

**Our reference**  
ECS/JC/BATA22169-9120903

**Your reference**  
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25 August 2016

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Dear Rami

## Application for authorisation

We act for British American Tobacco Australia Limited, Imperial Tobacco Australia Limited and Philip Morris Limited (together, the '**Applicants**').

The Applicants wish to apply for authorisation.

## Application documentation

On behalf of the Applicants, I attach:

- (a) completed Form A and supporting submission; and
- (b) a copy of the Anti-illicit Tobacco Cooperation Deed that was made between the Applicants today (25 August 2016) and which is provided pursuant to section 44ZZRM.

## Application fee

We are processing an EFT for the \$7,500 application fee today. We will send you the EFT receipt once the payment has been processed.

## Further information

Please contact me if you have any queries or require further information.

Yours faithfully  
**Corrs Chambers Westgarth**



**Eddie Scuderi**  
Partner

# Form A

Commonwealth of Australia

*Competition and Consumer Act 2010 — subsections 88 (1A) and (1)*

## **EXCLUSIONARY PROVISIONS AND ASSOCIATED CARTEL PROVISIONS: APPLICATION FOR AUTHORISATION**

To the Australian Competition and Consumer Commission:

Application is hereby made under subsection(s) 88 (1A)/88 (1) of the *Competition and Consumer Act 2010* for an authorisation:

- to make a contract or arrangement, or arrive at an understanding, a provision of which would be, or might be, a cartel provision within the meaning of Division 1 of Part IV of that Act and which would also be, or might also be, an exclusionary provision within the meaning of section 45 of that Act.
- to give effect to a provision of a contract, arrangement or understanding that is, or may be, a cartel provision within the meaning of Division 1 of Part IV of that Act and which is also, or may also be, an exclusionary provision within the meaning of section 45 of that Act.
- to make a contract or arrangement, or arrive at an understanding, where a provision of the proposed contract, arrangement or understanding would be, or might be, an exclusionary provision within the meaning of section 45 of that Act.
- to give effect to a provision of a contract, arrangement or understanding where the provision is, or may be, an exclusionary provision within the meaning of section 45 of that Act.

*(Strike out whichever is not applicable)*

PLEASE FOLLOW DIRECTIONS ON BACK OF THIS FORM

### **1. Applicant**

- (a) Name of Applicant:  
*(Refer to direction 2)*

A91550 This application is made by British American Tobacco Australia Limited, Imperial Tobacco Australia Limited and Philip Morris Limited (together, the '**Applicants**').

- (b) Description of business carried on by applicant:  
*(Refer to direction 3)*

The Applicants are suppliers of legal tobacco products in Australia, including manufactured cigarettes and loose tobacco sold to consumers by authorised retailers of those products.

- (c) Address in Australia for service of documents on the applicant:

Corrs Chambers Westgarth  
Level 42, 111 Eagle Street  
Brisbane QLD 4000

## **2. Contract, arrangement or understanding**

- (a) Description of the contract, arrangement or understanding, whether proposed or actual, for which authorisation is sought:

*(Refer to direction 4)*

Please refer to the supporting submission attached to this Form A.

- (b) Description of those provisions of the contract, arrangement or understanding described at 2 (a) that are, or would or might be, exclusionary provisions and (if applicable) are, or would or might be, cartel provisions:

*(Refer to direction 4)*

Please refer to the supporting submission attached to this Form A for details about the relevant provisions of the proposed arrangement.

- (c) Description of the goods or services to which the contract, arrangement or understanding (whether proposed or actual) relate:

Please refer to the attached supporting submission for further details about the illicit tobacco products affected by the proposed arrangement.

- (d) The term for which authorisation of the provision of the contract, arrangement or understanding (whether proposed or actual) is being sought and grounds supporting this period of authorisation:

The Applicants seek authorisation for a period of 5 years.

## **3. Parties to the proposed arrangement**

- (a) Names, addresses and descriptions of business carried on by other parties or proposed parties to the contract or proposed contract, arrangement or understanding:

As noted above, each of the Applicants are in the business of supplying legal tobacco products in Australia. The names and addresses of the Applicants are:

- (i) British American Tobacco Australia Limited  
166 William Street  
Woolloomooloo NSW 2011

- (ii) Imperial Tobacco Australia Limited  
Level 4 4/ 8 Inglewood Place  
Baulkham Hills NSW 2153

(iii) *Until 30 April 2017:*

Philip Morris Limited  
252 Chesterville Road  
Moorabbin VIC 3189

*From 1 May 2017:*

Philip Morris Limited  
30 Convention Centre Place  
South Wharf VIC 3006

- (b) Names, addresses and descriptions of business carried on by parties and other persons on whose behalf this application is made:  
(Refer to direction 5)

Not applicable

#### **4. Public benefit claims**

- (a) Arguments in support of application for authorisation:  
(Refer to direction 6)

Please refer to the supporting submission attached to this Form A.

- (b) Facts and evidence relied upon in support of these claims:

Please refer to the supporting submission attached to this Form A.

#### **5. Market definition**

Provide a description of the market(s) in which the goods or services described at 2 (c) are supplied or acquired and other affected markets including: significant suppliers and acquirers; substitutes available for the relevant goods or services; any restriction on the supply or acquisition of the relevant goods or services (for example geographic or legal restrictions):  
(Refer to direction 7)

Please refer to the supporting submission attached to this Form A.

#### **6. Public detriments**

- (a) Detriments to the public resulting or likely to result from the contract arrangement or understanding for which authorisation is sought, in particular the likely effect of the contract arrangement or understanding, on the prices of the goods or services described at 2 (c) and the prices of goods or services in other affected markets:  
(Refer to direction 8)

Please refer to the supporting submission attached to this Form A.

- (b) Facts and evidence relevant to these detriments:

Please refer to the supporting submission attached to this Form A.

## **7. Contracts, arrangements or understandings in similar terms**

- (a) This application for authorisation may also be expressed to be made in relation to other contracts, arrangements or understandings or proposed contracts, arrangements or understandings, that are or will be in similar terms to the abovementioned contract, arrangement or understanding:

- (b) Is this application to be so expressed?

No.

- (c) If so, the following information is to be furnished:

- (i) description of any variations between the contract, arrangement or understanding for which authorisation is sought and those contracts, arrangements or understandings that are stated to be in similar terms:

*(Refer to direction 9)*

Not applicable.

- (ii) Where the parties to the similar term contract(s) are known — names, addresses and descriptions of business carried on by those other parties:

*(Refer to direction 10)*

Not applicable.

Where the parties to the similar term contract(s) are not known — description of the class of business carried on by those possible parties:

Not applicable.

## **8. Joint Ventures**

- (a) Does this application deal with a matter relating to a joint venture (See section 4J of the *Competition and Consumer Act 2010*)?

No.

- (b) If so, are any other applications being made simultaneously with this application in relation to that joint venture?

Not applicable.

- (c) If so, by whom or on whose behalf are those other applications being made?

Not applicable.

**9. Further information**

- (a) Name, postal address and telephone contact details of the person authorised by the applicant seeking authorisation to provide additional information in relation to this application:

Eddie Scuderi  
Partner  
Corrs Chambers Westgarth  
Level 42, 111 Eagle Street  
Brisbane QLD 4000

Dated **25 August 2016**

Signed on behalf of the Applicants

A handwritten signature in black ink, appearing to be 'ES' with a long horizontal stroke extending to the right.

.....  
(Signature)

Eddie Scuderi  
(Full Name)

Corrs Chambers Westgarth  
(Organisation)

Partner  
(Position in organisation)

## DIRECTIONS

1. Use Form A if the contract, arrangement or understanding includes a provision which is, or might be, a cartel provision and which is also, or might also be, an exclusionary provision. Use Form B if the contract, arrangement or understanding includes a provision which is, or might be, a cartel provision or a provision which would have the purpose, or would or might have the effect, of substantially lessening competition. It may be necessary to use both forms for the same contract, arrangement or understanding.

In lodging this form, applicants must include all information, including supporting evidence, that they wish the Commission to take into account in assessing their application for authorisation.

Where there is insufficient space on this form to furnish the required information, the information is to be shown on separate sheets, numbered consecutively and signed by or on behalf of the applicant.

2. Where the application is made by or on behalf of a corporation, the name of the corporation is to be inserted in item 1 (a), not the name of the person signing the application and the application is to be signed by a person authorised by the corporation to do so.
3. Describe that part of the applicant's business relating to the subject matter of the contract, arrangement or understanding in respect of which authorisation is sought.
4. Provide details of the contract, arrangement or understanding (whether proposed or actual) in respect of which the authorisation is sought. Provide details of those provisions of the contract, arrangement or understanding that are, or would or might be, exclusionary provisions. Provide details of those provisions of the contract, arrangement or understanding that are, or would or might be, cartel provisions.

In providing these details:

- (a) to the extent that any of the details have been reduced to writing, provide a true copy of the writing; and
  - (b) to the extent that any of the details have not been reduced to writing, provide a full and correct description of the particulars that have not been reduced to writing.
5. Where authorisation is sought on behalf of other parties provide details of each of those parties including names, addresses, descriptions of the business activities engaged in relating to the subject matter of the authorisation, and evidence of the party's consent to authorisation being sought on their behalf.
  6. Provide details of those public benefits claimed to result or to be likely to result from the proposed contract, arrangement or understanding including quantification of those benefits where possible.
  7. Provide details of the market(s) likely to be effected by the contract, arrangement or understanding in particular having regard to goods or services that may be substitutes for the good or service that is the subject matter of the application for authorisation.

8. Provide details of the detriments to the public, including those resulting from any lessening of competition, which may result from the proposed contract, arrangement or understanding. Provide quantification of those detriments where possible.
9. Where the application is made also in respect of other contracts, arrangements or understandings, which are or will be in similar terms to the contract, arrangement or understanding referred to in item 2, furnish with the application details of the manner in which those contracts, arrangements or understandings vary in their terms from the contract, arrangements or understanding referred to in item 2.
10. Where authorisation is sought on behalf of other parties provide details of each of those parties including names, addresses, and descriptions of the business activities engaged in relating to the subject matter of the authorisation, and evidence of the party's consent to authorisation being sought on their behalf.



## **Attachment to Form A**

### **EXCLUSIONARY PROVISIONS AND ASSOCIATED CARTEL PROVISIONS: APPLICATION FOR AUTHORISATION**

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

25 August 2016

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# 1 Introduction

This submission is jointly lodged by British American Tobacco Australia Limited (**BAT**), Imperial Tobacco Australia Limited (**ITAL**) and Philip Morris Limited (**PML**) (together, the **Applicants**) as part of an application for authorisation to which this submission is attached.

The Applicants' tobacco products are heavily controlled and regulated products that are imported and sold in compliance with a wide range of Commonwealth, State and Territory laws.

These include, but are not limited to, laws relating to customs and excise duties, plain packaging, product warning labels, fire risk reduction, retailer licensing and a range of point-of-sale restrictions.

In early 2016 over 160 submissions were made to a Federal Parliamentary committee established in December 2015 to examine the use and consequences of illicit tobacco in Australia.<sup>1</sup>

Based on those submissions and the Applicants' own research and investigations, the Applicants consider that there is clear, strong and building support for the view that the combination of plain packaging laws and the continuing rounds of excise increases on legal tobacco products is fuelling an increase in the importation, availability, supply of, and demand for, illicit tobacco products in Australia.

A recent bi-annual KPMG report commissioned by the Applicants estimates that the Australian illicit tobacco market accounted for 14% of tobacco consumption in 2015. This would amount to approximately \$1.49 billion in foregone excise revenue to the Commonwealth.<sup>2</sup>

The Applicants have become increasingly concerned about the trade in illicit tobacco with which their own heavily controlled, regulated and taxed tobacco products must directly compete. It is clear that other parties affected by the trade in illicit tobacco, from law enforcement agencies to health departments to small retailers that do not sell illicit tobacco are also concerned about the nature and increase in the trade in illicit tobacco.

Aside from being illegal pursuant to a raft of Commonwealth, State, Territory and local government laws (some of which impose criminal sanctions), the supply of illicit tobacco products has serious impacts on a range of public interest factors, including:

- (a) significant loss of Commonwealth revenue in the form of lost customs and excise duties and GST;
- (b) a burden on the time and resources of law enforcement agencies;

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<sup>1</sup> The Parliamentary committee is discussed in more detail under section 2.5 of this submission. Unfortunately, that committee ceased to exist due to the double dissolution on 9 May 2016.

<sup>2</sup> KPMG Illicit tobacco in Australia, 2015 Full Year Report, 15 April 2016, 6.

- (c) a funding source for serious and organised crime, which is known to be actively involved in the market for the importation and supply of illicit tobacco in Australia;
- (d) undermining of tobacco control measures, including plain packaging, and product warning labels;
- (e) damaging the business of legitimate retailers and wholesalers of tobacco products who find themselves having to compete with an illegal trade;
- (f) increased fire risk associated with the unknown compliance of illicit tobacco products with the mandatory requirements of the *Trade Practices (Consumer Product Safety Standard) (Reduced Fire Risk Cigarettes) Regulations 2008*<sup>3</sup> and
- (g) increased biosecurity risks (introduction of pests or disease) associated with the importation of illicit chop-chop tobacco.

The Applicants have a common objective of taking coordinated, measured and targeted steps to cease supply of their tobacco products to retailers and wholesalers that supply illicit tobacco products (as described in this submission). The Applicants submit that this objective is consistent with the ACCC's mandate (with respect to the authorisation process) to ensure that the proposed conduct has a net public benefit. The Applicants also submit that the public benefits test is satisfied for the following reasons:

- (a) the trade in illicit tobacco causes a range of serious public detriments and reducing that trade would help reduce these public detriments;
- (b) the conduct proposed by the Applicants is unlikely to have any material detrimental impact on competition in the Australian tobacco market, other than a detrimental impact on the ability of persons that supply illicit tobacco products to compete with those that supply lawful tobacco products; and
- (c) it is not in the interests of the Applicants to adopt a course of conduct that would result in the cessation of the supply of their lawful tobacco products to retailers or wholesalers who do not supply illicit tobacco because such conduct would have a detrimental impact on the sale of the Applicants' products. That is, the Applicants intend to adopt a careful, measured and evidence-based approach to identifying whether a retailer or wholesaler is supplying illicit tobacco and implement a process to warn and give that retailer an opportunity to cease supply of illicit tobacco before supply of the Applicants' legal tobacco products to that retailer or wholesaler is suspended or terminated.

The Applicants support the efforts of law enforcement agencies in Australia to counter the importation and supply of illicit tobacco. However, the Applicants consider that the law enforcement agencies have been, necessarily so,

<sup>3</sup> An example is the ACCC product recall action against Tap United Pty Ltd for the supply of Spoonbill Blue cigarettes that did not comply with the *Trade Practices (Consumer Product Safety Standard) (Reduced Fire Risk Cigarettes) Regulations 2008* (see product recall notice published 29 September 2015 at < <http://www.productsafety.gov.au/recall/tap-united-pty-limited-spoonbill-blue-cigarettes> >).

focussing their resources 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 lack of regular, effective and consistent prosecution of retailers and wholesalers may embolden some retailers and wholesalers to continue or increase their acquisition and resupply of illicit tobacco.

Even in the exceptional circumstance where action against a retailer results in a successful prosecution, based on the Applicants' research and investigations it is not uncommon for a retailer of illicit tobacco to simply recommence their supply of illicit tobacco soon after being prosecuted, presumably because such retailers find that the benefits of continuing to supply illicit tobacco outweigh the potential penalties.

The Applicants' research (and the investigations of federal agencies, such as the Department of Immigration and Border Protection) reveals that most of the trade in illicit tobacco to consumers is conducted through existing retailers.<sup>4</sup>

Such retailers typically also engage in conduct that involves supplying legal tobacco products of the Applicants as a front or cover for the retailer's trade in illicit tobacco,<sup>5</sup> as opposed to the far less desirable (for the offending retailer) and higher-risk conduct of overtly supplying only illicit tobacco.

The Applicants are in a unique position to disrupt this type of conduct by jointly ceasing supply of their legal tobacco products to illicit tobacco retailers identified by them.

Joint and coordinated action by the Applicants is essential if their disruption of such conduct is to be effective. This is because, if only one of the Applicants ceases supply, the offending retailer would be able to continue acquiring and supplying legal tobacco products of the other Applicants, allowing the retailer to continue to engage in the conduct of using legal tobacco sales as a front or cover for their supply of illicit tobacco.

Crucially, it is the Applicants' opinion that the ability of a retailer or wholesaler to supply legal tobacco products (such as those of the Applicants) which allows the retailer or wholesaler to more easily supply illicit tobacco products 'under-the-counter', that is, they use the supply of legal tobacco products as a front or cover for that illicit trade.

It also means that such retailers have the competitive advantage of two potential customers, one customer that will ask for legal tobacco by brand name and other customers that will ask for an illicit product. There is also the potential for such retailers to switch a consumer of legal tobacco products to illicit tobacco by offering them the choice.

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<sup>4</sup> For example, the Department of Immigration and Border Protection has stated: "The Department's investigations suggest that sales of illicit tobacco follow similar distribution and sales patterns as duty-paid tobacco, and that illicit tobacco is available from a number of traditional tobacconists and tobacco retailers." (Department of Immigration and Border Protection, Inquiry into Illicit Tobacco (Submission no. 77), 4).

<sup>5</sup> Ibid.

The Applicants' research indicates that over 70% of illicit tobacco is sourced by consumers from retailers of legal tobacco products, including independent supermarkets, tobacconists, convenience stores, service stations and newsagencies. Investigations by the Department of Immigration and Border Protection also suggest that sales of illicit tobacco follow similar distribution and sales patterns as duty-paid tobacco and is available for purchase from a number of traditional tobacconists and tobacco retailers.<sup>6</sup>

It is the Applicants' opinion that, if the ability of such a retailer or wholesaler to acquire and supply the Applicants' legal tobacco products is removed, so too is one of the key factors that permits them to conduct a trade in illicit tobacco.

The Applicants are the three major suppliers of legal tobacco products in Australia. This places them in a unique position to take coordinated, measured and targeted action to cease supply of their products to illicit tobacco retailers and wholesalers in a way that is likely to discourage the supply of illicit tobacco at the retail and wholesale level of the market.

The Applicants consider that current 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. The Applicants are in a unique position to be an effective and valuable complement to law enforcement efforts by discouraging the supply of illicit tobacco at the retail and wholesale level of the market.

Authorisation is sought for the Applicants to make and give effect to a deed between them to govern the process by which they will work together to identify, issue warning notices to and suspend or cease supply of their tobacco products to retailers and wholesalers who, despite written warnings or undertakings no longer to supply illicit tobacco products in Australia, continue to do so.

That deed will be subject to a condition precedent of the grant of final authorisation for the proposed contract (including giving effect to the contract) by the ACCC.

Authorisation is sought for the term of the contract (including options to extend), being a total period of 5 years.

Reference material cited in this submission (including in footnotes) is attached to this submission. An index to reference material is set out on page 22.

## **2 Background**

### **2.1 Laws and law enforcement**

A complex range of Commonwealth, State and Territory laws apply to the importation, supply and use of tobacco in Australia.

These include Commonwealth laws to regulate plain packaging, product warning notices and fire safety laws. For example, plain packaging laws are

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<sup>6</sup> Department of Immigration and Border Protection, Inquiry into Illicit Tobacco (Submission no. 77), 4.

the subject of the *Tobacco Plain Packaging Act 2011* (Cth) and the *Tobacco Plain Packaging Regulations 2011* (Cth), while fire safety laws are the subject of the *Trade Practices (Consumer Product Safety Standard) (Reduced Fire Risk Cigarettes) Regulations 2008* (Cth)).

State and Territory laws regulate the retailing of tobacco, bans on point-of-sale displays of tobacco products and bans on smoking in public places. State and Territory governments also administer the licensing of tobacco retailers, which is required in most States and territories of Australia.

The Department of Immigration and Border Protection (**DIBP**) (including its operational arm, the Australian Border Force) is responsible for detecting, deterring and disrupting the illicit trade of tobacco before the border, at the border and in the post-border environment.<sup>7</sup>

The DIBP is responsible for administering the *Customs Act 1901* and the *Customs Tariff Act 1995*. Customs duties are applied to imported tobacco products.

Illicit tobacco avoids customs duty because it is smuggled into the country or not declared.

The DIBP works in partnership with the Australian Taxation Office (**ATO**). The ATO is responsible for detecting, investigating and prosecuting illicit domestically grown or manufactured tobacco products (no commercial tobacco production licences have been granted in Australia since 2006).

The ATO is responsible for administering the *Excise Act 1901* (Cth) and the *Excise Tariff Act 1921* (Cth). Excise duties are applied to tobacco products manufactured or produced in Australia.

Illicit tobacco produced in Australia avoids excise duty because it is farmed and processed covertly, to avoid detection.

The ATO notes that illegal importation (not domestic production) is the major source of illicit tobacco products entering Australian retail markets.<sup>8</sup> It follows that the main revenue impact of illicit tobacco is on the loss of customs duties that would otherwise have applied to the importation of that tobacco, had it been declared.

The Australian Federal Police and relevant State, Territory and local government law enforcement divisions and bodies also play a role in enforcing legislation relevant to the importation and supply of illicit tobacco in Australia.

## **2.2 The Australian illicit tobacco market**

At the time of lodging this application for authorisation, the Australian illicit tobacco market comprises four distinct categories of illicit tobacco:

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<sup>7</sup> Department of Immigration and Border Protection, Inquiry into Illicit Tobacco (Submission no. 77), 3.

<sup>8</sup> Australian Tax Office, Parliamentary Joint Committee on Law Enforcement: Inquiry into Illicit Tobacco (Submission 16), 3.

<p><b>Contraband</b></p> <p>Genuine manufactured cigarettes that are sold without the payment of applicable excise taxes in Australia. Contraband cigarettes tend to have been bought in a low-tax country or acquired without taxes (for export purposes) and smuggled into Australia illegally for re-sale.</p> <p>Contraband also includes illicit whites. Illicit whites (known as 'cheap whites') are typically produced for the purpose of smuggling them into countries where they are not legitimately sold.</p>	
<p><b>Unbranded chop-chop or loose leaf tobacco</b></p> <p>Loose leaf tobacco commonly known as chop-chop carries no health warnings and is consumed as a substitute for legal roll-your-own (RYO) tobacco.</p> <p>Chop-chop is also inserted into empty cigarette tubes and sold pre-made in boxes at tobacco retailers.</p>	
<p><b>Counterfeit</b></p> <p>Illegal manufacturing in which a product bears a trademark without the owner's consent. Illegally manufactured products can be sold in the source country or smuggled into another country.</p> <p>The majority of counterfeit products are illegal copies of legitimate overseas brands. The Marlboro brand is particularly impacted by counterfeit conduct (see adjacent image for an example of counterfeit Marlboro cigarettes).</p> <p>Counterfeit cigarettes may also be supplied in plain packaging (see adjacent image for an example of counterfeit plain-pack 'Craven A' cigarettes).</p>	



### Illicit shisha

Shisha is flavoured tobacco which originates from the Middle East and North Africa. It is also goes by other names including 'molasses tobacco', 'narghile', 'maasal', 'tunback' and 'ajami'.

It is consumed through a water pipe (known as a 'hookah').

Shisha comes in a wide range of flavours, such as mint, lemon, orange and apple.

While shisha does not always contain tobacco, where it does, it must comply with Australian tobacco laws.<sup>9</sup>

Illicit shisha products do not comply with applicable Australian plain packaging, graphic health warning and/or excise duty laws.

The adjacent images depict illicit shisha products.



All four categories of tobacco described above are illegal because they contravene some or all of the laws referred to in section 2.1 of this submission.

For example:

- (a) **Contraband cigarettes** are smuggled into the country without the payment of applicable customs duties and often include trade marks and brand names in contravention of the plain packaging laws. They may also fail to include graphic health warnings that comply with Australian law;
- (b) **Unbranded chop-chop tobacco** is smuggled into the country or produced without the payment of applicable customs or excise duties and supplied without graphic health warnings and in contravention of plain packaging laws;
- (c) **Counterfeit cigarettes** are smuggled into the country without payment of customs duties and supplied in packaging that bears trade marks applied without the trade mark owner's consent and also in plain packaging formats; and

<sup>9</sup> See for example Department of Health guidance on how tobacco laws apply to shisha at <http://www.health.gov.au/internet/main/publishing.nsf/Content/tpp-shisha-fags>

- (d) **Illicit shisha** (that contains tobacco) is smuggled into the country and does not comply with plain packaging, graphic health warning and/or excise duty laws.<sup>10</sup>

The DIBP has stated that, in its experience, there are three types of illicit tobacco offenders:

- (a) organised criminal groups that use established domestic production or smuggling mechanisms to trade in a range of illicit commodities;
- (b) commercial enterprises that engage in the production or import and trade of illicit tobacco; and
- (c) opportunists who produce or smuggle tobacco primarily for personal use.<sup>11</sup>

Like the ATO, the Australian Crime Commission believes that most illicit tobacco is imported into Australia rather than grown domestically.<sup>12</sup> However, in the last 12 months there have been substantial seizures of locally grown tobacco, including:

- (a) in March 2015, a 32 hectare illegal tobacco crop in Merrigum, Victoria was discovered in a joint operation between the Australian Tax Office, Australian Federal Police and Victoria Police;<sup>13</sup>
- (b) in May 2015, an illegal tobacco crop with an estimated street value of \$1 million was seized on a farm in Undera in the Goulburn Valley, Victoria;<sup>14</sup> and
- (c) in April 2016, a 24 hectare illegal tobacco crop was seized in Dingwall, Victoria. The crop was estimated to have an excise value of approximately \$16 million and once manufactured would have made around 30 million cigarettes.<sup>15</sup>

Large-scale smuggling operations into Australia commonly involves commercial volumes of tobacco products:

- (a) in September 2015, a seizure by the Australian Border Force of 9 million Manchester branded cigarettes from the United Arab Emirates in an operation that involved corrupt waterfront officials and a crime syndicate involved in the supply of cocaine. The cigarettes had a black market value of \$5.4 million;<sup>16</sup>
- (b) in October 2015, the Australian Border Force seized a record haul of 71 tonnes of tobacco in 3 shipments destined for sale in Australia. The

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<sup>10</sup> Detections of illicit shisha products by the Australian Customs & Border Protection Service have occurred (see Australian Customs & Border Protection Service 2014-15 Annual Report, p 19).

<sup>11</sup> Ibid.

<sup>12</sup> Australian Crime Commission, Organised Crime in Australia 2015 Report, 2015, page 68.

<sup>13</sup> Tobacco crop bust at Merrigum, Kyabram Free Press, March 2015.

<sup>14</sup> Another big tobacco crop seized in Goulburn Valley, Weekly Times Now, May 2015.

<sup>15</sup> Illegal tobacco crop uncovered in Dingwall, Victoria, Weekly Times Now, April 2016.

<sup>16</sup> 12 charged, cocaine and \$700,000 seized after multi-million-dollar cigarette-smuggling operation busted in Sydney, ABC, September 2015.

tobacco had a street value of \$40 million and would have delivered the Government \$27 million in tax revenue;<sup>17</sup>

- (c) in October 2015, a haul of almost 6 million illicit cigarettes after raids of storage centres and homes in Melbourne;<sup>18</sup> and
- (d) in April 2016, the Australian Border Force and the Australian Federal Police dismantled a tobacco smuggling syndicate in Melbourne, seizing 13 million cigarettes, more than 8 tonnes of loose leaf tobacco and \$1.7 million in cash.<sup>19</sup>

In its submission to the Parliamentary committee inquiry into illicit tobacco, the Australasian Association of Convenience Stores (which claims to be the peak body for the convenience store industry in Australia) stated:

Awareness among small retailers in Australia of illicit tobacco is high and has increased since the introduction of plain packaging. Customers are aware of illicit tobacco and some are actively seeking it out.<sup>20</sup>

Regrettably, existing Government policy including relentless legal tobacco excise increases is putting further pressure on the legal tobacco market and heightening the demand for illicit tobacco among otherwise law-abiding consumers.<sup>21</sup>

The evidence on this score is clear: the more tax is applied to a packet of cigarettes, the more consumers will seek cheaper and potentially illegal alternatives. Criminal gangs have shown they are not only willing but very capable of filling any gaps in the legal tobacco market.<sup>22</sup>

Illicit tobacco is by very definition non-compliant. There are no product quality controls and criminals have no issue in selling tobacco to minors. The proliferation of non-compliant tobacco products of dubious quality is the direct result of Government regulations surrounding the retail of legal tobacco in Australia.<sup>23</sup>

The Australian illicit tobacco trade involves the importation and domestic production of illicit tobacco and the supply to consumers of all four categories of illicit tobacco.

The trade is driven by opportunists, criminal gangs and organised criminal groups, as well as wholesalers and retailers that choose to break the law by acquiring and resupplying illicit tobacco.

Illicit tobacco is acquired by consumers primarily through the existing channel of tobacco retailers that choose to sell illicit tobacco under-the-counter using legal tobacco as a front or cover.

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<sup>17</sup> Record haul of illegal tobacco worth \$40 million seized by Australian Border Force, ABC, October 2015; Department of Immigration and Border Protection, Inquiry into Illicit Tobacco (Submission no. 77), 5.

<sup>18</sup> Millions of cigarettes smuggled into Melbourne seized in raids, ABC, October 2015.

<sup>19</sup> Australian Border Force smashes tobacco smuggling ring, ABF Newsroom, April 2016.

<sup>20</sup> Association of Convenience Stores, Inquiry into Illicit Tobacco (Submission 21), 1.

<sup>21</sup> Ibid.

<sup>22</sup> Ibid.

<sup>23</sup> Ibid.

Consumers are becoming increasingly aware of the availability of illicit tobacco which, coupled with the increasing cost of legal tobacco products, is motivating consumers to seek out and acquire illicit tobacco.

### **2.3 Effectiveness of current enforcement approach**

The Applicants support the efforts of law enforcement agencies in Australia to stop the importation and supply of illicit tobacco.

However, the Applicants do not consider that those efforts are having any material impact on the supply of illicit tobacco at the retail or wholesale level of the market, for a number of reasons, including:

- (a) the enforcement efforts of Commonwealth agencies such as DIBP and the ATO are focussed much higher in the supply chain (on importation and tobacco leaf farming), not on wholesale or retail supply;
- (b) Commonwealth agencies acknowledge that successful investigation and prosecution is difficult and that there are inconsistencies in the laws they enforce, which can complicate enforcement;
- (c) the State, Territory and local government agencies that do have a mandate to target the supply of illicit tobacco at the retail and wholesale level often do not have sufficient resources to have any material impact on the supply of illicit tobacco or they have other higher-priority concerns that consume their resources; and
- (d) there is a disparate approach to enforcement between the States and Territories resulting in a lack of any coordinated approach to enforcement at a national level.

The conduct proposed by the Applicants in this submission may complement existing law enforcement efforts, particularly at the retail level of trade where the Applicants consider that enforcement efforts are currently not effective.

### **2.4 Involvement of organised crime**

A number of Commonwealth law enforcement agencies and Ministers have expressly acknowledged the role of organised crime in the Australian illicit tobacco market.

In a 2015 report titled 'Organised Crime in Australia', the Australian Crime Commission considered the illicit tobacco market in Australia and, among other observations, stated:

Organised crime remains entrenched within the illegal tobacco market in Australia. It continues to perceive involvement in this market as a low risk, high profit enterprise.<sup>24</sup>

There are indications that those groups involved in the market are highly networked and that they have made significant effort to gain a knowledge of Customs procedures, priorities and detection limitations.<sup>25</sup>

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<sup>24</sup> Australian Crime Commission, *Organised Crime in Australia* (2015), 68.

<sup>25</sup> *Ibid.*

It is highly likely that the illegal tobacco market will remain attractive for serious and organised crime groups because of the very large profits that can be made with very low risk.<sup>26</sup>

The Applicants note that these observations by the Australian Crime Commission:

- (a) support the Applicant's claims that current enforcement measures are not acting as a sufficient and effective deterrent to the trade in illicit tobacco (such that the risk of participating in that trade is currently seen as 'low risk'); and
- (b) that the 'very large' profits made by those participating in the trade in illicit tobacco are profits that are made at the cost of legitimate businesses along the entire legal tobacco supply chain.

The findings in the Australian Crime Commission report are consistent with the following observations of the Australian Federal Police in its submission to the Parliamentary committee inquiry into illicit tobacco:

The Polaris JWFT has established that the illicit tobacco market continues to remain attractive for organised crime syndicates, given the potential for the significant profits coupled with relatively low risk (compared to other illicit commodities such as drugs or firearms). It has also been established that profits derived from illicit tobacco provide funding for other criminal activities, the importation of border controlled drugs and counterfeit goods.

Minister Peter Dutton, Minister for Immigration and Border Protection, has stated:

There are clear links to organised crime and we know that groups smuggling illegal tobacco into Australia are also involved in other illegal activities such as narcotics.<sup>27</sup>

It is clear that organised crime is actively involved in and profiting from the demand and supply of illicit tobacco in Australia. The Applicants consider that there is now a serious and urgent need to take steps to reduce the attractiveness of the trade in illicit tobacco by organised crime in Australia.

## 2.5 **Parliamentary Joint Committee: Inquiry into Illicit Tobacco**

On 2 December 2015, the Parliamentary Joint Committee on Law Enforcement initiated an inquiry into illicit tobacco (**Inquiry into Illicit Tobacco**).

The terms of reference of the Committee were to examine the use and consequences of illicit tobacco in Australia, including the importation of contraband, counterfeit, and unbranded tobacco as well as domestically grown illicit tobacco.

The Committee was established to examine:

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<sup>26</sup> Australian Crime Commission, *Organised Crime in Australia* (2015), 69.

<sup>27</sup> Media release, Peter Dutton MP Minister for Immigration and Border Protection, Record illicit tobacco seizure leads to new strike team, October 2015.

- (a) the nature, prevalence and culture of illicit tobacco use in Australia, including in indigenous, regional and non-English speaking communities;
- (b) the role of Commonwealth law enforcement agencies in responding to the importation, use, manufacture, distribution and domestic growth of illicit tobacco;
- (c) the loss of revenue to the Commonwealth arising from the consumption of illicit tobacco products;
- (d) the involvement of organised crime, including international organised crime, in the importation, distribution and use of illicit tobacco in Australia;
- (e) the effectiveness of relevant Commonwealth legislation; and
- (f) other related issues.

The inquiry received over 160 submissions and held public hearings on 4 March 2016.<sup>28</sup>

At the double dissolution of the federal parliament on 9 May 2016, the parliamentary committees of the 44th Parliament ceased to exist. This inquiry has therefore lapsed and no report on the submissions made will be issued.

Nonetheless, submissions were made to the Committee and remain publicly available on the Parliament of Australia website.<sup>29</sup> These submissions are very current (having been made in early 2016) and include submissions by Commonwealth law enforcement agencies, several of which are cited in this submission as well as submissions by those participants in the legal tobacco market that are impacted by the unlawful trade in illicit tobacco.

## 2.6 How do consumers acquire illicit tobacco in Australia?

Investigations by the DIBP suggest that sales of illicit tobacco follow similar distribution and sales patterns as duty-paid tobacco and is available for purchase from a number of traditional tobacconists and tobacco retailers.<sup>30</sup>

The DIBP states:

In our 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 make a similarly conscious choice to purchase illicit tobacco.<sup>31</sup>

The DIBP's experience also indicates that there are people engaged in the legal tobacco supply chain who facilitate the illicit trade in tobacco, such as customs brokerage companies and freight forwarding firms.<sup>32</sup>

<sup>28</sup> Parliamentary Joint Committee on Law Enforcement: Inquiry into Illicit Tobacco.

<sup>29</sup> [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Joint/Law\\_Enforcement/Illicit\\_tobacco/Submissions](http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Law_Enforcement/Illicit_tobacco/Submissions)

<sup>30</sup> Department of Immigration and Border Protection, Inquiry into Illicit Tobacco (Submission no. 77), 4.

<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

The Applicants argue that a significant role is played by retailers of legal tobacco products that knowingly choose to supply illicit tobacco to consumers on an 'under-the-counter' basis.

It is the role played by illicit tobacco suppliers that will primarily be targeted by the contract and conduct proposed between the Applicants described in this submission.

### 3 Contract, arrangement or understanding

#### 3.1 Market share of the Applicants

The Applicants are the major suppliers of manufactured cigarettes and loose tobacco in Australia.<sup>33</sup>

All manufactured tobacco products that are lawfully supplied in Australia are imported as tobacco leaf or packaged (finished, ready for sale) product.

Tobacco can only be lawfully grown in Australia (for personal or commercial use) pursuant to an excise licence. There are no current licences for commercial tobacco crops in Australia. However, as noted in section 2.2 above, detections of illegal tobacco crops in Australia have occurred in the last 12 months.

#### 3.2 Proposed contract and arrangement between the Applicants

Each of the Applicants propose to individually identify an indefinite number of illegal tobacco suppliers and take action to encourage those suppliers (whether they be retailers or wholesalers) to cease acquiring and/or supplying illicit tobacco products.

In particular, the Applicants intend to achieve this by two different approaches, which are summarised below as the '*Covert purchase model*' and the '*Agency cooperation model*'.

##### ***Covert purchase model***

- (a) The Applicants will individually engage their own private investigators to make covert (mystery shopper) purchases of tobacco products from retailers and wholesalers around Australia.
- (b) The private investigators will be provided with a list of items which indicate whether a particular tobacco product purchased by them is or might be illicit tobacco.
- (c) If the private investigators identify purchased product(s) as constituting suspected illicit tobacco, they will provide a written report to the Applicant(s):
  - (i) identifying the name and street address of the retail store or wholesaler from which the potentially illicit tobacco product(s) was purchased;

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<sup>33</sup> KPMG LLC, Illicit tobacco in Australia, 2015 Full Year Report (15 April 2016), 11.

- (ii) stating the date and time of the purchase;
  - (iii) specifying the price at which the purchase was made (as evidenced by a receipt, if one is provided);
  - (iv) detailing the basis for their suspicion that the product(s) constitutes illicit tobacco; and
  - (v) attaching physical packaging evidence or other physical evidence, if any, in support of their belief that the product(s) purchased constitutes illicit tobacco;
- (d) Following receipt of the report and the corresponding tobacco product(s) acquired through covert purchases, the Applicants will perform, or arrange for the performance of, examination and testing of the acquired tobacco product(s) to determine whether the product acquired through covert purchase is illicit tobacco;
- (e) If the Applicants agree that the product(s) sold by the retailer/wholesaler (and acquired through one or more covert purchases) constitutes an illicit tobacco product, the Applicants will:
- (i) cause a letter to be served upon (or delivered by some other method that enables proof of delivery to be established), the retailer:
    - (A) advising of the fact that the retailer/wholesaler made a sale (with details of that sale) of suspected illicit tobacco product;
    - (B) identifying the reasons why the purchased tobacco is considered illicit;
    - (C) seeking a written undertaking from the retailer/wholesaler that they will cease and desist from selling illicit tobacco from a specified date; and
    - (D) advising that, should the retailer/wholesaler fail to provide the undertaking or to comply with it, the Applicants will cease to supply their products to the retailer/wholesaler until further notice;
  - (ii) at their election, the Applicants may jointly decide not to make further sales of their legal tobacco products to that retailer or wholesaler for an agreed period where the retailer or wholesaler:
    - (A) fails to provide the written undertaking referred to in paragraph 3.2(e)(i)(C); or
    - (B) having provided the written undertaking, subsequently breaches the undertaking as evidenced by a further covert purchase of illicit tobacco product from that retailer or wholesaler (the Applicants would cause the steps in paragraphs (c) and (d) to be performed with respect to the retailer/wholesaler after the undertaking had been given to determine compliance with the undertaking).



### ***Agency cooperation approach***

Upon one or more of the Applicants being advised of a successful prosecution of a retailer or wholesaler for the sale of illicit tobacco product, the Applicants may jointly decide not to make further sales of their tobacco products to that retailer or wholesaler (as applicable) for an agreed period and advise the retailer or wholesaler (as applicable) of the reasons for that decision in writing.

## **4 Period for which authorisation is sought**

Authorisation is sought for a limited period of 5 years to cover the term of the contract between the Applicants referred to in section 1 of this submission.

The Applicants submit that a 5 year period is a reasonable and relatively short period of authorisation that is appropriate for the Applicants to implement and assess the effectiveness of their proposed conduct.

## **5 Public benefits**

### **5.1 Introduction**

The DIBP has stated that:

The illicit trade in tobacco products in Australia significantly affects government, industry, healthcare and the economy, as it:

- causes loss of Commonwealth revenue;
- acts as a funding source for serious and organised crime; and
- undermines tobacco prevention and control initiatives of the Australian Government by increasing the accessibility and affordability of tobacco products, particularly where these do not meet the plain packaging, graphic image and health warning requirements.<sup>34</sup>

The Applicants' objective is that, by giving effect to the proposed contract and arrangements between them, they will reduce the availability and supply of illicit tobacco in Australia at the retail level.

A key objective of the proposed arrangements between the Applicants is that they will supplement law enforcement activities by discouraging retailers of legal tobacco products from selling or continuing to sell illicit tobacco products on an under-the-counter basis.

Reducing the level of illicit tobacco supplied in Australia is likely to have a number of material public benefits including:

- (a) **Reduction in the loss of revenue** being suffered by retailers and wholesalers that only sell legal tobacco products, caused by those retailers and wholesalers having to compete with those that sell illicit tobacco;

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<sup>34</sup> Commonwealth Department of Border Protection, Inquiry into Illicit Tobacco (Submission 77), 3.

- (b) **Reduction in lost excise duties** in respect of sales of illicit tobacco on which no excise duty is paid;
- (c) **Supporting efforts by law enforcement** If giving effect to the proposed arrangement between the Applicants results in a material reduction in the importation, availability or supply of illicit tobacco in Australia, this would reduce the burden on law enforcement agencies, particularly with respect to reducing availability and supply at the retail-end of the supply chain;
- (d) **Ensuring effectiveness of health warnings** about the dangers of smoking tobacco products, as illicit tobacco products are generally sold without any health warnings or if they do include health warning, those health warnings are not compliant with those required under Australian law;
- (e) **Reduced fire risk** Illicit tobacco products are unregulated and potentially pose a fire safety risk; and
- (f) **Reduction of risks arising from inadequate pest control measures** in respect of chop-chop illicit tobacco products, which are not subject to the stringent pest control measures adopted by the Applicants and their suppliers for their legal loose-leaf tobacco.

We discuss each of these public benefits in more detail below.

## 5.2 Reduction in the loss of revenue

Jeff Rogut, Chief Executive Officer of the Australasian Association of Convenience Stores Limited has stated:

Legal tobacco products represent a significant proportion of total convenience store sales in Australia. According to the most recent AACS State of the Industry report, on average over 37% of a typical convenience store's sales and 25% of a store's gross profit comes from legal tobacco.<sup>35</sup>

The Applicants point out that suppliers (such as tobacco retailers and wholesalers) that sell only legal tobacco products pay relevant duties and taxes for the sale of those products. The lawful sale of tobacco products benefits all of those in the legal supply chain including the importer, distributor and retailer, all of whom are regulated and pay taxes.

A number of the submissions to the Parliamentary Committee inquiry into illicit tobacco made by sole traders operating stores that sell only legal tobacco products, expressed frustration that they have to compete with retailers that sell illicit tobacco.

If the proposed arrangement between the Applicants has the result of reducing the availability and supply of illicit tobacco to consumers in Australia, this will likely benefit those retailers and wholesalers of legal tobacco products that choose not to contravene the law.

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<sup>35</sup> Australasian Association of Convenience Stores, Inquiry into Illicit Tobacco (Submission no. 21), 3.

### **5.3 Reduction in the loss of excise duties**

Lawful tobacco products are the subject of heavy customs and excise duties and taxes in Australia that have increased over time and are due to increase further.

While it is difficult to accurately estimate the extent of the market for the supply of illicit tobacco in Australia, any reduction in the size of that market through the efforts of the Applicants implementing the proposed arrangement between them is likely to result in a reduction in customs and excise duties lost to illicit tobacco, on which no excise duty or other taxes are paid.

In a report prepared by KPMG (commissioned by the Applicants), it estimates that Australia's illegal tobacco market has risen from 11.5% of total tobacco consumption in 2012 to 14% in 2015.<sup>36</sup>

One of the key objectives of the proposed arrangements between the Applicants is to reduce the availability and supply of illicit tobacco products. If this objective is successful, there is likely to be a corresponding reduction in the loss of customs and excise duties to illicit tobacco on which no duty is paid.

### **5.4 Supporting efforts by law enforcement**

While it is not the intention of the proposed arrangement between the Applicants to be a form of law enforcement, the enforcement measures and government resources available to take action against individual retailers and wholesalers is limited in most States and Territories of Australia.

An example of the difficulties and frustrations faced by local law enforcement officers targeting the retail supply of illicit tobacco is the experience of the Rural City of Wangaratta.<sup>37</sup> A copy of a submission made by that local government is included in the reference material that accompanies this submission. That submission describes a costly and resource-consuming action against a supplier of illicit tobacco. The submission states:

While this illicit tobacco problem is quite clearly a Commonwealth Government responsibility, the practicality is that Local Government is left to deal with the problem, which incorporates significant financial costs and staff resources to investigate and undertake legal action, in order to address the problem.

and

Given the significant time, costs, resources and staff involved, along with the outcome achieved, I will not be recommending that Council pursue this matter any further.

If the Applicants are permitted to implement the proposed arrangement between them, that arrangement may be very effective at addressing the availability and supply of illicit tobacco at the retail-end of the supply chain where it seems there may, in some instances, be a lack of willingness, resources and/or capacity by law enforcement to take action against smaller operators that supply illicit tobacco products.

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<sup>36</sup> KPMG LLC, Illicit tobacco in Australia, 2015 Full Year Report (15 April 2016), 6.

<sup>37</sup> Rural City of Wangaratta, Inquiry into Illicit Tobacco (Submission 1).

If the proposed conduct by the Applicants is successful in reducing the availability of illicit tobacco products, this may have an impact on the illicit tobacco supply chain, including at the level of the supply chain where agencies such as the DIBP and the ATO operate and at the retail-end where local government enforcement officers operate. This in turn may have the effect of reducing the enforcement burden on those law enforcement agencies and their officers.

## 5.5 Ensuring effectiveness of health warnings

The increased availability and supply of illicit tobacco in Australia works against the health objective of tobacco control measures.

On this point, the Commonwealth Department of Health stated in its submission to the Inquiry into Illicit Tobacco (footnotes not included):

By making cigarettes 'cheaper, more accessible and more difficult to regulate', the availability of illicit tobacco (usually sold at a cheaper price) impacts directly on the effectiveness of price-based public health policies aimed at decreasing smoking rates. It is recognised internationally that if illicit tobacco is widely available, some smokers (most likely to be from low income groups) will shift to buying and consuming cheaper illicit products rather than reducing consumption or quitting in response to price rises. As to the effectiveness of other tobacco control strategies, non-compliance with Australia's other tobacco control measures means that smokers accessing illicit tobacco products may not benefit from measures including tobacco plain packaging, graphic health warnings, and other information including access details for the Australian Government's "Quit Now" resources.<sup>38</sup>

Illicit tobacco products are supplied without compliant health warnings or with no health warnings at all.

One of the key objectives of the proposed arrangements between the Applicants is to reduce the availability and supply of illicit tobacco products. If this objective is successful, it will help improve the impact and effectiveness of tobacco control measures in the Australian community.

## 5.6 Reduced fire risks

Another risk posed by illegal cigarettes is their fire risk.

Fire risk requirements are set out in the *Trade Practices (Consumer Product Safety Standard) (Reduced Fire Risk Cigarettes) Regulations 2008 (RFR Regulations)*.

Cigarettes sold by the Applicants and other suppliers of legal cigarettes adhere to the RFR Regulations. There can be no certainty that illicit cigarettes are compliant with these fire safety laws.

One of the key objectives of the proposed arrangements between the Applicants is to reduce the availability and supply of illicit tobacco products. If this objective is successful, it will help reduce the availability and supply of tobacco products that may not adhere to these fire safety laws.

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<sup>38</sup> Department of Health, Inquiry into Illicit Tobacco (Submission 157), 3.

## **5.7 Reduction of risks arising from inadequate pest control measures**

The Applicants operate to ensure that all elements of the supply chain adopt appropriate fully documented, specified and auditable standards to ensure that raw materials used to manufacture, and associated with the dispatch of, legal tobacco products are pest free and pose no threat to Australia's natural environment.

The measures adopted include:

- the use of pheromone traps;
- separation of finished products from raw materials;
- fumigation and infestation measures applied to storage facilities;
- specified cleaning requirements in respect of machinery used in the manufacturing process;
- factory cleaning standards applied to all facilities involved in the manufacture products; and
- apest (beetle) identification and eradication measures.

There is no way of knowing whether the producers and importers of chop-chop illicit tobacco products into Australia follow similar procedures.

Allowing the Applicants to discourage suppliers of illicit chop-chop tobacco from continuing to trade in that tobacco as proposed in this application for authorisation will help reduce the risk to the Australian natural environment by reducing the risk of pests and diseases entering the country via smuggled illicit chop-chop tobacco.

## **6 Market definition**

The Applicants consider that the relevant market in which they would conduct the subject of the proposed contract between them to be the market for the supply of tobacco products (both legal and illicit) to consumers in Australia.

## **7 Counterfactual**

The Applicants submit that, if they are not permitted to engage in the conduct proposed in this application, the availability and supply of illicit tobacco by retailers and wholesalers will increase if more serious repercussions for illicit tobacco retailers and wholesalers are not implemented by the Applicants, particularly following further increases in tobacco excise duties on legal tobacco products.<sup>39</sup>

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<sup>39</sup> The next 12.5% tobacco excise increase will occur on 1 September 2016, with a further four annual increases of 12.5 per cent per year from 2017 until 2020.

At the retail level, the Applicants are of the view that suppliers of illicit tobacco currently have little to fear in terms of prosecution and consumers can readily acquire illicit tobacco in Australia from a variety of suppliers of legal tobacco.

If the Applicants are not permitted to engage in the conduct described in this application (which is limited to a period of 5 years), current and potential suppliers of illicit tobacco are likely to be further emboldened to continue or increase their acquisition and resupply of illicit tobacco to consumers. This will place added pressure on those retailers that chose not to acquire and resupply illicit tobacco, retailers that find themselves having to compete with the unfair advantages enjoyed by those that trade in illicit tobacco.

Such an outcome is also likely to further support demand for the importation of that illicit tobacco into Australia, placing an additional burden on law enforcement agencies charged with intercepting illicit tobacco before it enters the Australian market and addressing its supply at the retail-end of the market.

In the Applicants' opinion, there is presently no other effective means of addressing the acquisition and supply of illicit tobacco at the retail level other than by the coordinated conduct proposed in this application.

## 8 Public detriment

The Applicants submit that the proposed arrangement between them would not result in any significant detriment and that any public detriment would be far outweighed by the substantial public benefits discussed in section 5 of this submission.

The proposed arrangement between the Applicants will be implemented with safeguards to ensure that only retailers and wholesalers of illicit tobacco products will be targeted for non-supply. Those safeguards will include:

- (a) a systematic evidence-based approach to conducting covert-purchases to identify the source of the illicit tobacco product;
- (b) appropriate measures to confirm that particular products purchased from a retailer are in fact illicit; and
- (c) the issuing of a warning/cease and desist letter with an opportunity for the retailer to respond.

It is clearly not in the interests of the Applicants to target retailers or wholesalers of legal tobacco products (who do not acquire or sell illicit tobacco products) as to do so would affect the sale of the legal tobacco products of the Applicants and damage the valuable commercial relationship that exists between the Applicants and the retailers and wholesalers of legal tobacco products in Australia.

Implementation of the proposed arrangement between the Applicants is unlikely to have any detrimental impact on competition in the Australian tobacco market other than in connection with the competition that exists between legal tobacco suppliers and those that sell illicit tobacco products.

## 9 Conclusion

For the reasons set out in this submission and the application to which it is attached, the Applicants submit that the extensive public benefits of the proposed contract and arrangement between them will significantly outweigh any public detriment.

## Index to reference documents

No.	Document
1	KPMG LLC, Illicit tobacco in Australia, 2015 Full Year Report (15 April 2016).
2	Deloitte, Illicit trade of tobacco in Australia, February 2011.
3	Department of Immigration and Border Protection, Inquiry into Illicit Tobacco (Submission no. 77).
4	Australian Tax Office, Parliamentary Joint Committee on Law Enforcement: Inquiry into Illicit Tobacco (Submission 16).
5	Australian Customs & Border Protection Service 2014-15 Annual Report, p19.
6	Australian Crime Commission, Organised crime in Australia (2015).
7	<i>Tobacco crop bust at Merrigum</i> , Kyabram Free Press, March 2015.
8	<i>Another big tobacco crop seized in Goulburn Valley</i> , Weekly Times Now, May 2015.
9	<i>Illegal tobacco crop uncovered in Dingwall</i> , Victoria, Weekly Times Now, April 2016.
10	<i>12 charged, cocaine and \$700,000 seized after multi-million-dollar cigarette-smuggling operation busted in Sydney</i> , ABC, September 2015.
11	<i>Record haul of illegal tobacco worth \$40 million seized by Australian Border Force</i> , ABC, October 2015.
12	<i>Millions of cigarettes smuggled into Melbourne seized in raids</i> , ABC, October 2015.
13	<i>Australian Border Force smashes tobacco smuggling ring</i> , ABF Newsroom, April 2016.
14	Australasian Association of Convenience Stores, Inquiry into Illicit Tobacco (Submission 21).
15	Sydney Morning Herald, Customs officials allegedly involved in drug and tobacco smuggling (19 May 2016).
16	Media release, Peter Dutton MP Minister for Immigration and Border Protection, Record illicit tobacco seizure leads to new strike team, October 2015.
17	Rural City of Wangaratta, Inquiry into Illicit Tobacco (Submission 1).
18	Commonwealth Department of Health, Inquiry into Illicit Tobacco (Submission 157).