

**Australian Competition
&
Consumer Commission**

PRE-DECISION CONFERENCE

Minutes

**Authorisation A91550
lodged by British American Tobacco Australia Limited, Imperial Tobacco
Australia Limited, and Philip Morris Limited.**

13 February 2017

The information and submissions contained in this minute are not intended to be a verbatim record of the pre-determination conference but a summary of the matters raised. A copy of this document will be placed on the ACCC's public register.

**Pre-Decision Conference: Authorisation A91550 lodged by British
American Tobacco Australia Limited & Ors**

13 February 2017

Melbourne

ACCC, 360 Elizabeth St.

Video link to ACCC Canberra Office (23 Marcus Clarke St)

Attendees:

Australian Competition and Consumer Commission

Roger Featherston, Commissioner

David Jones, General Manager, Adjudication Branch

David Hatfield, Director, Adjudication Branch

Hannah Ransom, Senior Project Officer, Adjudication Branch

Simone Warwick, Principal Lawyer, Merger & Authorisation Law Unit

Michele Laidlaw, Seconded Counsel, Merger & Authorisation Law Unit
(Canberra)

Applicants

Michael Bray, British American Tobacco, Head of Litigation and Regulation

James Keulemans, British American Tobacco, Head of Corporate and
Government Affairs

Andrew Gregson, Imperial Tobacco, Head of Corporate and Legal Affairs

Gary Dickson, Imperial Tobacco, Regulatory and Legal Compliance Manager

Andrew Agor, Philip Morris, Senior Counsel

Mark Powell, Philip Morris, Manager, Public Policy

Interested Parties

Jos de Bruin, Master Grocers' Association (MGA), CEO

Jeff Rogut, Australasian Association of Convenience Stores (AACS), CEO

Fred Harrison, Ritchies Supermarkets, CEO

Heath Michael, Australian Retailers' Association (ARA), Director of Policy,
Government and Corporate Relations (Canberra)

Lloyd Weedall, Department of Health (DOH), Director (Tobacco Control
Branch) (Canberra)

Brooke Dewar, Department of Immigration and Border Protection (DIBP),
Assistant Director (Trade and Customs Branch) (Canberra)

Conference commenced: 1:05pm AEST

Introduction

Commissioner Featherston welcomed attendees, made some introductory remarks outlining the purpose of the conference, declared the pre-decision conference open and invited the party that called the conference, British American Tobacco, on behalf of the Applicants, to make an opening statement.

Opening Statements

Michael Bray, Head of Litigation and Regulation at British American Tobacco, as spokesperson for the Applicants, stated that the authorisation application was a result of a genuine concern held by the Applicants about an acknowledged problem. Illicit tobacco undermined government tobacco control strategies, cost the government revenue, and funded organized crime. Mr Bray noted there was strong retailer support for the application, and said the Chair of the Joint Committee on Law Enforcement's inquiry into illicit tobacco had challenged the industry to develop solutions itself to the problem of illicit tobacco. The Applicants wish to discuss solutions to the concerns raised by the ACCC in its draft determination.

Mr Bray provided information, along with a slide presentation, on the nature of illicit tobacco in Australia, including 'chop chop', contraband 'picture packs' (which do not make an attempt to appear to comply with plain packaging requirements), non-compliant 'plain packs' (which make an attempt at plain packaging but do not meet the requirements), counterfeit packs (which try to pass themselves off as branded products), and shisha.

Andrew Agor, Senior Counsel for Philip Morris, said that price was the key indicator of whether a product was illicit. Illicit products were significantly cheaper because they evade taxes. The '888' pack in the slide presentation is an example of this. The plain packaging non-compliance was a secondary indication, but primarily it was the price which indicated that taxes had not been paid on the product.

Mr Bray said the Applicants were now proposing a more robust appeals process including mediation and arbitration, and that the Applicants would not cease supply to a retailer until any appeals process was resolved. In relation to the ACCC's concern that the conduct could be used to target smaller competitors of the Applicants, Mr Bray noted that, should the Applicants together cease supply to a retailer stocking the products of a smaller competitor, the smaller competitor would in fact presumably get a 100% share of that retailer's business.

James Keulemans, Head of Corporate and Government Affairs at British American Tobacco, said it was virtually impossible for a retailer to inadvertently sell illicit tobacco – because the price was so different and because the packaging was visibly non-compliant with plain packaging and health warning requirements.

Jeff Rogut, CEO of the Australasian Association of Convenience Stores, said that tobacco is a very important product category for AACS's members. On average, tobacco represented 38% of his members' sales. Stores could go broke without this product. Mr Rogut said AACS members would welcome another set of eyes overseeing illicit tobacco as no one was policing illicit tobacco at the retail level. Based on KPMG estimates of the size of the illicit market, stores are losing \$260 million per year to illicit tobacco. There is also a high level of awareness and concern about illicit tobacco amongst consumers.

Fred Harrison, CEO of Ritchies Supermarkets, said his business has worked hard to increase tobacco sales as it is a product which attracts customers from the major chains. He said some of his customers are now reporting that they won't buy tobacco there anymore as they are purchasing 'chop chop' or some other illicit product elsewhere.

Mr Harrison noted that sales of tobacco to underage consumers are heavily policed by regulators, but that retailers of illicit products do not seem to be policed at all. This situation is unfair for retailers of legitimate tobacco products. The Applicants' proposal is an opportunity to do something about the situation.

Mr Harrison suggested the ACCC consider appointing an ombudsman, an independent party to be agreed by all parties, who could decide in cases where the Applicants wish to cease supply to a retailer who they believe to be supplying illicit tobacco. The ombudsman could determine when action should be taken and what the consequences in a particular case should be, having been presented with evidence by the tobacco companies.

Jos de Bruin, CEO of the Master Grocers' Association, said his organisation had small, medium and large members, and that tobacco was a higher proportion of sales for the smaller retailers – up to 40%. Mr de Bruin said businesses are frustrated because the costs of running their businesses are high, tobacco sales are dropping through leakage to illicit suppliers, and nothing seems to be being done about the problem.

Mr de Bruin said a survey had been done in Sunnybank shopping centre in Queensland where cigarette butts were collected from around the shopping centre. 60% of those collected were thought to be illicit. Mr de Bruin said the government is not acting and illicit tobacco is affecting legitimate businesses. The tobacco industry has proposed this solution as a desperate measure.

Heath Michael, Director of Policy, Government and Corporate Relations for the Australian Retailers Association (**ARA**), said about half of the ARA's members sell tobacco. He has spoken to his members and they have no objections to removing illicit tobacco suppliers in this way. Suppliers of whatever illegitimate product (such as counterfeit designer handbags) should be denied supply by legitimate suppliers. Mr Michael said there are consequences for retailers selling tobacco to underage customers; there are no consequences – and no enforcement – for illicit suppliers. There needs to be consequences for suppliers of illicit tobacco. ARA members want a mechanism to remove suppliers of illicit tobacco from the market.

Andrew Gregson, Head of Corporate and Legal Affairs for Imperial Tobacco, said that the application had been an act of some desperation, and that the Applicants were prepared to make whatever changes to the arrangements were necessary to satisfy the ACCC.

Mr Bray said that, in relation to the ACCC's stated concerns about interfering with government investigations, he noted this was an issue raised by the Department of Health (**DOH**) and not by the Department of Immigration and

Border Protection (**DIBP**). Mr Bray said the Applicants are happy to notify government enforcement agencies of any intended boycott and will refrain from boycotting if advised to by government.

Mr Bray said that the concern about targeting small businesses had not been raised by any retailer.

Mr Bray said the covert purchase model is already well established through 'mystery shopping' conducted by individual tobacco companies. BAT has provided information and evidence obtained through mystery shopping to DOH. The covert purchase model is aimed at compliance with the law.

Mr Gregson said the Applicants have proposed to open the agreement to all legitimate suppliers of tobacco.

David Hatfield, Director in the Adjudication Branch of the ACCC, asked if small tobacco suppliers would be able to veto a decision to boycott a retailer.

Mr Bray said a small competitor could participate in mediation over a decision; the actual decision to boycott a retailer would be a factual matter. Mr Bray did not believe mediation would be arduous for a small business.

Commissioner Featherston asked the Applicants to clarify how the decision to boycott was to be taken, in the event that the group expanded beyond the original three Applicants.

Mr Bray said the decision could be taken by consensus.

Mr Agor said the decision could be taken automatically, on a factual basis, to avoid the situation where any one tobacco supplier could seek to avoid boycotting any preferred retailers. Mr Agor said the aim would be to remove discretion in the decision. Any retailer found to be selling illicit tobacco should be warned and then boycotted.

Mr Bray said the Applicants would agree to limit the authorisation application to only include some types of tobacco products, if this addressed the Commission's concerns. For example, the Applicants could be granted authorisation only to boycott retailers and wholesalers of 'chop chop' tobacco and 'picture packs'.

Commissioner Featherston said that he could see that, based on the examples shown by the Applicants, some breaches of plain packaging requirements could be technical and minor. It is possible that a retailer may not be aware that they were selling non-plain packaging compliant products.

Mr Agor said that it was not the Applicants' intention to seek out the minutiae. Mr Agor said the price point was a major indicator of illicit products and a retailer selling tobacco products so far below retail price must be aware that they are selling illicit products.

Mr Bray said that identifying suppliers of illicit tobacco at the retail level was relatively easy, and that the implementation of the proposed arrangements would send a strong deterrent message to retailers.

Commissioner Featherston noted that a submission from a retailer suggested that a retailer could source licit tobacco products elsewhere than from the Applicants, and therefore a boycott may not be overly damaging to a retailer.

Mark Powell, Manager of Public Policy at Philip Morris, said that they had spoken to retailers who had been cut off by Philip Morris and had obtained alternative supply, but who sought to have Philip Morris reinstate direct supply because they thought there were beneficial trading terms from direct trade. This includes cost because there is no mark up from a wholesaler, but also in terms of trading and support. So the possibility of a boycott would involve some disincentive to retailers.

Commissioner Featherston asked about the likelihood of a retailer of both licit and illicit tobacco products moving to illicit products only, in response to a boycott.

Mr Gregson said that, while some suppliers of illicit tobacco currently only sell illicit product, it seems a stretch to think a retailer would move to 100% illicit product in response to a boycott by the Applicants. Retailers who would be targeted by the conduct have established legitimate businesses, and often use their supply of legitimate tobacco products as cover for their illicit activities.

Mr Rogut commented that the sale of illicit tobacco products is not currently policed and that they are very easy to purchase.

Mr Harrison said that local authorities are not addressing the issue and that the problem will grow unless something is done.

Mr Michael said that customers looking for illicit tobacco approach retailers asking for their cheapest tobacco. In this way, legitimate tobacco products provide a cover for suppliers of illicit products. A mechanism is needed which ensures that retailers are doing the right thing.

Mr Gregson said that the Applicants acknowledge their proposal is not a complete solution, and they can't say exactly how effective it will be. However they are prepared to report to the ACCC on the effectiveness of the arrangements, and to accept authorisation for a shorter period.

Mr Bray said that the ACCC accepted in its draft determination that any reduction in the supply of illicit tobacco is a public benefit. Mr Bray said there was strong community interest in finding a solution to the problem.

David Jones, General Manager of the Adjudication Branch of the ACCC, asked if it was intended that the mystery shoppers would be employed independently by each of the Applicants individually.

Mr Bray confirmed this was the case. The Applicants proposed to pool the reports from their mystery shopping and use the joint reports to identify which retailers to boycott, and agree to do this.

Mr Bray said that BAT currently undertakes mystery shopping on 500 retailers a month. BAT has previously unilaterally ceased supply to retailers found to be stocking illicit tobacco. Anecdotally, retailers cease supply of illicit tobacco in about half of these cases.

Mr Gregson said the Applicants proposed to issue a warning letter in the first instance, a six month suspension of supply in the second instance, and 12 months for the third.

Mr Hatfield asked the representatives of retail industry associations what impact they expected a six month boycott of the Applicants' products would have on a retailer and whether it would be sufficient to shut a small supplier down.

Mr Rogut said it wouldn't necessarily shut a retailer down, but it would do commercial damage to them. Franchisees may also risk being found to be in breach of their franchise agreement.

Mr Jones asked how much damage an individual boycott (by only one of the Applicants) would be likely to inflict on a business.

Mr Rogut said both would be significant. Retailers need direct supply from the Applicants to ensure margin.

Mr Harrison said some retailers buy the Applicants' products directly from other retailers, where they are cut off by one of the Applicants. If all three boycotted, these retailers would probably be close to going out of business. A boycott due to illicit tobacco could also threaten a business' shopping centre lease.

Mr Gregson said it would send a more significant message to have a boycott by all three Applicants.

Mr Michael said retailers of illicit tobacco are breaking the law, and shouldn't be allowed to operate at all.

Mr de Bruin said the Queensland government is proposing licensing for tobacco retailers, but this represents more red tape for legitimate businesses. He submitted that the Queensland government hasn't paid sufficient attention to the illicit tobacco problem, which has upset retailers. If there has not been leadership from government, then industry needs to be allowed to step in. Mr de Bruin said he thought a warning from all three companies would probably be sufficient for many businesses to cease supply of illicit products. Businesses which complied would not be sent out of business.

Mr Bray said that, in relation to legislative reform, the tobacco industry hasn't yet seen the detail but expect it to be largely focussed on activities at the

border. Authorising the conduct could result in immediate action at the retail level. Authorisation could be withdrawn by the ACCC if the legislative reform occurs.

Mr Gregson said the appeals process had been introduced as a mechanism to address the possibility that retailers may be wrongly targeted by the conduct.

Mr Bray said that, at the introduction of the plain packaging requirements, BAT and the other Applicants went to great lengths to ensure their products complied. Small tobacco suppliers should be subject to the same scrutiny. However, the Applicants are prepared to limit the conduct to 'chop chop' and 'picture packs'.

Mr Powell asked what the ACCC thought of the Applicants' proposals.

Commissioner Featherston said that he could not indicate how the Commission may respond to the proposals as he could not speak for the other Commissioners.

Mr Jones asked what measures had been tried by each of the Applicants individually with respect to illicit tobacco? He also asked if the Applicants had a position as to the legality of the mystery shopping.

Mr Agor said he considered the legality of the mystery shopping conduct to be an odd question. He said that consumers don't usually know when they have purchased something whether it is legal or illegal, until they examine it later. Mr Keulemans said he could not imagine a court rejecting evidence gained in this way.

Mr Powell said evidence gained this way had been used in court for convictions, and noted that government departments had relied on the evidence also.

Commissioner Featherston said it was not necessarily relevant that evidence obtained this way has been used previously in court. The evidence may not have been challenged as inadmissible.

Mr Agor said the Applicants were mainly asking for authorisation for the boycott conduct, not for the mystery shopping. Joint action was needed because if only one does it, the others would take their business.

Commissioner Featherston asked about the significance of the cost of mediation to retailers.

Mr Rogut said if a business is legitimate and believes it has been wrongly targeted, that it will be prepared to mediate.

Mr Michael said that retailers are regularly engaged in mediation and other processes.

Mr Bray said the question to be decided by the mediator was a factual one, so the burden on retailers who appeal would not be substantial.

Mr Hatfield asked if DOH or DIBP had any comment to make.

Mr Lloyd Weedall, Director in the Tobacco Control Branch of the Department of Health (DOH), said he did not have much to add to the Department's earlier submission, but noted that the covert purchase model would involve conduct which was in breach of the *Tobacco Plain Packaging Act 2011* (Cth).

Mr Harrison said the conduct was designed to address illegal activity, which needs a strong response. There may be mistakes made along the way, but the problem requires ruthless action.

Mr Agor said a common sense approach was required and common sense said that mystery shopping as a plain packaging breach was not a reasonable argument.

Mr Gregson said they were not asking for ACCC approval for the mystery shopping conduct; the Applicants have been undertaking mystery shopping for some time and are willing to accept any risks that arise from that.

Mr de Bruin said that retail associations would be involved as well, because a retailer who has an issue would contact their association. But if a retailer chooses not to follow the rules, there needs to be consequences for that.

Mr Hatfield said that, given the extent of the proposals of the Applicants, the ACCC would want to engage in a further round of interested party consultation. The ACCC may need the Applicants' agreement to extend the statutory timeframe to enable proper consultation.

Brooke Dewar, Assistant Director of the Trade and Customs Branch of the Department of Immigration and Border Protection, said that the Department hoped to be in a position to share further detail about the planned legislative reforms in the next round of consultation.

Commissioner Featherston then called for any further comments. No further comments were made. The Commissioner closed the conference by noting that the ACCC would be providing a further opportunity for parties to make written submissions in respect of its draft determination and that the ACCC would be writing to those who attended the conference to provide details of how such submissions could be made, as well as to provide participants with a record of the conference, which would also be placed on the ACCC's public register.

Conference closed: 2:25pm.