or may be, an exclusionary provision unless it is satisfied in all the circumstances that the provision has resulted, or is likely to result, in such a benefit to the public that the contract, arrangement or understanding ought be authorised.

### **Application A90942**

- 5.6 The TCV lodged application A90942 under section 88(1) of the TPA to make and give effect to a provision of a contract, arrangement or understanding, a provision of which would have the purpose, or would have or might have the effect of substantially lessening competition within the meaning of section 45 of the TPA.
- 5.7 The relevant public benefit test for this application is found in sub-sections 90(6) and 90(7) of the TPA.

- 5.8 In respect of the making of the arrangement, section 90(6) of the TPA provides that the ACCC shall not make a determination authorising a provision of a proposed contract, arrangement or understanding, other than an exclusionary provision, unless it is satisfied in all the circumstances that:
- the provision of the proposed contract, arrangement or understanding would result, or be likely to result, in a benefit to the public and
  - this benefit would outweigh the detriment to the public constituted by any lessening of competition that would result, or be likely to result, if the proposed contract or arrangement was made and the provision concerned was given effect to.
- 5.9 In respect of the giving effect to the arrangement, section 90(7) of the TPA provides that the ACCC shall not make a determination authorising a provision of a contract, arrangement or understanding, other than an exclusionary provision, unless it is satisfied in all the circumstances that:
- the provision of the contract, arrangement or understanding has resulted, or is likely to result, in a benefit to the public and
  - this benefit outweighs, or would outweigh, the detriment to the public constituted by any lessening of competition that has resulted, or is likely to result, from giving effect to the provision.

#### **Application A90943**

- 5.10 Application A90943 was lodged under section 88(8) of the TPA for the TCV to engage in conduct that constitutes or may constitute the practice of exclusive dealing.
- 5.11 The relevant public benefit test for this application is found in sub-section 90(8)(a) of the TPA. This section provides that the ACCC shall not make a determination authorising proposed conduct that constitutes, or may constitute, exclusive dealing, unless it is satisfied that in all the circumstances the proposed conduct would result, or be likely to result, in such a benefit to the public that the proposed conduct should be allowed to take place.

#### **Application of the tests**

- 5.12 While there is some variation in the language between the test in sub-section 90(6) and the test in sub-section 90(8), the ACCC has until recently adopted the previous view of the Trade Practices Tribunal (now the Australian Competition Tribunal) that, in practical application, the tests are essentially the same.<sup>27</sup>

---

<sup>27</sup> *Re Media Council of Australia (No 2)* (1987) ATPR at 40-774; *Re 7-Eleven Stores Pty Ltd* (1994) ATPR 41-357.

- 5.13 This view has been reconsidered by the Australian Competition Tribunal (the Tribunal) and it has found that the two tests are not precisely the same.<sup>28</sup> In particular the Tribunal considered that the test under section 90(6) was limited to a consideration of those detriments arising from a lessening of competition. It was the Tribunal's view that the test under section 90(8) was not so limited.
- 5.14 However, with respect to the TCV's applications, the ACCC is satisfied that the public detriments resulting from the arrangements arise directly from a lessening of competition. Consequently, the differences in the tests identified by the Tribunal do not affect the assessment of the current applications.

### **Definition of public benefit and public detriment**

- 5.15 Public benefit is not defined by the TPA. However, the Tribunal has stated that the term should be given its widest possible meaning. In particular, it includes:

...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principle elements ... the achievement of the economic goals of efficiency and progress.<sup>29</sup>

- 5.16 Similarly, public detriment is not defined in the TPA but the Tribunal has given the concept a wide ambit. It has stated that the detriment to the public includes:

...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.<sup>30</sup>

### **Future with-and-without test**

- 5.17 The ACCC also applies the 'future with-and-without test' established by the Tribunal to identify and weigh the public benefit and anti-competitive detriment generated by arrangements for which authorisation has been sought.
- 5.18 Under this test, the ACCC compares the public benefit and anti-competitive detriment generated by arrangements in the future if the authorisation is granted with those generated if the authorisation is not granted. This requires the ACCC to predict how the relevant markets will react if authorisation is not granted. This prediction is referred to as the 'counterfactual'.

---

<sup>28</sup> *Australian Association of Pathology Practices Incorporated* [2004] ACompT 4; 7 April 2004.

<sup>29</sup> *Re 7-Eleven Stores; Australian Association of Convenience Stores Incorporated and Queensland Newsagents Federation* (1994) ATPR ¶ 41-357 at 42677. The Tribunal recently followed this in *Qantas Airways Limited* [2004] ACompT9.

<sup>30</sup> *Ibid* at 42683.

**Term of authorisation**

- 5.19 Section 91(1) of the TPA allows the ACCC to grant authorisation for a specific period of time.
- 5.20 The ACCC may authorise different aspects of conduct for which authorisation is sought for different periods.

**Future parties**

- 5.21 Section 88(10) of the TPA provides that an authorisation may be expressed so as to apply to or in relation to another person who becomes a party to the proposed arrangements in the future. In this instance, as well as seeking authorisation for itself and its members, the TCV has also expressed its application so as to apply in relation to future parties.

## **6. ACCC EVALUATION**

- 6.1 The ACCC's evaluation is in accordance with the public benefit test outlined in Chapter 5 of this determination. As required by the test, it is necessary for the ACCC to assess and weigh the likely public benefits and anti-competitive detriments flowing from the proposed arrangements.

### **The relevant market**

- 6.2 The first step in assessing the public benefits and anti-competitive detriment of the conduct for which authorisation is sought is to consider the relevant market(s) in which that conduct occurs.
- 6.3 However, depending on the circumstances, the ACCC may not need to comprehensively define the relevant markets as it may be apparent that a net public benefit will or will not arise regardless of the scope of the defined market.
- 6.4 The TCV submits that the relevant area of competition is the Australian wholesale market for cured tobacco leaf. BATA supports this market definition.
- 6.5 In this matter, the ACCC is of the view that it is not necessary to comprehensively define the relevant market(s). In this respect, it is the ACCC's view that its assessment will not be overly affected by the possible variations in precise market definition.
- 6.6 The ACCC considers the market directly affected by this application for authorisation is the market for the wholesale supply of tobacco leaf to Australian manufacturers.
- 6.7 With respect to the wholesale supply of tobacco leaf to Australian manufacturers, the ACCC notes:
- there are currently 135 member tobacco growers of the TCV, 43 of which are family owned companies with the balance being individual farmers<sup>31</sup>
  - grower members of the TCV are effectively the only source of Australian grown threshed tobacco leaf
  - growers are responsible for all aspects of tobacco growing, including picking, curing, securing and storing tobacco leaf prior to delivery to the TCV's Myrtleford premises

---

<sup>31</sup> TCV supporting submission, 29 November 2004, p26.



- there is no statutory obligation for PM and BATA to acquire domestically grown tobacco leaf and significant amounts of imported tobacco (approximately 80 per cent) are used in the domestic manufacture of tobacco products
- where manufacturers do acquire local tobacco leaf they may only do so from growers granted a licence under the Excise Act
- manufacturers submit that as tobacco leaf can generally be sourced more cheaply overseas, they pay a premium for locally grown tobacco leaf for the production of certain domestic cigarette brands (for example, particular leaf qualities to which Australian consumers are accustomed) and
- the market price for 'chop chop' is approximately four to six times greater than the market rate paid by manufacturers.<sup>32</sup>

### **The counterfactual**

- 6.8 As noted in Chapter 5 of this determination, in order to identify and measure the public benefit and detriment generated by conduct, the ACCC applies the 'future with-and-without test'. This involves identifying a counterfactual; that is, the ACCC makes a judgement as to what, on the information and evidence before it, is the most likely situation without the authorisation.
- 6.9 The ACCC then compares the public benefit and public detriment arising in the future if authorisation is granted with the public benefit and detriment arising under the counterfactual.

#### *Application A90942 - collective bargaining*

- 6.10 With respect to the collective bargaining application for authorisation, the TCV submits that in the absence of authorisation, it is likely that manufacturers and all tobacco growers will be compelled to enter separate contract negotiations.<sup>33</sup>
- 6.11 BATA supports this view. In particular, it submits that in the absence of authorisation:
- ...it will be forced to deal with individual growers. As BATA requires a certain quantity of tobacco and requires different grades of tobacco (and therefore requires run of crop), it will still need to enter into contracts for supply of tobacco with a range of growers.<sup>34</sup>

---

<sup>32</sup> BATA submission, 24 January 2005, p8.

<sup>33</sup> TCV supporting submission, 29 November 2004, p29.

<sup>34</sup> BATA submission, 24 January 2005, p14.

- 6.12 Conversely, PM submits that conducting individual negotiations with Victorian growers is not the only counterfactual that is reasonable to anticipate. In particular, PM submits that it:

...acquires tobacco leaf through a variety of different arrangements in many countries, including through contract with intermediary companies who acquire and aggregate tobacco leaf directly from growers... Given the complexity and cost associated with negotiations with a large number of individual growers, PM would not wish to individually negotiate contracts with all growers. Accordingly, it is likely that some alternative scenario which avoids individual contracts between PM and growers would develop should authorisation be refused.<sup>35</sup>

- 6.13 Given that the proposed arrangements would be likely to raise concerns under the TPA, it is unlikely, absent authorisation, that the TCV will be able to collectively negotiate contracts on behalf of growers with tobacco manufacturers.
- 6.14 In addition, while it might be possible for an alternative intermediary organisation to be established to represent growers in negotiations with manufacturers, depending on the structure of any such organisation, similar issues under the TPA may also be raised. Furthermore, the establishment of such an organisation would also involve amending current excise legislation, which currently requires, among other things, for all licensed growers in Victoria to purchase an approved shareholding in the TCV.
- 6.15 Consequently, the ACCC considers that the most likely situation without the proposed arrangements is one where each tobacco grower would be required to individually negotiate the terms and conditions of their contract(s) with either PM or BATA, including the price and the quantity of tobacco grown.

*Applications A90942 and A90943 – control of the quantity of tobacco supplied by growers and the requirement that all tobacco must be supplied to the TCV*

- 6.16 The ACCC notes the supply restriction on growers under the proposed arrangements is reinforced by existing Commonwealth legislation. As mentioned previously, ATO licensing requirements stipulate that Victorian growers must, amongst other things:<sup>36</sup>
- bale all tobacco within seven days of curing and then move all tobacco grown to the TCV's storage facility within 7 days of baling
  - acquire within three months of the conditional licence, and maintain thereafter, an 'approved shareholding' in the TCV
  - not produce tobacco seed, leaf or product of any sort without an approved licence and TCV shareholding and

---

<sup>35</sup> PM submission, 7 January 2005, p3.

<sup>36</sup> TCV supporting submission, 29 November 2004, p16.

- leave all tobacco which is deemed 'out of quota' (that is, it does not comply with the current grade and price schedule) with the TCV for destruction.
- 6.17 The ACCC notes that the ATO supports authorisation of the proposed arrangements, which underpin the ATO's existing excise compliance regime. Specifically, the arrangements are designed to ensure that tobacco is only grown in sufficient quantities to meet legal demand and is not available other than to PM and BATA.
- 6.18 In this regard, the ACCC considers that in the absence of authorisation, industry compliance with current excise legislation would need to be achieved by some other means otherwise there is a risk that the current excise regime would be undermined.

### **Public detriment**

- 6.19 As previously mentioned, the TCV seeks authorisation for:
- the negotiation by the TCV on behalf of its members for the adoption of common terms and conditions in respect of the sale of Victorian growers' tobacco to cigarette manufacturers
  - exclusive dealing arrangements as between individual growers (who are members of the TCV) and the TCV for the supply of growers' tobacco through the TCV and
  - implicit control over the quantity of tobacco able to be supplied by each grower to the TCV, which is currently governed by the growing entitlement attaching to the number of TCV shares held by each grower.
- 6.20 The ACCC notes the proposed arrangements the subject of the applications for authorisation have been ongoing since the deregulation of the tobacco industry in the early 1990's and are supported by the two cigarette manufacturers the growers supply.
- 6.21 An assessment of the public detriment generated by the proposed arrangements, taking into account all submissions from interested parties, follows.

## **Collective negotiations**

- 6.22 The collective negotiations between the TCV and the manufacturers are in relation to:
- the amount of tobacco to be grown each year under the Purchasing Agreements
  - the grade and price schedules for tobacco applicable to each season and
  - the arrangements and fee scales applicable under the Threshing Agreements.
- 6.23 A major feature of most collectively negotiated agreements is an agreement as to the (generally common across the bargaining group) price to be paid to the group and other terms and condition of supply or acquisition.
- 6.24 Competition between buyers or sellers ordinarily directs resources to their most efficient or productive use. Where buyers or sellers collude on the terms or conditions of acquisition or supply, competition can be distorted and resources directed to less efficient uses.
- 6.25 This distortion in competition can often result in increased prices to consumers, less choice, lower quality of product or services and increased costs to producers than would otherwise exist.
- 6.26 In particular, agreements between competitors which interfere with the price at which they are willing to supply or acquire goods or services will ordinarily divert resources away from those more efficient uses and towards less efficient uses.
- 6.27 This is the foundation of the principles of competition and, as such, Parliament has deemed agreements between competitors as to price to substantially lessen competition in breach of the TPA.<sup>37</sup>
- 6.28 Aside from price, businesses compete on issues such as quality, service and other terms of trade. Just as price agreements stifle competition on price, non-price agreements can stifle competition in areas such as quality and service.
- 6.29 In its past consideration of collective bargaining arrangements the ACCC has accepted that where collective bargaining results in an increased price being paid to the bargaining group, or reduced competition on other terms of supply, where there is capacity for any such increase to be passed on in the form of higher prices, less choice or lower quality of products offered to consumers, this could constitute an anti-competitive detriment. However, the extent of the detriment and the impact on competition of the collective agreement will depend upon the specific circumstances involved.

---

<sup>37</sup> Section 45A of the TPA

- 6.30 In the current application, the TCV negotiates the total quantity of tobacco to be supplied by growers and the grade and price schedule for tobacco with each manufacturer individually. However, the TCV submits that it aims to negotiate a grade and price schedule which is, as near as possible, the same for each manufacturer. The practical result being that one grade and price schedule emerges from negotiations in each season.<sup>38</sup>
- 6.31 Each grade of tobacco is defined according to the plant composition, colour and quantity. The TCV submits it attempts to obtain the best possible price for each grade of tobacco.<sup>39</sup> For example, in 2004 the grade and price schedule contained 30 different prices and approximately 84 different grades of tobacco, ranging from a high of \$8.30 to \$1.50 per kilogram of tobacco.<sup>40</sup>
- 6.32 The TCV submits its ability to increase the price paid to growers is constrained by competition provided by imported tobacco leaf. In this regard, the ACCC notes manufacturers are no longer required by legislation to use a percentage of locally grown tobacco leaf. Whilst cigarette manufacturers submit they prefer a certain percentage of locally grown tobacco leaf to manufacture certain domestic cigarette brands, the ACCC notes a significant proportion (currently 80 per cent) of tobacco used in domestic production is imported, at a lower cost to manufacturers.
- 6.33 Both manufacturers submit they pay a premium for particular grades of domestically grown tobacco leaf. In this regard, PM believes that under the proposed arrangements, there is still effective competition between growers to produce tobacco to meet the volumes and qualities required by PM. In particular, it considers:
- By offering a price premium for better grades of tobacco leaf, PM has actively encouraged Victorian growers to compete more effectively not only between themselves but also against imported product by increasing the production of higher quality products.<sup>41</sup>
- 6.34 Similarly, BATA submits that the negotiation of different grades of tobacco provides incentive to growers to improve the overall quality of domestic crops.<sup>42</sup>
- 6.35 The ACCC considers that the capacity of growers to negotiate increases in prices paid to them as a result of bargaining collectively is also limited by competitive pressure in the industry. In this regard, the TCV submits that the overall target market for tobacco products is declining. As a result, manufacturers are seeking to maintain pressure on input costs in an effort to retain profitability, either through reducing Australian tobacco purchasing costs or by greater import substitution.<sup>43</sup>

---

<sup>38</sup> TCV supporting submission, 29 November 2004, p12.

<sup>39</sup> Ibid.

<sup>40</sup> TCV supporting submission, 29 November 2004, p12.

<sup>41</sup> PM submission, 7 January 2005, p2.

<sup>42</sup> BATA submission, 24 January 2005, p13.

<sup>43</sup> TCV supporting submission, 29 November 2004, p32.

- 6.36 Similarly, PM submits there is vigorous competition in the supply of manufactured tobacco products by suppliers such as BATA and PM and others. Competition between these producers exerts pressure upstream to tobacco growers to remain competitive in terms of production volumes, qualities and prices in line with end adult consumer demand for particular products.<sup>44</sup>
- 6.37 Given the incentives for growers to compete on the basis of quality under the proposed arrangements and the competitive pressure from imported tobacco and within the Australian industry, the ACCC considers there is likely to be minimal anti-competitive detriment as a result of the proposed collective bargaining arrangements.
- 6.38 The ACCC notes that in some industries collective bargaining can result in significant anti-competitive effects. However, in the context of the tobacco industry's regulatory environment the ACCC is satisfied in this instance that minimal anti-competitive detriment arises from the collective bargaining arrangements.

### **Exclusive dealing**

- 6.39 Broadly, exclusive dealing involves one person who trades with another, imposing restrictions on the other's freedom to choose with whom, or in what, it deals. Under the proposed arrangements, tobacco growers may not supply tobacco leaf for sale to anyone other than the TCV.
- 6.40 In particular, the Growers Agreement provides that a member of the TCV must:
- appoint the TCV as the member's exclusive agent for the sale, marketing and invoicing of tobacco leaf grown in Victoria<sup>45</sup> and
  - supply and deliver all tobacco grown to the TCV and not sell it to any other person, unless otherwise agreed with the TCV.<sup>46</sup>
- 6.41 As previously noted, the ACCC considers that the proposed arrangements underpin the ATO's regulation of tobacco growing. The ACCC notes that the objective of preventing growers supplying tobacco directly to sources other than the TCV is to prevent the illicit trade of tobacco, thereby maximising the collection of excise revenue from the sale of tobacco products.
- 6.42 As noted at paragraph 6.18, the ACCC considers that, absent the proposed arrangements, compliance with the ATO's regulations would need to be achieved by other means. Any alternative means of ensuring compliance would necessarily contain a similar restriction as the current arrangements on who tobacco growers can supply.

---

<sup>44</sup> PM submission, 24 January 2004, p2.

<sup>45</sup> Clause 2.1 of the Grower's Agreement.

<sup>46</sup> Clause 5(a) of the Grower's Agreement.

- 6.43 In addition, the ACCC notes that the proposed exclusive dealing arrangement does no more than prevent growers supplying tobacco other than to the only legal domestic purchasers. As previously noted, the manufacturers support the continued acquisition of tobacco via this arrangement.
- 6.44 For these reasons the ACCC considers there is negligible public detriment generated by the proposed exclusive dealing arrangement.

**Restrictions on the quantity of tobacco supplied by growers**

- 6.45 As outlined in paragraphs 3.14 - 3.16, under the proposed arrangements tobacco growers can only supply a fixed quantity of tobacco to the TCV, which is currently governed by the growing entitlement attached to the number of TCV shares held by each grower. The aggregate amount of tobacco negotiated with the two manufacturers under the Purchasing Agreements forms the basis for determining each grower's tobacco growing entitlement.
- 6.46 The ACCC notes the proposed arrangements are designed to ensure that tobacco is grown in only sufficient quantities to meet the legal domestic tobacco leaf supply requirements of the two manufacturers.
- 6.47 The TCV submits that no meaningful increase in competition would be likely to arise from altering the current arrangements. It contends that manufacturers would still largely determine the overall amount of tobacco to be grown in Victoria because they supply all lawful demand for retail related tobacco products.<sup>47</sup>
- 6.48 The ACCC notes that any un-used grower entitlement in a growing season is apportioned pro rata to all other growers who want to grow more tobacco than their existing entitlement allows.
- 6.49 Conversely, where a grower supplies a quantity of tobacco to the TCV in excess of their grower entitlement, and the TCV accepts the excess quantity, that volume is deducted from the amount a grower is entitled to deliver in the next growing season.
- 6.50 The ACCC considers the TCV's arrangements do no more than limit the aggregate quantity of tobacco supplied to that necessary to meet domestic legal demand.
- 6.51 The proposed arrangements do, however, limit, to some extent, the capacity for individual growers to compete to supply tobacco as each grower's growing entitlement is determined on a pro rata basis. Consequently, the capacity of an individual grower to realise any efficiencies which may be generated by growing greater quantities is reduced.

---

<sup>47</sup> Ibid, p34.

- 6.52 Having said this, manufacturers have submitted that the primary means by which competition between growers manifests itself is through competition over the quality of tobacco grown. Manufacturers pay a premium for higher grades of tobacco and both manufacturers have submitted that this facilitates effective competition between growers and provides incentives for growers to improve the quality of crops grown.
- 6.53 Consequently, the ACCC considers that the restriction on the quantity of tobacco each grower may supply to the TCV generates minimal anti-competitive detriment.
- 6.54 As noted in respect of the collective bargaining arrangements, the ACCC considers such conduct could result in significant anti-competitive effects in some industries. However, in the context of the tobacco industry's regulatory environment the ACCC is satisfied in this instance that minimal anti-competitive detriment arises from restricting the quantity of tobacco supplied by growers.

### **Public benefits**

- 6.55 The TCV submits that the arrangements will deliver substantial public benefits, including:
- the protection, preservation and maximisation of public excise and taxation revenue collected from the lawful production and sale of tobacco leaf and tobacco products
  - collective negotiation by the TCV on behalf of member growers is an effective and efficient means of conducting contract negotiations and
  - the minimisation of the monopolistic or duopolistic tendencies of the tobacco manufacturers.
- 6.56 An assessment of the public benefits claimed by the TCV, taking into account all submissions from interested parties, follows.

### **Protection, preservation and maximisation of public excise and taxation revenue**

- 6.57 The illegal trade of tobacco in Australia (commonly referred to as 'chop chop') involves the diversion of locally grown tobacco into illicit distribution paths. The ACCC understands that this diversion can take one of two forms. Namely, the theft of tobacco bales stored on farms or the direct sale of tobacco to illicit distributors, where growers can receive a price of around four to six times greater than they can receive selling tobacco to manufacturers through the TCV. The TCV submits that the value of lost taxation revenue as a result of this illegal trade is estimated to be \$400 - \$600 million per year.<sup>48</sup>

---

<sup>48</sup> TCV supporting submission, 29 November 2004, p33.



6.58 The TCV submits the conduct for which authorisation is sought assists the industry and the ATO in minimising this illegal trade of tobacco. In particular, it considers that, together with the ATO's licensing requirements (discussed in further detail at paragraph 2.25), the arrangements help to ensure that tobacco is:

- sufficiently secured as soon as possible on a grower's farm
- delivered as early as possible into high level security storage at TCV's premises and
- sold to recognised legal buyers only.<sup>49</sup>

6.59 The ATO considers the erosion of revenue from the diversion of tobacco into the illicit market is a concern. It also considers the TCV fulfils a number of important functions, including facilitating the sale of tobacco through a legitimate distribution network.<sup>50</sup>

6.60 BATA submits that the principle public benefit which flows from the proposed conduct 'stems from the role the TCV plays in combating the illegal trade in tobacco'. BATA agrees with the TCV's estimate of lost excise revenue, and considers that such revenue:

...provides public benefits by way of funding for education and health...<sup>51</sup>

6.61 In addition, BATA submits it is difficult to combat, and almost impossible to eradicate, the illegal trade in tobacco for the following reasons:

- The decline in demand for Australian tobacco leaf in part reflects the decline in demand for tobacco products generally.
- The structure of the of the Australian tobacco industry and, in particular, its relatively high labour costs, make the cost of Australian tobacco on the international market significantly more expensive than its international competitors.
- The high cost of tobacco production makes all the more attractive the ability to earn larger revenues from the sale of tobacco illegally. It estimates that growers who sell six bales of tobacco illegally can increase their income by up to \$48 000 compared to selling the bales legally (based on a price of \$8000 per bale).<sup>52</sup>

---

<sup>49</sup> TCV supporting submission, 29 November 2004, p33.

<sup>50</sup> Ibid, *Annexure D – Letter from the ATO to the TCV dated 18 November 2004*.

<sup>51</sup> BATA submission, 21 January 2005, p6.

<sup>52</sup> Ibid, p8.

- 6.62 In this regard, BATA submits the focus on fighting the illegal trade of tobacco has been, and is likely to continue to be, on the monitoring of tobacco production and the detection of the diversion of tobacco grown for supply illegally. Accordingly, this requires some means of monitoring the amount of tobacco grown and the amount sold legally.<sup>53</sup>
- 6.63 PM also supports this public benefit claim and submits that:
- ...the role that the TCV plays in licensing growers, and the benefits that accrue from the fulfilment of this role in reducing trade in chop chop, are likely to be reduced unless a peak organisation such as TCV continues to exist.<sup>54</sup>
- 6.64 BATA further submits that the protection of excise revenue is not the only public benefit that flows from minimising the sale of chop chop. It considers chop chop may pose additional health risks to consumers compared to legal tobacco. For example, chop chop may be cut with straw or dampened to increase its weight, which can increase the prevalence of mould and fungi spores that can enter the lungs and cause certain illnesses.<sup>55</sup> In support of this claim, BATA referred to a 2003 study by Dr Renee Bittoun, Director of the Smokers Clinic at St Vincent's Hospital Sydney<sup>56</sup>, which reported that smoking of chop chop has resulted in a number of emergency hospital admissions where prolific levels of mould in the chests of patients were found.
- 6.65 Under the arrangements for which authorisation is sought, the TCV strictly regulates the amount of tobacco grown by its members and to whom it is supplied. In particular, the arrangements are designed to ensure that:
- tobacco is grown only in sufficient quantities to meet the domestic tobacco leaf supply requirements of PM and BATA and
  - growers supply all tobacco grown in Victoria to the TCV and not to any other person.
- 6.66 As previously mentioned, the TCV has marketed all of Victoria's legally grown tobacco leaf since the mid 1990's. Over this period, the ACCC is advised that the ATO has worked closely with the TCV as part of its excise revenue protection strategy.<sup>57</sup> In this regard, the ATO submits that it relies heavily on the TCV's ability to control the tobacco leaf supply chain from growers to manufacturers. To facilitate this, in 2003 the government made a financial contribution towards construction costs of secure storage facilities owned and operated by the TCV.<sup>58</sup>

---

<sup>53</sup> Ibid.

<sup>54</sup> PM submission, 7 January 2005, p3.

<sup>55</sup> BATA submission, 21 January 2005, p7.

<sup>56</sup> Smoking Research Unit, Department of Psychological Medicine, University of Sydney NSW 2003, reported in the TSANZ Conference Correspondent Adelaide 2003 – see <http://www.thoracic.org.au/tuesdayconferencereportfinal.pdf> and <http://www.mydr.com.au/default.asp?article=3934>

<sup>57</sup> Ibid, Annexure D, Letter from ATO to TCV dated 18 November 2004.

<sup>58</sup> Ibid.

- 6.67 The ACCC considers controlling the quantity of tobacco grown in Victoria assists the monitoring of legal tobacco production and the detection of the diversion of tobacco into the illegal market. It also reduces the capacity for individual growers to grow more tobacco than their growing entitlement, as the loss of TCV membership would also result in the loss of the grower's only legal revenue source from the sale of tobacco. As such, the ACCC is of the view that controlling the quantity of tobacco grown by individual growers is likely to result in a benefit to the public to the extent that it assists in minimising the incidence of excise tax avoidance through illegal sales of tobacco.
- 6.68 The ACCC also notes there may be greater health risks to consumers associated with smoking illegal cigarettes. In particular, the ACCC understands that chop chop is not produced under normal health regulations and legal restrictions. Consequently, there is no quality control of its contents unlike legally manufactured tobacco products.<sup>59</sup> In this regard, the ACCC considers there may be additional benefits from reducing sales of chop chop to consumers.
- 6.69 Finally, the ACCC notes that trade in chop chop is, by definition, organised and controlled by persons acting illegally. As such, any initiative which reduces the availability of illegally grown tobacco is likely to reduce the incidence of criminal activity in the community more generally, which the ACCC also considers to be a public benefit.
- 6.70 As previously noted, the ACCC considers that in the absence of the proposed arrangements, industry compliance with current excise legislation would need to be achieved by some other means. That is, similar supply restrictions would likely to be imposed on growers. However, the ACCC notes the wide spread industry support for achieving compliance through the proposed arrangements. In this regard, the ACCC considers the proposed arrangements to be an efficient and effective means of ensuring compliance with the existing excise requirements and achieving the public benefits associated with such compliance.

### **Effective and efficient contract negotiations**

- 6.71 The TCV submits that efficiencies arise as a result of collectively negotiating on behalf of its members the terms and conditions for the sale of tobacco, including grade and price schedules and the volume to be grown in each season.

---

<sup>59</sup> Australian Government Department of Health and Ageing website, <http://www.health.gov.au> viewed 5 May 2005.

6.72 In particular, the TCV submits:

The manufacturers have asserted that, whilst individual contracts may be negotiated with growers, it is a more practical and efficient use of resources and operational effort for manufacturers to deal with Australian tobacco growers as a group via the TCV.<sup>60</sup>

6.73 PM supports the TCV's claim that collective negotiations are more efficient than individual negotiations between it and tobacco growers.

6.74 As previously mentioned, BATA considers the alternative to collective bargaining would be for it to individually negotiate terms and conditions of tobacco supply with a range of growers.

6.75 In considering previous applications for authorisation, the ACCC has noted that negotiation costs are likely to be lower in implementing a collective bargaining agreement involving a single, or small number, of negotiating processes than where the acquirer or supplier must negotiate and implement agreements with every business with which it deals. Where these savings are likely to be passed on in the form of lower prices to consumers, the ACCC has accepted that this would constitute a public benefit.

6.76 However, in instances where, absent authorisation, standard form contracts, with limited capacity for individual negotiation as to variations in those standard terms are likely to be employed, significant negotiation cost savings are unlikely to result from collective negotiations. That is to say, even where contracts are negotiated individually, in such circumstances there is likely to be little additional negotiating cost involved in doing so compared to a situation where a collective agreement is entered into.

6.77 In respect of the current application, the ACCC notes that, absent authorisation, negotiations would need to be undertaken by each manufacturer with up to 135 individual growers and in respect of up to 84 different grades of tobacco. Given the variety of grades of tobacco grown, individually negotiated contracts would need to be tailored to match each grower's product mix with each manufacturer's demand for each grade of tobacco. As noted by the TCV and PM, such negotiations are likely to involve considerable cost relative to a situation where negotiations are centrally coordinated through the TCV.

---

<sup>60</sup> TCV supporting submission, 29 November 2004, p31.

## **Minimising the monopolistic or duopolistic tendencies of tobacco manufacturers**

- 6.78 The TCV submits that under the collective bargaining arrangements it has a greater ability to influence the terms and conditions of the supply agreements entered into with PM and BATA. It submits that, due to the relative bargaining strength of the cigarette manufacturers, combined with the overall declining retail market for tobacco products, in the absence of authorisation manufacturers will continue to put pressure on input costs in an effort to retain profitability, either by reducing Australian purchasing costs or by greater import substitution.<sup>61</sup>
- 6.79 The TCV submits that in the past the manufacturers have attempted to exercise their buying power to lower prices for tobacco grades and impose conditions in the growing and presentation of tobacco for sale.<sup>62</sup>
- 6.80 BATA denies there is a large disparity in bargaining power between growers and manufacturers as claimed by the TCV. It submits that the TCV and its member growers are aware that BATA requires Australian tobacco leaf in the manufacture of certain brands of its cigarettes, for which it pays a premium. It also notes that growers, through the TCV, own the only working tobacco threshing plant in Australia.<sup>63</sup>
- 6.81 Similarly, PM contends there is not a significant imbalance in bargaining power between individual growers and cigarette manufacturers. PM submits that it has actively encouraged Australian growers to produce high quality tobacco products and has paid a price premium for such tobacco leaf. It believes that, rather than demonstrate unequal bargaining power, this illustrates that PM is reliant on growers to produce tobacco products of sufficient quality and quantity to allow it to compete successfully downstream.<sup>64</sup>
- 6.82 In the past, the ACCC has concluded that a mere change in the amount of bargaining power is not, in itself, a public benefit. Rather, the ACCC has focused on the likely outcomes resulting from the change in bargaining position flowing from the proposed arrangement for which authorisation is sought. It is these likely outcomes which are essential to the net public benefit test.
- 6.83 The ACCC recognises that there is a combination of factors which, in some circumstances, result in smaller businesses having very little bargaining power compared with larger businesses, particularly in a monopsony or oligopsony market.

---

<sup>61</sup> TCV supporting submission, 29 November 2005, p32.

<sup>62</sup> Ibid.

<sup>63</sup> BATA submission, 24 January 2005, p13.

<sup>64</sup> PM submission, 7 January 2005, p2.

- 6.84 The ACCC has previously considered numerous applications for small primary producers to collectively bargain with the processors to whom they supply. In its past consideration of these applications, the ACCC has generally found that the most common situation in the absence of an authorisation to collectively bargain, or some form of industry regulation, is one where primary producers offering a common good or service in similar circumstances are offered essentially standard form contracts with little capacity to negotiate variations on those standard terms or conditions. Such contracts are often offered on a 'take it or leave it' basis, with limited, if any, scope for the other party to have input into the terms of the contract.
- 6.85 In respect of the current application, the TCV has submitted that growers, as individuals, are in a weak bargaining position relative to multinational companies such as cigarette manufacturers, and that absent authorisation, growers would be compelled to enter arrangements substantially on the terms of the two cigarette manufacturers.
- 6.86 While the ACCC notes the manufacturers' claims that there is currently a level of interdependence between growers and the cigarette manufacturers, it considers that individual growers are likely to be in a comparatively weak bargaining position. The ACCC is of the view that individual growers are captive to the manufacturers in that there is no alternative source of legal demand for the product they supply. On the other hand, manufacturers are able to source the vast majority of their tobacco needs on the international market, as demonstrated by the fact that 80 per cent of tobacco used in the domestic manufacture of tobacco products is imported.
- 6.87 In addition, while manufacturers have submitted they pay a premium to source some grades of tobacco leaf domestically in order to satisfy the specific tastes of Australian consumers, the relative bargaining power of an individual grower in seeking to negotiate with the manufacturers is likely to be limited by the many other local growers from whom different grades of leaf could be sourced.
- 6.88 It is generally accepted that competition between buyers and sellers on terms and conditions of supply, through the process of arbitrage is likely to lead to an efficient outcome. Where either buyers or sellers are restricted in their ability to provide effective input into those terms and conditions, the most efficient outcome may not be achieved. There can therefore be a public benefit in collective bargaining arrangements that increase the effective input of the weaker party to the bargain.
- 6.89 In the current circumstances, the ACCC accepts that there is an imbalance in bargaining power between individual growers and cigarette manufacturers, which might, if growers were required to negotiate individually, limit their capacity to have effective input into contract terms and conditions.

- 6.90 The ACCC considers that the proposed collective bargaining arrangements will improve the growers' bargaining position in negotiations with manufacturers and provide a greater opportunity for growers, with the assistance of the TCV, to have more effective input into contract terms and conditions, which the ACCC considers generates some, limited, public benefit.

### **Balance of public benefit and detriment**

- 6.91 The ACCC may only grant authorisation if it is satisfied that, in all the circumstances, the proposed arrangements are likely to result in a public benefit that will outweigh any public detriment.
- 6.92 The ACCC is satisfied that the proposed arrangements are likely to result in a benefit to the public, particularly by assisting to minimise the:
- incidence of excise tax avoidance through the illegal sale of tobacco
  - health risks associated with the illegal sale of tobacco and
  - incidence of criminal activity associated with the illicit trade in tobacco.
- 6.93 The ACCC is also satisfied that the proposed arrangements are likely to result in some cost savings through the central coordination of growing terms and conditions.
- 6.94 Finally, the ACCC considers that improving the bargaining power of growers, thereby providing growers with the opportunity for more effective input into contract terms and conditions will result in some, limited, public benefit.
- 6.95 The ACCC considers there is likely to be minimal anti-competitive detriment as a result of the proposed collective bargaining arrangements, particularly given the competitive pressures from imported tobacco and within the industry. The ACCC is also satisfied that the arrangements do not inhibit competition between growers to improve the quality of tobacco supplied to manufacturers.
- 6.96 Given current excise legislation, the ACCC is also satisfied that preventing growers from supplying tobacco to anyone other than the TCV (and through the TCV, the only legal purchasers of tobacco) under the proposed arrangements will result in negligible public detriment.
- 6.97 The ACCC considers any detriment generated by restrictions on the quantity of tobacco each grower can supply is also likely to be minimal as the proposed arrangements do no more than match the aggregate quantity of tobacco grown to the legal domestic demand. In addition, growers will still compete on the quality of crops grown with higher quality crops attracting a premium price from manufacturers.

- 6.98 Overall, on balance, the ACCC considers that in all the circumstances, the public benefit is likely to outweigh the public detriment. This conclusion has been strongly influenced by the current regulatory environment of the tobacco industry.

**Duration of authorisation**

- 6.99 The TCV seeks authorisation for the proposed arrangements for approximately ten years until January 2015.
- 6.100 In general, authorising arrangements for a limited time period allows the ACCC, at the end of the period of authorisation, to evaluate whether the public benefits upon which its decision is made actually eventuate in practice and the appropriateness of the authorisation in the current market environment.
- 6.101 The ACCC proposes to grant authorisation for five years. Authorising the proposed arrangements for this period does not require that contracts entered into be for the duration of the authorisation.
- 6.102 It is open for the applicant to reapply for authorisation at the expiration of an authorisation. In the event that an application for reauthorisation is received by the ACCC, whether reauthorisation should be granted would be considered based on the circumstances at that time.
- 6.103 In addition, the ACCC may review the authorisation, prior to the expiry of the authorisation, if there has been a material change of circumstance since the authorisation was granted.



## 7. Determination

### The applications

- 7.1 On 29 November 2004 the Tobacco Co-operative of Victoria (TCV) lodged applications for authorisation A90941, A90942 and A90943 with the Australian Competition and Consumer Commission (ACCC).
- 7.2 Application A90941 was made using Form A, Schedule 1 of the *Trade Practices Regulations 1974*. The application was made under subsection 88(1) of the *Trade Practices Act 1974* (TPA) for the TCV and its members to make and give effect to a contract, arrangement or understanding, a provision of which would be, or might be, an exclusionary provision within the meaning of section 45 of the TPA.
- 7.3 Application A90942 was made using Form B, Schedule 1 of the *Trade Practices Regulations 1974*. The application was made under subsection 88(1) of the TPA for the TCV and its members to make and give effect to a provision of a contract, arrangement or understanding, a provision of which would have the purpose, or would have or might have the effect of substantially lessening competition within the meaning of section 45 of the TPA.
- 7.4 Application A90943 was made using Form E, Schedule 1 of the *Trade Practices Regulations 1974*. The application was made under subsection 88(8) of the TPA for the TCV and its members to engage in conduct that constitutes or may constitute the practice of exclusive dealing.
- 7.5 In particular, the TCV seeks authorisation for itself and on behalf of its members for:
- exclusive dealing arrangements as between individual growers and the TCV for the supply of growers' tobacco through the TCV
  - the negotiation by the TCV on behalf of Victorian tobacco growers for the adoption of common terms and conditions for the sale of Victorian growers' tobacco to each Australian cigarette manufacturer and
  - implicit control over the quantity of tobacco able to be supplied by each grower to the TCV, which is currently governed by the growing entitlement attaching to the number of TCV shares held by each grower.
- 7.6 The TCV has also expressed the application so as to apply in relation to future members of the TCV.

### **The public benefit test**

- 7.7 For the reasons outlined in Chapter 6 of the determination, the ACCC considers that in all the circumstances the arrangements for which authorisation is sought are likely to result in a public benefit that would outweigh the detriment to the public constituted by any lessening of competition arising from the arrangements.
- 7.8 The ACCC is also satisfied that the arrangements for which authorisation is sought are likely to result in such a benefit to the public that the arrangements should be allowed to take place.
- 7.9 The ACCC therefore **grants** authorisation to applications A90941, A90942 and A90943 for five years.
- 7.10 This determination is made on 3 August 2005.

### **Conduct for which the ACCC proposes to grant authorisation**

- 7.11 The authorisation granted by the ACCC extends to:
- exclusive dealing arrangements as between individual growers (who are members of the TCV) and the TCV for the supply of growers' tobacco through the TCV
  - the negotiation by the TCV on behalf of its members for the adoption of common terms and conditions in respect of the sale of Victorian growers' tobacco to each Australian cigarette manufacturer and
  - implicit control over the quantity of tobacco able to be supplied by each grower to the TCV, which is currently governed by the growing entitlement attaching to the number of TCV shares held by each grower.
- 7.12 The collective negotiations between the TCV and tobacco manufacturers are in relation to:
- the amount of tobacco to be grown each year under the Purchasing Agreements
  - the grade and price schedules for tobacco applicable to each season and
  - the arrangements and fee scales applicable under the Threshing Agreements.

### **Interim authorisation**

- 7.13 At the time of lodging the application, the TCV requested interim authorisation for the proposed arrangements. On 15 December 2004 the ACCC granted interim authorisation.
- 7.14 Interim authorisation will continue to protect the proposed arrangements from action under the TPA until the date the ACCC's final determination comes into effect or until the ACCC decides to revoke interim authorisation.

### **Date authorisation comes into effect**

- 7.15 This determination is made on 3 August 2005. If no application for review of the determination is made to the Australian Competition Tribunal (the Tribunal), it will come into force on 25 August 2005. If an application for review is made to the Tribunal, the determination will come into effect:
- where the application is not withdrawn – on the day on which the Tribunal makes a determination on the review, or
  - where the application is withdrawn – on the day on which the application is withdrawn.



Approved for Public Register

☒ YES / ☐ NO

Approved for Internet

☒ YES / ☐ NO

418105