



Australian
Competition &
Consumer
Commission

Draft Determination

Application for authorisation

lodged by

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

in respect of

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

Date: 15 December 2016

Authorisation number: A91550

Commissioners: Sims
Rickard
Cifuentes
Court
Featherston

Summary

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

The ACCC considers that the proposed arrangements are likely to result in substantial detriments.

The ACCC is concerned that the proposed arrangements may reduce competition between manufacturers of tobacco (as the conduct could be used to selectively target retailers that stock competing brands).

Further, they may result in detriment to businesses which may be wrongly or mistakenly subject to a joint decision of the Applicants to cease supply, without any opportunity for independent review of that decision.

The proposed arrangements may also undermine public health outcomes and enforcement agency efforts to enforce tobacco control laws and their underlying policies.

While the ACCC recognised that the proposed arrangements may result in some public benefits through reducing loss of excise duties, improving the effectiveness of regulatory measures around the sale of tobacco, reducing the loss of revenue by retailers and wholesalers who only sell legal tobacco products, and reducing the enforcement and compliance burden on government regulatory agencies, these potential benefits are only likely to result if the proposed arrangement results in a decrease in the supply of illicit tobacco. The ACCC considers there are a number of aspects of the proposed conduct which have potential to affect the extent to which this will occur, and the likelihood of it occurring.

The ACCC is not satisfied that the proposed arrangements are likely to result in a net public benefit.

The ACCC seeks submissions in relation to this draft determination before making its final decision.

The application for authorisation

1. On 25 August 2016 British American Tobacco Australia Limited, Imperial Tobacco Australia Limited and Philip Morris Limited (the **Applicants**) lodged an application for authorisation¹ (A91550) with the ACCC. The Applicants are seeking authorisation for a period of five years in relation to a proposed agreement to cease supply of tobacco products to retailers and wholesalers that supply illicit tobacco products.

The proposed conduct

2. The Applicants propose to engage in joint and coordinated actions against retailers and wholesalers where the Applicants form the view that a retailer or wholesaler is supplying illicit tobacco, including agreeing to jointly cease supplying those suppliers with tobacco products for an agreed period.
3. The Applicants intend to take actions against such suppliers, based on information gathered using two different approaches, which they describe as the '*Covert purchase model*' and the '*Agency cooperation model*'. Neither approach includes an independent review or appeal mechanism for retailers or wholesalers adversely impacted by the proposed conduct.

Covert purchase model

4. The Applicants propose to individually engage their own private investigators to make covert "mystery shopper" purchases of tobacco products from retailers and wholesalers throughout Australia. Private investigators are to make assessments of whether a particular tobacco product purchased by them may be illicit tobacco based on a set of criteria. If a private investigator purchases what they suspect to be illicit tobacco, they are to provide a written report to the Applicant/s identifying the details of the purchase and supplier, the basis for their suspicion that the product is illicit, and attaching physical evidence in support of their belief.
5. The Applicants propose to then examine and test the covertly acquired products to determine whether they are illicit tobacco. If the Applicants agree that the product is illicit tobacco, they would cause a letter to be served upon the retailer advising of the purchase of suspected illicit tobacco, identifying the reasons the purchased tobacco is considered illicit, and seeking a written undertaking from the supplier that they will cease and desist from selling the suspected illicit tobacco from a specified date. The supplier would also be advised that, should they fail to provide or comply with the undertaking, the Applicants will cease to supply their products to that supplier until further notice.
6. The Applicants propose to jointly decide not to make further sales of their legal tobacco products to a supplier for an agreed period, where the supplier fails to provide such an undertaking, or breaches the undertaking as evidenced by a further covert purchase of suspected illicit tobacco from that supplier.

¹ Authorisation is a transparent process where the ACCC may grant protection from legal action for conduct that might otherwise breach the Competition and Consumer Act 2010 (the CCA). Applicants seek authorisation where they wish to engage in conduct which is at risk of breaching the CCA but nonetheless consider there is an offsetting public benefit from the conduct. Detailed information about the authorisation process is available in the ACCC's Authorisation Guidelines at www.accc.gov.au/publications/authorisation-guidelines-2013

Agency cooperation approach

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

Rationale

8. The Applicants submit that the proposed agreement is necessary because the efforts of law enforcement agencies in Australia to counter the importation and supply of illicit tobacco are focussed primarily on interrupting and preventing organised criminals involved in the importation and distribution of illicit tobacco, rather than focussing on individual retailers or wholesalers who may be supplying illicit tobacco. The Applicants further submit that, where action is taken against retailers by law enforcement agencies, it is not uncommon for a retailer of illicit tobacco to recommence supply of illicit tobacco soon after being prosecuted. The Applicants consider current enforcement measures at the retail and wholesale levels of the market have failed to have any material impact on the supply of illicit tobacco products.
9. In the view of the Applicants, the majority of illicit tobacco is sourced by consumers from retailers that also supply licit tobacco products. Such retailers use the supply of licit tobacco as a front for their trade in illicit tobacco, reducing the risk involved in the supply of illicit tobacco. The Applicants submit such retailers also have the advantage of two potential customers – one seeking licit and one illicit tobacco products – and that there is the potential for them to switch a consumer of licit tobacco products to illicit products. The Applicants express the view that, if the ability of a supplier to acquire and supply the Applicants' legal tobacco products is removed, so too is one of the key factors that permits them to conduct a trade in illicit tobacco.
10. The Applicants submit that they are in a unique position to disrupt the supply of illicit tobacco by suppliers of licit tobacco products, by ceasing supply of licit tobacco products. They submit that an agreement between them for joint and coordinated action is essential to their disruption because, if only one of the Applicants were to cease supply, the retailer or wholesaler would be able to continue to acquire and supply legal tobacco products from the other Applicants. The Applicants submit their coordinated action would complement law enforcement efforts by discouraging the supply of illicit tobacco at the retail and wholesale level of the market.

The Applicants

11. The Applicants are the three major suppliers of tobacco products in Australia, including manufactured cigarettes and loose tobacco. They (or their parent companies) are also major suppliers of tobacco products globally.

Background

Tobacco supply in Australia

12. The National Tobacco Strategy 2012-2018 (**National Tobacco Strategy**) sets out a national framework for government aiming to reduce tobacco-related harm in

Australia, and provides a framework for building the evidence base for tobacco control and monitoring progress. The goal of the National Tobacco Strategy is to “improve the health of all Australians by reducing the prevalence of smoking and its associated health, social and economic costs, and the inequalities it causes.” In November 2012, the National Tobacco Strategy was endorsed by all Australian Commonwealth, state and territory health ministers.

13. Tobacco products are subject to a range of Commonwealth, state and territory laws. Tobacco products which are imported into Australia are subject to customs duty under the *Customs Act 1901* (Cth) and the *Customs Tariff Act 1995* (Cth), collected by the Department of Immigration and Border Protection (**DIBP**). DIBP is also responsible for detecting, deterring and disrupting the trade in illicit tobacco.
14. The Australian Tax Office (**ATO**) is responsible for detecting, investigating and prosecuting illicit domestically grown or manufactured tobacco products, as these fall under the *Excise Act 1901* (Cth), administered by the ATO. All legal tobacco products are currently imported into Australia as there are no current licences to grow or manufacture tobacco in Australia.² Illicit tobacco in Australia is almost entirely overseas-sourced product,³ although there have been some recent seizures of local illicit tobacco crops.⁴
15. About 70% of the retail value of licit tobacco products sold in Australia is comprised of excise or customs duty and goods and services tax (GST).⁵
16. In addition to the applicable customs duties and excise, tobacco products sold in Australia are required to comply with a range of legislative requirements including under the *Tobacco Plain Packaging Act 2011* (Cth) and associated regulations, which prohibit the use of logos, brand imagery, and promotional text on tobacco products and packaging, and set out the colours, size and font permitted for retail tobacco packaging. The plain packaging requirements are administered by the Department of Health.
17. Health warnings are required on tobacco product packaging under the *Competition and Consumer (Tobacco) Information Standard 2011* (the Standard). The Department of Health has policy responsibility for the health warnings, while the Standard is enforced by the ACCC, in collaboration with the state and territory fair trading agencies. The ACCC also has responsibility to ensure compliance with safety requirements to reduce fire risk from cigarettes.
18. In addition, state and territory laws regulate the retailing of tobacco, including the licensing of tobacco retailers which is required in most states and territories⁶ of Australia.
19. The Applicants are the three largest suppliers of legal tobacco products in Australia. British American Tobacco Australia Limited has previously reported that the

² ATO, *Submission to the Inquiry into illicit tobacco*, 2016, page 3.

³ Australian Crime Commission (ACC), *Organised Crime in Australia 2015*, p145.

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

⁵ Scollo, Michelle, “Trends in tobacco consumption”, in *Tobacco in Australia: Facts and Issues*, Cancer Council Victoria, 2012.

⁶ At the time of writing, retailers of tobacco in Victoria and Queensland were not required to hold a licence.

Applicants have a 99% share of the licit tobacco products in Australia.⁷ Other estimates find a combined market share closer to 85%, with the remaining 15% of licit tobacco sold comprising much smaller independent wholesalers operating within smaller geographic areas.⁸

Illicit tobacco in Australia

20. The World Health Organization Framework Convention on Tobacco Control (**WHO FCTC**) defines the illicit trade in tobacco products as being “any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale or purchase [of tobacco products] including any practice or conduct intended to facilitate such activity.”⁹
21. The Department of Health has previously stated that “illicit tobacco” is primarily tobacco on which legally-required duties and taxes have not been paid.¹⁰
22. The Applicants’ submission of 23 November 2016 indicates that for the purposes of the proposed arrangements, any product that is counterfeit or does not meet the requirements of any Australian laws and regulations, including the provisions under the plain packaging legislation, will be considered illicit.
23. The Australian Criminal Intelligence Commission (formerly Australian Crime Commission) has identified three different forms of illicit tobacco supplied to the Australian market. These are:
 - unbranded tobacco (known as ‘chop chop’). This is roughly-processed tobacco sold either as loose leaf, or packed into cigarette tubes
 - contraband – manufactured cigarettes or tobacco imported illegally and sold without the payment of applicable duties. The ‘contraband’ category can include the genuine products of tobacco manufacturers, which may be smuggled from a different (lower-taxed) jurisdiction without the payment of customs duty at importation, or have evaded customs duty as a result of being diverted from legitimate supply¹¹
 - counterfeit –generally a copy of a particular product and carrying a trademark without the permission of the trademark owner.¹² If duty is not paid on counterfeit cigarettes, they can also be considered ‘contraband’.¹³

⁷ Official Committee Hansard, Parliamentary Joint Committee on Law Enforcement, *Illicit Tobacco*, 4 March 2016, p 10.

⁸ IBISWorld, *Tobacco Product Wholesaling: Australian Industry Report*, August 2016.

⁹ World Health Organization (WHO), *Framework Convention on Tobacco Control* (FCTC), Article 1.

¹⁰ Department of Health, *Submission to the Inquiry into Illicit Tobacco*, February 2016, p6.

¹¹ For example, where customs duty is paid on imported tobacco products that are subsequently exported, parties can claim a “drawback” of the customs duty. Such products may be diverted prior to being exported and find their way back into the illicit market within Australia. See: <https://www.ato.gov.au/Business/Excise-and-excise-equivalent-goods/Tobacco-excise/Claiming-excise-refunds,-drawbacks-and-remissions/#Drawbacks>.

¹² ACC, *Organised Crime in Australia 2015*, p68.

¹³ Scollo, Dr Michelle, “The pricing and taxation of tobacco products in Australia”, in *Tobacco in Australia: Facts and Issues*, Cancer Council Victoria, 2012.

24. Internationally, it is recognised as highly challenging to accurately estimate the size of any illicit tobacco market, due to the nature of tax avoidance and evasion.¹⁴ There is no current official estimate of the size of the illicit tobacco market in Australia.¹⁵
25. Estimates which do exist vary considerably in both their market size and means of measurement. The most recent bi-annual report by KPMG¹⁶ commissioned by the Applicants provided an estimate that illicit tobacco constituted 14% of total tobacco consumption in Australia in 2015, by weight, and this amounts to approximately \$1.49 billion in foregone excise revenue to the Commonwealth.¹⁷
26. The World Health Organisation (**WHO**) has expressed the view that the tobacco industry has often exaggerated the proportion of the tobacco market related to illicit trade,¹⁸ and a number of interested parties (including the Department of Health, DIBP, Cancer Council Victoria, and Cancer Council Western Australia), in submissions to assist the ACCC's assessment of this matter, consider the industry estimates to be unreliable due to methodological shortcomings including unrepresentative sample sizes and groups, restrictive survey measures, and drawing upon unreliable secondary sources to validate results. Other studies have also criticized the methodology employed.¹⁹
27. The results of an AIHW survey have indicated a considerably lower rate of illicit tobacco consumption than the KPMG report. The AIHW found that 3.6% of respondents to their survey reported currently smoking unbranded ('chop chop') tobacco, and 10% reported having purchased branded tobacco which did not comply with plain packaging requirements (presumed to be contraband), the majority of these only occasionally. Less than 1% of survey respondents reported use of illicit tobacco "half the time or more".²⁰ An independent study's findings were consistent with those reported in the AIHW's survey.²¹ While the AIHW survey used different measures to the KPMG report (measuring prevalence of unbranded or contraband tobacco smoking among smokers vs the proportion, by weight, of tobacco consumption which was illicit), they appear to provide very different estimates of the prevalence of illicit tobacco in Australia.
28. The Applicants consider that there has been an increase in the importation, availability, supply of, and demand for, illicit tobacco products in Australia from 11.5% of total tobacco consumption in 2012 to 14% in 2015, contributed to by

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

¹⁵ Department of Health, *Submission to the Inquiry into Illicit Tobacco*, 2016, p3.

¹⁶ KPMG, *Illicit tobacco in Australia: 2015 Full Year Report*, 15 April 2016.

¹⁷ The ACCC notes that this excise figure relies on the assumption the entire volume of tobacco purchased in the illicit market would be purchased in the licit market in the absence of illicit tobacco.

¹⁸ WHO FCTC Secretariat report, *The Tobacco Industry and the Illicit Trade in Tobacco Products*, 2016.

¹⁹ See Scollo, Zacher, Durkin, Wakefield, *Early evidence about the predicted unintended consequences of standardised packaging of tobacco products in Australia: a cross-sectional study of the place of purchase, regular brands and use of illicit tobacco*, British Medical Journal, 2014:4; and Quit Victoria and Cancer Council Victoria, *Illicit trade of tobacco in Australia: a critique of a report prepared by Deloitte for British American Tobacco Australia Limited, Philip Morris Limited and Imperial Tobacco Australia Limited*, 2011.

²⁰ Australian Institute of Health and Welfare, *National Drug Strategy Household Survey Detailed Report*, 2013, pp25-26.

²¹ Scollo, Dr Michelle, Zacher, Meghan, Coomber, Kerri, and Wakefield, Melanie, "Use of illicit tobacco following introduction of standardised packaging of tobacco products in Australia: results from a national cross-sectional survey", *Tobacco Control*, 2015: 24.

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

29. The Australian Border Force (within DIBP) reports having seen no discernible impact on the illicit tobacco trade as a result of the introduction of plain packaging,²² and a government-commissioned post-implementation review of the plain packaging measures likewise found no substantive impact on the illicit tobacco market, if any at all.²³ An independent study found no evidence in Australia of increased use of contraband or 'chop chop' tobacco between 2011 and 2013.²⁴
30. The WHO and Australian government agencies identify that there is no clear or direct correlation between high taxes and the size of the illicit tobacco market.²⁵ However, the DIBP note that excise increases may impact on the size of the illicit trade in tobacco.²⁶ The Department of Health also accepts that it is recognised, in some circumstances, that increasing excise (leading to increases in price) may influence both the demand for cheaper tobacco and the profitability of illicit tobacco imports.²⁷
31. Government agencies have identified that organised crime has a high level of involvement in illicit tobacco in Australia, and understand that it is perceived by participants as a low risk, high profit enterprise.²⁸
32. The Applicants advise their research indicates that 70% of the trade in illicit tobacco to consumers is conducted through existing retailers of licit tobacco. DIBP has previously reported that its investigations suggest that sales of illicit tobacco follow similar distribution and sales patterns as licit tobacco, and that illicit tobacco is available from a number of tobacconists and tobacco retailers,²⁹ but notes in its submission that it is unable to comment on the proportion of the illicit trade that is conducted through existing retailers.
33. DIBP reports that, in its experience, illicit tobacco is usually concealed under the counter or in a paper bag, indicating that retailers make a conscious choice to purchase and then sell illicit tobacco, and that illicit tobacco smokers also make a conscious choice to purchase illicit tobacco.³⁰

²² DIBP, *Submission to the Inquiry into Illicit Tobacco*, 2016, p5.

²³ Siggins Miller Consultants Pty Ltd, *Consultancy services to inform the development of a Post Implementation Review of the tobacco plain packaging measure: Regulatory Burden Measurement & Analysis of Costs and Benefits*, January 2016.

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

²⁵ World Health Organization, *Illegal Trade of Tobacco Products: What you should know to stop it*, 2015, p7; Department of Health, *Supplementary Submission to the Inquiry into Illicit Tobacco*, 2016, p5.

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

²⁷ Department of Health, *Submission to the ACCC interested party consultation on the British American Tobacco & ors Application for Authorisation A91550*, November 2016, pp4-5.

²⁸ ACC, *Organised Crime in Australia 2015*, p145; Australian Federal Police (AFP), *Submission to the Inquiry into Illicit Tobacco*, February 2016; ATO, *Submission to the Inquiry into Illicit Tobacco*, 2016; Department of Immigration and Border Protection, *Submission to the Inquiry into Illicit Tobacco*, 2016.

²⁹ DIBP, *Submission to the Inquiry Into Illicit Tobacco*, 2016, p4.

³⁰ DIBP, *Submission to the Inquiry into Illicit Tobacco*, 2016, p4.

Enforcement of illicit tobacco laws

34. The Department of Health has identified that enforcement and compliance aimed at combating illicit trade in tobacco products is a critical element of Australia's approach to tobacco control, as it ensures that continuing smokers remain in the legal tobacco market where they are exposed to the full range of Australia's tobacco control measures.³¹ DIBP has also said that combatting the importation of illicit tobacco is one of its key operational priorities.³²
35. A number of government law enforcement agencies are involved in a collaborative whole-of-Government approach to combatting illicit tobacco. These include the Department of Health, DIBP, the ATO, the Australian Federal Police (AFP), the Australian Criminal Intelligence Commission, the ACCC, and state and territory police.³³
36. Government enforcement agencies have previously identified a range of limitations on their ability to investigate and prosecute illicit tobacco offences.³⁴ These include:
- different law enforcement powers available between law enforcement agencies
 - differing priorities between agencies
 - inconsistencies between border regulations and domestic requirements (i.e. that tobacco must comply with requirements including plain packaging, health warnings, and safety requirements at the point of sale but not at the border)
 - inconsistencies between legislative regimes. Specifically, that for successful prosecutions the place of origin of the illicit tobacco (i.e. either imported or domestically grown and/or manufactured) is required to be established in order to determine whether the offenders should be prosecuted for evasion of excise (under the *Excise Act 1901*) or customs duty (under the *Customs Act 1901* and the *Customs Tariff Act 1995*). This is not always easy to determine when the tobacco is seized somewhere other than at the border.
 - the requirement that, in order to obtain a conviction under the relevant sections of the *Customs Act 1901*, it must be established that the offender either intended to defraud the revenue, or knew the tobacco was imported with the intention to defraud the revenue.
37. These difficulties manifest particularly in enforcement actions which occur at the level of the retailer or wholesaler.
38. The ACCC understands that the Australian Government is working to develop a number of reforms to address the above issues,³⁵ including as part of the *Tobacco*

³¹ Department of Health, *Supplementary Submission to the Inquiry into Illicit Tobacco*, April 2016, p2.

³² DIBP, *Submission to the Inquiry into Illicit Tobacco*, 2016, p3.

³³ Department of Health, *Supplementary Submission to the Inquiry into Illicit Tobacco*, April 2016, p2.

³⁴ DIBP, *Submission to the Inquiry into Illicit Tobacco*, 2016; AFP, *Submission to the Inquiry into Illicit Tobacco*, February 2016; ATO, *Submission to the Inquiry into Illicit Tobacco*, 2016.

excise measure to improve health outcomes and combat illicit tobacco announced in the 2016-17 Budget.³⁶

World Health Organization Framework Convention on Tobacco Control

39. Australia's National Tobacco Strategy is consistent with Australia's obligations as a party to the WHO FCTC, which entered into force on 27 February 2005.³⁷ Australia was an original signatory to the WHO FCTC. Parties to the WHO FCTC have committed to implement a range of tobacco control measures focussed on reducing the demand and addressing the supply of tobacco products, including action to combat illicit trade in tobacco products.

40. Article 5.3 of the WHO FCTC sets out a general obligation on each party:

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

Consultation

41. The ACCC tests the claims made by an applicant in support of its application for authorisation through an open and transparent public consultation process.

42. The ACCC invited submissions from a range of potentially interested parties including tobacco retailers, industry associations, state and federal government departments, anti-smoking non-government organisations and research institutions.³⁸

43. The ACCC received 21 submissions from interested parties. Submissions from retailers and their industry associations and academics³⁹ were generally supportive of the application, although some raised issues.⁴⁰ A number of concerns were raised in submissions from government and non-government anti-smoking organisations.

44. On 23 November 2016 the Applicants provided a submission in response to these issues.

³⁵ See for example Department of Health, *Submission to the ACCC interested party consultation on the British American Tobacco & ors Application for Authorisation A91550*, November 2016; DIBP *Submission to the Inquiry into Illicit Tobacco*, 2016, p7.

³⁶ See: http://www.budget.gov.au/2016-17/content/bp2/html/bp2_revenue-08.htm.

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

³⁸ A list of the parties consulted and the public submissions received is available from the ACCC's public register www.accc.gov.au/authorisationsregister.

³⁹ Dr Adam Masters (Transnational Research Institute on Corruption, Australian National University), and Prof. Sinclair Davidson (School of Economics, Finance and Marketing, RMIT University. Professor Davidson is also a Senior Research Fellow at the Institute of Public Affairs).

⁴⁰ Submissions by the Australian Lottery and Newsagents' Association and the Black Cat Consultancy are available on the ACCC's public register.

45. Submissions from the Applicants and interested parties are considered as part of the ACCC's assessment of the application for authorisation and are discussed below.

ACCC assessment

46. The ACCC's assessment of the proposed arrangement is carried out in accordance with the relevant net public benefit tests⁴¹ contained in the *Competition and Consumer Act 2010* (Cth) (the **CCA**). In broad terms, the ACCC may grant authorisation if it is satisfied that the likely benefit to the public from the proposed arrangement would outweigh the likely detriment to the public, including from any lessening of competition.

Relevant areas of competition

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

Future with and without

49. To assist in its assessment of the proposed arrangement against the authorisation test, the ACCC compares the benefits and detriments likely to arise in the future with the conduct for which authorisation is sought against those in the future without the conduct the subject of the authorisation.
50. The Applicants submit that, absent the proposed agreement, the availability and supply of illicit tobacco by retailers and wholesalers will increase due to pressure on consumers from excise increases and the further emboldening of current and potential suppliers of illicit tobacco.
51. The ACCC considers that, should the conduct for which authorisation is sought not occur, Commonwealth, state and territory government agencies will continue to be responsible for the investigation and enforcement of breaches of the relevant legislation.
52. The ACCC notes that one or more of the Applicants currently individually conduct covert purchases of potentially illicit tobacco to obtain intelligence data,⁴² and that it is possible they may choose to continue to do so in the absence of authorisation. As noted in their submission of 23 November 2016, the Applicants may also, on an individual basis, give effect to terms in their contracts with retailers and wholesalers to cease supply of their products if a retailer or wholesaler is discovered to be selling tobacco considered to be illicit.

⁴¹ Subsections 90(5A), 90(5B) and 90(8).

⁴² KPMG, *Illicit tobacco in Australia: 2015 Full Year Report*, 15 April 2016, p26.

Public benefit

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

...anything of value to the community generally, any contribution to the aims pursued by society including as one of its principal elements ... the achievement of the economic goals of efficiency and progress.⁴³

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

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

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

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

56. The size and rate of growth of the illicit tobacco market are relevant to the ACCC's consideration because they affect the magnitude of any public benefits which may be expected to result from the proposed arrangements. While estimates of the size of the illicit tobacco market vary and are contested (see discussion at paragraphs 24

⁴³ *Queensland Co-operative Milling Association Ltd* (1976) ATPR 40-012 at 17,242; cited with approval in *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,677.

– 27), all parties consider the issue of illicit tobacco is an important problem. It is clear to the ACCC that a substantial market in illicit tobacco exists and that any reduction in this market would constitute a benefit. The key question for the ACCC’s consideration, therefore, is how effective the proposed arrangements are likely to be in reducing the size of the illicit market.

57. The ACCC notes that a range of factors have potential to affect the extent to which the proposed arrangements reduce the availability and supply of illicit tobacco, and the likelihood this will occur. A discussion of these factors follows.

Impact of the proposed arrangements on the illicit tobacco market

58. The ACCC notes that the proposed arrangements can only address illicit tobacco that is sold by retailers who also stock the licit tobacco products supplied to them by the Applicants. On the estimates supplied by the Applicants, 70% of the current illicit tobacco market has the potential to be targeted by the proposed arrangements; however DIBP states it is unable to comment on the proportion of illicit trade that is conducted through existing retailers. DIBP notes that it is possible that a proportion of the sellers who were targeted by the Applicants in their implementation of the proposed arrangements would switch to selling entirely illicit tobacco products (thus reducing the proportion of illicit tobacco supplied by retailers of licit tobacco products and able to be targeted by the proposed arrangements).
59. The ACCC considers that, because only illicit tobacco sold by retailers who also stock licit tobacco products is able to be targeted by the proposed arrangements, it is likely that the distribution of illicit tobacco would change (to an unknown extent) in response to the proposed arrangements such that more illicit tobacco would be sold through retailers who do not stock licit tobacco products. The ACCC considers that this is likely to reduce the effectiveness of the proposed arrangements at decreasing the supply of illicit tobacco, and therefore to reduce the public benefits which are likely to result from the proposed arrangements.

Defining and identifying “illicit” tobacco

60. The Applicants advise that they intend to perform “examination and testing of the acquired tobacco product(s) to determine whether the product acquired through covert purchase is illicit tobacco.”
61. The Department of Health submits that non-compliance with tobacco plain packaging does not necessarily mean that a product is illicit, and questions how the Applicants would determine if a product is illicit without access to customs records.
62. In response, the Applicants submit there is a range of forensic means available to establish whether a product is in fact illicit, such as verifying if a product is compliant with plain packaging and contains Australian health warnings, or by expert analysis of the packaging in the case of counterfeiting. The Applicants submit that any product which does not meet the requirements of Australian laws and regulations – including the provisions under plain packaging legislation – is illicit.
63. While the Applicants submit that they can use testing to identify products which do not comply with plain packaging or health warning legislation, or products which are counterfeit, it is not possible to ascertain via examination or testing whether the legally-required duties and taxes have been paid on a particular tobacco product.

64. The proposed conduct will therefore be unable to target particular types of illicit tobacco products. Some types of contraband (those which have been legitimately manufactured for the Australian market but which have leaked into the market without appropriate duties or taxes having been paid, for example) will be impossible to distinguish from licit tobacco products.
65. As a result, the ACCC considers the proposed arrangements could only effectively identify (and therefore target) some types of illicit tobacco – specifically, tobacco products which do not comply with plain packaging or health warning legislation, or those which are counterfeit. This may, in turn, lead to an increased supply of some contraband tobacco which is indistinguishable from licit tobacco (except that duties have not been paid). This will further reduce the public benefits which are likely to result from the proposed arrangements.

Legislative responses

66. Part of the rationale put forward by the Applicants for the proposed arrangements is that law enforcement agencies have been focussing on interrupting and preventing organised criminals involved in the importation and distribution of illicit tobacco, rather than focussing on individual retailers or wholesalers who may be supplying illicit tobacco, and that current government enforcement measures at the retail and wholesale level of the market are not working and have failed to have any material impact on the supply of illicit tobacco products.
67. The Department of Health advises that “work continues at a whole of government level – through various fora... - on a legislative reform program aimed at strengthening the ability of Commonwealth, state, and territory law enforcement agencies to tackle illicit tobacco at all levels of the supply chain.” As discussed in paragraphs 36 – 37 above, government enforcement agencies have previously identified a range of limitations on their ability to investigate and prosecute illicit tobacco offences at the retail and wholesale levels.
68. In response, the Applicants submit that changes to the law may take some time and, once implemented, may not be effective or may be affected by the level of resources available to relevant government agencies to implement and enforce those laws.
69. The ACCC considers that such reforms are likely to strengthen the ability of the Commonwealth, state and territory law enforcement agencies to tackle illicit tobacco at all levels of the supply chain, including the retail level. As such, the ACCC considers that the legislative reforms would reduce the benefits which are likely to result from the proposed arrangements. However, the ACCC accepts that any legislative reform programme would take a longer time to implement than the proposed arrangements.

Incentives in relation to illicit tobacco

70. The Applicants submit that, in the specific case of combating illicit tobacco, the interests of industry and government are aligned, and that they share the same objective of reducing the availability and supply of illicit tobacco to consumers.
71. The ACCC accepts that the interests of industry and government may in part be aligned in this regard, because illicit products will to some extent be considered substitutes for licit products. However, the ACCC considers that the Applicants also

have other interests, such as maximising the sales of licit tobacco and of their own products, which may not align with government interests.

72. It has been suggested that the illicit tobacco market may benefit tobacco companies by providing a source of cheaper tobacco to the population, and thereby increasing overall tobacco sales through increased uptake and consumption.⁴⁴
73. Additionally, in relation to contraband cigarettes or tobacco (which are legitimately manufactured overseas but have evaded customs duty through being diverted from legitimate supply or smuggled in from a different (lower-taxed) jurisdiction), global tobacco companies make profit on the sale of these products before they enter the illicit market. This may give the Applicants an incentive not to target such contraband tobacco products in their implementation of the proposed arrangements.
74. The Department of Health notes in its submission that tobacco companies overseas have played a role in illicit trade, including aiding persons to sell or be in possession of illicit products.
75. These conflicting incentives may reduce the potential benefits of the proposed arrangements.

ACCC conclusion on public benefits

76. The ACCC accepts that a reduction in the availability and supply of illicit tobacco is likely to result in some public benefits by:
- reducing the loss of excise duties
 - improving the effectiveness of regulatory measures around the sale of tobacco including health warnings, plain packaging, price measures, fire risk, and pest control measures
 - reducing the loss of revenue by retailers and wholesalers who only sell legal tobacco products, to those retailers and wholesalers who sell illicit tobacco, and
 - reducing the enforcement and compliance burden on government regulatory agencies.
77. The ACCC considers that there is considerable uncertainty as to the extent to which the proposed arrangements are likely to reduce the supply of illicit tobacco.
78. The ACCC notes that the proposed arrangements can target only a portion of the supply of illicit tobacco (i.e. that which is sold by a retailer who also sells legal tobacco products, and is either counterfeit or does not comply with plain packaging or health warning legislation). While the Applicants have some incentive to reduce the size of the illicit tobacco market, they may also have conflicting incentives, in particular not to target contraband products.
79. It is likely, therefore, that in response to implementation of the proposed arrangements, the patterns of importation and distribution of illicit tobacco may simply change, for example, contraband tobacco supply may increase, as may

supply by sellers who only stock illicit tobacco products. Given the benefits claimed by the Applicants will materialise only to the extent the overall supply of illicit tobacco is reduced, this would therefore reduce the benefit likely to result from the proposed arrangements.

80. Further, the likelihood of legislative and regulatory responses to the enforcement problems the proposed arrangements are seeking to address will reduce any public benefit likely to result from the proposed arrangements.

Public detriment

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

...any impairment to the community generally, any harm or damage to the aims pursued by the society including as one of its principal elements the achievement of the goal of economic efficiency.⁴⁵

82. The Applicants submit that the proposed arrangements are unlikely to result in any detrimental impact on competition other than in relation to competition between legal tobacco suppliers and those that sell illicit tobacco products. The Applicants have identified safeguards within the arrangements which they submit ensure only suppliers and wholesalers of illicit tobacco products would be targeted, including an evidence-based approach to conducting covert purchases, measures to confirm products are illicit, and the issuing of warning/cease and desist letters to suppliers.

83. Interested parties submit that the proposed arrangements are likely to result in detriments including:

- there may be issues with consistency, transparency and accountability in the arrangements because there is no provision to seek review and no independent oversight of decisions
- it is inappropriate for tobacco companies to be involved in regulating tobacco, because there is a fundamental and irreconcilable conflict between the tobacco industry's interests and public health policy interests, and
- action by the Applicants at a retail level has the potential to interfere with larger government investigations which may be underway either at the border or at retail level.

84. Having considered the submissions of the Applicants and interested parties, the ACCC's assessment of the likely public detriments from the proposed arrangement follows.

Lessening of competition between tobacco manufacturers

85. Together, the Applicants comprise the vast majority of the market for licit tobacco products in Australia (see paragraph 19) and therefore would have considerable market power if acting in concert. The Applicants seek authorisation for an arrangement which would involve repeated interactions to share commercially

⁴⁵ *Re 7-Eleven Stores* (1994) ATPR 41-357 at 42,683.

sensitive information about retailers and to reach agreement to boycott particular retailers. Any such arrangement between three dominant market participants raises significant competition concerns. It is also possible that the Applicants may implement the proposed arrangements in such a way as to further their own commercial interests and reduce competition between tobacco manufacturers.

86. The Department of Health submits that there is a conflict of interest regarding the business interests of the Applicants and other minor tobacco brands. The Cancer Council Victoria submits the proposed arrangements have the potential to be misused to further commercial (or personal) interests. Tobacco wholesaler Black Cat Consultancy raises concerns that the arrangements are open to possible abuse of power by the Applicants, by targeting newcomers, traders they feel threaten their market share, or traders that reject their trading terms, and advises that it is constantly defending its tobacco products (not the Applicants' brands) to retailers who have been informed by representatives of the Applicants that the products are illegal.
87. The ACCC notes that, given the Applicants' proposed definition of "illicit" tobacco for the purposes of the proposed arrangements, it is also possible that tobacco products on which duty has in fact been paid would be subject to action by the Applicants under the proposed arrangements on the basis that they do not comply with plain packaging legislation.
88. The Department of Health has previously stated that its activities in relation to non-compliance with plain packaging legislation are most often undertaken in a conciliatory manner (including educative responses and issue of warning letters) aimed primarily at quickly rectifying non-compliance. Enforcement action is proportionate to the breach identified and strategic decisions are made on a case by case basis.⁴⁶
89. This means that the Applicants may, under the proposed arrangements, make joint decisions not to supply a retailer who stocks a minor competing tobacco brand on the basis of non-compliance with plain packaging legislation, in circumstances where the Department of Health has considered, or would consider, a conciliatory, educative response to be appropriate. This may discourage retailers from stocking a minor brand of licit tobacco products, and may also cause commercial harm to the minor brand, thus reducing competition.
90. The ACCC is concerned that there is scope under the proposed arrangements for the Applicants to selectively target retailers in order to pursue unrelated commercial objectives. For example, the Applicants could boycott retailers who stock tobacco products not manufactured by the Applicants which would result in detriment from a lessening of competition between tobacco manufacturers (by limiting the access of smaller manufacturers to retail outlets). Alternatively, the Applicants may use the proposed conduct to limit price competition by targeting retailers who are discounting the Applicants' products.

Lack of appeals or independent review

91. Under the proposed arrangements, there is no appeal or independent review mechanism available for businesses to which the Applicants decide jointly to cease supplying tobacco products.

⁴⁶ Department of Health, *Supplementary Submission to the Inquiry into Illicit Tobacco*, April 2016, p4.

92. The Department of Health submits that there may be issues with consistency, transparency and accountability in the arrangements because there is no provision to seek review and no independent oversight of decisions. The Australian Lottery and Newsagents Association submits that an appeal mechanism and a small informal review body should be incorporated into the arrangements. Black Cat Consultancy raised concerns regarding the transparency of the process, including a right of appeal and oversight.
93. In response to concerns raised by interested parties, the Applicants advise that they do not consider that the joint exercise of their private rights or the conduct that is proposed to be authorised should include any independent appeals process, noting that the proposed arrangements involve opportunity for the relevant supplier to respond to evidence presented to them by the Applicants. The Applicants note that the exercise of private rights is not currently subject to any bespoke appeals process other than the usual actions that would be available through existing contractual arbitration provisions or the courts.
94. The ACCC notes that the Applicants' rationale for joint and coordinated action is that, if only one of the Applicants ceases supply, a retailer would be able to continue acquiring and supplying legal tobacco products from the other Applicants. Together, the Applicants supply the vast majority of the licit tobacco market in Australia (see paragraph 19). The Applicants cite figures from the Australasian Association of Convenience Stores that on average over 37% of a typical convenience store's sales and 25% of a store's gross profit comes from legal tobacco products.⁴⁷
95. The ACCC considers that joint decisions made by the Applicants under the proposed arrangements not to supply small businesses are likely to have detrimental impacts to the small businesses concerned. The ACCC acknowledges that some retailers and wholesalers supply illicit tobacco. However, there is a risk that some businesses may be wrongly or mistakenly subject to a joint decision of the applicants to cease supply, without any opportunity for independent review of that decision.
96. In addition, some businesses may be penalised disproportionately to their involvement in the sale of illicit tobacco. The length of a boycott and how it may be brought to an end by a retailer are unclear. The ACCC considers these aspects of the proposed conduct constitute a public detriment.

Undermining public health outcomes

97. A number of interested parties submit the proposed arrangements may undermine public health outcomes by interfering with the work of government in relation to tobacco control and that it is inappropriate for tobacco companies to be involved in regulating tobacco because there is a fundamental and irreconcilable conflict between the tobacco industry's interests and public health policy interests.

Inappropriateness of industry involvement in tobacco control

98. A number of interested parties have raised issues in relation to the appropriateness of the tobacco industry being involved in a monitoring and law enforcement role in relation to tobacco control.

⁴⁷ Australasian Association of Convenience Stores, *Submission to Inquiry into Illicit Tobacco*, p3, cited in submission by the Applicants dated 25 August 2016, p 16.

99. Cancer Council Western Australia submits that the enforcement of laws to reduce the supply of illicit tobacco is a matter for the Australian Government, and industry interference is therefore unnecessary.
100. The Minister for Health, Culture and the Arts (Western Australia) submits that there are significant inherent conflicts of interest associated with the tobacco industry becoming involved in monitoring and enforcement activity related to tobacco control, and notes the WHO FCTC which outlines that there is a need to protect tobacco control from industry interference.
101. The Department of Health submits, “Effective tobacco control is, by its nature, antithetical to the economic interests of the tobacco industry.” The Department of Health notes that “the tobacco industry has a long, proven history of trying to delay, dilute and defeat the World Health Organisation’s and governments’ attempts to reduce tobacco use.”
102. The Applicants submit that the proposed arrangement consists of actions performed in a private capacity against private parties, and does not require, contemplate or rely upon any government agency involvement. The Applicants note that the proposed conduct does not amount to a form of ‘law enforcement’, and that authorisation is sought to exercise individual contractual remedies in a coordinated manner.
103. The ACCC accepts that the proposed arrangements may not strictly constitute ‘law enforcement’. The ACCC also accepts that the proposed arrangements do not rely upon government agency involvement. However, the proposed arrangements do involve the Applicants monitoring the compliance of tobacco retailers and/or wholesalers with the law, and taking joint action against any retailers/wholesalers that the Applicants consider are contravening relevant laws. Any such joint action is likely to have a significant impact on a retailer or wholesaler, which the parties submit is intended to discourage retailers from contravening the law by selling illicit tobacco. The relevant laws are those which enshrine the government’s tobacco control policies.
104. In this way, while the proposed arrangements do not rely on government agency involvement, they may interfere with government tobacco control measures. By engaging in the proposed arrangements, the Applicants may also give the impression to tobacco suppliers and to the public that the Applicants are engaging in some form of ‘quasi-law enforcement’. Also, the proposed arrangements constitute a blunt instrument (of boycotting retailers) by the three dominant market players, in contrast to the more direct and proportionate approach of law enforcement (see for example paragraphs 89-90 above).
105. The Applicants submit that in the specific case of combating illicit tobacco, the interests of industry and government are aligned.
106. However the ACCC considers that the tobacco industry may have incentives which do not align with government objectives in relation to illicit tobacco (see paragraphs 70 - 75). Therefore, the Applicants may have mixed incentives in relation to the market for illicit tobacco, and an incentive not to target the illicit sale of contraband products manufactured by the Applicants.
107. As the proposed arrangements may interfere with government tobacco control policies, and given the ACCC’s view that the Applicants’ interests are not entirely aligned with the interest of government, the ACCC considers that the proposed

arrangements are likely to result in a public detriment by potentially undermining government health policies and enforcement agency efforts to enforce tobacco control laws (and ultimately the government policies that underpin those laws). For example, the proposed arrangements could enable the Applicants to selectively target the sale of those illicit tobacco products which they do not profit from (which may increase the supply of their own branded products which are contraband). The proposed arrangements may also provide the Applicants with the opportunity to exaggerate the effectiveness of the arrangements in order to influence any future proposed measures relating to tobacco control, and thus argue against the need for further regulation and legislation.

WHO FCTC

108. As a signatory to the WHO FCTC, the Australian Government has obligations under Article 5.3 to protect its tobacco-related public health policies from the interests of the tobacco industry (see paragraphs 39 - 40 above). The obligation in relation to Article 5.3 falls on the Australian Government.
109. A number of submissions from interested parties refer to concerns related to Article 5.3, including that the proposed arrangements may be inconsistent with Article 5.3 as they may create a perception of government being in partnership with industry, and referring to the need to protect health policies from industry interests.
110. The Applicants submit that, aside from matters of transparency (and that this requirement is clearly satisfied by the authorisation process), Article 5.3 of the WHO FCTC has no bearing on their application, because it does not require, contemplate or rely upon any government agency involvement. The Applicants further submit that the proposed arrangements consist of actions performed in a private capacity against private parties.
111. In assessing an application for authorisation, the ACCC assesses the likely benefits and detriments arising from the proposed conduct pursuant to the relevant statutory tests. The proposed conduct for which authorisation is sought does not require any involvement with government agencies. It involves the Applicants seeking to make and give effect to provisions in an agreement to, amongst other things, jointly cease supplying their products to retailers who they consider to be supplying illicit tobacco.
112. The ACCC has however considered the policy underlying Article 5.3. The WHO FCTC recognises “the need to be alert to any efforts by the tobacco industry to undermine or subvert tobacco control efforts”.⁴⁸ As set out above (at para 107), the ACCC considers the proposed conduct is likely to result in public detriment by potentially undermining government health policies and enforcement agency efforts to enforce tobacco control laws and their underlying policies.

Disrupting government investigations

113. The Department of Health raised an issue that proposed conduct of the Applicants may interfere with investigations being conducted by law enforcement. However, the Department of Health notes that this area does not fall within the policy remit of the department.
114. DIBP notes that the application does not impact directly on border controls, legislation or activities.

⁴⁸ WHO, Preamble, *Framework Convention on Tobacco Control*, 2003.

115. The Applicants, in response, notes that the Department of Health does not provide any examples of how the proposed arrangements would interfere with investigations being conducted by law enforcement.
116. As the Applicants are unaware of government investigations that may be underway, the ACCC considers that their actions may unintentionally disrupt government investigations by DIBP, police or the ATO at any point in the supply chain. For example, investigations or a decision to cease supply by the Applicants at the retail level may result in a change of behaviour by a retailer or importer, who may be under investigation by a government agency.
117. In the process of potentially preventing the supply of illicit tobacco by an individual retailer, therefore, the Applicants may unintentionally disrupt a much larger enforcement action at the point of importation, undermining enforcement and deterrent outcomes. To the extent this occurs, the ACCC considers it would be a considerable detriment. However, the ACCC does not have sufficient information at the current time to assess the likelihood of this.

Purchasing non-compliant tobacco

118. Under the *Tobacco Plain Packaging Act 2011* it is an offence for a person to purchase tobacco products in retail packaging that does not comply with the requirements of that Act (i.e. prohibition of logos, brand imagery and promotional text, and restrictions on colour, size, format and materials of packaging), unless it is purchased for their own personal use.⁴⁹
119. The implementation of the 'covert purchase' component of the proposed arrangements involve the purchase of tobacco products which may not comply with the requirements of the *Tobacco Plain Packaging Act 2011*, as the purchases are not for personal use. This conduct may therefore constitute a contravention of that Act. .
120. The ACCC is also concerned that the proposed arrangements may potentially contravene provisions of the *Customs Act 1901* (Cth) and the *Excise Act 1901* (Cth) in relation to the possession of smuggled tobacco products or tobacco products on which excise duty has not been paid.
121. To the extent the proposed arrangements involve conduct in contravention of these Acts, the ACCC considers that such conduct should be regarded as a detriment.

ACCC conclusion on public detriments

122. Given the concerns outlined above related to the nature of the proposed arrangements and the incentives of the Applicants in implementing the arrangements, the ACCC considers that it is likely that substantial detriments will arise from the proposed arrangements in the form of:
- lessening of competition between tobacco manufacturers including by potentially limiting access of smaller manufacturers to retail outlets

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

- retailers wrongly, mistakenly or unfairly subject to a joint decision of the Applicants to cease supply, without any opportunity for independent review of that decision
- undermining public health outcomes and enforcement agencies efforts to enforce tobacco control laws and their underlying policies

123. The ACCC considers the proposed arrangements would also result in detriment to the extent their implementation would involve conduct which may contravene the *Tobacco Plain Packaging Act 2011*, or provisions of the *Excise Act 1901* (Cth) or the *Customs Act 1901* (Cth).

Balance of public benefit and detriment

124. In general, the ACCC may grant authorisation if it is satisfied that, in all the circumstances, the proposed arrangement is likely to result in a public benefit, and that public benefit will outweigh any likely public detriment, including any lessening of competition.

125. The ACCC considers that, to the extent the proposed arrangements reduce the supply of illicit tobacco, they may result in some benefits in the form of reducing the loss of revenue by some suppliers of licit tobacco products, reducing lost customs duties, increasing the level of compliance with regulatory requirements, and ensuring the effectiveness of regulatory measures around the sale of tobacco.

126. However, the ACCC considers that there is considerable uncertainty regarding the extent to which the proposed arrangements are likely to reduce the supply of illicit tobacco. The ACCC considers that the benefits likely to result from the proposed arrangements are reduced because the proposed arrangements can only target a portion of illicit tobacco. This may result in changes to, rather than reductions in, the supply of illicit tobacco. Further, the potential for these benefits to be achieved is reduced by the likelihood of legislative and regulatory responses to the enforcement problems the proposed arrangements are seeking to address.

127. The ACCC considers the proposed arrangements are likely to result in substantial public detriments through reducing competition between manufacturers of tobacco, detriment to retailers who are wrongly, mistakenly or unfairly targeted, undermining public health outcomes and enforcement agencies' efforts to enforce tobacco control laws and their underlying policies, and to the extent implementation of the proposed arrangements involves engaging in conduct which may contravene the *Tobacco Plain Packaging Act 2011* or provisions of the *Excise Act 1901* (Cth) or the *Customs Act 1901* (Cth).

128. For the reasons outlined in this draft determination, the ACCC is **not satisfied** that the proposed arrangement is likely result in a public benefit that would outweigh the likely public detriment, including the detriment constituted by any lessening of competition that would be likely to result.

Draft determination

The application

129. Application A91550 was made using a Form A, under subsections 88(1) and 88(1A) of the CCA. Authorisation is sought to make and give effect to an

arrangement between the Applicants to engage in joint and coordinated actions against retailers and wholesalers where the Applicants form the view that a retailer or wholesaler is supplying illicit tobacco, which may include agreeing to jointly cease supplying those retailers and wholesalers with tobacco products for an agreed period. Authorisation is sought as the proposed arrangement may contain a cartel provision and/or be an exclusionary provision within the meaning of section 45 of the CCA.

130. Subsection 90A(1) of the CCA requires that before determining an application for authorisation the ACCC shall prepare a draft determination.

The net public benefit test

131. For the reasons outlined in this draft determination, the ACCC is **not** satisfied, pursuant to sections 90(5A) and 90(5B) of the CCA, that in all the circumstances the arrangement for which authorisation is sought is likely to result in a public benefit that would outweigh any likely detriment to the public constituted by any lessening of competition arising from the proposed arrangement.

132. The ACCC is also **not** satisfied, pursuant to section 90(8) that the arrangement for which authorisation is sought is likely to result in such a benefit to the public that the proposed arrangement should be allowed to take place.

133. The ACCC therefore **proposes to deny** authorisation to application A91550.

134. This draft determination is made on 15 December 2016.

Next steps

135. The ACCC now seeks submissions in response to this draft determination. In addition, consistent with section 90A of the CCA, the applicant or an interested party may request that the ACCC hold a conference to discuss the draft determination.